

CENTRAL BANK OF THE REPUBLIC OF ARMENIA

FINANCIAL STABILITY REPORT

2016

First half

2016

This Financial Stability Report presents an assessment of potential risks that could threaten the stability of financial system of the Republic of Armenia as well as the capacity of the financial system to absorb such risks.

More detailed information on Armenia's macroeconomic environment and financial system analyses is available in the Central Bank's periodicals, such as Status Report on Monetary Policy Implementation and Armenian Financial System: Development, Regulation, and Supervision.

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Financial stability can be characterized as the concurrence of financial and macroeconomic conditions at a time when the financial system, i.e. financial institutions, markets and market infrastructures, is capable of withstanding probable shocks and instability, minimizing the probability of interruption of intermediation function.

In defining financial stability, it is taken into consideration that financial instability can emerge as a result of the interruption of internal functions of the financial system, as well as unfavorable developments in domestic and world economies, credit risk issues connected with major borrowers and lenders, shifts in economic policies and infrastructures.

Maintaining financial stability involves efforts to identify main risk sources, poorly-managed financial risks, ineffective asset pricing and, finally, implementation of the policy as appropriate.

PREFACE

The Financial Stability Report of the Central Bank of the Republic of Armenia is prepared on a semiannual basis. It contains a broad assessment of risks that could threaten the stability of the financial system as well as the capacity of the financial system to withstand such risks. Through publishing information concerning a variety of reviews on financial stability, the Central Bank seeks to bring interested parties' attention to those risks and events that could undermine the financial stability of the Republic of Armenia as well as provide an opportunity to debate on how to minimize such risks.

The Central Bank is tasked with maintaining the stability and functionality of the financial system of Armenia. The Central Bank's statutory responsibility for the country's financial stability is directly related to its primary goal of price stability. Disruptions in the financial sector may create impediments to effective implementation of monetary policy and long-term and stable economic growth. At the same time, monetary and macroeconomic stability contributes to the minimization of risks threatening financial stability. The financial sector plays an important role in the overall economic system, and the financial sector needs to maintain continuity and sustainability of processes to contribute to the normal growth of the entire economy.

The Central Bank carries out an ongoing monitoring and analysis of financial stability for early disclosure of any changes and variations that could threaten financial stability. The report refers to the risks revealed in the macro-environment and the financial sector and their influence on the developments in all sectors of the economy and financial system.

Risks affecting the financial stability of Armenia can emerge in the domestic economy, external economy and the financial sector itself. In this sense, the main preconditions for financial stability are:

- favorable developments in the global economy and international financial markets,
- sound domestic macroeconomic environment whereby households and companies are creditworthy enough,
- effective financial system with risks that are prudent and manageable,
- financial infrastructures with operational continuity to the benefit of the financial system functioning.

Based on the abovementioned facts, risks that can potentially undermine financial stability of Armenia are presented in this report as follows:

- risks derived from developments in the global economy,
- risks derived from developments in the macroeconomic environment of Armenia,
- risks derived from developments in the financial market of Armenia,
- risks derived from financial institutions of Armenia,
- risks derived from financial infrastructures of Armenia.

The report addresses the risks revealed in those areas and measures their possible impact on the developments in the overall economy and all parts of the financial sector. The report mainly focuses on the risks to the banking sector and development trends:

assets of commercial banks account for almost 90 percent of entire financial system assets. Therefore, the banking sector stance mainly determines overall financial stability and development trends.

ABSTRACT

In the first half of 2016, the financial system of Armenia was adversely affected by a number of materialized risks. However, the economic indices signal some pick-up in momentum.

The persistent low level of global economic growth may boost the likelihood of further materialization of risks.

Monetary authorities kept implementing accommodative policies to stimulate economic growth. The prospect of rising interest rates is believed to impose risks on the global economy.

The banking capital grew, creating an additional cushion to absorb risks.

In the first half of 2016, the financial system of Armenia was adversely affected by a number of risks coming from the previous year. Owing to the actions taken by the Central Bank, the stability of the financial markets was maintained, as well as some growth in lending and attracting deposits was observed.

In the first half of 2016, the decline in the international prices of base metals, domestic consumption, as well as foreign investment was maintained. Given the geopolitical developments, Russia faced an economic downturn, which, in turn, negatively affected the inflow of private remittances to Armenia and the export to Russia.

The recovery of global economic growth was slower than assessed before. The geopolitical disputes resulted in a decline in world trade volumes and lower prices for some commodities.

The monetary authorities of both developing and developed countries carried out expansionary monetary policy to support economic growth. During the year, monetary policy interest rates remained low. In the emerging countries, the capital outflow continued in parallel with the domestic currency depreciations.

The economic developments in Armenia's main trade partners, some countries of the European Union and Russia have been unfavorable, and their negative impact on the domestic economy still persists (for details, please see the box "Economic developments in Russian Federation" and the section "Developments in the global economy").

In the first quarter of 2016 economic growth was 4.4% in Armenia. However, the overall growth rate for the first half of the year was only 2.8% (3.0% in 2015) due to sluggish growth in the second quarter. The main contributor to the growth was the higher-than-forecasted growth in manufacturing (for details, please see the section "Macroeconomic environment developments in Armenia").

Given the recent deflationary environment, the Central Bank significantly weakened the monetary conditions, which extenuated the downward impact of the private consumption and the private investment.

In an environment depicted with persistent risks associated with slow economic and aggregate real disposable income growth, the profitability indicators of the banking sector declined. At the same time, the commercial banks managed to increase their loan and deposit portfolios and improve their capital adequacy and liquidity. These developments were mainly due to the capital replenishments as the banks were required to comply with the new minimum total capital threshold. No additional significant risks to the financial system were observed: they remained manageable and did not entail any financial stability issues (for details please see the sections "Stability of financial institutions" and "Stability of financial market infrastructures").

1. DEVELOPMENTS IN THE GLOBAL ECONOMY¹

1.1. MACROECONOMIC ENVIRONMENT

The prospects of global economic growth have weakened. The economies of developing and emerging countries faced a number of headwinds, such as lackluster economic growth of developed countries, low commodity prices, as well as sluggish recovery of global trade and weak capital flows. The economic features of commodity-exporting and importing countries differed considerably. The economic conditions of commodity and oil-exporting countries remain challenging, where measures are being taken to adjust the economy to the reality of depressed prices. The oil and commodity-importer countries are in a more favourable position. Still the negative impact of low prices on commodity- and oil-exporting countries overpasses its positive effect on the importers.

Though some acceleration of global growth is estimated in the coming years, the downside risks will be maintained. These risks include:

- *softer-than-expected economic recovery in developed countries,*
- *capital outflows from emerging markets and the ensuing financial market volatility,*
- *the probable decline of global demand caused by the structural transformation process of Chinese economy,*
- *the economic problems and ongoing slow growth in developed countries and Russia,*
- *as well as geopolitical issues worldwide.*

Economic growth remained subdued during the half of the year with highlighted downside risks. Meanwhile, the recovery in financial markets and fuel and energy resources endured transmitting optimistic impulses to the world economy.

A number of issues outlined earlier this year materialized during the first half, among which are slower-than-expected economic recovery in developed countries, heightened geopolitical uncertainties, low effectiveness of monetary policies, and reluctance of policy makers to switch to expansionary fiscal policy.

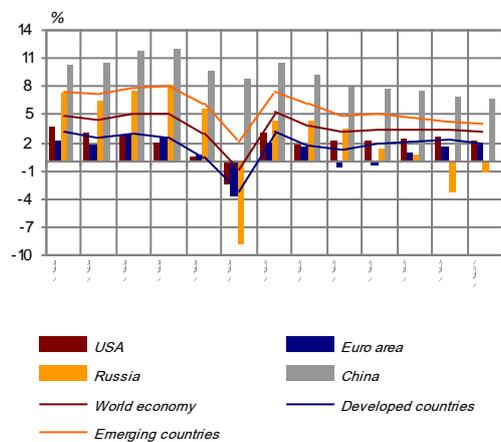
The global economy will undergo a slow pace of growth in 2016. Moreover, both in developed and developing countries no significant changes in economic growth rates relative to the previous year will be recorded. The global economic growth is currently estimated at 3.1%, according to the IMF (3.1% in 2015).

During the first half of the year economic growth rate did not accelerate in developing and emerging countries, while a continuous frail recovery pace of economic growth was recorded in developed countries.

Economic growth for 2016 in advanced economies is now forecast at 1.8%, down 0.1 pp. from the previous year's indicator.

The risks hindering economic growth in the previous year persisted.

Regional economic growth rates



^{*} Indicators marked by asterisk in this chart and the ones following thereafter are the IMF estimates (April 2016).

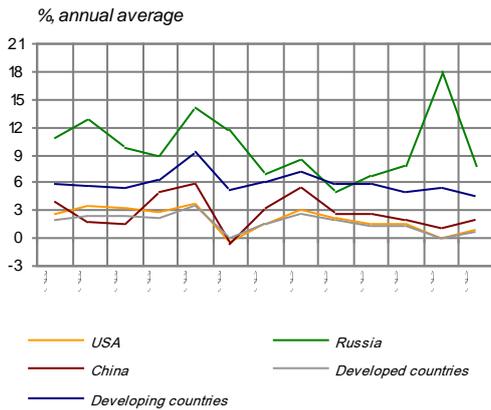
Source: IMF.

¹ International developments and predictions were based on information taken from the IMF, World Bank, Economist Intelligence unit, Financial times, Bloomberg, RBC, the Institute of International Finance and other sources.

In developing countries the economic growth will slightly accelerate and stand at 4.1% as opposed to 4.0% of the previous year².

In the context of the current economic activity and price changes in commodity markets, a low inflationary environment was maintained in the global economy. Consequently, the IMF has estimated the inflation 0.7% in advanced countries and 4.6% in developing countries. Moreover, no inflationary pressures are expected to occur in the following year.

Inflation in selected countries



Source: IMF.

IMF Overview of the world economic growth projections, 2014-2016, in percent

Indicator (economic growth)	2014 forecasts as of 31.10.2014	2014 assessments as of 31.01.2015	2015 forecasts as of 31.01.2015	2014 assessments as of 30.04.2015	2015 forecasts as of 30.04.2015	2014 assessments as of 31.07.2015	2015 forecasts as of 31.07.2015	2014 assessments as of 31.10.2015	2015 forecasts as of 31.10.2015	2015 assessments as of 15.04.2016	2016 forecasts as of 16.07.2016
World economy	3.3	3.3	3.5	3.4	3.5	3.4	3.3	3.4	3.1	3.1	3.1
Developed countries	1.8	1.8	2.4	1.8	2.4	1.8	2.1	1.8	2.0	1.9	1.8
USA	2.2	2.4	3.6	2.4	3.1	2.4	2.5	2.4	2.6	2.4	2.2
Euro area	0.8	0.8	1.2	0.9	1.5	0.8	1.5	0.9	1.5	1.7	1.6
Developing countries	4.4	4.4	4.3	4.6	4.3	4.6	4.2	4.6	4.0	4.0	4.1
CIS	0.8	0.9	-1.4	1.0	-2.6	1.0	-2.2	1.0	-2.7	-2.8	-0.6
Russia	0.2	0.6	-3.0	0.6	-3.8	0.6	-3.4	0.6	-3.8	-3.7	-1.2
China	7.4	7.4	6.8	7.4	6.8	7.4	6.8	7.3	6.8	6.9	6.6

Economic growth projections remained unchanged during the first half of the year.

In the first half of the year, the investments stood on a lower level, parallel to weak economic growth in developed countries. Moreover, the inflation stood below the inflation target mainly due to lower prices of basic commodities.

Economic growth in US was lower-than-expected in the first half of the year. The low level of oil prices affected negatively the energy sector, while stable dollar and subdued demand of developing countries reduced the export. On the other hand, the growth of real disposable income along with positive developments in the labour market stimulated private consumption. The latter had the largest contribution to the economic growth. Apparently, the current level of the US economic growth will continue in the coming years, with reduction of the debt burden of households, increase in revenue, expected positive developments in the labour market, stabilization of the real estate market, as well as accommodative fiscal policy being the main contributors.

According to the IMF estimates, a 2.2% economic growth will be recorded in the US in 2016, as opposed to 2.4% last year.

² All the forecasts and assessments of IMF were taken from "World Economic Outlook update, July 2016"

In the European countries a recovery in economic growth was recorded in the first half of 2016. Economic growth was higher-than-expected in the first quarter mainly due to high domestic demand. Although the fundamentals predicted further improvement in economic growth, the UK's decision in favour of leaving the EU in June³ has caused significant ambiguity regarding the future economic developments.

The low raw material prices and some recovery in the credit market due to the unprecedented volume of the ECB's quantitative easing actions contributed to the recovery of economic growth. Economic growth was hampered by weak investment climate, low external demand and a number of geopolitically driven uncertainties.

The stable recovery of domestic demand, the positive developments in the labour market, the quantitative easing, as well as lower oil prices and easy monetary conditions are expected to support further economic activity of the euro area. Meanwhile, these positive factors may be offset by weaker investment prospects, due to low economic growth of emerging markets – the main partner countries of the euro area.

The IMF estimates economic growth in the euro area to be 1.6% for 2016 as compared to 1.7% in the previous year.

In 2016, growth in emerging markets and developing economies—while still accounting for over 70 percent of global growth—continued to decline, and no significant recovery is expected for the future.

The main reasons of slowing economic growth rates in emerging countries are economic slowdown in China, due to low domestic demand and a weak investment climate, as well as low prices of stock commodities and strict financial conditions (especially in Latin America and oil-producing countries), geopolitically driven economic difficulties (especially in the CIS, Middle East and North African countries). The economic slowdown in developing countries will persist in the near-term, fuelled by low prices of exported products, monetary policy tightening trends worldwide, weak export, as well as inevitability of economic reforms.

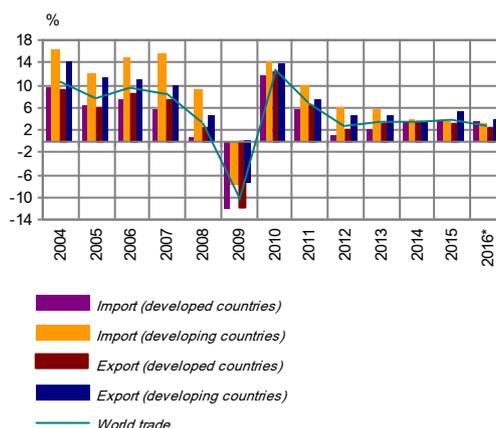
The Chinese government pursued its efforts in navigating the economic momentum by transitioning toward private-consumption rather than state-investment economy. In fact, the development prospects of world economy and especially China in the coming years depend on the success of the course of this policy.

Economic growth in China is estimated at 6.6% in 2016, which is lower from the previous year's indicator by 0.3 pp. and is the lowest since the global financial crisis.

³ On June 23 2016, a referendum to leave or to stay within the EU took place in the UK, which resulted in an overall vote to leave the EU, by 51.9%. The referendum was followed by abrupt fluctuations in the financial markets and the UK's national currency depreciated sharply. The latter lost its AAA rating. A month later, however, the international financial situation calmed down and the major indexes returned to the pre-Brexit level. Overall, Brexit increased the economic uncertainties around the world, and according to estimates it will have negative contribution to economic growth of both the European Union and the Great Britain.

Slow economic growth rates persisted in emerging markets.

Annual growth rate of world trade

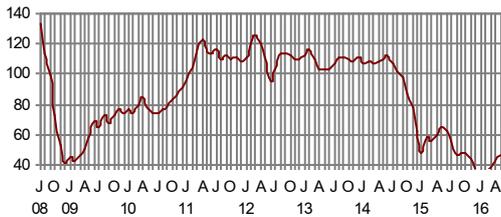


Source: IMF.

The decline in world trade volumes was conditioned by slow economic growth in key developed and developing countries.

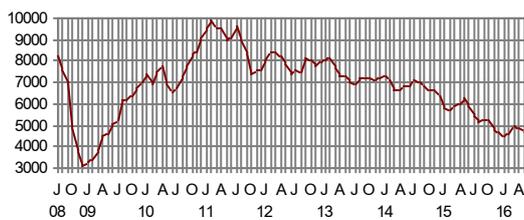
Low-level prices were maintained in the commodity markets.

Brent oil prices
(USD per barrel)

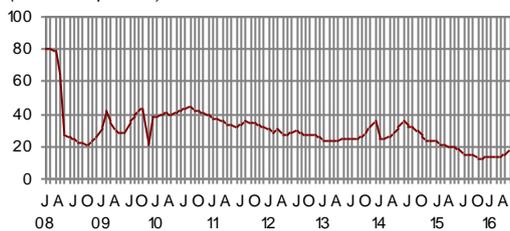


The fluctuations of prices of base metals were largely in line with economic and political developments.

Copper prices
(USD per ton)

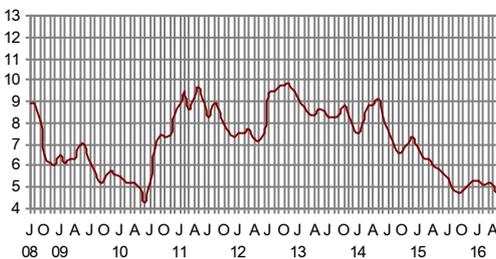


Molybdenum prices
(1000 USD per ton)

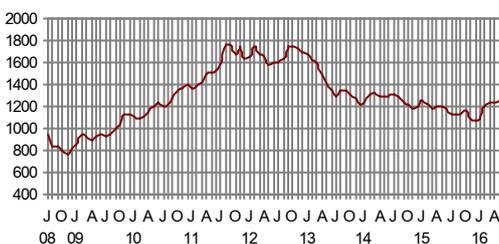


Wheat prices recorded a decline as compared to the same period of the previous year.

Wheat prices
(USD per bushel)



Gold prices
(USD per troy oz)



Source: Bloomberg Data Warehouse.

The IMF revised its growth project for the economic growth of developing countries to 4.1% in 2016 from 4.0% in the previous year.

The world trade volumes were the lowest in 2015 since the global financial crisis. No significant growth of world trade has been recorded in 2016, either. The world trade slowdown was mainly driven by weak economic growth and a shift from an export-oriented economic model to one driven by domestic demand in China, which accounts for more than 10.0% of the world trade. At the same time, the ongoing conflicts between Russia and the EU considerably hindered the expansion of trade volumes (for details, please see the box “Economic developments in Russian Federation”). Given the IMF data, the annual growth rate of world trade will stand at 2.7% in 2016 from 2.6% of the previous year.

In the first half of 2016, the low level of the international prices of main commodities was maintained, conditioned by worldwide trends and distinctive developments in certain commodity markets.

Brent crude oil average semiannual price was USD 40.3 a barrel, maintaining the declining trend of the previous year. Compared to the same period of the previous year, the price drop made 30.6%. Though the oil prices rose slightly starting from the beginning of the year, they remain on a low level with main contributing factors such as the significant increase in the volume of world oil supply and reserves.

The main factors hindering the future sharp rise of oil prices are the outlook of continuing huge supply and low demand due to China’s sluggish economic growth.

In the first half of 2016, the declining trend of copper and molybdenum prices persisted; the average semiannual price of copper declined by 20.7% as compared to the same period of the previous year to 4698.8 US dollars/tonne. The average semiannual price of molybdenum dropped by 24.4% YoY to 15.3 thousand US dollars/tonne compared to the same period of the previous year.

