

Appendix

*Approved:
under the Central Bank of Armenia
Board Decision No. 26 A,
dated 25.02.2025*

STATUS REPORT ON IMPLEMENTATION OF THE MONETARY POLICY PROGRAM (Quarter 1, 2024 – Quarter 4, 2024)

A low inflationary environment persisted in the Republic of Armenia throughout 2024: the 12-month inflation continued to decline in the first quarter, it then gradually increased, floating in the positive territory since the second half of the year. These inflationary trends were primarily driven by the influences transmitted from the external sector and the monetary policy implemented by the Central Bank of Armenia.

The year saw a decrease in wages, inflation of services with sticky prices, and declining inflationary expectations, which has been largely due to gradual adjustment of aggregate demand and softened tension in the labor market. In such a situation, in 2024 the Central Bank of Armenia continued to ease monetary conditions, reducing the policy rate by a total of 2.25 percentage points.

As a result of the monetary policy carried out by the Central Bank of Armenia in the period under review and prior to it, and prompted by the influences transmitting from the external sector, the 12-month inflation continued to decline in the first quarter of 2024, hitting its lowest level of -1.7% in February, then it gradually increased, amounting to 1.5% at the end of the year. The 12-month core inflation behaved similarly in the aforementioned period when it decreased to -0.7% until February before rising to 0.9% at the yearend.

1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

A variety of scenarios were deliberated in light of the uncertainties in the macroeconomic environment in 2024. Type A scenarios of setting higher interest rates relative to market expectations were about risks to formation of an elevated neutral interest rate and risk premium for Armenia, which derived from uncertainties over the neutral interest rate in the USA, geopolitical developments, and the fiscal policy in Armenia. Other scenarios pointed to the creation of excess demand and its long-term persisting in the domestic economy. On the other hand, type B scenarios speculating on faster reducing interest rates relative to market expectations highlighted risks to the gradual slowing in construction sector growth, rapid weakening of domestic and external demand and labor market conditions, as well as the sluggishness in global economic growth outlook. The monetary policy carried out in combination with prudent risk management in times of uncertainties has been steered to stabilizing the 12-month inflation around the 4% target in the mid-term horizon.

In the period under review, as geopolitical developments further unfolded and uncertainties and risks persisted, the economic trends diverged across the main partner countries of the Republic of Armenia. Thus, economic activity remained elevated in the USA and Russia, largely supported by strong growth in domestic consumption, especially services. In the Eurozone, economic growth has slowed significantly due to the slackened potential growth. In the period under review, global inflation continued slowing, although prices of goods and services which have sticky prices were still relatively high in the partner countries. In terms of rising prices in international commodities market and possible supply chain disruption, the risks proved material due to the geopolitical challenges in the Middle East since the beginning of the year 2024, as well as mounting tensions in international trade relations. Given the above developments, the deflationary effects on the Armenian economy from the external sector have generally been weak throughout 2024; only at the end of the year, as certain inflation risks materialized, some minor inflationary effects spilled over from the external environment.

The economic activity persisted high in Armenia in the period under review, which was primarily driven by strong growth recorded in the services, construction, and trade sectors. However, a certain slowdown in economic activity has been observed since the second half of 2024 – it came closer to the estimated level of long-term sustainable growth. At the same time, in the context of high economic growth, there were certain issues related to its inclusiveness and structural peculiarities. In the period under review, aggregate demand has seen adjustment, largely approaching its sustainable level. Moreover, its structure has incurred a gradual slowdown in the growth rate of external demand chiefly due to the slowdown in the growth rate of tourism. Instead, domestic demand has revived considerably thanks to strong growth in private consumption, which was backed by the continued increase in incomes and spending of previously accumulated savings. At the same time, the gradual slowdown in demand and an increase in labor supply have somewhat eased the labor market

conditions. All this brought about certain stabilization in wages, inflation in services which have sticky prices, and inflationary expectations.

