

Appendix

*Approved
under the Central Bank of Armenia
Board Decision No. 200 A,
dated 26.11.2024*

STATUS REPORT ON IMPLEMENTATION OF THE MONETARY POLICY PROGRAM (Quarter 4, 2023 – Quarter 3, 2024)

In the one-year period between the fourth quarter of 2023 and the fourth quarter of 2024, the inflationary environment in the Republic of Armenia has remained low; in the first half the 12-month inflation decreased, while in the second half it increased somewhat, floating in the positive territory at the end of the period. Such inflationary developments were driven mainly by deflationary pressures transmitting from the external sector, and the monetary policy implemented by the Central Bank of Armenia.

Amid a gradual adjustment in demand, tensions in the labor market have continued to ease, including due to an increase in labor supply. The aforementioned trends were reflected in falling wages, inflation in services which have sticky prices, and inflationary expectations. In that situation, in the period under review, 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 as well the influences transmitting from the external sector, in the period under review the 12-month inflation continued to decline until February of 2024, reaching -1.7% in February, then it increased to 0.6% in September. The 12-month core inflation behaved similarly – in the period mentioned it decreased to -0.7% in February before rising to 0.7% in September.

1. MONETARY POLICY IN THE PERIOD UNDER REVIEW

According to the main judgements of the scenario presented in the MP program for the fourth quarter of 2023, in the short-term perspective, the 12-month inflation would still be persisting below the target. This would be primarily due to the deflationary effects spilling over from international markets and a certain decrease in inflationary expectations, which would be concomitant with a slowing growth rate of wages in the labor market and mitigating inflationary expectations. With the monetary policy being carried out and in view of the macroeconomic developments, the 12-month inflation would be gradually increasing in the medium term to stabilize around the 4% target.

In the period under review, in the middle of geopolitical developments and persisting uncertainties, the growth rates of economic activity and aggregate demand both in the world and the main partner countries of the Republic of Armenia continued to slow down, although demand in these countries remained strong. Meanwhile, in the second half of the period under review, weak signs of easing labor market conditions have been observable in the partner countries, especially the United States, with demand incurring some adjustment. In the period under review, global inflation continued to slow, yet prices of goods and services which have sticky prices remained relatively high in the partner countries. In terms of rising prices in international commodities market and possible supply chain disruption, the risks proved to be material due to the geopolitical challenges the Middle East has been facing since the beginning of 2024, as well as mounting tensions in international trade relations. However, in the period under review, the Armenian economy has sustained prevalently deflationary effects from the external sector.

The economic activity persisted high in Armenia in the period under review, which was driven primarily by strong growth recorded in the construction, trade, and industry sectors. Even though weakened to some extent in the third quarter of 2024, the economic activity was still above the estimated level of long-term sustainable growth. At the same time, in the context of high economic growth, there arose certain issues related to its inclusiveness and structural peculiarities. In the course of the past year, aggregate demand too remained elevated, but its structure has seen a gradual slowdown in the growth rate of external demand primarily due to the slowdown in the growth rate of tourism. Instead, domestic demand has significantly revived thanks to strong growth in private consumption, which was supported by the continued increase in incomes and the spending of previously accumulated savings. At the same time, the increase in labor supply has somewhat eased the labor market conditions, which in turn brought about certain stabilization in wages, inflation in services which have sticky prices, and inflationary expectations.

