

“Recent Developments in Global Economy and Implications for Armenia”

Armenia Capital Markets: New
Opportunities and Challenges
hosted by the EBRD

February 7, 2014



Outline

IMF Revised Macroeconomic Global Outlook









Global Financial System in Transition

Implications for Armenia: Managing Risks, Maximizing Opportunities

Global recovery is strengthening,...but we are not yet out of the woods

Real GDP Growth Projections for the Global Economy

(percent change from a year earlier)

								
	World	U.S.	Euro Area	Japan	Russia	China	CCA	Armenia
2014 (Oct. 2013)	3.6	2.6	1.0	1.2	3.0	7.3	6.1	4.8
2014 (Current)	3.7	2.8	1.0	1.7	2.0	7.5	6.1	4.3
2015 (Oct. 2013)	3.9	3.4	1.3	1.2	3.5	7.1	6.1	5.5
2015 (Current)	3.9	3.0	1.4	1.0	2.5	7.3	6.1	4.5

Source: IMF, *World Economic Outlook*.

Global Financial Markets: Transitioning towards Stability

Transitions

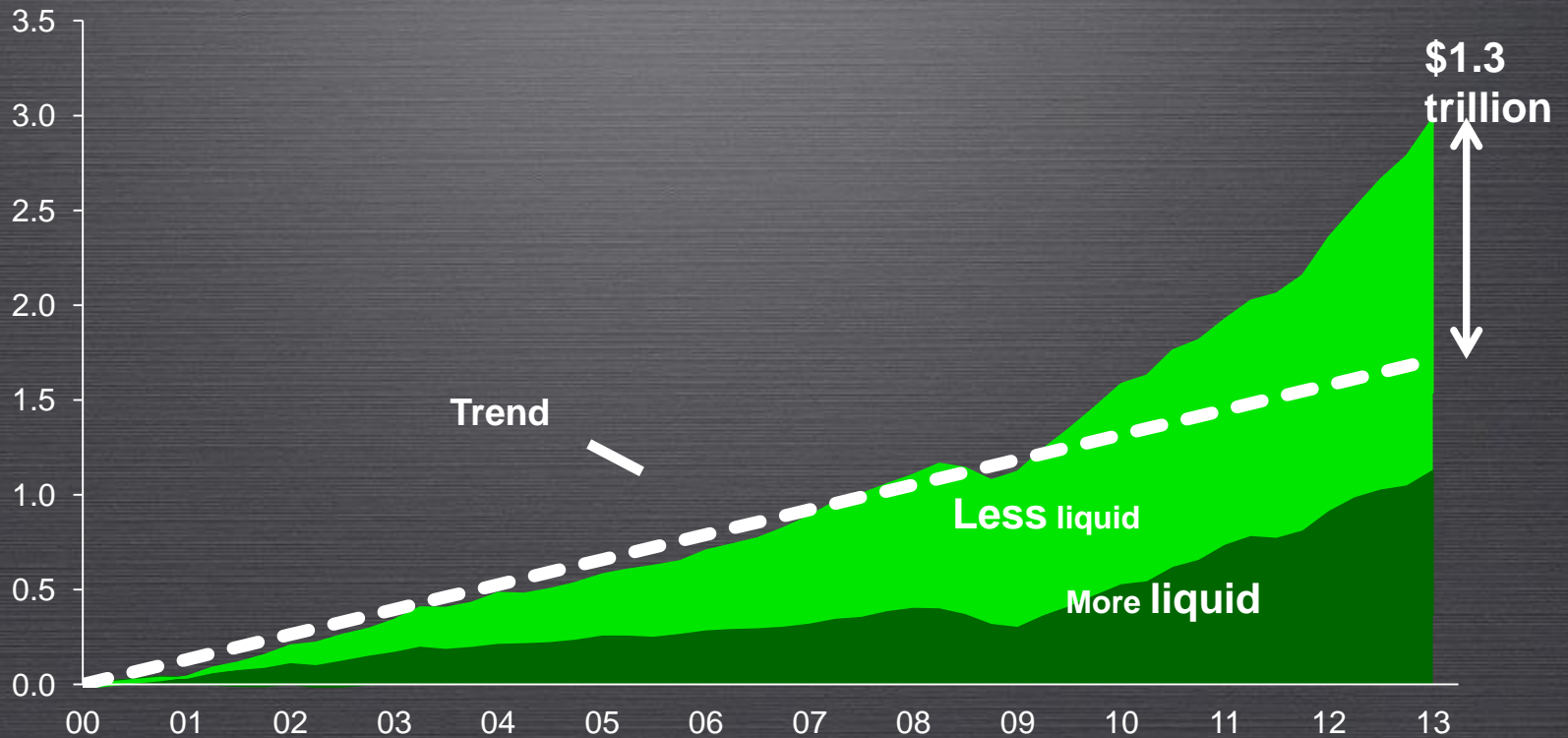
- Monetary: US exit, Japan entry
- Financial: Emerging markets, euro area.
- Regulatory: Global regulatory reform

