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Republic of Armenia

Central Bank

Annual Report
2005

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2005

Presented to
the National Assembly of the
Republic of Armenia

Chairman of CBA  T. Sargsyan

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Republic of Armenia

Central Bank

Annual Financial Statements

2005

2005 Annual Financial Statements of the Central Bank of the Republic of Armenia

According to Article 17 of the Law on the Central Bank of the Republic of Armenia, the Central Bank of the Republic of Armenia (the CBA) hereby presents to the National Assembly of the Republic of Armenia the financial statements as of and for the year ended 31 December 2005, including the balance sheet, the income statement, the cash flow statement, the statement of changes in equity and the notes to the financial statements.

The financial statements of the CBA are based on the accounting principles adopted and approved by the Board of the CBA, in compliance with International Financial Reporting Standards (IFRS). Armenian Accounting Standards are similar to IFRS in all material respects.

The Board of the CBA is responsible for the accuracy of the accounting information reflected in the financial statements. It has a general responsibility to safeguard the assets of the CBA and to prevent and detect fraud and other irregularities.

Independent auditor's report

to the Board of the Central Bank of the Republic of Armenia

We have audited the accompanying balance sheet of the Central Bank of the Republic of Armenia (the "Bank") as at 31 December 2005, and the related statements of income, cash flows and changes in equity for the year then ended. These financial statements are the responsibility of the Board of the Central Bank of the Republic of Armenia. Our responsibility is to express an opinion on these financial statements based on our audit. In our auditor's report dated 25 March 2005 we expressed an unqualified opinion on the financial statements of the Bank as at and for the year ended 31 December 2004.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Bank Management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as of 31 December 2005, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Paris, 28 March 2006



«Grant Thornton»

1. MACROECONOMIC SITUATION, INFLATION, AND MONETARY POLICY

1.1. MACROECONOMIC SITUATION

During 2005, the overall macroeconomic environment changed considerably due to both real sector developments and government policy measures. Moreover, the economy was significantly influenced by external factors, such as financial inflows and changes in prices of essential commodities (including oil, wheat, and non-ferrous metals) in international markets.

As a result of the large-scale financial influx and the last five years' robust growth, the increase in private sector income accelerated capital construction growth. Resources mainly concentrated in the industry and service sectors, as well as housing construction.

During 2005, the components of aggregate supply were greatly influenced by, among other factors, the favorable climatic conditions, which contributed to the strong real growth of agricultural output and the increase in agricultural processing volumes, a part of which was destined for export. Furthermore, the strong real growth of agricultural output led to a significant decline in wholesale and retail prices, contributing to higher private consumption.

The patterns of sustainable economic growth, the low inflation, and the continuous inflow of funds led to consistent appreciation of the Armenian dram, which in turn created a favorable situation for acceleration of the dram monetization process. The amendments to the Republic of Armenia Law on Currency Regulation and Currency Supervision, made in the second half of the year with a view to expanding the circulation of the national currency, were vital.

Thus, the macroeconomic environment that emerged in Armenia during 2005 facilitated the achievement of robust economic growth and low inflation.

The Republic of Armenia Law on the 2005 State Budget and the 2005 Monetary Policy

Some Key Macroeconomic Indicators (program and actual)

Indicator *(in %, unless otherwise specified)*	2004 actual	2005 program	2005 actual
Real GDP growth	10.1	8.0	13.9
GDP deflator growth	6.0	4.0	3.1
Inflation *(December-to-December)*	2.0	3.0	-0.2
Inflation *(year-to-year)*	7.0	2.2	0.6
Real growth of domestic demand*	11.1	9.1	13.2
Real consumption growth	10.9	7.5	11.1
Public consumption growth	16.2	20.4	20.3
Private consumption growth	10.2	6.0	9.7
Real growth of gross investment	12.3	15.8	22.4
Public capital investment growth	-26.8	30.5	23.4
Private capital investment growth	24.1	13.1	22.2
Real growth of imports	-1.6	7.4	20.8
Real growth of exports	1.1	7.8	9.5
Devaluation of the nominal exchange rate	-7.8	-9.1	-16.2
Growth of dram broad money (M2) *(average for period)*	6.1	17.9	37.8
Growth of monetary base *(average for period)*	7.0	13.6	39.0
In % of GDP			
Budget deficit *(including privatization proceeds)*	-1.7	-2.3	-2.0
Current account deficit *(including grants)*	-4.5	-3.4	-4.2
Gross investment	23.9	25.2	26.3
National savings	15.4	19.3	22.2

* *The 2005 indicators for gross demand and its elements are CBA estimates.*

Program projected 8% real GDP growth, under 3% yearend inflation, and a GDP deflator of 104%. According to data from the National Statistical Service (NSS) of the Republic of Armenia, economic growth in 2005 was 13.9%, with a 103.1% GDP deflator, and CPI of 99.8% (December-to-December).

The main reason for the deflation in 2005 was the rich agricultural harvest, which considerably lowered the agricultural product prices. Inflation was also contained by the lower prices of imports, which were due to the appreciation of the Armenian dram in the context of large-scale financial inflows.

In 2005, both imports and exports by far exceeded the targets. The 20.8% real growth in imports was mainly due to increased household income and growth in consumer products and capital construction, leading to a significant increase in commodity imports. A large share of rapid growth of exports was due to increased exports of non-ferrous metals and finished foodstuffs. As a result, the current account deficit share in GDP shrunk by 0.3 percentage points over 2004 to reach 4.2%, compared to a target of 3.4% (for details in exports and imports, see the section on the External Sector).

During 2005, the impact of fiscal policies on inflation was broadly neutral (vis-à-vis the program targets): due to its expansionary behavior being manifested at the end of the second half of the year, the impact will be felt only in 2006.

In the context of these developments in 2005, the monetary policy was carried out on the basis of the need to meet the demand for the dram, resulting from dramization and strong growth, with a primary focus on meeting the program inflation target.

Aggregate Supply[1]

The positive trends of the last four years' economic development were sustained in 2005, as growth came in at an above-target 13.9%. However, the structure of growth somewhat changed.

Parallel to the strong increase in gross agricultural output, construction grew much faster in 2005 than before.

The 35.1% increase in capital construction added value contributed 5.4 percentage points to real GDP growth. Construction volumes grew faster in 2005 than in 2004, but slower than in 2002 and 2003. In 2002 and 2003, capital construction growth was due to Lincy Fund-financed large-scale construction, whereas in 2005, it was mainly due to an increase in construction carried out by the private sector (including households and businesses).

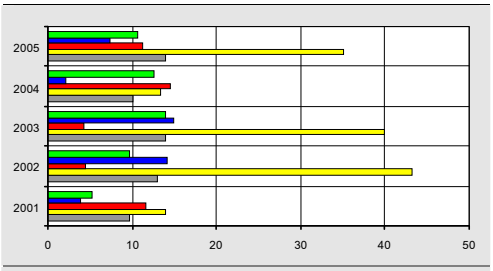


Chart 1.1
Real Growth of Value Added in the Main Sectors of Economy (%)

In 2005, the contribution of agriculture to growth (2.5 percentage points) was 0.6 percentage points less than that in 2004 due to the 11.2% real growth of value added in agriculture.

During the year, the industry sector reported some progress, which restored the pace of added value growth in this sector. For instance, value added in the industry grew by 7.4% (compared to 2.1% in 2004), which contributed 1.4 percentage points to growth (compared to 0.4 in 2004).

Despite the significant changes in the telecommunications sector in 2005 (i.e. the market entry of a new mobile operator), value added in telecom services fell. With a 10.6% increase in value added in this sector, its contribution to growth did not change much (a decline of 0.6 percentage points compared to 2004, to reach 3.7 percentage points in 2005).

GDP seasonality in 2005 almost did not change in comparison to 2004; however, starting from the second half of 2005, the pace of growth always exceeded that in 2004, due to the faster increase in the volume of capital construction.

