

**THE CENTRAL BANK OF
THE REPUBLIC OF ARMENIA**

*Approved under the Central Bank Board
Resolution No 141A, dated
23.08.2022*

**STATUS REPORT ON IMPLEMENTATION OF THE MONETARY
POLICY PROGRAM
(QIII 2021 – QII 2022)**

In the period from the 3rd quarter of 2021 to the 2nd quarter of 2022, a high inflationary environment persisted in Armenia. Both the inflationary effects transmitted from the external sector and the growth of domestic demand contributed to it. Thus, the large-scale use of vaccines in the second half of 2021 significantly mitigated the impact of the pandemic on the global economy, as a result of which a faster-than-expected recovery of economic activity and total demand was observed. However, the growth of global demand at such rates, amid disruptions of supply chains, was accompanied by a significant expansion of the external inflationary environment, which transmitted a significant inflationary effect to the prices of the RA commodity market through a number of imported products. Subsequently, due to Central Bank's policy aimed at curbing high inflation and anchoring inflationary expectations, a significant decrease in 12-month inflation was observed from the end of the year, but beginning end-February 2022, new inflation factors resulting from the aggravation of the Russian-Ukrainian conflict and the application of sanctions against Russia, emerged both in the international commodity markets and in the RA economy.

Given the existing situation and pursuant to the goal of ensuring price stability, during the reporting period the Central Bank continued to pursue a stricter monetary stance, raising the policy rate by a total of 2.75 percentage points (in March 2022, the Central Bank raised the policy rate by 1.25 percentage points, responding to the high inflation situation formed amid the unprecedented uncertainties observed since the end of February). As a result, inflationary environment has softened somewhat since the end of the year, and 12-month inflation after increasing until December (reaching from 6.5% in June to 9.6% in November), during December 2021 - February 2022 decreased to 6.5%, and then grew again in the second quarter, reaching 10.3% in June. Accordingly, it is expected that in the medium-term 3-year horizon, inflation rate will gradually slow down and stabilize around the target of 4%.

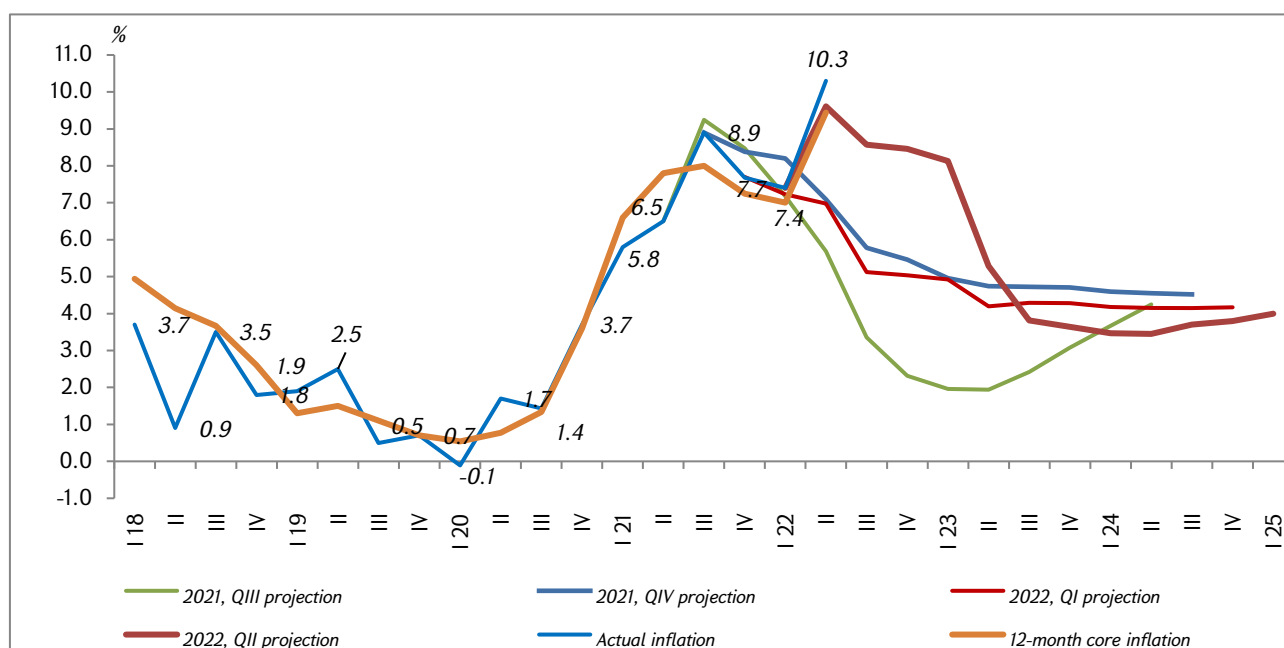
1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

Under the basic assumptions of the scenario presented in the 2021, QIII program, due to the expected effects from the international commodity markets and the surpassing growth of domestic demand against the expansion of production capacities, the high inflation environment would persist in the first half of the reporting period. Then, gradually decreasing, in 2022, it would approach the 4% target, stabilizing around it in the medium term.

