

Financial Stability Report (2022 annual report)

2023-04-18

More detailed information on Armenia's macroeconomic environment is available in the Inflation Report, Monetary Policy Program, Status Report on Implementation of the Monetary Policy Program periodical publications.

Previous publications of the Financial Stability Report and Inflation Reports are available on the official website of the Central Bank of Armenia (www.cba.am).

EXECUTIVE SUMMARY

In an environment of increased uncertainties caused by the geopolitical tensions, in 2022, the financial system of the Republic of Armenia ensured the normal path of the financial intermediation.

During the year, the credit growth rate of the banking system was generally in line with the growth of real incomes of the economy. The credit market witnessed a surge in activity, evident across all lending domains. Thanks to the robust economic growth, the banking system adhered to normal stance of lending, effectively curbing any further escalation of debt burden and credit risk. Nevertheless, mortgage lending emerged as a distinct outlier, with sustained high growth rates, potentially leading to overheating risks in the mortgage market.

During 2022, the key prudential indicators of the banking system improved significantly.

The banking system's profitability witnessed a substantial upturn, following the low profitability rates observed in previous years. The main driver behind the increase in profitability was the growth in non-interest income, which was fueled by the expanding customer base and a substantial surge in payment and foreign exchange transactions. Additionally, capital adequacy and system liquidity indicators increased, significantly enhancing the loss absorption capacity of the banking system.

In the environment of high inflation and increased inflationary expectations, there has been a significant rise in the policy rate. Meanwhile, the increase of interest rates for existing and new loans was relatively small. Consequently, the impact of these rate

changes on the further escalation of debt servicing costs remained moderate.

A relatively small upward correction of loan interest rates was mainly conditioned by high profitability, capitalization, and liquidity of the banks, which allowed the banking system to refrain from significant increases in loan interest rates. The relatively minor increase in loan interest rates can be attributed primarily to the robust financial health of the banks, characterized by high profitability, capitalization, and liquidity. This enabled the banking system to avoid significant rate hikes. Additionally, factors like fierce competition among banks, reduced demand loan types, a limited share of loans with floating interest rates in the overall loan portfolio, and substantial inflows of funds into the banking system during the year played key roles in contributing to the modest growth of loan interest rates.

Given the heightened geopolitical tensions, the current environment is marked by increased uncertainties, posing risks of future economic activity contraction and the prolonged maintenance of elevated interest rates. Consequently, the potential for a future increase in the debt burden also remains high.

In recent years, the combination of rising income levels and an increase in the proportion of lower interest rate and longer maturity loans in credit portfolios has helped maintain the economy's debt burden at a relatively low level. Nonetheless, the current context of escalating geopolitical uncertainty and both domestic and external inflationary pressures presents substantial risks. These include the possibility of a decline in future economic activity and the continuation of elevated policy rates. As a consequence, there are also high risks of a potential increase in the economy's debt burden and the materialization of credit losses."

There are risks of overheating in the mortgage and real estate market.

The recent years' surge in mortgage loans and real estate prices have been mutually reinforcing in their nature, signifying potential risks of overheating in the real estate market. As of the end of 2022, the Central Bank estimates the possible overvaluation of real estate prices, representing a deviation of about 16-22% from their fundamental levels.

The stress tests indicate that the banking system can successfully withstand the assumed stress events. Nevertheless, given the growing uncertainties, there is a heightened likelihood of systemic cyclical risks materializing. In this context, it becomes crucial for commercial banks to adopt prudent and balanced approaches in managing risks and dis-

tributing dividends.

The Board of the Central Bank of Armenia decided to increase the countercyclical capital buffer.

During the year, the cyclical risks stemming from developments in the overall credit market were generally well balanced (neither elevated nor subdued), while the banking system recorded a high level of profitability and capital adequacy. In light of these circum

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