Challenges and Risks

- Side effects of unwinding U.S. QE
- Low inflation in Euro Area
- Structural vulnerabilities of EME and capital outflows reversal
- Difficult policies choices ahead

In a context of massive shift to fixed income...

U.S. Mutual Fund Cumulative Flows into Bonds
(trillions of U.S. dollar)



...especially towards EME Fixed Income...

Cumulative Bond Flows from Advanced Economies to Emerging Markets (percent of AE GDP)

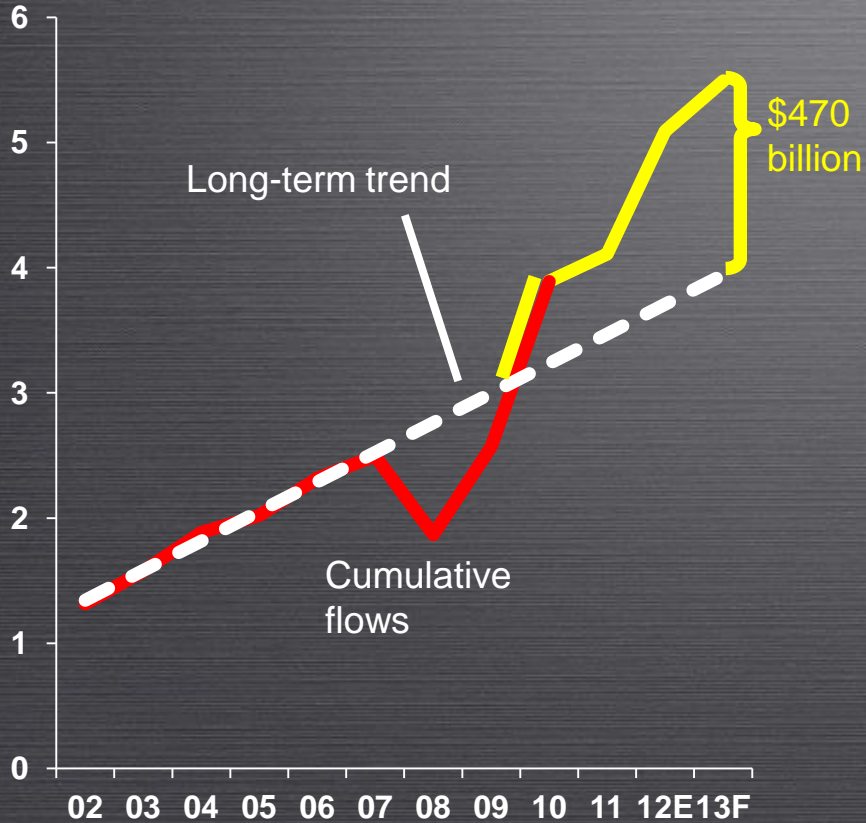
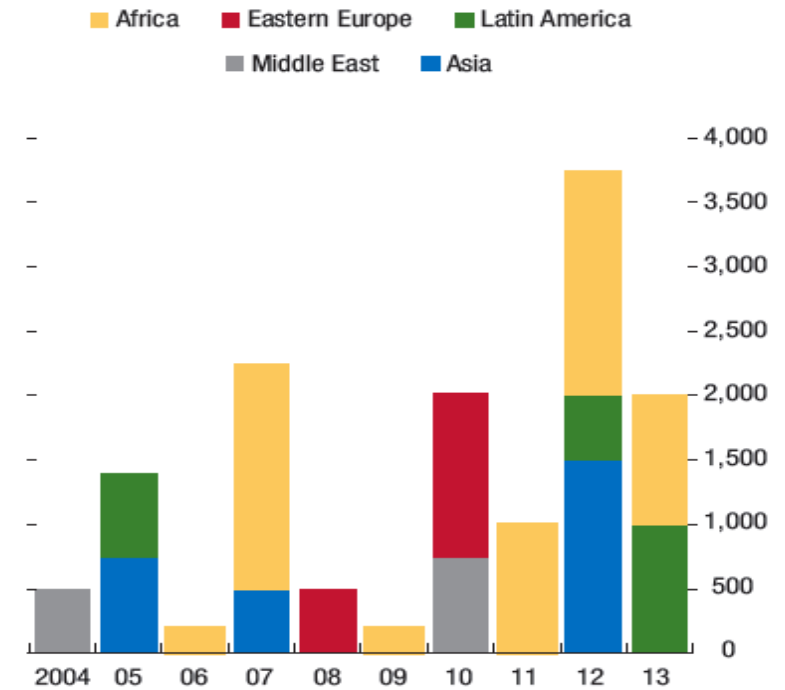


