

Financial Stability Report (2019 1st half)

2019-10-29

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

During the first half of 2019, given the high economic growth in Armenia, positive developments of the labor market, and the easy monetary conditions, the financial system of Armenia remained stable. Meanwhile, financial intermediation continued to deepen, and the credit and deposit portfolios grew. The global growth remained on track during the first half of 2019, although with some slowdown. According to the IMF projections, this trend will be sustained during the second half of 2019. A slowdown in economic growth is expected in the European Union countries, the principal partner countries. During the half-year, the risk of sustained trade protectionism by advanced economies was maintained, which harmed global trade growth, while slowing the growth rate of the global economy overall. In the short and medium-term, a slower-than-anticipated economic recovery of emerging markets and developing countries, continuation of tensions in the international trade, possible fluctuation in financial markets, as well as risks caused by unfavorable geopolitical developments will be highlighted. Given the current economic developments during the first halfyear, developed countries returned to a more accommodative monetary policy. In emerging countries, a capital outflow was recorded, causing slower economic growth rates and depreciation pressures on domestic local currencies.

In the European Union countries and in Russia, which are the leading trade partners of Armenia, a relatively slow economic growth was recorded during the reported period. The latter has not yet caused a fall in foreign demand but has negatively impacted the inflow of money transfers to Armenia from abroad (for details, see section "Developments in the Global Economy"). During the first half of 2019, the economic growth in Armenia was 6.8%, which was mainly driven by structural changes in the economy, institutional reforms by the Government, and the increase in private spending and strong credit growth. The latter, in turn, was fuelled by the accommodative monetary policy of the central bank of

Armenia (for details, see section "Macroeconomic developments"). During the first half of 2019, the Central Bank of Armenia retained its monetary policy direction unchanged, given both the domestic and foreign macroeconomic developments. The refinancing rate was lowered by 0.25 percentage points and was set at 5.75%. Given the persistent economic activity during the first half of 2019 and positive developments in the labor market, lending growth was recorded in the financial system. Due to easy monetary policy, the interest rates for loans and deposits continued to decline. Parallel to more active lending by commercial banks, credit risk has increased slightly, as the share of non-performing loans has gone up slightly. As loan portfolios grew, the banking sector's capital adequacy and liquidity ratios decreased. These indicators, however, continue to remain higher than the minimum regulatory requirements of the Central Bank. Non-bank financial institutions have recorded an expansion of their activities, while the prudential ratios have been maintained within the required limits. Even though the risks hindering the financial stability of Armenia, stemming from both foreign and domestic macroeconomic conditions grew, the financial system has demonstrated a high-risk absorption capacity (for details see section "Stability of financial institutions").

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