International stock prices of base metals, ceteris paribus, will remain subject to development trends of emerging market economies, in the short-term. No significant growth of prices will be recorded.

International wheat prices have assumed a declining trend during the half of the year. The average semiannual price was 5.3 US dollars per bushel in the first half of 2016, declining by 10.7% as compared to the same period of the previous year. In the short term, expectations for wheat prices are on a downward trend, conditioned by an oversupply, though a stabilization of prices is expected in the medium term.

The average semiannual gold price amounted to USD 1220.5 per troy ounce in the first half of 2016, increasing by 1.2% against the previous year. No significant change in gold prices is assumed in the short term, owing to expected recovery rate of the global economy.

Economic developments in the Russian Federation

In the first half of 2016, a slowing pace of economic downturn was recorded in Russia. The main reasons for slowing downturn were positive developments in processing and agricultural sector. The negative impact of low oil prices on economic growth was maintained, while the sanctions limited the entry to foreign financial markets. The main contributors to the ongoing recession (though with lower pace) are low energy prices, the current geopolitical stance and sanctions¹, as well as capital outflows and volatility of the national currency.

A non-competitive business environment and weak development of infrastructures remain major impediments to the Russian economic growth. Nonetheless, in the midst of increasing oil prices expectations in the near term, the Russian economic growth may return to positive territory.

According to the Russian Federal State Statistics Service data, a 0.9% economic downturn was recorded in the first half of 2016, compared to 3.8% fall in the same period of 2015². Processing, construction, investment, as well as households' real disposable income indicators have had negative input to economic growth, while agriculture contributed positively.

The highest rates of semiannual deteriorations were recorded in exploitation of residential buildings (by 7.4%) and retail trade turnover (by 5.3%). Significant reductions were detected in capital investment and construction sector, 6.9% and 5.2%, respectively. The main factors hindering investment were the decline in consumer demand in midst of fall in households' disposable income, as well as limited financial resources. The ongoing low-level of oil prices and the foreign economic uncertainties aggravated the existing problems.

According to the Russian Federal State Statistics Service data, exports in January-July amounted to USD 127.7 billion, representing a YoY 29.7% decrease in relation to the same period of 2015.

Imports amounted to USD 83.6 billion, declining by 9.5% YoY. Thus, the trade balance surplus amounted to USD 44.1 billion, deteriorating by 50.6% as compared to the same period of the previous year.

As of July 2016, the 12-month inflation was 0.5%, 0.1 pp. more than reported last year. According to the preliminary data provided by the Russian Ministry of Economic Development, the unemployment rate remains low, which, ignoring the seasonal factor, is an estimated 5.6%.

In the first half of 2016, the Russian currency strengthened as compared to the previous half of the year, on account of some growth of international oil prices and relatively strict monetary policy by the Russian Central Bank. The real appreciation of the ruble against the US dollar amounted to 8.15%, against the euro to 6.2%. The international foreign currency reserves of Russia increased during the reporting half of the year to USD 392,8 billion.

The Central Bank of Russia has altered the refinancing rate once during the half of the year, reducing it by 0.5 pp. to a 10.5% rate. It is noteworthy, that the Central Bank of Russia has used foreign currency repo tool in order to keep the smooth functioning of the banking sector. During the half of the year, however, the demand for such operations has reduced.

During the first half of 2016, loans to non-financial corporations and households by the Russian banking sector have fallen by 5.0% (if not counting the exchange rate factor, 1.6%). At the same time, the share of non-performing loans in total loans to non-financial corporations sector was 6.8%, while non-performing consumer loans were 8.5%.

¹ As for geopolitical tensions associated with Ukraine, starting from March 2014, the United States and the European Union launched series of trading and economic sanctions against Russia. This has negatively affected the capital flows, foreign investment and domestic economic growth overall. The announced sanctions apply to the financial, energy and military manufacturing sectors. In particular, restrictions were imposed on ammunition, some articles of dual-use purpose, as well as on export of a number of oil manufacturing equipment and technology to Russia. Any financial assistance that would be for trading of items included in the list of restrictions has been prohibited. Furthermore, restrictions were imposed on individual companies and organizations active in financial, defense and fuel/energy sectors, with the main stipulation that transactions with financial instruments with 30-day and more maturity issued after September 12, 2014 is prohibited.

² Information on the Russian economic developments, as well as estimates and projections are taken from the periodical "О текущей ситуации в экономике Российской Федерации по итогам января-июля 2016 года" ("About the current economic stance of the Russian Federation in January-July 2016) issued by the Russian Ministry of Economic Development.

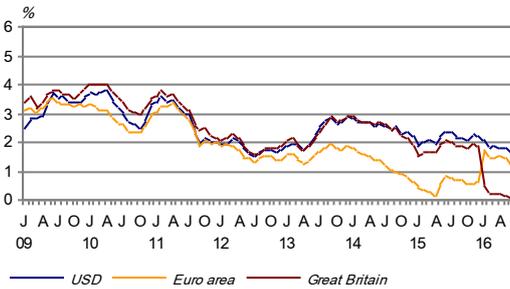
[http://economy.gov.ru/wps/wcm/connect/12777398-a399-40e6-8a87-e1962531a13d-%D0%9C%D0%BE%D0%BD%D0%B8%D1%82%D0%BE%D1%80%D0%B8%D0%BD%D0%B3+%D1%8F%D0%BD%D0%B2%D0%B0%D1%80%D1%8C-%D0%B8%D1%8E%D0%BB%D1%8C+2016.pdf?MOD=AJPERES&CACHEID=12777398-a399-40e6-8a87-e1962531a13d](http://economy.gov.ru/wps/wcm/connect/12777398-a399-40e6-8a87-e1962531a13d/%D0%9C%D0%BE%D0%BD%D0%B8%D1%82%D0%BE%D1%80%D0%B8%D0%BD%D0%B3+%D1%8F%D0%BD%D0%B2%D0%B0%D1%80%D1%8C-%D0%B8%D1%8E%D0%BB%D1%8C+2016.pdf?MOD=AJPERES&CACHEID=12777398-a399-40e6-8a87-e1962531a13d)

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1.2. INTERNATIONAL FINANCIAL MARKETS

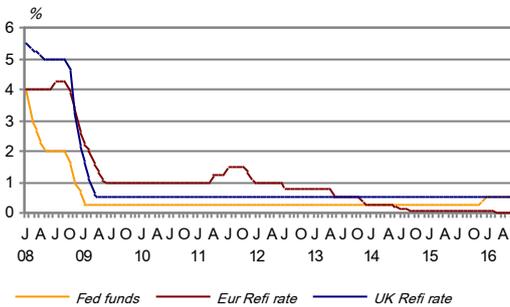
The yields of government bonds declined in both the US and the EU.

10-year government bond yield



Central banks of key developed and emerging countries carried on accommodative monetary policy.

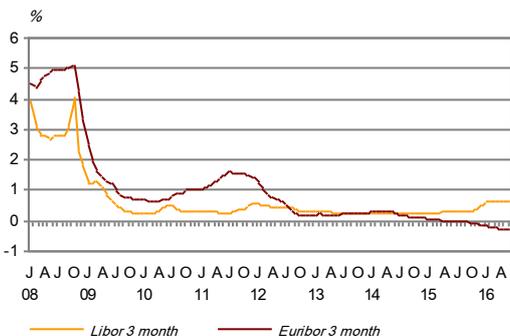
Interest rate policies of Central banks



Source: Bloomberg Data Warehouse.

The Fed did not increase the benchmark interest rates during the half of the year.

Interbank interest rates



Source: Bloomberg Data Warehouse.

During the first half of 2016, no significant fluctuations in international financial markets were observed: except for sharp ups and downs following Brexit, which, however, practically levelled up during the first following month. The main set of risks remained unchanged.

A number of countries worldwide continued to implement accommodative monetary policy in order to stimulate global economic growth. Furthermore, starting from the last yearend the US Federal Reserve did not increase the rates during the first half of the year.

Capital outflows from emerging countries continued leading to national currency depreciations.

In the first half of 2016, the long-term government bond yields both in the US and the EU decreased, owing to the quantitative easing program of the euro area and the delay of further interest rate increase in the United States. The loan market stance was favourable for the real sector borrowers: some improvement in lending conditions and higher demand for credit by households and companies were recorded. It is noteworthy, that the euro area interest rates to attract credit resources were on the low historical levels, while commercial banks' solvency was higher than in 2012.

In the first half of 2016, given the instable growth of global economy and the new economic challenges, the key developed countries carried on with a low interest rate policy.

The ECB continued to conduct its asset purchase program with a monthly volume of 60 billion euros in the first quarter of 2016. In March 2016, the ECB lowered the refinancing rate from 0.5% to 0.0% and increased the amount of its monthly asset purchases up to 80 billion euros⁴.

The Bank of England kept monetary policy rate at a low level, the revision of which would not only depend on the rate of unemployment but also on changes of a number of economic activity indicators, as the Bank had announced.

In December 2015, the US Fed hiked its benchmark interest rates for the first time since the global financial crisis to its new target between 0.25 percent and 0.50 percent. The competent authorities have emphasized the gradual adjustment and solely under the conditions of sustainable economic growth. In the first half of 2016, no further rise of interest rates was recorded, mainly due to weak growth of Chinese economy and worse-than-expected positive developments of the US labour market. Market participants expect further hikes of rates no sooner than in December of the current year, moreover, during the following 3 years the rate will grow by 1.0 pp. according to the expectations.

Given the capital inflows to the US due to the rate growth prospects and low prices of commodities, a number of developing countries have seen substantial capital outflows, which resulted in a low level of investments and slow economic growth.

During the reporting period, major currencies assumed volatile trends. The U.S. dollar has slightly depreciated versus the euro,

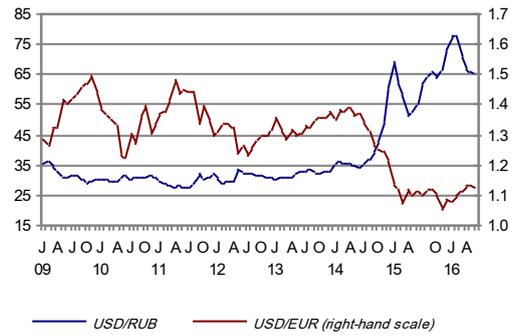
⁴ The ECB intends to carry out this project until March 2017. <https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html>

driven by both expectations and the economic policies conducted by the United States and the European countries.

The depreciation trend of currencies of emerging markets, which started in 2013, has changed its direction to appreciation during the half of the year. The latter, however, is difficult to explain by domestic economic trends, as the economic developments cannot be considered as positive during the first half. The currency appreciation patterns were attributable to the delay of the gradual increase of the Fed's policy rates. The currency patterns will be conditioned by the Fed's policy and domestic developments across countries, such as need for external financing, domestic monetary policy, political stability, price patterns of commodities and sensitivity against the fluctuations of the US dollar.

Low base rates and global economic imbalances determined the maintenance of low-level interbank interest rates.

Dynamics of USD exchange rate versus RUB and EUR



Source: Bloomberg Data Warehouse.

SUMMARY

The global economy continued recovering in the first half of 2016, though slower-than-expected because of the materialization of the downward risks.

In developed countries, including the USA, issues like sluggish pace of economic growth, low inflation and risks of financial system remain on the agenda. Under such conditions, developed countries kept on implementing a low interest rate policy. Though the US changed the direction of its policy rates at the end of the previous year, it did not increase the rates during this half of the year.

Developing countries encountered capital outflows amidst low economic growth. At the same time, the private debt burden volumes have been risky from the financial stability viewpoint. Apart from the economic risks hampering growth in emerging markets, geopolitical risks associated with the crisis in Ukraine, as well as relations between Russia and the West got a particular emphasis.

Russia's economic recession, the depreciation of the Russian ruble and the decline in private consumption considerably decelerated the inflow of non-commercial remittances from this country and the export to Russia.

Uneven world economic growth, low level of emerging market countries' economic activity and current economic challenges in Russia negatively affected Armenia's investment environment, economic growth and private transfers.

2. MACROECONOMIC ENVIRONMENT IN ARMENIA

2.1. MACROECONOMIC DEVELOPMENTS ⁵

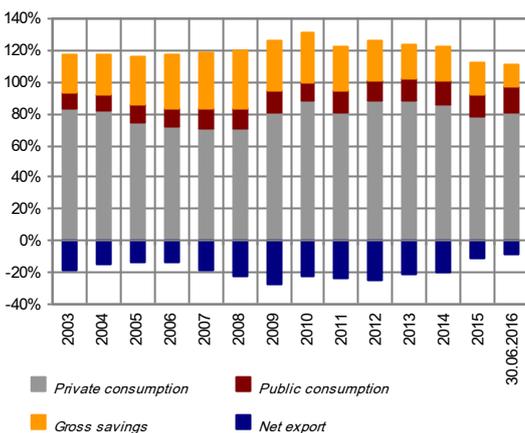
Real GDP growth and main sectors of economy



Source: National Statistics Service of Armenia.

Sluggish economic growth of the second quarter of 2016 resulted in a 2.8% semiannual economic growth.

GDP expenditure components (share in GDP)



Source: National Statistics Service of Armenia.

The economic issues in the partner countries of Armenia, the ongoing low-level of the global economic growth and the geopolitical uncertainties continue to have a negative impact on the domestic economy by creating additional risks to stability of the financial system.

During the first half of the year, the expansionary fiscal policy of the Armenian government and the easing of monetary policy by the Central Bank of Armenia were maintained, resulting in a YoY 2.8% economic growth.

The contribution to economic growth came mainly from the export sectors, particularly high production volumes of manufacturing. The increase of the value added in the manufacturing sector was 6.8% YoY. A growth of value added was recorded in all sectors of the manufacturing, in particular mining and open-pit exploitation, processing, electricity production and water supply by YoY 17.9%, 2.1%, 8.6% and 7.2%, respectively.

The growth of value added in agriculture was a mere 0.3% for the period under the review, while the aggregate output in January-June grew by 3.3%. The sector growth was due to an increase in production volumes of such sub-sectors as plant propagation, animal production and fishing production by 2.2%, 3.8% and 2.3%, respectively.

The adverse developments persisted in the construction sector. In the first half of 2016, the construction sector value added decreased by 4.8% YoY. The volumes of construction funded by nearly all means decreased, except for construction funded by international loans and communities.

The growth of value added in the services sector was 2.0% YoY, given the positive growth ratios in arts, entertainment and recreation services (39.8%), financial and insurance activities (3.0%) and transport (17.5%) sub-sectors.

The semiannual growth of wholesale trade by 5.0% was offset by the decline in retail trade; resulting in an overall reduction of trade by 0.3%.

The development trend of the aggregate demand continued largely in the same direction.

Private consumption has fallen by 1.4%, in the first half of the year. The rate of decline has slowed significantly compared to 2015, due to a higher-than-expected economic activity, deflationary environment and decline in trading volumes. The shortening of private sector spending has been mitigated by the easing of monetary policy by the CBA and the expansionary fiscal policy

⁵ For details on the developments of macroeconomic environment in Armenia, please see the quarterly publication "Inflation Report 2016, 3rd quarter".

carried out by the Armenian government. Thus, the public consumption has grown by 12.4% YoY. The pace of decline in private investments slowed down due to relatively large volumes of investments and structural reforms in tradable sectors of the economy.

The fall of private consumption is attributable to continuous decrease in money transfers from Russia, low level of business activity as well as slowdown of loans to economy. The private investment dropped by 6.6% during the reporting period, due to insufficient domestic demand, on the one hand, and the low progress in construction sector, on the other. Unlike the private investment, the public investment grew by 15.6%.

In the first half of 2016, amidst slow recovery of economic activity, loans to economy have risen by 3.4%. The increase in lending was fuelled by the easing of credit conditions and some growth in lending demand. The lending to event catering and other services sectors, trade and agriculture grew by 18.3%, 6.9% and 10.1%, respectively. Parallel to lending, the share of non-performing loans and receivables in total loans and receivables grew to 10.3%. During the first half of the year, the shares of non-performing loans in construction, event catering and other services, trade and manufacturing sectors grew.

According to the lending survey conducted in the second quarter of 2016, easing of credit conditions for all types of loans was noted. At the same time, a slight increase in business lending was observed, though still lower compared to the pre-crisis indicators.

In the third quarter of 2016, the banks and credit organizations expect some expansion of credit supply, while credit demand will increase relatively slowly.

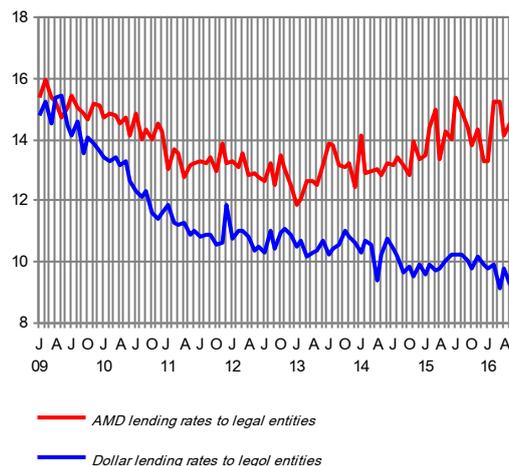
According to the Central Bank's surveys, the Business Climate Indicator rose to 51.0 in the second quarter of 2016, which is within the stability range. Moreover, the indicator has risen by 0.6 points compared both to the previous quarter and the same period last year.

According to the NSSA data, budget revenues⁶ have increased by 1.6% in the first half of the year. The growth was attributable to a 7.8% growth of income tax sub-item. Public expenditures⁷ grew by 6.2% compared to the same period of the previous year. Moreover, almost all expenditure figures grew. As a result, the fiscal policy had a 1.0 expansionary impact on the aggregate demand, due mainly to the expansionary impact of the revenues.

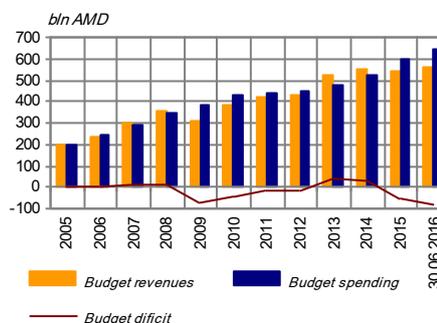
The accelerated growth of expenditures over revenues has resulted in a state budget deficit of AMD 84.8 bln.

In June 2016, the 12-month inflation was -1.1%. The deflation was mainly caused by a 3.5% decline in the prices of food products resulting from a weaker domestic and external demand, which contributed to the deflation by -1.21 pp. overall.

Lending rates to legal entities (%)



Main indicators of state budget



In June 2016, the 12-month inflation was -1.1%.

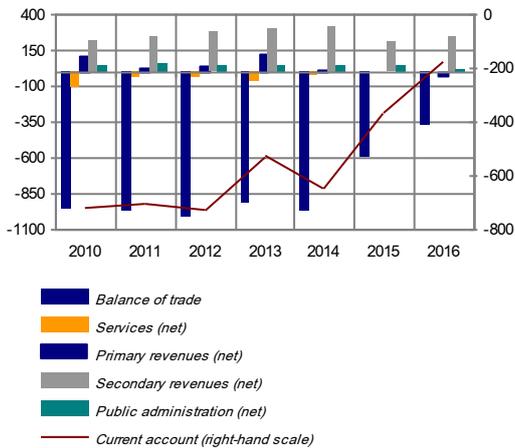
⁶ This includes extra-budgetary funds, and does not include funds received within the framework of projects financed from external sources..