[1] *Data presented in the "Aggregate Supply" section is taken from the National Statistical Service "Social-Economic Situation in Armenia during January-December 2005" bulletin.*

Contribution of Main Branches of the Economy to Real GDP Growth (in percentage points)

Indicators	2000	2001	2002	2003	2004	2005
Industry	1.4	0.9	2.7	2.9	0.4	1.4
Agriculture	-0.3	2.7	1.0	1.0	3.1	2.5
Construction	2.4	0.5	4.0	5.6	2.1	5.4
Services	1.2	4.0	4.2	3.6	4.3	3.7
Net taxes on goods and imports	1.2	1.5	1.4	0.8	0.2	0.9
Economic growth	5.9	9.6	13.2	13.9	10.1	13.9

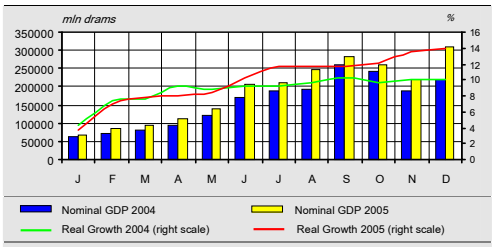


Chart 1.2
Monthly GDP Dynamics

Industry. During 2005, developments in the industry greatly deviated from the trends of previous years: though [in both 2004 and 2005] gross output in this branch grew more slowly than the whole economy, real growth of the industry was about 5 percentage points higher in 2005 than in 2004.

In 2005, the output growth was not evenly distributed between the sub-sectors of industry. Unlike 2004, when there was a decline, real output of the processing industry grew in 2005. Opposite trends were reported in the mining industry: what was growth in 2004 turned into a decline of output volumes in 2005.

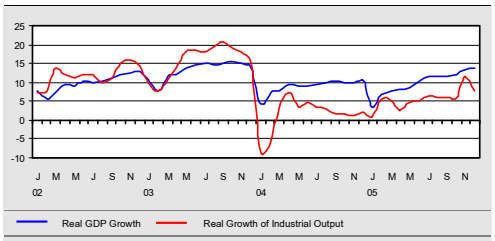


Chart 1.3
Real GDP and Industrial Output Growth Dynamics

The 4.4% real decline in the mining industry was mainly due to the 4.6% decline in the extraction of metal ores, including the extraction volumes of both gold and non-ferrous metals. While the gold extraction volume fell due to the shrinking of reserves in active mines, the non-ferrous metal extraction volume decreased because of the slower increase of their prices in international markets.

In 2005, gross output in the processing industry grew by 9.7%, compared to a 0.7% decline in 2004. The main reason for this growth was the 35% real growth in the metal industry, which contributed 7.1 percentage points to the real growth of the processing industry. As a result, the share of this sub-sector in the industry grew by about 7 percentage points to 19.4%. Continued investments in this branch have created a solid foundation for further improvements in productivity and product diversity, as well as increased output. This acceleration of growth was due to the 96.6% and 67.8% increases in the output of ferromolybdenum and zinc concentrate, respectively.

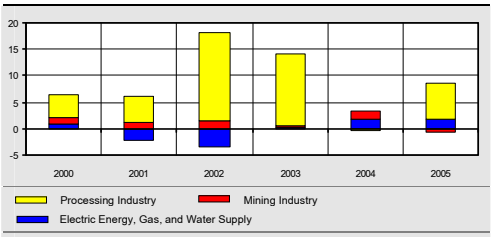


Chart 1.4
Structure of Industrial Output by Segments of Production (%)

As in 2004, the greatest increase (57.1%) was reported in the chemical industry, which contributed 1.8 percentage points to the real growth of the processing industry. In 2005, the chemical industry continued to see faster-growing output of synthetic rubber (a 2.1-fold growth). As a

Shares and Real Growth of Branches of Industry

Branch of Industry	2002		2003		2004		2005	
	Share (%)*	Growth (%)**	Share (%)*	Growth (%)**	Share (%)*	Growth (%)**	Share (%)*	Growth (%)**
Electric energy, gas, and water supply	24.4	-14.4	22.2	1.3	19.1	9.9	17.5	10.7
Mining industry	8.9	16.8	11.0	2.4	17.8	8.7	17.4	-4.4
Processing industry, of which:	66.7	25.0	66.8	20.3	63.1	-0.7	65.1	9.7
Food industry	35.7	7.0	33.9	13.1	31.1	1.0	28.1	4.1
Metallurgy	9.0	23.5	10.9	18.3	12.9	2.1	19.4	34.9
Jewelry production	6.0	82.7	5.2	29.3	3.1	-15.3	3.7	26.1
Chemical industry	2.1	-20.7	1.7	-17.5	2.0	54.9	2.5	14.0
Tobacco industry	3.1	55.6	3.4	27.6	2.8	18.5	2.4	57.1
Machinery and equipment production	1.3	-30.6	1.4	18.1	1.2	14.2	2.1	-2.6
Total industry	100	16.1	100	15.1	100	2.1	100	7.5

** Share in total industry.*
*** Real growth of gross output in a branch.*

result of starting the operation of a new plant, the output of caustic soda about doubled (though its share in the chemical industry remains low).

The 4.1% real growth of the food industry in 2005 was mainly due to higher outputs of alcoholic beverages and preserves. The output of fruit and vegetable preserves grew by 34.9%, while fruit juice output grew by 27.8%, and wine output grew by 12.3%.

Almost all of the industrial output was sold during the year. Exports of industrial output fell to 2% in 2005, compared to 8.6% in 2004. As a result, the share of exported industrial products in the total industrial output fell to 36.5%.

Agriculture. In 2005, as in 2004, favorable climatic conditions resulted in double-digit (11.2%) real growth of gross output in agriculture. Similar to 2004, this strong increase mainly came from the plant cultivation sub-sector.

Owing to the favorable weather and climate, gross output in plant cultivation grew by 14.9% in 2005, compared to 20.1% in 2004. While in 2004, the increase was mainly due to grains and potato crops, the strong performers in 2005 were fruit, grapes, and vegetables. Fruit crops, in particular, grew about 2.8-fold, while vegetable crops grew by 10.5%, and grape crops grew by 10.4%. Most of this increase took place in Syunik, Armavir, and Ararat.

However, considering that the increased output in the plant cultivation sub-sector was mostly due to the favorable weather, it is necessary to make large investments in this sub-sector in order to sustain its growth by means of improving the irrigation system and implementing new techniques.

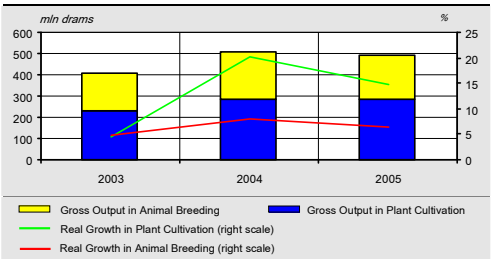


Chart 1.5
Dynamics of Agriculture Sub-sectors, 2003 - 2005

In 2005, the growth of the animal breeding sub-sector slowed down. The increase in meat output exceeded the 2004 figure by 1.3 percentage points, reaching 4.8% in 2005, while the milk output growth (7.1%) was slower than in 2004. Egg production volumes fell by 8% in 2005, compared to the 12.1% real growth in 2004.

Construction. Unlike 2004, construction growth accelerated considerably in 2005, as a result of which real growth of capital construction reached 34.2%, compared to 17.2% in 2004. Most of this growth was domestically-financed.

In 2005, the share of construction financed by external loans and humanitarian aid fell by 4 percentage points to 4%. The composition of domestic sources of funding did not change much, though each of them increased considerably. The volume of construction financed from the state budget grew by about 50%, while construction financed by enterprises and households grew by 39.1% and 38.1%, respectively, mainly due to the continuous increase in household income on the background of the last five years' strong economic growth, as well as the influx of external funds, which was reflected in higher investments of enterprises.

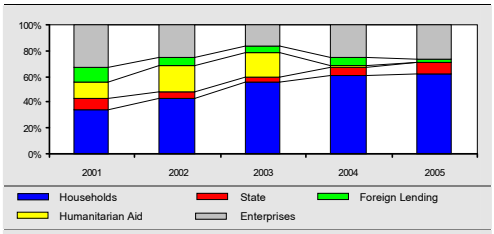


Chart 1.6
Structure of Financing Sources of Construction, 2001 - 2005

39% of the construction was carried out in industrial premises, about half of which was financed by enterprises. The share of industrial construction in total capital construction carried out by households grew by about 8 percentage points, as a result of which households financed 24% of the construction of industrial premises.

