

Financial Stability Report (2010 annual report)

2011-03-29

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 Annual Report of the Central Bank, Status Report on Monetary Policy Implementation and Armenian Financial System: Development, Regulation, Supervision.

ABSTRACT

Armenia's financial sector has been reasonably stable during the year. Reported economic growth was slower from expectations due to the downfall in agriculture. Instead, growth trend persisted in other branches of the economy. With private remittances and gross national disposable income growing, household incomes kept on increasing. However, inflation has diminished real incomes.

No worsening of risk levels was observed in the financial sector while further positive development expectations solidified instead. The banking system brought growth of lending back on track yet it broadly remained conservative in terms of assessing borrowers. Inflation pressures transmitted from external commodity markets as well as reported slump in agriculture have altered inflation developments significantly. In response, the Central Bank had to revise policy tools to manage inflation adequately. The global economic growth continued, outstripping the projected levels. However, economic growth asymmetry across developed and developing countries is a concern. Advanced economies and some emerging economies need to strengthen employment and financial standing of households, stabilize public debt and scale it down in the future, and to carry out reforms in financial systems.

An unprecedented rise of raw material and food prices built downside risks to the economic growth in advanced economies and high inflation risks for developing and emerging economies. The pace of recovery is even slower in Armenia's main partner countries, i.e. Russia, Euro-area (see details in Developments in world economy section).

There was 2.1 percent economic growth recorded in Armenia fuelled, by and large, by

contributions from the services and industry branches. The decline in agriculture affected economic growth and prices increases on food products. In the second half of the year the official unemployment rate started to dwindle after a slight rise in the first half, and this decrease was associated with growing demand for labor. Growth of external trade and private remittances bounced back albeit the pre-crisis level is yet to be achieved. Over the second half of the year, current account deficit has improved by 2.0 pp to roughly 14 percent of GDP amid accelerated growth rates of exports in dollar terms and slowed growth rates in imports.

In the first six months of 2010 the Central Bank has raised the refinancing rate by a total of 2.25 pp and limited the use of quantitative easing instruments. During the first half of the year the de-dollarization measures coupled with the tightening of monetary conditions made it possible to bring the 12-month inflation close to the upper border of the target band. In the second six months, however, the inflationary environment resurged, this time totally due to supply-side factors which are not a subject of monetary regulation. In a situation like this, in spite of accelerating inflation, the Central Bank withheld from further increasing the refinancing rate, since all estimations hinted that the domestic demand, then recovering at a slow pace, was not creating inflationary pressures (see details in Development in macroeconomic environment in Armenia section).

In 2010, Armenian commercial banks posted growth indicators while maintaining their capital adequacy and liquidity ratios above normative requirements and handling market risks within a comfortable territory of manageability. Banks and credit organizations further eased lending conditions and the growth rate in lending persisted (see details in Stability of financial institutions in Armenia section).

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