

*Approved under  
the Central Bank of Armenia Board Decision No. 27 A,  
dated 20.02.2024*

**STATUS REPORT ON IMPLEMENTATION OF THE  
MONETARY POLICY PROGRAM  
(Quarter 1, 2023 – Quarter 4, 2023)**

*In the one-year period between 1st quarter of 2023 and 1st quarter of 2024, the inflationary environment in the Republic of Armenia has softened substantially. The 12-month inflation fell sharply in the first half of the year, forming around the level of zero since the second half. Such inflationary developments were attributable mainly to considerably weakened inflationary pressures transmitting from the external sector and even minor deflationary effects late in the year, as well as the monetary policy implemented by the Central Bank of Armenia.*

*Given the significant slowing in the 12-month inflation, on the one hand, and that the demand and inflationary expectations factors were still strong, on the other, in the first half of 2023, up until June, the Central Bank of Armenia left the policy rate unchanged. With inflation following a decline path as a result of external deflationary spillovers and labor market-derived inflationary pressures in the domestic economy somewhat neutralizing, the Central Bank of Armenia gradually eased monetary conditions, from June up to the yearend, lowering the policy rate by a total of 1.5 percentage points.*

*As a result of deflationary spillovers from the external sector and the contractionary monetary policy implemented by the Central Bank of Armenia, both headline and core inflation declined rapidly during the reporting period. Thus, in the period under review, the 12-month inflation decreased by about 9 percentage points to -0.6% in late 2023, and the 12-month core inflation slumped by around 10 percentage points to -0.4% at the end of the year. However, in the period under review, in the face of persisting high demand and inflationary expectations in Armenia, the prices of services and some products were adjusted at a relatively slow pace.*

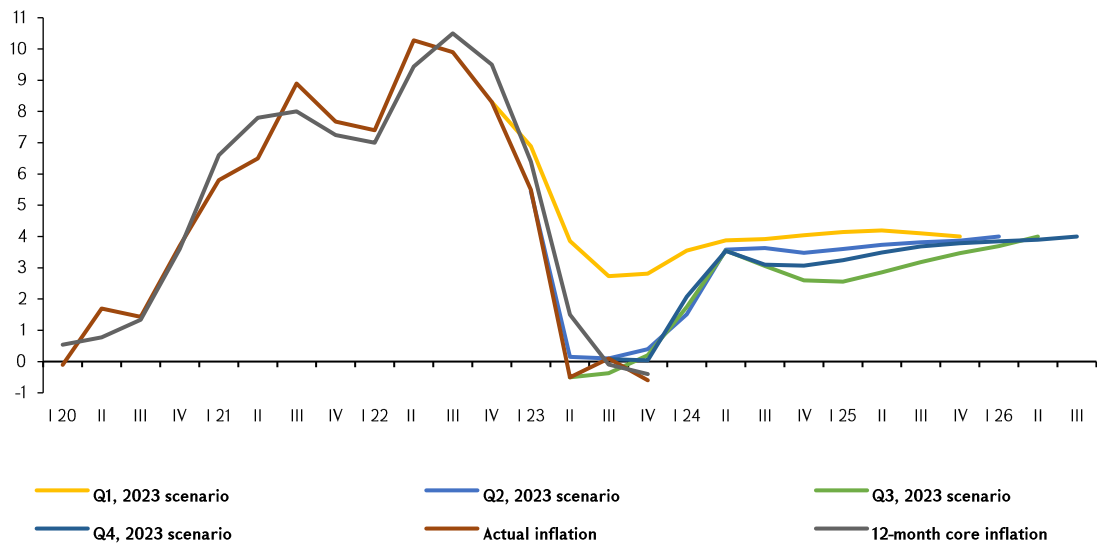
## 1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

According to the main judgements of the scenario presented in the program for the first quarter of 2023, the high-inflationary environment would be decreasing rapidly in the near term mostly driven by noticeable weakening of inflationary pressures from foreign markets, the effects of the implemented contractionary monetary policy and dram appreciation. However, the strong demand and declining yet high inflationary expectations would continue to fuel inflation in wages and especially goods and services with sticky prices. In view of the expected macroeconomic developments and the monetary policy being carried out, the 12-month inflation will, after a sharp decline in 2023, stabilize around the 4% target in the medium term.