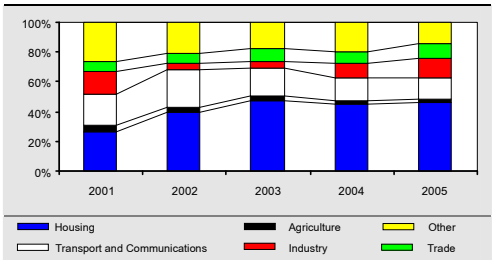


Chart 1.7
Branch Structure of Construction, 2001- 2005

Within the branch structure of construction, the share of the industry grew by about 4 percentage points, mainly on account of the 2.4-fold increase in the volume of capital construction in the processing industry. At the same time, despite the 24.2% increase in construction in the transport and communication sector, the share of general service sector capital construction in total construction fell by 4 percentage points to 38.6%. The increase in construction in the communication sector was mainly due to investments made by a second mobile operator that entered the market during the second half of 2005.

In 2005, strong growth was reported in housing construction: its share in total construction grew by about 2 percentage points. As a result, housing construction, which grew by about 39% in real terms, accounted for 46.6% of total construction. As in the previous years, it was mainly financed by households and, partially, by enterprises.

Services. Real growth of services and trade reached 12.1%, indicating sustained growth from the previous years.

In transport, both passenger and cargo traffic grew. The 14.6% increase in cargo traffic was mainly achieved on account of the 25% growth of pipelines, due to the intensification of the gas installation process in the country. Rail cargo traffic shrunk by about 3.6%: the only commodity to increase was cement, while cargo traffic of all other commodities shrunk. The 4.1% increase in passenger traffic was mainly due to road transport (which grew by 8%), which in turn was driven by the three-fold increase in the taxi passenger traffic.

In 2005, communication services continued to grow at a high pace: revenue from communication services grew by 26.1% in real terms (compared to 21.2% in 2004). This was greatly facilitated by significant progress made in 2005, as, starting from July 1, a second mobile operator entered the market. As a result of toughening competition, tariffs declined, and the volume of mobile telephony services grew by 61.5%. Moreover, the continued implementation of a digital telephony to replace the old telephone stations in the country resulted in a 16.4% increase in real revenue from telephone conversations.

In 2005, growth of the volume of retail trade continued to slow down: as a consequence, real growth fell by 1 percentage point over 2004 to reach 9.3%. The largest increase (23.9%) in sales turnover took place in shops, which account for 47.5% of total sales.

Deleted: assistance

Prices and Tariffs

The 2005 Monetary Policy Program projected yearend and average annual inflation targets of up to 3% and 2.2%, respectively. As a result of the developments in 2005, 0.2% deflation was reported in December, while average annual inflation came in at 0.6%.

In 2005, inflation bore the influence of both domestic and external factors. During the first quarter, the main factors included the exchange rate appreciation, which somewhat contained inflation through lower import prices, and the yearend-2004 demand increase, which materialized during Q1 of 2005 due to the time lag. After the first quarter, however, inflation was considerably influenced by the rich agricultural crops, especially of fruit and vegetable.

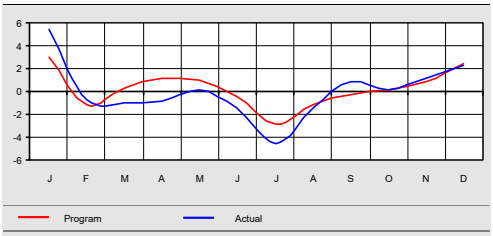


Chart 1.8
Program and Actual Inflation (%)

Inflation seasonality further exacerbated in 2005, mainly due to strong agriculture growth, leading to rather profound deflation during the second and third quarters. Thus, despite the projected 1.8% inflation and 4.3% deflation during the second and third quarters, respectively, deflation of 2.2% and 5.0% was actually reported.

Inflation by Goods and Services.[2] ***Core Inflation.*** Deflation in 2005 was mainly due to the lower prices of foodstuffs: compared to December 2004, foodstuff[3] prices fell by 1.2%, whereas prices of non-foodstuff goods and services increased by 2.1% and 1.9%, respectively.

Lower foodstuff prices were due mainly to lower prices of grains (deflation of 4.2%, contribution of 1.3 percentage points to the foodstuff deflation), fruit (deflation of 17.4%, contribution of 1.0 percentage point), and fish produce (deflation of 19%, contribution of 0.3 percentage points). As a result of the significant increase in agricultural crops, the prices of peach, plum, strawberry, and apricot fell the most (by 65.5%, 51.5%, 44.7%, and 44.1%, respectively), while prices of pear and grapes fell by about 11%. Besides, with somewhat declining wheat prices in international markets, grain prices fell by 33.2%, which resulted in a 20% decline in the price of flour.

Within the foodstuff category, prices of vegetables grew by 9.5% due to the unexpectedly high increase in the prices of almost all the products in this category in December. In November 2005, compared to November 2004, vegetable prices had fallen by 10.5%; in December, however, vegetable prices grew by 22.4%, mainly due to higher household income leading to considerably higher demand for vegetables during the New Year's celebrations. Thus, the 1.1 percentage point increase in the price of vegetables contributed to the foodstuff category inflation indicator.

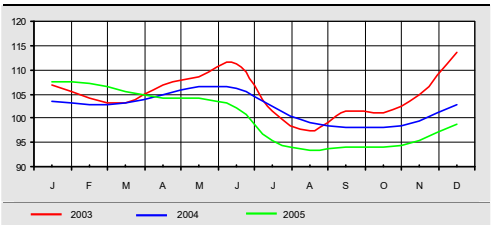


Chart 1.9
Price Index for Foodstuffs (including alcohol and tobacco) in 2003 - 2005 (the baseline for each year is December of the previous year) (%)

The 2.1% inflation reported in the non-foodstuff category in 2005 was mainly due to external factors. As a consequence of higher world prices of oil, prices of gasoline, oil, and diesel fuel grew by 11.1%, 9.8%, and 4.4%, respectively, thereby contributing 1.7 percentage points to the increase in prices of non-foodstuffs. The price of liquid gas grew by 15.6%, which contributed 0.3 percentage points to the increase in prices of non-foodstuffs. The Republic of Armenia Public Service Regulatory Commission decided to increase the potable water tariff by 26.1%, effective from May 2005, which contributed 0.7 percentage points to the increase in prices of non-foodstuffs. Cement prices, too, became much higher (by 27.3%).

[2] *Inflation figures are presented in comparison to December 2004.*
[3] *Including alcoholic beverages and tobacco.*

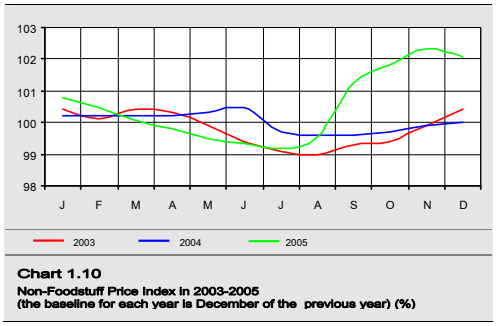


Chart 1.10
Non-Foodstuff Price Index in 2003-2005 (the baseline for each year is December of the previous year) (%)

Service prices grew by 1.9%, mainly on account of higher prices of utilities (1.3%), urban transport (1.7%), culture (10.5%), and education services (7.9%), which was in turn due to a considerable increase in household income and inbound tourism. At the same time, the tariffs of outgoing telephone conversations fell by 14.3% due to the development of Internet phone services. Moreover, tougher competition in the mobile phone market due to the entry of a new operator from mid-2005 significantly lowered the tariffs of mobile services, which, however, did not have an impact on CPI, because these services are not included in the consumer basket.

