

Financial Stability Report (2020 annual report)

2021-05-14

This Financial Stability Report presents an assessment of potential risks that could threaten the stability of the Republic of Armenia's financial system as well as the capacity of the financial system to absorb such risks. More detailed information on Armenia's macroeconomic environment is available in the Status Report on Monetary Policy Implementation. Previous publications of the Financial Stability Report are available on the official website of the Central Bank of Armenia: .

EXECUTIVE SUMMARY

In 2020, Republic of Armenia economy has suffered from the effects of two successive shocks, the pandemic and the martial law. These shocks have in turn created challenges for the financial system, which are significantly different from the those of all previous crises. Restrictions to prevent the spread of the coronavirus, martial law at the end of the year and the high level of uncertainty that followed, resulted in an economic downturn. The Central Bank of Armenia and the Government responded to the current economic situation by pursuing an expansionary macroeconomic policy. The government's policy also included targeted measures to assist affected businesses and vulnerable social groups.

In face of unprecedented shocks, the financial system managed to maintain the proactive stance of activity during the year, which became largely possible due to the sufficient capital and liquidity potential.

Banks continued to provide banking services, giving priority to increasing the availability of online/remote services and customer awareness raising. The commercial lending offered by commercial banks and the revision of loan terms have enabled borrowers affected by the pandemic to redistribute their debt service burden adequately to their future income expectations. Amid growing uncertainties and risks, the banking system continued to lend to the economy, although lending growth rates slowed. The deepening uncertainties and the reduction of the opportunities on attracting financial resources for the banking system led to the reduction of the growth rates of crediting in the fourth quarter. The demand for lending has also decreased due to the growing uncertainty of economic prospects among businesses.

Despite a certain reduction in the growth rate of mortgage lending, the annual growth remains high. In order to effectively address mortgage lending and real estate market risks, the Central Bank is considering the introduction of appropriate macroprudential instruments (in particular, setting Loan-to-Value ratio or other similar arrangements). Against the background of economic decline recorded during the year and decrease of incomes, growth of credit risk was observed. In the face of shrinking incomes of households and economic entities, deterioration of solvency and problems with the debt service emerged. In such circumstances, the materialization of credit risk losses of financial institutions and the share of non-performing loans in the credit portfolio grew. The growth of non-performing loans was mainly due to the increase in the share of non-performing loans in the consumer credit portfolio. Financial institutions have succeeded in mitigating and slowing down the emergence of credit risk through credit reviews and credit holidays, as well as government assistance programs. The provision of credit holidays by financial institutions created an opportunity to curb the swift materialization of credit risk, as well as carry over possible losses to future times. This allowed avoiding a significant deterioration in the quality of the credit portfolio, especially in the first half of the year. At the end of the year, the growth rate of non-performing loans accelerated, which can continue in 2021 as well.

Capital adequacy and banking system liquidity prudentials during the year were met. Despite the recorded credit growth and the absorption of materialized risks, the decrease in the capital adequacy ratio was moderate. Reflected by a decrease in the growth rate of deposits and certain outflow of deposits at the end of the year, the decrease in liquidity indicators was insignificant. As of the end of the year, both capital adequacy and liquidity remained above the thresholds. In the current situation, conservative approaches to lending by financial institutions are quite possible. In almost all directions of lending, a decrease in the volume (flows) of new loans compared to the previous year was observed. Amid the declining economic activity, growth of credit losses and lingering uncertainty, moderate growth rates of the credit portfolio are expected.

Macroprudential policy measures were mainly aimed at strengthening the banking system's resilience to growing risks and ensuring the sustainability of financial intermediation. In order to ensure the continuity and smoothness of lending to the economy, the Central Bank has signaled the banks about the possibility of using capital buffers. At the same time, the level of the anti-cyclical capital buffer remained unchanged at 0%. With the view to mitigating the shocks of liquidity demand, the Central Bank provided the banks with necessary dram and foreign exchange liquidity through its toolkit. The Central Bank emphasizes the use of prudent and balanced capital management approaches by banks. The probability of growth of credit losses and their

deferred impact in the future is estimated as high. Given the current level of capitalization of the banking system, it is obvious that possible violations of the capital buffers can rarely occur in banks. However, due to the current situation, the Central Bank considers it important that banks refrain from distributing dividends and bonuses as much as possible. At the same time, it is important that banks do not engage in transactions that would jeopardize the smoothness and stability of their activity.

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