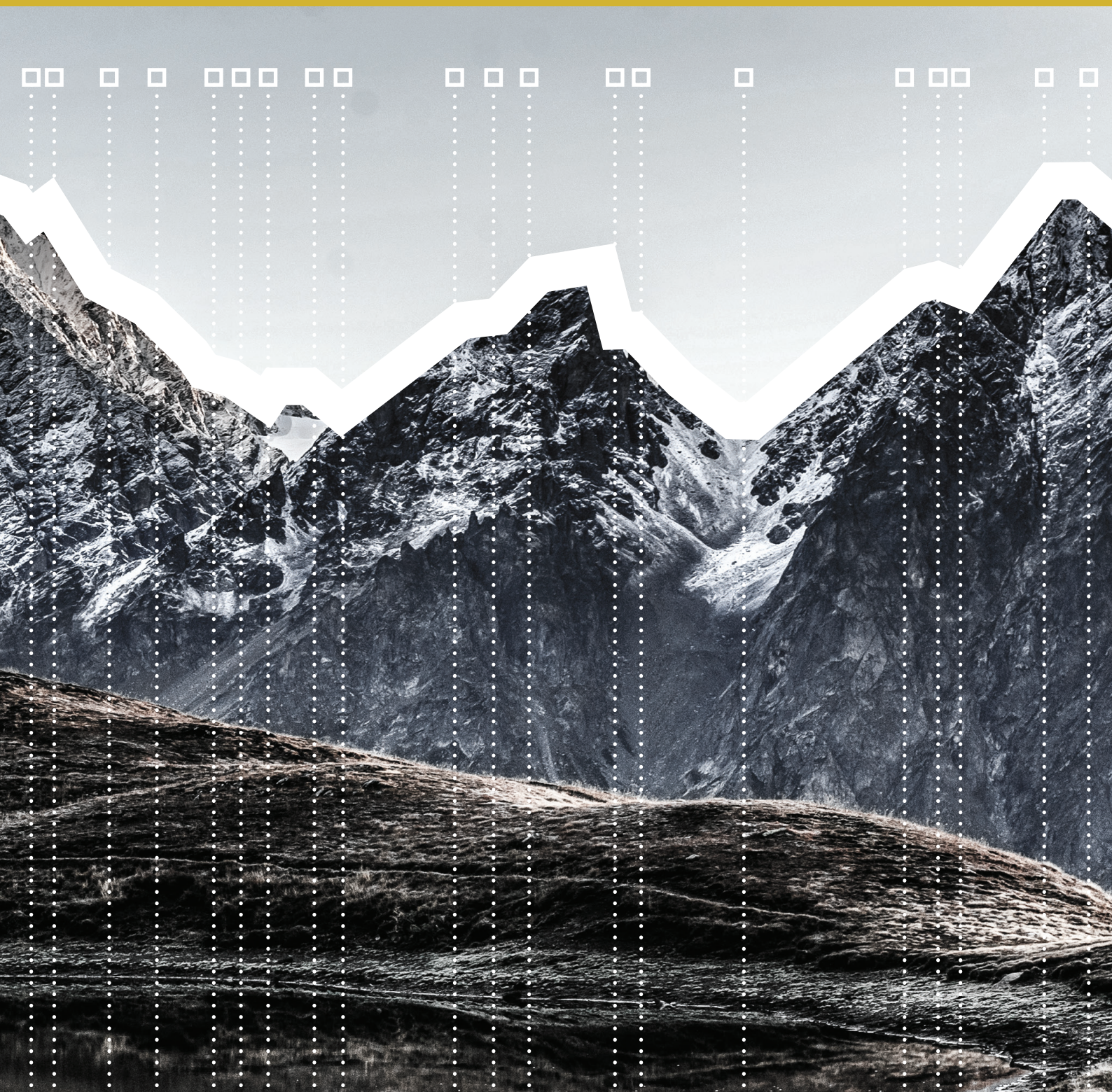




THE CENTRAL BANK OF  
THE REPUBLIC OF ARMENIA

# Inflation Report

2022 / 1





*Approved under the Central Bank Board  
Resolution No 51 A  
dated March 28.03.2022*

# Inflation Report /1

*Monetary Policy Program, Q1, 2022*

✦  
*Status Report on Implementation of the Monetary  
Policy Program, Q4, 2021*

*The inflation targeting strategy of the Central Bank of Armenia highlights the importance of communicating of the Bank to the general public by publishing, inter alia, quarterly inflation reports.*

*The first section of the inflation report includes the Monetary Policy Program that provides main directions of the monetary policy in the forecast horizon as well as forecasts of inflation and other macroeconomic indicators. These forecasts are based on the Bank's assessment of the current situation and future assumptions by the Bank, which also include the impact of the Bank operations.*

*The second section includes the Status Report on implementation of the monetary policy program of the previous year, which presents the results of monetary policy implementation and covers the actual developments in the domestic economy.*

*Publishing of inflation forecast and underlying assumptions in parallel to target inflation indicator makes monetary policy of the Bank more transparent, understandable and predictable, which considerably increases the public confidence in the Bank. The Bank believes that a clear and trusted monetary policy positively affects the anchoring of inflation expectations and maintaining financial stability in terms of cost reduction.*

*According to the rule of monetary policy, the policy is aimed at minimizing the deviations between the 4% target and the inflation forecasts. The path to inflation rate shaped as a result of projected policy directions is published as a Projection Probability distribution chart for the 12-quarter time horizon.*

*Projections in this report are based on the actual information available by March 15, 2022, i.e. the day on which the refinancing rate was set, the results of survey conducted by the Bank and the judgment made pursuant to the information on future developments of the macroeconomic environment.*

*All inflation reports which have been published to date are available on the Bank's website ([www.cba.am](http://www.cba.am)) which also contains all press-releases and other monetary policy-related publications.*

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## 1. EXECUTIVE SUMMARY

***At the beginning of 2022, both the global economy and the Armenian economy experienced a rapid recovery of economic activity, and 12-month inflation in Armenia was declining at a faster pace than expected. The escalation of the Russian-Ukrainian military-political conflict and sanctions imposed on the Russian Federation have created unprecedented uncertainties in terms of both global and regional economic developments. Amid significant uncertainties and complex risks, the Central Bank of Armenia developed several scenarios for the development of the situation, one of which underpins the current monetary policy program.***

According to this scenario, as a result of the Russian-Ukrainian military-political conflict and the application of severe sanctions against Russia, a significant slowdown in economic growth, and in the case of Russia, an economic downturn, is expected this year. At the same time, supply chain disruptions and current uncertainty incited a significant expansion of inflationary environment in various global commodity markets, including energy and food, and inflation expectations have amplified.

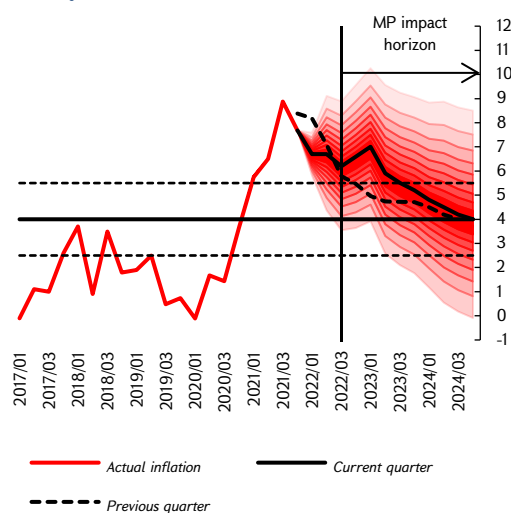
These developments, in particular the sanctions imposed on Russia, will strongly affect the Armenian economy, mainly by way of industrial decline and shrinking remittances. The negative impact of the latter on the gross demand will be partially offset by the expected recovery in the sphere of tourism due to the significant growth of tourists visiting Armenia, mainly from Russia. On the other hand, a number of goods imported from international commodity markets convey a strong inflationary effect to domestic prices, which in turn is reflected in the increased inflation expectations and risks.

According to the scenario designed by the Central Bank of Armenia, in view of the above-mentioned factors, a high inflationary environment is expected in the coming quarters. In such circumstances, given the significant increase in the country's risk premium and rising inflation expectations, the Central Bank has already raised the policy rate through a relatively large step. Along with previous policy rate hikes, this will lead to a gradual decline in 12-month inflation under the expected macroeconomic developments and stabilization around the target 4% in the medium term.

According to this scenario of the Central Bank's short-term projections, in case of a negative impact of the economic sanctions imposed on Russia, which is the main partner of the Republic of Armenia, the Armenian economic growth forecast in 2022 has been

*Amid significant uncertainties and complex risks, the Central Bank of Armenia developed several scenarios for the development of the situation, one of which underpins the current monetary policy program.*

**Chart 1**  
**Inflation (12-month) projection probability distribution for 3-year horizon**



Source: NSS, CBA projection

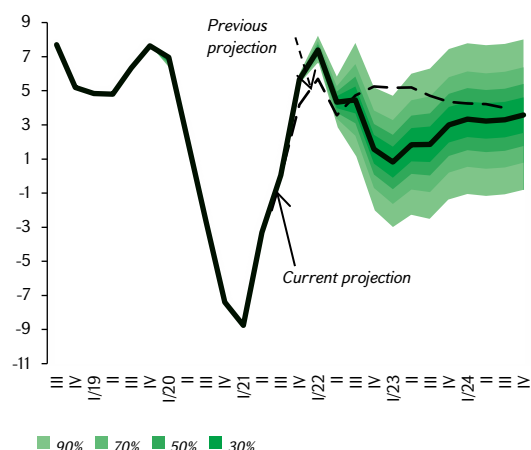
significantly lowered. In the medium term, economic growth will also be lower than previously expected. Economic growth will remain low until the end of the year, then it gradually will accelerate and stabilize around a long-term equilibrium level.

The revision of economic growth forecast for 2022 is largely conditioned by the expected decline in industry, as well as the slowdown in growth in construction and services. At the same time, aggregate demand will be negatively impacted by weakening external demand and a significant reduction in remittances, while tourism is expected to have a positive contribution. The slowdown of economic growth in the medium term will result from the expected frail investment climate, which in turn will lead to a slower recovery in productivity.

***The risks of inflation and economic growth deviating from the predicted trajectory in the forecast horizon are balanced*** (see the details in Subsection 2.2.4 “Key Assumptions and Risks”). Amid the current geopolitical developments and high uncertainty, the Central Bank is reviewing various scenarios and monitoring changes in the macroeconomic situation on a daily basis, and in case of any emergence of risks, stands ready to respond accordingly, ensuring the fulfilment of the price stability objective in the medium term.

Chart 2

Real GDP growth (cumulative)<sup>1</sup> forecast probability distribution for 3-year horizon



Source: NSS, CBA projection

<sup>1</sup> The growth rate of each quarter is calculated as the cumulative growth rate for the last four quarters.

## 2. FORECAST, FORECAST CHANGES AND RISKS

### 2.1. External Environment Developments

***The significant increase in uncertainty ensuing from the Russian-Ukrainian military-political conflict, and the hard-hitting sanctions imposed on Russia will negatively affect the economies of all partner countries over the projected horizon. The impact will be particularly strong in the European Union, reflected in the slowdown in economic growth, and, unequivocally, in Russia, where an economic downturn is projected for this year. On the other hand, due to conflict, reduction of supply or supply chain disruptions in a number of commodity markets are observed, creating additional inflationary pressures.***

***Economic Developments in the USA.*** Current developments in the US economy indicate a faster-than-expected short term economic recovery. Thus, according to the Bureau of Economic Analysis of the US Department of Commerce, the growth of US economy in the fourth quarter of 2021 was 5.4% on a year-to-year basis, which was higher than previously projected by the CBA and was mainly conditioned by the growth of private consumption and reserves resulting from a certain increase in inflation expectations. It is expected that due to these factors, economic growth in the first half of this year will again exceed the previous forecast. Over the course of the year, this will be almost completely offset by the effects of growing geopolitical uncertainties and the faster tightening of monetary policy pursued by the US Federal Reserve. As a result, both in 2022 and in the medium term, economic growth will be at levels close to the previous forecast.

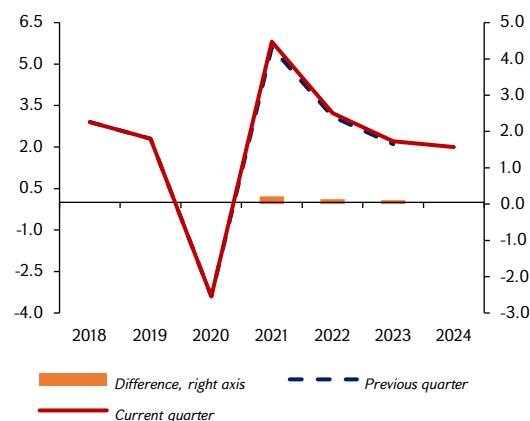
The pace of recovery of the labor market will be somewhat slower than the current level as a result some weakening of economic activity in the face of growing global uncertainty, but it will be possible to return to pre-crisis levels of jobs in the second half of 2022, in line with the previous projection.

Inflation in the average quarterly personal consumption expenditure<sup>2</sup> in the United States continued to accelerate in the fourth quarter of 2021, reaching 5.5% yoy (up to 6.1% in January). Inflation in the USA in the fourth quarter was higher than expected under the previous program forecast, mainly due to higher prices for housing

*The significant increase in uncertainty ensuing from the Russian-Ukrainian military-political conflict, and the hard-hitting sanctions imposed on Russia will negatively affect the economies of all partner countries over the projected horizon. The impact will be particularly strong in the European Union, reflected in the slowdown in economic growth, and, unequivocally, in Russia, where an economic downturn is projected for this year.*

*Under the impact of the conflict, reduction of supply or supply chain disruptions in a number of commodity markets are observed, creating additional inflationary pressures.*

Chart 3  
US economic growth projections (%)



Source: BEA, CBA projection

<sup>2</sup> The personal consumption expenditure price index target is 2%, which on average is commensurate with headline inflation of 2.3%.

services and used cars because of rising demand. This trend will still continue in the short term. The acceleration of inflation was also conditioned by persisting disruptions in the production chains, together with the growth of energy and food prices. In the short run, high prices for these commodities, especially energy, and recovery of demand will keep inflation high.

Long-term inflation expectations have stabilized, but continue to be somewhat higher than the target level. It should be noted that amid the persistently high inflationary environment conditioned mainly due to supply factors, a growth in the prices of products with the most rigid prices was observed. Under these conditions, the US Federal Reserve, having completed the purchase of assets under the quantitative easing program, will continue to raise interest rates at a much faster rate than previously projected. It is noteworthy that the expectations of a rapid increase in policy interest rates are already reflected in the medium and long-term market interest rates, contributing to a certain restraint of the demand position.

In the medium term, along with the gradual elimination of the supply factors and the easing of monetary and fiscal policies, inflation will start to decelerate, approaching the target level at the end of the horizon.

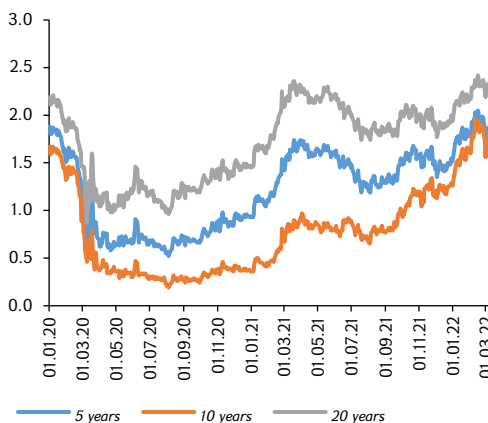
**Economic developments in the Eurozone.** The economic growth developments in the Eurozone in the fourth quarter of 2021 were in line with the projections of the Central Bank of Armenia. Despite the active use of vaccination, the spread of a new type of infection still forced various Eurozone countries to apply local restrictions, which has had some deterrent effect on economic activity. According to Eurostat estimates, the economic growth of the Eurozone in the fourth quarter of 2021 totaled 4.6% yoy.

Despite offsetting the negative consequences of the further spread of the pandemic, the Eurozone, being in the vicinity of the conflict zone and having significantly closer economic ties with Russia, will suffer greater economic losses in the current situation than the United States. Thus, because of the growing uncertainty about the future on one hand, and contraction of exports of goods and services to Russia (sanctions on touristic inflow), the economic growth rate of the Eurozone will slow down significantly in both the short and medium term. Notably, the continuing disruption of global production chains and supplies of some commodity groups as a result of sanctions, puts additional pressure on the recovery of supply in the economy.

In the fourth quarter of 2021, 4.5% inflation was observed, mainly due to the high energy prices. The current level of inflation continues to exceed the ECB target. At the beginning of the first quarter of 2022,

Chart 4

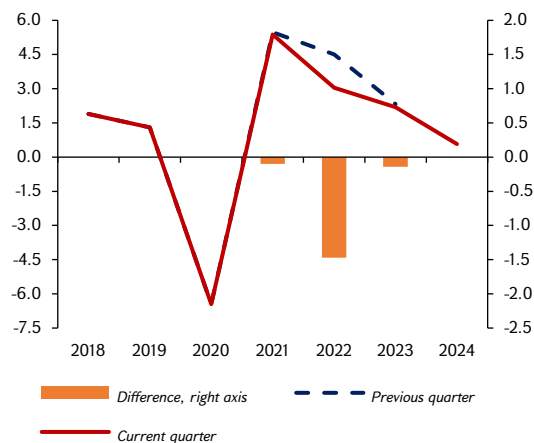
Interest rates on US government bonds with different maturities (%)



Source: St. Louis Federal Reserve System

Chart 5

EU economic growth projections (%)



Source: Eurostat, CBA projections



inflation in the Eurozone continued to accelerate, and it is expected that the high inflation environment in the short term will still persist, mostly due to the high energy and food prices, and recovery of demand. However, demand in the Eurozone is still sluggish, and long-term inflation expectations remain close to the inflation target.

Under the above developments, after the neutralization of the temporary supply factors, inflation will be mitigated and stabilized around the target level in the medium term, and the European Central Bank will keep interest rates at current lows, at least until the end of the year, gradually reducing asset purchases.

**Economic developments in Russia.** According to the State Statistics Service of Russia, in the fourth quarter of 2021, the Russian economy observed a higher-than-expected growth of 4.4% yoy. However, the escalation of geopolitical tensions at the beginning of the year and the tough economic sanctions imposed on Russia completely changed the outlook.

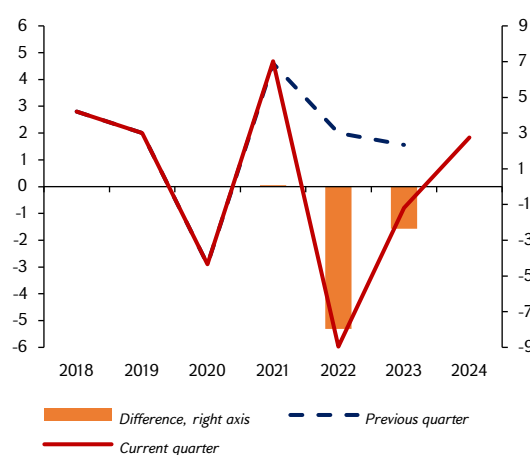
Partial separation of the Russian banking sector from the international financial system, freezing of huge state and private foreign assets and, in general, the blocking of Russia's access to international capital markets will lead to a significant slowdown in lending and financing of the economy by the banking and financial system. The costs of conducting foreign trade transactions will also upsurge, affecting foreign trade activity.