⁷ This includes working funds of project implementation units.

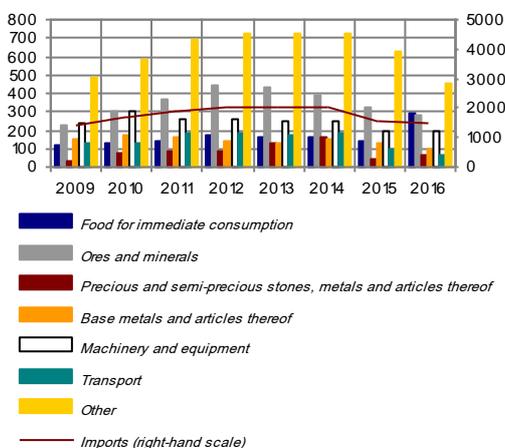
2.2. FOREIGN TRADE

The current account deficit/GDP ratio significantly improved.

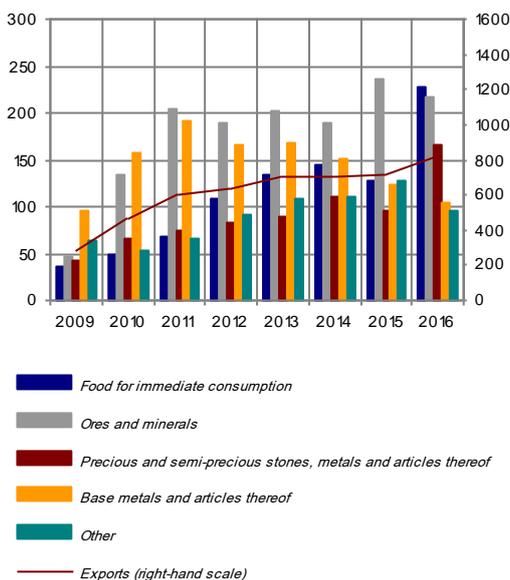
Main indicators of balance of payments, semiannual (mln USD)



Armenia's imports by commodity groups, semiannual (mln USD)



Armenia's exports by commodity groups, semiannual (mln USD)



The current account deficit of Armenia has improved in the first half of 2016 as compared to the same period of the previous year, amounting to USD 166.6 million, given the CBA data. Hence, in the period January-June 2016, the current account deficit/GDP ratio was -4.0%.

The reduction of the current account deficit was mainly due to a significant amelioration of the negative balance of goods and services. The improvement of the trade balance resulted by the growth of exports of goods amidst a decrease of imports in real terms.

Given the Central Bank of Armenia's data, the real exports of goods and services increased by 20.5%, according to the balance of payments, though the international prices of goods were low. The net imports increased by 1.2%.

The dollar value of the imports of goods and services has decreased by 3.9%, while the export value increased by 7.8%.

By structure of imports, an increase in import volumes was recorded in "Precious and semi-precious stones, precious metals and articles thereof" and "Food for immediate consumption and agricultural products" items. Meanwhile, the volumes of "Mining products" and "Base metals and articles thereof" decreased.

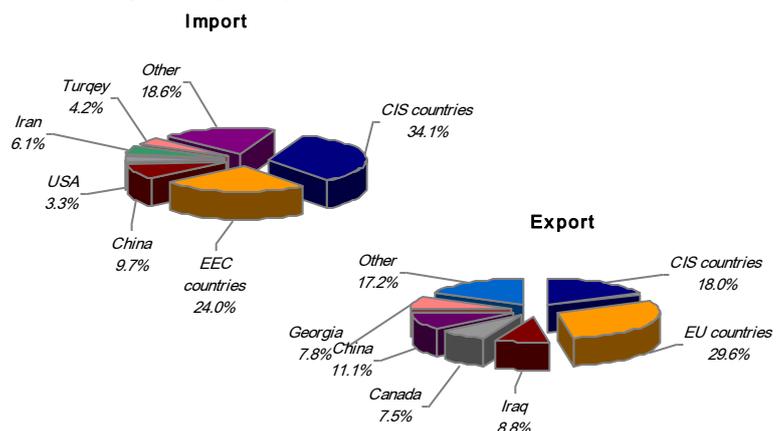
By structure of exports, the main increases were in "Food for immediate consumption" and "Precious and semi-precious stones, metals and articles thereof" at 37.8% and 83.4%, respectively. As a result their shares in total exports increased.

Meanwhile the shares of "Ores and minerals" and "Base metals and articles thereof" posted decreases.

In the first half of 2016, Armenia's foreign trade concentration by countries did not change significantly. The CIS and the EU countries remain the main trade partners of Armenia, with, respectively, 22.6% and 28.2% shares in exports and 34.0% and 23.6% shares in imports. The exports volumes to Iraq, Georgia, and Canada have grown, while the exports to China has decreased.

In the first half of 2016, according to the Herfindahl-Hirschman index, the concentration of commodity exports has improved compared to the previous year to 0.184.

Armenia's foreign trade, by country, as of 30.06.2016



Source: National Statistics Service of Armenia.

2.3. HOUSEHOLD INCOME AND DEBT BURDEN

Given the domestic and foreign macroeconomic developments, the average nominal wages grew slightly in the first half of 2016 as compared to the same period of the previous year, 2.8% YoY. The average monthly wages grew due to a rise in the private sector wages (5.7% YoY). A 0.5% YoY fall in the public sector wages led to the overall low growth of wages. Parallel to the growth of wages, the unemployment rate fell by 0.4 pp. to 18.3% YoY. The decline in unemployment is due to the progressive decrease in the number of unemployed compared to the economically active population.

Given the CBA assessments, the increasing trend of wages will likely be sustained during the year resulting to a 3.6% growth in wages for 2016⁸. The unemployment rate will fall to 17.8% from 18.5% last year.

In the first half of 2016, the declining rates of net current private transfers (12.9%) and outbound workers' compensation (22.6%) were preserved, conditioned by the adverse foreign economic developments. According to the CBA surveys⁹, in the first half of 2016, the share of urban households receiving non-commercial remittances increased by 0.4 percentage point and stood at 12.2% on average¹⁰.

The 12-month ratio of the net current private transfers and outbound workers' compensation to GDP declined, reaching 9.4% from 12.5% in the same period last year. The decline in remittances and outbound workers' compensation affected the current consumption, the disposable income and the trend of the outbound workers' compensation and remittances flows will continue throughout 2016¹¹.

Amidst the deflationary environment, the increase in nominal wages and fall in unemployment have both contributed to the growth of households' real income. However, the decrease of the remittances from abroad negatively impacted the disposable income of households. Given the abovementioned developments, the households deposits increased by 4.2% to AMD 1,048.7 bln.

The ongoing economic developments have also been reflected in the components of consumer confidence index¹². In the first and second quarters of 2016, the consumer confidence index has grown as compared to the same periods of the previous year. Both the current and the future conditions indexes have increased. Such current conditions sub-indexes as changes in the financial conditions and households assessments of the overall economic situation grew considerably. However, the current conditions index remained lower than the 45-55 range of stability, due to low level of the abovementioned indexes. The future conditions index remained within the range of stability.

⁸ Source: "Inflation Report" by the CBA, 3rd quarter, 2016.

⁹ Source: summaries of quarterly surveys on "Consumer confidence Index" by the CBA, 2016 H1. The survey was conducted among urban households and comprises their data only.

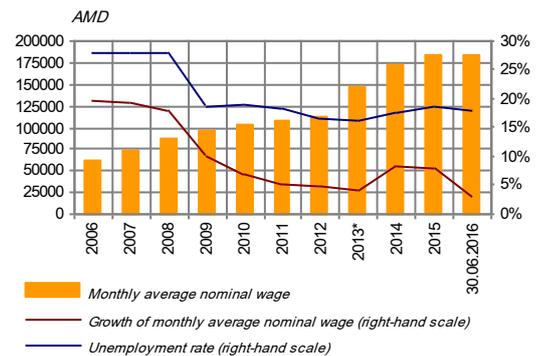
¹⁰ No significant amendments were made in the management of workforce inflow to Russia by the migration authorities.

¹¹ Source: "Inflation Report" by the CBA, 3rd quarter, 2016.

¹² Source: summaries of quarterly surveys on "Consumer confidence Index" by the CBA, 2016 H1.

The wages grew and the unemployment rate decreased during the first half of the year.

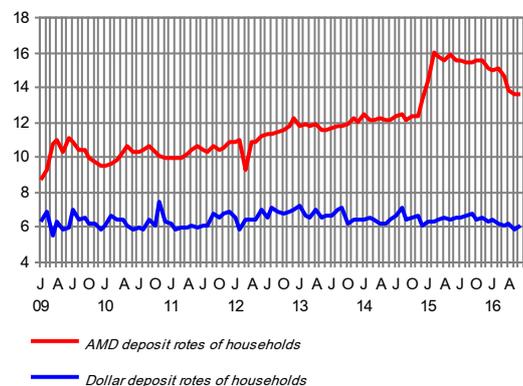
Nominal average wage and unemployment



* The indicator is calculated according to the Republic of Armenia Law on Income Tax, effective from 01.01.2013, which stipulates that mandatory social charges payable by the employer have been also included in salaries and salary equivalents since January 1, 2013.

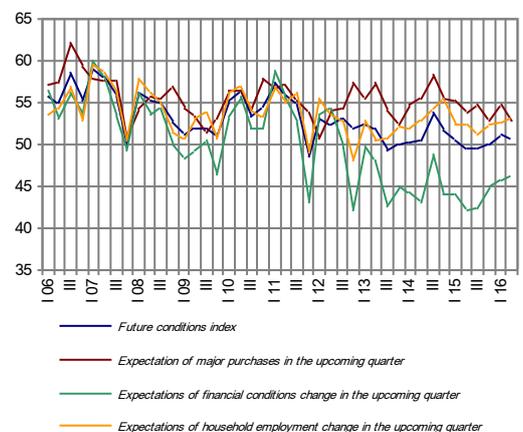
Source: National Statistics Service of Armenia.

Deposit rates of individuals (%)

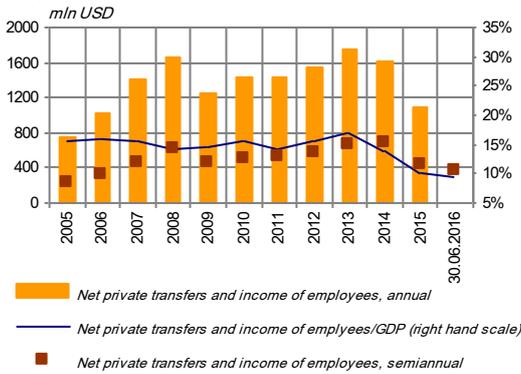


The declining pace of non-commercial remittances and net compensation of outbound workers was maintained.

Future conditions index and its components

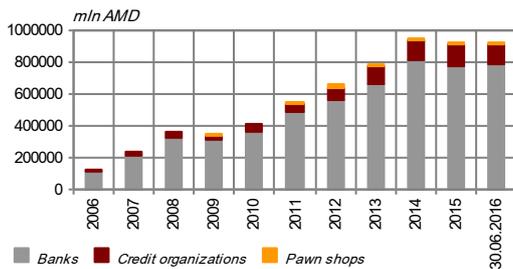


Net private transfers and wages of seasonal employees

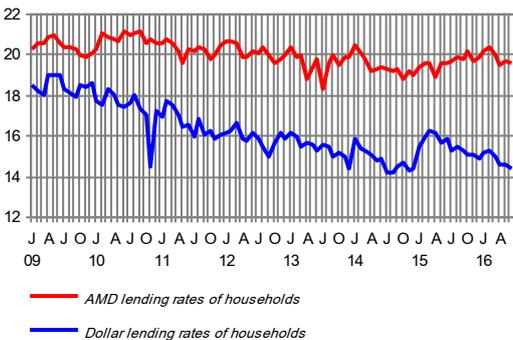


The liabilities of households to financial institutions have grown.

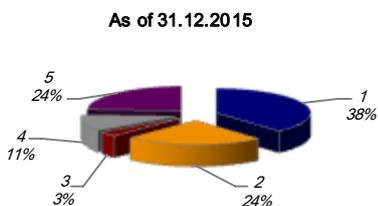
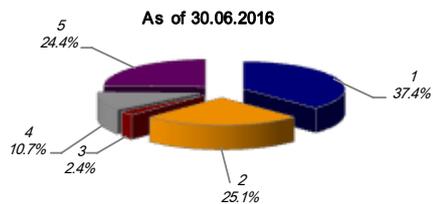
The structure of household indebtedness to financial institutions



Lending rates to individuals (%)



Consumer loan portfolio structure of banks and credit organizations



1. Card loans
2. Gold collateralized loans
3. Car loans
4. Household and computer appliances loans
5. Other

Source: Central Bank of Armenia.

The sub-index of expectations for changes in financial conditions in the upcoming quarter has improved significantly, which grew to 46.3 in the second quarter of 2016. The sub-index of expectations for changes in employment rates in the upcoming quarter also grew, reflecting the positive developments in the labor market.

The lower remittances from abroad, as well as high level of debt burden affected the credibility of households, and therefore the volume of lending to households¹³. Resident households' total liabilities to the financial institutions have risen by 0.5% to AMD 924.8 billion during the period under review. The volume of credit liabilities to banks, credit organizations and pawnshops have grown by 0.2%, 2.0% and 2.7%, respectively.

The lending to households remains the most active in consumer loans. According to the quarterly surveys of the Central Bank the loan offer index outpaced that of loan demand¹³. During the first half of the year, the consumer loans increased by 1.5%, due to a 7.4% growth in gold collateralized loans. Loans for purchase of household and computer appliances, as well as other consumer loans posted 3.5% and 2.3% growth rates, respectively. Both car and card loans declined by 20.9% and 1.3%, respectively. The shares of card loans (37.4%) and gold collateralized loans (25.1%) in total consumer loans prevail. The trend of credit terms mitigation observed from the third quarter of the previous year was maintained, due to growing competition between banks and other financial institutions.

These improvements include revisions of loan repayment schedules, creditworthiness assessments, as well as the application of non-interest charges and loan-to-value ratios.

Banks and credit organizations expect that both supply and demand for consumer lending will grow in the coming quarter¹³.

In the first half of 2016, mortgage lending by both banks and credit organizations improved by 0.6%, contributed by a 0.2% increase in mortgage loans for real estate purchase and 4.4% increase in mortgage loans for real estate renovation.

Amidst lower creditworthiness and incomes of households, refinancing projects of Housing for Youth and the National Mortgage Company continue to contribute to the mortgage market activity. Their refinanced mortgage loans have remained merely unchanged and have constituted 24.3% of total mortgage lending portfolio. In March 2016, amendments were made in the government program "Affordable housing for young families" in order to incorporate a greater number of young families¹⁴. Amendments in the RA Law on Income tax, enacted from 1st January 2015, had a positive impact on the mortgage market, and particularly on lending for real estate acquisitions in the primary market¹⁵.

¹³ Source: quarterly survey on "Lending conditions by banks and credit organizations of Armenia" by the CBA, 1st half 2016.

¹⁴ According to those changes, the maximum age limit for potential young beneficiaries, the maximum cost of housing under the program and the maximum amount of mortgage loans provided were raised.

¹⁵ No. 205-N decision of the RA Government on "Establishing the procedure of income tax refund to hired employees, individual entrepreneurs and notaries equal to amount of the interests paid for mortgage loans" February 19, 2015. According to these changes, income tax paid by borrowers is being refunded by the government proportionally to the amount of interest for mortgage loans.

During the half of the year, the share of foreign exchange mortgage loans remained quite high, at 52.7%, though on a declining scale.

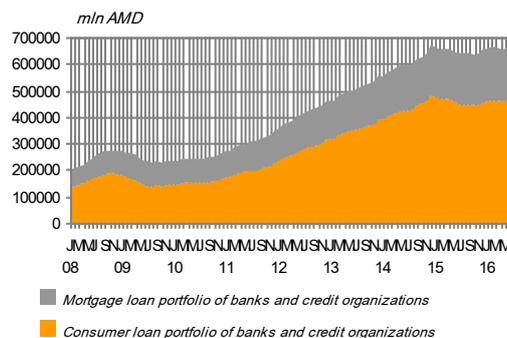
In the first half of 2016, the share of household loans in the GDP remained 18.2%, due to a lower lending to resident households as compared to GDP growth. A decrease was registered in debt to deposits ratio, which amounted 88.2% as of end of the first half of the year, against 91.5% in 2015. This means that households have become net creditors for credit institutions.

The share of FX deposits in total deposits remains high (70.6%). This limits the banks' ability to allocate financial funds in Armenian dram assets, and especially the ability to give AMD loans to households.

Given the weaker creditworthiness of households, as well as the accelerated growth of the loan portfolio in the preceding years, the credit risk losses of commercial banks have grown in the first half of 2016. This has not affected the solvency of banks, but has impacted their profitability. The share of non-performing consumer loans was 10.1%, fueled mainly by the growth in the NPLs of FX consumer loans. The share of non-performing mortgage loans in total mortgage loans grew by 1.3 pp. to 7.8%. Again, this was caused by higher non-performing loans in FX loans.

Overall, the risks arising from the household sector impacted the profitability of financial institutions on a decreasing scale. However, the stability of the financial system is maintained at a satisfactory level.

Consumer and mortgage loan portfolio of banks and credit organizations

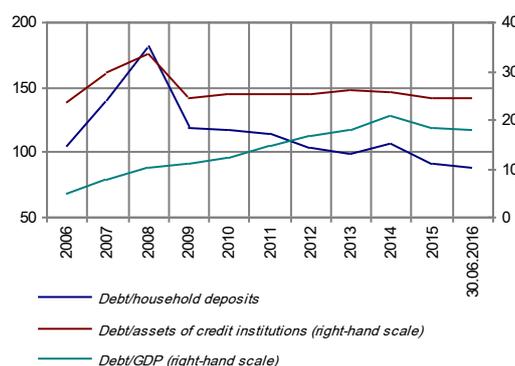


Source: Central Bank of Armenia.

The debt burden of Armenian households decreased.

The risks stemming from loan portfolio quality of households was on an arising scale.

Household debt burden indicators, %



Source: Central Bank of Armenia.

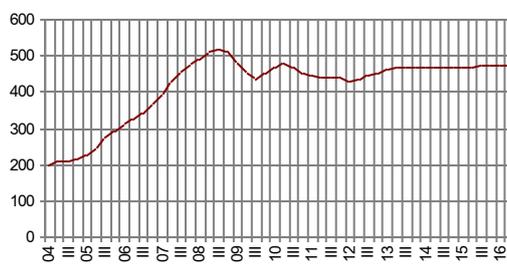
2.4. REAL ESTATE PRICES

In the first half of 2016, no stirring of activity was noticed in the real estate market amidst the expansion of foreign and domestic uncertainties. The prices of apartments in multi-apartment homes¹⁶ both in Yerevan and in other Armenian towns remained merely unchanged as compared to the previous two halves last year. Risks to the real estate price fluctuations were insignificant in regards to financial stability. In the first half of 2016, as compared to the first and the second halves of 2015, the average market prices of apartments in residential apartment buildings in Yerevan increased by 0.2% and 0.1%, respectively, on 1m² surface basis, while prices in other towns increased by 0.3% and 0.2%, respectively.

