

*Approved under
Central Bank Board Decision No. 192A,
dated 20.11.2020*

**STATUS REPORT ON IMPLEMENTATION OF THE
MONETARY POLICY PROGRAM
(Q4, 2019 - Q3, 2020)**

During the year preceding the fourth quarter of 2020, the inflationary environment in Armenia remained low due to both demand and supply-side factors. Thus, in the course of the fourth quarter of 2019 and first quarter of 2020 the Government carried out somewhat a contractionary fiscal policy, and mainly deflationary effects were transmitted from the outside world. The low inflationary environment was also driven by diverse competition observable in a number of commodity markets and structural shift in demand from non-durable consumer goods market to durable consumer goods market. In the meantime, a relatively high growth of private consumption was registered, mainly owing to the positive impact of lending by the financial sector. Significant deflationary factors emerged in the second and third quarters of 2020, and these derived mostly from the coronavirus pandemic that broke out in the world and Armenia early in the year, measures taken to prevent it, and changed behavioral patterns. In the current situation, despite the considerable extent of stimulative fiscal policy implemented, there has been a significant decline in economic activity and aggregate demand, mainly due to reducing private consumption and postponed investments under high uncertainty about the economic outlook. To contain deflationary pressures and bring the inflation close to the target in the 3-year forecast horizon, the Central Bank has meantime increased the amount of stimulus of the monetary policy by gradually reducing the refinancing rate by a total 1.25 pp: as of end-September 2020 it makes up 4.25%.

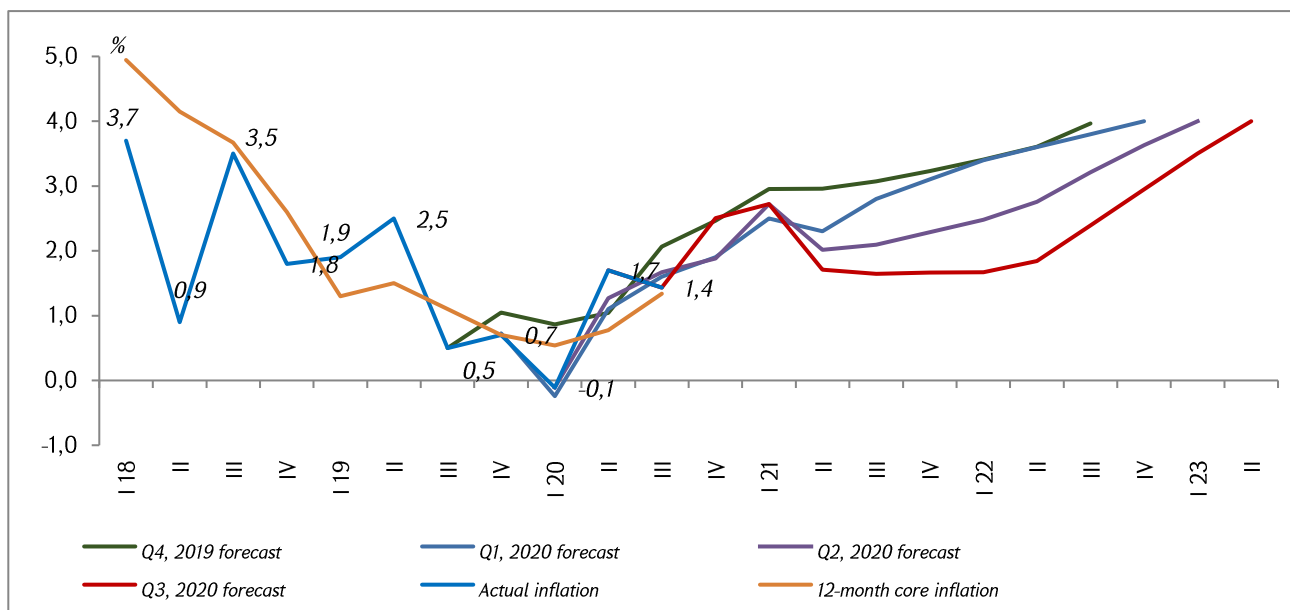
1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

According to forecasts of the monetary policy program for the fourth quarter of 2019, the inflationary environment in the reporting period would remain low in anticipation of a weak aggregate demand. The latter, in turn, would be affected by the contractionary fiscal policy to be pursued at that time and the influences transmitted from a low inflationary environment persisting in the outside world. At the same time, some supply factors such as continued competition in commodity markets and a certain shift in demand from non-durable consumer goods market to durable consumer goods market would further contribute significantly to the shaping of low inflation. Under such conditions, the Central Bank intended to continue implementing a stimulative monetary policy, giving preference to the gradual recovery of inflation. As a result, the 12-month inflation rate would still be kept low in the short term perspective and approach and stabilize around the 4% target in the medium term perspective.

In the reporting period, as expected, a low inflationary environment was shaped, but because of some new deflationary patterns, the 12-month inflation proved lower than anticipated, deviating downside the projection path. The deviation was due to both demand and supply factors observable for that period.

