

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

*Approved under the Central Bank Board
Resolution No 38A, dated
February 22, 2022*

**STATUS REPORT ON IMPLEMENTATION OF THE
MONETARY POLICY PROGRAM
(QI 2021 – QIV 2021)**

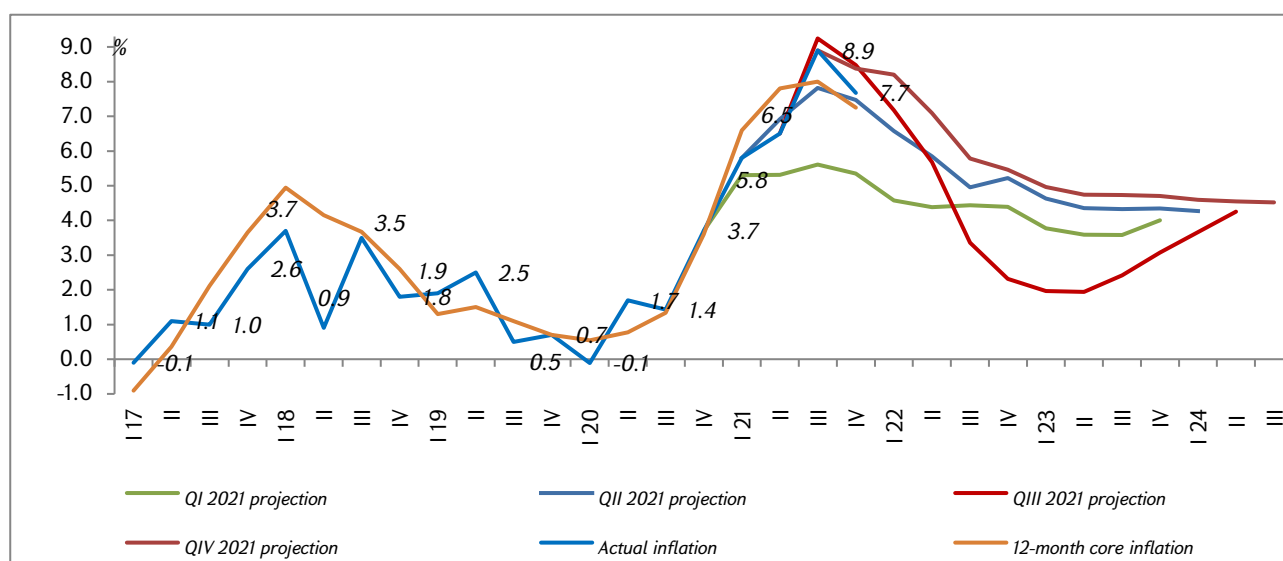
The reporting period passed amid the rapid spread of new waves of the pandemic, with parallel wide use of coronavirus vaccines worldwide. In this context, global economy and the health care system continued to face new challenges and uncertainties about economic outlook. However, the impact of the consecutive waves of pandemic on the global economy has had a mild, mainly due to active vaccination process and avoidance of severe economic restrictions. Subsequently, economic activity and aggregate demand in the reporting period was restored faster than expected. Affected by the disruption of production chains, the latter significantly exceeded the supply growth rate. Due to the above-mentioned factors, inflationary environment in international commodity markets and the main partner countries of the Republic of Armenia has significantly expanded, with equivalent impact on the prices of domestic commodity market of Armenia. Given the current situation and pursuant to the goal of ensuring price stability, the Central Bank gradually raised policy interest rate during the reporting period, neutralizing expansionary monetary stance. In 2021, policy interest rate was raised by a total of 2.5 percentage points, summing up the year by 7.75%. Hence, while 12-month inflation grew from 3.7% at the end of 2020 to 7.7% at the end of 2021, it is projected that it will decline over the 3-year horizon and anchor around the 4% target.

1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

Monetary policy to be implemented at the beginning of the reporting period was based on a number of assumptions described below, which were outlined in the QI, 2021 program, with expectations of persisting low economic activity and weak demand environment, mostly conditioned by the ongoing spread of coronavirus worldwide, martial law declared in the country at the end of the previous year and the resulting uncertainties about the economic outlook. At the same time, however, as a result of some short-term supply factors transmitted from international markets and in the domestic economy, a significant growth of inflation and inflation expectations was observed. According to the baseline scenario of the Central Bank, their impact would remain in the short run, gradually diminishing in the medium term, and 12-month inflation would be adjusted towards the target. Given the short-term nature of inflation factors, monetary policy was aimed at neutralizing the risks of accelerating inflation expectations without harming domestic demand recovery as far as possible.

In light of these inflation developments, the projected short-term inflation trajectory to reach the target in each subsequent quarter of the reporting year was adjusted upwards.

