

(2012/1) The Monetary policy program Q1, 2012

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Actual indicators and developments in 2011

The beginning of 2011 was characterized by high inflation environment which had been a consequence of increased international prices of raw materials and food products, declined supply in agriculture in Armenia due to the recorded downfall in that sector as well as second round effects of high inflation and high inflationary expectations during 2010.

At the end of 2010 the Board of the Central Bank outlined a necessity to tighten monetary conditions if second round effects of high inflation and expectations persist in the consumer market. In its announcements the Central Bank was repeatedly stressing about great likelihood of inflation rates to have been in a downsloping trajectory since the second half of 2011 yet price increases took broader segments of the consumer market, however. This was concomitant with uncertainties from the external environment, which at a later point were reflected in intensification of inflationary pressures in global raw materials and food products markets and, accordingly, expansion of the inflation environment in Armenia. The 12-month inflation reached 11.5 percent in March (price increase on food products made as much as 8.3 pp of contribution). The Board of the Central Bank announced that the monetary inflation was manageable and that the inflation environment remained primarily a supply-side product, while recovery of aggregate demand and labor market developments were creating moderate inflationary pressures. In such a situation raising the interest rate was a necessity in order to mitigate second round effects of high inflation and anchor the expectations.

To curb the inflation environment in the coming months through neutralizing second round effects and anchoring expectations, the Board of the Central Bank raised, three months in a row since February, the refinancing rate for a total of 1.25 pp. In the subsequent months the inflation environment became somewhat temperate not only due to tightened monetary conditions but also because of implementation of contractionary fiscal policy, weakened inflationary pressures on the Armenian economy from the external sector, neutral impact from private consumption, even weaker inflationary impact from the labor market relative to the previous period, and falling prices of agricultural products amid growing output in that sector. In the mid of the year however the 12-month inflation was still far from the confidence band as it contained the second half of 2010's high

inflation. In June the 12-month inflation reached 8.5 percent.

The developments in this period of time indicated that inflationary risks were in balance. At the start of the third quarter a steep reduction in inflation was forecast, the inflation prospect was more optimistic which prompted the Board of the Central Bank to loosen monetary conditions and the refinancing rate was lowered by 0.5 pp, as a result. At the end of the year the Armenian economy was progressing in line with the scenario as outlined in the fourth quarter's monetary policy program, which means implementation of a neutral policy, i.e. setting an interest rate level which leaves neither expansionary nor contractionary impact on the inflation environment. Under current conditions of economic development such an interest rate level is around an 8 percent. Based on what was described above, the Board of the Central Bank left the refinancing rate unchanged in the last months of 2011. As it was outlined in the 2011 monetary policy programs, the 12-month inflation started reducing since the middle of the year and at the end of the year it entered the confidence band of $4\% \pm 1.5$ pp, making up 4.7 percent. Prices of food products, non-food products and service tariffs made, respectively, 3.1 pp, 0.7 pp and 0.9 pp of contribution to the 12-month inflation indicator.

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