In terms of their impact on inflation, the reporting period may fall into two parts, related to the differences in fiscal policy implementation, private consumption behavior, and a number of supply factors. Thus, the Government's fiscal policy carried out in the fourth quarter of 2019 and first quarter of 2020 proved more contractionary than expected. However, domestic demand in that period tracked higher growth than predicted owing to increased growth in private consumption, which in turn was fuelled by a relatively large increase in consumer loans the financial system provided to the economy. In the meantime though, certain supply-side factors that contained the inflation included the impact of low prices in the outside world transmitted onto domestic prices, the increased effectiveness of the use of resources in the non-tradable sector of the economy, and the increasingly competitive commodity markets. Based on this, the Central Bank has revised the quarterly inflation forecasts and the path to recovery. At this period of time the Central Bank left the refinancing rate unchanged.

According to the Central Bank forecasts, a low inflationary environment will persist in the short term, it will expand in the medium term; at the end of the forecast horizon the 12-month inflation will stabilize around the target value



The inflationary developments in the second and third quarters of 2020 derived totally from healthcare and economic consequences of the New coronavirus disease (COVID-19) that broke out in a number of countries around the world at the start of the year and in Armenia since March. After healthcare and economic constraints were imposed on the back of uncertainty about the economic outlook at that time, a sharp decline in economic activity was observable, with significant reductions in all sectors of the economy. In such a situation, the Government implemented considerably a stimulative fiscal policy aimed at social and economic assistance. However, high uncertainty accumulated due to the pandemic has driven the public to take a precautionary approach to private consumption and investment, which has outpaced fiscal stimulus, leading to weakening domestic demand and maintaining a low inflationary environment. A wide scale offensive launched by

Azerbaijan on September 27th along the entire line of contact with the Republic of Artsakh, and the martial law declared in the Republic of Armenia in that situation, as well as the new wave of coronavirus that broke out and spread rapidly have brought in additional uncertainties at the end of the quarter in terms of outlook to economic recovery and inflation developments.

In the reporting period, taking into account the possible deflationary effects under a persistent weak aggregate demand, the Central Bank conducted a stimulative monetary policy and further prioritized the gradual recovery of inflation, since, according to the Central Bank estimation, a low inflation in the macroeconomic situation at that time was contributing to the anchoring long-term inflation expectations and enhancing public confidence in the monetary policy pursued by the Central Bank. In the course of a one-year period under review, the Central Bank has gradually cut the refinancing rate by a total 1.25 pp, in anticipation of slowing of aggregate demand under high uncertainty caused by the spread of the pandemic.

At the same time, reacting to the significant increase in demand for dram liquidity amid the pandemic, the Central Bank has injected, through its main tool, the required amount of liquidity into the system, helping short-term interest rates shape around the policy rate of the Central Bank. In the reporting period, the Central Bank repeatedly signaled the financial market that, in view of predicted macroeconomic developments, the monetary conditions will be kept expansionary for as long a period of time as necessary, to fulfil the inflation target in the medium term.

2. INFLATION IN THE PERIOD UNDER REVIEW

In the one-year course following the fourth quarter of 2019, the 12-month inflation remained low and demonstrated certain volatility primarily attributable to agricultural product price changes. Specifically, a fall in seasonal food prices in the fourth quarter of 2019 and early in 2020 has generally contributed to the inflation negatively, pushing it down to -0.1% y/y in March. Starting from the second quarter of 2020, inflation recovered to a certain extent, which is a result of the rise in prices of seasonal agricultural products, especially fruits. So, in September the 12-month inflation amounted to 1.4%. In the meantime, the 12-month core inflation rate has recovered to a certain extent during the third quarter of 2020 - to around 1.3% as of September, whereas regulated service tariffs and seasonal food product prices have risen by 1.1% and 5.1% y/y, respectively. It should be noted that the inflationary impact of a change in customs rates on some goods in the beginning of 2020, as was estimated, amounted to about 0.2 pp. The price increase on items "Tobacco" and "Alcoholic beverage" still incurs the inflationary impact of a change in excise duty rates at the beginning of the year.

Table 1

Items/designation	Weight	12-month inflation	Contribution to y/y inflation
Core inflation	72.7	1.34	0.97
Bread and cereals	7.73	3.77	0.29
Meat	9.58	-3.04	-0.29
Oils and fats	2.37	2.38	0.06
Sugar	0.53	6.42	0.03
Alcoholic beverage	2.79	11.49	0.32
Tobacco	1.39	6.32	0.09
Clothing	2.45	-2.75	-0.07
Footwear	1.32	-2.75	-0.04
Medicines and health products	4.62	2.92	0.14
Fuel	5.29	-1.60	-0.08
Air passenger transportation services	0.48	-0.78	0.00
Education	3.14	2.04	0.06
Hospital services	2.66	1.37	0.04
Outpatient care services	2.37	2.84	0.07
Seasonal food products	11.47	5.14	0.59
Eggs	1.15	-3.68	-0.04
Fruits	4.19	20.11	0.84
Vegetables	6.13	-6.87	-0.42
Regulated services	15.88	1.05	0.17