

Financial Stability Report (2021 annual report)

2022-04-05

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 2021, the financial system of the Republic of Armenia managed to ensure the continuity of the financial intermediation function, in the context of economic recovery and the uncertainty due to the spread of new waves of the pandemic. During the year, the volume of new loans provided to the economy by the banking system increased compared to the previous year. Deposits grew with relatively high pace, completely recovering to the pre-war level already in the first quarter of the year. No significant tightening of lending conditions by the financial system was recorded during the year.

The credit portfolio of the banking system has decreased, mostly due to the relatively weak demand for credit in the economy. The shrinkage in the loan portfolio was also facilitated by the reasoned materialization of credit risk driven by the shocks of the previous year, and by the decrease of the loan portfolio equivalent in AMD as a result of the evaluation of the Armenian dram. If the exchange rate effect is excluded, the annual growth rate of the total loan portfolio is near to zero. The share of mortgage loans in the structure of total loan portfolio provided to households has increased as a result of continuous high growth rates of mortgage loans in recent years. Given the decreasing consumer loans and high growth of mortgage loans, the share of the latter in the structure of the households' loan portfolio has increased significantly. The steady high growth rate of mortgage loans in recent years is mainly due to the implementation of the current state program of loan interest refunds from the income tax of the borrowers. Concurrently, those high growth rates of mortgage loans contain signals of possible excess of lending or risky lending, which was addressed by the Central bank with the introduction of Loan-to-value (LTV) ratio instrument.

The quality of the loan portfolio improved, along with the recovery of economic activity

and the reduction of credit risk. The share of non-performing loans in total loans has decreased significantly by the end of the year and is now at a historically low level. Moreover, a decrease in the share of non-performing loans was registered in all major types of loans. The average credit losses decreased, compared to the previous year, nevertheless remaining at a high level compared to the non-stress years.

The capital adequacy and liquidity indicators of the banking system improved during the year. The banking system has continuously maintained its capital adequacy higher than the required minimum levels, providing preconditions for absorbing possible losses and ensuring continuity of operations. As a result of the progressive growth of the deposit portfolio compared to the loan portfolio, the banking system's liquidity has been continuously improving. The record of the banking system yields was quite low in the beginning of 2021, conditioned by the adverse effects of the previous year's shocks. The profitability of the banking system started to somehow recover during the second half of the year. The low level of profitability of the banking system in recent years is due to the reduction of the net interest margin conditioned by deepening competition, as well as the more frequent recurring shock events, which lead to increased costs of credit losses.

The low level of profitability remains one of the main challenges of the Armenian banking system, having a restraining effect on the investment potential of the system development and capacity expansion. Given the rapid growth of financial intermediation in recent years and the ever-deepening competition, the improvement of profitability through the extensive growth of banking portfolios and scale effect can no longer be considered as the only basic direction necessary to ensure return. Therefore, it is critical that the financial system of the Republic of Armenia implements qualitative and tangible changes in intermediation, ensuring continuous enhancement of the system digitization, the proposed toolkit and risk management systems.

The macroprudential policy pursued by the Central Bank was aimed at maintaining the continuity of lending to the economy and further improvement of the currency liquidity buffers. The anti-cyclical capital buffer was maintained at 0% during the year, which was based on the developments in the credit market and the position of the Armenian economy on the financial cycle. During the year, the developments in lending by main sectors were not homogeneous, rather obviously high growth rates of lending were recorded only in the field of mortgage loans. To effectively address the risky developments in the mortgage and real estate market, the Central Bank has introduced a macro-prudential instrument of the demand / collateral value ratio, which has been in force since April 2022. To further strengthen the currency liquidity buffers, the foreign exchange component of the reserve requirement continued to increase, because of which

the currency liquidity of the financial system was at an unprecedentedly high level at the end of the year.

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