In terms of risk management of real estate price fluctuations, the loan-to-value ratio for property-backed loans set by the commercial banks has a great importance. Largely, it varies in the range of 60-80%; in such case the credit risk derived from possible fluctuations in the real estate prices is significantly restrained (for details, please see the subsection "Market risk of commercial banks").

The apartment prices remained merely unchanged.

Apartment average price index in Yerevan (sq m)

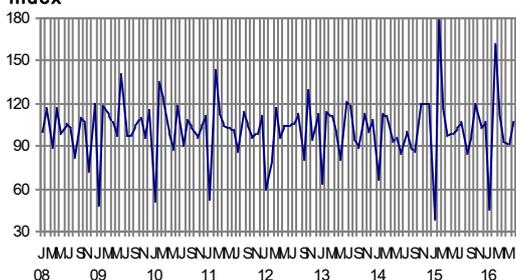


Source: State Committee of Real Estate Cadaster of the Government of Armenia.

¹⁶ As there is no single index of real estate average price in Armenia, the criterion for real estate price developments is considered the average price index of apartments in Yerevan

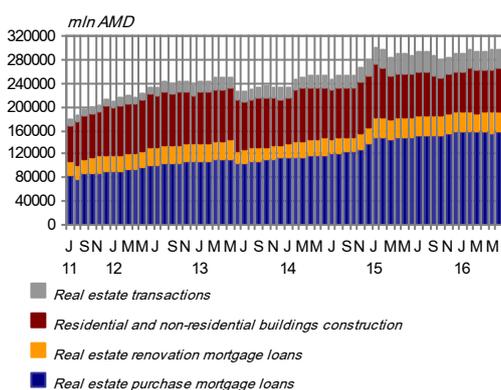
The real estate sale and purchase transactions have increased slightly, in comparison with the same period of the previous year.

Real estate sale and purchase transactions index



Source: State Committee of Real Estate Cadaster at the Government of Armenia.

Loans to real estate market



Risks associated with the sale of collateral remain key risks.

Real estate out of operation held for sale and got as collateral with the commercial banks (bln AMD)



In January-June 2016, the decline in disposable income of households has led to the reduction of solvent demand for real estate, which in turn affected the real estate market activity¹⁷. In the first half of 2016, the numbers of real estate sale and purchase transactions in Yerevan and other towns have increased by 0.2% and 0.3%, respectively, as compared to the first half of the previous year. In January 2015, amendments to the law on Income tax came into force, which contributed to the stirring of the real estate primary market. Mortgage loans for the acquisition of real estate grew slower than in the previous years and stood at 0.2% (for details, please see the subsection “Household income and debt burden”).

According to the quarterly surveys conducted by the Central Bank of Armenia, the sale and purchase transactions in the real estate market will be more active in the primary market than in the secondary market¹⁸.

The volume of residential houses commissioned to operate decreased by 45.7% in the first half of 2016 compared to the same half of 2015, conditioned by minor activity in the real estate market. Volumes of residential houses commissioned to operate financed both by organizations and households decreased by 49.2% and 45.2%, respectively. The share of residential houses commissioned to operate financed by organizations has fallen to 11.8% in the first half of 2016, as compared to 12.6% in the first half of 2015. The majority of construction companies, who have participated in the quarterly survey conducted by the CBA, consider low demand as the main hindering factor for real estate construction¹⁹.

Residential buildings completion by sources of financing

Sources of financing	Exploited residential buildings (sq. m) in H1 2016	Share in total	Percentage change as to H1 2015
Total, of which :	33 126	100%	-45.7%
State budget	0	0	0
Corporations' funds	3 910	11.8%	-49.2%
Household funds	29 216	88.2%	-45.2%

Source: the National Statistics service of Armenia.

Loans provided for construction of residential and non-residential buildings has increased by 7.9% to AMD 72.4 billion. The share of non-performing loans in real estate construction loans has also increased to 19.9%.

In the midst of low activity of the real estate market, liquidity risks associated with the sale of collateral are persisting for the commercial banks, as the volumes both of real estate received as collateral and real estate not in use and held for sale have grown.

¹⁷ Source: quarterly surveys on “Lending conditions by RA banks and credit organizations” by the CBA, 1st half 2016.

¹⁸ Source: summaries of quarterly surveys on “Lending conditions by RA banks and credit organizations” by the CBA, 1st half 2016

¹⁹ Source: summaries of quarterly surveys on “Business environment index” conducted by the CBA, 1st half 2016.

SUMMARY

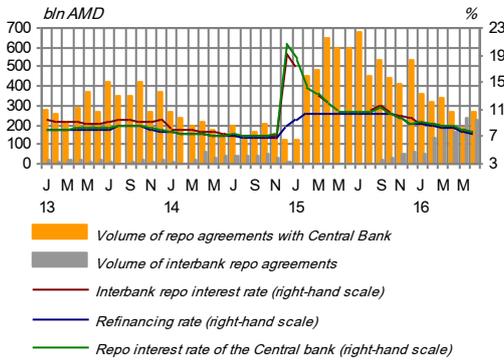
in the first half of 2016, lackluster world economic growth and negative developments in Russian economy, Armenia's main partner, led to a 2.8% economic growth in Armenia. Economic growth was mainly contributed by an increase in production volumes in manufacturing and services. The key non-domestic risks to financial stability of Armenia remain the decline in private remittances and outbound workers' compensation, which negatively impacted the income levels of households. The low-inflationary environment had some positive impact on the purchasing power during the year. Despite the decrease in remittances and factor income, the current account deficit-to-GDP ratio has improved, given the progress in the negative balance of goods and services.

3. FINANCIAL MARKETS STABILITY

3.1. MONEY AND CAPITAL MARKETS

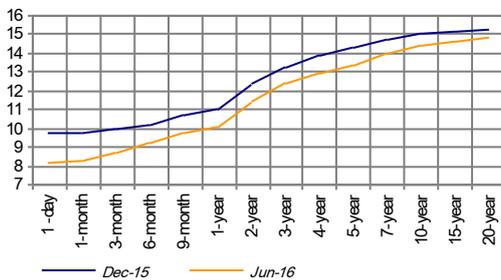
The financial market interest rates have reflected the easing monetary conditions.

Monthly volume of repo transactions and repo interest rates (interbank and with the CBA)

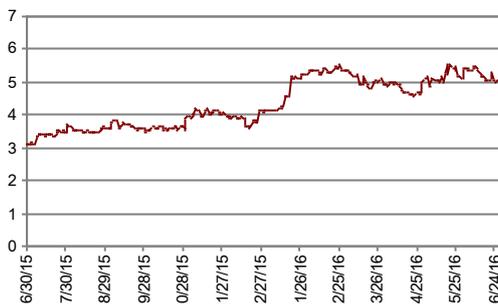


The yields for all maturity bonds have fallen.

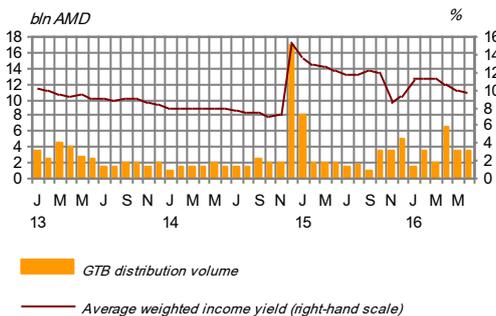
Yield curves of Armenian government bonds



Spread of 6-month and 10-year bonds



Short-term treasury bond allocation volumes and weighted average yields



Source: Central Bank of Armenia.

Since the beginning of 2016, the Central Bank's measures have mostly had an expansionary direction. In the first half of the year, the Central Bank Board has reduced the refinancing rate four times by 1.25 pp. overall.

The gradual easing of monetary conditions was reflected in other rates of the financial market as well. The financial market short term rates reacted immediately to the reduction of refinancing rate, while the long term rates reacted with a certain delay.

The interbank repo rate displayed a behavior in line with the Central Bank policy impulse. The average rate was 7.75% in June, declining by 1.95 pp. as compared to December.

The drop of interest rates in the financial market was reflected by changes in the yield curve level of the government securities²⁰. The decline in the short-term interest rates was more marked than in the long-term interest rates. As a result, the spread between 10-year and 6-month bonds widened by 1.2 pp. and stood at 5.4% in the end of the first half of the year.

The Central Bank's policy, the decline in inflation expectations, as well as the excess liquidity of banks due to the capital replenishments led to the decrease in banks interest rates of loans and attracted funds.

For a summarized illustration of the current trends in the government bonds market, the Central Bank calculates indices of government bonds²¹, presented in the table below.

Indices of government bonds in 2016 H1

Index	TBI	G03	G05	G5I	GMI
Modified duration	0.43	1.36	1.83	5.41	3.01
Risk weighted yield	10.10	12.11	12.71	15.30	13.57
Average maturity (year)	0.47	1.60	2.33	12.96	6.11
Average weighted coupon %		9.74	9.85	12.00	10.61
Market Price of government securities (bln AMD)	22076	137559	189665	93762	283426
Market value index change in case of +/-1% yield change (mln AMD)	+/- 95	+/-1869	+/-3464	+/-5075	+/-8530
Market value index change in case of yield change by the standard deviation ²² (mln AMD)	9	162	284	492	552

²⁰ The yield curve involves dependence between the yields and maturities of the government bonds. Starting from July 2013, the Central Bank is using a new approach in building the yield curve by applying the Nelson and Siegel Model; this is a parametric statistical model and it approximates the yield curve of all periods as a function.

²¹ There are 5 indices calculated for government bonds, of which 4 for coupon bonds and 1 for discount bonds. The coupon bond indices are G03, G05, G5I, which cover bonds with maturities, respectively, from 0 to 3 years, 0 to 5 years and 5 years and more; and GMI, which is a coupon bond index. Indices include the bonds issued in AMD by the Ministry of Finance, with semi - annual fixed coupons and AMD 1 billion and higher turnover. Discount government bonds TBI include bonds with maturity of one week and more, with AMD 400 million and higher turnover. For details, please see the CBA website: www.cba.am

²² Standard deviation of risk weighted yield between 31/12/2015 and 30/06/2016.

As of the end of June 2016, the modified duration of government coupon bonds outstanding was 3.01 (2.82 in the yearend), with an average maturity of 6.11 years (5.76 in the yearend). These indicators for discount bonds were 0.43 and 0.47, respectively (0.34 and 0.37 in the yearend).

In case of a 1% change (increase or decrease) in the yield of government securities, investors' likely loss or gain could be about AMD 8.5 billion or 2.3% of the market value of government securities. Moreover, a notable portion of the change might come from the long-term securities, as they have greater sensitivity to the interest rate change.

Operations in securities markets (including repo and reverse repo transactions but excluding operations with the Central Bank) carried out by investment service providers²³ increased by more than 2.7 times compared to the same period of the previous year and amounted to AMD 3 trillion 464 billion. This upsurge was due to a sharp rise of repo transactions during the half of the year. The transactions involving securities trades constituted 6.8% of the operations mentioned above.

In the first half of 2016, the liquidity of government securities market (according to the indicator describing the level of liquidity)²⁴ decreased as compared to the same period of the previous year. The liquidity level was the highest in May. The volatility of the liquidity of the government securities market was low during the first half of the year, while the standard deviation of liquidity indicator was 1.8.

Within the total trades of government securities, the share of medium-term and long-term securities trades amounted to 62.3% and 32.1%, respectively. The share of short-term bonds in total trades reached 5.6%.

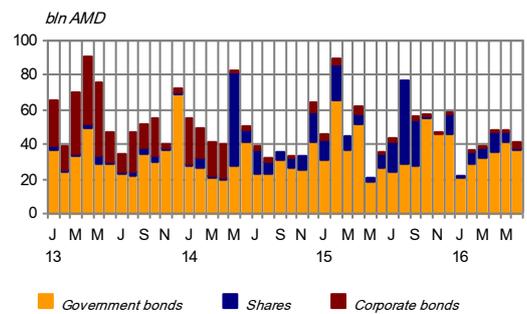
The volume of repo and reverse repo transactions (excluding operations with the Central Bank) carried out by investment service providers has increased by more than three times as compared to the first half of the previous year, and amounted to AMD 3 trillion 229 billion. Again, almost all repo transactions involved government securities.

In the first half of 2016, the total volume of securities trades in the regulated market amounted to AMD 19.5 billion. In the regulated market, transactions with government securities comprised the prevailing part, 49.5%. The trades with corporate securities and shares constituted 21.0% and 29.5%, respectively.

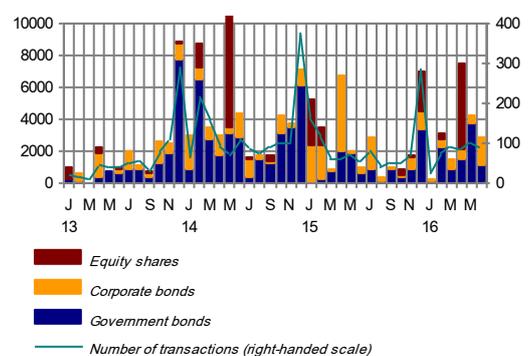
The share of regulated market in the structure of securities trades by investment service providers has been 8.3% since the beginning of the year.

As of the end of the first half of 2016 the capitalization of securities market was AMD 128.7 billion, increasing by AMD 24.9 billion or 24.0% as compared to the year-end. The concentration of capitalization by issuers has declined; the share of the first three issuers was 81.7%, while the share of the first five issuers was 95.0%.

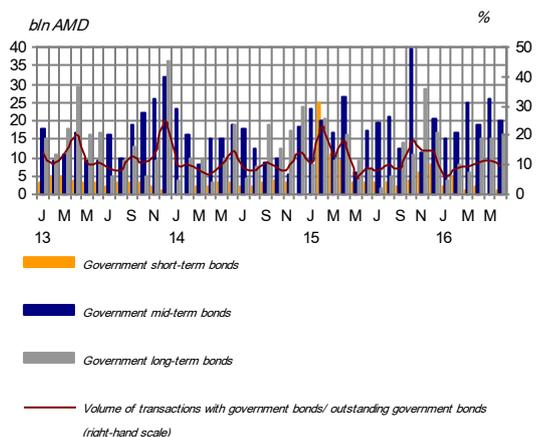
Security trades by investment service providers



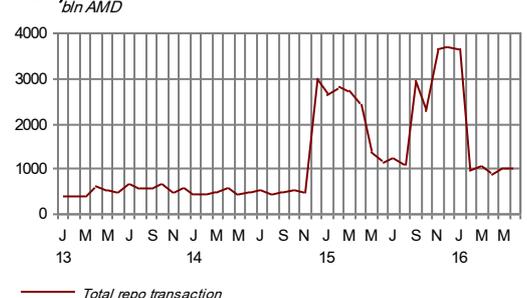
Security trades and repo transactions at regulated market of securities (mln AMD)



Transactions with government securities and the government securities to outstanding government securities ratio



Repo transactions by investment service providers (including repo transaction with the CBA)

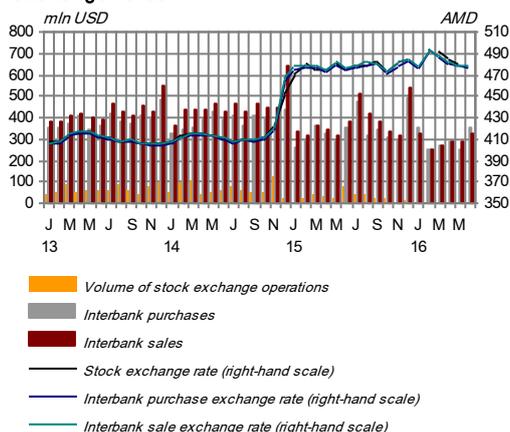


²³ As of 30.06.2016, investment service providers included 20 commercial banks and 8 investment companies.

²⁴ The liquidity indicator of government securities market is calculated as a ratio between an amount of monthly trade transactions executed by investment service providers in the secondary market of government bonds and an amount of government bonds outstanding.

Source: Central Bank of Armenia.

Operations in the exchange market and exchange rates



Source: Central Bank of Armenia.

Share of the 3 and 5 largest issuers' by capitalization, 2010 – 2016 H1 (%)

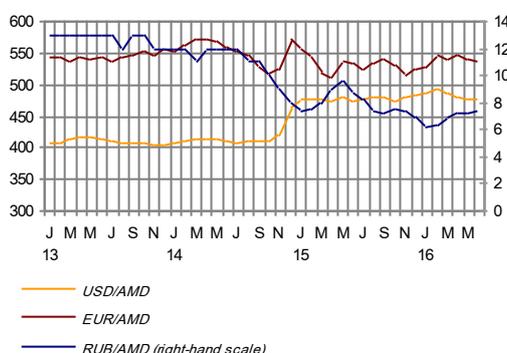
Period	Capitalization of the 3 largest companies (%)	Capitalization of the 5 largest companies (%)
31.12.2010	80.1	94.7
31.12.2011	83.8	96.6
31.12.2012	78.8	96.2
31.12.2013	79.8	96.7
31.12.2014	86.5	97.2
31.12.2015	83.0	98.0
30.06.2016	81.7	95.0

3.2. FOREIGN EXCHANGE MARKET

During the first half of 2016, there were no significant fluctuations in the foreign exchange market. The Armenian dram/ U.S. dollar exchange rate has mainly appreciated. In June 2016, the monthly average AMD exchange rate appreciated versus the US dollar by 1.13%, versus the Euro and the Russian ruble by 2.12% and 5.78%, respectively.

In June 2016, the real effective exchange rate of Armenian dram has appreciated by 3.23% as compared to the previous yearend. The nominal effective exchange rate of Armenian dram has appreciated by 1.30%²⁵.

Foreign exchange rates in the exchange market (AMD)



Source: Central Bank of Armenia.

SUMMARY

During the first half of 2016, the loosening of monetary policy was reflected in the interest rates of the financial market.

The decline of the government securities yields has led to a decrease all along the yield curve.

The fluctuations in the financial markets did not cause substantial risks in the first half of 2016, thus financial stability remained intact.

²⁵ For the exchange rate behavior and the foreign competitiveness, the nominal and real effective exchange rates are also considered, which are calculated based on the respective weights of foreign trade with twelve main partner countries (Euro area, Russia, Ukraine, South Korea, Bulgaria, Switzerland, Iran, the USA, Turkey, Georgia, Japan, China).

4. STABILITY OF FINANCIAL INSTITUTIONS

The first half of 2016 was highlighted with rather active participation in the financial system. This was due to fewer macroeconomic uncertainties arising from regional developments and a stabilization outlook for remittances inflow. Under such conditions, some recovery in financial intermediation was recorded. The financial sector assets-to-GDP and credits-to-GDP ratios rose by 0.6 and 1.2 percentage points to 77.4% and 44.6%, respectively.

Armenia's financial system remains bank-dominated; accounting for 88.4% of the financial system assets. In this context, identifying and evaluating banking sector risks is essential for the assessment of domestic financial stability. The shares of insurance and securities markets and other participants of the financial market remain small enough, so their impact on the financial stability is negligible.

4.1. COMMERCIAL BANKS

Banking sector stability map

The banking sector stability map provides a general understanding of the behavior of the banking sector stability, reflecting the change of the indicators of banking risks relative to the previous period.