At the same time, a significant reduction in exports to Russia (especially technological products) and direct investments by a number of developed countries, and the restriction of exports from Russia to these countries will have profound negative economic consequences in the short and medium term, as well as significantly weaken Russia's long-term growth potential.

The imposed sanctions, which make it difficult to import Russian goods from third countries (disconnection from SWIFT, problems with transportation of Russian goods and provision of insurance services, etc.), lead to certain differentials between international prices and the prices of Russian equivalent goods. This is especially evident in case of oil. Thus, difference between the prices of international "Brent" and Russian "Urals" oil on certain days has reached up to 20-30 US dollars per barrel. Subsequently, the positive impact of the growth of commodity prices on the Russian economy is depressed as well.

It should also be noted that the negative effects of sanctions will be mitigated to some extent by the identification of new export markets and the establishment of new trade partners, as well as the impact of anti-crisis measures implemented by the Russian government. As a result, under the above developments, Russia in the current and the

**Chart 6**  
Russia economic growth projections (%)



Source: Rosstat, CBA projections

upcoming years will experience an economic decline of 6% and 1%, respectively, and as a result of economic reconstruction and demand recovery, some growth (around 1.8%) is expected in the last part of the horizon.

Developments at the end of last year indicate a quicker recovery of demand relative to supply, which was also reflected in inflation dynamics. Thus, in the fourth quarter, inflation was 8.0% instead of 6.8% in the previous quarter (still exceeding the target of 4%). Inflation accelerated to 8.7% in January. A number of factors, inter alia, food and non-food prices, acceleration of core inflation and high inflation expectations continued to contribute to acceleration of inflation and keeping it at the current high level. Amid the current inflationary pressures, the Central Bank of the Russian Federation raised policy rate by 1.75 percentage point in the fourth quarter, then by another 1.0 percentage point in February, setting it at 9.5%.

In view of the significant growth of inflation expectations and imminent risks of ruble depreciation, aggravation of capital outflow risks and a significant decrease in Russia's sovereign rating by international rating agencies amid the drastic changes in geopolitical and economic conditions, RCB raised policy interest rate to 20% at extraordinary meeting on February 28 and imposed also severe restrictions on capital flows.

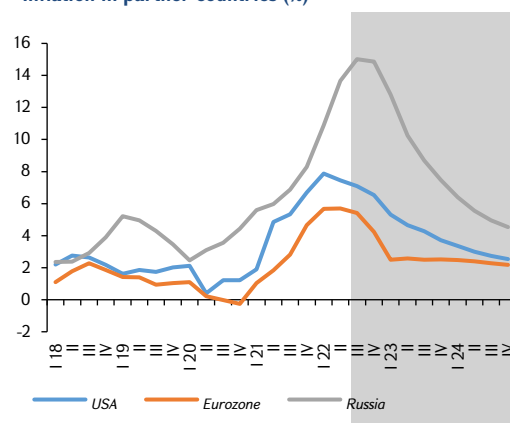
According to the CBA's current assessments, the Central Bank of Russia, taking into account the above-mentioned developments and staying committed to the inflation targeting regime, will still maintain the current high level of the policy interest rate in the short term, and subsequently, along with easing and stabilizing inflation expectations, will gradually lower it, ensuring that inflation approaches the target level at the end of the forecast horizon.

**Developments in commodity markets. Amid ongoing supply-side problems and demand recovery, commodity prices continue to shape at high levels.**

Due to the modest recovery of the restrained demand, prices in the international copper market grew slightly in the fourth quarter, in line with the expectations. As a result, during the fourth quarter of 2021, the growth of international copper prices totaled 2.0% qoq, and the forecasts for copper prices for the short term remained at the same levels as before. In the medium term, amid the higher growth of demand compared to supply, international copper prices will continue to rise in line with the previously projected levels, approaching USD 12,000 per ton at the end of the horizon.

Due to the continuous recovery of market demand and the slow growth of supply volumes, a growth of international oil prices was

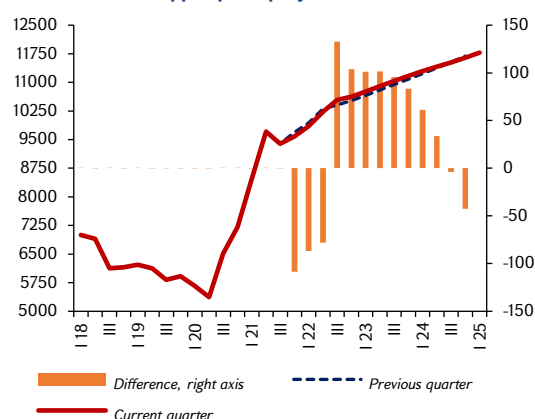
**Chart 7**  
Inflation in partner countries (%)



Source: BLS, Eurostat, Rostat, CBA projections

**Amid ongoing supply-side problems and demand recovery, prices of raw materials and food in commodity markets continue to shape at high levels.**

**Chart 8**  
International copper price projections



Source: World Bank, CBA projections

observed in line with the expectations for the fourth quarter. In the fourth quarter of 2021, the price growth on a quarterly basis totaled 9.0%. With the escalation of geopolitical tension and the sanctions on Russia, significant risks of deficit have emerged in the oil market, reflected in the price spikes and volatility in the short term. Despite the gradual tightening of monetary policies in developed countries, no decrease in oil prices is observed, as the impact of inflationary factors continues to prevail amid the high uncertainties. As a result, short-term forecasts have been revised upwards against the previous program.

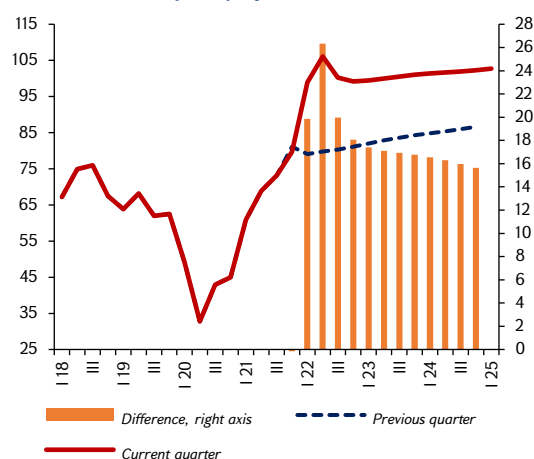
In the medium term, global oil supply will also recover at a slow pace, considering that given low oil prices and pessimistic long-term expectations recent years investments (especially in 2020) in oil infrastructure were insufficiently low. Overall, according to the Central Bank forecasts, parallel to the close of the active phase of the current geopolitical events, oil prices will fall to some extent, still remaining at higher levels.

Food prices continued to rise in the fourth quarter of 2021, which is attributed to low supply expectations. However, prices in the sugar and grain markets stabilized in the fourth quarter due to optimistic expectations for the harvest at the end of the previous year. At the beginning of the year, a significant increase in prices was observed in several food markets, in particular, wheat and vegetable oils, mostly fueled by expectations of supply shortages from Ukraine and Russia. It is estimated that the current high levels of prices in the food markets will continue in the short term.

***According to the current estimates of the Central Bank, as a result of the higher growth of demand over supply, international food prices in the medium term will be shaped at higher levels than previously expected. The negative impact of the conflict in Ukraine on the recovery of global demand will to some extent curb inflation. However, considering the farming related problems in the zone of conflict, the growth of global food supply will slow down, resulting in inflation.***

Chart 9

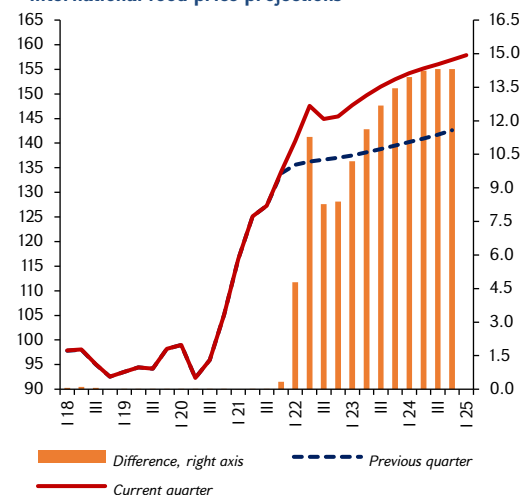
International oil price projections



Source: World Bank, CBA projections

Chart 10

International food price projections



Source: FAO, CBA projections

## 2.2. Forecasts

### 2.2.1. Inflation and Monetary Policy

***In line with the forecast, inflation in the current quarter indicated signs of stabilization. In February 2022, 12-month inflation was 6.5%, and core inflation 6.4%. The Russian-Ukrainian***

***In February 2022, 12-month inflation totaled 6.5%, and core inflation 6.4%.***

***military-political conflict and the sanctions imposed on Russia will have an additional negative impact on the economic growth prospects of the partner countries, as well as on the international commodity markets and supply chains, leading to significant inflation. Furthermore, these developments have led to a large increase in uncertainty, as a result of there are evidences of significant volatility of financial markets. So far, only moderate inflationary effects on inflation are observed from the domestic economy. The Central Bank considers that in the current situation it is necessary to raise policy interest rate.***

Economic growth expectations in partner countries have been revised downwards. In the US and the Eurozone, economic growth is expected to slow down this year, and a significant economic decline is expected in Russia. The reason for that is the sharp growth of uncertainty about the geopolitical and economic prospects as a result of the Russian-Ukrainian military-political conflict, and the negative effects of extensive sanctions imposed on Russia. In terms of the Armenian economy, the external demand will strongly decline, as a result of which inflationary pressures will be eased, and deflationary effects will be manifested in the medium term. On the other hand, these developments exacerbate the still disrupted supply chains, and in terms of certain inputs and food products create expectations and risks of significant price augmentation. Against this background, the prices of both inputs and food, as well as inflation rates in the partner countries, continue to grow, significantly exceeding the previous forecasts. Accordingly, developments in the foreign sector will in overall transmit spill-over inflationary effects to the Armenian economy.

The aforementioned geopolitical developments, particularly sanctions imposed on Russia, will in general have a significant negative impact on the Armenian economy, subsequently, economic growth rates in Armenia will decrease this year. The decrease will be mainly reflected in the decline of the industry. On the other hand, the tourism sector is recovering at a certain pace, mainly due to the significant flow of tourists from Russia. The economic downturn in Russia will result in a strong drop of remittances, which will have a restraining effect on aggregate demand in both the short and medium term. The latter, in turn, will have a certain restraining effect on general inflation, partially offsetting the growing external inflationary pressures. It is estimated that in the light of significant inflationary impacts from the external sector and the demand developments described above, short-term public inflation expectations have increased somewhat.

At the same time, the surge of geopolitical risks in the region and high uncertainty have led to increased volatility in the Armenian financial markets and higher risk premium.



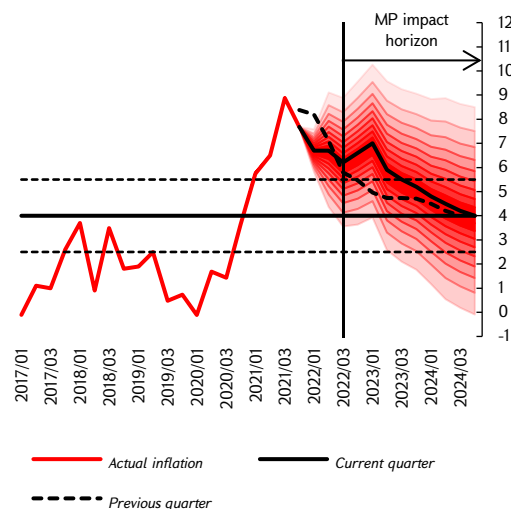
To this end, ***the CBA Board considers that policy interest rate should be increased at a relatively large step, by 1.25 percentage point.*** The Board finds that in case of continuing risks of uncertainty related to the economic outlook and rising inflation expectations, it will contemplate over the possible tightening of monetary policy. Under the medium-term monetary policy and restrained aggregate demand, inflation, remaining above the target in the short run, will gradually decline, approaching its target.

The Central Bank considers that the risks of inflation deviating from the programmed trajectory are balanced.

*The CBA Board considers that policy interest rate should be increased at a relatively large step, by 1.25 percentage point. The Board finds that in case of continuing risks of uncertainty related to the economic outlook and rising inflation expectations, it will contemplate over the possible tightening of monetary policy.*

Chart 11

**Inflation (12-month) projection probability distribution for 3-year horizon**



Source: NSS, CBA projection

Table 1

Period	Inflation Interval Projection Probability Distribution				
	<1.0%	1.0-2.5%	2.5-5.5%	5.5-7.0%	>7.0%
Q I 2022	0.0%	0.0%	1.3%	69.9%	28.7%
Q II	0.0%	0.2%	20.1%	38.0%	41.7%
Q III	0.1%	1.1%	32.9%	35.6%	30.3%
Q IV	0.1%	1.1%	26.7%	31.9%	40.2%
Q I 2023	0.1%	0.9%	20.9%	28.3%	49.8%
Q II	1.0%	4.4%	37.1%	27.3%	30.1%
Q III	1.9%	6.5%	42.0%	25.6%	24.1%
Q IV	2.8%	8.2%	44.4%	23.9%	20.7%
Q I 2024	5.1%	11.0%	45.8%	21.0%	17.2%
Q II	8.2%	13.1%	44.1%	18.5%	16.1%
Q III	10.5%	14.8%	44.1%	16.9%	13.7%
Q IV	12.4%	15.8%	43.6%	15.8%	12.5%

Source: NSS, CBA projection

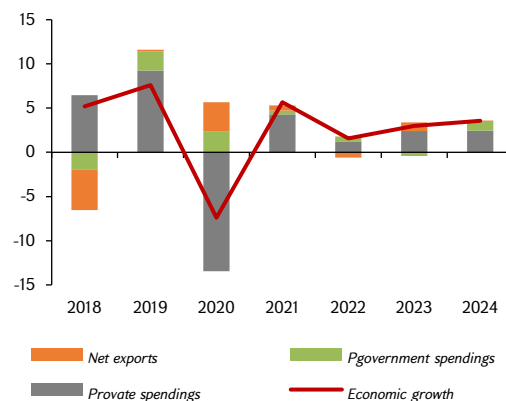
## 2.2.2. Economic Activity <sup>3</sup>

Compared with the deep economic decline in 2020, the economic growth in 2012 gained the momentum, with the annual growth exceeding the CBA projections (5.7% instead of 4.2%). The more positive than actually expected developments continued in early 2022, but the escalation of the Russian-Ukrainian conflict, the resulting economic sanctions imposed on Russia and its economic decline (see Section 2.1) will affect the Armenian economy as well. Thus, a moderate increase in private spending is expected in 2022 because of the expected decrease in remittances from Russia, as well as decisions to defer investments because of uncertainty. The latter is especially relevant for enterprises with Russian capital operating in Armenia and exporting to Russia. It should be noted that the dependence of the Armenian economy on remittances from Russia has diminished in

*Compared with the deep economic decline in 2020, the economic growth in 2012 gained the momentum, with the annual growth exceeding the CBA projections (5.7% instead of 4.2%).*

Chart 12

**Contribution of demand components to growth (percentage point)**



Source: NSS, CBA projection

<sup>3</sup> For a detailed economic growth forecasts, see the "GDP Projection Probability Distribution", Chart 24, Table 2.

<sup>4</sup> Demand does not take into account changes in inventories of tangible assets, as it is calculated by the CBA as a balance sheet item and does not reflect the real level of investment. Therefore, growth calculated by supply and demand factors can vary. See: [https://www.armstat.am/file/article/sv\\_04\\_19a\\_112.pdf](https://www.armstat.am/file/article/sv_04_19a_112.pdf)

recent years, as a result of which the impact on the Armenian economy, compared to previous similar situations, is significantly milder. External demand will also be weak because of declining incomes in Russia, as a result of which exports will be restrained during the year. On the other hand, according to the Central Bank expectations, in the face of the economic sanctions and military-political conflict, tourist flows from Russia to Armenia have grown, which will somewhat mitigate the negative impact on Armenia's economic activity. Subsequently, economic growth in 2022 has been revised downwards and is projected at 1.6%.

*Economic growth in 2022 has been revised downwards and is projected at 1.6%*

Compared to the previous program, economic activity in the medium term, has been revised downwards because of the expected lower level of investment, which in turn will contribute to the slower recovery of productivity, whereby GDP growth at the end of the horizon will be close to its long-term potential.

**External Demand.** According to the Central Bank's estimations, in 2021, current account deficit/GDP ratio has improved over 2020 and is around 2.5% instead of the 1.8% projected in the previous program of the Central Bank. Somewhat higher assessment of current account deficit compared to the previous program of the Central Bank is conditioned by the expected growth of the trade balance deficit, as well as lower-than-expected level of personal remittances. Thus, real growth of exports and imports in the fourth quarter was higher than projected by the Central Bank. The high growth of real exports of goods and services in 2021 was mainly due to the more positive developments in the main partner countries, while the high growth of real imports of goods and services was due to some acceleration in the recovery of domestic demand. The growth of the imports of goods and services in USD terms outpaced the growth of exports of goods and services in USD terms, as a result of which the trade balance deficit enlarged. Compared to the previous projection, remittances of individuals in USD terms are expected to be slightly lower. As a result, in 2021, the total remittances are estimated to grow by about 20.0%. The high growth of remittances from the USA and other countries (as a group) played a significant role in the high annual growth.

Developments in 2022 will evolve under the conditions of high geopolitical uncertainties in the region with a complete disruption of trade with Ukraine and a significant reduction of trade with Russia in the short term. As a result of the projected decline of the Russian economy, a significant drop in remittances is expected. At the same time, positive developments of the export of tourism will to some extent mitigate these negative effects.

The real growth forecast for exports of goods and services has been revised downwards, mainly because of the downturn in the Russian

economy. Exports will decrease in mineral products and processed food groups. As a result, the decline in external demand, amid high uncertainty, will lead to a 1.8% decline in exports of goods and services in 2022.

Given the significant slowdown in domestic demand, the growth of real imports of goods and services in 2022 is projected at zero level.