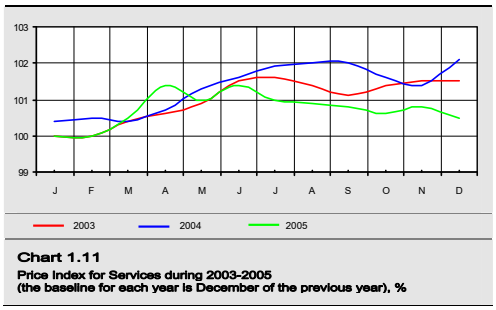


Chart 1.11
Price Index for Services during 2003-2005 (the baseline for each year is December of the previous year), %

A study of price patterns requires examining core inflation, as well.[4] Core inflation in December 2005 over December 2004 was 0.5%; for January-December 2005 over the same period in 2004, core inflation was 0.6%, mainly on account of higher prices of potato (0.2 percentage points), eggs (0.1 percentage point), butter (0.1 percentage point), and beef (0.1 percentage point).

[4] *Starting from June 2004, the Central Bank publishes the official core inflation figure using the 15 percent cut average method. A detailed overview of the calculation methodology is presented in the "Newsletter of CBA" (Q1, 2004).*

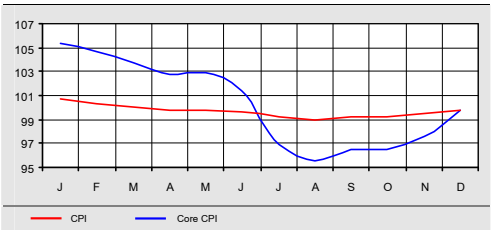


Chart 1.12
Inflation and Core Inflation (December 2004 = 100)

GDP Deflator and Branch Price Indices.[5] In 2005, the GDP deflator was 103.1%, compared to 106% in 2004. Major change took place in the branch price structure: higher price indices in construction and industry were accompanied with a lower price index in agriculture and lower cargo transportation tariffs.

In terms of impact on the CPI, the agriculture price index is among the more important branch deflators: in 2005, the agriculture price index fell by 9.3%, compared to a 9.6% increase in 2004. This deflation was due to a 26.5% price decline, in turn caused by the abundant crops in the area of plant cultivation. Prices of fruit, wheat, and barley dropped considerably.

During the year, the capital construction price index grew by 18.5%, compared to 1.3% in 2004. This strong increase was mainly due to higher prices of construction and installation works, as well as construction materials.

The growth of the industrial output price index slowed down (7.7% in 2005, compared to 21.7% in 2004). This was mainly due to slowing down of the increase in world prices of non-ferrous metals, which slackened the increase in non-ferrous metal industry prices (30.6% in 2005, compared to 77% in 2004). Food industry prices fell by 4.9% in 2005, compared to a 14.1% increase in 2004. This was partially due to somewhat lower prices of bread products and products of plant origin.

As in 2004, cargo transportation tariffs continued to decline, resulting in a 10.4% decline in tariffs. The increase in automobile transport tariffs (8% in 2005) was higher than in 2004, whereas tariffs of other types of transport declined more in 2005 than in 2004.

[5] *January-December 2005 indicators are calculated in comparison to January-December 2004.*

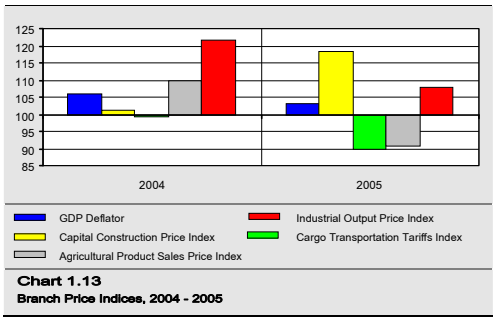


Chart 1.13
Branch Price Indices, 2004 - 2005

Wages and Labor Market

During 2005, labor market developments continued in line with growing economic activity. On an average annual basis, official unemployment fell by 1.5 percentage points over 2004 and reached 8.1%. December-2005 unemployment was 7.6%. At the same time, the average unemployment benefit grew about 1.8-fold in real terms in 2005 over 2004, reaching AMD 6,044 by yearend-2005.

It is worth mentioning that only 14% of the officially-registered unemployed have higher education, whereas about 80% of them have high school or vocational education. Demand for ordinary workers accounted for 80.7% of the total demand for workforce. Medical professions accounted for 62.5% of demand for qualified workforce.

As for the territorial profile of unemployment, the highest average annual unemployment was reported in Syunik (17.7%), Shirak (17.5%), and Lori (17.2%), while the lowest was in Aragatsotn (1.9%).

On the background of continuing economic growth, increasing demand for workforce, and decreasing unemployment, wages continued to grow in 2005. During January-December 2005, compared to the same period in 2004, average monthly nominal wages grew by 18.7% in real terms, reaching about AMD 65,000 at yearend-2005.

Wages increased in all the sectors of the economy: the highest (about 37%) increase in average monthly wages was reported in the social sector, while in construction and industry, which were strong performers in 2005, wages grew by 15.2% and 14.6%, respectively. As a result of economic growth and increased competition in the labor market, wage inequity between different sectors of the economy has been somewhat mitigated. In 2005, average wages in construction and the industry exceeded the national average wages by 34% and 32%, respectively (compared to 42.8% and 44.3%, respectively, in 2004). Nevertheless, average wages in lending and insurance remain the highest—exceeding the national average by more than 3.3-fold.

Aggregate Demand[6]

During 2005, as in the previous five years, aggregate demand grew more than projected, which resulted in a 13.9% GDP growth. Some change took place in the structure of aggregate demand, where, in the context of sustained growth of domestic demand, external sector performance deviated considerably, which lowered net exports.

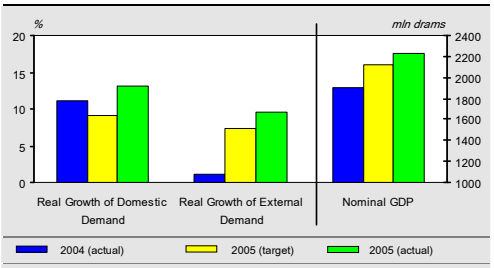


Chart 1.14
Components of Aggregate Demand

As a result of recent years' strong growth, resulting in higher household income, as well as the sustained large-scale influx of private transfers, domestic demand continued to grow rapidly in 2005. Nevertheless, slower growth of private sector spending was accompanied with an increase in public spending, which lowered the share of private sector spending in domestic demand by 1.5 percentage points to 86.8%.

Parallel to a slower increase in private transfers, real growth of private consumption slowed down in 2005 to 9.7%, compared to 10.2% in 2004. As a result, the share of private consumption in GDP fell by about 7 percentage points to 77.2%.

[6] *The indicators of real growth of aggregate demand are CBA estimates.*

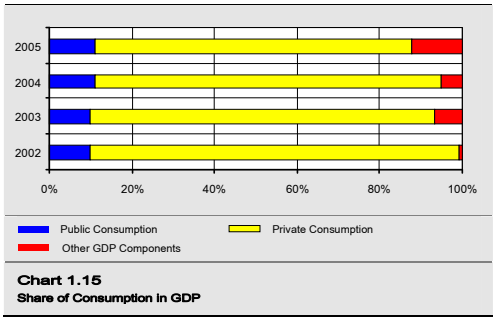


Chart 1.15
Share of Consumption in GDP

Although private investment grew faster than projected in the 2005 Monetary Program, it fell short of its performance in 2004 (22.2% in 2005, compared to 24.1% in 2004). Nevertheless, the share of private investment in gross investments remained virtually unchanged at about 84%. The bulk of private investments continued to be directed at industry and services.

In 2005, public sector spending stayed within the Program, growing by 27.3%. Public investment growth (23.4%) fell short of the Program target. As a result, public spending had a somewhat expansionary impact on the economy.

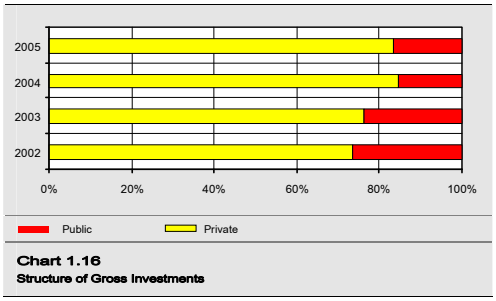


Chart 1.16
Structure of Gross Investments

Public consumption grew by 4 percentage points in 2005 over 2004, and reached 20.3%.