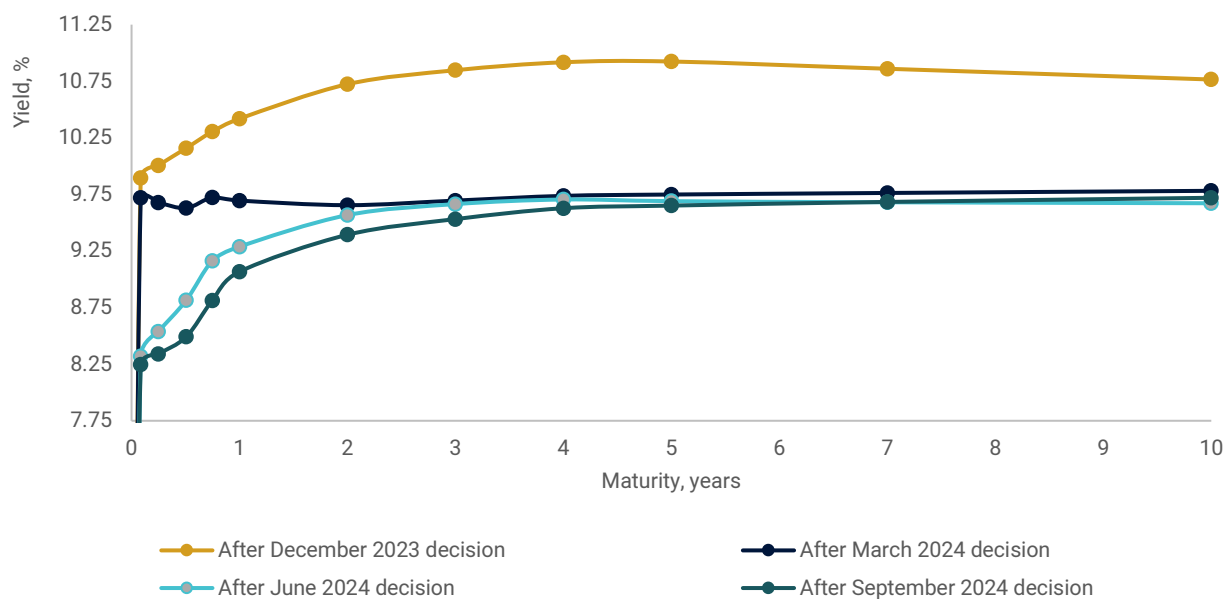
In view of the prospect that a low inflationary environment would persist in external and domestic commodity markets and the inflationary factors would phase out considerably, the Board of the Central Bank of Armenia continued reducing the policy rate by a total of 2.25 percentage points during the period under review, setting it at 7.5% in September of 2024.

In doing so, there has been a firm choice for a gradual easing of monetary conditions, given the high uncertainty about inflationary expectations and the risks of expanding domestic demand factors in the economy. Such an approach expressed the Board's consistency in an effort to further regulating demand and stabilizing inflationary expectations.

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 behavior of the yield curve was generally in line with the change in the policy rate.