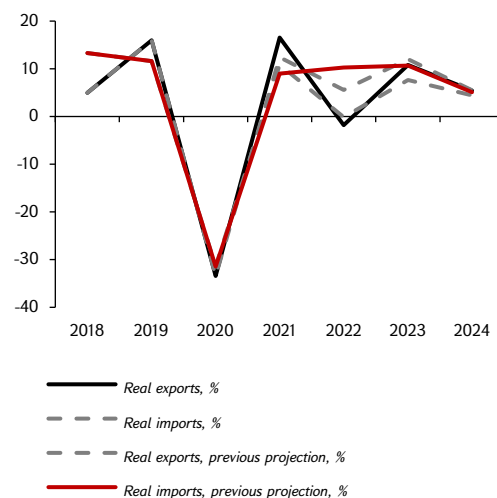
Projections on remittances have been revised downwards because of the expected downturn in the Russian economy, where seasonal workers' dollar-denominated earnings are expected to decline significantly. At the same time, in line with the previous forecast, it is expected that remittances from the United States will also slow down. Given these forecasts materialize, net inflow of total remittances in dollar terms (including seasonal workers income and private transfers) will decrease by 20% in 2022.

Subsequently, the current account deficit/GDP ratio in 2022 will grow both compared to the previous forecasts and 2021, totaling around 4.4%.

The easing of uncertainty in the medium term, as well as the recovery of global and domestic economies will be reflected in the gradual recovery of investments, as a result of which the current account deficit/GDP ratio will gradually approach and stabilize at the estimated equilibrium level of 4.0-6.0%.

Chart 13

Change in real export and import of goods and services in the medium term (%)



Source: NSS, CBA projection

### Box 1

#### Armenia's Trade Turnover with Russia and Ukraine

##### Armenia-Russia Trade Turnover

Armenia and Russia are large and important trade partners. In 2021, trade turnover between Armenia and Russia amounted to \$ 2.6 billion, an increase of 20.9% over the previous year. Thus, in 2021, goods worth \$ 847.3 million were exported from Armenia to Russia (the share in total exports, 28.0%), and goods worth \$ 1.78 billion were imported (the share in total imports, 33.3%).

Alcoholic beverages (mostly cognac), precious and semi-precious stones, fish, fruits and vegetables have the largest share in the structure of exports from Armenia to Russia (see Chart 14). The main export market of most of the mentioned product groups is Russia (see Chart 15). The main market for cognac exports is Russia, followed by Belarus and Ukraine (at 5-6% weights). Almost all of the fish exports go to Russia, which complicates the issue of possible market substitution of these products. There is also almost no possibility of substitution for textiles with code "61" (Germany's share is about 3%). In terms of medicines, there is a possibility of export substitution to Georgia, Uzbekistan and Moldova.

Given the high uncertainties in the region amid the military-political conflict, and the fact that Russia is the main export market for most of the

Chart 14

Armenia's exports to Russia in two-digit foreign trade classification, weights (%)

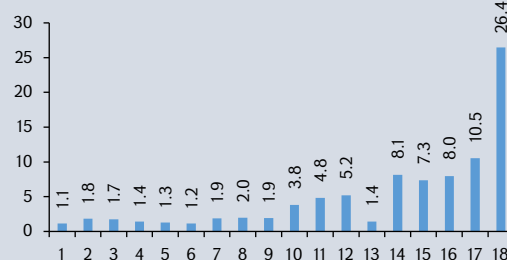
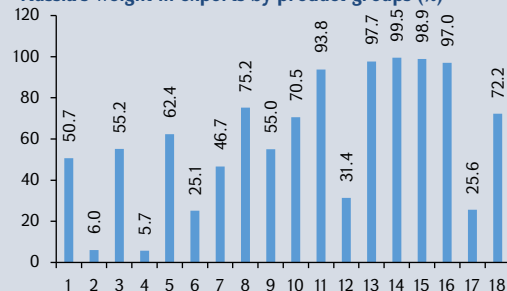


Chart 15

Russia's weight in exports by product groups (%)



1. Pharmaceuticals, 2. Cigarettes and tobacco, 3. Optical, photographic parts, 4. Iron and steel, 5. Cocoa and cocoa preparations, 6. Vehicles and parts, 7. Mechanical devices and parts, 8. Dairy products, eggs, honey, 9. Electrical devices and their parts, 10. Vegetable and fruit preparations, 11. Knitted clothes, 12. Clothes not knitted, 13. Chemical products, 14. Fish products, 15. Vegetables, 16. Fruits, 17. Precious and semi-precious stones, 18. Drinks

Source: NSS, CBA estimates

above-mentioned commodity groups, it is expected that in the short term, export substitutability opportunities to other countries, especially to the European market, are very limited. This indicates the main areas of export vulnerability in Armenia in light of economic difficulties in Russia. For example, the developments in 2014 are indicative, when as a result of the crisis in Russia in 2014-2015, a significant decrease in cognac exports was observed, while export substitutions to other countries were negligible. Still, unlike 2014, depending on how long the business community expects these developments to last, export restructuring to other countries' markets is possible.

Within the structure of imports from Russia, gas and oil have the largest share, 38.2% (see Chart 16). In 11 of the major commodity groups reviewed, Russia's share exceeds 40%. Russia's share is quite large in the imports of grain products, vegetable oils, oil and gas, aluminum. In terms of import of oil, grain products, oils of vegetable origin, dependence from Russia is very high. Hence, in case of import disruptions there, certain risks may arise in Armenian consumer and commodity markets.

### Armenia-Ukraine Trade Turnover

In 2021, trade turnover between Armenia and Ukraine totaled USD 168.9 million. Armenia's imports from Ukraine far exceed its exports (see Chart 18). In 2021, USD 25.7 million worth of goods were exported from Armenia to Ukraine, and USD 143.2 million were imported, with the negative balance of bilateral trade totaling USD 117.5 million. The share of Ukraine in the structure of exports from Armenia in 2021 was 0.9%, while the share of imports was 2.7%.

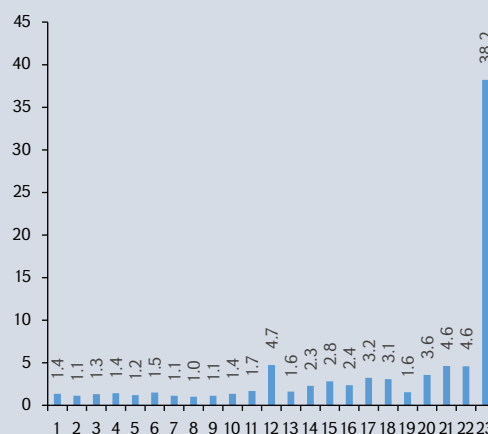
### Export and Import Structure

According to January-November 2021 data, Armenia exported to Ukraine mainly alcoholic and non-alcoholic beverages (65% of the total) and cigarettes (21.5%). Products of vegetables, fruits, nuts or other parts of plants and medicines are also exported. The range of imports from Ukraine to Armenia is quite large. The main products are tobacco (13.4%), meat and meat products (12.8%), ferrous metals (10.5%), milk, dairy products, poultry eggs (5.5%), food product residues and waste, animal feed (6.9%) and so on.

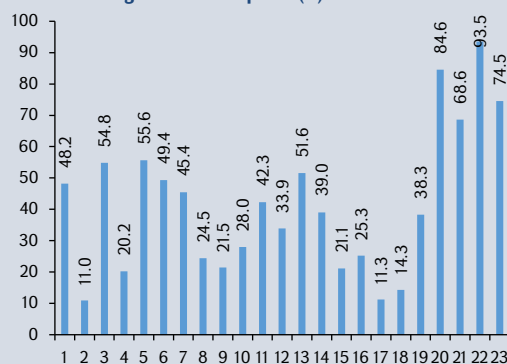
It should be noted that the substitutability of imports from Ukraine from other countries, especially from Russia, is estimated quite high. Therefore, as a result of the current military-political conflict, other things being equal, the substitutability of imports from Ukraine in the medium term is estimated to be high, which will largely mitigate the negative effects of trade disruptions on the Armenian product markets and economy.

In summary, the impact of complete disruption of trade with Ukraine on the Armenian economy is estimated to be small. In the medium term, the opportunities for export substitution to other countries, especially to

**Chart 16**  
Imports from Russia by product groups (%)



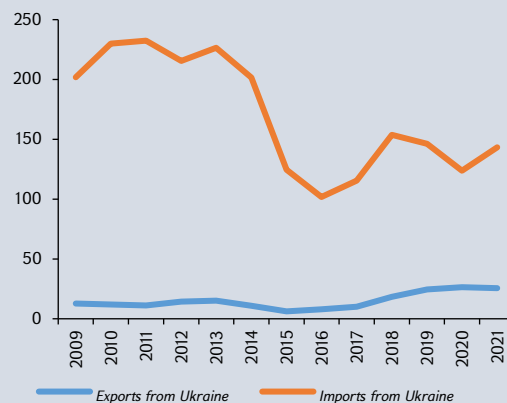
**Chart 17**  
Russia's weight in total imports (%)



1. Glass and glassware, 2. Pharmaceutical products,
3. Cereals, 4. Iron and steel, 5. Various edible preparations, 6. Sugar and confectionery, 7. Detergents, lubricants, 8. Rubber items,
9. Cigarettes and cigarette substitutes, 10. Items made of paper,
11. Wood and wooden items, 12. Precious or semi-precious stones,
13. Cocoa and cocoa preparations, 14. Items made of iron or steel,
15. Vehicles and parts, 16. Plastics and articles thereof,
17. Machinery, mechanical devices, 18. Electrical machinery,
19. Perfume, cosmetics, 20. Animal or vegetable fats and oils,
21. Aluminum and articles thereof 22. Grain, 23. Mineral fuels

Source: NSS, CBA estimates

**Chart 18**  
Trade with Ukraine



Source: NSS, CBA estimates



Russia, are high. Those for substitution of Ukrainian imports with imports from Russia are also high.

The impact of the expected decline of the Russian economy on Armenia's exports is estimated to be large, taking into account the fact that Russia is Armenia's main partner in terms of large export groups. At the same time, historical analysis also shows that the opportunities for channeling goods exported to Russia to other markets are small. Hence, decrease of Russia's potential GDP growth in the short and long term will cause significant risks in terms of slowdown of Armenia's export growth potential.

Chart 19  
Structure of Exports to Ukraine (%)

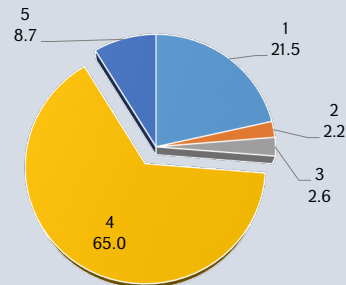
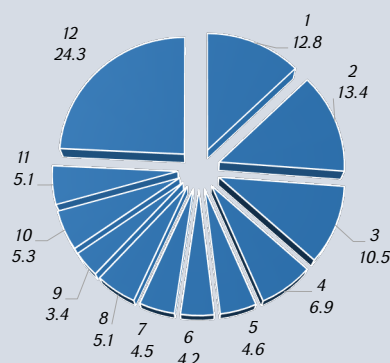


Chart 20  
Structure of imports from Ukraine (%)



1. Meat, 2. Cigarettes and tobacco substitutes, 3. Iron and steel, 4. Animal feed, 5. Cereals, confectionery 6. Cocoa, cocoa preparations, 7. Electrical machinery and parts, 8. Paper items, 9. Drinks, 10. Mechanical devices, 11. Dairy products, eggs, honey, 12. Other

Source: NSS, CBA estimates

**Fiscal Policy.** The impact of fiscal policy on aggregate demand in 2022 was evaluated based on the indicators of 2022 State Budget Law, current economic developments and the resulting Central Bank's assessments (in particular, depending on the economic developments, a scenario of shortfall of revenues and corresponding expenditures in terms of the CBA's GDP growth scenario was analyzed). Having said, that Government fiscal policy response to the existing economic situation has not been included in the analysis.

According to 2022 State Budget Law indicators, the Government debt will be reduced to 60.2% of GDP, while according to the fiscal rule, current expenditures will be limited to tax revenues, and capital expenditures will have an outpacing growth. However, given current economic developments, there are certain risks of deviation from the key indicators set in the budget law in relation to the economic growth scenario, tax collection and, therefore, the prospects for execution of expenditures depending on revenue collection.

According to the Central Bank estimates, in 2022, tax/GDP ratio<sup>5</sup> will grow over 2021 by 0.9 percentage as provided in 2022 State Budget Law. However, according to the GDP estimate of the Central Bank, this implies some shortfall of taxes compared to the budget program in the context of lower economic growth. Also taking into account that current expenditures, according to fiscal rules, in 2022 are limited to tax revenues and the nominal GDP growth rate of the previous 7 years, the government's ability to meet current expenditures may also be affected if economic growth falls short of forecasts. Therefore, some shortfall of current government expenditures was also assumed, in line with the assessment of smaller tax revenues resulting from low economic growth. It was projected that the shortfall of expenditures will come from non-collection of about AMD 65 billion drams planned in 2022 reserve fund not categorized under the main budgetary items, which means that no significant changes in the expenditures structure will occur.

As a result of a balanced change in revenues and expenditures, the deficit/GDP ratio in 2022 will be 3.1% (in line with the 2022 State Budget Law). This is 1.2 percentage points lower than in 2021, reflecting the goal of reducing the debt of the Government of the Republic of Armenia and ensuring fiscal stability in the medium term.

As a result of adjusting government budget expenditures and revenues from flows that do not have an impact on gross demand, compared to 2021, 0.7 percentage contractionary effect of fiscal policy is expected in 2022. The latter will be due to contractionary revenue impulse and slightly expansionary expenditure impulse.

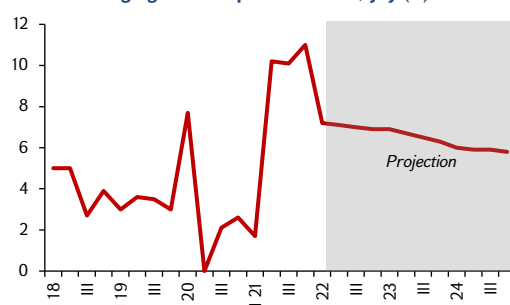
***In the medium term, the fiscal assessment has not changed from the previous forecast.*** Based on the draft program of 2022-2024, it is expected that in the medium term, along with the recovery of the economy, the Government will proceed to fiscal consolidation ensuring a gradual reduction of the budget deficit and debt burden due to the higher tax revenues and the improvement of the expenditure structure.

***Labor Market.*** Economic developments projected for 2022 will also affect labor market, mainly restraining the growth of private wages because of the slowdown in aggregate demand and economic activity. Further to the economic slowdown, the unfavorable economic environment in Russia will result in a slight drop of seasonal migration from Armenia in the near future. Subsequently, part of the seasonal workers will be included in the economically active population of the Republic of Armenia, increasing the number of both the unemployed and the employed. This in turn will have a certain restraining effect on

*Compared to 2021, 0.7 percentage contractionary effect of fiscal policy is expected in 2022.*

Chart 21

Nominal wage growth in private sector, y/y (%)



Source: NSS, CBA projections

<sup>5</sup> GDP indicators used in the program are the CBA projections.

the growth of wages. On the other hand, persisting high inflationary environment will put some pressure on private nominal wages. As a result, nominal wages in the private sector are projected to grow by about 6.7% in 2022. The growth rate of nominal wages in the private sector in the medium term, will be in line with the developments of the underlying economic growth and inflation.

Because of the slowdown in economic activity and certain drop of seasonal migration, higher unemployment rate of 16.7% is expected in 2022. In the medium term, the unemployment rate will remain in the range of 16.4-16.9%.

Given the slow growth of private wages and productivity (economic), as well as certain growth of unemployment, unit labor costs of enterprises in 2022 will be slightly subdued, stabilizing around its underlying target, i.e. target inflation rate of 4% at the end of the forecast horizon. Therefore, significant inflationary or deflationary effects from the labor market are not expected.

### 2.2.3. Comparison with the Previous Projection

***Economic growth estimates have been revised downwards along the forecast horizon.***

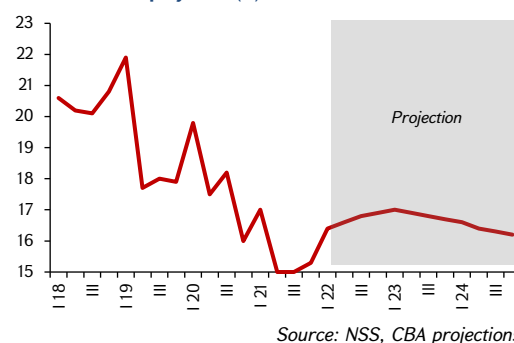
Compared to the previous forecast, economic growth in 2022 was revised downwards and is estimated at around 1.6% instead of the previous 5.3%. Except for agriculture, the indicators of all sectors were revised downwards given the projected lower level of external and domestic demand in Armenia as a result of the Russian-Ukrainian conflict and sanctions against Russia.

Economic growth at the close of 2021, which continued in early 2022, was greatly contributed by the industry. Investments in the sector stirred up, mostly due to the notable growth of food and beverage production. However, the impact of the expected economic downturn in Russia resulting from sanctions will particularly affect the mining and processing industries of Armenia. This, operation of Teghut mine was suspended (see Table 3 in “Projection Assumptions” section). The majority of beverage production is cognac production, the temporary suspension of which due to logistical problems will have some negative impact on the industry.

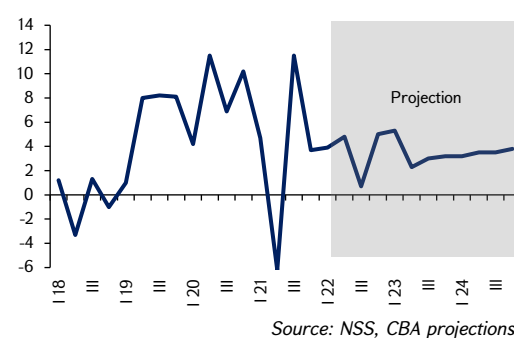
In addition, the decline in the processing industry will be fueled by the decline in food products, basic metals production and other sectors. Thus, the decline of the industry in 2022 will be one of the main factors driving down economic growth.

The growth of the services sector has also been revised downwards, mainly in view of the drop in remittances from Russia and the

**Chart 22**  
Level of unemployment (%)



**Chart 23**  
Unit labor costs growth, y/y (%)



slowdown in private demand. Furthermore, if the expected decline in industry and exports takes place, decline in the transport services will be observed as well. On the other hand, the low performance of the services sector will be partially offset by the increase in inbound tourism expected from Russia, however, in general, the growth of the sector is estimated to be lower than the previous projection.

Compared to the previous program, projections for the construction sector have been revised downwards given some investment delays amid the high uncertainty. Still, the growth of this sector in 2022 will remain at a high level, mainly due to the capital construction of residential buildings and budget financed projects.

The growth of the agricultural sector has been slightly revised upwards, mainly because of the actual high growth observed in the sector, as well as the expected involvement the part of seasonal workers in farming amid unfavorable economic conditions in Russia. The impact of this factor is viewed as small in the program, and is generally considered a positive risk.

Compared to the previous projection, the medium-term economic growth projection has been revised downwards, mainly due to lower expected investment levels resulting from uncertainties, which in turn will contribute to a slower recovery in productivity. As a result, economic growth in the medium-term horizon will be low and will reach a long-term steady state level only at the end of the horizon.