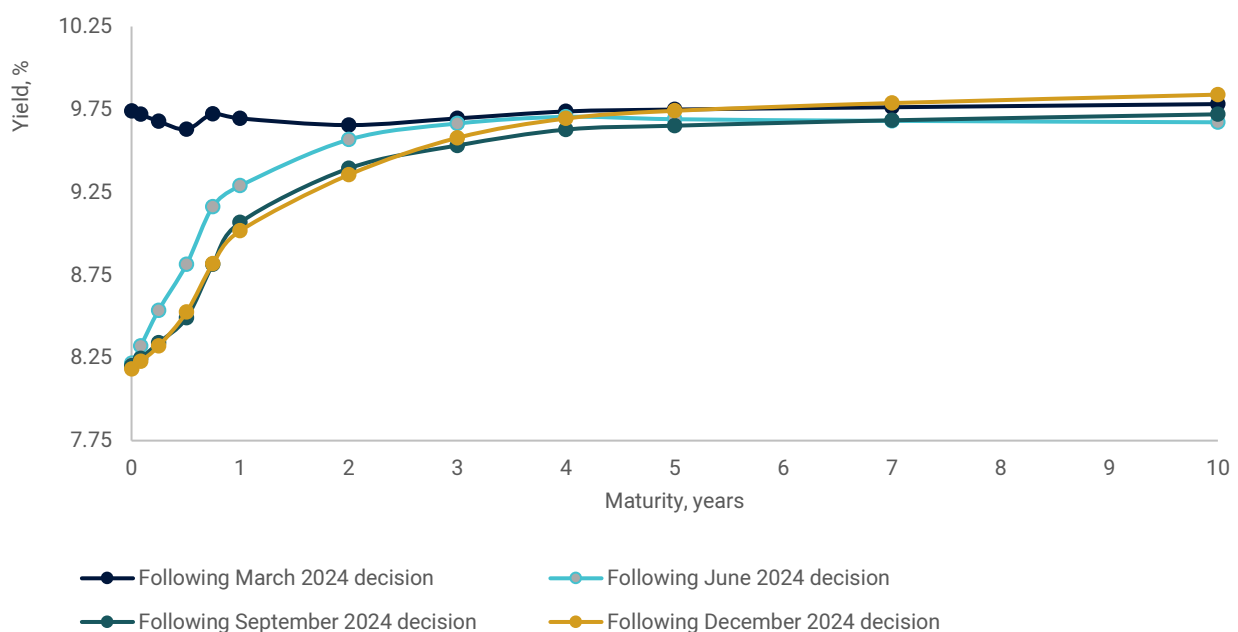
In view of the current situation, given its commitment to achieving the goal of price stability and prudent management of potential risks arising from uncertainties, the Central Bank of Armenia continued to gradually reduce the policy rate in the course of the year by a total of 2.25 percentage points, setting it at 7.0% in December of 2024. In doing so, there has been a firm choice for gradual easing of monetary conditions. Thus, until the fourth quarter, balancing the risks in either direction, the Board of the CBA has found it more reasonable to gradually ease the policy stance in line with market expectations, and in the fourth quarter, as type B scenarios were materializing with a greater likelihood, the Board emphasized the need to manage significant repercussions deriving from type A scenarios.

As a result, in view of the developments mentioned above and the monetary policy carried out in the period under review and prior to it, **in 2024 the 12-month inflation increased by 2.1 percentage points and amounted to 1.5% at the end of the year, and the 12-month core inflation rose by 1.3 percentage points, reaching 0.9% at the yearend.**

In the period under review, market interest rates came in mostly shaping around the operational target, i.e. the policy rate. In the government bonds market, the movement of the yield curve has largely mirrored the rationale behind lowering the policy rate. Thus, with inflationary expectations stabilizing and the Central Bank's policy rate further on a decline path, the yield curve shifted downward during the year, which has been particularly notable in the short and mid-term segments.