During 2005, the trends reported in the structure of exports and imports in 2004 were sustained. Exports of non-ferrous metals and finished foodstuffs grew rapidly. Imports were dominated by not only consumer products, but also investment commodities. As a result, real growth of exports was 9.5%, with imports growing by 20.8%.

Real Growth of GDP Components

Indicators	2005 (actual)	2005 (program)	2004 (actual)
Real GDP	13.9	8.0	10.1
Domestic demand	13.2	9.1	11.1
Consumption	11.1	7.5	10.9
Public	20.3	20.4	16.2
Private	9.7	6.0	10.2
Capital investments	22.4	15.8	12.3
Public	23.4	30.5	-26.8
Private	22.2	13.1	24.1
Imports	20.8	7.4	-1.6
Exports	9.5	7.8	1.1

1.2. FISCAL SECTOR[1]

According to the Republic of Armenia Law on the 2005 State Budget, state budget revenues and grants were targeted at 16.4% of GDP, with a tax-to-GDP target of 14.7%, and an expenditure-to-GDP target of 18.7%. Strong economic growth contributed to higher-than-planned collection of tax revenue, though the tax-to-GDP target was not met.

Based on fiscal impulse estimates, the impact of fiscal policy on aggregate demand was an expansionary 1.2 (of which, a restrictive 0.6 impact of the revenue impulse, and an expansionary 1.8 of the expenditure impulse). The expansionary impact of fiscal policies was rather visible during the second half of the year, in view of large expenditure disbursements in December.

State Budget Revenues

In 2005, Republic of Armenia state budget revenues and grants grew by 25.2% over 2004 (taxes and duties grew by 20.4%, while grants grew by 0.9%). Non-tax revenues and capital revenues grew faster than ever before (by 143% and 36%, respectively). This was due to proceeds from the privatization of the Zangezour Copper-Molybdenum Plant and the sale of state-owned land located within Yerevan. The revenue performance exceeded the targets in all the months of 2005.

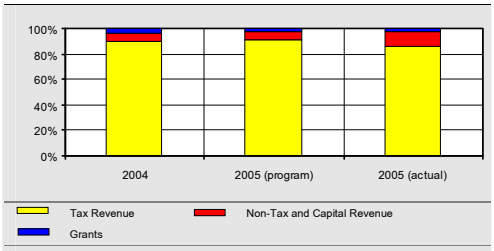


Chart 1.17
Structure of State Budget Revenues and Grants

State budget revenues and grants amounted to 16.7% of GDP compared to 15.7% in 2004; taxes and duties were 14.4% of GDP compared to 14.1% in 2004 and 14.05% in 2003.

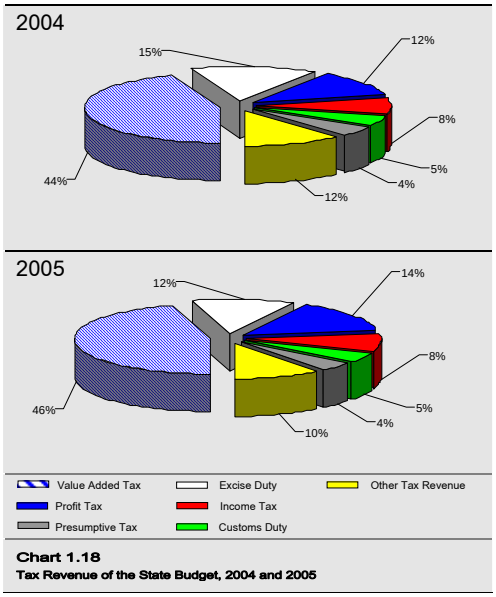


Chart 1.18
Tax Revenue of the State Budget, 2004 and 2005

During 2005, the share of indirect taxes[2] in total taxes and duties slightly declined to 62.8%, compared to 64.1% in 2004. Compared to 2004, indirect taxes grew by 18%. Compared to 2004, direct taxes[3] grew by about 40%, most of which was due to the profit tax and income tax (profit tax and income tax grew by 45.4% and 30.4% in 2005 compared to 2004, respectively). The share of direct taxes in tax revenue grew by 3.2% in 2005 compared to 2004 and reached 22.8%. Direct and indirect taxes accounted for 3.3% and 9.1% of GDP, respectively, compared to 2.7% and 9.0% in 2004. The share of other taxes in total tax revenue fell by 1.9 percentage points [over 2004] to 14.4%.

Leveling out of tax collection disproportions continued in 2005: 18.4% of average monthly taxes were collected during the last three days of the month; 14% was collected on the last day of the month, whereas in 2004 and 2003, this figure was 24.7 and 43.6, respectively.

[1] The analysis uses the "Social-Economic Situation in the Republic of Armenia during January-December 2005" Newsletter of the NSS and the preliminary annual adjusted program of the 2005 State Budget, submitted to the Central Bank by the Ministry of Finance and Economy.

[2] Indirect taxes include the value added tax, the excise tax, and customs duties.

[3] Direct taxes include the personal income tax, the corporate profit tax, the land tax, and the property tax.

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State Budget Expenditures

In 2005, the state budget expenditure target was virtually met (99 percent of the annual adjusted target[4]). In 2005, state budget expenditures grew by 33.5% compared to 2004[5]; current expenditures grew by 22.7%, while capital expenditures and net lending grew by 120.2% and 25.8%, respectively. Thus, state budget expenditures grew by 2.1% of GDP to 17.7%.

Compared to 2004, public consumption grew by 25.9% as a share of current expenditures, and by 0.7% as a share of GDP (to reach 9.3% of GDP). The share of government transfers in GDP grew by 0.2 percentage points to 3.4%.

As a share of GDP, capital expenditures grew by 1.5 percentage points to 3.2%. This was mainly due to higher domestically-financed capital expenditures (75% in 2005 compared to 46% in 2004 and 21.2% in 2003). This trend of increase in domestically-financed capital expenditures is conducive of short-term and long-term sustainability of growth. The share of externally-financed capital expenditures in total capital expenditures fell to 25%. Compared to 2004, the share of externally-financed expenditures in total expenditures fell by 29% as a consequence of the shortfall in disbursements of external project financing.

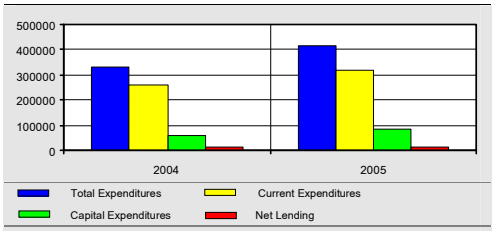


Chart 1.19
Structure of State Budget Expenditures in 2003 - 2004 (AMD million)

As a result of the execution of the adjusted 2005 program of state expenditures, the yearend-2005 balance of the Treasury Single Account fell by AMD 20.2 billion over yearend 2004. During the first half of 2005, funds accumulated in the Treasury Single Account, while the second half was characterized with spending. The average monthly balance of total Government claims on the Central Bank was AMD 56.1 billion in 2005, compared to AMD 38 billion in 2004.

[4] *The expenditures do not include externally-financed PIU proceeds.*
[5] *Including the PIUs.*

State Budget Deficit

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In 2005, the state budget deficit was AMD 44.9 billion (2% of GDP compared a 2.3% target). The main reason for this deviation was the higher-than-expected GDP growth, as well as the shortfall in external financing of PIUs. Deficit financing had the following structure: net external financing was 34.5% of the deficit, while domestic financing was 65.5%. External financing was about 45% of the target, due to shortfalls in PIU financing and the non-receipt of the Poverty Reduction Support Credit tranche (now expected in 2006). Net proceeds from placement of state securities were AMD 6.3 billion in 2005 (52.6% of domestic financing).

