

(2011/3) The Monetary Policy Program of the Republic of Armenia Q3, 2011

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Q2, 2011 actual indicators and developments

Somewhat a moderate inflationary environment relative to the previous quarter as well as gradual balancing of risks was forecast for the second quarter of 2011. The following were to contribute to the mitigation of the inflationary environment:

Lagged impact of monetary conditions tightened since the start of the year and the change in the reserve requirement mechanism;

Weakened inflationary pressures transmitted to the Armenian economy from external sector;

Neutral impact of private spending;

Somewhat a weaker inflationary impact (relative to the previous period) from the labor market;

Restrictive impact of fiscal policy;

Expected fall in prices of agricultural products in the wake of increased output volumes in domestic agriculture, relative to the previous year.

In spite of the aforementioned impulses, mostly non-inflationary, the level of the 12-month inflation were to remain high until the end of the quarter, still containing price increases of agricultural products transmitted from 2010, price increases of primary goods in world markets, second-round effects of lasted high inflation and inflation expectations.

In the second quarter of 2011 the inflationary environment was shaped under possibly positive demonstration of the aforementioned factors (dual-sided, balanced risks were outlined in respect of domestic demand and agricultural sector). So, 1.6 percent deflation was recorded, and the 12-month inflation made up 8.5 percent instead of the forecast 9.2 percent. However, contribution of food price increases is still high enough, as much 7.3

pp, of which 4.2 pp alone coming from agricultural products and about 3 pp from imported food products. Contribution from non-food prices and service tariffs to the 12-month inflation made up 0.5 pp and 0.8 pp, respectively. Deflation recorded during the quarter was conditioned by the falling of prices of food products, with contribution making up 1.7 pp. During the quarter core inflation was added by 1.2 percent, still incurring the impact of high prices of food products. As a result, the 12-month core inflation reached 6.7 percent.

Because the second quarter monetary policy program had projected gradual deceleration of inflation for the upcoming 12-month time horizon, determined by both developments in domestic economy and external sector and partial neutralization of the factors that were the main cause for the previous year's inflation, the Board of the Central Bank had left the refinancing rate unchanged after last raising in April by actively using liquidity adjustment tools since then. The Board's position with regard to the refinancing rate was based on a consensus that the likelihood of further expansion of the inflationary environment is very little, and that the formed interest rates in financial market will further restrain existing inflationary environment, as a result of which inflation in the forecast time horizon will be in the range of 4%+1.5.

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