Figure 1

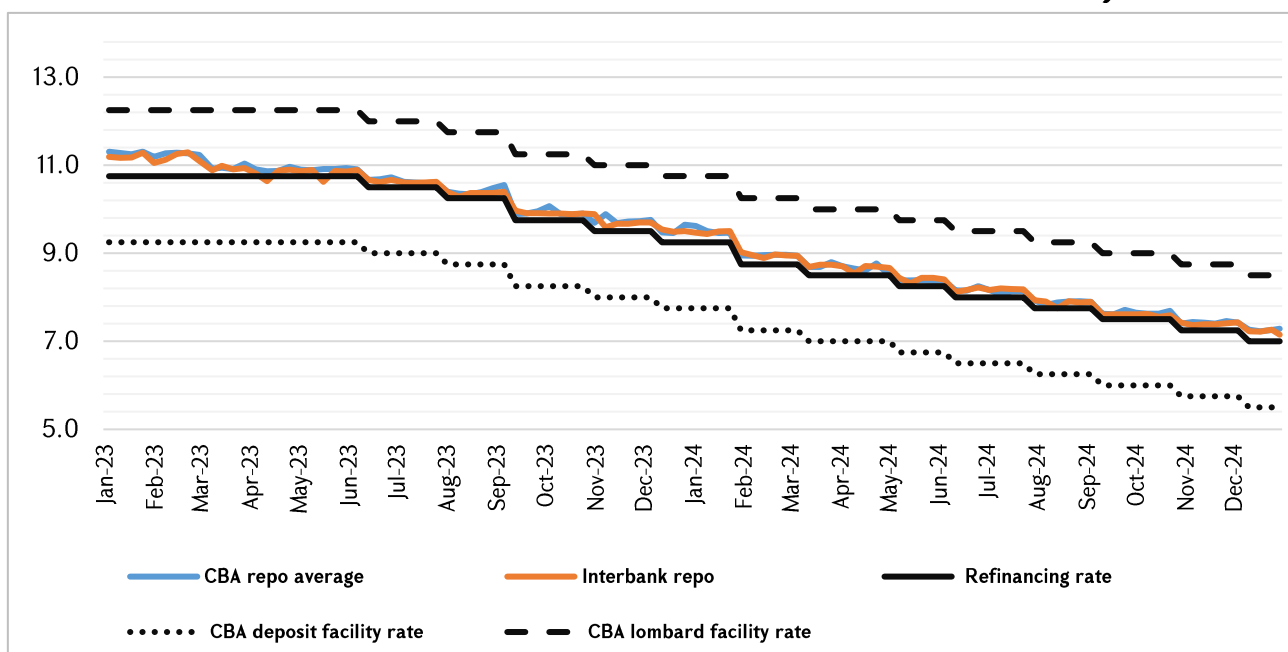
The yield curve of Armenian government bonds following the CBA interest rate decisions



In the year under review, with demand staying robust for lending, the consumer and mortgage loans continued to grow rapidly, while interest rates in the banking system demonstrated mainly a stable behavior. In the foreign exchange market in 2024, the Armenian dram continued to strengthen moderately against the US dollar on the back of sustained growth in export and trade-related activity and a decrease in the country risk premium. Under this circumstance, in order to ensure the normal functioning of the financial market, the Central Bank of Armenia arranged only a situational participation in the foreign exchange market mainly by purchasing foreign currency.

Figure 2

The Central Bank of Armenia instruments and short-term market interest rates dynamics



2. INFLATION COMPONENTS IN THE PERIOD UNDER REVIEW

The inflationary environment in the Armenian economy remained low in the period under review owing to the effects transmitted from the global economy and the impact of the monetary policy implemented by the Central Bank of Armenia in previous years. This was evident in the subdued growth of consumer prices and core inflation.