**Table 2**

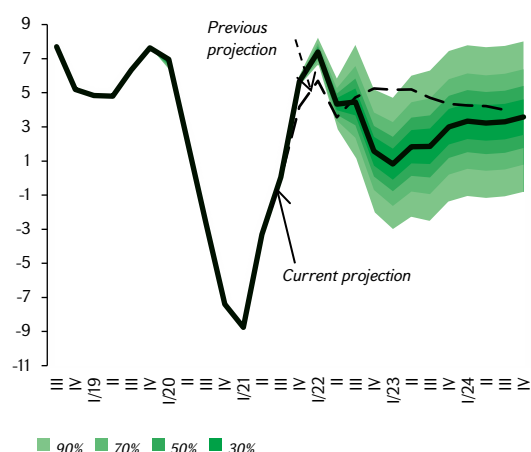
<b>Probability Distribution of Real GDP Growth (Cumulative) Projection</b>		
Period	30% Probability Interval	90% Probability Interval
January-December 2021 / January-December 2020	5.6 – 5.7	5.3 – 6.0
January-December 2022 / January-December 2021	0.7 – 2.4	(-2.0) – 5.2
January-December 2023 / January-December 2022	2.0 – 4.0	(-1.4) – 7.4
January- December 2024 / January December 2023	2.5 – 4.6	(-0.9) – 8.0

Source: NSS, CBA projection

Compared to the previous projection, in 2021, current account deficit/GDP ratio will grow, mainly because of the growth in the trade balance deficit as a result of some recovery of domestic demand at the end of the year. In 2022, current account deficit/GDP ratio will grow compared to the previous projection because of the downward revision of remittances.

**Chart 24**

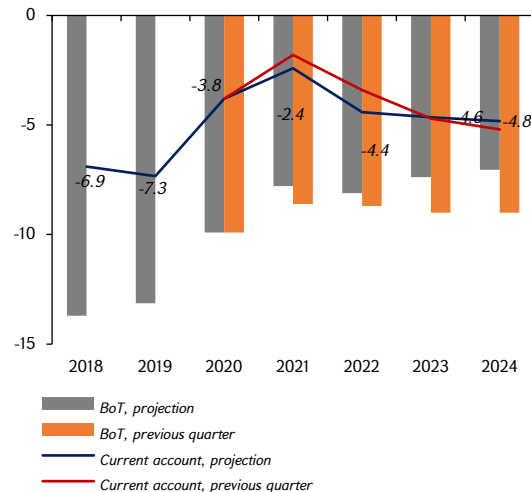
Real GDP growth (cumulative)<sup>6</sup> forecast probability distribution for 3-year horizon



Source: NSS, CBA projection

**Chart 25**

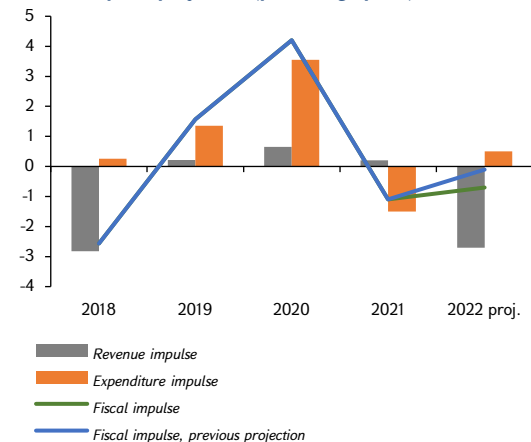
Current account/GDP medium-term projections (%)



Source: NSS, CBA projections

**Chart 26**

Fiscal impulse projection (percentage point)



Source: CBA estimates

<sup>6</sup> The growth rate of each quarter is calculated as the cumulative growth rate of the last 4 quarters.



For 2022, fiscal impulse is estimated as slightly more contractionary, at 0.7 percentage points over of the smaller contraction projected in the previous program.

According to the current projection, while general inflation in the short run will be slightly lower compared to the previous program, due to the lower growth of seasonal agricultural prices, core mal inflation will be somewhat higher than previously projected. The high level of core inflation will still be conditioned by the growing inflationary developments in the international commodity markets and pressures transmitted to the domestic economy. Accordingly, in the short run, inflation will have a higher trajectory than projected in the previous program, and in the medium term, it will gradually decrease and stabilize around the target level in the forecast horizon (see Chart 1. Inflation Projection Probability Distribution).

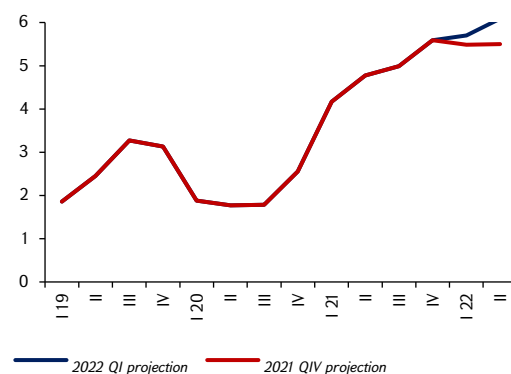
***Short-term inflation expectations will be higher than the previous forecasts as a result of spill-over inflationary effects transmitted from the external sector to the Armenian economy.***

#### 2.2.4. Main Assumptions and Risks

This section presents the main assumptions underlying the Monetary Policy Program for the first quarter of 2022, and the risks to implementation of the program coming from external sector developments, fiscal policy, emerging trends and short-term projections.

Chart 27

Short-term inflation expectations (%)



Source: CBA assessment

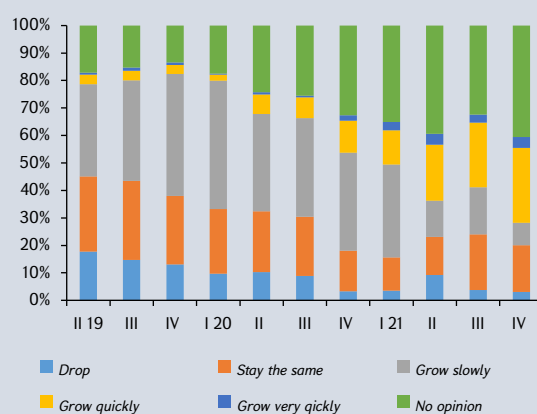
#### Box 2

##### ***The results of survey on expectations of households and the financial system***

According to a survey conducted by the Central Bank on households and financial sector organizations' expectations for a number of macroeconomic indicators in Q4 2021, inflation expectations for the second quarter in terms of general trends have risen somewhat. In particular, the share of households expecting high and very high inflation for the one-year horizon in the structure of the surveyed households has increased somewhat among the respondents. Furthermore, results of the survey reflect higher level of uncertainty of households about the expected inflation in the fourth quarter.

Chart 28

Household inflation expectation surveys



Source: CBA

## Projection Judgments

**Table 3**

Main Judgements and Assumptions	Possible developments if these assumptions prove to be correct
<p>The active phase of the Russian-Ukrainian conflict will end in the second quarter of this year, but the sanctions will be kept throughout the forecast horizon.</p> <p>The probability of new waves of the pandemic, which will have a significant economic impact, is expected to be low.</p> <p>While acceleration of inflation in partner countries continues to be largely related to supply factors, high inflation will persist.</p> <p>As a result of supply chain disruptions, delays in the supply of goods and shortages of certain goods will be observed throughout 2022 as well (supply of some types of inputs and food products will worsen due to the conflict).</p> <p>Expansionary economic policies in advanced economies will gradually ease.</p> <p>The recovery of oil extraction within the framework of the OPEC + agreement will be gradual, in line with the established schedule.</p>	<ul style="list-style-type: none"> <li>✓ The sharp rise in uncertainty about the future and economic sanctions against Russia will have a significant negative impact on the economies of partner countries.</li> <li>✓ Medium-term inflation expectations have accelerated in all partner countries. The assessment shows that inflation in the US and the EU continues to be moderate.</li> <li>✓ In the context of the expected tightening of monetary policy in developed countries, medium-term and long-term market interest rates have been adjusted upwards.</li> <li>✓ Prices in international commodity markets will remain high.</li> </ul>
<p>Amid growing geopolitical instability and uncertainty in the region, the short-term risk premium of Armenia has significantly grown.</p>	<ul style="list-style-type: none"> <li>✓ In the first quarter of the year, the country's risk premium grew amid the escalation of the Russian-Ukrainian conflict (by about 3 percentage points according to the Central Bank estimate). According to current forecasts, after the end of the active phase of the conflict, it will be largely restored and then will slowly approach long-term sustainable levels.</li> </ul>
<p>Inflation expectations have risen somewhat.</p>	<ul style="list-style-type: none"> <li>✓ Research shows that public short-term inflation expectations have increased to some extent under the impact of the ongoing inflationary developments in international markets.</li> </ul>
<p>Revenue contractionary and expenditure (moderately) expanding effects of fiscal policy for 2022 are expected.</p>	<ul style="list-style-type: none"> <li>✓ In 2022, the contractionary effect of fiscal policy is estimated at 0.7 percentage points under the scenario of certain shortfall of tax revenues and, consequently, less spending from the reserve fund. Number of factors, the new tax revenue assessment was 97.3% of the target in the law taking into account the new economic growth projection by the Central Bank, higher indirect tax revenues in the context of high inflation, certain tax shortfalls because of the suspension of the Teghut mine operation, as well as higher tax revenues in the first 4 months of 2022. According to the 2022-2024 MTEFP, in the medium term,</li> </ul>

	a neutral impact of fiscal policy is expected, along with a gradual reduction of the budget deficit and debt burden.
Higher uncertainty in Armenia and disruption of foreign trade relations as a result of the sanctions on Russia during the active phase of the Russian-Ukrainian conflict.	<ul style="list-style-type: none"> <li>✓ Amid the Russian-Ukrainian conflict and the sanctions imposed on Russia, uncertainty is expected to increase in Armenia, with a subsequent delay of investment decisions (particularly in industry) negatively affecting economic activity in 2022.</li> <li>✓ Cessation of cognac production and export till the end of the active phase of the conflict, then gradual resumption of production and export.</li> <li>✓ Termination of Armenia's trade relations with Ukraine (both export and import) throughout the active phase of the conflict.</li> <li>✓ Sanctions imposed on the Russian financial system will not cause significant disruptions in terms of Armenia's foreign trade relations. In particular, it is assumed that Russian intermediary banks through which commercial transfers are made can be substituted by other foreign intermediary banks, and commercial and non-commercial transfers with Russia will not be interrupted.</li> </ul>
Suspension of Teghut mine operation.	<ul style="list-style-type: none"> <li>✓ Suspension of Teghut mine operations with a restart perspective till the second quarter of 2022 inclusive, with subsequent resumption of operation and reaching the previous level of output and exports: The closure of the Teghut mine will have a 1.1% negative contribution to industry and a 0.23% negative contribution to economic growth in the second quarter.</li> </ul>
Some slowdown in seasonal migration from Armenia.	<ul style="list-style-type: none"> <li>✓ The adverse economic environment in Russia will lead to a certain slowdown in seasonal migration from Armenia. Most of the latter is considered as a positive risk.</li> </ul>
Changes in excise and customs rates by 2023 deriving from the requirement to apply common rates in the EEU.	<ul style="list-style-type: none"> <li>✓ The annual impact of the excise tax change expected in 2021-2023 is estimated at about 0.4 percentage point, and the impact of the change in customs rates at 0.3 percentage point for each year.</li> </ul>
The impact of termination of GSP + preferences on the Armenian economy will be moderately weak.	<ul style="list-style-type: none"> <li>✓ The impact of termination of preferences will be mainly on the textile industry, in which case the maximum impact on the overall industry is estimated at 0.7%.</li> </ul>

Source: CBA

### Box 3

#### **The impact of the Russian-Ukrainian military-political conflict on partner countries and the economy of Armenia: counterfactual scenario.**

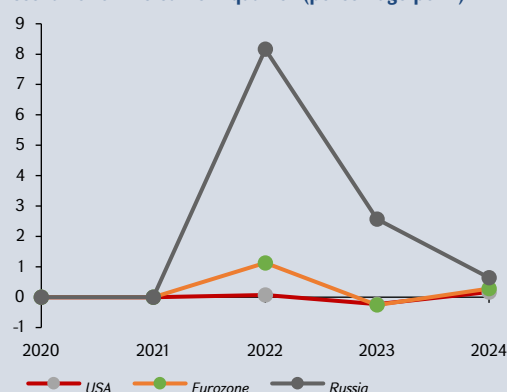
The Russian-Ukrainian military-political conflict, undoubtedly has a significant impact on the global economy, international commodity and financial markets, as well as the Armenian economy. In order to assess the economic impact of the conflict on the current and future developments of the economy, an additional retrospective scenario analysis was conducted, which aims to describe the developments of economic processes and policies comparing them with the current scenario.

In the absence of escalation of the conflict and the resulting severe sanctions hitting hard the main partner countries of the Republic of Armenia and the commodity markets, developments in the economy of the Republic of Armenia would be significantly more positive. Prior to the active phase of the conflict, economic developments and forecasts would follow the following scenario: **Due to the high rates of coronavirus vaccination in leading economies, and especially the confirmation of judgments about the relatively milder effect of Omicron strain, there has been some cautious optimism about the acceleration of global economic growth. The growing uncertainty over the possible escalation of the Russian-Ukrainian conflict since the end of last year was apparently restraining the optimism to some extent.** It should also be noted that labor market conditions in all partner economies were recovering at a fairly high rates, and, for example, in the case of Russia and the EU, unemployment was at historically low levels. Hence, in case of a scenario without conflict escalation and sanctions, the cumulative growth of gross output in Russia, one of the key partner economies of Armenia, would total more than 11% over the forecast horizon, of which about 8 percentage points in the current year alone. The impact of the conflict is also significant in the Russia's important trade partner European Union, where economic growth, in the absence of conflict, would be about 1 percentage point higher this year. The effects on the US economy would be less pronounced. **Disruptions in production and supply chains around the world since the spread of the pandemic, albeit at a slower pace, would gradually be neutralized this year. Accordingly, the resulting inflationary effects would persist throughout 2022. The escalation of the conflict has evidently deepened these problems, especially with regard to the international commodities, in the production and export of which Russia and Ukraine's share is high.** This is particularly evident in the markets of energy and a range of agricultural products (wheat, corn, sunflower, etc.).

**Given the above-mentioned factors of supply and demand, the inflationary environment in the partner countries would continue to expand, and monetary policy would gradually become more containing. Given the absence of additional inflationary pressures,**

Chart 29

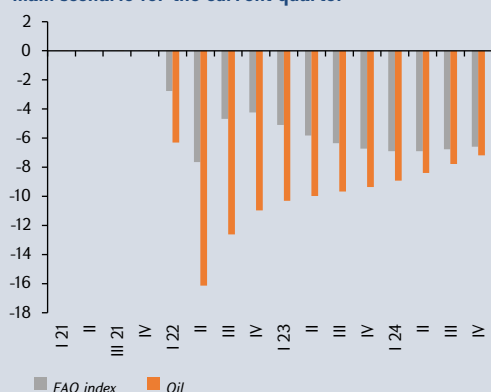
Economic growth in key partner countries in the absence of conflict escalation: difference vs. the main scenario for the current quarter (percentage point)



Source: CBA projections

Chart 30

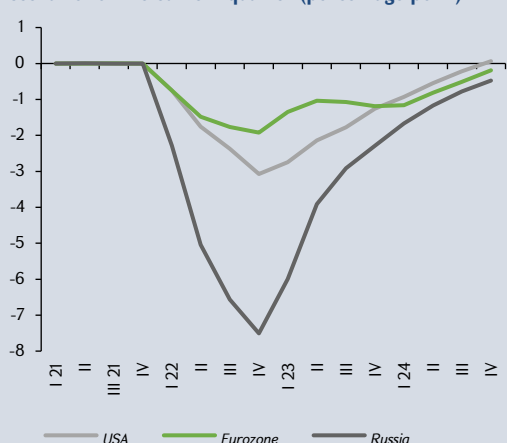
Commodity prices in the absence of the conflict escalation: percentage difference compared to the main scenario for the current quarter



Source: CBA projections

Chart 31

Inflation in partner countries in the absence of the conflict escalation: difference compared to the main scenario for the current quarter (percentage point)



Source: CBA projections



**and the shocks of inflation expectations in Russia included in the current scenario, inflation in partner countries would naturally grow, but at somewhat slower pace.**

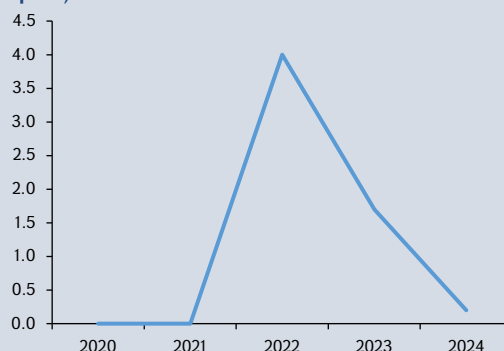
**As a result, in the absence of the above-mentioned developments, the policy response in the main partner countries would also be weaker in the forecast horizon.** The developments observed in Armenia at the end of 2021 and the beginning of 2022 indicate a high level of economic activity, accompanied by a significant acceleration of private investments. Thus, good grounds were created for the expansion of the productive opportunities for the economy in the medium term. At the same time, exports of industrial products accelerated and a gradual recovery of international tourism was evident. Hence, it was expected that the economic growth in the medium term would still be higher than the long-term potential level and would gradually stabilize around the latter in the forecast horizon. As a result, due to the developments in the outside world and a certain reduction in uncertainty, economic growth in Armenia would be significantly higher than the current forecast.

Prior to the outbreak of the active phase of the conflict, inflationary environment in Armenia was still characterized by somewhat high indicators, mainly bearing the effects of inflationary pressures transmitted to Armenia from international commodity markets. According to estimates, as a result of the Central Bank's consistent increase in the policy interest rate and the explicit messages about it, inflation expectations in the last year have stabilized. On the other hand, it was expected that under the scenario of the outlined fiscal policy and parallel to offsetting positive factors from foreign remittances, the conducive overall demand environment would gradually be neutralized. Under the impact of these factors and lower inflation in seasonal food markets, the 12-month inflation would fall faster than expected. In other words, in the absence of conflict, inflation in the forecast horizon, especially in the short-term sector, would proceed at a significantly slower pace than the current forecast.

Summing up the counterfactual scenario in the absence of the Russian-Ukrainian military-political conflict, it can be clearly stated that the current monetary policy stance, together with the revision of forecasts and the ensuing risks, are mostly the result of the shocks caused by the escalation of the conflict. In other words, if the conflict did not escalate, macroeconomic situation would be significantly more favorable: there would be lower inflation and higher economic growth, and the degree of uncertainty about economic prospects would be much lower.