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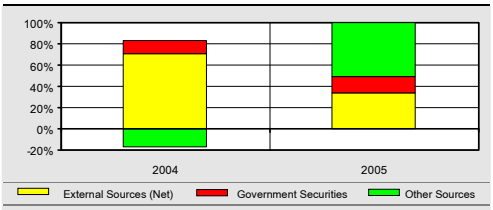


Chart 1.20
Structure of State Budget Deficit Financing Sources

Coordination of Fiscal and Monetary Policies

During 2005, coordination of fiscal and monetary policies continued to be marked by inconsistencies between state budget programs. Significant deviation between the monthly fiscal targets and the quarterly indicators of the 2005 state budget was a consequence of using different programming methodologies between these two programs. Under these circumstances, the monetary policy programming and banking sector liquidity management process was affected by uncertainties coming from fiscal sector. This was clearly illustrated by the December execution of state budget expenditures, which exceeded the December expenditure target by about AMD 11 billion.

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An important activity aimed at the management of monetary policy and banking liquidity in 2005 was the issuance of additional securities (of AMD 15.6 billion during the year) by the Ministry of Finance and Economy and the depositing of securities placement proceeds with the CBA. From June, the CBA started to issue and place its own securities. For several years now, interest rates on state securities have been declining on the backdrop of increasing maturities. In 2005, the yield from state medium-term securities was 5.09% (compared to 5.6% in 2004), while the yield from long-term state securities was 8.83% (compared to 9.27% in 2004).

Recent years' trends in monetary and fiscal policy coordination have indicated that coordination effectiveness could benefit from adjustment of quarterly programs of the state budget, publication of the adjusted breakdown of fiscal indicators, and explanation of the reasons for deviation between the monthly programs and the quarterly indicators.

1.3. EXTERNAL SECTOR

The integration of the Armenian economy with the world adds importance to the external sector of the economy. A number of developments that emerged in 2004 continued during 2005. International prices of oil and gasoline grew, while prices of gold and base metals increased considerably. Unlike 2004, the US dollar strengthened in 2005 against other international currencies. At the same time, the Armenian economy remained highly active in 2005: the volume of foreign trade grew considerably; private remittances and net factor incomes increased, and the current account remained relatively stable.

The gap between savings and investments remained almost unchanged in 2005 compared with the year 2004. The increase in the public sector gap was offset by a decrease in the private sector gap.

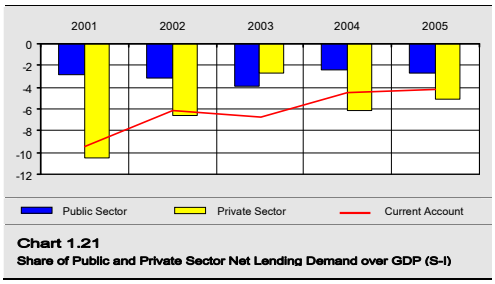


Chart 1.21
Share of Public and Private Sector Net Lending Demand over GDP (S-I)

According to the 2005 Monetary Policy Program, the current account deficit in nominal terms was projected to remain virtually stable. Such stability would be achieved as a result of deepening of the trade balance deficit, which would be offset by an increase in income and private and public transfers. On this background, the current account to GDP ratio was projected to improve considerably and to reach 3.4% due to strong GDP growth and appreciation of the nominal exchange rate.

Compared to 2004, a significant increase in foreign direct investment was projected on account of the privatization of a large state-owned enterprise (the Copper-Molybdenum Plant) and the implementation of large-scale investment projects by a number of enterprises. As a result, capital and financial account inflows were projected to exceed the current account deficit, which would lead to an increase in the Central Bank's gross foreign reserves.

Under the Monetary Policy Program, exports and imports of goods would grow by 12.5% and 12.3%, respectively, resulting in a 12.4% increase in the external trade turnover, which would reach US $2.2 billion.

In 2005, exports of goods (credit) amounted to US $981.4 million, representing a US $243.1 million (32.9%) increase over 2004. This tangible growth of exports was mainly due to the improvment of terms of trade, driven by the huge increase in base metal prices in international markets: the international price of copper, for instance, increased by 28% in 2005, while the price of molybdenum about doubled. This contributed to the increase in export values from Armenia. To this end, the "Base metals and articles thereof" commodity group largely contributed to the growth of commodity export: exports of this group grew by US $178 million (2.3-fold) in 2005. As a result of this growth, the share of this commodity group in total exports increased considerably to 33.2%. Export growth was also supported by the "Precious and semiprecious stones, metals, and articles" and "Finished foodstuffs" commodity groups. Exports of goods in the "Precious and semiprecious stones, metals, and articles" group (in contrast with the decline in 2004) grew by US $37.2 million (12.4%) in 2005. Exports of goods in the "Finished foodstuffs" group grew by US $27.5 million (39.7%). The latter was mainly due to the higher exports of alcoholic beverages, namely brandy.

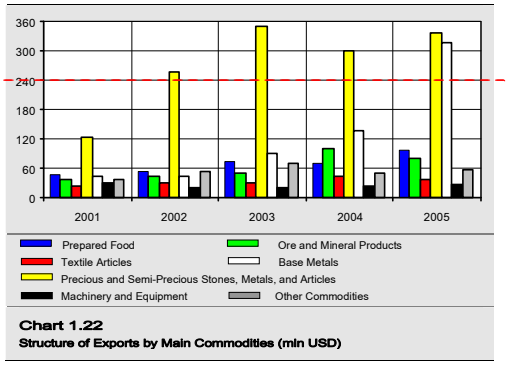


Chart 1.22
Structure of Exports by Main Commodities (mln USD)

Some changes took place in the geographic structure of exports. Compared to 2004, Russia's share increased up to 12.5%, compared to 10.8%

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in 2004. This was mainly due to the higher exports of brandy to Russia. The share of CIS countries in total exports was 18.9% in 2005.

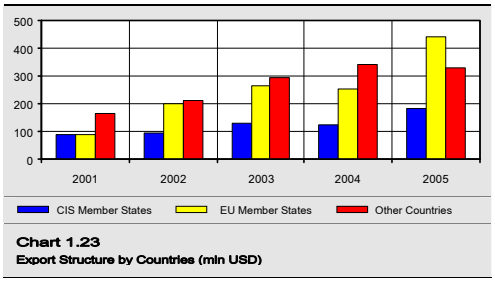


Chart 1.23
Export Structure by Countries (mln USD)

The share of EU member states in Armenia's exports grew considerably in 2005, reaching 46.6%, compared to 35.3% in 2004. This increase was fueled by the Netherlands and Germany, the shares of which increased up to 13.7% and 15.5%, respectively, compared to 3.6% and 11.5% in 2004. Higher exports to these two countries were mainly due to the increase in exports of the "Base metals and articles thereof" group. Moreover, the shares of exports to the USA and Israel fell.

Imports of goods (debit) amounted to US $1,566.1 million in 2005, representing a US $369.8 million (30.9%) increase over 2004. Import growth was high for almost all commodity groups, with the exception of the "Products of plant origin" and "Textile articles" groups. The recent years' high economic activity, continuously increasing income, and an appreciating exchange rate resulted in a high demand for imported goods. Import growth was largely fueled by the commodity groups that have big share in total imports. The first one was the "Machinery and equipment" group, imports of which grew by US $91.5 million (67.5%). Import growth of this group took place on account of machinery and equipment imports by a number of large enterprises for the purpose of implementing investment projects. The second one was the "Mineral products" group, imports of which grew by US $85.7 million (40.9%), mainly due to the increase in the volumes of gasoline and natural gas imports, as well as higher prices of gasoline. Moreover, imports of a number of other commodity groups also considerably increased, including the "Precious and semiprecious stones, metals, and articles" group, imports of which grew by US $56.1 million (19.2%). Imports of the "Ground, air, and water transportation means" group increased by US $53.4 million (57.7%) in 2005, mainly due to the sizeable increase in imports of cars, which was a result of higher household income and an emerging market for consumer loans. Growth was also high for the "Finished foodstuffs," "Base metals and articles thereof," and "Products of chemical and related industries" commodity groups.

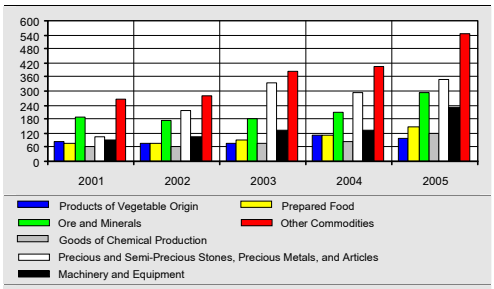


Chart 1.24
Structure of Imports by Main Commodities (mln USD)

The geographic structure of imports did not see major change in 2005. CIS countries accounted for 22.3% of imports, while the EU member states—for 33.4%.