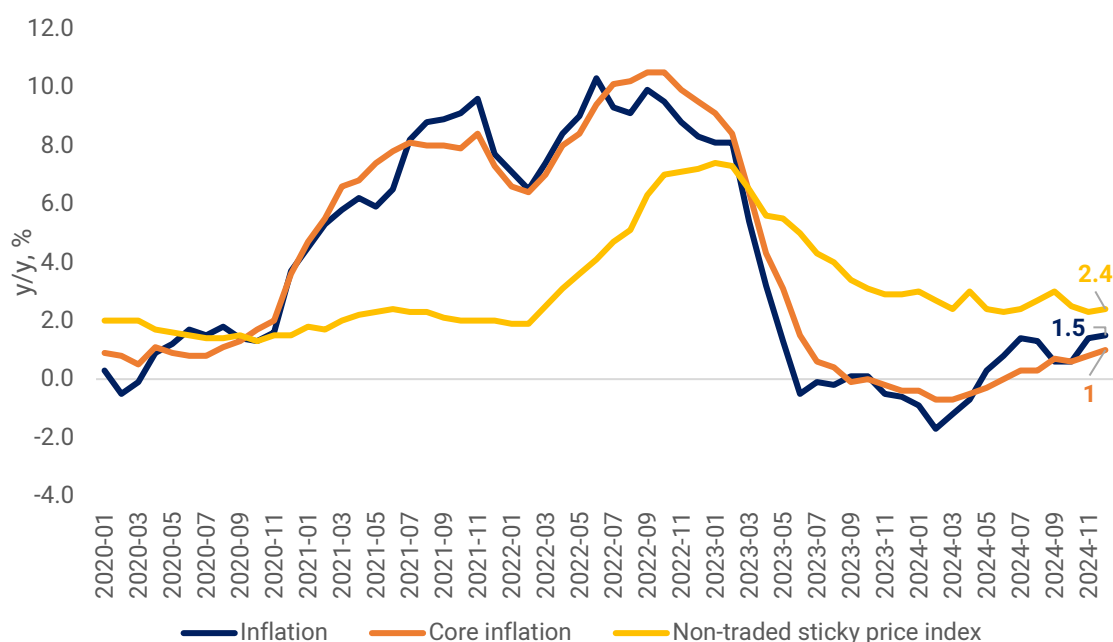
Core inflation, which excludes seasonal food products and regulated services, continued to decline during the first quarter of 2024; it then stabilized into the positive territory in the second half of the year, amounting to 1.0% y-o-y in December. The core inflation dynamics were shaped by price deflation stemming from domestically produced goods and imported goods (especially non-food ones) and a certain decline in services inflation on the back of a slowing growth in external demand. Thus, amid somewhat a sluggish economic activity and weaker demand in the world and main trade partner countries, as well as relatively tight monetary conditions, the deflationary effects transmitted from international food markets have generally persisted over the past year, manifesting in deflationary developments for imported goods. Nevertheless, unfavorable weather conditions in the second half of the year led to a rise in prices for certain products in international commodity markets. This, in turn, affected the prices of imported food products, aligning them close to the target level by year-end. In the meantime, the risks and uncertainties associated with geopolitical developments in the Middle East throughout 2024 have brought in additional price volatility and further exerted certain inflationary pressures on the global energy market, which were also mirrored in fuel price fluctuations in the domestic market.

Over the past year, tourist flows have been somewhat adjusted compared to 2023, reflecting a significant weakening of domestic inflationary pressures driven by external demand in a number of sectors. In this context, the prices in several services sectors which have relatively sticky prices (rent, restaurants and hotels, hairdressing, medical, financial, postal services) have been somewhat adjusted and displayed gradual stabilization trends (see Figure 3).

In the period under review, inflation of non-tradable and general services with sticky prices has subdued to some extent and approached the target indicator amid gradual adjustment in aggregate demand and easing labor market conditions. However, it still outstrips headline inflation because of low inflationary dynamics of imported food products in its structure. It should also be noted that the increase in prices of product groups “Tobacco products” and “Alcoholic beverage” out of the *Core Inflation* components has incurred the inflationary impact from the change in excise tax rates in early 2024.