The elements of the stability map²⁶ point out to a reduction of risks, due to positive changes of different indicators of the banking sector, in the first half of 2016, relative to the second half of 2015 (for details, please see subsections “Credit risk”, “Liquidity risk”, “Market risk”, “Capital adequacy and Profitability”).

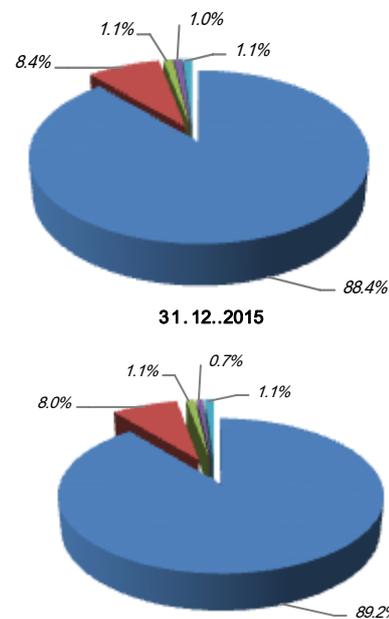
4.1.1. Financial intermediation and concentration

In the first half of 2016, in line with the increasing activity of the commercial banks in the credit market, the banking intermediation grew. The banking sector credits-to-GDP and deposits-to-GDP ratios grew by 1.3 and 1.7 pp. to 41.1% and 36.4%, respectively. The broad money-to-GDP ratio grew by 1.3 pp. to 38.4%.

²⁶ The banking sector stability map contains indicators denoting capital adequacy, assets quality, liquidity, profitability, interest rate risk and foreign exchange risk. These indicators were firstly measured on a 1 to 10-scale basis and then calculated in accordance with the IMF methodology. Note that the nearer the value to the center of the map, the lower the level of risks associated with the indicator, and vice versa. The banking sector stability map shall not be interpreted as an indication of the level of financial stability, rather it provides a picture whether the level of risks involved has increased or decreased.

The banking risk management is highly important in terms of financial stability.

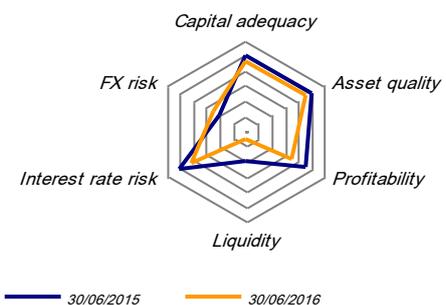
Structure of financial system assets, by financial institutions
30.06.2016



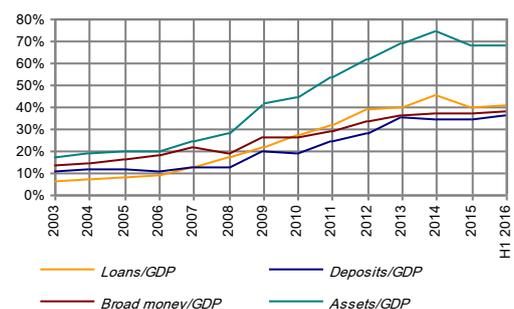
1. Banks, 2. Credit organizations, 3. Insurance companies, 4. Investment companies, 5. Other financial institutions

Source: Central Bank of Armenia.

Banking sector stability map

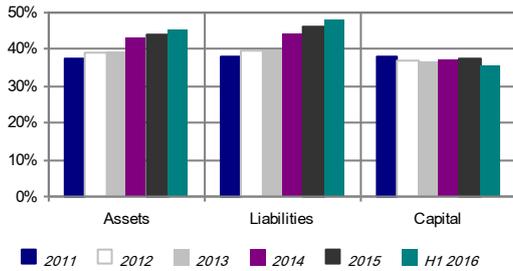


Financial intermediation

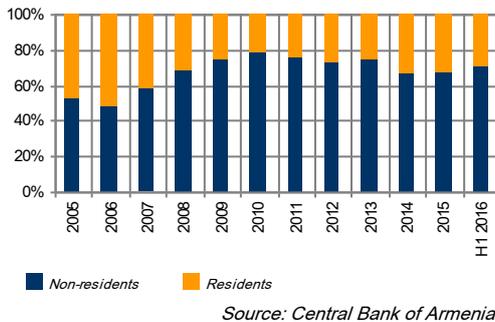


Source: Central Bank of Armenia.

Shares of assets, liabilities and capital of the 4 largest banks in the banking sector



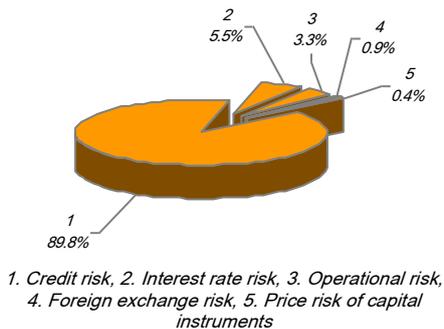
Foreign investors' participation in statutory capital of Armenian banking sector



Source: Central Bank of Armenia.

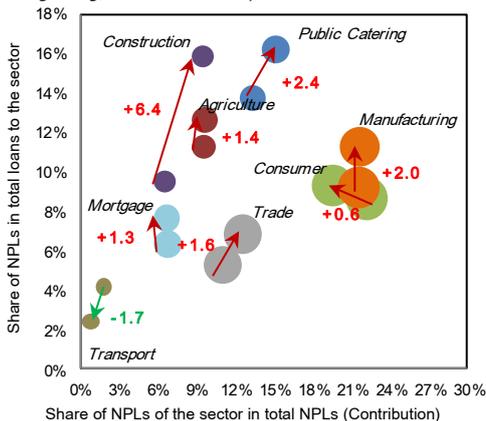
Credit risk is the key risk to the financial stability.

Structure of risk weighted assets calculated in the banking sector capital adequacy ratio



Source: Central Bank of Armenia.

Change of the share of NPLs in loans to economy sectors
(The end of the arrow shows data as of 30.06.2016, the beginning, as of 31.12.2015)



Total capital of the banking sector grew by 6.6% while total assets remained unchanged. As a result, the total capital-to-assets ratio (the leverage ratio) increased by 1.0 percentage point to 15.9%. The increase of total capital was due to statutory capital replenishments. 4 banks replenished the statutory capital by a total of AMD 29.3 billion, of which 23.0 billion came from non-resident sources. Consequently, non-resident participation in the statutory capital of the banking sector has increased by 2.9 percentage points to 70.6%.

Herfindahl-Hirschman concentration index

Indicators	31.12.13	31.12.14	31.12.15	30.06.16
Total assets	0.0699	0.0728	0.0764	0.0791
Total liabilities	0.0727	0.0751	0.0800	0.0845
Total capital	0.0613	0.0627	0.0630	0.0607

Source: Central Bank of Armenia.

The shares of assets and liabilities of the 4 largest of the 21 banks in the beginning of the year²⁷ have increased by 1.1 and 1.8 percentage points to 45.1% and 47.7% respectively, while the share of total capital has decreased by 1.8 pp. to 35.5%.

According to the main indicators of the Herfindahl-Hirschman Index (assets, liabilities, and total capital)²⁸, the concentration of the banking sector remains low; this limits the likelihood of the concentration risk to financial stability.

4.1.2. Credit risk

The credit risk remains the most important risk to the financial stability in terms of ensuring the solvency of the banking sector. The share of credit risk in risk-weighted assets of commercial banks accounts for 89.8% (as of 31.12.2015, it was 89.1%). In this context, the prudential management of the credit risk is extremely important.

During the first half of 2016, loans to economy increased by 3.4%. The shares of consumer loans, manufacturing and trade loans were large in the total loan portfolio, making up 20.0%, 18.2% and 17.4%, respectively.

The share of non-performing loans and receivables (classified as “watched”, “substandard”, and “doubtful”) has grown by 1.3 percentage point to 8.7% of total loans and receivables during the first half. The shares of “watched”, “substandard”, and “doubtful” loans and receivables were 2.5%, 3.1% and 3.1%, respectively. (As of 31.12.2015, they were 3.3%, 2.2% and 1.9%). High credit growth reported in the previous years and some decrease in the levels of income inflows from abroad has contributed to the deterioration of the loan portfolio quality.

²⁷ At the moment of the publication of this report, there are 19 commercial banks and one development bank (Pan Armenian Bank JSC) functioning in the Republic of Armenia. The decrease of the number of the banks is a result of a merger of two commercial banks.

²⁸ The Herfindahl - Hirschman Concentration Index varies between 0 and 1, characterizing the level of concentration (values near 0 denote lower concentration).

During the first half of the year, a considerable decrease of loan quality was noted in loans and receivables to construction, public catering and services, and manufacturing sectors. The shares of non-performing loans to these sectors grew by 6.4, 2.4 and 2.0 percentage points to 15.9%, 16.2% and 11.2%, respectively.

The Herfindahl-Hirschman sectorial concentration index for lending was 0.11 at the end of the first half, pointing to a moderate concentration of loans in the banking sector. The same indicator, calculated using the banks' average, amounted to 0.2. The higher value of the indicator of sectorial concentration according to the banks' average in comparison with the banking sector indicates relatively high sectorial concentration of loan portfolios in some banks.

The share of loans to large borrowers has increased by 0.3 percentage point to 25.2% of total loan portfolio as compared to the beginning of the year²⁹.

Credit risk stress scenarios³⁰

30.06.2016	Stress scenarios		
	25 % of watched, substandard and doubtful loans classified into losses	75 % of doubtful loans classified into losses	30 % of standard loans classified into watching loans
Loss of the banking sector	AMD 33.8 billion or 6.4% of total regulatory capital of the banking sector	AMD 20.6 billion or 3.9 % of regulatory capital of the banking sector	AMD 60.5 billion or 11.5% of regulatory capital of the banking sector
Total capital adequacy of the banking sector in case of stress scenario	16.5%	16.9%	15.8%

Source: Central Bank of Armenia.

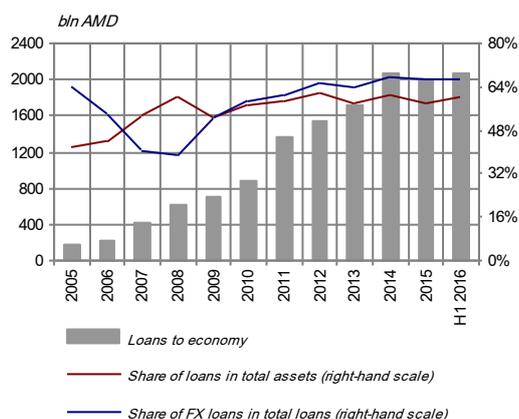
Compared to the beginning of the year, the results of credit risk stress tests conducted at the end of the first half of 2016 showed some improvement, attributable to the increase of banks' capital adequacy due to statutory capital replenishments and net profit. The considered stress scenario revealed cases of infringement of the capital adequacy requirement at some banks. However, these banks have sufficient capital to absorb plausible losses arising from credit risk. In this context, the probability of emergence of insolvency problems in the banking sector is estimated to be low.

Stress scenario of credit risk derived from off-balance sheet contingent liabilities

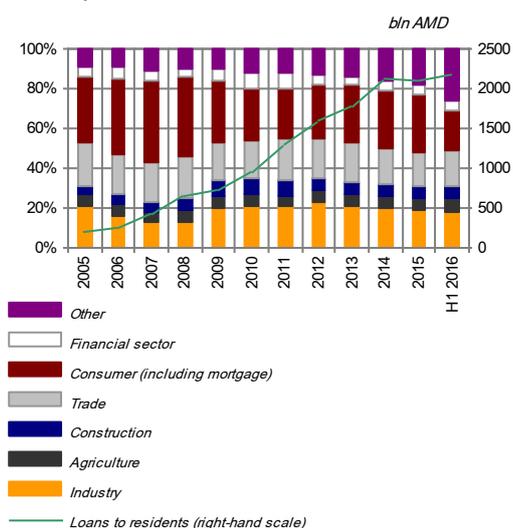
30.06.2016	Stress scenarios
	When 50% of off-balance sheet contingent liabilities performed
Banking sector capital adequacy ratio before the stress	17.4%
Banking sector capital adequacy ratio after the stress	17.3%

Source: Central Bank of Armenia.

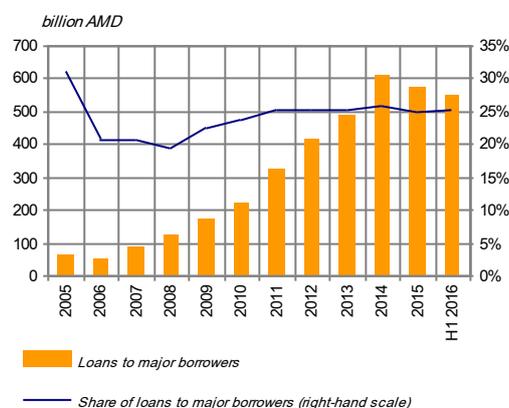
Loans to economy



Structure of bank loans to residents, by economy sectors



Loans to major borrowers/total loans

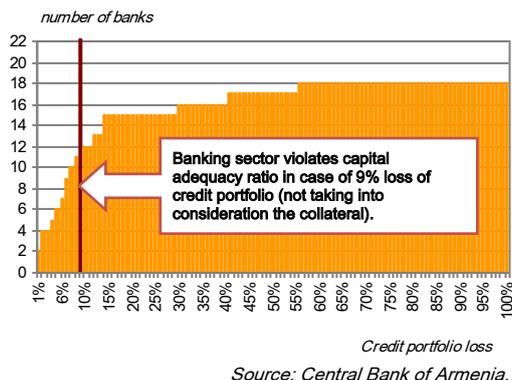


Source: Central Bank of Armenia.

²⁹ The bank's risk on large borrowers exceeds 5% of average monthly regulatory total capital, considering the interdependence.

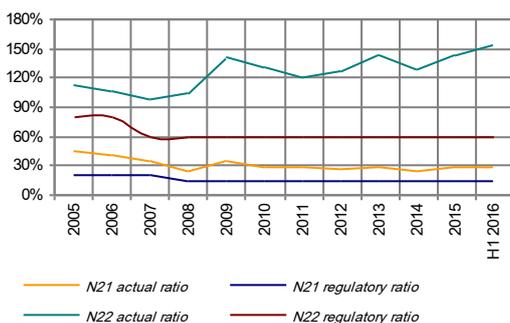
³⁰ This and further stress scenarios are not forecasting emergence of any risks, but are rather aimed to reveal the weaknesses of the financial system, as well as to assess its ability to absorb such risks.

Number of banks violating the capital adequacy regulatory ratio under dynamic growth of loan losses

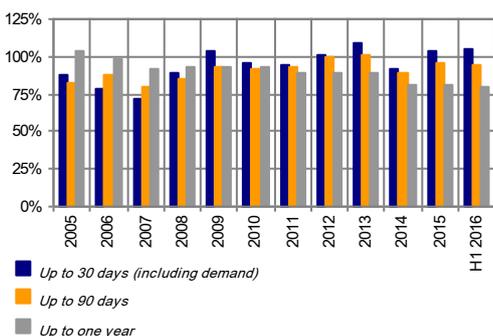


The liquidity of commercial banks remains sufficient.

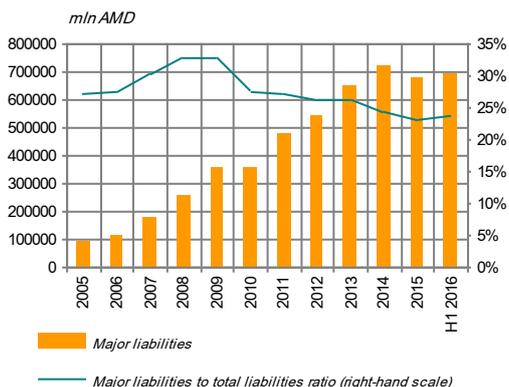
Dynamics of actual and regulatory liquidity ratios of the banking sector



Ratio of the banking sector short-term assets to liabilities, by terms to maturity



Ratio of the banking sector major liabilities to total liabilities



Source: Central Bank of Armenia.

The results of the stress scenario of credit risk derived from off-balance sheet contingent liabilities denote that the capital adequacy ratio at individual banks is not plunging more than 0.5 percentage point, and no infringement of the ratio by any bank is reported. In this context, the impact of credit risk arising from off-balance sheet contingent liabilities on financial stability is estimated to be insignificant.

4.1.3. Liquidity risk

In the first half of 2016, the overall level of liquidity of commercial banks remained slightly unchanged, while the foreign exchange liquidity displayed a diminishing trend. Prudential ratio of total liquidity remained unchanged at 28.0%, while current liquidity ratio increased by 10.6 percentage points to 153.5% (with minimum thresholds of 15.0% and 60.0%). Prudential ratios of total liquidity and current liquidity for Group 1 foreign currencies have fallen by 3.8 and 16.9 percentage points to 15.7% and 83.8%, respectively (with minimum thresholds of 4.0% and 10.0%). Regarding each bank individually, total liquidity and current liquidity prudential ratios were in line with regulatory requirements, and no infringement of such indicators by any bank has been reported.

As for assets and liabilities by maturity baskets, the cash inflows practically cover cash outflows, in up to 90-day timeframe, in case if the liabilities are not being refinanced. In a near term horizon, there is a significant liquidity gap of only 91-365-day maturity basket. This is a coherent outcome of longer maturities for loans parallel to the deepening of banking intermediation³¹. The ratios of assets to liabilities for up to 30-day (including demand), up to 3-month and up to 1-year maturity baskets amounted to 105.2%, 94.8% and 80.4%, respectively³².

The matched cash flows of assets and liabilities for up to 30-day (including demand) maturity baskets are particularly important for maintaining the current liquidity. In the post-crisis period, the ratio has always been in the range of 90% to 110%, pointing to the banks' ability to assure current liquidity on a continuous basis.

In the first half of 2016, risks to debt concentration of commercial banks have increased somehow: the share of large liabilities in total liabilities grew by 0.9 pp. to 23.9%³³.

The foreign borrowings of commercial banks have decreased by 11.6%. The funds attracted from international financial institutions have fallen by 22.3% to 31.3% of total foreign borrowings. The main lender countries include Netherlands (21.8%), Luxembourg (13.5%), the USA (11.2%) and Great Britain (6.9%).

The share of long-term loans amounted to 94.2%, growing by 1.0 pp. as compared to the beginning of the year, which almost excludes risks related to refinancing of such liabilities in a near-term horizon.

³¹ The liquidity positions were calculated as the ratio of assets to liabilities of respective maturity baskets.

³² The calculation of ratios of assets and liabilities includes off-balance sheet contingent liabilities by a 20% weight.

³³ The bank's liabilities for major creditors exceed 5% of total liabilities without considering the interconnectedness.

From the perspective of stability of loan financing sources, the loans to deposits ratio has increased by 1.2 percentage points relative to the beginning of the year and stood at 113.6%³⁴.

Liquidity risk stress scenarios

30.06.2016	Stress scenarios		
	Withdrawal of 25% of individuals' time deposits	Withdrawal of 25% of demand liabilities	Withdrawal of 25% of demand liabilities and 25% of individuals' time deposits
Total liquidity ratio of banking sector	22.1%	24.6%	18.0%
Current liquidity ratio of banking sector	111.5%	171.0%	115.4%

Source: Central Bank of Armenia.