Chart 32

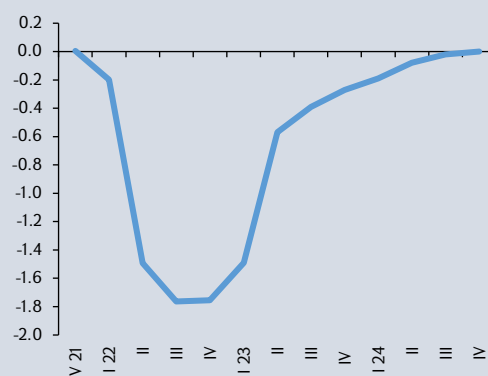
Economic growth in Armenia: difference compared to the main scenario for the current quarter (percentage point)



Source: CBA projections

Chart 33

12-month inflation in Armenia: difference compared to the main scenario for the current quarter (percentage point)



Source: CBA projections

## Forecast Risks

The Russian-Ukrainian military-political conflict and the resulting large-scale sanctions against Russia have sharply increased the level of geopolitical uncertainty in the region and around the world. Against the background of the negative effects of the recent pandemic, it poses

additional risks and challenges in terms of stabilizing the world economy, international markets of raw materials, food products and finance, as well as ensuring the sustainability of the disrupted value chains.

All these undoubtedly create high uncertainty and significant risks for the Armenian economy reflected in the ongoing relatively broad ranges of uncertainty over inflation and other macroeconomic data projections (See Chart 1. Inflation Projection Probability Distribution and Chart 2. GDP Real Growth Projection Probability Distribution). Accordingly, amid high uncertainties, the most significant quantitative risks that exist around the baseline scenario are presented below.

**In terms of aggregate demand, the following risks stand out:**

- External demand risks are mainly related to the weakening of economic growth or economic decline in partner countries, especially Russia as a result of the Russian-Ukrainian military conflict, possible disruption of trade transactions, business relations and supply agreements between Armenia and Russia against the background of the sharp weakening of Russian ruble, and structural rearrangements in the market. In addition, as a result of the military-political developments, there are certain positive risks of an influx of tourists from Russia and Ukraine to Armenia, as well as an increase in the demand for transit air transportation through the territory of Armenia.
- The impact of fiscal policy on aggregate demand in 2022 is strongly related to the process of both revenue collection and public expenditures execution. There are risks both in terms of lower-than projected by the CBA tax collection and corresponding lower spending. In the event of public spending savings or smaller than planned disbursements from external funding sources, expenditures may have a contractionary effect. 2022 state budget law provides for a rather high level of public capital expenditures. However, If capital expenditures continue to be underperformed as in recent years, the expanding impact of expenditures will diminish, as well as risks will emerge to economic growth and boosting potential. Therefore, implementation of capital expenditures envisaged by the program is crucial, especially in terms of ensuring long-term economic growth. Moreover, in the current situation, some changes in the planned scenario of budget revenue and expenditure policy are possible, which is a positive risk in terms of demand developments.

**In terms of supply, the following inflationary risks stand out:**

- In case of possible disproportionate tightening of expansionary policies in advanced economies, there are risks of capital outflows from developing countries, sharp reassessments of country risk premiums as well as other, primarily inflation-related risks.
- Commodity market prices risks are associated both with the pace of global economic recovery and the possible disruption of supply chains and regular supply volumes in international markets as a result of the on-going Russian-Ukrainian military-political conflict and sanctions against Russia.

As a result, the risks to the inflation deviation from the forecast in the medium term are estimated to be balanced and, in general, quantitatively still high (see Chart 1. Inflation Projection Probability Distribution).

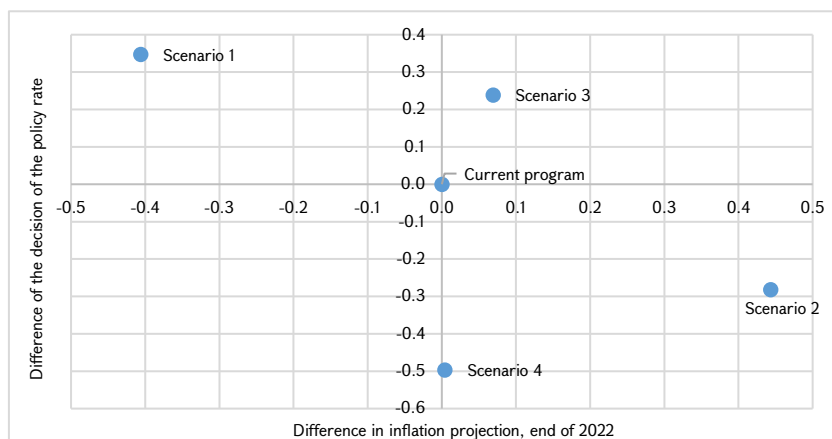
In addition to the above-mentioned inflation risks, there are additional potential medium-term risks to economic growth, which are two-sided. In particular, risks are related to the following internal factors:

- Uncertainties related to the development of the Amulsar mine and Alaverdi copper smelter, which pose an upward risk.
- Relocation of employees and establishment of IT enterprises in Armenia in the context of geopolitical developments in the region, which will have a positive contribution in terms of medium-term economic growth (+0.4 percentage points).
- Significant difficulties and disruptions in the activities of local companies with Russian capital, which will have a negative impact on the economic growth in Armenia.
- Migration of labor resources/businesses from Russia to Armenia in the long run as a result of the reduction of the per capita income gap between Russia and Armenia, which will have a positive impact on the Armenian economy (at 0.3-0.4 percentage points of the annual GDP).
- Slowing of seasonal migration from Armenia because of the unfavorable economic environment in Russia, which is a positive factor in terms of agriculture (at 0.3% pp of 2022 GDP).
- Negative risks associated with the spread of new waves of pandemic and their economic consequences.
- Implementation of the € 2.6 billion EU Eastern Partnership assistance package, which is a growth side risk (annual GDP growth of 0.9-1.0%).

*In general, as significant uncertainties remain related to geopolitical situation, coronavirus, international value chain rearrangements and possible financial and economic developments, the Central Bank seeks to reduce the potential risks arising from these uncertainties by modeling and evaluating different scenarios of further developments. In particular, given the peculiarities of the current stage and the possible emergence of various types of risks, several scenarios of economic development have been considered in more depth: long-term persistence of geopolitical risks (Scenario 1), improvement of the relative competitiveness of Armenian exporters in the Russian and international markets (Scenario 2), implementing more expansionary policies in the foreign sector (Scenario 3), a more enhancing environment for Armenia in the international capital markets (Scenario 4). The possibilities of their respective policy responses have been considered, to respond adequately with the situation in case of the first signs of their emergence.*

Chart 34

Scenarios of economic development in the current situation



Source: CBA projections

### 3. ACTUAL DEVELOPMENTS IN Q4, 2021

#### 3.1. Inflation

##### 3.1.1. Fulfillment of the Inflation Target

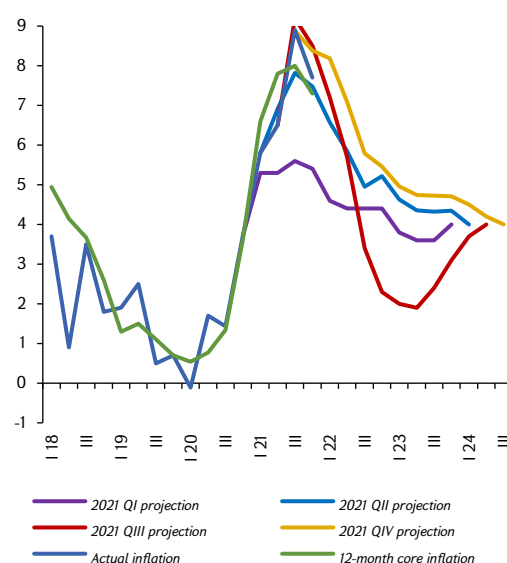
Monetary policy to be implemented at the beginning of the reporting period was based on a number of assumptions described below, which were outlined in the QI, 2021 program, with expectations of persisting low economic activity and weak demand environment, mostly conditioned by the ongoing spread of coronavirus worldwide, martial law declared in the country at the end of the previous year and the resulting uncertainties about the economic outlook. At the same time, however, as a result of some short-term supply factors transmitted from international markets and in the domestic economy, a significant growth of inflation and inflation expectations was observed. According to the baseline scenario of the Central Bank, their impact would remain in the short run, gradually diminishing in the medium term, and 12-month inflation would be adjusted towards the target. Given the short-term nature of inflation factors, monetary policy was aimed at neutralizing the risks of accelerating inflation expectations without harming domestic demand recovery as far as possible.

In light of these inflation developments, the projected short-term inflation trajectory to reach the target in each subsequent quarter of the reporting year was adjusted upwards.

During the reporting period, macroeconomic developments both in the external sector and in the Armenian economy were more positive than expected. Thus, as a result of the widespread use of coronavirus vaccination and the avoidance of severe restrictions to a possible extent, a faster recovery of global economic activity and external demand has been observed. Under the influence of a number of supply factors manifested against the background of positive demand developments (forecasts of low supply of new crops, increase in freight costs, disruption of production chains), significant inflationary developments were observed in the international commodity markets. This was also reflected in the formation of a high inflationary environment in the main partner countries of the Republic of Armenia, under which inflationary pressures were transmitted to the economy of the Republic of Armenia through a number of imported food products. In the second quarter of 2021, supply-side inflationary spill-over effects from international food prices to domestic prices in the first quarter were supplemented by demand-side factors, conditioned by the outpacing growth of private consumption over the output capacity expansion opportunities. The latter was mainly due to the sharp increase in household consumption expenditures at the expense of the

Chart 35

12-month inflation projection for the reporting period was periodically revised upwards



Source: NSS, CBA projections



accumulated savings, as well as the large inflow of remittances from abroad.

Amid the inflationary developments described above, in the first half of the year, the Central Bank continued to pursue a policy of tightening monetary conditions introduced since December last year, gradually reducing and neutralizing the expansionary monetary stance. Given the increase of inflationary effects in the second quarter over the first quarter, the Central Bank raised its policy rate by only 0.25 percentage points in the first quarter and 1.0 percentage point in the second.

Due to higher-than-expected growth rate of tourism, in the second half of the reporting period, the impact of external demand factors in the domestic services was quite significant. At the same time, uncertainties over the economic and geopolitical outlook have been reflected by rising inflation expectations. In such circumstances, the Central Bank raised the refinancing rate by a large step of 0.75 percentage points in the third quarter as well. Despite the slight decline of 12-month inflation rates in the fourth quarter, inflation factors persisted under inflationary spill-over effects from the external sector (persisting high energy prices and disruptions in production chains) and positive demand environment. This in turn was reflected in the dynamics of core inflation with the quarterly annual indicator of the latter growing strongly to 5.6%, compared to 4.7% in the previous quarter. At the same time, the impact of current inflation factors and expected changes in the prices of regulated services in the fourth quarter was reflected in the higher public inflation expectations. In view of these developments, the Central Bank raised the refinancing rate additionally by 0.5 percentage points in the fourth quarter.

It should be noted that in 2021, domestic financial market responded adequately to the changes in the policy rate of the Central Bank, and short-term market interest rates were mostly shaped around it.

To sum up, policy rate in the reporting period grew by 2.5 percentage points in overall in 6 out of 8 stages and was set at 7.75% at the end of the year. The Central Bank kept the refinancing rate unchanged only in March and November, on the grounds that despite the relatively high inflation background and uncertainty over the economic outlook, the future-oriented and consistent tightening of monetary policy since December 2020 has a sufficient effect on regulating the high demand, curbing inflation and meeting the medium-term inflation target. While, in line with the expectations, 12-month inflation grew in 2021, from 3.7% at the end of 2020 to 7.7% at the end of 2021, it is estimated, that as a result of the actions implemented during the year within the framework of monetary policy, 12-month inflation will gradually decrease and in the 3-year forecast horizon will approach the target 4%.

## Box 4

### Alternative monetary response (counterfactual analysis)

#### How much would inflation be if the policy rate remained unchanged?

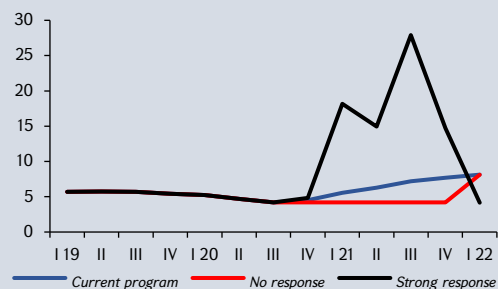
To ensure price stability, as well as increase confidence, central banks must respond immediately to the expected inflation. At the end of 2020, when inflation in Armenia was still significantly below the target level (12-month inflation in November amounted to 1.6%), the Central Bank of Armenia forecasted its acceleration in 2021 because of inflationary effects of demand recovery amid supply chain disruptions. As a result, in December 2020, after a period of continuous easing of monetary conditions in the previous quarters, a decision was made to respond to the expected acceleration of inflation by raising the refinancing rate by 1.0 percentage point. During 2021, the Central Bank continued to consistently tighten monetary policy (reduce the expansionary stance) aimed at anchoring public inflation expectations in the face of external inflation factors and ensuring the goal of price stability. During the year, interest rate was gradually raised by 2.5 percentage points, as a result of which the peak of 12-month inflation was recorded in November 2021. Since then, 12-month inflation has been declining to just 6.5% in February 2022.

It is noteworthy that while inflation factors in 2020-2021 were mainly of global nature, various central banks around the world delayed the policy response, considering the existing inflation as a "temporary" phenomenon. The main goal of monetary policy is to curb inflation expectations and prevent accelerated inflation in the face of "temporary" inflation factors. To this end, the activities of the Central Bank of Armenia were aimed at solving this problem. Given such circumstances a question arises: what would be inflation dynamics in Armenia if interest rates, like in many other countries, were unchanged?

To this end, policy response exercises were conducted to compare inflation dynamics under various scenarios. In particular, if the Central Bank did not respond to the expected acceleration of inflation by changing interest rate from December 2020 and left the interest rate unchanged throughout 2021, inflation would continue to accelerate during the year, reaching 13 percent. As a result, starting from 2022, more drastic interest rate increases will have been needed to reduce and regulate high inflation. Furthermore, such policy would harm public confidence in the Central Bank and accelerate inflation expectations, which would make it more costly to ensure price stability in the medium term.

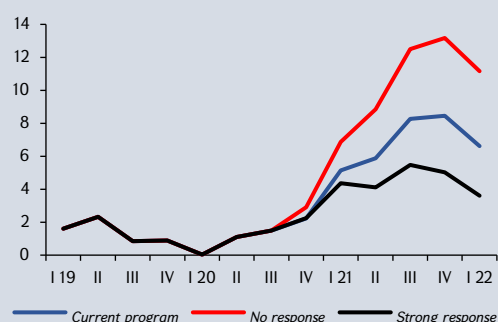
And what actions would be necessary so that inflation by the end of 2021 could be close to the target 4%? The Central Bank should have reacted very sharply, raising the interest rate to about 28% in the third quarter of 2021 to reach this target. Such policy would be very costly for the economy, significantly curbing demand and GDP.

Chart 36  
Interest rate



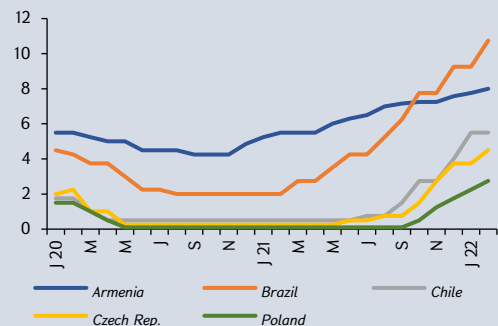
Source: CBA projections

Chart 37  
12-month inflation



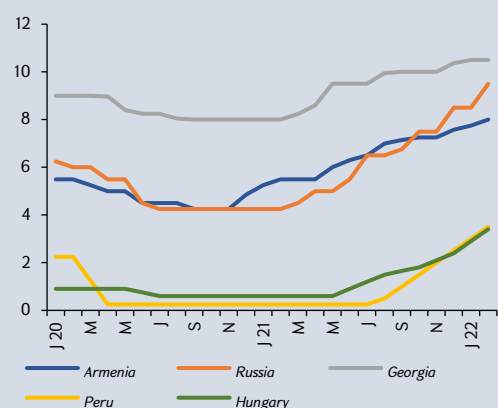
Source: CBA projections

Chart 38  
Interest rates on development countries



Source: Web pages of countries

Chart 39  
Interest rates on development countries



Source: Web pages of countries

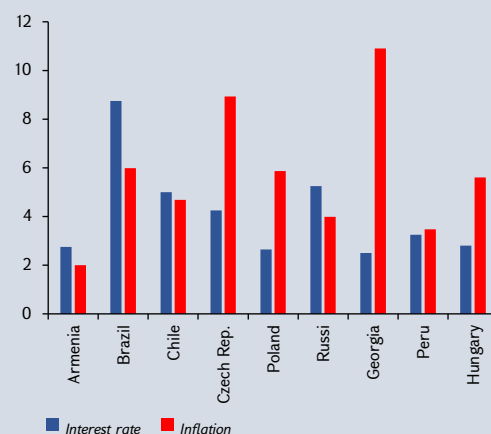
The analyzes show that the CBA monetary policy is constructed in such a way that inflation with minimum public expenditures approaches the target within 3 years, ensures price stability and thus creates preconditions for long-term sustainable economic growth.

In order to curb inflation expectations, central banks must pursue a future-oriented policy, preventing high acceleration of inflation. It can be noted that Armenia was one of the first in the world to start raising the interest rate in December 2020, having projected acceleration of inflation (see Charts 38, 39).

As a result, the timely and necessary response allowed the Central Bank of Armenia, by slightly raising the interest rate less, to have a smaller growth of inflation. In addition, the failure of the future-oriented response means the need for more drastic and large-scale responses in the future to curb inflation and return it to a manageable range. The latter is also evident in policies conducted by a number of developing countries (see Charts 38, 39). It is also noteworthy that the 12-month inflation in those countries has increased at a faster rate compared to Armenia, although those countries raised interest rates to a greater extent (see Chart 40).

Chart 40

Change in interest rate and 12-month inflation  
(February 2022 vs. January 2021)



Source: Web pages of countries, CBA estimates

### 3.1.2. Prices

***Inflation has accelerated since the beginning of 2021, and, as projected, inflation environment in the reporting period remained high.***

The growth of inflation by the year-end was mainly conditioned by the acceleration of core inflation. Within its structure, growth of imported food and non-food products' prices resulting from the high inflationary environment in international commodity markets was significant. Thus, spill-over effects from international markets resulted in a sharp growth in the prices of "Bakery and Cereals", "Meat Products", "Oils and Fats" and "Sugar" commodity groups in the domestic economy. The growth of international energy prices affected domestic fuel prices. The 12-month inflation during the reporting period was also significantly contributed by the growth in the prices of pharmaceuticals, which was almost entirely due to the high gross demand during the pandemic. The sharp growth of international freight prices is also notable as it had a direct impact on inflation of imported goods (in particular, electrical appliances, clothing and footwear, as well as personal care items).