In the first half of the reporting period, the 12-month inflation decreased sharply, and the short-term estimate in the first and second quarters of 2023 has been subsequently revised downside. In the second half of the year, the 12-month inflation fluctuated mainly around the projected trajectory.

*Chart 1*

***In the period under review, the 12-month inflation has reduced at rapid rates, so the short-term estimate in the first and second quarters of 2023 has been subsequently revised downside***



In the period under review, economic activity and demand in the world and the main partner countries of the Republic of Armenia continued to slow down amid current geopolitical developments and persisted uncertainties. With such developments, coupled with contractionary monetary policy being carried out in these countries, a significant decrease in the prices of food and energy was observable in international commodity markets, as well as the inflationary environment in the world economy has softened to some extent. Under these conditions, inflationary pressures on the Armenian economy from the external sector has weakened significantly over the first half of 2023, with deflationary effects already noticeable since the second half of the year. In the period under review, a higher-

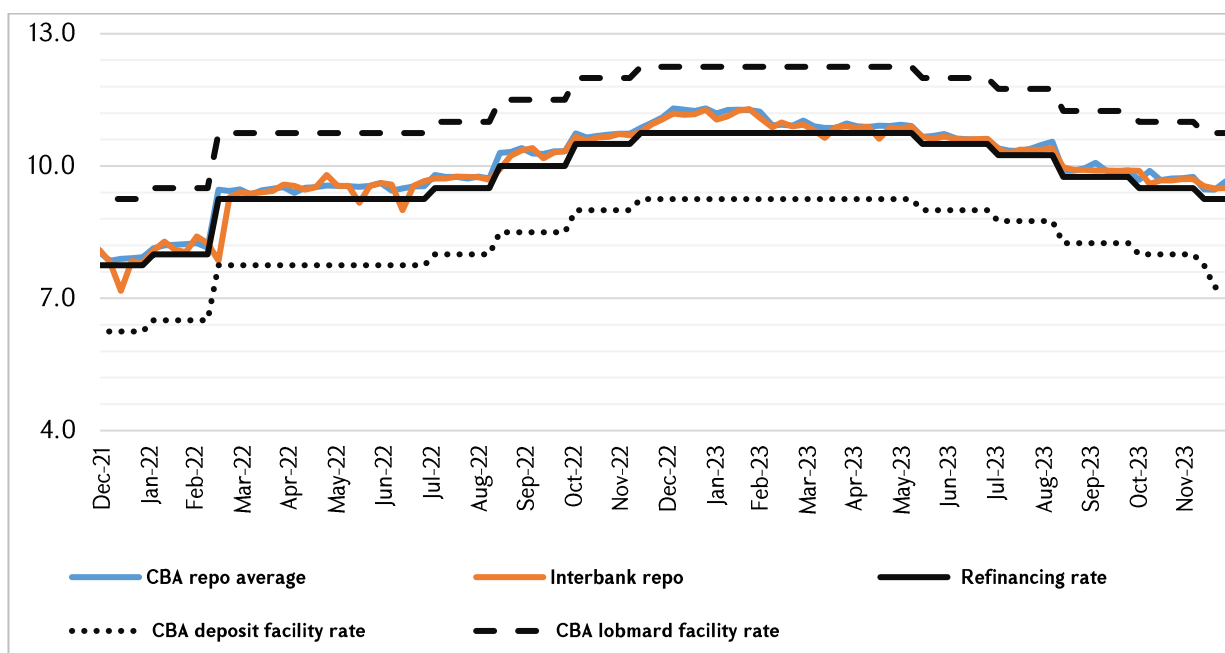
than-expected activity has been reported in the domestic economy primarily thanks to high growth recorded in services and construction sectors. Aggregate demand also remained elevated during the year, which was specifically visible in the first half of the year through the substantially grown external demand, especially in the service sector, while incurring the impact of both international visitors, including tourists, and a large influx of financial resources. The IT and manufacturing industries benefited positive developments as well, pointing to trends in manufacture potential and export growth there. At the same time, influenced by a broad demand coming from international visitors and a sizable inflow of financial transfers from abroad, Armenia's currency market saw the dram appreciating considerably. A certain weakening of external demand was observed in the second half of the reporting year due to the slowdown in tourism growth rate. Simultaneously, the domestic demand has rebounded notably thanks to the high growth of private consumption, which was facilitated by spending of previously accumulated savings and continued increase in incomes.