12-month short-term inflation forecasts for the reporting period were periodically revised upwards



During the reporting period, macroeconomic developments both in the external sector and in the Armenian economy were more positive than expected. Thus, as a result of the widespread use of coronavirus vaccination and the avoidance of severe restrictions to a possible extent, a faster recovery of global economic activity and external demand has been observed. Under the influence of a number of supply factors manifested against the background of positive demand developments (forecasts of low supply of new crops, increase in freight costs, disruption of production chains), significant inflationary developments were observed in the international commodity markets. This was also reflected in the formation of a high inflationary environment in the main partner countries of the Republic of Armenia, under which inflationary pressures were transmitted to the economy of the Republic of Armenia through a number of imported food products. In the

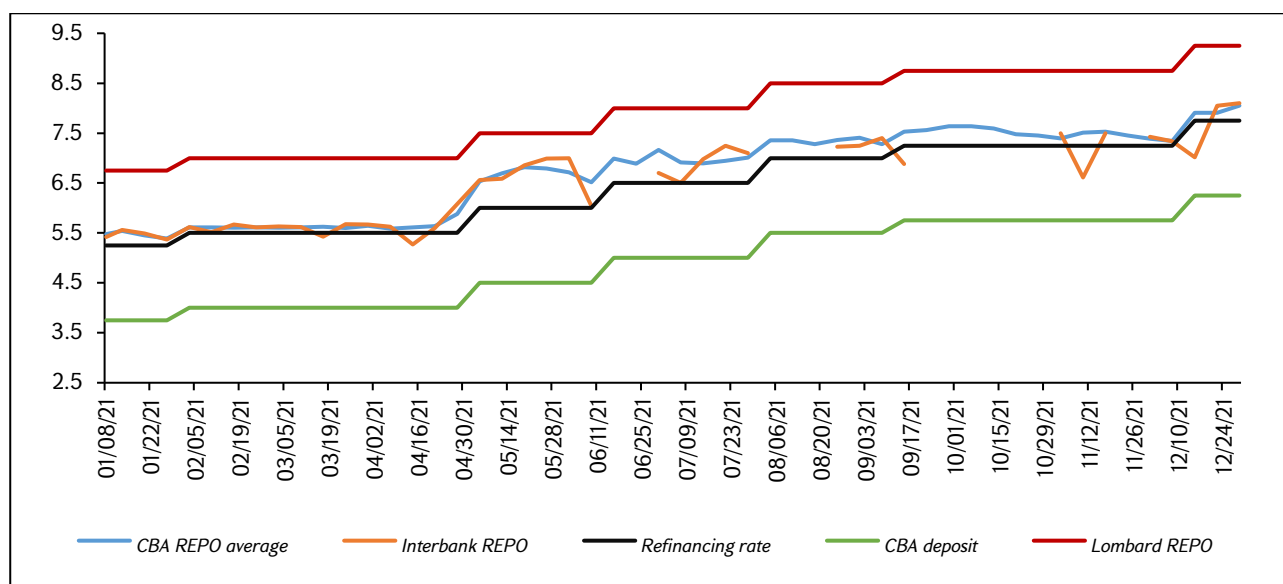
second quarter of 2021, supply-side inflationary spill-over effects from international food prices to domestic prices in the first quarter were supplemented by demand-side factors, conditioned by the outpacing growth of private consumption over the output capacity expansion opportunities. The latter was mainly due to the sharp increase in household consumption expenditures at the expense of the accumulated savings, as well as the large inflow of remittances from abroad.

Amid the inflationary developments described above, in the first half of the year, the Central Bank continued to pursue a policy of tightening monetary conditions introduced since December last year, gradually reducing and neutralizing the expansionary monetary stance. Given the increase of inflationary effects in the second quarter over the first quarter, the Central Bank raised its policy rate by only 0.25 percentage points in the first quarter and 1.0 percentage point in the second.

Due to higher-than-expected growth rate of tourism, in the second half of the reporting period, the impact of external demand factors in the domestic services was quite significant. At the same time, uncertainties over the economic and geopolitical outlook have been reflected by rising inflation expectations. In such circumstances, the Central Bank raised the refinancing rate by a large step of 0.75 percentage points in the third quarter as well. Despite the slight decline of 12-month inflation rates in the fourth quarter, inflation factors persisted under inflationary spill-over effects from the external sector (persisting high energy prices and disruptions in production chains) and positive demand environment. This in turn was reflected in the dynamics of core inflation with the quarterly annual indicator of the latter growing strongly to 5.6%, compared to 4.7% in the previous quarter. At the same time, the impact of current inflation factors and expected changes in the prices of regulated services in the fourth quarter was reflected in the higher public inflation expectations. In view of these developments, the Central Bank raised the refinancing rate additionally by 0.5 percentage points in the fourth quarter.

It should be noted that in 2021, domestic financial market responded adequately to the changes in the policy rate of the Central Bank, and short-term market interest rates were mostly shaped around it.

