

*Approved by
Decision No. 81A dated 24.05.2024 of the
Board of the Central Bank of Armenia*

**MONETARY POLICY PROGRAM
IMPLEMENTATION REPORT
(Q2 2023 – Q1 2024)**

In the one-year period from the second quarter of 2023 to the second quarter of 2024, a low-inflation environment was formed and sustained in the Republic of Armenia. Deflationary effects from the external sector, the monetary policy implemented by the Central Bank of Armenia, and the appreciation of the dram were the main factors that contributed to this. Taking into account the effects of a continued decrease in inflation due to deflationary influences from the external sector, a slowdown in wage growth in the RA labor market, as well as the effects of some reduction in inflation expectations on the overall inflation environment, the Central Bank gradually eased monetary conditions during the period under review, lowering the policy rate by 2.25 percentage points overall.

As a result of external deflationary effects and the monetary policy implemented by the Central Bank, the 12-month inflation decreased by 6.7 percentage points in the reporting period, reaching -1.2% in March 2024. The 12-month core inflation rate also decreased at almost the same rate, by 7.1 percentage points, and was -0.7% in March.

1. MONETARY POLICY IN THE REPORTING PERIOD

According to the main judgments of the scenario presented in the program for the second quarter of 2023, the 12-month inflation rate was expected to decrease somewhat in the short term, while high demand and inflationary expectations in the RA economy persisted, in which case wages and inflation of a number of services and goods with the most “sticky prices” would remain high. In accordance with the expected macroeconomic developments and the monetary policy being implemented, the 12-month inflation rate was expected to remain below the target level in the short term, and then gradually increase, stabilizing around the target 4% level in the medium term.

During the reporting period, in the context of ongoing geopolitical phenomena and continuing uncertainties, the growth rates of economic activity and demand throughout the world and in the main partner countries of the Republic of Armenia continued to slow down. In the context of these developments and the contractionary monetary policy implemented in those countries, there was a significant decrease in prices, particularly for food and energy, in international commodity markets, and some softening of the inflationary environment in the global economy. Since the beginning of 2024, geopolitical tensions in the Middle East have created certain risks in terms of further growth of global energy prices and possible disruption of supply value chains. Despite this situation, the observed effects of the external sector on the RA economy have mainly been deflationary.

There was consistently high economic activity in Armenia during the period under review, due largely to high growth in the services and construction sectors. There were positive developments in the IT and manufacturing industry sectors as well, which was reflected in trends of increasing production capacity and exports in these sectors. Over the past year, aggregate demand has also remained high but has undergone structural changes. Thus, in the first half of the period, with the impact of a significant influx of foreign visitors, including tourists, as well as financial inflow, especially in the service sector, there was a significant increase in external demand. In the second half, this trend weakened somewhat due to a slowdown in tourism growth, while, at the same time, domestic demand picked up significantly due to high growth in private consumption, supported by continued increases in income and the spending of previously accumulated savings. At the same time, under the influence of high demand from international visitors and a significant inflow of financial transfers from abroad, there was an appreciation of the dram in the RA currency market.

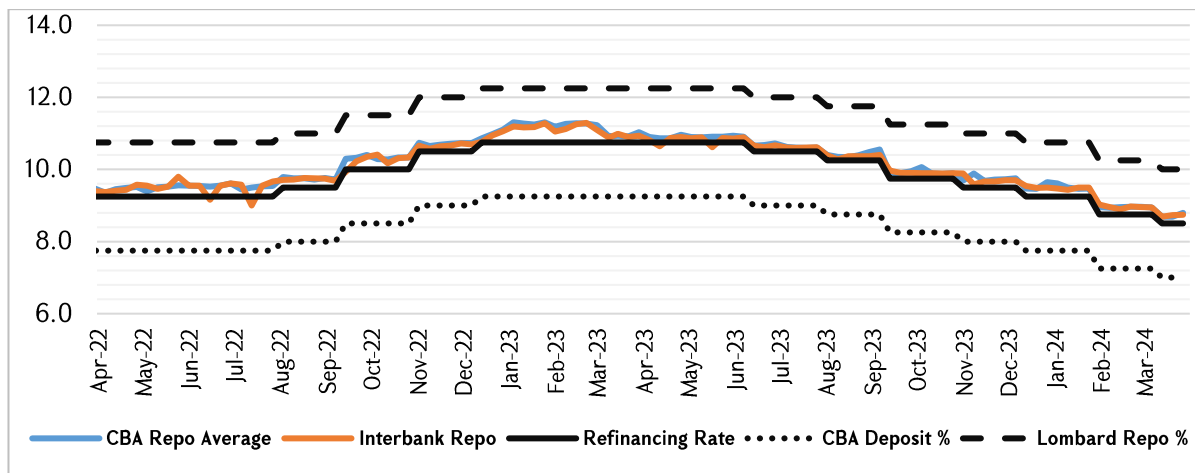
With the prospect of such developments and in the face of still high demand and inflationary effects derived from the labor market in parallel with deflationary phenomena observed with regard to imported food products in the first half of 2023, the Central Bank left the policy rate unchanged until June, maintaining relatively tight monetary conditions. In the period from June 2023 to April 2024, due to the prospect of continued deflationary trends in both foreign and domestic commodity markets and significant neutralization of inflationary factors, the Central Bank reduced the policy rate by a total of 2.25 percentage points, setting it at 8.5% in March 2024. At the same time, given continuing high uncertainty regarding inflation expectations and the risks of expanding domestic demand factors in the

