

Financial System of Armenia. Development, Regulation, Supervision 2009

2010-12-20

Inflation

The 2009 was full of crisis challenges for the financial system of Armenia. Negative indications of global crisis penetrated the financial system already in the fourth quarter of 2008, when economic growth rate declined almost in all areas of real sector.

While implementing policy for mitigating negative impacts of global crisis on Armenian financial system, the Central Bank of Republic of Armenia (hereinafter CBA) considered combination of price stability and financial stability as high priority objective of monetary policy. Because of foreign exchange pressures and conversion of dram denominated deposits to USD, the probability of emergence of foreign exchange liquidity and capital adequacy risks rose. For neutralizing those risks the CBA expanded its intervention in foreign exchange market at the beginning of the year (January and February) with the view of stabilizing foreign exchange rate. At the same time the CBA was quite active in the financial market allowing banks to strengthen their financial positions and withstand challenges rising from the global financial crisis. At the beginning of March, when the financial system was already sufficiently capitalized, liquid and ready to withstand challenges of financial crisis, the CBA stopped the intervention. As a result, the national currency depreciated and average annual nominal exchange rate of Armenian dram against US dollar depreciated for 18.8 percent (while end of 2009 to end of 2008 19.4 percent). Because of economic slump, decline of remittances and factor returns, and also because of depreciation of national currency, the risk-related expenses increased. It is notable, however, that the risks stayed at manageable level and the financial system didn't have liquidity and solvency issues. At the same time, because of comparably small volume of short-term external liabilities, Armenian financial system didn't face the problem of resource outflow from the local economy. In the result of anti-crisis activities implemented by the CBA and other financial institutions none of the financial institutions (as well as non-bank institutions) of Armenia faced insolvency problem. The largest participant of the financial system is the banking system which accounts 92 percent of the assets.

From the point of view of the banking system developments the year can be divided into two halves. The first half of the year was the period for identifying and assessing the risks

caused by the crisis, adjustment of the financial positions and development of risk mitigation mechanisms. During the first half of 2009 both Armenian banking system and borrowers exhibited cautious behavior, which brought to decline of credit market activity. As a result, in the first half loans to economy declined for one percent. In the same period the share of non-performing loans (‘‘watched’’, ‘‘substandard’’ and ‘‘doubtful’’ loans) totaled 10 percent. At the beginning of the second half the credit market significantly activated (14 percent growth of loans to economy on annual basis), which was facilitated by stable income expectations of borrowers by banks and borrowers themselves and also by expanding monetary policy and government facilitated programs. In the second half the share of non-performing loans declined and by the end of the year totaled only 4.8 percent of total loans. During 2009, change of the loans structure was one of the distinctive developments according to which loans were mainly issued to legal entities expanding their share in loan portfolio, which in its turn contributed to the economic activity in the second half of 2009.

It is also important that during 2009 capital investments (including also leasing, factoring, credit risk bearing other assets) of the banking system stayed at the same level as in 2008 totaling around 970 billion drams. But since in 2007 and 2008 credit investments rapidly increased, and consequently during 2009 in comparison with the previous year the volume of repayments increased, the growth of credit investments (difference between allocated and repaid credits) during 2009 was less than in 2008 (in 2008 the growth totaled 202 billion drams). One of the specific developments of the year is the surge of dollarization level. The shares of dram assets and liabilities dropped by 12.5 percentage points and respectively totaled 46.9 percent and 32.4 percent.

Overall, despite various challenges in 2009, the banking system has preserved growth and development tendencies and demonstrated high level of flexibility under the crisis conditions. The banking system ensured 29.5 percent growth of assets, 18.2 percent growth of capital and even though low, but profitability (Return on Assets 0.74 percent, Return on Equity 3.43 percent). The level of financial intermediation increased in 2009, but it is still less than in many other CIS countries. Parallel to the growth of assets decrease of nominal GDP was registered. As a result, the ratio of banking system assets to GDP increased by 13.8 percentage points and totaled 41.9 percent. The ratio of loans issued by banking system to GDP increased by 5.3 percentage points and totaled 22.2 percent. In 2009 the CBA took number of measures in order to mitigate the impact of financial crisis on Armenian financial system. The CBA proceeded with reforms to ensure sustainable development of the banking, securities and insurance markets aiming at ensuring financial stability of Armenian financial system, improving clearing systems and

sustainable development of financial system.

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