Dynamics of CBA instruments and short-term market interest rates



To sum up, policy rate in the reporting period grew by 2.5 percentage points in 6 out of 8 stages and was set at 7.75% at the end of the year.

While, in line with the expectations, 12-month inflation grew in 2021, from 3.7% at the end of 2020 to 7.7% at the end of 2021, it is estimated, that as a result of the actions implemented during the year within the framework of monetary policy, 12-month inflation will gradually decrease and in the 3-year forecast horizon will approach the target 4%.

2. INFLATION IN THE PERIOD UNDER REVIEW

Inflation has accelerated since the beginning of 2021, and, as projected, inflation environment in the reporting period remained high.

The growth of inflation by the year-end was mainly conditioned by the acceleration of core inflation. Within its structure, growth of imported food and non-food products' prices resulting from the high inflationary environment in international commodity markets was significant. 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. The growth of international energy prices affected domestic fuel prices. The 12-month inflation during the reporting period was also significantly contributed by the growth in the prices of pharmaceuticals, which was almost entirely due to the high gross demand during the pandemic. 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).

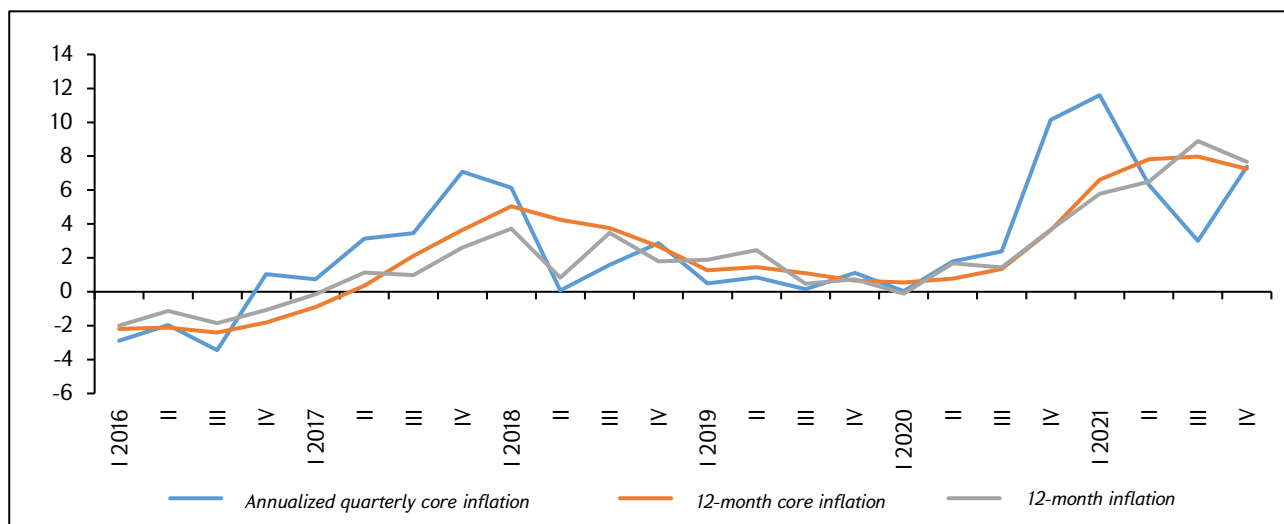
Along with the faster-than-expected recovery of demand in the Armenian economy, inflation also accelerated during the reporting period as a result of changes in the prices of domestic goods and services. To this end, the adjustment of prices for a number of services with high price rigidity (medical, hairdressing, legal, postal services) should be noted.

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 the second and third quarters of 2021. 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. In the absence of these factors, the fourth quarter saw a milder-than-expected increase in seasonal food prices, which contributed to a faster-than-expected decline in 12-month inflation at the end of the year.

During the year, tariffs for regulated services endured moderate inflationary fluctuations, with 1.1% year-over-year growth in the fourth quarter of 2021.

Significant slowdown in quarterly annualized core inflation during the reporting period was followed by some acceleration at the end of the year



Designation	Weight	12-month inflation	Contribution to y/y inflation
Core inflation	74.40	7.25	5.39
Bread and cereals	7.70	10.16	0.78
Meat	9.70	7.45	0.72
Oils and fats	2.30	14.69	0.34
Sugar	0.40	19.77	0.08
Alcoholic beverage	2.90	8.87	0.26
Tobacco	1.60	9.91	0.16
Clothing	2.50	13.03	0.33
Footwear	1.60	11.27	0.18
Household appliances	0.50	8.94	0.04
Medicines and health products	4.00	6.08	0.24
Fuel	6.00	8.05	0.48
Air passenger transportation services	0.60	-3.91	-0.02
Outpatient care services	2.90	1.60	0.05
Seasonal food products	9.60	21.93	2.11
Eggs	1.30	12.75	0.17
Fruits	3.70	1.76	0.07
Vegetables	4.70	40.05	1.88
Regulated services	16.00	1.06	0.17