Along with the faster-than-expected recovery of demand in the Armenian economy, inflation also accelerated during the reporting period as a result of changes in the prices of domestic goods and services. To this end, the adjustment of prices for a number of services with high price rigidity (medical, hairdressing, legal, postal services) should be noted.

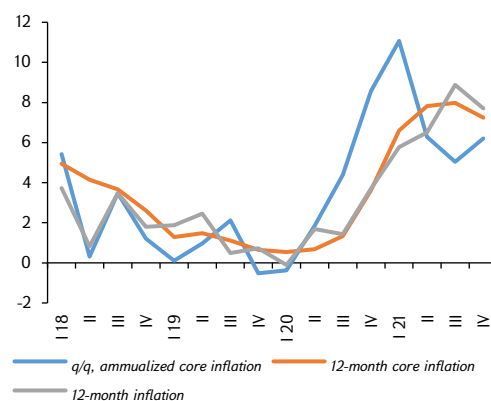
Growth of prices of "Tobacco" and "Alcoholic Beverages" product groups, in line with the estimates, continued to be affected by inflationary impact of the change of excise tax rates at the beginning of the year.

In addition to the above-mentioned factors, low deflation of seasonal food products, not typical for the season, has in turn significantly contributed to the acceleration of inflation in the second and third quarters of 2021. In particular, the low deflation of vegetable prices was mainly caused by bad weather conditions, reduction of sown areas of certain products and the growth of exports. In the absence of these factors, the fourth quarter saw a milder-than-expected increase in seasonal food prices, which contributed to a faster-than-expected decline in 12-month inflation at the end of the year.

During the year, tariffs for regulated services endured moderate inflationary fluctuations, with 1.1% year-over-year growth in the fourth quarter of 2021.

Chart 41

The significant slowdown in core quarterly inflation during the reporting period was followed by some acceleration at the end of the year



Source: NSS

Table 4

Consumer price inflation by commodity items as key contributors			
Designation	Weight	12-month inflation in December 2021	Contribution to y/y inflation
<b>Core inflation</b>	<b>74.4</b>	<b>7.3</b>	<b>5.4</b>
Bread and cereals	7.7	10.2	0.8
Meat	9.7	7.5	0.7
Oils and fats	2.3	14.7	0.3
Sugar	0.4	19.8	0.1
Alcoholic beverage	2.9	8.9	0.3
Tobacco	1.6	9.9	0.2
Clothing	2.5	13.0	0.3
Footwear	1.6	11.3	0.2
Household appliances	0.5	8.9	0.0
Medicines and health products	4.0	6.1	0.2
Fuel	6.0	8.1	0.5
Air passenger transportation services	0.6	-3.9	0.0
Outpatient care services	2.9	1.6	0.1
<b>Seasonal food</b>	<b>9.6</b>	<b>21.9</b>	<b>2.1</b>
Eggs	1.3	12.8	0.2
Fruits	3.7	1.8	0.1
Vegetables	4.7	40.1	1.9
<b>Regulated services</b>	<b>16.0</b>	<b>1.1</b>	<b>0.2</b>

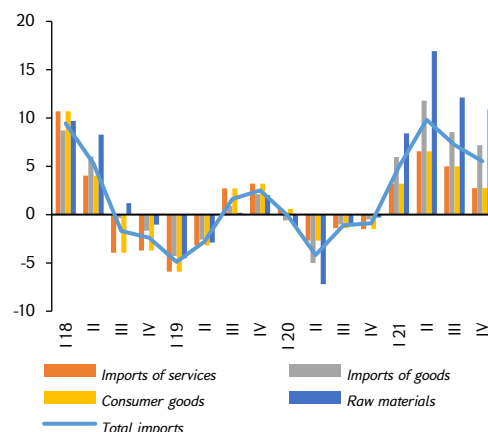
Source: NSS

**Import prices.** In the fourth quarter of 2021, a certain stabilization of food prices was observed in the world economy, which was reflected in the stabilization of import prices in USD terms in Armenia. However, the latter are still higher than the level of the same quarter of the previous year. During the fourth quarter, import prices in USD terms dropped by 0.5% as compared to the previous quarter, with subsequent growth by 5.5% yoy against the same period of the previous year. During the fourth quarter, growth was mainly observed in the prices of intermediate goods in USD terms while final consumption goods prices in USD terms slightly dropped.

As for the developments compared to the same period of the previous year, 5.5% yoy growth was mainly the result of the growth of oil, wheat and sugar prices. Growth was observed on almost all imported intermediate goods. Growth in consumer goods prices compared to the previous year was mainly the result of higher dollar prices of consumer goods from China and Russia.

Chart 42

In 2021 QIV, the growth of dollar prices for imports of goods and services slowed down compared to the same quarter of the previous year, y/y, %



Source: CBA estimates

## Box 5\*

### **Assessment of the impact of the temporary ban on the import of goods of Turkish origin to the Republic of Armenia on inflation**

According to the decision of the Government of the Republic of Armenia in October 2020, temporary restrictions were imposed on the import of products of Turkish origin (final goods), which was maintained throughout 2021. Given some issues of products substitutability, the decision to restrict imports may obviously involve inflationary risks, which are analyzed below in the context of the actual impacts in 2021. It is also important from the point of view of identifying possible directions of inflation in the future. The estimates are based on a study of the 14 largest consumer goods groups imported from Turkey in terms of relative prices in USD terms (according to foreign trade statistics), taking into account their actual substitution<sup>7</sup>. First, let's look at the composition and product groups imported from Turkey in recent years.

\* Prepared by Harutyun Sargsyan (Monetary Policy Department).

<sup>7</sup> In order to obtain more accurate estimates, it is necessary to conduct parallel analysis of individual product groups with a very narrow breakdown, for comparison of their quality indicators, which was not possible because of the lack of relevant data.

Table 1\*\*

**Armenia's imports from Turkey according to two-digit foreign trade classification, in USD million**

		2018	2019	2020	The share of commodity groups in imports from Turkey in 2020
Commodity Code	<b>Total</b>	<b>250.7</b>	<b>265.4</b>	<b>229.7</b>	
'84	Machines, mechanical devices, their parts	21.8	23.6	29.5	12.8
'61	Clothing and accessories - knitted or woven	24.7	30.6	23.9	10.4
'39	Plastics and articles thereof	18.7	19.2	16.6	7.2
'08	Fruits	15.5	15.4	12.7	5.5
'85	Electric machines, equipment and parts	10.1	11.7	10.4	4.5
'76	Aluminum and articles thereof	7.5	7.0	9.0	3.9
'60	Knitwear or knitted fabrics	11.9	10.8	8.9	3.9
'62	Clothing products and clothing accessories, non-knitted or woven	15.6	7.1	8.4	3.7
'44	Wood and wooden items	8.8	8.7	7.6	3.3
'34	Detergents, lubricants	8.1	7.2	6.6	2.9
'32	Dyes, pigments	5.8	6.0	6.5	2.8
'64	Shoes and parts	11.7	6.8	6.4	2.8
'83	Different metal products	4.4	5.8	6.4	2.8
'52	Cotton	11.7	7.3	6.2	2.7
'87	Vehicles and their parts and accessories	6.9	10.1	6.0	2.6
'94	Furniture, bedding	4.9	6.9	5.8	2.5
'73	Items made of iron or steel	4.5	5.0	5.6	2.4
'96	Various industrial products	2.2	1.7	4.6	2.0
'07	Vegetables	2.2	3.5	4.5	2.0

According to the two-digit foreign trade classification, "Machinery, mechanical equipment, nuclear reactors, boilers, parts thereof", "Clothing and apparel, knitted or crocheted", "Plastics and articles thereof", "Edible fruits and nuts, citrus peel or melon peel", "Electrical machinery and equipment and parts thereof, recorders and reproducers, TV-sets" commodity groups account for a large share of imports from Turkey (see Table 1). In general, the scope is quite large.

In 2021, as a result of the import ban from Turkey, there was a significant decrease of imports (around 67%)<sup>8</sup>, and in some cases, the decrease in imports of mainly consumer goods was 90% or more (see Table 2).

Table 2

**Change in imports from Turkey in 2021**

		2020- 11 mln USD	2021-11 mln USD	2021/2020, %
Commodity Code	<b>Total</b>	<b>193.3</b>	<b>64.6</b>	<b>-66.6</b>
'84	Machines, mechanical devices, their parts	21.4	10.9	-49.0
'61	Clothing and accessories - knitted or woven	22.0	0.3	-98.7
'39	Plastics and articles thereof	14.5	5.1	-64.9
'08	Fruits	10.3	0.4	-96.0

\*\* Source for all tables in the Box: NSS, CBA estimates.

<sup>8</sup> Restrictions apply only to final consumption goods.



'85	Electric machines, equipment and parts	8.0	0.4	-94.7
'76	Aluminum and articles thereof	7.0	7.1	1.8
'60	Knitwear or knitted fabrics	7.1	7.6	7.3
'62	Clothing products and clothing accessories, non-knitted or woven	6.9	0.1	-97.9
'44	Wood and wooden items	7.0	7.8	11.9
'34	Detergents, lubricants	5.9	0.5	-92.1
'32	Dyes, pigments	5.3	2.1	-60.3
'64	Shoes and parts	5.6	1.1	-80.6
'83	Different metal products	5.1	2.2	-55.5
'52	Cotton	5.3	3.4	-35.4
'87	Vehicles and their parts and accessories	5.6	0.4	-92.0
'94	Furniture, bedding	4.9	0.2	-96.9
'73	Items made of iron or steel	4.5	0.2	-95.2
'96	Various industrial products	3.9	0.3	-91.8
'07	Vegetables	3.1	0.4	-87.2

*In light of these developments, it is important to assess the possibility to substitute imports of these product groups by imports from other countries, which, due to price differences, may have additional inflationary or deflationary effects. In terms of inflationary effects, we will next consider commodity groups with a large share in total imports from Turkey (the majority of which are consumer goods), imports of which declined significantly. Those are mostly textiles, household goods, fruits and vegetables, furniture and related products, household electrical appliances. We will present the logic of the estimations with the example of one textile product group, and for the other product groups the evaluation of final results will be presented.*

**Table 3**

***Distribution of imports of "Men's or boys' suits, ensembles, jackets, blazers, trousers" product group by main countries (product code 6103)***

RA import, USD thousand	2020-Q1	2020-Q2	2020-Q3	2020-Q4	2021-Q1	2021-Q2	2021-Q3
World	709	272	643	774	677	599	1106
China	204	80	211	150	267	160	466
Bangladesh	42	35	55	88	57	82	282
Cambodia	14	14	53	85	112	46	107
Russia	57	35	39	58	40	89	38
Turkey	210	42	162	274			

**Table 4**

***Unit value of import of "Men's or boys' suits, ensembles, jackets, blazers, trousers" product group, kg/USD***

Exporters	2020-Q1	2020-Q2	2020-Q3	2020-Q4	2021-Q1	2021-Q2	2021-Q3	2021-Q4	2020- average price in USD	2021- average price in USD
World	25	28	25	16	26	22	23	22.5	23.5	23.4
China	20	43	24	15	17	17	18	18	25.5	17.5
Bangladesh	21	23	20	22	25	23	31		21.5	26.3
Cambodia	52	69	71	81	90	54	73		68.3	72.3
Russia	12	15	11	14	15	10	5.5	11.9	13.0	10.6
Turkey	34	27	22	9.83					23.2	26.3
Unit value of Turkish exports	12	13	14	13	14	15	15	15	13.0	14.8

Let us consider import values and prices per unit of textile products with two-digit and four-digit classification based on foreign trade data. In particular, possible import substitutions for "Men's or boy's suits, jackets, etc. (6103)" product group came from China and Bangladesh and the weights of the latter have increased in comparison with 2020 (see Table 3). Given the weighted price of import of this product group from those countries (17.2 USD/kg in 2021, and Turkey's unit value of USD 26.3 / kg), as a result of the substitution, compared to Turkish imports, relative prices<sup>9</sup> dropped by about 35%. We will approximate prices of Turkey imports with changes in the unit value of Turkish exports of the given product group.

The impacts of relative import prices on other major textile products were assessed and summarized with the same logics: substitutions at both higher and lower prices have been recorded (see Table 5).

**Table 5**

**Changes in relative prices of textile products <sup>10</sup>**

Product code	Average price of the substitution countries / Average price of Turkish exports in 2021, %	The share of imports from Turkey in total imports of the relevant product group
6103	-34.8	28.7
6104	-39.3	21.7
6109	-19.2	24.0
6114	36.7	75.2
6110	6.4	17.4
6203	-31.4	18.1
6204	-21.4	21.2
6302	-19.2	16.1
64	51.9	15.5

Taking into account Turkey's weight in the import of each product group, as well as the weight of the given product in the general group, it was estimated that inflationary effect of import substitution for terms of general textile product groups in USD terms was 3.2% (see Table 6).

**Table 6**

**Relative increase in import prices of textiles in USD terms**

Product code	Average price of the substitution countries / Average price of Turkish exports in 2021, %	The share of imports from Turkey in total imports of the relevant product group	Impact on prices in USD terms	The weight of the corresponding code in the general textile imports (61+62+63+64)	Contribution of Turkey's imports substitution to inflation of textile imports in USD terms
6103	-34.8	28.7	-10.0	1.3	-0.1
6104	-39.3	21.7	-8.6	3.3	-0.3
6109	-19.2	24.0	-4.6	4.2	-0.2
6114	36.7	75.2	27.6	10.2	2.8
6110	6.4	17.4	1.1	8.2	0.1
6203	-31.4	18.1	-5.7	6.1	-0.4
6204	-21.4	21.2	-4.5	8.8	-0.4
6302	-19.2	46.0	-8.8	1.7	-0.2
64	51.9	15.47	8.0	22.4	1.8
					3.2

<sup>9</sup> Changes in relative prices in the analysis are in USD terms. They were weighed by the respective weights of China and Bangladesh.

<sup>10</sup> See product code names in the Annex.

Let us consider the changes in prices as a result of the substitution of product groups of fruits, vegetables, electrical equipment, soap and other cleaning items. Fruits were substituted mainly from Iran, Georgia and Ecuador. In terms of vegetables, substitutions were from Iran and Egypt. In terms of furniture and accessories, substitutions came from China and Russia. Substitutions for soap and other cleaning supplies came mainly from Russia, Bulgaria and Iran. As a result of the substitutions in these product groups, both price drops and inflationary effects were assessed (see Table 7).

**Table 7**

**The change in prices of the observed product groups (in USD terms) as a result of substitution**

Product code	Average price of the substitution countries / Average price of Turkish exports in 2021, %	The share of imports from Turkey in total imports of the relevant product group	Change in prices (in USD terms) as a result of import substitution of the assessed product group
08	28.8	18.2	5.2
07	-24.6	24.4	-6.0
8516	25.2	3	0.8
94	-9.9	8.3	-0.8
3402	15.6	21.7	3.4
3401	-41.7	15.9	-6.6

In order to assess the effects of the change in import prices of the assessed product groups (in USD terms) on consumer prices in Armenia, price change estimates were weighed with the corresponding weight of the given product group in the consumer basket. As a result, the total impact of the assessed product groups on consumer prices in Armenia was estimated to be quite small, 0.13 percentage points in USD terms (see Table 8).

**Table 8**

**Impact on total prices**

	Clothing and footwear	Fruits	Vegetables	Electric appliances	Furniture	Soap	Other cleaning supplies
Weight of imports of the given product group in the RA consumer basket	2.10	0.9	0.80	0.60	0.90	0.09	2.0
Changes in prices (in USD terms) as a result of substitution of imports from Turkey	3.19	5.2	-6.0	0.8	-0.8	3.4	-6.6
Contribution to inflation	0.07	0.05	-0.05	0.0045	-0.01	-0.01	0.07
Total impact on inflation	<b>0.13</b>						

In conclusion, as a result of ban of imports from Turkey, import substitutions for consumer goods came mainly from China, Bangladesh, Russia, Iran and Georgia. As a result of the substitution of the assessed

product groups, total impact of the difference in prices (in USD terms) on inflation in Armenia is estimated to be rather small 0.13 percentage point. The estimates obtained with this approach refer to the change in prices of imports in USD terms, which was taken as a basis for the assessment of the direct impact on inflation.

*Annex. Product Code Names*

*6103 Men's or boys' suits, ensembles, jackets*

*6104 Women's or girls' suits, ensembles, jackets*

*6109 Knitted T-shirts and similar articles*

*6110 Knitted jerseys, pullovers, cardigans*

*6114 Other garments knitted or crocheted*

*6203 Men's suits, ensembles, jackets*

*6204 Women's suits, ensembles, jackets*

*6302 Bedlinen for children*

*64 Footwear, gaiters and the like*

*08 Fruits*

*07 Vegetables*

*8516 Electrical appliances*

*3401 Soap*

*3402 Other cleaning supplies (excluding soap)*

## 3.2. Economic Developments

### 3.2.1. Economy Position

***During the reporting period, the GDP gap remained in the positive range.*** In the fourth quarter of 2021, economic growth was 9.0% (see section 3.2.3), much higher than the Central Bank's previous forecast and mainly due to higher-than-expected levels of industry, construction and private investments. The above developments mainly indicate an increase in the productive capacity of the economy, due to which GDP gap did not change significantly compared to the previous quarter and remained in a small positive range, still positively contributing to persisting inflationary environment.

*Economic growth in the fourth quarter of 2021 totaled 9.0%.*

### 3.2.2. Expenditure Aspect of the Economy

Economic growth in the fourth quarter of 2021 totaled 9.0%, which is above the previous estimates. Economic growth was largely driven by higher private spending, while government spending and net exports had a negative contribution. The upward shift in demand was due to

lower-than-expected negative contributions of government spending and external demand. Private spending was in line with expectations, but the structure changed to some extent. In particular, in parallel with the developments in construction and industry, growth of private fixed assets was higher than expected, while private consumption grew less than expected. Weak private consumption observed in the previous quarter remained in the reporting quarter as well, reflected, inter alia, in the relatively higher level of private savings. Thus, due to 8.1% and 28.1% growth of private consumption and private fixed assets, respectively, the growth of private spending in the fourth quarter totaled 12.3%.

During the fourth quarter of 2021, under the higher-than-expected developments of the global and domestic economies, growth rates of exports of goods and services outpaced the previous estimates. The growth of export of services, in particular, tourism, exceeded the growth of its import. At the same time, it should be noted that some acceleration in domestic demand was observed, reflected in a higher-than-projected growth of imports of goods and services. In particular, in line with the acceleration of private investment, import of investment goods was higher than expected. Thus, the growth of real exports of goods and services in the fourth quarter of 2021 totaled 31.4% yoy, and the growth of real imports of goods and services, 26.6% yoy. The real growth of exports of goods and services in 2021 was 16.5%, exceeding real growth of imports of goods and services (10.9%).

To sum up, net real export contribution to GDP in the fourth quarter was less negative than expected.

