

Appendix

*Approved under
the Central Bank of Armenia Board Decision No. 139A,
dated 27.08.2024*

STATUS REPORT ON IMPLEMENTATION OF THE MONETARY POLICY PROGRAM (Quarter 3, 2023 – Quarter 2, 2024)

In a one-year horizon spanning a period from the 3rd quarter of 2023 through the 3rd quarter of 2024, the deflationary environment in the Republic of Armenia persisted. This was driven mainly by the deflationary effects transmitted from the external sector and the monetary policy implemented by the Central Bank of Armenia.

Given the influence of the persisting deflationary environment in Armenia, the effect of inflation of wages following easier conditions in the labor market on the back of increased labor supply and the effect of sticky prices of certain services, as well as the impact of diminished inflationary expectations, in the period under review the Central Bank of Armenia continued to ease monetary conditions, lowering the policy rate by a total of 2.5 percentage points.

As a result of deflationary spillovers from the external sector and the monetary policy implemented by the Central Bank of Armenia, the 12-month inflation has continued to decrease between July 2023 and February 2024, reaching -1.7% in February, and then it increased to 0.8% in June. The 12-month core inflation followed almost the same pattern: in the period mentioned above it has declined to -0.7% in February and then rose, reaching 0.0% in June.

1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

According to the main judgements of the scenario presented in the Q3, 2023 Program, the inflation in the short term was expected to remain below the 12-month inflation target. This would be determined mostly by deflationary spillovers from international markets and a certain decline in inflationary expectations, despite a slow rate in inflation adjustment for a number of services and goods amid a relatively strong demand. In view of the monetary policy being carried out and expected macroeconomic developments, the 12-month inflation would gradually increase over the medium term and stabilize around the 4% target.

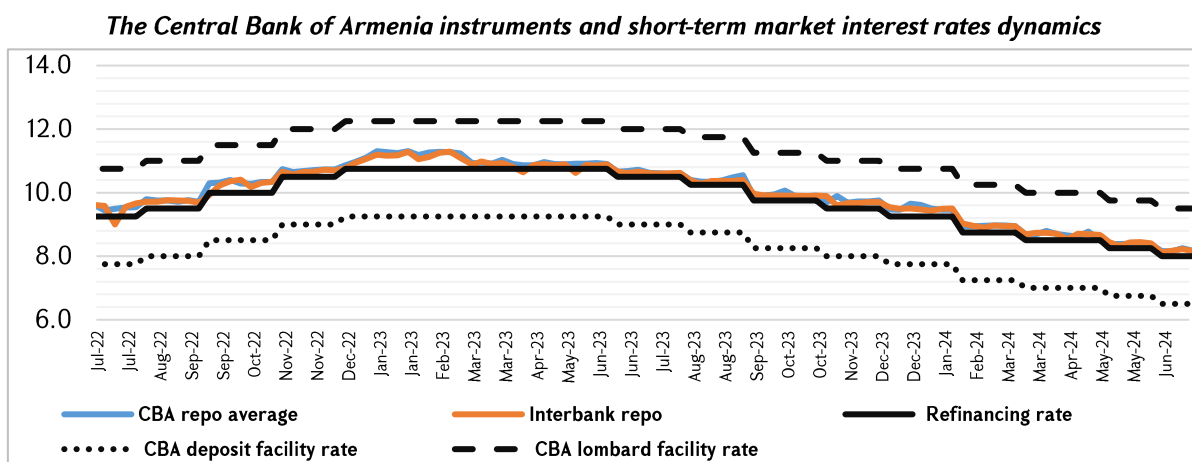
In the period under review, as developments in the geopolitical landscape further unfolded and uncertainties persisted, the growth rates of economic activity and demand globally and in the main partner countries of the Republic of Armenia continued to slow. However, demand remained elevated thanks to the effects of overheated labor markets. In such conditions, a significant decrease especially in food and energy prices as a result of central/national banks' contractionary monetary policy implemented in those countries was observable in international commodity markets, with the inflationary environment in the world economy softened to a certain extent. Difficult geopolitical situation in the Middle East since the beginning of 2024 as well as growing tension in international trade relations have caused certain risks in terms of further price increases in the international commodity market and possible disruption of supply chains. Nevertheless, in the period under review, there have been primarily deflationary effects transmitted from the external sector on Armenia's economy.