economy, the Central Bank mainly preferred a gradual easing of monetary conditions, indicating consistency of further demand management and stabilization of inflation expectations.

Due to the continuation of the Russia-Ukraine conflict, as well as the increased volatility of the RA financial market as a result of internal political developments in the region during the reporting period, the Central Bank has been consistent in ensuring adequate regulation of liquidity in the financial market. As a result, market interest rates have largely been shaped around the operational target of the policy rate. Due to the same factors, some volatility was observed in the foreign exchange market, which in some cases created risks of market disruption, leading the Central Bank to situationally participate in the market in order to ensure the normal functioning of the financial market. During the reporting year, the behavior of the yield curve in the government bond market was consistent with the change in the policy rate. The impact of the events taking place in Artsakh at the end of September 2023 was reflected in an increase in volatility and uncertainty in the financial system, as well as a slight increase in the yield curve. By the first quarter of 2024, given the Central Bank's reduction of the policy rate, the long-term and short-term segments of the yield curve shifted downwards again in January and in March, respectively. During the reporting period, amid sustained high domestic demand, both consumer and mortgage loans continued to grow at a rapid pace, and the banking system maintained high levels of liquidity and capital.

Chart 1

Behavior of Central Bank Instruments and Short-Term Market Interest Rates



In summing up, we note that as a result of deflationary influences from the external sector, the monetary policy that was implemented, and the appreciation of the dram during the year under review, the 12-month inflation rate decreased by 6.7 percentage points and was -1.2% in March 2024. The 12-month core inflation rate also decreased at a rapid pace (by 7.1 percentage points) and was -0.7% by the end of March. It is estimated that the 12-month headline inflation rate will remain below target in the near future and then increase significantly and stabilize near the 4% target in the medium term.

2. INFLATION COMPONENTS IN THE REPORTING PERIOD

During the reporting period, inflationary pressures in the economy weakened significantly due to deflationary effects transmitted from the global economy, as well as the impact of the monetary policy implemented by the Central Bank in previous years and the appreciation of the dram. This was reflected in a significant slowdown in both consumer price growth and core inflation.

In the observed period, core inflation, which excludes seasonal food products and regulated services, continued to decline, remaining in the negative range at the end of the reporting period. It was -0.7% y/y in March, which largely reflects deflationary trends transmitted from imported goods (e.g., bakery products, oils and fats, sugar, etc.).

Thus, during the previous year, in the context of a slight slowdown in economic activity throughout the world and in key partner countries and a relatively weak demand environment, as well as relatively contractionary monetary conditions, the deflationary effects transmitted from food markets persisted, which was reflected in the deflation of imported goods. It should also be noted that the appreciation of the Armenian dram and the gradual transfer of this influence also had an impact on the decrease in the prices of imported goods. Nevertheless, during the reporting period, risks and uncertainties related to geopolitical developments in the Middle East continued to have an inflationary impact on global energy prices, affecting fuel prices in the domestic market as well.

