

CODE

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January 19, 2021, 1-N

**APPROVING THE SIZE OF BANKS' COUNTERCYCLICAL CAPITAL BUFFER
(Q IV, 2020)**

With the view to ensuring financial system resilience;

Pursuant to Article 2.3 and Article 20 (e) of the Republic of Armenia law “On Central Bank of the Republic of Armenia”, Article 54.1 (1) of the Republic of Armenia law “On Banks and Banking” and “Procedure on Setting and Calculation of Buffers Above Capital Adequacy Threshold for Banks” approved by the Republic of Armenia Central Bank Board Resolution No 16, dated February 4, 2019;

Republic of Armenia Central Bank Board, herewith

Resolves:

1. Set the countercyclical buffer of banks' capital at 0% of risk-weighted assets;
2. This Resolution shall enter into force on the day following its promulgation.

**Republic of Armenia
Central Bank Governor**

January 21, 2021

Yerevan

Martin Galstyan

RATIONALE

COUNTERCYCLICAL CAPITAL BUFFER (Q IV, 2020)

At the meeting of January 19, 2021, the Board of the Central Bank decided to set banks' countercyclical capital buffer at 0% of risk-weighted assets.

Pursuant to paragraph 12 of [“Procedure on Setting and Calculation of Buffers Above Capital Adequacy Threshold for Banks”](#), the Central Bank of the Republic of Armenia shall set the countercyclical capital buffer (hereinafter, CCyB) on a quarterly basis. When setting the CCyB, the Central Bank shall be guided by the provisions of the document "[General Methodology Underlying Setting of the Countercyclical Capital Buffer](#)", according to which, the Central Bank of the Republic of Armenia shall set the size of the CCyB based on credit to GDP ratio gap assessed by Basel methodology, the financial cycle index describing the systemic risk developments and other early warning indicators.

When making the decision on the countercyclical capital buffer, the Central Bank of the Republic of Armenia was guided by a comprehensive analysis of the following facts:

1. Private sector credit to GDP ratio in the third quarter of 2020, amounted to 74.2%¹. The gap calculated for this indicator (credit to GDP difference from its long-term trend) was 7.5 percentage points, which, on other equal terms, implies the application of a positive CCyB rate². However, such a large gap was conditioned not by the excessive growth in lending, but by a significant decline in economic activity. It is expected, that lending trends will adjust to reflect the current economic situation, which will lead to a gradual reduction of the positive credit to GDP gap. Therefore, in the current situation, this indicator cannot be reliable indicator for the application of the positive CCyB rate. Given the above, it should be noted that when making a decision on the CCyB, the Central Bank is also guided by other early warning indicators describing the systemic risk such as changes in stock and flow indicators of lending, indicators representing given, the financial cycle index (FCI), etc.
2. During the third quarter of 2020, the financial cycle index continued its downward trend, which indicates that due to the existing uncertainties, the risk appetite of financial system participants decreased, and strongly conservative behavior prevailed in the credit market.

¹ The share in GDP of the credit portfolio (including leasing and factoring) provided to the economy by the financial sector (in %).

² According to the Basel Committee methodology, it is proposed to use the 2 percentage point credit/GDP gap as a starting point for setting a positive CCyB.

3. In the third quarter of 2020, the downward trends in lending growth continued, which intensified in the fourth quarter 2020^թ, due to the increase in risks and uncertainties as a result of the military conflict that began on September 27. Declining trends were observed in all lending directions, which were especially significant in consumer and mortgage lending. , Compared to the same periods of the previous year, a tendency of decreasing prices was evident the real estate market too.
4. Because of the economic downturn and private sector income reduction during the year, the volumes of funds attracted by the financial system have also decreased. These funds serve as the main source for financing the lending process to the economy, so their decrease may lead to the prevailing of declining trends in the lending market.
5. As a result of the comprehensive analysis of the existing uncertainties, as well as the indicators describing the developments in the credit market, the Central Bank considers it possible that slowdown of lending rates in the coming periods will continue in the near future as well.

Aiming to mitigate the possible negative effects on the financial system due to the spread of the coronavirus and martial law, as well as to contribute to maintaining the continuity of the process of leveraging the Armenian economy, **the Central Bank finds it feasible to leave the rate of the countercyclical capital buffer unchanged at 0%.**