In line with the expectations, in the reporting period until March 2022, the 12-month inflation gradually decreased and already in February dropped to 6.5%, demonstrating a trend to approach its target level in the near future. However, due to geopolitical developments, since the end of February, a significant expansion of the inflationary environment and a much higher-than-expected level of inflation were observed. To this end, the trajectory to reach the target indicator in the second quarter has been adjusted for the short-term period and a higher level of inflation has been projected.

Chart 1

During the observed period, the 12-month inflation dynamics was generally in line with the projection, significantly exceeding the expected level only in the second quarter of 2022, given which the short-term indicator for the relevant quarter was projected at a higher level.



In the second half of 2021, amid the large-scale vaccination against coronavirus from the beginning of the year and refraining from strict economic restrictions, the recovery of global economic activity and foreign demand continued at a faster pace. In Armenia, the inflationary factors mainly sustained due to the inflationary effects still transmitted from the external sector (high energy prices and supply chain disruptions) and shaping of a positive demand environment. The latter was

strongly contributed by the high growth, especially in domestic services, which in turn, was affected by the higher-than-expected growth of tourism. At the same time, although a certain decrease in the 12-month inflation rates was observed at the end of the year, due to the impact of the persisting inflationary factors and the expected changes in the prices of regulated services, the level of public inflationary expectations remained high. In view of these developments, the Central Bank raised the refinancing rate additionally by 1.25 percentage points in the second half of 2021.

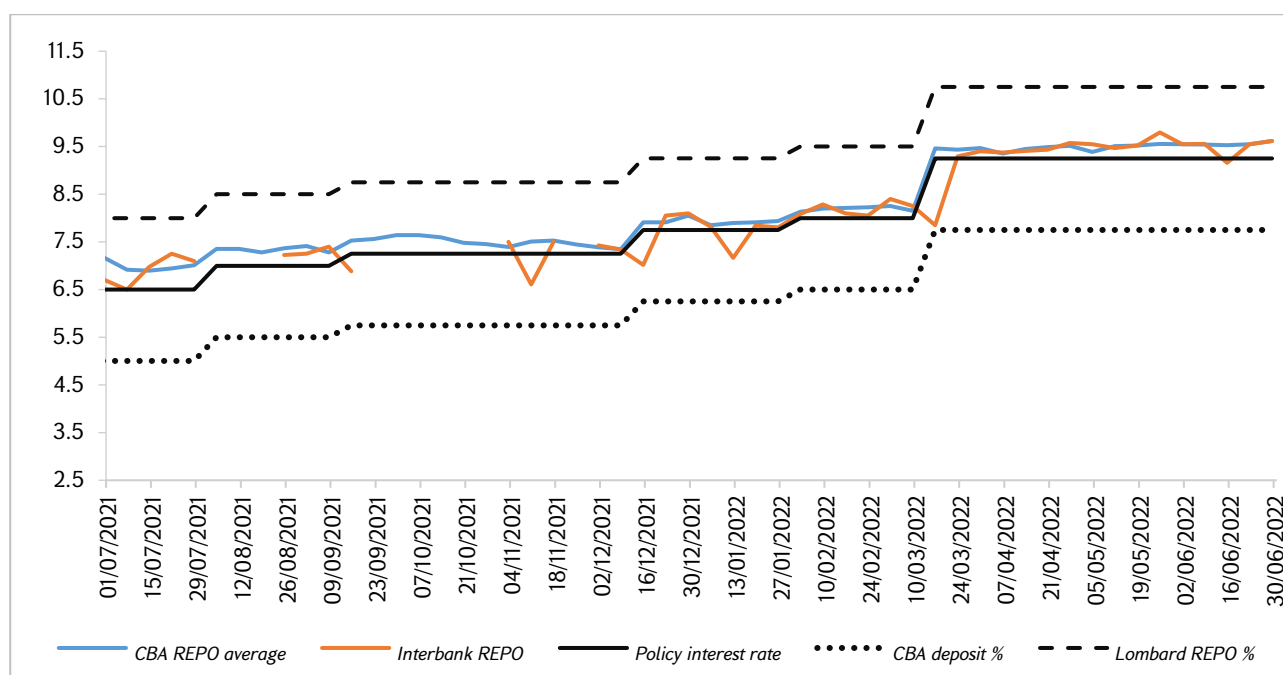
In the first half of 2022, macroeconomic environment of the Republic of Armenia and especially inflationary developments were greatly affected by the Russian-Ukrainian conflict that has intensified since the end of February, the various sanctions applied to the Russian economy and the ensuing unprecedented uncertainties. The latter were manifested by a significant slowdown of the economic growth in the main partner countries of RA, as well as the price upsurge in international energy and commodity markets as a result of disruptions in supply chains. The negative impact of such developments on the domestic economy was mainly reflected in a certain decrease of the short-term economic activity, and high prices on certain imported products in Armenian commodity market. Already in the second quarter of 2022, a significant acceleration of the economic activity was observed, mainly due to the high growth of the service sector driven by the extensive inflow of international visitors and finances to Armenia. This proved to be a significant factor for the expansion of the inflationary environment at the end of the reporting period, especially in the services sector. At the same time, as a result of the Russian-Ukrainian conflict, a significant increase of volatility of RA capital market and the country's risk-premium was observed in the short term, which also contributed to a certain rise of inflationary expectations and inflationary risks. Under these circumstances, the Central Bank raised policy rate by 1.5 percentage points in the first half of 2022. Responding to the high inflationary environment caused by geopolitical developments, in March, the Central Bank tightened monetary terms by a relatively large step of 1.25 percentage points. In the second quarter, the Central Bank refrained from changing the interest rate, given the prevailing role of global inflationary phenomena and, especially, foreign demand effects, within inflation factors, which would gradually decrease amid parallel appreciation of the Armenian dram. Furthermore, a relatively large tightening of monetary terms in the first quarter of 2022 deemed a sufficient response to further alleviation of the high inflation environment.