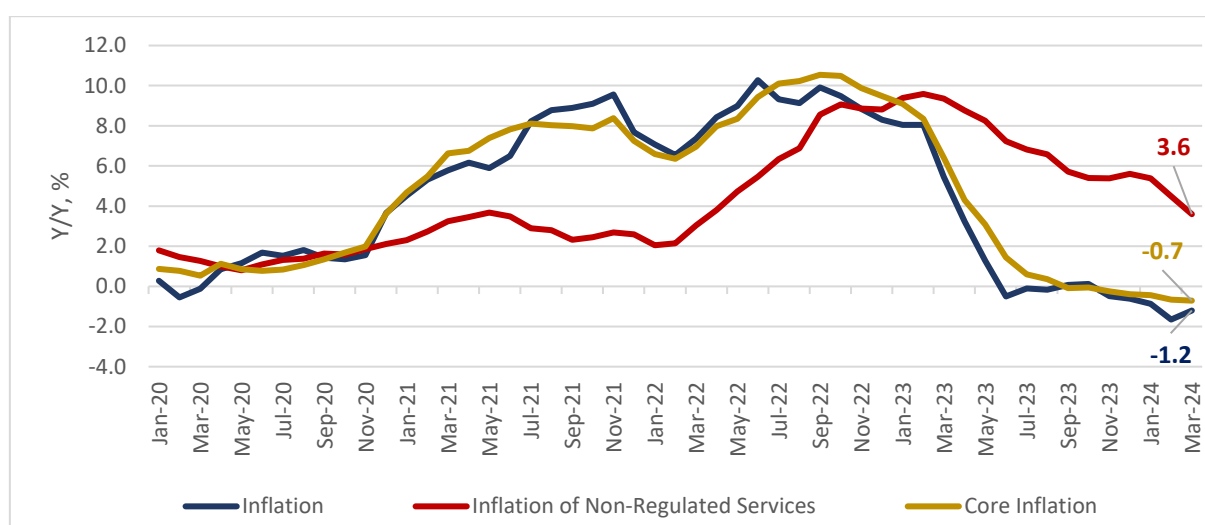
The high demand generated in the RA economy from the large inflow and presence of international visitors to Armenia has increased inflationary pressures on locally produced goods and especially services. Given this situation, the prices of a number of services with sticky prices (such as apartment rent, restaurants and hotels, hairdressing, medical, financial and postal services) were adjusted, remaining at high levels during the reporting period and showing decreasing trends only at the end (see Chart 2).

At the same time, the acceleration of domestic demand during the year, which was mainly facilitated by continued income growth and spending of previously accumulated savings, as well as parallel growth in consumer lending, caused some inflationary pressure in the consumer market. The influx of forcibly displaced people from Artsakh to Armenia also contributed to this after September 2023.

It should also be noted that, from the core inflation components, the increase in prices for the “Tobacco Articles” and “Alcoholic Beverage” product groups reflected the inflationary impact of changes in excise tax rates in early 2024, as was expected.

Chart 2

During the reporting period, external inflationary effects were significantly mitigated, resulting in both headline and core inflation decreasing sharply.



In recent months, the deflation of seasonal food products, due to both seasonal and some, albeit limited, possible impact from greenhouse activities, as well as deflation of imported products in this product group, have significantly contributed to the maintenance of deflationary trends in the economy.

It is also noteworthy that, at the beginning of the first quarter of 2024, prices of regulated services increased somewhat, mainly due to the one-off inflationary effect of car parking fees from January.

Table 1

Product Group	Weight	12-Month Inflation March 2024	Contribution to y/y Inflation
Core Inflation	75.4	-0.7	-0.5
Bread Products and Cereals	8.9	-6.8	-0.6
Meat	10.6	-1.7	-0.2
Oils and Fats	2.9	-16.5	-0.5
Sugar	0.5	-4.6	0.0
Dairy Products	4.6	-3.8	-0.2
Alcoholic Beverages	2.0	7.1	0.1
Tobacco Products	2.3	8.2	0.2
Clothing	2.1	0.2	0.0
Shoes	1.2	2.9	0.0
Household Appliances	0.6	3.4	0.0
Fuel	4.5	5.4	0.2
Passenger Air Travel	2.2	18.5	0.4
Outpatient Services	2.3	0.9	0.0
Actual Rent Paid by Tenant for Additional Accommodation	2.0	4.2	0.1
Restaurants and Hotels	2.1	3.8	0.1
Banking and Post Office Service Fees	0.7	7.7	0.1
Seasonal Food Products	10.3	-7.0	-0.7
Eggs	1.3	3.5	0.0
Fruits	3.5	-2.7	-0.1
Vegetables	5.5	-13.8	-0.8
Regulated Services	14.3	1.2	0.2
Other Groups of Goods and Services			
Imported Food Products	15.5	-6.3	-1.0
Unregulated Services	19.3	3.6	0.7