With the prospect of such developments, with demand persisting high and inflationary effects deriving from the labor market, as well as the deflationary patterns seen for imported food products in the course of the first half of 2023, the Central Bank of Armenia left the policy rate unchanged up until June, keeping the monetary conditions relatively tight.

In the second half of 2023, with the prospect of continued deflationary trends in both foreign and domestic commodity markets and significant neutralization of inflationary factors, the Central Bank of Armenia lowered the policy rate by a total of 1.5 percentage points to 9.25% at the end of the year. At the same time, given a persistently high level of uncertainties over inflationary expectations and risks of expanding domestic demand in the economy and increase in inflation expectations, the Central Bank of Armenia has generally favored a gradual easing of monetary conditions, expressing the prudence for ensuring further regulation of demand and stabilizing inflation expectations.

In the period under review, taking into consideration the increased volatility in Armenia's financial market as a consequence of the continued Russia-Ukraine conflict, the Central Bank of Armenia has been consistent in fulfilling its goal of handling sufficient liquidity in the domestic financial market, as a result of which the market interest rates have shaped mainly around the operational goal, i.e. the policy interest rate. Due to the same factors, there was a certain volatility on the currency market, pointing, in a particular episode, to possible risks to market disruption. The Central Bank of Armenia reacted to this through a situational intervention in the financial market, with the aim to helping it function normally. Meantime, consumer and mortgage lending to individuals grew strongly in the course of 2023 amid accelerating domestic demand.

The Central Bank of Armenia instruments and short-term market interest rates dynamics



To sum up, in the one-year period under review, the 12-month inflation has decreased by 8.9 percentage points, reaching -0.6% at the end of 2023, as a result of the considerably weakened inflationary effect from the external environment, the contractionary monetary policy implementation and the dram appreciation. The 12-month core inflation has also decreased rapidly, shaping at the level of -0.4% at the end of the year. It is estimated that the 12-month headline inflation rate will persist below the target value in the near-term but will increase notably and stabilize around the 4% target in the medium run.

## 2. INFLATION COMPONENTS IN THE PERIOD UNDER REVIEW

While inflationary effects from the external sector weakened during 2023, strong domestic demand contributed to the prices of some goods and services remaining elevated (see Chart 3).

Following the escalation of the Russia-Ukraine conflict, prices in international food markets (especially in product groups “Bread and cereals,” “Meat,” “Dairy products,” and “Oils and fats”) rose considerably, with these inflationary effects being transmitted to domestic prices. Starting from the end of 2022 and continuing throughout 2023, amid a continued slowdown in economic activity globally and in Armenia’s main trading partner countries, as well as relatively sluggish demand and contractionary monetary conditions in the global economy, these inflationary effects weakened considerably, reflected in falling prices of some commodities (sunflower oil, grain, sugar, etc.). At the same time, declining energy prices in the world during 2023 had a substantial impact on Armenia’s domestic fuel market prices, though this was offset in the end of the year by increases in global fuel prices driven by geopolitical developments in the Middle East.