In the reporting period, short-term interest rates in Armenian financial market mostly shaped around the CBA policy rate. It should be noted that geopolitical developments in early 2022 lead to the growing uncertainty in Armenian currency market in March, which was reflected in the AMD volatility. Thus, in the initial period, amid an unprecedented uncertainty, a sharp depreciation of dram was observed. After that, due to the significant growth in the demand of international visitors (external demand) for domestic services and the large inflow of foreign

remittances, a significant appreciation of the dram took place. With the view to offsetting short-term market disruptions and the ensuing problems, during that period the Central Bank performed situational interventions in the currency market, contributing to the smooth operation of financial market.

Chart 2

Dynamics of CBA instruments and short-term market interest rates



To sum up, policy rate in the reporting period was raised by 2.75 percentage points in total, and was set at 9.25% in June 2022.

As a result, as expected, 12-month inflation increased in the first half of the reporting period, from 6.5% in June 2021 to 9.6% in November 2021, after which it decreased under transmitted effects of previous monetary policy actions to 6.5% in February 2022. After that, due to geopolitical events, this indicator increased significantly, reaching 10.3% in June. It is estimated, that as a result of consistent monetary policy, inflation will gradually decrease approaching the target of 4% in the medium term.

2. INFLATION IN THE PERIOD UNDER REVIEW

Certain easing of the inflationary pressure from the end of 2021 was followed by a sharp acceleration of inflation from the second quarter of 2022.

At the beginning of the reporting period, driven by the growth in prices of imported food and non-food items, the acceleration of core inflation continued. The latter was affected both by prices of food products in international markets and the high aggregate demand. Thus, spill-over effects from international markets resulted in a sharp growth in the prices of “Bakery and Cereals”, “Meat Products”, “Oils and Fats” and “Sugar” commodity groups in the domestic economy (prices of imported food products grew by about 15% during that time). Furthermore, the growth of international energy prices affected domestic fuel prices. The sharp growth of international freight prices is also notable as it had a direct impact on inflation of imported goods (in particular, electrical appliances, clothing and footwear, as well as personal care items).

In line with the projections, by the end of 2021, price-impact effects of the above-mentioned factors have weakened under the impact of the Central Bank’s consistent monetary policy. However, at the end of the first quarter of 2022, amid the escalation of the Russian-Ukrainian conflict, inflation accelerated sharply both in global commodity markets and the Armenian economy. This factor caused significant inflationary pressure, particularly in terms of basic goods. At the same time, due to the inflow of international visitors to Armenia, the acceleration of aggregate demand has increased inflationary pressures in local goods and services market, under which the prices of a number of services with relative price rigidity (apartment rent, restaurants and hotels, hairdressing, financial services) have been adjusted.

Growth of prices of “Tobacco ” and “Alcoholic Beverages” product groups, in line with the estimates, continued to be affected by inflationary impact of the change of excise tax rates at the beginning of the year.

