
CBA Chairman : Initiation of Securities Market Will Change Companies.

NOYAN TAPAN. 11/1/2007-

We present the interview of NT correspondent with the Chairman of the Central Bank of Armenia (CBA) Tigran Sargsian.

NT: It is already a year since the CBA started the policy of inflation targeting. Impression of an observer is that this policy has had success, at least, infaltion was kept relatively low in the complex situation in 2006. Is this impression correct?

T.S.: I think it is premature to make assessments. We see the prospect in the following way: the first three years after adopting this strategy should be transitional ones for us. During this period we have to formulate clearly the rules of inflation targeting, make the appropriate amendments in legislation and, more importantly, we should create an opportunity to establish a correlation between the short-term interest rates and the long-term credit interest rates and the level of prices. At the same time, we received technical assistance and invited foreign experts who helped us to work out a new set of instruments necessary for financial operations. Our aim is that during these years the CBA can operate on the financial market with this a set of instruments that will help with the identification of transitional mechanisms. For this reason, it would be correct to make an assessment in three years.

NT: However, some set of instruments is already being used this year. Is it possible that it will change?

TS: In the next three years the set of instruments will remain the same: we should be consistent so that the game rules will be understandable for market participants. Thanks to these instruments the relation between the short-term and long-term interest rates will form.

NT: Can we say that in principle, the strategical directions exist, and only the problem of their realization remains?

TS: We can. We should observe these rules consistently, use those instruments, about which market participants are informed so that these patterns will manifest themselves. Particularly, every week we present our repo operations, offering market participants to use our dram resources. The use of these rules in the long run dictates to market participants such an environment, in which they would have a clear strategy in managing their primary liquidity. They know that every Wednesday the CBA offers dram liquidity to them, the CBA also tries to remove excess money by selling its own securities. Observing these rules in the long run will form the relation of these interest rates.

NT: Nevertheless, these rules have functioned for a year...

TS: The rules function, market participants know them but it is necessary that these rules impact participants' behaviour so that in the issue of liquidity management this set of instruments will become a pattern for them.

NT: Can we, however, give some preliminary results for 2006? Is there

any correlation between the interest rates of repo transactions and the rates formed in the Armenian market, and, as a consequence of all this, between the change rates of monetary aggregates? Is there such a dependence?

TS: That's a good question. It is important for us that the rates of repo transactions will be in line with interest rates. The 2006 data allows us to conclude that we have already got a result: we managed to guide the interest rate market and to form this relation. We are satisfied with this.

NT: In 2006 the economic growth was again very high. In this respect how the monetary and credit aggregates were changed in 2006?

TS: The growth of the broad money and the monetary base exceeded our expectations, which we had calculated based on the expected indices of economic growth. We envisaged a 10% GDP growth but it will be higher (NT: preliminary estimates show it is 13% or more). Last year the growth of broad money and the monetary base made about 30%, while the growth of dram portion of the monetary base - 42%.

It shows that a change in favor of Armenian drams is taking place in broad money. Drams' portion is growing more rapidly than that of dollars. The same is true for deposits. We expect the amount of dram deposits to become equal to that of foreign currency deposits soon. (NT: In mid 2006, 62% of deposits with the Armenian banks was in foreign currency).

NT: The impression is that in terms of market management, in 2006 the bonds issued by the CBA played a more important role than repo transactions did.

TS: Indeed, these bonds, which we started to issue in 2005, played an important role in neutralizing excessive liquidity. They also gave the CBA some extra resources to make foreign currency interventions in order to neutralize exchange rate fluctuations and prevent the extremely sharp appreciation of the Armenian dram. We'll continue this policy in 2007. Our bonds currently amount to 40 billion drams (some 108 million AMD). In 2006, the amount of foreign currency interventions reached 220 million dollars, up from 102 mln dollars in the previous year. By the way, thanks to purchase of this amount of foreign currency, at the end 2006 the CBA foreign reserves exceeded one billion dollars for the first time.

NT: The CBA has also undertaken the management of formation Armenia's securities market - something, at which several unsuccessful attempts were made previously. How is this process proceeding? Of course, it would be naive to expect considerable progress in a year period. However, is there any qualitative change?

TS: The CBA Board has approved a new concept of development of the securities market. The main ideology is the following: we gave up supervisory relations with thousands of reporting issuers and aim to identify a small group of promising open joint stock companies in our market, as well as companies which intend to issue their securities and operate in the securities market of their own free will - being aware of this market's importance and of the necessity to develop their own business. We significantly reduced the number of reporting issuers (those who have to submit reports to us) and sharply increased the amount of the minimum capital, that is, only big companies are presented, there are about thirty of them.