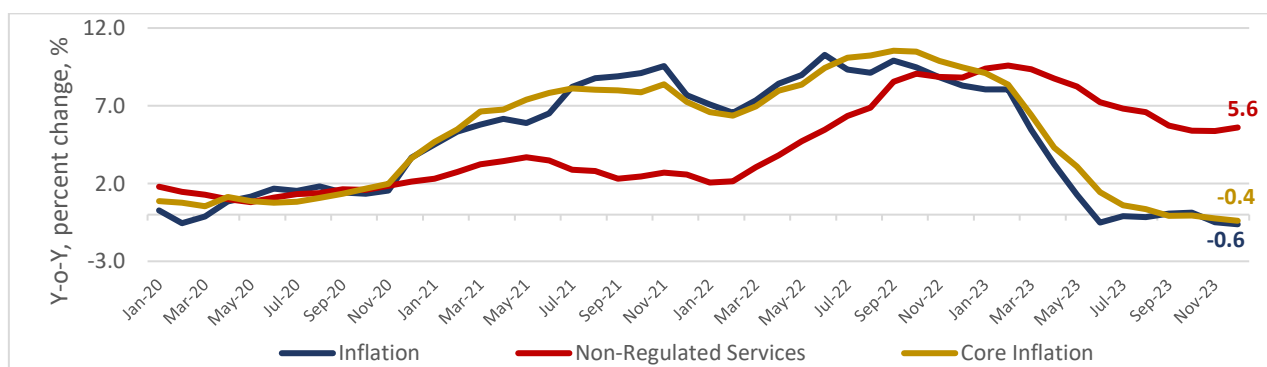
It should also be noted that the sustained appreciation of the Armenian dram in the context of high external demand has also had a significant impact on declines in the prices of imported goods.

Driven by the substantial inflow and presence of international visitors, strong demand conditions in the Armenian economy has added inflationary pressures on domestically-produced goods and services. In this context, increases in sticky prices (especially for services including apartment rent, restaurants and hotels, hairdressing, financial, postal services) were observed, and sticky prices remained elevated over the course of the year, but began to exhibit some downward trends at the end of the period. Growth in external demand as well as strong growth in the construction sector also contributed to increased demand for durable goods.

On the other hand, the recorded increase in domestic demand during the year was largely driven by strong growth in private consumption on the back of spending of previously accumulated savings and continued rise in incomes. This has created additional inflationary pressures in the consumer market, in addition to new demand pressures stemming from the influx of forcibly displaced people from Nagorno-Karabakh to Armenia in September 2023.

**Chart 3**

***In the period under review, the inflationary spillovers from the external sector have eased significantly, and both the headline and core inflation have subdued sharply***



The increase in prices of the product groups “Tobacco articles” and “Alcoholic beverage” within the Core Inflation basket was assessed to have been driven by the change in excise tax rates at the beginning of the year, especially with regard to the tobacco. With respect to domestically-produced alcoholic beverages, the relative slowdown in their export volumes contributed to more modest inflation for these goods, thus somewhat constraining the overall inflationary effects in the broader product group.

In addition to the factors mentioned above, the deceleration of inflation throughout 2023 has been attributable to falling prices of seasonal food products, as the impact of unfavorable weather conditions in the first half of 2022 gradually diminished, while benefiting from noticeably warm weather conditions in the second half of 2023.

Moreover, while the increase in tariffs for regulated services in the first half of 2022 generated secondary inflationary effects that were particularly evident in the second half of 2022, these secondary effects entirely extinguished during 2023.

Table 1

Product/item	Weight	12-month inflation: December 2023	Contribution to y/y inflation
<b>Core inflation</b>	<b>73.9</b>	<b>-0.4</b>	<b>-0.3</b>
Bread and cereals	8.5	-8.7	-0.7
Meat	10.6	-1.0	-0.1
Oils and fats	2.9	-20.6	-0.6
Sugar	0.5	-6.1	0.0
Dairy products	4.4	-2.9	-0.1
Alcoholic beverage	2.5	6.0	0.2
Tobacco articles	2	11.5	0.2
Clothing	2.2	-0.1	0.0
Footwear	1.2	5.1	0.1
Household appliances	0.6	4.4	0.0
Fuel	5.4	2.4	0.1
Air passenger transportation services	1.1	25.1	0.3
Outpatient care services	2.6	6.0	0.2
Actual rent paid by the tenant for additional accommodation	1.1	4.5	0.0
Restaurants and hotels	1.9	4.0	0.1
Fees for services by banks, post offices	0.8	10.3	0.1
<b>Seasonal food products</b>	<b>11.0</b>	<b>-2.9</b>	<b>-0.3</b>
Eggs	1.6	-0.2	0.0
Fruits	4.1	0.7	0.0
Vegetables	5.3	-6.6	-0.3
<b>Regulated services</b>	<b>15.1</b>	<b>0.0</b>	<b>0.0</b>
<b>Other product and service groups</b>			
Imported food products	15.3	-7.9	-1.2
Non-regulated services	17.3	5.6	1.0