In addition to the above-mentioned factors, low deflation of seasonal food products, not typical for the season, has in turn significantly contributed to the acceleration of inflation. In particular, the low deflation of vegetable prices was mainly caused by bad weather conditions, reduction of sown areas of certain products and the growth of exports. The impact of those factors mostly persisted throughout the reporting period.

As expected, tariffs of the regulated services in the first half of 2022, recorded a sharp growth conditioned by the increase in the tariffs of water supply from January, electricity from March, and natural gas supply from April. As of the end of June, their total contribution to 12-month inflation was about 1.0 percentage points.

Chart 3

Some easing of the inflationary pressure from the end of 2021 was followed by a sharp acceleration of inflation from the second quarter of 2022.

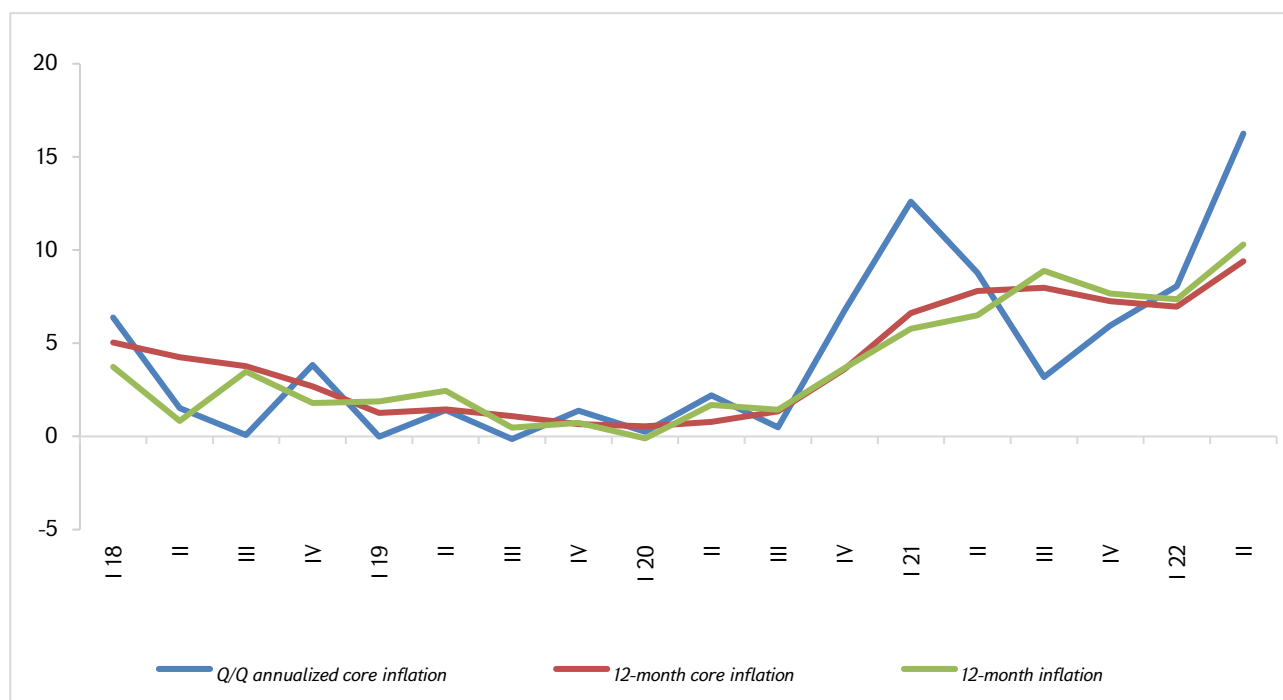


Table 1

Designation	Weights	12-month inflation in June 2022	Contribution to y/y inflation
Core inflation	75.10	9.4	7.1
Bread and cereals	8.10	19.9	1.6
Meat	9.00	11.6	1.0
Oils and fats	2.60	5.1	0.1
Sugar	0.50	6.9	0.0
Dairy products	4.15	21.0	0.9
Alcoholic beverage	2.40	6.9	0.2
Tobacco	1.40	10.3	0.1
Clothing	1.30	10.5	0.1
Footwear	0.80	10.4	0.1
Household appliances	0.60	7.4	0.0
Fuel	6.80	9.5	0.6
Air passenger transportation services	0.60	17.6	0.1
Actual rent paid by the apartment renter for additional accommodation	1.00	32.9	0.3
Restaurants and hotels	1.00	6.8	0.1
Fees for services of banks, post offices	0.58	7.5	0.0
Imported food products	14.8	14.4	2.1
Seasonal food products	9.40	25.3	2.4
Eggs	1.30	-24.0	-0.3
Fruits	3.20	16.2	0.5
Vegetables	4.90	45.8	2.2
Regulated services	15.50	5.0	0.8