
Armenia Devalues Currency

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RFE/RL Armenia Report - 03/03/2009

Armenia effectively devalued its national currency, the dram, by more than 20 percent on Tuesday after the International Monetary Fund pledged to provide it with \$540 million in emergency loans designed to minimize the impact of the global economic crisis.

The dram tumbled from 305.7 to 372.5 per U.S. dollar in trading at Yerevan's NASDAQ OMX stock exchange immediately after the Central Bank of Armenia (CBA) decided to limit its hard currency injections in the local market.

The heavy intervention has prevented the Armenian currency from depreciating against the dollar and other major currencies since the onset of the global downturn last fall. Local opposition politicians and economists have criticized this exchange rate policy as a needless waste of the country's modest external reserves currently worth \$1.2 billion, down by about \$400 million from the September 2008 level.

In a written statement, the CBA's governing board, which has until now denied artificially bolstering the dram, said it has decided to 'revert to the policy of a floating exchange rate.' It said the move will boost Armenia's 'external competitiveness' and spur job creation. It forecast that the dollar's average exchange rate will vary from 360 to 380 drams this year.

Citing a likely rise in inflationary pressures resulting from the dram depreciation, the CBA board also decided to raise its re-financing rate by 100 basis points to 7.75 percent.

As the Central Bank announced the decisions, the IMF's managing director, Dominique Strauss-Kahn, issued a statement saying that he has asked the fund's Executive Board to approve \$540 million in 'stand-by' loans for Armenia. He said the Armenian authorities will be able to draw \$239 million of the funds, repayable in 28 months, immediately after board approval expected later this week.

Strauss-Kahn described as 'strong and credible' the authorities' strategy of coping with the fallout from the deepening global recession. 'The comprehensive policy package developed by the Armenian authorities in consultation with IMF staff includes the return to a floating exchange rate regime ; with supporting monetary, fiscal and financial sector policies, and well-targeted structural reforms,' he said.

The announced change in the exchange rate policy was also welcomed by the World Bank. 'The return to a flexible exchange rate regime was necessary given the difficult international environment that Armenia is facing,' Aristomene Varoudakis, head of the bank's Yerevan office, told RFE/RL.

'We believe that this will help Armenia strengthen its competitiveness,' he said. 'It will help domestic companies compete more effectively with imports. It will help exporting companies to export at better prices and compete in global markets.'

All that will give Armenia 'a chance to grow faster,' added the World Bank official. He predicted last week that the country will at best post zero growth this year.

According to IMF projections, the Armenian economy will contract by 1.5 percent in 2008 after 14 consecutive years of robust growth. The latest official statistics show Gross Domestic Product falling by 0.7 percent in January 2009.

The dollar bought 360 drams and sold for 380 drams in currency exchange shops across Yerevan on Tuesday evening. The wide buy-sell margin reflected mounting uncertainty about the dram's future value and broader market trends.

Petrol prices in the Armenian capital soared by approximately 20 percent, and the country's largest food retailer closed its supermarkets for two hours in the afternoon, citing the sudden drop in the dram's exchange rate. 'We want to understand the situation reigning in the market and hold urgent negotiations with suppliers and representatives of state structures,' Vahan Kerobian, executive director of the Star supermarket chain, said in a statement. 'The measure is also aimed at preventing panic and alarm.'

The CBA and the Western lenders were confident that the dram depreciation will not destabilize Armenia's financial system. 'Having discussed the situation resulting from the global financial and economic crisis, the Board concluded that Armenia's financial system is stable, sufficiently capitalized, extremely liquid and ready to confront further challenges,' Artur Javadian, the Central Bank governor, told journalists.

'We don't have concerns, and the reason for that is that Armenia entered this crisis with a very strong banking system,' agreed the World Bank's Varoudakis. 'Armenian banks are liquid and well capitalized.'

The dram's nominal value against the U.S. dollar nearly doubled between 2003 and 2008 on the back of soaring remittances from hundreds of thousands of Armenians working abroad and Russia in particular. The large-scale cash inflows, which enable Armenia to finance massive trade and current account deficits, are expected to fall significantly this year.