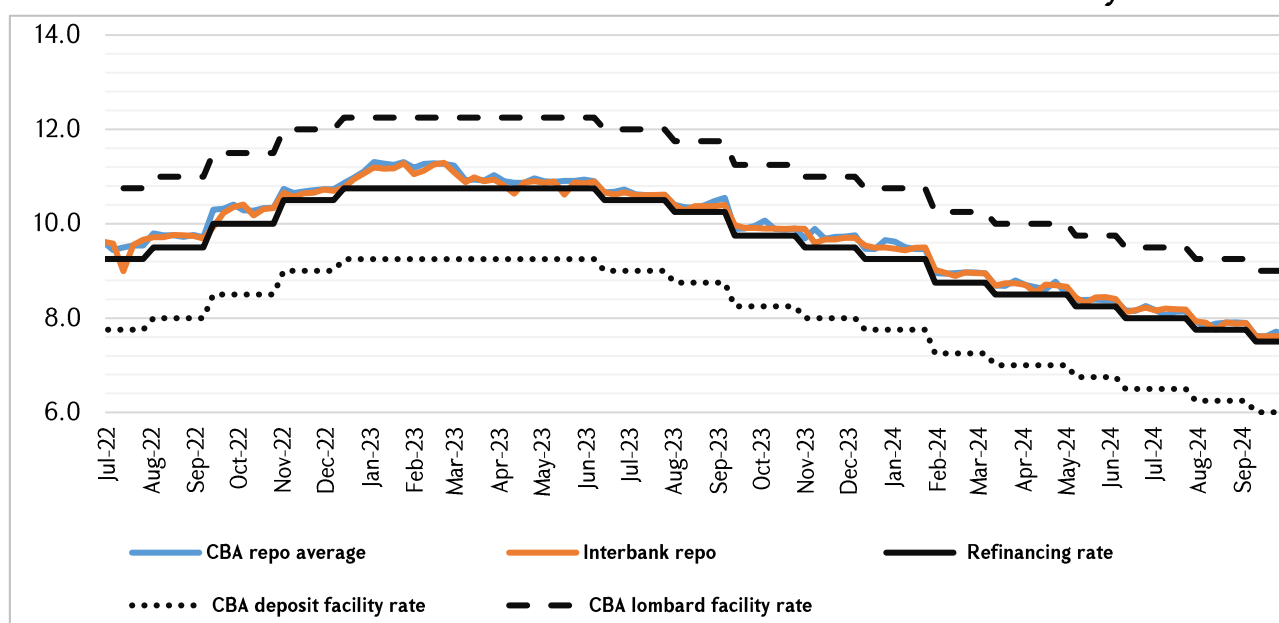
Chart 1

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



The events that took place in Artsakh at the end of September of 2023 were expressed in terms of increased volatility and uncertainty in the financial market, with the yield curve moving upward to a certain extent as well. In the first quarter of 2024, as inflationary expectations stabilized and the Central Bank of Armenia further exercised policy rate cuts, the long-term and short-term segments of the yield curve again shifted downward. In the year under review, with domestic demand staying robust, 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 the meantime, the Armenian dram continued to strengthen moderately on the back of sustained growth in export and trade-related activity as well as a decrease in the country risk premium. Under such conditions, the Central Bank of Armenia arranged a situational intervention in the financial market, with the aim to helping it function normally, mainly by way of purchasing foreign currency.

Chart 2

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

To sum up, in the period under review the Board of the Central Bank of Armenia has followed a prudent risk management approach when implementing monetary policy. In this context, the Board has deliberated a variety of scenarios; out of risks to lingering of a low inflationary environment and faster declining interest rates in comparison with market expectations, the Board pinpointed, in particular, the uncertainties related to rapid easing of domestic and external demand conditions, of labor market conditions, and the global economic outlook. Scenarios on keeping the policy rate at a level higher than market expectations were deliberated too, chiefly in consideration of uncertainties over Armenia's neutral interest rate and risk premium deriving from geopolitical developments, on the one hand, and the fiscal policy, on the other. In the period under review, for the sake of effectively balancing the aforementioned risks, the Board considered it more appropriate to gradually ease the policy stance in line with market expectations. The estimation was that as a result of such a policy, the 12-month inflation would increase in the short term and stabilize around the target 4% in the medium term.

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, the impact of the monetary policy implemented by the Central Bank of Armenia in previous years, and a certain adjustment in aggregate demand. This was evident in the subdued growth of consumer prices and core inflation.

In the early stages of the period under review, i.e. the first half of 2024, core inflation, which excludes seasonal food products and regulated services, continued to decline; it then stabilized into the positive territory, amounting to 0.7% y-o-y in September of 2024. Core inflation dynamics were shaped by price deflation stemming from imported goods (both food and non-food) and a 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 persisted over the past year, manifesting in deflationary developments for imported goods. The gradual pass-through effect of the Armenian dram's appreciation has also been pronounced, contributing to a fall in prices of imported goods, especially at the beginning of the period under review. Nevertheless, the risks and uncertainties associated with geopolitical developments in the Middle East throughout 2024 brought in additional price volatility and exerted inflationary pressures on the global energy market, affecting fuel prices.

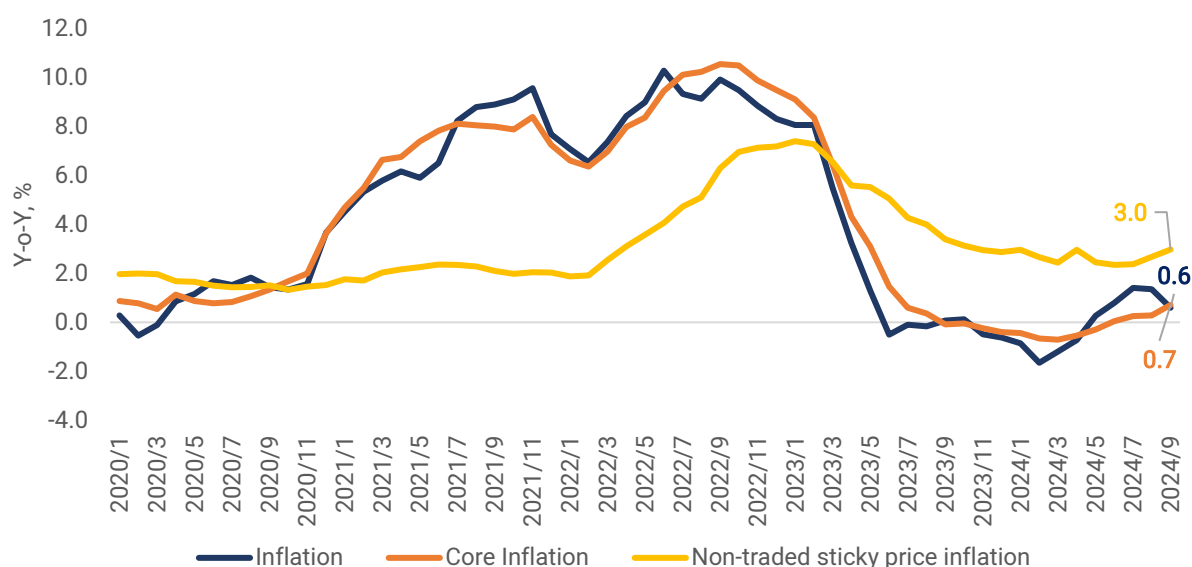
Throughout the past one-year period, domestic inflationary pressures have eased significantly, determined by a decline in external demand from international visitors. In this context, the prices in several services sectors with relatively sticky prices (rent, restaurants and hotels, hairdressing, medical, financial, postal services) have been somewhat adjusted and displayed gradual stabilization trends (see Chart 3).