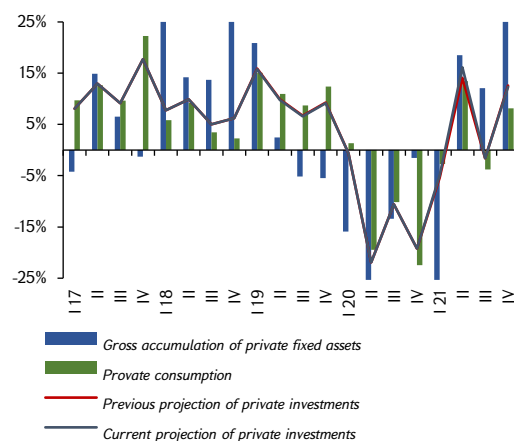
According to estimates, net remittances of individuals (includes seasonal workers income and private transfers) in the third quarter of 2021 will drop by about 8.0% yoy in USD terms, according to estimates, which is lower than the Central Bank forecast in the previous quarterly program.

**Fiscal Policy<sup>11</sup>.** Actual budget revenues in the fourth quarter of 2021, shifted more in the direction of more collection and expenditures - in overperformance. As a result, the impact of fiscal policy on aggregate demand has been in line with expectations and is estimated to be almost neutral.

Budget revenues in the fourth quarter of 2021 accounted for 102% of the adjusted plan due to the surplus of tax and other revenue

Chart 43

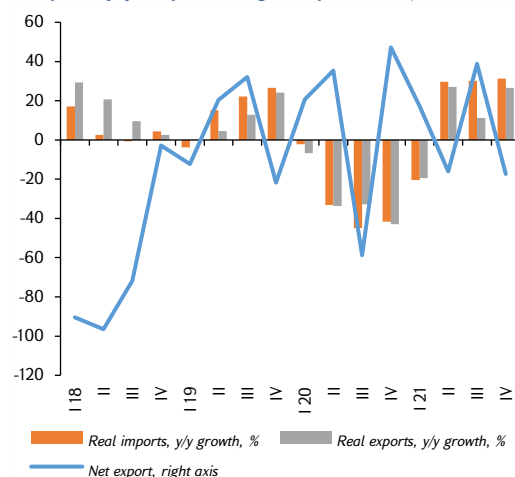
Private spending structure (y/y growth)



Source: NSS, CBA assessment

Chart 44

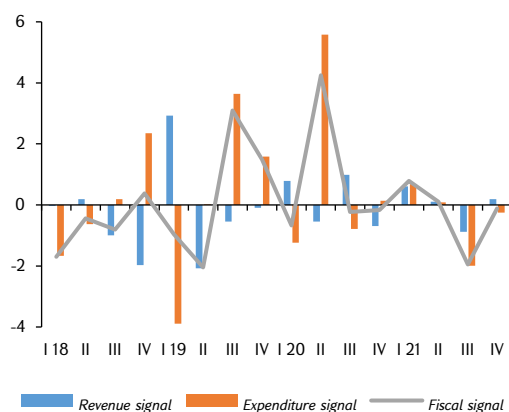
In 2021 QIV, net exports position deteriorated (net real exports, y/y, %, positive sign - improvement)



Source: NSS

Chart 45

Fiscal policy in the fourth quarter of 2021 had a neutral impact on the previous quarter



Source: CBA assessment

<sup>11</sup> The review of the fiscal sector was based on the actual consolidated budget indicators at the fourth quarter.

collection. In addition, the Joint tax account increased significantly in the fourth quarter (about AMD 17.5 billion drams), which, considered as the amount actually collected from the economy, was included in the impulse calculation. Subsequently, given that higher revenue collection occurred under higher-than-expected economic growth, revenue impulse was slightly expanding as expected.

State budget expenditures in the fourth quarter were above the Central Bank projections, and net lending was in line with them. As a result, the expenditures' impulse was neutral instead of the projected slightly constraining one. Within the structure of state budget expenditures, **government consumption** was in line with the CBA projections, while actual expenditures **on acquisition of non-financial assets** exceeded them significantly mostly due to the higher internally financed expenditures.

As a result of the above-mentioned developments in revenues and expenditures, a deficit of AMD 156.4 billion was accrued in the fourth quarter, totaling 51.5% of the annual deficit.

To summarize, in the fourth quarter of 2021, a mainly neutral impact of fiscal policy was observed both in terms of demand and inflation.

As for the main annual indicators of the state budget, revenues totaled AMD 1,684.1 billion and expenditures totaled AMD 1,988.0 billion, growing by 7.9% and 4.9%, respectively as compared to the same period of the previous year.

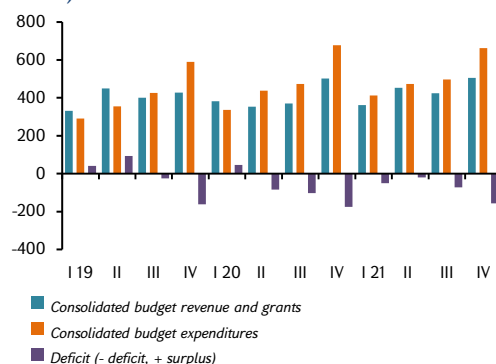
State budget deficit in 2021 totaled AMD 303.9 billion drams. The impact of fiscal policy on aggregate demand was 1.1 percentage points constraining, mainly due to the constraining impact of expenditures.

### 3.2.3. Output Aspect of the Economy

GDP growth in the fourth quarter of 2021 totaled 9.0%, well above the Central Bank projection, mainly due to higher-than-expected growth in industry and construction, 13.3% and 3.7%, respectively. The growth dynamics of services and agriculture were close to the projection, 10.1% and 0%, respectively. The economic growth was strongly promoted by the industry, in particular, due to the rather high growth in the manufacturing. The previous positive trends in the construction and services sectors continued. It should be noted that in recent months corporate and household funded construction has begun to grow in line with the acceleration of private investment in the reporting quarter. Strong contribution of services to economic growth continued in line with the Central Bank's expectations. As for the

Chart 46

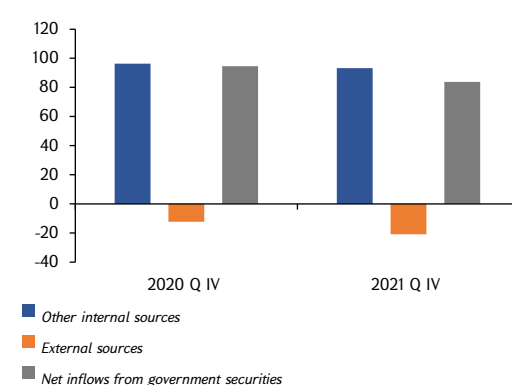
Main indicators of the consolidated budget (AMD billion)



Source: NSS

Chart 47

State budget deficit in 2021 QIV was financed from domestic sources (AMD billion)

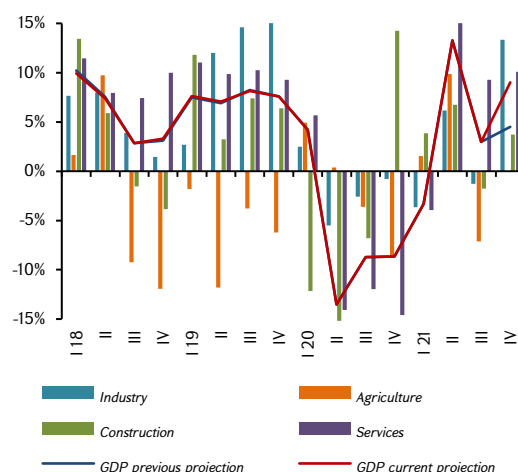


Source: MoF

**The impact of fiscal policy on aggregate demand was 1.1 percentage points constraining, mainly due to the constraining impact of expenditures.**

Chart 48

GDP Sectoral Structure (y/y growth, %)



Source: NSS, CBA assessment



agriculture, the impact of unfavorable weather conditions of the previous quarter weakened in the fourth quarter and had a slighter impact than the Central Bank projected.

### 3.2.4. Labor Market

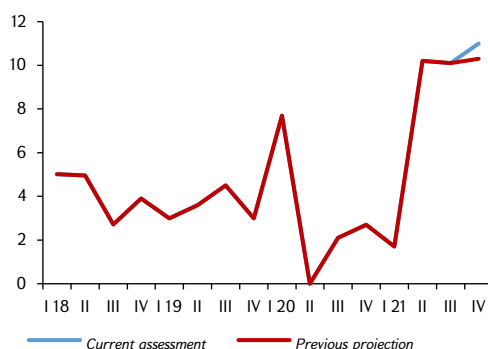
In the fourth quarter of 2021, the growth rate of nominal wages of the private sector was somewhat higher than the previous projections of the Central Bank, totaling 11%, mainly driven by higher-than-expected economic activity. The growth rate of real wages of the private sector in the fourth quarter of 2021 was about 3.6%.

Unemployment rate in the fourth quarter of 2021, is estimated at 15.3%, which is in line with previous projections of the Central Bank. The continuing high growth of private wages and low unemployment rate in the reviewed quarter indicate a certain activation of the labor market. The latter is in line with the estimated positive GDP gap in the economy and also reflects the decline in labor supply due to migration trends observed since the beginning of 2021.

During the reporting period, the growth of unit labor costs of enterprises somewhat slowed to 3.7% amid higher output per unit labor and growth of private wages. As a result, inflationary pressures from the labor market weakened.

Chart 49

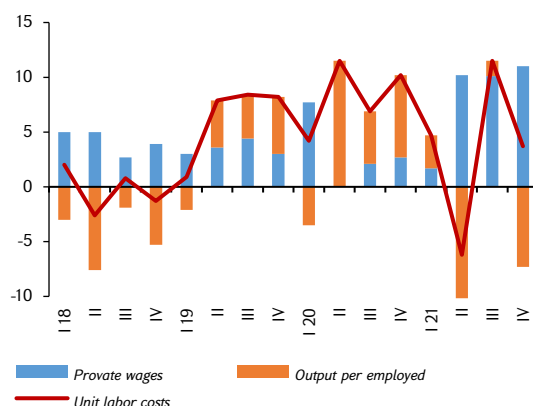
Private nominal wages (y/y growth, %)



Source: NSS, VBA assessment

Chart 50

Unit labor costs (y/y growth, %)



Source: NSS, CBA assessment

### 3.3. Financial Market Developments

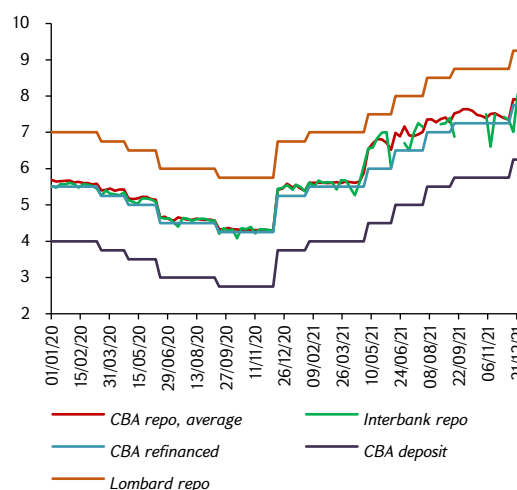
**In the fourth quarter of 2021, the Central Bank Board raised the refinancing rate by 0.5 percentage point setting it to 7.75%.**

In November, the Board decided to leave the refinancing rate unchanged asserting that along with the persisting inflationary impacts in both the external sector and the domestic economy, consistent tightening of monetary policy since the end of 2020 was sufficient to curb inflation and sustaining the medium-term inflation target. However, at its next meeting in December, the CBA Board, decided to increase the refinancing rate by 0.5 percentage points given the significant growth of inflationary impacts from the external sector. Furthermore, the Board emphasized the upward risks of inflation deviating from the projected medium-term trend amid the continuing uncertainty in the economic outlook and signaled to respond adequately in case the risks of materialize, in order to ensure fulfillment of the goal of price stability.

**In the fourth quarter of 2021, the Central Bank Board raised the refinancing rate by 0.5 percentage point setting it to 7.75%.**

Chart 51

During the quarter, short-term interest rates continued to stay around the CBA policy rate



Source: CBA

<sup>12</sup> Productivity In unit labor costs is represented by a negative contribution.

Table 5

Average quarterly interest rates in Armenia's financial market								
Indicators	03.02.21-16.03.21	17.03.21-04.05.21	05.05.21-15.06.21	16.06.21-03.08.21	04.08.21-14.09.21	15.09.21-02.11.21	03.11.21-14.12.21	15.12.21-01.02.22
Central Bank refinancing rate (end of quarter)	5.5	5.5	6.0	6.5	7.0	7.3	7.3	7.8
Central Bank repo rate	5.6	5.7	6.7	7.0	7.3	7.6	7.4	7.9
Interbank repo rate (up to 7-day)	5.5	5.6	6.6	6.9	7.1	7.8	7.1	7.7
Yield of government securities on a yield curve (as of end-quarter)								
Treasury bills (1 year)	6.8	6.8	7.2	7.6	8.2	8.6	8.8	9.0
Notes (5 year)	8.2	8.2	8.4	8.8	9.4	9.7	9.8	9.9
Bonds (30-year)	9.2	9.3	9.5	9.6	10.0	10.1	10.1	10.2

Source: CBA

In 2021 Q4, despite the slight decrease in demand for short-term liquidity by banks, the latter remained at a fairly high level. The Central Bank continued to provide banks with the necessary liquidity through its main 7-day repo instrument, at the same time promoting short-term interest rates around the CBA policy interest rate.

The response of the government bond market to the raise of the CBA refinancing rate was more pronounced in the short-term and medium-term segments. The growth of bond yields was partially restrained by the issuer through incomplete placement of the issued bonds. Subsequently, interest rate growth along the entire yield curve by end-December averaged 0.26 percentage points over the end of the previous quarter.

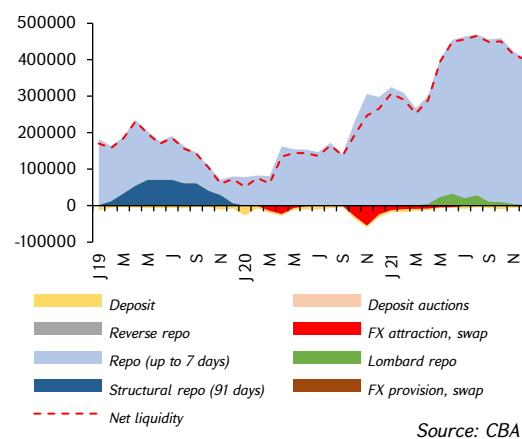
The impact of the CBA policy on interest rates of funds attracted by the banking system was still weak. A small increase in deposit interest rates was observed in terms of interest rates on deposits of legal persons with a maturity for up to 1 year.

In the fourth quarter of 2021, the downward trend of the loan portfolio continued, conditioned by both economic and political uncertainties and the relatively weaker demand for loans by the economy. Positive trends were observed only in terms of mortgage lending. As a result, in December 2021, the total volume of loans in 12 months terms dropped by 3.9%.

Nevertheless, according to the lending conditions surveys conducted by the Central Bank, in the fourth quarter of 2021, lending criteria for both business and consumers were somewhat alleviated. In particular, recovery expectations in some sectors of the economy,

Chart 52

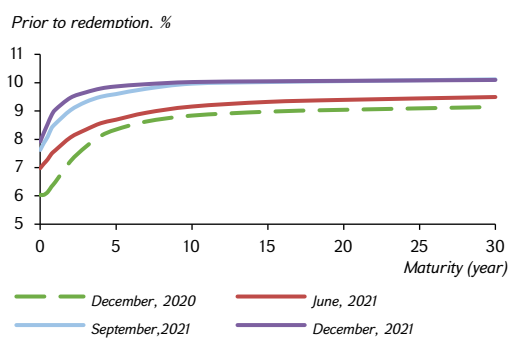
Liquidity absorbed and injected through CBA transactions (average monthly stock, AMD million)



Source: CBA

Chart 53

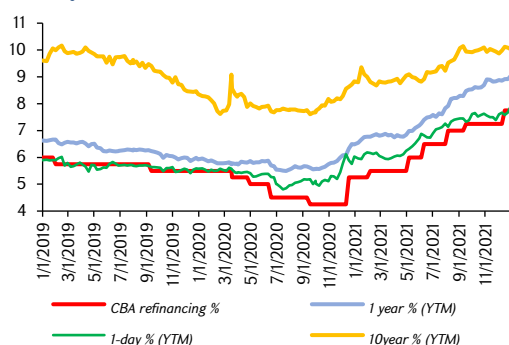
In 2021 QIV, government bond yields grew both along the short-term and medium-term segments of the curve



Source: CBA

Chart 54

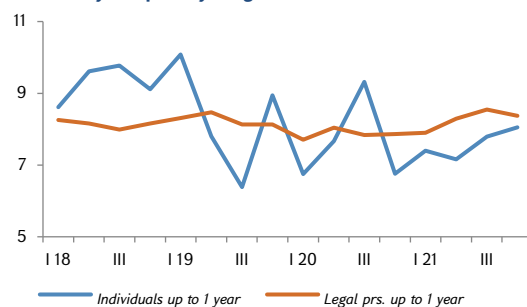
Dynamics of the CBA refinancing rate and government bonds yields



Source: CBA

Chart 55

In 2021 QIV, interest of legal persons' deposits with a maturity of up to 1 year grew



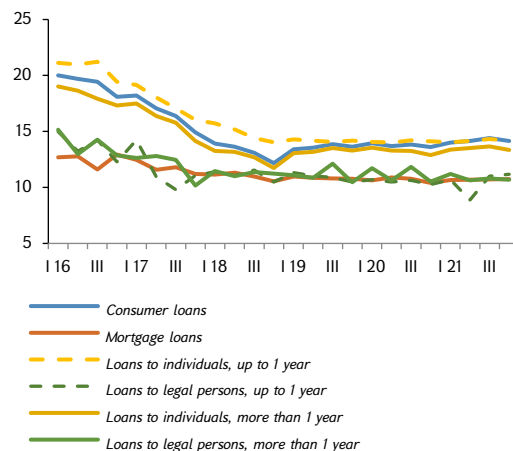
Source: CBA

together with the higher risk appetite of banks and credit organizations had a positive impact on credit supply; at the same time lending interest rate terms were tightened to some extent, which, however, was evident only in December interest rate on business loans for up to 1 year maturity.

In FX market, during appreciation trends of the quarterly AMD/USD average exchange rate continued with appreciation totaling around 2.0 over the previous quarter. The Central Bank made a small net purchase of USD 5.0 million in foreign exchange market with the view to neutralizing the temporary situational distortions in FX market.