In the period under review, economic activity has consistently been strong in the Republic of Armenia owing to the high growth recorded especially in the construction, trade and industry sectors. At the same time, in terms of high economic growth, certain problems arise in relation to its inclusiveness and structural specificity. Over the past year, aggregate demand continued to remain high, but its structure has seen a gradual slowdown in the external demand growth rate primarily because of slowing in the growth rate of tourism. Instead, domestic demand has picked up significantly driven by high growth in private consumption on the back of continued income growth and spending of previously accumulated savings. In the meantime, the increase in labor supply has somewhat eased the labor market conditions, which was reflected in a continuous decline in wages.

In the period under review, with the prospect of continued deflationary trends in external and domestic commodity markets and inflationary factors predicted to phase out remarkably, the Central Bank of Armenia reduced the policy rate by a total of 2.5 percentage points, setting it at 8.0% in June of 2024. Furthermore, given a persistently high level of uncertainties over inflationary expectations and risks that the factors of domestic demand would end up expanding in the economy, the Central Bank of Armenia favored a gradual easing of monetary conditions, expressing the prudence for ensuring further regulation of demand and stabilizing inflationary expectations.

In the period under review, market interest rates have come to shaping mainly around the operational goal, i.e. the policy rate. The yield curve in the government securities market has performed in general in concurrence with the change in the policy rate. The events that took place in Artsakh at the end of September of 2023 brought about increased volatility and uncertainty in the financial system, while a certain increase in the yield curve was noticeable, too. In the first quarter of 2024, as the Central Bank of Armenia cut the policy rate, one could see the yield curve's long-term segment and short-term segment having shifted downward again, in January and March, respectively. In this period of time, moderate appreciation of the dram continued to be seen in the foreign exchange market, which was attributable to the steady high growth in export and trade-related activity and the decreased country risk premium. In this situation, to make sure the financial market functions normally, the Central Bank of Armenia had a situational intervention in the foreign exchange market by making mostly purchases of foreign currency. The consumer and mortgage loans continued to grow rapidly due to domestic demand which persisted high throughout the period under review.

Chart 1



To sum up, the 12-month inflation has further followed a decline path between July 2023 and February 2024, influenced by the deflationary spillovers from the external sector and the implemented monetary policy in the course of a one-year period under review, reaching -1.7% in February but then rising again to amount to 0.8% in June. The 12-month core inflation displayed almost the same performance when it declined to -0.7% in February but increased thereafter, reaching 0.0% in June. The 12-month inflation rate is estimated to increase in the near term and stabilize around the 4% target in the medium run.

2. INFLATION COMPONENTS IN THE PERIOD UNDER REVIEW

In the period under review, the deflationary environment persisted in the Armenian economy, driven by global economic developments, the impacts of the monetary policy pursued by the Central Bank of Armenia in preceding years, and somewhat weakened growth in aggregate demand. This was reflected in both low consumer price growth and core inflation rate.

In the period under review, core inflation, which excludes seasonal food products and regulated services, continued to decline, reaching 0.0% y/y at the end of the reporting period. This reflects, on the one hand, the deflationary effects transmitted from imported goods (both food and non-food products), and, on the other hand, a certain decline in inflation of services against the backdrop of a slowdown in external demand growth. Thus, the previous one-year period saw sustained effects of deflationary spillovers from food markets (in the context of slowing economic activity and somewhat sluggish demand both globally and in the main trading partner countries), as well as relatively contractionary monetary conditions. These trends have been reflected in the deflationary patterns of imported goods. Additionally, it is worth noting that the appreciation of the Armenian dram, and the gradual transmission of its effects to the economy, have also had their implications on the decrease in prices of imported goods. Nevertheless, in the period under review, risks and uncertainties related to geopolitical developments in the Middle East continued to have inflationary effects on global energy prices, which have also impacted fuel prices in the domestic market.