Figure 3

In the period under review, deflationary spillovers from the external sector were reflected in low consumer prices and core inflation



As for seasonal food product prices, particularly within the *Fruit* product group, the usual seasonality pattern showed a certain degree of softening over the course of 2024, which is attributable to the impact of greenhouse farm activities as well as deflationary trends observed in imported goods within this group. The adjustment of inflation 'accumulated' in the *Vegetables* product group in September and October, occurred in November, leading to inflation slightly exceeding the seasonal level.

It is also noteworthy that the tariffs for regulated services increased to some extent in early 2024, mainly due to a one-off inflationary impact of parking fees introduced since January.

Table 1

Product/item	Weight	12-month inflation: December 2024	Contribution to y/y inflation
Core inflation	75.4	0.9	0.7
Bread and cereals	8.9	0.6	0.05
Meat	10.6	-0.9	-0.09
Oils and fats	2.9	9.7	0.28
Sugar	0.5	-4.2	-0.02
Dairy products	4.6	-2.0	-0.09
Alcoholic beverage	2.0	7.0	0.14
Tobacco products	2.3	1.1	0.03
Clothing	2.1	-3.4	-0.07
Footwear	1.2	-1.2	-0.01
Household appliances	0.6	2.8	0.02
Fuel	4.5	-2.1	-0.09
Air passenger transportation services	2.2	8.1	0.18
Outpatient care services	2.3	4.1	0.09
Actual rent paid by the tenant for additional accommodation	2.0	-4.4	-0.09
Restaurants and hotels	2.1	1.4	0.03
Fees for services by banks, post offices	0.7	1.0	0.01
Seasonal food products	10.3	4.7	0.5
Eggs	1.3	-3.7	-0.05
Fruits	3.5	-0.1	0.00
Vegetables	5.5	9.7	0.53
Regulated services	14.3	1.8	0.3
Other product and service groups			
Imported food products	15.5	3.4	0.5
Non-regulated services	19.3	3.0	0.6

Table 2

Product/item	12-month inflation: as of March 2024	12-month inflation: as of June 2024	12-month inflation: as of September 2024	12-month inflation: as of December 2024
Core inflation	-0.7	0.0	0.7	0.9
Bread and cereals	-6.8	-1.8	-1.1	0.6
Meat	-1.7	-2.5	-1.4	-0.9
Oils and fats	-16.5	-9.8	-1.7	9.7
Sugar	-4.6	-5.6	7.4	-4.2
Dairy products	-3.8	-3.2	-3.2	-2.0
Alcoholic beverage	7.1	7.4	7.2	7.0
Tobacco products	8.2	2.3	1.3	1.1
Clothing	0.2	-3.1	-4.1	-3.4
Footwear	2.9	0.2	-2.3	-1.2
Household appliances	3.4	3.3	3.1	2.8
Fuel	5.4	7.3	0.3	-2.1
Air passenger transportation services	18.6	18.2	25.0	8.1
Outpatient care services	0.9	2.2	2.4	4.1
Actual rent paid by the tenant for additional accommodation	4.2	2.0	4.4	-4.4
Restaurants and hotels	3.8	3.2	2.7	1.4
Fees for services by banks, post offices	7.7	1.8	1.8	1.0
Seasonal food products	-7.0	5.1	-1.8	4.7
Eggs	3.5	7.6	8.0	-3.7
Fruits	-2.7	6.3	1.0	-0.1
Vegetables	-13.8	7.0	-4.3	9.7
Regulated services	1.2	1.6	1.4	1.8
Other product and service groups				
Imported food products	-6.3	-2.0	0.5	3.4
Non-regulated services	3.6	3.6	5.3	3.0