**Chart 56**

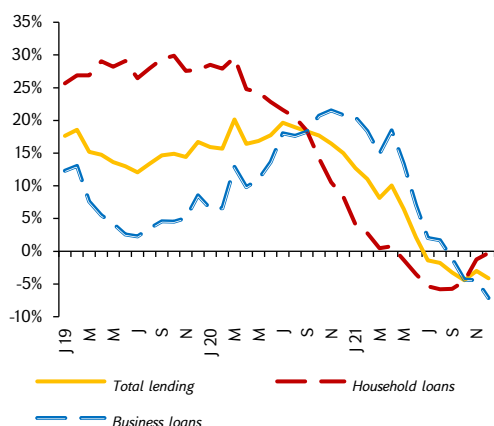
In 2021 QIV, the growth of lending interest rates was observed only in business loans with a maturity for up to 1 year



Source: CBA

**Chart 57**

12-month dynamics of banks' lending



Source: CBA

**Chart 58**

USD/AMD exchange rate dynamics in 2021



Source: CBA

## 4. SUMMING UP

***According to the monetary policy program of the Central Bank of Armenia for the first quarter of 2022, 12-month inflation will still be above the target, gradually decreasing and stabilizing around the 4% target in the medium term.*** Inflation in the short run will be conditioned by supply factors related to inflationary effects from the external sector through a number of goods, and demand factors mostly in terms of the expected positive developments in the tourism sector. At the same time, the country's risk-premium upsurged because of the geopolitical situation. Given the above, the Central Bank raised policy interest rate, and asserted that if the risks in terms of the economic outlook uncertainty and rising inflation expectations persist, it will consider the need for possible further tightening of monetary policy in the near future. Inflation will gradually decrease in the medium term due to the implemented monetary policy, and will ***stabilize around the target of 4%*** at the end of the forecast horizon.

***The risks of deviating from the projected inflation trajectory in the forecast horizon are balanced,*** and in case of their emergence the Central Bank stands ready to respond adequately, in order to ensure the achievement of the medium-term price stability objective.

## BOARD MEETING OF THE CBA

MINUTES (15.03.2022)

### On the Refinancing Rate

**The CBA Board Meeting of March 15, 2021 attended by CBA Governor M. Galstyan, Deputy Governors N. Yeritsyan and H. Khachatryan, and Board Members A. Stepanyan, H. Ghahramanyan, D. Nahapetyan, A. Manukyan and L. Sahakyan**

The Board meeting opened with a report of the situation as of March 15. It addressed the developments on inflation, external environment, and real, fiscal, financial and monetary sectors of the economy. In the context of the current geopolitical developments, the key topic of discussion were the possible effects of the Russian-Ukrainian military-political conflict and various sanctions on the Russian economy on the global and Armenian economy and financial markets.

Compared to 0.6% in the same month of the previous year, inflation in February totaled 0.1%. Inflation was mainly triggered by 0.2% and 0.1% growth in prices for non-food products and services, respectively. In February, the overall price in "Food, Beverage and Tobacco" group remained unchanged, although within it prices of "Meat" and "Coffee, Tea and Cocoa" subgroups grew by about 5.0% in total, and the prices of "Fruit", "Vegetables", "Dairy" and "Oils" subgroups dropped by a total of 7.5%. **As a result, 12-month inflation fell to 6.5% at the end of the month.** In February, the **12-month core inflation** continued to drop as well, totaling **6.4%**.

Current developments in the external sector were presented. First, it was noted that the various sanctions imposed on the Russian economy as a result of the escalation of the Russian-Ukrainian conflict were reflected in a significant increase in volatility of international financial markets and uncertainty over economic prospects. This has a negative impact on the macroeconomic environment of Armenia's partner countries, as a result of which a sharp decline in the Russia's economy and a slowdown of economic growth in the USA and the Eurozone is expected this year. At the same time, disruptions in supply chains, prices in international commodity markets, including energy and food grew significantly. The latter is reflected in higher-than-expected inflation in partner countries. Accordingly, the Central Banks of the partner countries are moving towards tightening their monetary

policies, in some cases raising, inter alia, policy interest rate with an unprecedented big step through extraordinary decisions.

The Board reviewed current developments of the RA economy, and it was noted that the growth of economic activity goes beyond the expected level. However, economic sanctions against Armenia's main partner Russia will have a direct negative impact on Armenia's economy. This will be mainly reflected in industrial decline and the slowdown of growth in the construction and services. Under such trends, the economic growth forecast for 2022 has been significantly revised downwards. In such circumstances, weaker external demand and a significant reduction in remittances will have a negative impact on aggregate demand, while a positive contribution is expected from the tourism sector. It was noted that the previous judgment of the impact of fiscal policy on domestic demand in the baseline scenario was preserved, according to which both in 2022 and in the medium term a certain consolidation and increase in capital expenditures are envisaged in line with the principle of debt sustainability. However, in the current situation, some changes in the budget revenue and expenditure policy are possible, and subject to clarification of the uncertainties associated with them, these changes will be taken into account in further projections of the Central Bank.

Developments in the financial market of Armenia were discussed; it was noted that the impact of the escalation of the Russian-Ukrainian conflict, severe financial and economic sanctions against Russia and the resulting uncertainty were primarily manifested in financial markets Armenia through higher volatility and country risk premium. Short-term market interest rates continued to shape around the Central Bank policy rate, while in the medium-term and long-term part of the yield curve a certain growth of interest rates was observed. According to estimates, the high level of uncertainty and the projected slowdown of economic activity in Armenia may result in a certain increase of credit risk in the financial system. Still, it was noted that at present liquidity and capital in the Armenian financial system is sufficient to ensure stable basic financing of the economy. Furthermore, it was noted that banking system will continue to service the real sector payment and settlement operations mostly in an uninterrupted way.

The Board was briefed on current inflation developments and estimations of inflation expectations. It was noted that since the end of last year, both general and core 12-month inflation have been gradually decreasing. However, in the context of the Russian-Ukrainian military-political conflict and sanctions against Russia, inflationary environment in the international commodity markets has significantly expanded, which has been transferred to domestic prices through a number of imported goods. It was also noted that the uncertainties were also



reflected in the dynamics of growing pricing and public inflation expectations.

Following a discussion of the situation report and external and domestic macroeconomic developments, the Board proceeded to addressing the monetary policy directions and making decision on the policy rate. In view of the significant growth of the country's risk-premium and rising inflation expectations in the face of intensifying geopolitical risks in the region and high uncertainty ***the Forecasting team suggested to the Board increasing the refinancing rate by 2.0 percentage points.*** The majority of the Board members agreed on the direction of the team proposal and the need for a drastic step. In reviewing different scenarios on the scale and duration of the impact of external and internal economic developments and the resulting uncertainty, Board members differed on the extent to which interest rates should be raised. At the same time, the position expressed by one of the members of the Board differed significantly from the opinion of the other members, as the latter proposed to leave the policy rate unchanged, based on the expectation of a significantly milder impact of the negative developments from external sector on the Armenian economy and inflation. Finally, considering the different scenarios in the conditions of uncertainty, the CBA Board ***decided to raise the refinancing rate by 1.25 percentage point.*** The Board further noted that if the risks in terms of the economic outlook uncertainty and rising inflation expectations persist, it will consider the need for possible further tightening of monetary policy in the near future. Under such policy measures, the 12-month inflation would gradually decrease, approaching the target of 4% in the forecast medium-term horizon and would stabilize around it.

The CBA Board further stated that the uncertainty related to the macroeconomic perspective due to geopolitical developments has significantly increased. At the same time, the risks of inflation deviation from the forecast direction are mainly balanced. In case of their materialization the Central Bank stands ready to respond accordingly in fulfilment of the price stability objective.

The Board approved the decision on interest rates of monetary instruments of the Central Bank and the proposed press release, which are attached.

## **THE CENTRAL BANK OF THE REPUBLIC OF ARMENIA**

### **BOARD DECISION**

#### **ON ESTABLISHMENT OF INTEREST RATES OF THE CENTRAL BANK OF MONETARY POLICY INSTRUMENTS AND PRESS RELEASE ON REFINANCING INTEREST RATE**

By virtue of Article 2(3), Article (20) “c” and “e” points of the Republic of Armenia law “On the Central Bank”, and provisions of the Republic of Armenia law “On Normative Legal Acts”, the Board of the Republic of Armenia Central Bank, herewith enacts:

1. Set the refinancing rate of the Central Bank of the Republic of Armenia at 9.25%.
2. Set the Lombard repo facility rate offered by the Central Bank of the Republic of Armenia at 10.75%.
3. Set the deposit facility rate offered by the Central Bank of the Republic of Armenia at 7.75%.
4. Approve the press release on the refinancing rate of the Central Bank of the Republic of Armenia (attached).
5. This decision shall enter into force on the day following the day of its publication on the website of the Central Bank of the Republic of Armenia.

Martin Galstyan,  
Governor of the Central Bank March 15, 2022

**PRESS RELEASE**  
**15.03.2022**

At the March 15, 2022 meeting, the CBA Board decided to raise the refinancing rate by 1.25 percentage points, setting it at 9.25%.

In February 2022, both 12-month and core inflation fell in line with the CBA projection, totaling 6.5% and 6.4%, respectively.

In the external sector, in the context of the Russian-Ukrainian military conflict, various sanctions have been imposed on Russia's economy. As a result, a significant increase in financial market volatility and uncertainty about economic prospects was observed. In the United States and the Eurozone slowdown of economic growth is expected this year, and economic decline is expected in Russia. At the same time, the disruption of the reviewed supply chains in the international commodity and food markets has caused a significant increase in prices. This is reflected in the formation of a higher-than-expected inflationary environment in partner countries. **As a result, a mainly inflationary impact is expected on the Armenian economy from the external sector.**

The impact of the sanctions imposed on Russia, will be reflected in the significant slowdown of economic growth in Armenia. This will be mostly conditioned by the industrial decline. Total demand will be affected by declining remittances and sluggish external demand. A positive contribution from tourism sector is expected. Growing geopolitical risks in the region and the high uncertainty has led to increased volatility in the Armenian financial markets and bigger risk premium. The existing uncertainties were reflected in the inflation dynamics and inflation expectations as well.

**In view of the above, the Board judges appropriate to increase the refinancing rate by a relatively large step.** The Board considers that amid the economic outlook uncertainties and provided the risks of rising inflation expectations persist, the need for possible tightening of monetary conditions in the near future will be considered as well. Due to this policy actions, 12-month inflation will gradually decrease and reach the target of 4% in the forecast horizon.

The CBA Board considers that as a result of the geopolitical developments, the uncertainty in terms of macroeconomic perspective has significantly expanded. At the same time, the risks of inflation deviation from the projected trajectory are mainly balanced. Should the risks materialize in any direction, the Board stands ready to respond accordingly in fulfilment of the price stability objective.

## ARMENIA: SELECTED MACROECONOMIC INDICATORS

Indicators	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
	actual	actual	actual	actual	actual	actual	actual	actual	program	program	program
<b>External sector</b>											
USA economic growth (% <i>real growth</i> )	2.3	2.7	1.7	2.3	2.9	2.3	-3.4	5.8	3.2	2.2	2.0
Eurozone economic growth (% <i>real growth</i> )	1.4	1.9	1.8	2.7	1.9	1.3	-6.5	5.4	3.0	2.2	0.6
Russia economic growth (% <i>real growth</i> )	0.7	-1.9	0.2	1.8	2.8	2.0	-2.9	4.7	-6.0	-0.8	1.8
USA inflation ( <i>average</i> , %)	1.6	0.1	1.3	2.1	2.4	1.8	1.2	4.7	7.2	4.5	2.9
Eurozone inflation ( <i>average</i> , %)	0.4	0.0	0.2	1.5	1.7	1.2	0.3	2.6	5.3	2.5	2.3
Russia inflation ( <i>average</i> , %)	7.5	14.4	6.8	3.6	2.8	4.4	3.3	6.7	13.6	9.8	5.4
Oil price (USD/barrel)	115.0	53.5	45.0	54.6	71.4	64.1	42.5	71.0	101.1	100.2	101.8
Copper price (USD/barrel)	6825.9	5497.4	4867.6	6201.5	6544.7	6024.1	6191.2	9314.7	10311.6	10966.9	11469.5
FAO index	99.3	93.0	91.9	98.0	95.9	95.0	98.0	125.7	144.6	150.5	155.6
<b>Domestic economy</b>											
<b>Prices</b>											
Inflation (y/y, <i>end of period</i> , %)	4.6	-0.1	-1.1	2.6	1.8	0.7	3.7	7.7	6.6	5.4	4.0
Consumer price index (y/y, <i>average</i> , %)	3.0	3.7	-1.4	1.0	2.5	1.5	1.2	7.2	6.5	5.9	4.4
Core inflation (y/y, <i>average</i> , %)	1.9	5.1	-2.0	0.8	4.0	1.2	1.3	7.2	7.0	6.0	4.3
<b>Gross product</b>											
GDP ( <i>billion Armenian dram</i> )	4828.6	5043.6	5067.3	5568.9	6017.0	6543.3	6181.7	6982.8	7532.5	8177.4	8827.6
GDP (% <i>real growth</i> )	3.6	3.2	0.2	7.5	5.2	7.6	-7.4	5.7	1.6	3.0	3.6
<b>Supply</b>											
Industry (% <i>real growth</i> )	-0.9	6.2	7.7	11.7	4.9	12.0	-1.7	4.2	-4.7	4.6	5.5
Agriculture (% <i>real growth</i> )	6.1	13.2	-5.0	-5.1	-6.9	-5.8	-4.1	-1.4	3.8	3.2	3.8
Construction (% <i>real growth</i> )	-4.5	-3.1	-14.1	2.8	0.6	6.5	-6.7	2.6	7.0	3.4	4.0
Services (% <i>real growth</i> )	6.7	1.6	3.2	10.6	9.1	10.0	-9.7	7.8	3.2	2.3	2.8
Taxes, net (% <i>real growth</i> )	1.8	-5.1	-3.7	9.7	8.0	7.1	-10.0	7.6	0.0	3.0	3.5
<b>Demand</b>											
Consumption (% <i>real growth</i> )	1.2	-6.0	-2.1	11.6	3.8	11.7	-10.1	3.7	-0.2	1.4	3.4
Public consumption (% <i>real growth</i> )	-1.2	4.7	-2.4	-2.1	-3.0	12.9	15.2	5.0	-6.6	-3.1	5.8
Private consumption (% <i>real growth</i> )	1.6	-7.5	-2.1	14.0	4.8	11.5	-13.9	3.4	1.2	2.4	2.9
Gross accumulation of fixed assets* (% <i>real growth</i> )	-2.2	2.5	-11.4	9.7	4.8	4.4	-8.6	7.7	12.6	3.9	3.5
Public investment** (% <i>real growth</i> )	10.0	13.6	5.0	31.7	-37.4	31.1	15.6	-9.9	52.0	0.9	4.2
Gross accumulation of private fixed assets (% <i>real growth</i> )	-3.4	1.2	-13.9	6.2	19.6	-0.5	-14.5	13.4	2.4	4.7	3.2
Export of goods and services (% <i>real growth</i> )	6.4	4.9	21.3	19.3	5.0	16.0	-33.4	16.5	-1.8	10.8	5.5
Import of goods and services (% <i>real growth</i> )	-2.7	-15.3	6.3	24.6	13.3	11.6	-31.4	10.9	-0.1	6.5	4.4
<b>Current account</b>											
Balance of trade ( <i>million US dollar</i> )	-2055.4	-1186.4	-976.9	-1400.9	-1724.4	-1727.9	-1356.2	-1535.8	-1600.5	-1378.5	-1388.2
Balance of services ( <i>million US dollar</i> )	-113.0	-96.4	70.4	159.4	24.7	-66.9	100.1	446.0	389.6	191.9	185.9
Remittances ( <i>million US dollar</i> )	1616.1	1098.3	1009.4	1179.3	1136.2	1143.8	1040.2	1251.1	1000.4	886.9	827.7
Current account ( <i>million US dollar</i> )	-883.1	-284.7	-107.9	-173.9	-875.9	-1002.3	-478.7	-336.9	-658.2	-747.5	-822.4
Balance of trade ( <i>share in GDP</i> , %)	-17.8	-12.2	-8.6	-10.8	-13.7	-13.1	-9.9	-7.8	-8.1	-7.4	-7.0
Balance of services ( <i>share in GDP</i> , %)	-1.0	-0.9	0.7	1.4	0.2	-0.5	0.8	3.2	2.6	1.2	1.1
Remittances ( <i>share in GDP</i> , %)	14.0	10.4	9.5	10.2	9.1	8.4	8.2	8.9	6.7	5.5	4.8
Current account ( <i>share in GDP</i> , %)	-7.6	-2.7	-1.0	-1.5	-7.0	-7.3	-3.8	-2.4	-4.4	-4.6	-4.8

Items	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
	actual	actual	actual	actual	actual	actual	actual	actual	program	program	program
<b>Public sector***</b>											
Revenues and grants (billion Armenian dram)	1144.8	1167.7	1171.1	1237.8	1341.7	1559.1	1560.4	1677.0	1915.9	1966.7	2148.3
Tax revenues (billion Armenian dram)	1064.1	1067.9	1079.7	1158.0	1258.1	1464.3	1385.2	1582.0	1808.8	1889.9	2084.0
Expenditures (billion Armenian dram)	1235.1	1409.0	1449.1	1504.8	1447.1	1623.0	1894.3	1957.6	2133.9	2135.5	2312.0
Deficit (billion Armenian dram)	-90.3	-241.3	-278.0	-267.0	-105.4	-63.9	-333.9	-280.6	-218.0	-168.8	-163.7
Revenues and grants (share in GDP, %)	23.7	23.2	23.1	22.2	22.3	23.8	25.2	24.0	25.4	24.1	24.3
Tax revenues (share in GDP, %)	22.0	21.2	21.3	20.8	20.9	22.4	22.4	22.7	24.0	23.1	23.6
Expenditures (share in GDP, %)	25.6	28.0	28.6	27.0	24.1	24.8	30.6	28.0	28.3	26.1	26.2
Deficit (share in GDP, %)	-1.9	-4.8	-5.5	-4.8	-1.8	-1.0	-5.4	-4.0	-2.9	-2.1	-1.9
<b>Monetary sector</b>											
Broad money (y/y, end of period, %)	8.3	10.8	17.5	18.5	7.5	11.2	9.0	-	-	-	-
Dram broad money (y/y, end of period, %)	-3.5	5.2	24.8	28.9	13.2	21.5	14.8	-	-	-	-
Loans to economy (y/y, end of period, %)	20.8	-3.3	6.0	16.5	17.2	18.5	14.3	-	-	-	-
USD/AMD (Armenian dram for one US dollar)	415.9	477.9	480.5	482.7	483.0	480.4	489.0	-	-	-	-
<p>* Hereinafter, the Central Bank will only present the indicator of the aggregate fixed asset accumulation instead of the aggregate accumulation, since the change in tangible working capital inventories is considered by Armenia's Statistics Committee as a balancing item and it does not show the true level of the aggregate accumulation. See <a href="https://www.armstat.am/file/article/sv_04_19a_112.pdf">https://www.armstat.am/file/article/sv_04_19a_112.pdf</a>.</p> <p>** Actual indicators of public investment are capital expenditures of the consolidated budget, and the forecasts are based on the currently revised macro framework for 2022-2024.</p> <p>*** Indicators of the 2021 budget are those of the law "On 2021 State Budget of the Republic of Armenia". The indicators for 2022-2023 are presented from the revised macro framework.</p>											

Source: CBA projections

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