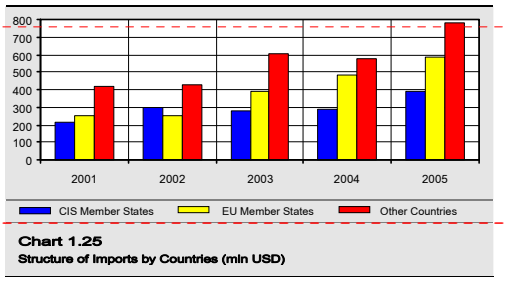


Chart 1.25
Structure of Imports by Countries (mln USD)

As a result of the aforementioned developments of exports and imports of goods, the external trade value grew by 31.7% and reached US $2.5 billion. In 2005, exports of goods financed 62.7% of imports (compared to 61.7% in 2004). The trade balance deficit grew by US $126.8 million (27.7%) in 2005 and reached US $584.7 million. Nevertheless, the trade balance deficit share in GDP was 11.9% (compared to 12.6% in 2004).

In 2005, the deficit balance of services improved by US $16.8 million due to the service

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Non-Commercial Remittance Dynamics, 2004-2005
(USD thousand)

	2004		2005		2005 over 2004 (%)	
	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow
USA	78787	20519	82628	30671	4.9	49.5
Russia	419014	68210	541308	83537	29.2	22.5
Other countries	146219	82567	128882	75585	-11.9	-8.5
Total	644019	171296	752819	189793	16.9	10.8

exports surpassing service imports. Both service exports and imports grew mainly on account of an increase in tourism services. Moreover, exports of transportation, computer, and information services also increased. Service exports grew by US $95.5 million (38.7%), while imports grew by US $78.7 million (24.8%).

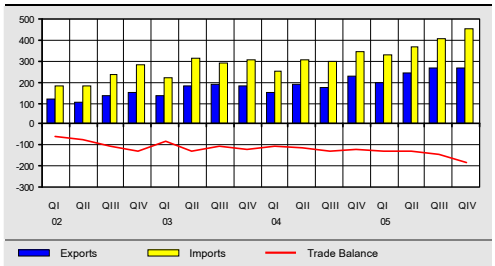


Chart 1.26
Export and Import Dynamics (mln USD)

The "Income" item grew by US $8.2 million in 2005, reaching US $44.9 million. This growth was mainly due to the higher income from seasonal migrant workforce (an increase of US $28.9 million or 16.2%). Revenue from the CBA's gross reserves management also somewhat increased. Net income paid against foreign investments[1] grew by US $20.7 million (14.6%) in 2005 over 2004.

The "Current transfers" item grew by US $59.1 million in 2005, reaching US $389.5 million. This growth was mostly due to the higher private remittances, which amounted to US $322.6 million. Public transfers grew by US $5.9 million, reaching US $66.9. Growth in private remittances and net factor income greatly benefited from higher income in the Russian economy, due to higher international price of oil, as Russia is a primary source of private remittances and net factor income.

During 2005, remittances of natural persons through the banking system of Armenia for non-commercial were US $752.8 million (this is about 17% higher than in 2004), while remittances from Armenia to the abroad were US $189.8 million (an increase of about 11%), compared to the inflow of US $644 million and the outflow of US $171.3 million in 2004. As a result, a net inflow of US $563 million was reported (compared to US $472.7 million in 2004), which represents a 19% increase over 2004.

Russia and the US account for the bulk of remittances made in 2005. Their combined share was 83% in non-commercial inflows and 60% in outflows. Remittances to and from Russia were significantly higher than those to and from the US, because bank tariffs for remittances to and from Russia are relatively lower.

The average amount per inbound remittance was US $692 during 2005 (compared to US $730 in 2004), and US $2,852 per outbound remittance (compared to US $2,997 in 2004).

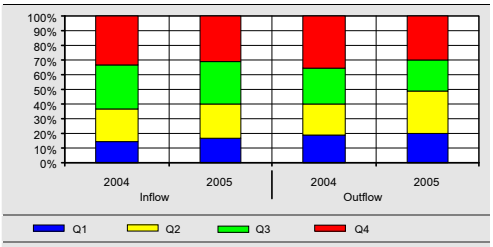


Chart 1.27
Quarterly Breakdown of Household Remittances (%)

Explicit seasonality of inbound remittances continued in 2005. The remittance inflow fell considerably during the first quarter, after which it

[1] *Reinvested profits accounted for a large share of income paid against foreign investments. Reinvested profits are recorded in the "Net Factor Income" line of the Current Account with a "-" sign, and in the "Direct investments in Capital and Financial Account" line with a "+" sign.*

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gradually increased during the second and third quarters, and peaked during the fourth quarter (the peak months were August and December).

In 2005, the current account deficit was US $204.2 million, compared to US $161.6 million in 2004. The current account deficit to GDP ratio, which characterizes the external sector, improved by 0.3 percentage points, reaching 4.2%.

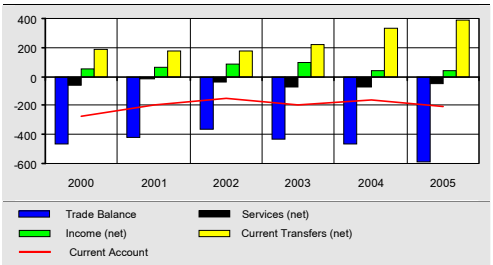


Chart 1.28
Dynamics of Current Account Components (mln USD)

The "Capital transfers" item grew in 2005 to reach US $50.7 million (compared to US $34.3 million in 2004). In 2005, capital transfers financed 24.8% of the current account.

In 2005, foreign direct investments amounted to US $248.3 million, representing a US $31.8 million (14.7%) increase over 2004. This high level of FDI was due to the privatization of the Zangezour Copper-Molybdenum Plant and the implementation of large-scale investment projects by a number of fully or partially foreign-owned enterprises. FDI financed 121.6% of the current account, which is a rather high indicator. The bulk of FDI was received from the following four countries: Greece (20%), France (8%), Germany (40%), and the US (6%). 22.9% of the real sector FDI was in the communications sector; 10.8% was in foodstuffs and beverages; and 39.9% went to the mining industry.

Net flows of the government external credit amounted to US $36.1 million during 2005 (including the disbursement of a US $49.7 million loan and the repayment of US $13.7 million of the old loans). External credits of the government financed 17.7% of the current account.

The behavior of the private sector[2] has fluctuated quite considerably in recent years. Unlike 2004, net foreign assets of the private sector shrunk by US $40.8 million in 2005. Net foreign assets of banks fell by US $69.9 million, mainly due to the change in the regulations for required reserves (to require that reserves against foreign currency liabilities be kept in foreign currency).

As a result, capital and financial account inflows significantly exceeded the current account deficit, leading to a significant increase in CBA's gross foreign reserves (during 2005, CBA's gross foreign reserves grew by US $161.9 million[3]). The increase in gross foreign reserves was mainly due to CBA's foreign currency purchases (of about US $102.4 million) in the inter-bank market, the banks' provisioning of foreign currency in the CBA for reserve requirement (US $49.5 million), the CBA's conversion of grants disbursed to the Government (US $20.7 million), and the conversion of the Government's privatization proceeds (US $30 million). Import coverage—a key indicator of the external sector, was 4.1 months in 2005, compared to 4.3 months in 2004, due to a strong increase in imports of goods.

Armenia's external public debt burden improved tangibly in 2005. External public debt (including government-guaranteed debt) was US $1,099 million in 2005, representing a US $84 million decline over 2004. During the year, US $59 million was borrowed from external sources, while debt service reached US $50 million. The main reason for the decline in external debt was the change in the exchange rate. A key indicator of external debt sustainability—the ratio of external debt to GDP, improved by 10 percentage points in 2005 over 2004, reaching 22%. Concessional lending of the IMF and the World Bank account for a larger share (98%) of external debt.