At the same time, in the period under review, amid high incomes, accumulated savings, and increasing consumer lending, the domestic demand conditions remain elevated, contributing to the persistent inflationary environment in general services sector as well as in non-tradable services with sticky prices.

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.

Chart 3

In the period under review, deflationary spillovers from the external sector contributed to maintaining a low level of consumer prices and core inflation



As for the patterns observed in seasonal food product prices (especially in the *Fruit* product group), the “traditional” seasonality has somewhat softened in the course of 2024, driven by the impact of greenhouse farm activities and deflationary trends observed in imported goods within this group.

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: September 2024	Contribution to y/y inflation
Core inflation	75.4	0.70	0.7
Bread and cereals	8.9	-1.1	-0.1
Meat	10.6	-1.4	-0.2
Oils and fats	2.9	-1.7	-0.1
Sugar	0.5	7.4	0.1
Dairy products	4.6	-3.2	-0.2
Alcoholic beverage	2.0	7.2	0.2
Tobacco products	2.3	1.3	0.0
Clothing	2.1	-4.1	-0.1
Footwear	1.2	-2.4	0.0
Household appliances	0.6	3.1	0.0
Fuel	4.5	0.3	0.0
Air passenger transportation services	2.2	25.0	0.7
Outpatient care services	2.3	2.4	0.1
Actual rent paid by the tenant for additional accommodation	2.0	4.4	0.0
Restaurants and hotels	2.1	2.7	0.1
Fees for services by banks, post offices	0.7	1.8	0.0
Seasonal food products	10.3	-1.8	-0.2
Eggs	1.3	7.8	0.1
Fruits	3.5	1.0	0.0
Vegetables	5.5	-4.3	-0.3
Regulated services	14.3	1.4	0.3
Other product and service groups			
Imported food products	15.5	0.5	0.1
Non-regulated services	19.3	5.3	1.35

Table 2

Product/item	12-month inflation: as of December 2023	12-month inflation: as of March 2024	12-month inflation: as of June 2024	12-month inflation: as of September 2024
Core inflation	-0.4	-0.7	0.0	0.7
Bread and cereals	-8.7	-6.8	-1.8	-1.1
Meat	-1.0	-1.7	-2.5	-1.4
Oils and fats	-20.6	-16.5	-9.8	-1.7
Sugar	-6.1	-4.6	-5.6	7.4
Dairy products	-2.9	-3.8	-3.2	-3.2
Alcoholic beverage	5.9	7.1	7.4	7.2
Tobacco products	11.5	8.2	2.3	1.3
Clothing	-0.1	0.2	-3.1	-4.1
Footwear	5.1	2.9	0.2	-2.3
Household appliances	4.4	3.4	3.3	3.1
Fuel	2.4	5.4	7.3	0.3
Air passenger transportation services	25.1	18.6	18.2	25.0
Outpatient care services	6.0	0.9	2.2	2.4
Actual rent paid by the tenant for additional accommodation	4.5	4.2	2.0	4.4
Restaurants and hotels	4.0	3.8	3.2	2.7
Fees for services by banks, post offices	10.3	7.7	1.8	1.8
Seasonal food products	-2.9	-7.0	5.1	-1.8
Eggs	-0.2	3.5	7.6	8.0
Fruits	0.7	-2.7	6.3	1.0
Vegetables	-6.6	-13.8	7.0	-4.3
Regulated services	0.0	1.2	1.6	1.4
Other product and service groups				
Imported food products	-7.9	-6.3	-2.0	0.5
Non-regulated services	5.6	3.6	3.6	5.3