Relative to the results of liquidity risk stress tests conducted at the beginning of the year, there has been some improvement in the stress tests results. Some banks reported breaches of total and current liquidity prudential requirements, in the case of the worst stress scenario. However, high liquid assets in these banks are sufficient to cover the simulated outflow of liabilities. In this context, the emergence of liquidity problems undermining financial stability is estimated to be negligible.

Stress scenario of liquidity risk derived from off-balance sheet contingent liabilities

30.06.2016	Stress scenarios
	When 50% of off-balance sheet contingent liabilities performed
Banking sector total liquidity ratio	25.0%
Banking sector current liquidity ratio	136.7%

According to the results of stress tests to assess liquidity risk arising from off-balance sheet contingent liabilities, some banks reported infringement of prudential total and current liquidity requirements. However, high liquid assets in these banks are enough to cover contingent liabilities. In this context, the liquidity risk arising from off-balance sheet contingent liabilities is estimated insignificant in terms of leaving an impact on financial stability.

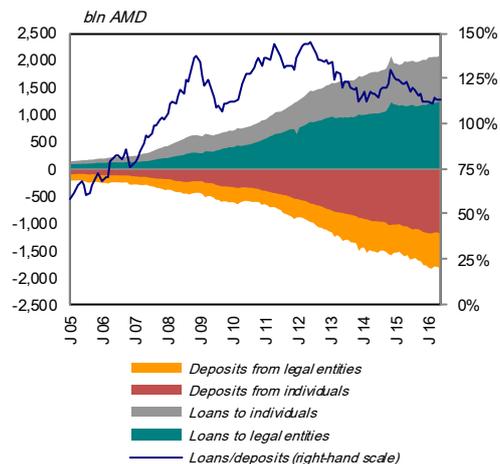
4.1.4. Market risk

Foreign exchange risk

In the first half of 2016, the Armenian dram exchange rate fluctuations against other currencies drove the domestic banking sector to the revaluation gains, reaching AMD 636 million or 0.1% of total regulatory capital. Because of foreign currency revaluation, 6 banks reported profit and 14 banks incurred losses. The banking sector generated net revenue of AMD 7.6 billion from foreign exchange transactions and derivatives.

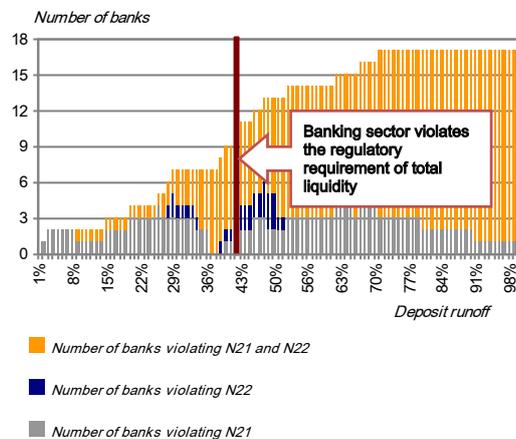
During the first half of the year, the share of foreign currency loans has increased by 0.6 percentage point to 67.2% of the total

Structure of deposit funds of the banking sector used for lending



Source: Central Bank of Armenia.

Number of banks violating liquidity regulatory ratios in case of individuals' call and time deposits runoff

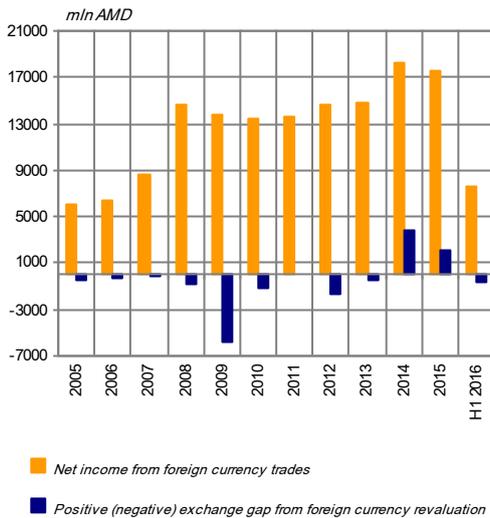


Source: Central Bank of Armenia.

The probable impact of market risk on financial stability is estimated to be insignificant.

³⁴ In the calculation of this ratio, loans include loans to real sector, while deposits include funds attracted from individuals and companies.

Net income of the banking sector from foreign currency trades and revaluation



Source: Central Bank of Armenia.

loan portfolio. The share of foreign currency deposits has decreased by 2.5 percentage points to 68.8% of total deposit portfolio. The banking sector's foreign currency net short position (including derivatives) amounted to AMD 16.2 billion or 3.0% of total regulatory capital (as of 31.12.2015, it was AMD 25.4 billion or 5.4% of total regulatory capital)³⁵.

Foreign exchange risk stress scenarios

30.06.2016	Stress scenarios		
	Profit (loss) in case of 5% appreciation (depreciation) of AMD/USD	Profit (loss) in case of 5% appreciation (depreciation) of AMD/EUR	Possible maximum 10-days loss estimated through VaR Model
Banking sector's profit/loss from foreign currency revaluation	AMD 662 million or 0.12% of regulatory capital (AMD -662 million)	AMD 174 million or 0.03% of regulatory capital (AMD -174 million)	AMD 508.0 million or 0.09 % of regulatory capital

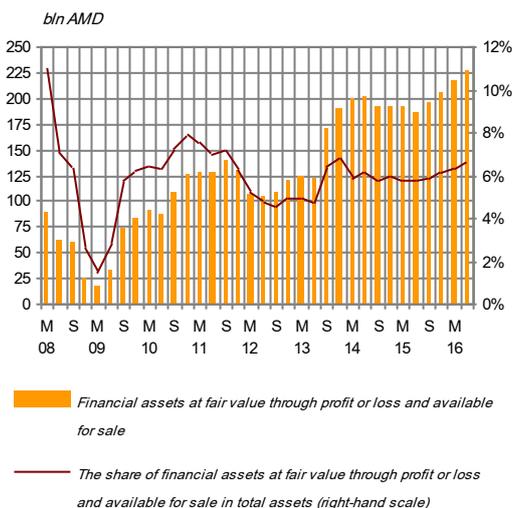
Source: Central Bank of Armenia.

If the worst possible stress scenarios reviewed in the above stress test³⁶ unfold, bank losses resulting from an open FX position will be insignificant and the impact of such losses on financial stability will be weak.

Interest rate risk

In the first half of 2016, the interest rate risk remained low. In the context of asset and liability management, the commercial banks use strict limits for maturity time baskets. Thus, the average weighted duration gap of the present value of assets and liabilities of the banking sector varies in the region of half-to-one year. This means that possible fluctuations in market rates will not lead to major losses in the banking sector.

Share of financial assets at fair value through profit or loss and available for sale in total assets



Source: Central Bank of Armenia.

Interest rate risk stress scenarios

30.06.2016	Impact of 2 pp. increase (decrease) of market interest rates on the economic value of capital, estimated through the "Duration Method"	Deviation of net interest income from expected income of the three months ahead in case of 2 pp. increase (decrease) of market interest, estimated through the "Interest rate-sensitive assets and liabilities Gap Method"
Banking sector's profit/loss	AMD -10.7 billion or 2.0% of banking sector capital (AMD 10.7 billion or 2.0% of banking sector capital)	AMD -641.0 million or 0.1% of banking sector capital (AMD 641.0 billion or 0.1% of banking sector capital)

Source: Central Bank of Armenia.

³⁵ The derivative instruments include derivative contracts signed with foreign governments, central (national) banks, financial organizations and international institutions that are rated A + (A1) or higher than A+ (A1) for long-term deposits by Standard & Poor's or Fitch (Moody's)

³⁶ The calculation of losses estimated through stress - scenarios and the VaR Model (the VaR Model is not considered as a stress - scenario since the calculation of the model considers historical exchange rate series of currencies) is based on FX positions of commercial banks as of 30.06.2016.

In case of the worst possible stress scenarios, possible losses of banks resulting from interest rate vary in the region of 3.3% of the capital. This implies that losses of the banking sector resulting from interest rate fluctuations are insignificant and the impact of such losses on financial stability will be weak.

Price risk

In the first half of the year, the price risk of the banking sector was very low. The share of financial assets available-for-sale and held at fair value through profit or loss has increased by 0.3 percentage point to 6.6% of total assets. (As of 31.12.2015, it was 6.3%).

The net income generated by the banking sector from revaluation of financial assets available-for-sale and held at fair value through profit or loss was AMD 867.0 million.

Risks associated with the real estate price fluctuations remained manageable. Domestic commercial banks further provided mortgages with loan-to-value ratio mostly between 60-80%, while taking quite a strict approach in evaluating borrowers' creditworthiness. Such restrictions significantly lower the possibilities of loan losses from real estate price volatilities.

Real estate price change stress scenarios

30% depreciation of real estate	30.06.2016
The banking sector's loss due to revaluation of own real estate property (price risk)	AMD 13.4 billion (or 2.6% of banking sector capital)
The banking sector's loss due to a 30% loss of vulnerable credit portfolio ³⁷ (taking into consideration that the collateral involved has been sold at a depreciated cost), if a stress-scenario occurs (<i>credit risk</i>)	AMD 19.0 billion (or 3.6% of banking sector capital)
The banking sector's loss due to a 100% loss of vulnerable credit portfolio (taking into consideration that the collateral involved has been sold at a depreciated cost), if a stress-scenario occurs (<i>credit risk</i>)	AMD 63.2 billion (or 12.0% of banking sector capital)

Source: Central Bank of Armenia.

In case of the stress scenario with 30% depreciation of real estate prices, the maximum potential losses of commercial banks associated with price risk and credit risk derived from the price risk have increased compared to the beginning of the year. This is mainly attributable to the increase in the loan-to-value ratio of real estate secured lending. In view of moderate fluctuations of the real estate price and the last years' developments, financial stability is assessed as not vulnerable to the impact of credit and price risks.

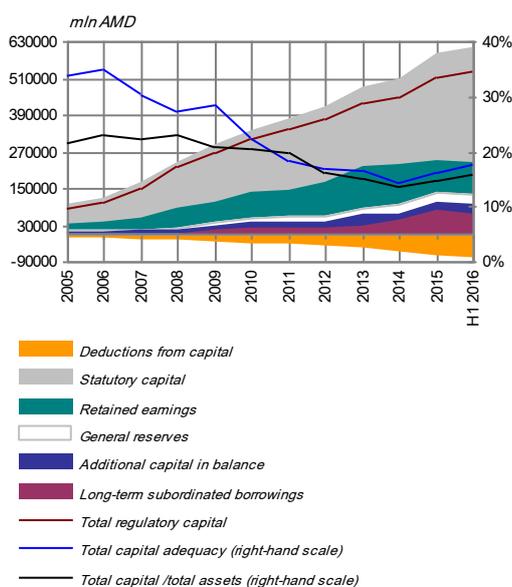
4.1.5. Capital adequacy and profitability

In the first half of 2016, commercial banks' total capital adequacy ratio rose by 1.2 percentage point to 17.4%. Individual

³⁷ Vulnerable loan portfolio represents the sum of loans outstanding, the residual values of which exceed the 30% devaluated values of the real estate used as collateral.

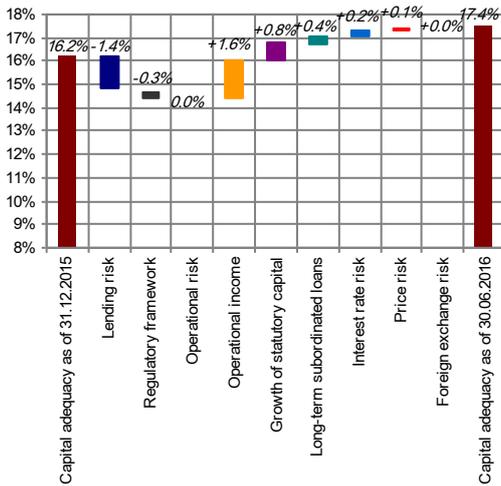
The capital adequacy of commercial banks is improving.

Structure of total regulatory capital

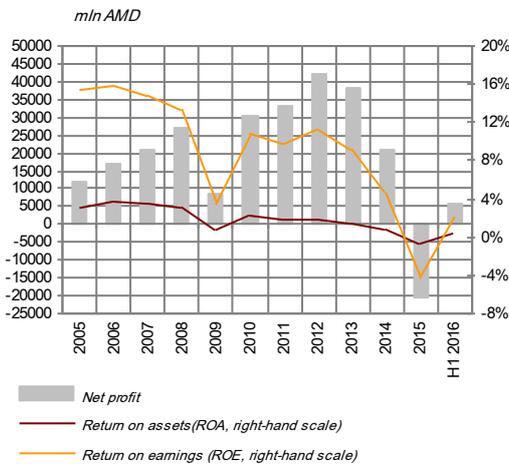


Source: Central Bank of Armenia.

Total capital adequacy of banks -Waterfall



Profitability ratios of the banking sector



Source: Central Bank of Armenia.

banks kept their total capital adequacy prudential indicators higher than the minimum requirement of 12.0%, so no bank reported breaches of capital adequacy requirements. The improvement of total capital adequacy at banks was driven by net profit, replenishment of statutory capital and the attraction of long-term subordinated loans. The deterioration of the loan portfolio quality and the deductions from the total capital under regulatory requirements have negatively influenced capital adequacy.

Total regulatory capital of commercial banks grew by 10.6% to AMD 524.9 billion during the half of the year. In terms of risk absorption capacity, the quality of the total regulatory capital structure is high. The share of CET1 capital is 84.1% of total regulatory capital.

The banking sector net profit, calculated in accordance with the International Financial Reporting Standards (IFRS), amounted to AMD 12.3 billion, while return on assets (ROA) was 0.7 percent and return on equity (ROE) was 4.7 percent, in the first half of 2016 (the ratios were 0.3% and 1.8% respectively, in the same period of the previous year).

The banking sector net profit, calculated in accordance with the Central Bank supervisory reports³⁸, amounted to AMD 5.6 billion, with 14 banks reporting net profit and 7 banks incurring losses. The annualized ROA and ROE profitability ratios of the banking sector were 0.3% and 2.1%, respectively (-0.5% and -2.9% in the same period of the previous year).

The return on equity improved due to an increase of the return on assets, while the decreased leverage ratio left its negative impact on it. The ROA grew as compared to the same period of the previous year due to a 1.1 pp. decrease of the net provisioning to assets ratio, which was attributable to the improvement of loan portfolio.

The shares of interest income, interest and non-interest expenses increased in the banking sector income and expenditure structure, while the shares of recoveries from asset loss provisions and allocations for asset loss provisions decreased. These structural changes are due to some improvement of the loan portfolio, as compared to the same period of the previous year.

³⁸ This differs from IFRS mainly on the part of contributions to assets loss provisioning.

4.2. CREDIT ORGANIZATIONS

Credit organizations represent the second largest sector of the Armenian financial system, with assets comprising 8.4% of the financial system. During the reporting period, assets, liabilities and total capital of credit organizations increased considerably.

Assets, liabilities, capital and profit of credit organizations

(thousand AMD)

Indicator	31.12.2015	30.06.2016	Growth (%)
Assets	308,627,870	330,206,944	7.0%
Liabilities	176,420,773	176,040,048	-0.2%
Capital	132,207,097	154,166,896	40.6%
Net profit	10,331,546	6,813,578	

Source: Central Bank of Armenia.

In the first half of 2016, the total capital of credit organizations demonstrated a growth rate outpacing that of the total assets by 33.6 percentage points. As a result, the total capital-to-assets ratio (leverage ratio) has increased by 3.9 percentage points to 46.7%.

The profit of credit organizations, calculated in accordance with the IFRS, totaled AMD 7.0 billion, with return on assets (ROA) and return on equity (ROE) at 4.3% and 9.5%, respectively.

During the half of the year, 21 credit organizations posted a profit and 11 reported losses, calculated in accordance with the Central Bank supervisory reports. The return on assets and return on equity of credit organizations have grown by 0.4 and 1.5 percentage points relative to same period of the previous year to 3.6% and 8.5%, respectively.

The share of non-performing loans and receivables has fallen by 0.3 percentage point to 6.3% of the total loan portfolio and receivables. The share of non-performing loans and receivables is relatively high in consumer loans, loans to construction and trade sectors, amounting to 18.1%, 11.0% and 10.6%, respectively.

Relative to the same period of the previous year, the ratio of net asset loss provisioning to total assets has decreased by 0.1 pp. to 1.3%.

In all maturity time bands of assets and liabilities (up to 180-day (including demand instruments), from 180-day to 1-year, more than 1-year), the amount of assets was in excess of the amount of liabilities. All other factors being equal, this clearly indicates that the level of liquidity risk of credit organizations is low.

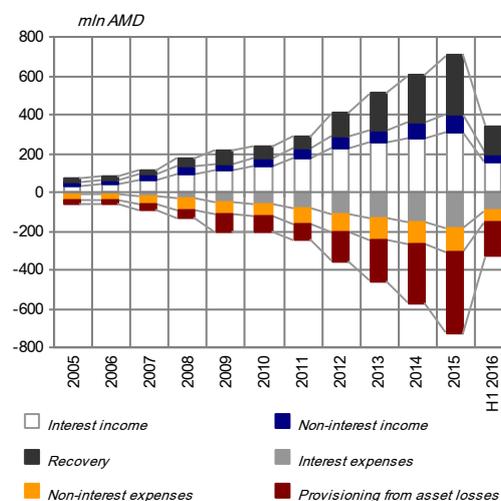
*Credit risk assessment stress scenarios*³⁹

30.06.2016	Stress scenarios		
	25 % of loans in watched, substandard and doubtful categories classified into loss loans	75 % of loans in doubtful category classified into loss loans	30 % of loans in standard category classified into watched loans
Total loss of credit organizations	AMD 3.6 billion or 2.4% of regulatory capital	AMD 927 million or 0.6% of regulatory capital	AMD 6.8 billion or 4.5% of regulatory capital

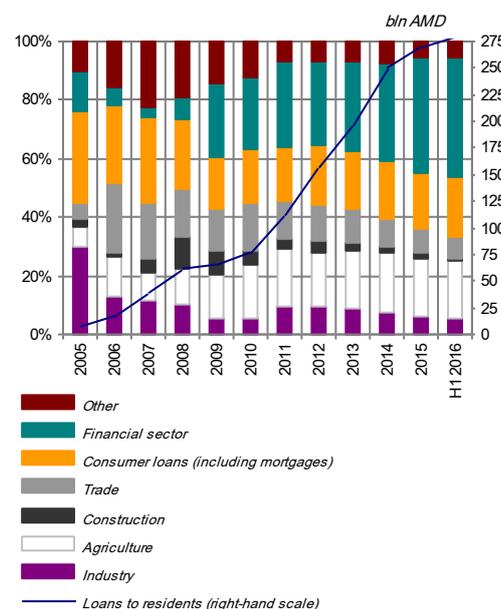
Source: Central Bank of Armenia.

³⁹ Stress scenarios are built on an assumption that the amounts of loans of credit organizations are unchanged and the secured property is ignored (which means when loans are classified as loss, a possible sale of the collateral is not considered).

Profit and loss of the banking sector



Balance of loans to residents by credit organizations, by economy sectors



Source: Central Bank of Armenia.

As compared to the banking sector, the credit organizations are much more capitalized. According to various stress scenarios, credit organizations are fully capable of absorbing potential risks.