Figure 1.2.1. International Bond Debut Issuance

(Millions of U.S. dollars)



Source: Dealogic.

...which translated into a large presence of non-resident investors and a rate compression.

Share of nonresident holdings of local currency government debt (percent)

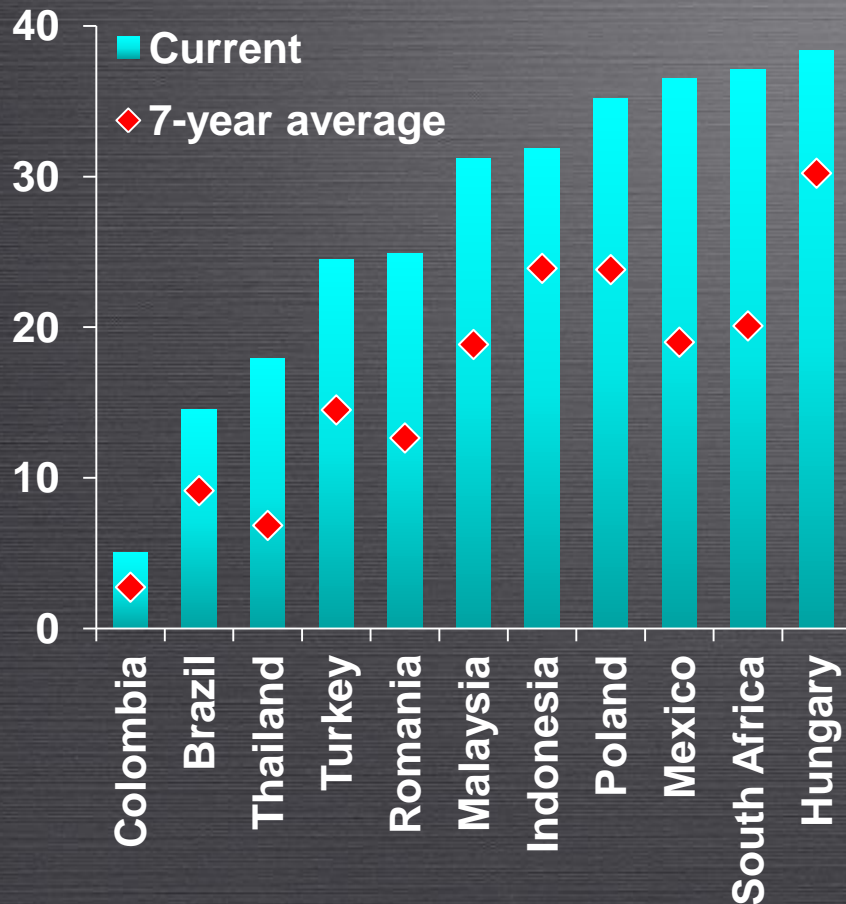
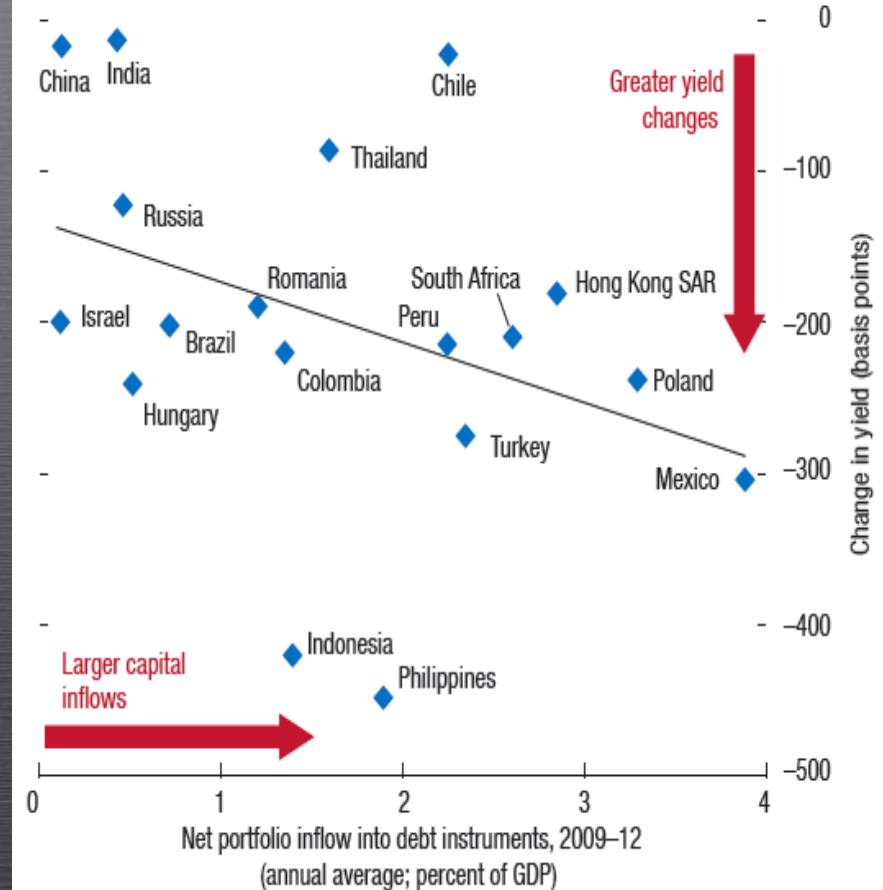