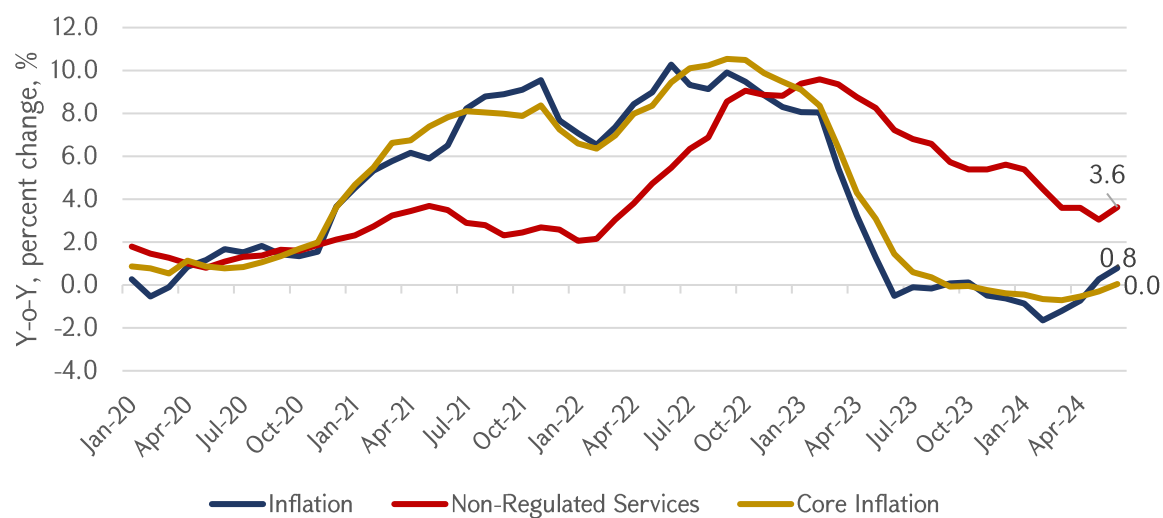
Over the course of the previous one-year period, and in the context of slowing external demand from international visitors, inflationary pressures have considerably weakened. Specifically, tariffs for a number of services with relatively sticky prices (e.g. apartment rent, restaurants and hotels, hairdressing, medical, financial, postal services, and so on) have adjusted and begun to show signs of gradually stabilizing (see Chart 2).

At the same time, in the period under review, persistently strong domestic demand conditions, given high incomes, accumulated savings and growth in consumer loans, has led to the emergence of some inflationary pressures in the consumer market. These high demand conditions have also been impacted by the influx of forcibly displaced persons from Nagorno-Karabakh to Armenia post September 2023.

Further, it is important to note that prices for certain products within the Core Inflation basket (i.e. “Tobacco” and “Alcoholic beverages”) have increased, as was previously estimated, driven by the inflationary effects of the change in excise tax rates introduced in early 2024.

Chart 2

In the period under review, deflationary effects from the external sector contributed to low levels of both the CPI and the core inflation rate.



With respect to seasonal food products (and especially fruit), the traditionally observed seasonality in these prices have somewhat softened throughout 2024, driven by the impacts of greenhouses, as well as deflationary trends for imported goods in these categories.

Finally, regulated service tariffs have risen to some extent in early 2024, primarily due to the one-time inflationary impacts of an increase in car parking fees introduced in January.

Table 1

Product/item	Weight	12-month inflation: June 2024	Contribution to y/y inflation
Core inflation	75.4	0.0	0.0
Bread and cereals	8.9	-1.8	-0.2
Meat	10.6	-2.5	-0.3
Oils and fats	2.9	-9.8	-0.3
Sugar	0.5	-5.6	0.0
Dairy products	4.6	-3.2	-0.1
Alcoholic beverage	2.0	7.4	0.1
Tobacco articles	2.3	2.3	0.1
Clothing	2.1	-3.1	-0.1
Footwear	1.2	0.2	0.0
Household appliances	0.6	3.3	0.0
Fuel	4.5	7.3	0.3
Air passenger transportation services	2.2	18.2	0.4
Outpatient care services	2.3	2.2	0.1
Actual rent paid by the tenant for additional accommodation	2.0	2.0	0.0
Restaurants and hotels	2.1	3.2	0.1
Fees for services by banks, post offices	0.7	1.8	0.0
Seasonal food products	10.3	5.1	0.5
Eggs	1.3	7.6	0.1
Fruits	3.5	6.3	0.2
Vegetables	5.5	7.0	0.4
Regulated services	14.3	1.6	0.2
Other product and service groups			
Imported food products	15.5	-2.0	-0.3
Non-regulated services	19.3	3.6	0.7