4.3. INSURANCE COMPANIES

As of June 30 2016, there were 7 insurance companies licensed to perform the insurance business in the Republic of Armenia.

During the first half of the year, the assets of insurance companies increased by 4.3% to AMD 42.9 billion and the amount of liabilities decreased by 0.4% to AMD 24.3 billion. Total capital has increased by 11.0% to AMD 18.6 billion. As of June 2016, the share of insurance companies in the financial system remained unchanged, 1.1% of total assets of the financial system. The amount of premiums written, the main indicator of insurance activity, has increased by 1.5% as compared to the same period of the previous year to AMD 16.2 billion (this indicator increased by 11.2% during the same period of the previous year).

The premium to GDP ratio, another key indicator of insurance companies, remained unchanged at 0.62%⁴⁰. In June 2016, the premium per capita ratio was AMD 10,538, increasing by 0.8% compared to 2015.

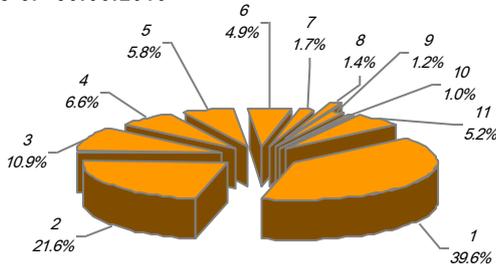
In the first half of 2016, the loss ratio of insurance companies has reduced by 3.1 percentage points to 45.8%⁴¹. The insurance companies' expense ratio has decreased by 1.2 percentage point in relation to the previous year to 28.6%⁴².

The shares of risk-weighted assets and required solvency in the insurance sector's capital adequacy ratio were 36.2 percent and 63.8 percent, respectively. The regulatory capital adequacy ratio of the insurance sector was 203.1% (the marginal value of regulatory capital adequacy is 100%).

Solvency risk

The change in solvency levels of insurance companies was assessed in the case of unfolding of stress-scenarios shown below (a 10.0% rise in the indemnification rate and a 5.0% growth of insurance payments). Results suggest that the level of solvency will not incur notable changes, so the likelihood of risks undermining financial stability in the insurance sector is very low.

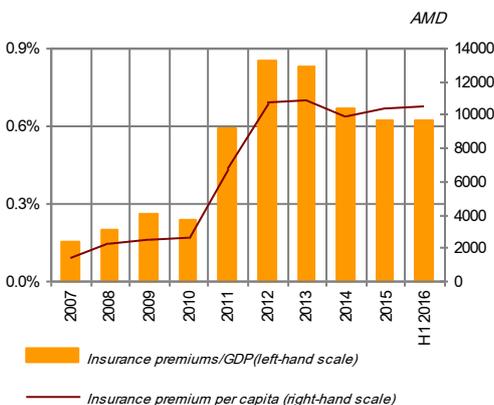
Structure of insurance sector assets, as of 30.06.2016



1. Deposits with banks, 2. Government and non-government securities (including Securities sold under repo agreements), 3. Sums receivable on direct insurance, 4. Fixed assets, 5. Costs for future periods and prepayments on insurance, 6. Reinsurers' share in insurance reserves, 7. Bank accounts and cash, 8. Interest receivables, 9. Claims arising from subrogation, 10. Provided borrowings, 11. Other assets

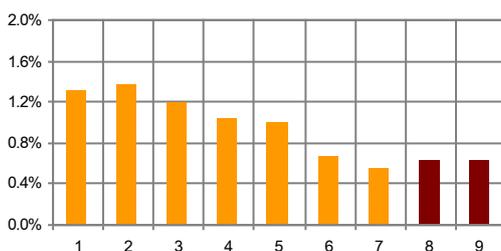
Source: Central Bank of Armenia.

Main ratios of the insurance sector



Source: Central Bank of Armenia.

Insurance premiums to GDP in EEC and CIS (2015)



1. Ukraine 2. Turkey 3. Russia 4. Romania 5. Georgia 6. Kazakhstan 7. Azerbaijan 8. Armenia 2015 9. Armenia 30.06.2016

Source: Central bank of Armenia, Swiss Re, Sigma No 4/2015:

⁴⁰ Based on the 2015 data, the premiums to GDP ratio on non-life insurance was 3.61% on average in developed industrial countries and 1.39% in emerging market countries (source: Swiss Re, Sigma No 3/2016, May 2016).

⁴¹ The loss ratio has been calculated using the following formula: (net accrued indemnity + net provisions to technical reserves + other transaction costs on insurance) / (earned insurance premiums – sums refunded on the contracts terminated- change of UIPR).

⁴² The expense ratio has been calculated using the following formula: non - interest expense / (earned insurance premiums – sums refunded on the contracts terminated- change of UIPR).

Solvency assessment stress scenarios

30.06.2016	Stress scenarios	
	Growth of reimbursement rates, 10%, and insurance payments increase, 5 %	Shocking growth of outstanding claims reserves, 25%
Required growth of UIPR of the insurance sector, if the stress scenario occurs	AMD 0.9 billion or 4.7% of regulatory capital of the sector	AMD 0.4 billion or 2.1% of regulatory capital of the sector
Total capital adequacy ratio of the insurance sector, if the stress scenario occurs	193.6%	198.9%

Source: Central Bank of Armenia.

Credit risk

Allocating funds of the insurance sector in low-risk assets allows keeping the investment risk at a low level. Assets equivalent to technical reserves are invested primarily in time and demand deposits with commercial banks as well as government and non-government bonds.

Credit risk assessment stress scenarios

30.06.2016	Stress scenarios	
	Classifying 30% of "standard" assets into "watched" category	Classifying 5% of "standard" assets into "loss" category
Loss of the insurance sector	AMD 0.7 billion or 4.0% of regulatory capital	AMD 1.3 billion or 7.3% of regulatory capital
The total capital adequacy ratio of the insurance sector, if the stress scenario occurs	196.9%	191.7%

Source: Central Bank of Armenia.

The results of the stress tests of credit risk assessment show that potential loss of the insurance sector is low.

Foreign exchange risk

The results of the foreign exchange stress scenario suggest that the loss of insurance companies resulting from foreign exchange risk is not considerable.

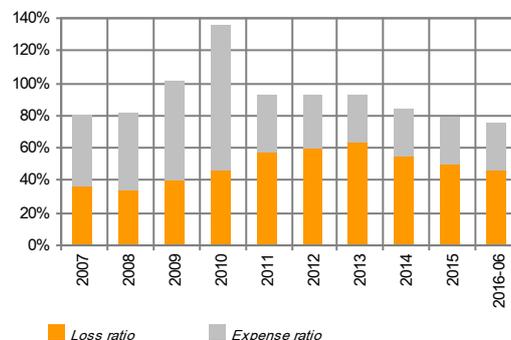
Foreign exchange risk assessment stress scenarios⁴³

30.06.2016	Stress scenarios		
	Gain (loss) in case of 5% AMD appreciation (depreciation) versus USD	Gain (loss) in case of 5% AMD appreciation (depreciation) versus EUR	Maximum potential 10-day loss valued through VaR method
Insurance sector's gain/loss in case of foreign exchange revaluation	AMD 70.5 million or 0.4% of regulatory capital (AMD -70.5 million)	AMD 0.3 million or 0.001% of regulatory capital (AMD -0.3 million)	AMD 18.7 million or 0.1% of regulatory capital

Source: Central Bank of Armenia.

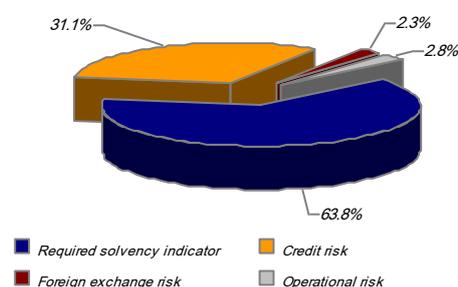
⁴³ The calculation of losses estimated through stress - scenarios and the VaR Model (the VaR Model is not considered as a stress - scenario since the calculation of the model considers historical exchange rate series of currencies) makes an assumption that FX position of insurance companies would not change in a 10 - day time - span.

Profit and loss ratios of the insurance sector



Source: Central Bank of Armenia.

Shares of risk weighted assets and required solvency in the capital adequacy ratio of the insurance sector, as of 30.06.2016



Source: Central Bank of Armenia.

Liquidity risk

The level of liquidity risk in the insurance sector is low, which can be seen through the results of the stress scenario.

Liquidity risk assessment stress scenario

30.06.2016	Stress scenarios
	Sharp increase of outstanding claims reserves, 25%
Required growth of outstanding claims reserves when the stress scenario occurs	AMD 0.4 billion or 2.1% of regulatory capital
Liquidity of insurance companies when the stress scenario occurs	568.2%

Source: Central Bank of Armenia.

Overall, the share of insurance sector in the financial system remains small. The risks to insurance companies are controllable and non-vulnerable in the context of financial stability.

4.4. MANDATORY PENSION FUNDS

In the first half of 2016, there were 2 investment fund managers with permission to operate as mandatory pension fund managers in Armenia. Each of the two manages three mandatory pension funds.

Net asset value (NAV) of mandatory pension funds, as of 30.06.2016

Name of the manager	Name of the pension fund	Net asset value (NAV)
AMUNDI-ACBA Asset Management Armenia CJSC	Balanced fund	AMD 684 million
	Conservative fund	AMD 21.4 billion
	Fixed income fund	AMD 384 million
C-QUADRAT AMPEGA Asset Management Armenia LLC	Balanced fund	AMD 258 million
	Conservative fund	AMD 20.9 billion
	Fixed income fund	AMD 161 million

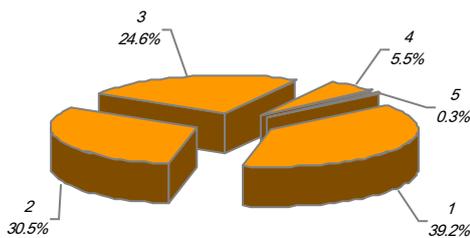
As of end of the first half of 2016, net asset value of the pension funds was AMD 43.8 billion, while net assets-to-GDP was 0.86%, increasing by 0.24 pp. compared to the end of 2015. There were 155,000 active participants in pension funds.

The Herfindahl-Hirschman concentration index for pension fund investments decreased as compared to 2015 to 0.31.

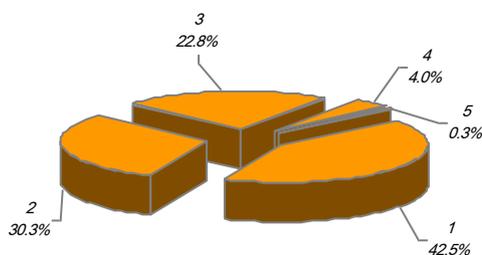
In the first half of 2016, the shares of non-government bonds, as well as cash and deposits in the structure of funds' investments have increased by 2.0 pp. each.

The share of foreign exchange assets of the funds is 36.3% or AMD 15.9 billion, the majority of which (AMD 13.4 billion) were equity shares.

Pension fund investments, as of 31.12.2015



Pension fund investments, as of 30.06.2016



1. RA Government bonds, 2. Equity shares, 3. Funds and deposits 4. Other bonds, 5. Other assets,

Source: Central Bank of Armenia.

4.5. SECURITIES MARKET PARTICIPANTS ⁴⁴

At the end of the first half of 2016, 35 classes of securities of 19 reporting issuers were admitted to trading in the regulated market. Two issuers were accountable on both shares and bonds.

At the end of the first half of the year, the total amount of shares issued was AMD 43.4 billion, while that of bonds was AMD 30.4 billion. The share of equity securities issued by four commercial banks was 58.3% of the total issuance of securities, while the share of bonds issued by four commercial banks was 57.7% of the total issuance of bonds. 12 of these 23 bonds were in foreign currency with their share making up 56.9%.

In the first half of 2016, there were 20 banks providing investment services and 8 investment companies in the securities market of Armenia.

Relative to the previous year-end, total assets of investment companies increased by 32.8% and amounted to AMD 38.0 billion, and total capital grew by 20.9% to AMD 5.0 billion. Total profit of investment companies was AMD 590.7 million. Moreover, all companies posted a profit.

The capital adequacy of investment companies grew by 0.9 pp as compared to the end of the previous year to 24.3% in June. The credit risk of investment companies accounted for 77.8% of risk-weighted assets, the market risk constituted 20.6% and the operational risk, 1.6%. Remarkably, the interest rate risk had the largest share in market risk of investment companies (82.5%), while foreign exchange and share price risks constituted 16.9% and 0.5%, respectively. The capital adequacy of investment companies is much higher than the required minimum level, and the abovementioned risks are manageable.

In the first half of the year, there were 2234 security issuers' registers and 106946 owners in the Central Depository of Armenia. There were 27 conversion transactions conducted in the Central Depository of Armenia, which augmented the number of securities by 27.4 thousand to 623.8 thousand.

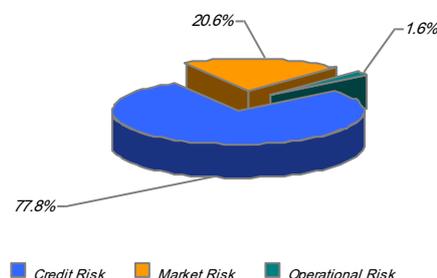
The securities market participants as a whole have low-risk level activity in terms of financial stability vulnerability.

SUMMARY

In the first half of 2016, the financial intermediation improved. The commercial banks have significantly increased the volumes of lending to the economy, which, however, was also accompanied by a decrease in the loan repayment. The accelerated growth of the loan portfolio in the previous years and economic growth slowdown were the main contributors to the deterioration of the loan portfolio quality. Nonetheless, the capital adequacy and the liquidity of the banking sector have improved due to the statutory capital replenishments. This has contributed to financial stability.

Non-bank financial institutions underwent volumetric expansion, while the regulatory indicators were maintained within required limits.

Structure of assets in the capital adequacy ratio of investment companies, as of 30.06.2016



Source: Central Bank of Armenia.

⁴⁴ The participants of the Armenian securities market are the security issuers and investors in securities, the investment service providers, managers of investment funds, and the Central Depository, as well as the operator of the securities regulated market.

5. FINANCIAL MARKET INFRASTRUCTURES STABILITY

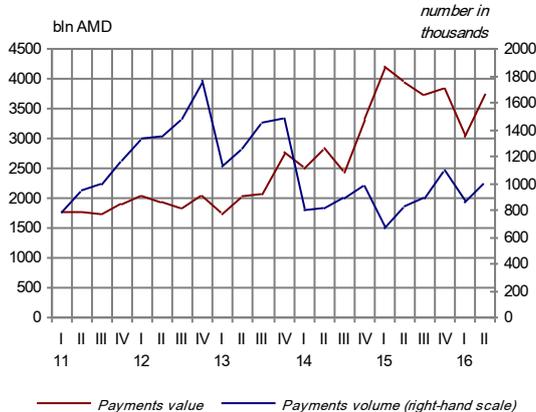
Given the importance and the impact of payment and settlement systems on the monetary policy and financial stability of Armenia, the Central Bank further pays due attention to systemically important payment and securities settlement systems and the telecommunication networks supporting their activity.

In Armenia, over 99 percent of interbank settlements are made via the Central Bank systems⁴⁵.

5.1. INTERBANK PAYMENTS VIA ELECTRONIC PAYMENT SYSTEM OF THE CENTRAL BANK

The results of monitoring of the EPS functioning suggest that the system is safe and does not create problems in terms of financial stability.

Payments via Electronic Payment System (without exchange market transactions)



Source: Central Bank of Armenia.

In the first half of 2016, there were about 1.9 million payments (payment messages), totaling AMD 6789.5 billion, executed via the Electronic Payment System (EPS) of the Central Bank of Armenia.

In the period under review, the value and number of payments were resumed after a sharp decrease in the first quarter, and registered a quick pace of growth afterwards. The interbank payments have the biggest share in total EPS payments. However, the operations with the Central Bank considerably affected the increase of EPS payments by value in the second quarter. These operations mostly include cash flows in relation to the Central Bank's deposit facility, which are liquidity flows rather than payments by their nature. The interbank payments have an important impact on the number of EPS payments, as the majority of those payments takes place by a single message type, while the number of operations with the Central Bank is small and constitutes an insignificant part of total payments.

The risks in the system are reviewed separately for each area described below.

Credit risk

Credit risk to the settlement bank (i.e. the Central Bank of Armenia) in the system is non-existent since the participant can use an intraday repo instrument in case of insufficient funds on their correspondent account, which is secured by government bonds of the Republic of Armenia, securities of the Central Bank of Armenia, and/or high-rated corporate bonds. The size of the attracted fund is calculated using the percentage subtracted from the market value of the bond (haircut). Nor is there credit risk to the recipient as it receives the notice of the payment only after the payment is made final and irrevocable⁴⁶.

There is no credit risk identified in the EPS.

⁴⁵ Payments via the Central Bank systems involve EPS payments without stock exchange trades, also transactions concerning the CBA indirect monetary instruments, the Central Bank's internal payments, as well as final settlements of ArCa cards system and the cash leg of the transactions of the Government Securities Accounting and Settlement System (GSASS). For details, please see the paper "Payments and Securities Settlement Systems in the Republic of Armenia", 2010.

⁴⁶ For details, please see the "Financial Stability Report", 2007, and the paper "Payments and Securities Clearance and Settlement Systems in the Republic of Armenia", 2010.

Liquidity risk

In the period under review the daily average indicator of own liquidity used for assessment of liquidity risk⁴⁷ surpassed the previous year's maximum indicator, reaching to 5.3 in March (the maximum was 4.7 in November 2015). This unprecedented high level was due to amendments in the regulatory framework of reserve requirements implemented in December 2014. As a result, the liquidity held in AMD correspondent accounts of banks with the Central Bank notably increased. The average ratios of the beginning day liquidity remained on the same level during the reported period. The value of payments (the debit turnover of accounts) declined, though increasing during the second quarter. The aforementioned resulted in a significant rise of own liquidity indicator, having a positive impact on the management of the liquidity risk in the system.

In assessing the liquidity risk, it should be noted that the calculation of the abovementioned indicator does not include incoming payments (crediting of the account) and/or funds from other sources to increase liquidity.

The indicator was monitored across the individual banks as well, and the results of the monitoring suggest that the likelihood of liquidity risk is minimal.

Reported rejections in the system and their share in total payments made through the system are also important measures for the assessment of the liquidity risk.

The number of rejections due to insufficient liquidity as well as its share in the EPS payments remain negligible – a maximum of 0.2% by value and 0.002% by number.

These rejections are merely due to individual cases and may be a result of improper management of liquidity (payment flows) by the participants, so this could not affect the liquidity of the system.

Intraday distribution of payments

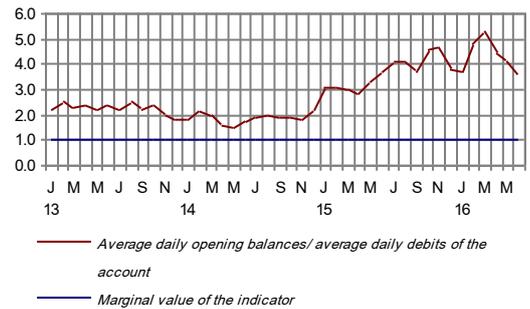
In the reported period, 28.4% of the value and 16.8% of the number of payments were settled during the peak hours (10:00-11:00 and 15:00-16:00, respectively).

