

Financial Stability Report (2020 1st half)

2020-10-09

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: .

ABSTRACT

During the first half of 2020, the challenges to financial stability due to COVID-19 pandemic differ drastically from the challenges of all previous crises. The unprecedented scale and nature of the pandemic have led to deep economic recession and uncertainties. The Government of the Republic of Armenia, and the Central Bank of Armenia have taken important measures to mitigate and neutralize the overall consequences of the decline of economic activity, consumption, and income, uncertainties in the financial markets and the banking system due to the pandemic.

The financial system of Armenia during the first half of 2020, has operated under ever-changing and uncertain macroeconomic environment. An economic decline has been registered because of the economic restrictions imposed to stop the spread of the pandemic and to mitigate its consequences. The Central Bank, taking into account the low inflation environment, and the delay of the recovery of external demand, continued implementing expansionary monetary policy by decreasing the refinancing rate. The lightening of the monetary conditions and the continuity of the anticrisis measures by the Government are aimed at recovering internal demand. The financial system has managed to ensure the continuity of the provision of financial services in the economy. Under the restrictions to stop the pandemic, the retail Banks have continued providing banking services. The priority was given to making online banking services more available. The credit holidays offered by the initiative of the commercial banks and the review of loan conditions allowed the borrowers most hit by the pandemic to redistribute the credit servicing burden according to their future expected income.

During the first half of 2020, the growth rate of credit to the economy has been preserved. Thanks to the relatively high level of capital and existence of liquidity buffers in

the banking sector, the anticrisis measures of the RA Government, as well as the appropriate policy response by the CB to the created situation, there has been no decline in the credit growth rate. The growth level of the lending is conditioned by the credit holidays provided by the financial institutions, as a result of which loan repayments have been postponed. However, it should be mentioned, that the developments related to the pandemic and the prospects related to the economic recovery are not certain, and with the weak recovery of incomes in the economy, it is possible that the growth rate of lending will slow down in the future.

Due to the restrictions to prevent the pandemic, the decline of economic activity and incomes will influence negatively the credit portfolio quality of financial institutions. It is assumed, that the loan holidays provided by the financial organizations has allowed to redistribute the expressions of credit risk growth and related losses over time, which will show up partially in the expensis of the second half of 2020 and the credit portfolio quality. The existence of enough capital buffers is an important precondition for financial stability, and the banking system should utilize rational approaches to capital management. In the current situation, the CBA prudential regulation and the macroprudential policy measures are exclusively directed towards enhancing the resiliency of the banking system towards the negative influences of the pandemic. Currently the banking system has enough capitalization. However, taking into account the possible expressions of credit risk due to the uncertainties related to the spread and duration of the pandemic, the banking system should manage capital carefully, avoid or postpone paying dividends.

In 2020, the CBA has realized prudential measures targeted at ensuring the continuity and resilience of the banking system under the risk conditions due to the pandemic. Particularly, the CBA has decreased for 1 percentage point the requirement for Tier 1 capital. This measure was in the list of actions planned for the past few years, but it was being postponed due to the existence of credit overheating risks.

The counter cycle capital buffer has been preserved at the level of 0 percent conditioned by the expectations of decline in credit overheating risks. The measures taken by the CBA are aimed at increasing the banking system's risk absorption capacity, and at the same time creating the opportunity to use the capital buffers developed in the past to satisfy the demand for lending in the economy.