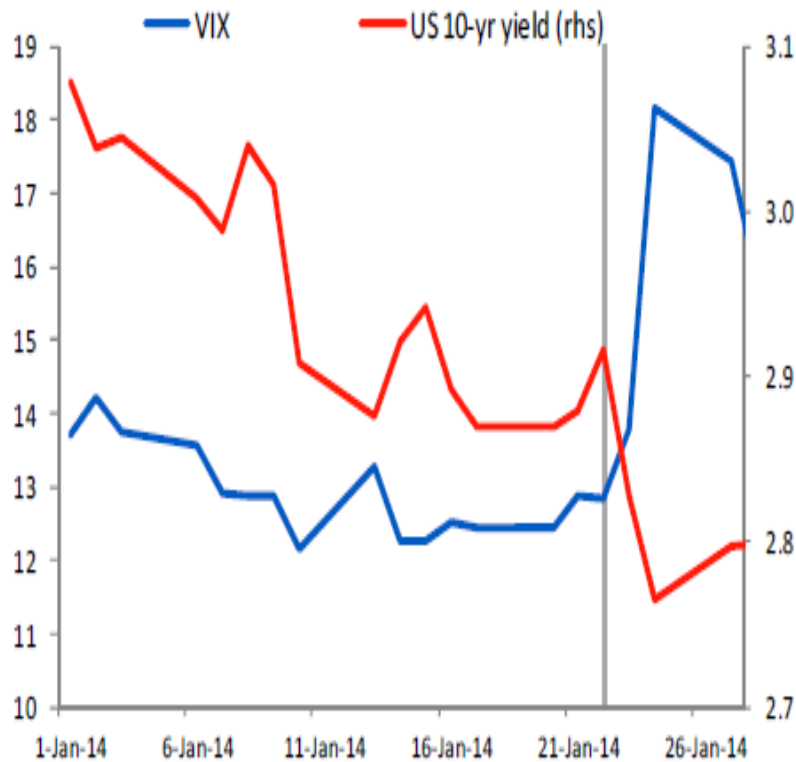
Figure 1.17. Impact of Portfolio Flows on Local Currency Bond Yields



More recently, a sudden large increase in EME volatility and large capital outflows

Increased global risk aversion ...