Despite some smoothening in the intraday distribution of payment volumes, 2 peak hours for value of payments remain in the system (at the beginning of the operational day, from 10:00 to 11:00, 28.4% of total value of payments and at the end of the operational day, from 15:00 to 16:00, 16.1% of total value of payments). It is noteworthy that a sharp increase of peak hour for value of payments was registered during the second quarter (from 10:00 to 11:00, 34.6% of total value of payments as compared to 22.2% registered in the first quarter), though, practically, the semiannual trend remained unchanged. This upsurge was mainly due to cash flows in relation to the Central bank's deposit facility.

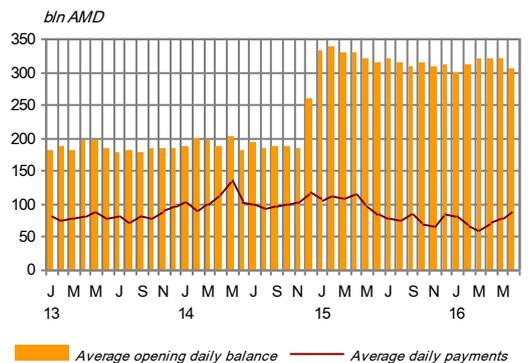
⁴⁷ The daily average indicator of own liquidity is calculated on the basis of a ratio of opening liquidity on dram correspondent accounts of commercial banks to debits (payments) through the account. Incoming payments are not included in the indicator so that a stress-scenario can assess the likelihood of bank rejections if additional liquidity is not available within a day, namely to which extent would banks generate their payments using only opening balances of their own funds. The calculation does not include cash enhancements through their own accounts of commercial banks. The indicator is calculated for a system level (aggregate for all banks), so indicators may vary across commercial banks.

The likelihood of emergence of liquidity risk and systemic problems in the EPS is negligible.

Dynamics of own liquidity indicator



Average daily payments and average daily opening balances

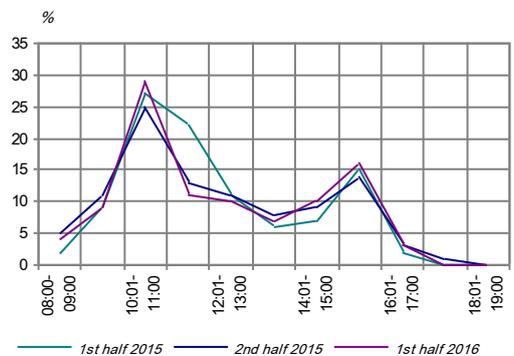


Source: Central Bank of Armenia.

The rejections due to insufficient liquidity are negligible.

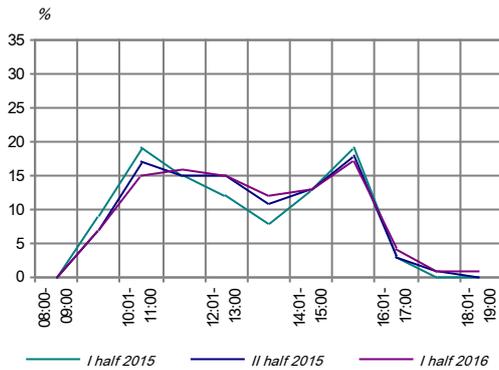
Some concentrations during certain hours did not cause problems.

Intraday distribution of value of payments on an average semiannual basis



Source: Central Bank of Armenia.

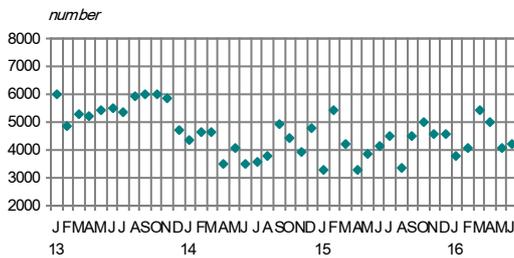
Intraday distribution of number of payments on an average semiannual basis



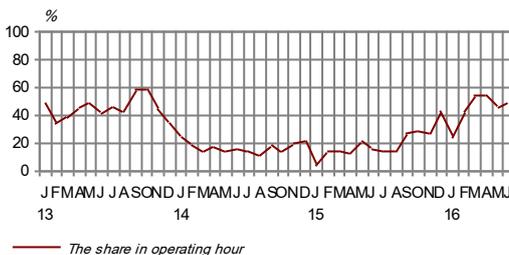
Source: Central Bank of Armenia.

During the reported period, the payments per hour grew, though the probability of risk emergence to the system capacity is low, overall.

Maximum number of payments per hour, by month

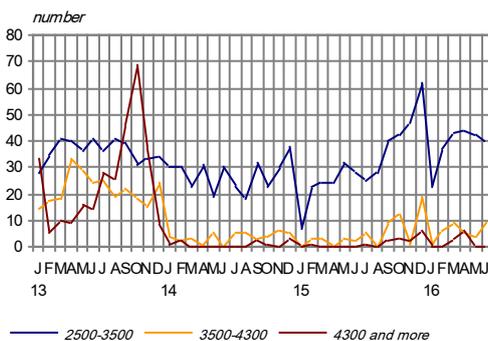


Dynamics of 2500 and more payments per hour and share in the operating hour in the given month



— The share in operating hour

Dynamics of payments exceeding the threshold of 2500, 3500 and 4300 payments per hour



Taking into consideration these trends, as well as the sufficient level of system capacity, positive outcomes of liquidity and operational availability indicators and negligible share of rejections in total payments (for details, please see the previous subsections), the uneven distribution and concentration of payments during certain hours of the day did not lead to problems and the likelihood of risk emergence to the system is generally low in the first half of 2016.

System capacity

In the first half of 2016, the hourly maximum of payment flows (the maximum number of payments per hour for each month) remained at the same level overall, although the number of payments settled during the highest peak hour of the year increased. The maximum hourly indicator grew to 5424 payments per hour against 5419 payments/hour in 2015. The peak hour was recorded in March, from 11:00 to 12:00, making up 30.2% of the number and 22.0% of the value of the day's payments.

The maximum daily indicator (number of payments per day) remained merely at the same level; 27,450, against 26,245 payments/day in 2015.

The shares of all marginal indicators (showing the significant flow of payments per hour) have increased. In particular, the 2500-3500 payments per hour ratio grew significantly.

Taking into account that the minimum potential capacity indicator registered in the system is higher than 6000 payments per hour, and that the cases of the abovementioned levels have small shares in total payments flow, the increase of payments per hour have had no negative effect and the probability of emergence of capacity-related risks is estimated to be low.

Operational availability of the system

In the period under review, only one significant incident affecting the operational availability of the EPS was reported, because of which the operational availability of the EPS was 99.3%. This is quite a high indicator and is in line with the service level defined by the operator⁴⁸.

The above-mentioned incident was caused by technical and operational software problems in the component of the Operational day, which is responsible for system settlement. It was decided to restore the data of the beginning of the day and the operational day was restarted at 15:00. As a result, the operational day was extended, but all the operations were carried out in the given day and no participant incurred problems.

⁴⁸ According to the EPS participation agreement the operational availability of the system should be at least 98.0% yearly.

5.2. CREDIT REGISTRY AND ACRA CREDIT BUREAU

As of the end of the first half of 2016, the number of loans recorded in the Credit Registry was 2,673,843 loans to individuals and 159,767 loans to legal persons, totaling 2,833,610 loans.

Number of loans registered in the Credit Registry, as of 2016 H1

Number of loans	Outstanding	Repaid	Total
Loans to individuals	635 540	2 038 303	2 673 843
Loans to legal persons	16 389	143 378	159 767
Total	651 929	2 181 681	2 833 610

As compared to the first half of the previous year, the total number of loans registered in the Credit Registry increased by 466,821 loans. The Credit Registry possessed information on 161,789 loans outstanding, in the first half of the previous year, and 139,867 loans outstanding, in the first half of this year.

A new software system will be launched till the end of 2016, which will greatly ease the burden of banks and credit organizations by allowing them to provide information to the Credit Registry and ACRA Credit Bureau in one united report.

The new software system includes new methods for identification of natural and legal entities. Moreover, the restriction on the information to the Credit Registry was renegotiated, so that the banks and the credit organizations will provide information on their total loan portfolio.

These amendments may lead to a more efficient use of information provided by the Credit Registry for monitoring and analysis.

The ACRA Credit Bureau

In the first half of 2016, the number of customers registered with the ACRA Credit bureau has increased by 2.3%, relative to December 2015, and amounted to 1,553,169 borrowers as of June 30. Of this number, 98.0 percent are individuals.

The number of loans available in the database has grown by 6.8% and reached 12,251,107, as of June 30, 2016.

Each natural or legal person may obtain information on their credit history from the Credit bureau. In order to get information on the credit history of one's customer or partner, the legal person should sign a contract with the Credit bureau and obtain the written consent of the owner of the credit history.

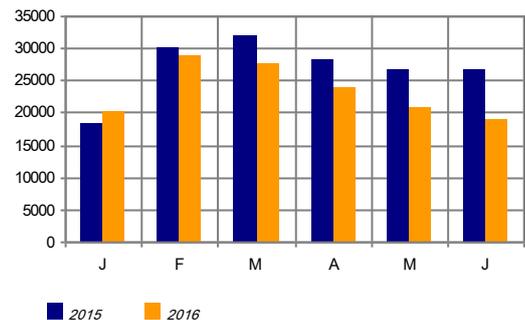
The Credit bureau has started providing credit reports since April 2007. The number of credit reports provided in the first half of 2016 has grown by 7.0 percent compared to the same period of the previous year.

Since 2016, the Credit bureau obtains information from the Securitization fund of credit portfolio and "Nairi Insurance" ILLC.

Negotiations between the Credit bureau and the RA Ministry of Finance concerning obtaining information on tax liabilities non-performed in a duly established timeframe are underway.

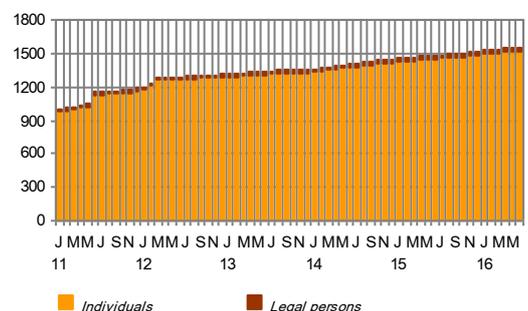
A multi-level coding system has been developed to protect the information owned by the Credit bureau and to prevent its illegal usage by third parties. The system traces all actions and an

Number of loans in the first halves of 2015-2016

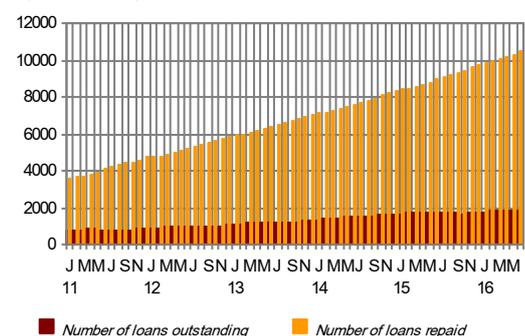


Source: Central Bank of Armenia.

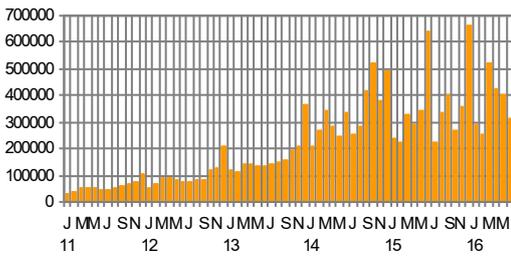
Number of borrowers registered in ACRA database (in thousands)



Number of loans registered in ACRA database (in thousands)



Number of reports provided by ACRA Credit bureau



ongoing monitoring of the system is in place to prevent suspicious and unauthorized actions.

5.3. GUARANTY OF DEPOSITS

In the end of 2015, the amendments to the Law on “Guaranteeing compensation of bank deposits of individuals” came into force, which imply the amount of deposits eligible for remuneration to be AMD 10 and 5 million instead of the previous AMD 4 and 2 million. The sum of guaranteed deposits grew significantly as a result of the increase of the amount of guaranteed deposits. This increase was 51.5% as compared to the end of the 3rd quarter of 2015, i.e. AMD 453,510 million. The share of guaranteed deposits in the total deposits grew by 11.8% compared to the previous quarter, and amounted to 39.1% due to the increase of the amount of guaranteed deposits.

As of the first half of 2016, as compared to the end of 2015, the amount of guaranteed deposits grew by 0.5 pp. to 39.6% of total deposits.

The guaranteed deposits of individuals grew by 5.8% during the last quarter of 2015, while the number of depositors holding guaranteed deposits grew by 2.8%. In the first half of 2016, guaranteed deposits grew by 2.7% and the number of depositors grew by 0.4% to 1,839,292 (excluding former USSR Savings Bank depositors).

The shares of depositors holding dram-denominated and foreign currency deposits (including non-refundable deposits) in total deposits remained the same; 27.3% and 72.7%, respectively.

As of end of the first half of 2016, the share of depositors who hold deposits not exceeding guaranteed amount in the total depositors holding guaranteed deposits was 98.4%. Even before the recent legislative amendments, the Fund was assessing this indicator, e.g. at the end of 2015, this indicator was between 90.3% and 99.3%.

Similar to the previous years, the depositors who hold deposits only in AMD made up the majority of depositors in the first half of 2016. The share of depositors holding only dram-denominated and only foreign exchange deposits constituted 85.3% and 5.6%, respectively in the total number of depositors, thus remaining almost unchanged as compared to 2015.

SUMMARY

The results of monitoring assure that the credit and liquidity risks are minimized in the EPS. The system capacity is sufficient and ensures the continuity of payments during the day. No operational risks were recorded in the system; the operational availability of the system was maintained on an internationally accepted level.

Overall, the functioning of both the EPS and GSASS are assessed as satisfactory enough; the developments in the

payment and settlement system are manageable in terms of the financial stability and no risks exposed to the system arise.

During the first half of 2016, an increase of loans registered with both the Credit Registry of the Central Bank of Armenia and ACRA Credit bureau was registered, along with the development of a united reporting form and the increased efficiency of the general performance.

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GLOSSARY OF TERMS

<i>Economic growth</i>	The growth of volume of goods and services produced in the economy during a certain period of time.
<i>Inflation</i>	An increase in the general level of prices of goods and services.
<i>Gross value added</i>	Is calculated according to economic activity as a difference between output and intermediate consumption of goods and services. The expression “gross” shows that the figure includes the value of fixed capital consumed during the production process.
<i>Consumer price index</i>	An index of the variation in prices paid by typical consumers for retail goods and other items. The consumer price index measures the changes in the price of a market basket of consumer goods and services purchased by households.
<i>Balance of payments</i>	A system of recording of all economic transactions of Armenia (residents and non-residents) with the rest of the world over a reporting period (a quarter, a year).
<i>Foreign trade</i>	This involves an exchange of capital, goods and services across international borders or territories, in the form of exports and imports.
<i>Real export and import</i>	Is a nominal value adjusted by respective import and export prices.
<i>Gross external debt</i>	Gross external debt, at any given time, is the outstanding amount of those actual current, and not contingent, liabilities that require payment(s) of principal and/or interest by the debtor at some point(s) in the future and that are owed to nonresidents by residents of an economy.
<i>Credit risk</i>	Credit risk refers to the risk that a borrower will default on any type of debt by failing to make payments which it is obligated to do. The risk is primarily that of the lender and includes the lost principal and interest, disruption to cash flows and increased collection costs.
<i>Liquidity risk</i>	Liquidity risk is the risk that a given security or asset cannot be traded by the financial institution quickly enough in the market to prevent a loss (or make the required profit).
<i>Foreign currency risk</i>	Foreign currency risk is the risk that a change in exchange rate in the market will adversely affect profits and/or capital of the financial institution.
<i>Interest rate risk</i>	Interest rate risk is the risk that interest rate volatilities in the market will adversely affect profits and/or capital of the financial institution.
<i>Price risk</i>	Price risk is the risk that a change in price of securities in the market or price of similar financial instruments on balance sheets will adversely affect profits and/or capital of the financial institution.
<i>Standard asset</i>	An asset which is serviced under a contract, and is not problematic.
<i>Watched asset</i>	An asset which is serviced under an original contract yet certain circumstances have emerged that may undermine the borrower’s ability to serve that asset.
<i>Substandard asset</i>	An asset the contractual obligations towards which are not performed due to the borrower’s fragile financial standing or inability to repay the debt.
<i>Doubtful asset</i>	An asset the contractual obligations towards which are not performed; it is more problematic, making its collection at the given time very difficult or impossible.
<i>Loss asset</i>	An asset non-collectable and fully impaired uncollectible, so that its recording on the balance sheet is no longer reasonable.
<i>Nonperforming asset</i>	An asset which has been classified by the bank as watched or substandard or doubtful or bad.
<i>Major borrower</i>	A party the risk on which exceeds 5 percent of total capital of the bank.
<i>Major liability</i>	A liability that amounts to 5 percent and more of total liabilities of the financial institution, without regard to affiliation.
<i>Return on assets (RoA)</i>	A ratio of net annual profit to average annual total assets.

<i>Return on equity (RoE)</i>	A ratio of net annual profit to average annual total capital.
<i>Total liquidity</i>	A ratio of high liquid assets to total assets.
<i>Current liquidity</i>	A ratio of high liquid assets to demand liabilities.
<i>Regulatory total capital</i>	The difference between total capital as shown in statement on financial standing and deductions as specified in Central Bank "Regulation 2 on Banks and Banking".
<i>Capital adequacy</i>	A ratio of regulatory total capital to risk weighted assets.
<i>Leverage</i>	A ratio of total assets to total capital.
<i>Off-balance sheet contingent asset</i>	Off-balance sheet contingent assets include outstanding credit lines, credit cards and overdrafts as well as letters of credit, guarantees and warranties provided.
<i>Net provisioning</i>	The difference between provisions to and recoveries from assets loss reserve fund.
<i>Net foreign currency position</i>	The difference between assets and liabilities in FX assets and local currency assets containing FX risk.
<i>Gross foreign currency position</i>	This position measures the sum of absolute values of positions of various currencies.
<i>The Herfindahl-Hirschman index</i>	This index is defined as the sum of the squares of the market shares. It varies between 0 and 1, characterizing the level of concentration (values near to 0 denote lower concentration).
<i>Economic cost of capital</i>	The difference of the present value of total assets and present value of total liabilities.
<i>Spread</i>	The difference between deposit and credit interest rates

ABBREVIATIONS

CBA	Central Bank of the Republic of Armenia
CDA SSS	Securities Accounting and Settlement System of the Central Depository of Armenia
CIS	Commonwealth of Independent States
CJSC	Close Joint Stock Company
ECB	European Central Bank
EPS	Electronic Payments System
EU	Euro Union
FRS	Federal Reserve System
GDP	Gross Domestic Product
GSASS	Government Securities Accounting and Settlement System
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
LLC	Limited Liability Company
NPL	Non-performing Loans
NSSA	National Statistics Service of Armenia
OPEC	Organization of the Petroleum Exporting Countries
OTC	Over-the-counter
RF	Russian Federation
RoA	Return on assets
RoE	Return on equity
USA	United States of America

