

The Monetary Policy Programm of the Republic of Armenia Q1, 2011

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(2011/1) Q4 2010 actual indicators and developments

In the beginning of 2011 the macroeconomic situation was characterized by high inflationary environment as influence of expansionary fiscal and monetary policies implemented in 2009 began to appear at the yearend 2009, and it was expected that in the first quarter of 2010 it would reach its peak. The other factor contributing to the inflationary environment were increased international prices of food and primary goods since the second half of 2009 amid economic recovery. The impact of price increases on the Armenian economy was expected primarily in the first quarter of 2010. The next factor was an increase of gas and water tariffs since April 1 2010, which affected inflation both directly (through such tariffs increase) and indirectly (through cost increases on other goods). In a situation like this, the Central Bank implemented a tightened monetary policy since January 2010, keeping on raising the refinancing rate in the first five months (a total of 2.5 pp), while taking on action to reduce dollarization.

The 12-month inflation of 9.4 percent recorded in February kept on declining and reached the upper border of the target in June, making up 5.8 percent. The situation, however, changed drastically, making more room for prices to inflate dramatically. Core inflation, nevertheless, continued to fall, reflecting the tightened monetary conditions at the start of the year.

The first factor, which sent new inflationary impulses to the economy, was a sharp increase in international wheat price, followed by price increases on other food products. The next major factor was a deep decline in agriculture which was demonstrated by an abrupt decrease in supply of agricultural products. It was obvious that inflationary environment was solely due to supply factors, which are not subject to the monetary regulation. In this situation, despite the acceleration of inflation, the Central Bank avoided to raise the refinancing rate because all assessments were showing that the slow pace of domestic demand recovery would not create inflationary pressures. In other words, high inflation was not due to demand factors subject to an influence of monetary policy. So, starting from June 2010, the Central Bank has left the key rate unchanged.

Inflation during 2010 was 9.4 percent, 7.5 pp of which alone was due to growth in food

prices: the growth of domestic prices of agricultural goods contributed around 5 pp to inflation and imported food, more than 2 pp. The contribution of food prices to headline inflation has increased in the fourth quarter. During the quarter inflation was 4.5 percent; food prices rose by 8.1 percent (with 4.4 pp contribution to headline inflation), non-food prices, by 1.5 percent (contribution, 0.2 pp), whereas service tariffs dropped by 0.2 percent (contribution, 0.05 pp). Average inflation recorded in the period January-December was 8.2 percent in relation to last year's average. Some intensification of the secondary effects and inflationary expectations from continued supply side driven inflation has been observed in the period November-December, which were reflected also in the core inflation indicator. During the quarter core inflation was 3.0 percent while the 12-month inflation reached 6.26 percent at the end of the year.

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