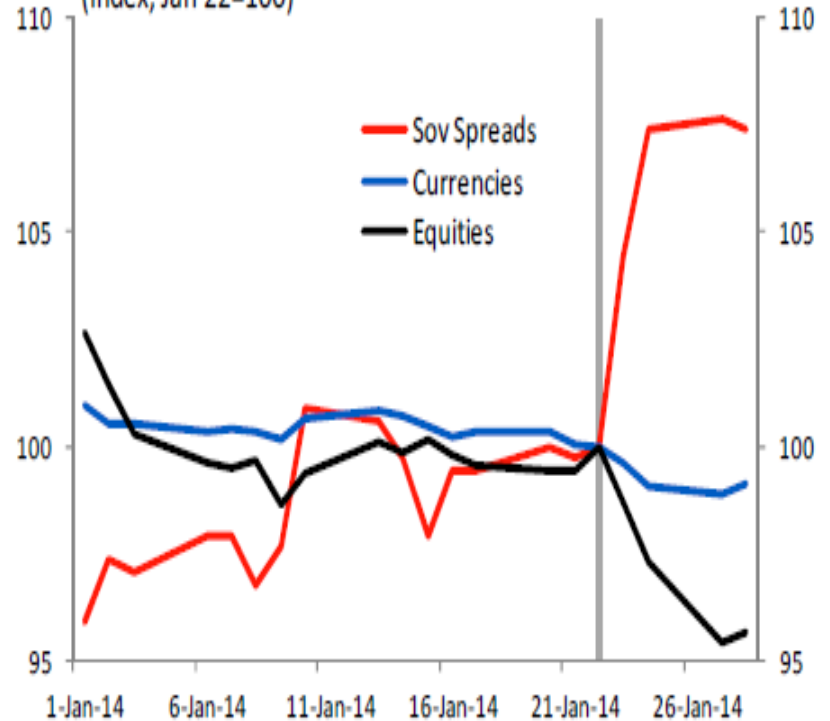
Global Risk Aversion and US Interest Rate



.. led to an across the board decline in EM asset prices.