NT: What is the amount of the minimum capital?

TS: It is 500 million drams. Besides, we work with enterprises which have many owners. Thus we aim to choose several dozens of enterprises which would agree to operate in an open and transparent way, present their financial reports, share their programs with the public, pass a stock exchange listing and, based on it, to issue their shares or bonds. This will enable to organize stock exchange trade in the primary market and to carry out secondary circulation if these securities. If we succeed in all this, we can fix that the securities market started functioning in Armenia. Naturally, it is necessary that these enterprises undergo audit by internationally recognized audit companies, which will certify that the reports of these enterprises are real. Besides, the game rules in stock exchange trade should be such as to create trust of investors, both Armenian and foreign ones. For this purpose we have cooperated with the Stockholm Stock Exchange (OMX) for a year now. OMX is now conducting a study of our market to reveal, among other:

What potential for corporate bonds exists in our market?

What are development prospects? What kind of legislation do we have?

What infrastructures are in Armenia?

Based on the OMX's report, we'll start the second stage of the securities market development. Today we are implementing rating of our enterprises. About 40 enterprises have received a CBA rating, which will allow the best of them to issue their bonds, while the CBA will help with the issue and placement of their bonds on the stock exchange. The first one is Cascade Credit company that has successfully issued and completely placed its bonds.

Our purpose is also to bring big and famous enterprises to the stock market so that they will issue their securities, which would allow tens of thousands of people to acquire these securities. We are negotiating with the management of these enterprises, offering them to use this exceptional opportunity and presenting those opportunities, which they would have when operating on the stock exchange. This is most important for enterprises intending to extend their capacities and increase productivity.

It is also very important that the cooperation with the OMX will enable us to form a marketplace in Armenia, which will integrate with international marketplaces, thanks to which our enterprises will be able to directly place their securities in international financial markets. It means that some alternative sources of finance will be offered to enterprises with development prospects. There will be no difference between Armenian and international markets.

NT: How many enterprises can meet these requirements at present? The stock exchange will function only in the event that it is liquid, that is, there are many securities which can be bought and sold.

TS: If we have an agreement with five big enterprises, that's enough to organize an active market work. The volumes of these five enterprises in a few years may exceed several billion dollars. So they can sell more securities than tens and hundreds of small enterprises. If the start of these five is successful, many will try to enter this market.

NT: So how many potential enterprises are there at the moment?

TS: Now we are working with thirty non-banking enterprises. Time and the OMX study will show how many of them will pass the examination and enter the stock exchange.

NT: What about the introduction of modern standards of corporate governance in banks, which is also among the CBA's goals announced in early 2006?

TS: It is proceeding well, although we are not fully satisfied with its process. Our purpose is to bring two or three Armenian banks into international market so that they can place their bonds in international financial market, for example, the London Stock Exchange.

NT: Do you believe that now all the Armenian banks already meet the requirements of modern corporate governance? Was there resistance on their part when shifting to these principles?

TS: There was. Any changes occur with difficulty and are painful because people have worked in those conditions for years. Therefore we help them, invite experts, explain. Some people resist, punitive measures have been imposed, there have been bankrupts. This is a market, and only winners remain. In general, banks are more prepared to enter financial market than other companies in Armenia. If two or three of them complete all this process successfully, we'll be happy instead of them (smiles).

NT: What is the situation in other sectors of the financial market?

TS: Let's start from the largest sector - insurance. In 2006, we closed eight non-performing insurance companies and in 2007 we'll finish this "cleaning" action. In addition, we have put into circulation a new draft law on insurance, which should be in line with European standards. We expect it to be passed by the National Assembly soon. We also create subordinate legislative acts and take steps to interest foreign insurance companies in operating in Armenia. Despite a decline in the number of insurance companies, the turnover in this sector increased in 2006.

The main provisions of the development strategy in this sector are:

1. "Cleaning" of the field of insurance companies.
2. Creation of infrastructures
3. Creation of actuary companies
4. Creation of a single system of accident statistics.
5. Introduction of compulsory insurance rules.

It is the preparatory stage of the insurance system development, it will take at least three years, as these problems are quite difficult to solve. For example, for road accidents, it is necessary to ensure that none of these accidents has been left off the registration list, which in its turn requires not only time and joint work of various departments but also qualified staff, whose lack is felt everywhere. The same is true for fires, health care and other sectors.

As regards the pension system, the government has approved its concept. We expect that the respective law will come into force in the

second half of 2007 and the reforms of the system will begin.