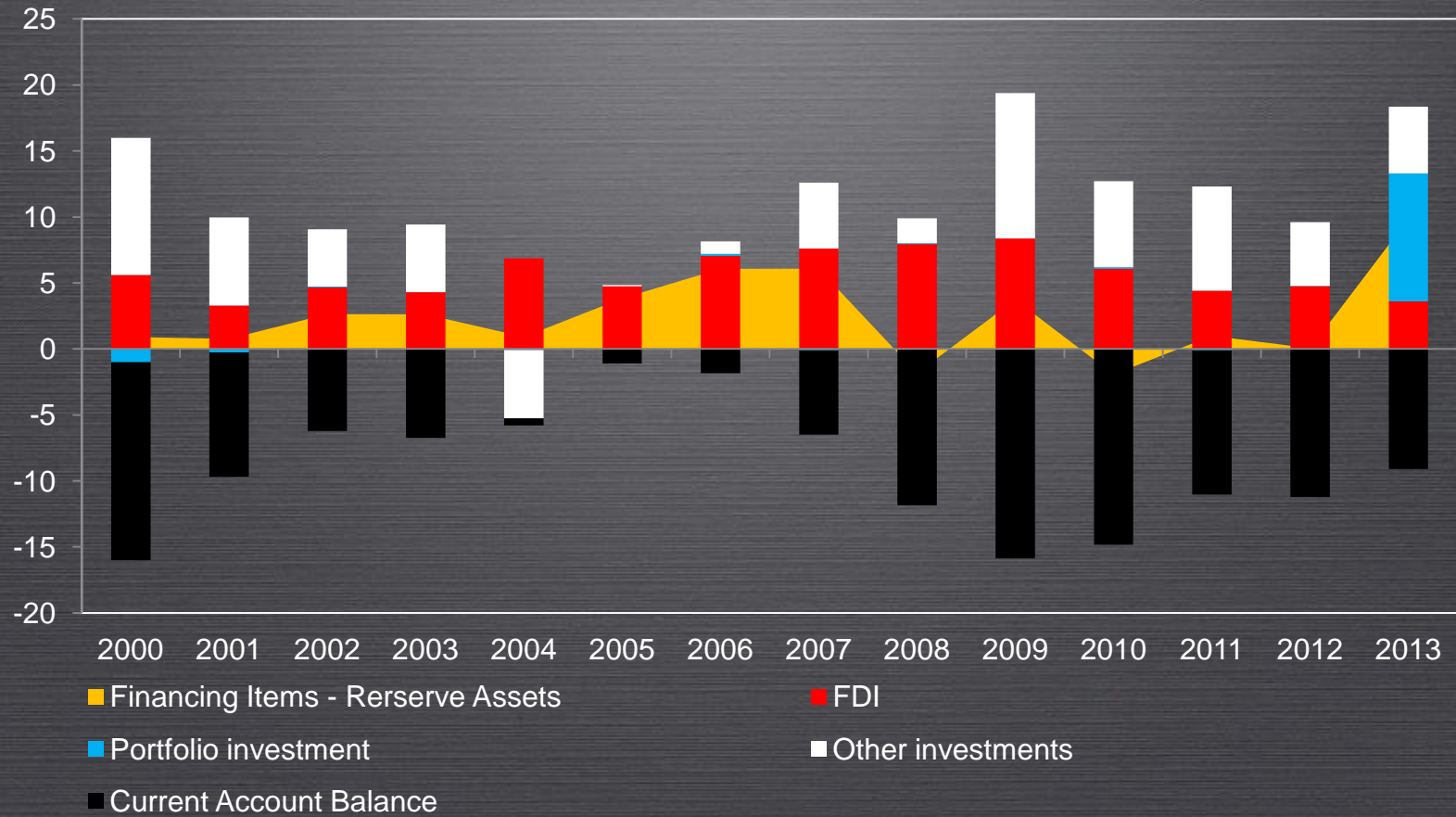
EM Currencies, Equities and Sovereign Yields, 2014

(Index, Jan 22=100)



And Armenia? Relatively shielded because of low level of portfolio capital inflows

Capital Inflow to Armenia (in percent of GDP)



Why Armenia should attract more capital inflows, even portfolio? Benefits & Challenges

Benefits

- Attracting FDI, and diversification of sources of financing BOP
- Reduction in cost of capital, increase potential GDP
- Spur financial sector development
- Strengthening volume of International Reserves

Challenges

- Overheating, increase in asset prices, competitiveness
- Exchange rate appreciations, sterilization costs
- Further sources of volatility, exposure to disruptive outflows
- Further dollarization, financial stability

... Capital Inflows have to be managed not discouraged

This is admittedly challenging. To do that there is a need for decisive actions to:

Deepening financial markets, developing capital markets

Improving Business Environment, legal frameworks,

Preserving macro-stability and strengthening policy framework

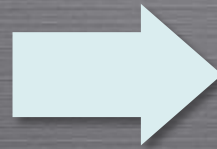
Enhancing banking supervision and macro-prudential tools

No single institution can do this alone. Coordination between central bank, ministry of finance, regulatory agencies, etc is essential.

A common shared objective and a medium-term vision is critical

Structural reforms should be stepped up, to improve Armenia's resilience and absorption capacity ...

Reforms



Goals

- International connectivity and competitiveness
- Public infrastructure and skills development
- Business environment, domestic competition, diversification
- Stronger social protection

- Higher private investment and FDI
- Reduce costs of doing business
- Overcome isolation
- Achieve strong, sustainable, inclusive growth

How could we get help ? Cooperation of Armenian authorities with the IMF

Long track record:
lending, policy advice, TA

Staff-level agreement on a
new three-year program

Policy Anchor:

- Consolidation of fiscal gains
- Further external adjustment/
greater dram flexibility
- Rebuilding buffers

Macro-critical reforms:

- Tax policy & administration
- Financial supervision
- Business environment
- Energy and transport