During 2005, external debt service amounted to US $62 million (including principal repayment of US $50 million and interest repayment of US $12 million). External debt liquidity indicators also improved considerably on account of fast-growing exports of goods and services. The ratio of external debt service to exports of goods and services improved from 9.7% in 2004 to 4.7% in 2005.

[2] *Excluding banks and credit organizations.*

[3] *Excluding CBA's after the date transactions, including accrued interest.*

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External loan obligations of Armenian banks and credit organizations[4] were US $47.7 million at yearend 2005, compared to US $22.0 million at yearend 2004. During 2005, commercial banks and credit organizations borrowed US $39.0 million from external sources and repaid US $13.8 of principal against outstanding loans.

The structure of Armenian commercial banks' external debt changed in 2005 over 2004. Kazakhstan, Germany, Luxembourg, and others joined the list of lending foreign countries. At yearend 2005, the main countries lending to Armenian commercial banks and credit organizations were the United Kingdom (16.9% in 2005, compared to 15.5% in 2004), Russia (14.7%, compared to 1.7%), Switzerland (10.5%, compared to 22.7%), the USA (10.3%, compared to 18.9%), Luxembourg (9.4%), and Germany (8.4%).

Banks mainly on-lent this debt to the following sectors: trade (US $14.3 million), industry (US $15.6 million), and finance (US $6.1 million).

At yearend 2005, the average weighed interest rate on this debt grew from 5.6% in 2004 to 7.6%. About 60.8% of the loans were at the floating [LIBOR] rate, with average maturity of about 4.2 years. The share of short-term loans in the borrowed financial resources fell from 8.6% in 2004 to 6.3% in 2005.

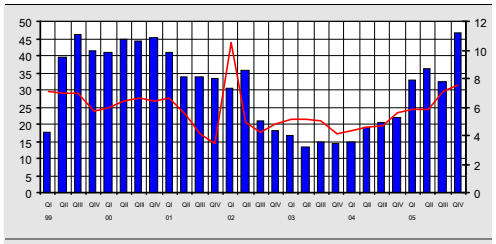


Chart 1.29
Dynamics of Private Debt of Armenian Banks and Credit Organizations, 1999-2005

Real Exchange Rate and Foreign Trade Prices

The Central Bank projected a 2.6% increase in the real effective exchange rate of the dram during 2005, on the backdrop of 2.2% average inflation and a 9.7% appreciation of the USD/AMD exchange rate. The average weighed inflation of trading partner countries was projected at 8.2%. The average weighed appreciation of exchange rates against the US dollar was projected at 4.2%. In actual terms, the real effective exchange rate appreciated by 9.0%, mainly due to the considerable (16.5%) nominal appreciation of the dram against the US dollar and the slow average weighed appreciation (0.6%) of exchange rates of partner countries. The average weighed inflations of Armenia and partner countries were somewhat below the projected levels (0.6% and 6.3%, respectively).

The appreciation of the real exchange rate of the Armenian dram in 2005 was a continuation of the trend from 2004, which was conditioned by external sector developments. Two key factors influencing this pattern are worth mentioning: the large-scale inflow of private remittances and the considerable improvement of the terms of trade. Private remittances grew by 19.7% in 2005, which, coupled with the 70.2% increase in 2004, had a tangible impact on external sector indicators. Under such conditions, the CBA's continued commitment to a free-floating exchange rate policy caused the real exchange rate to be adjusted through an appreciation of the nominal exchange rate, rather than high inflation, which would have been the case, if the CBA kept the nominal exchange rate fixed.

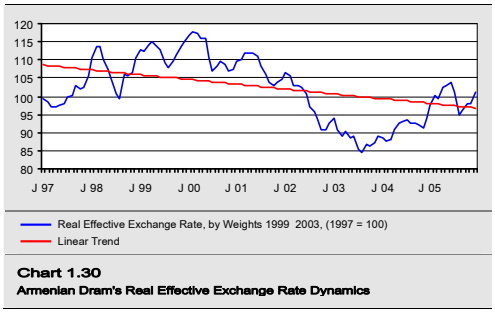


Chart 1.30
Armenian Dram's Real Effective Exchange Rate Dynamics

According to CBA's estimates, Armenia's terms of trade greatly improved in 2005 (by 15.0%, compared to a projected 0.4% deterioration). The reason was that export prices grew faster than import prices. The increase in dollar prices of exports was 22.7% (compared to a projected 4.0%), while import prices grew by 6.6% (compared to a projected 4.4%).

[4] Excluding loans received through the Armenian Government in the frameworks of projects of international financial institutions and other creditors.

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Real Effective Exchange Rate for Armenia in 1999 – 2005

	1999	2000	2001	2002	2003	2004	2005 target	2005 actual
Real exchange rate (1997 = 100)	112.3	111.9	108.0	98.4	88.4	91.4	93.7	99.6
Percent change	4.5	-0.4	-3.5	-8.9	-10.2	3.4	2.6	9.0
CPI (Armenia)	0.7	-0.8	3.2	1.1	4.7	7.0	2.2	0.6
Nominal exchange rate (Armenia)	-5.6	-0.8	-2.8	-3.2	-0.9	8.5	9.7	16.5
CPI (partner states)	18.5	9.9	8.9	7.6	6.9	5.8	8.2	6.3
Nominal exchange rate (partner states)	34.1	12.2	5.7	0.7	-6.9	-5.5	-4.2	-0.6

Export and Import Prices, 2000 - 2005

Compared to previous year	2000	20001	2002	2003	2004	2005
Exports unit value	**99.9**	**100.7**	**102.3**	**98.9**	**107.8**	**122.7**
Investments	98.9	102.1	100.1	102.3	99.9	97.8
Consumables	104.9	100.8	101.7	108.9	112.6	109.1
Diamonds	99.9	100.3	96.9	90.1	98.9	100.0
Intermediate consumption	99.0	96.5	102.6	103.7	113.7	146.4
Imports unit value	**100.5**	**99.9**	**103.9**	**103.1**	**110.1**	**106.6**
Investments	101.8	99.7	93.6	93.8	100.6	99.5
Consumables	100.5	105.3	105.7	112.4	111.0	107.6
Intermediate consumption	98.4	95.9	98.4	98.7	105.8	99.9
Oil products	107.6	102.7	99.0	99.5	125.8	142.1
Diamonds	97.4	102.9	112.9	101.9	119.5	100.0
Natural gas	96.9	98.4	94.8	99.5	99.6	100.0
Terms of trade	**99.4**	**100.9**	**98.5**	**95.9**	**98.0**	**115.0**

The reason for such an increase in export prices was the [46.4%] increase in prices of intermediate consumption goods, due to the significantly higher prices of base metals (copper and molybdenum). The 9.1% increase in prices of consumer goods was due to developments (inflation and nominal exchange rate) in the economies of partner countries—mainly Russia: Russia had a 7.6 percentage point impact, while the impact of the US and countries of the euro-zone was rather small.

Import prices increased because of higher prices of oil products and consumer goods (42.1% and 7.6% increases, respectively). Higher oil prices, in turn, were due to the higher real and speculative demand for and limited supply of oil. Prices of imported consumer goods also mainly grew as a result of inflation and exchange rate movments in Russia and the Ukraine (contributing 3.1 and 1.1 percentage points, respectively).

World Economy in 2005

Although world economy grew more slowly in 2005 than in 2004, it still maintained rather high pace of growth (4.2%).[5] In the first half of the year, world economy grew faster than in the second, due to the slightly increase in confidence in the world business environment. In the second half, growth of the world economy slowed down, partially due to the higher international prices of oil and the destructive bearing of Hurricane Katrina on the US economy. In 2005, the world economy mainly benefited from strong growth of services, which partially offset the slow growth of industry caused by high international prices of oil.

[5] *Information from IMF's "World Economic Outlook- 2005. September", unless otherwise specified.*

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World Economic Growth

	2003	2004	2005
World output	**4.0**	**5.1**	**4.3**
Developed countries	1.9	3.3	2.5
US	2.7	4.2	3.5
Euro zone	0.7	2.0	1.2
Japan	1.4	2.7	2.0
Other developed countries	2.5	4.4	3.2
Developing countries	6.5	7.3	6.4
Africa	4.6	5.3	4.5
Central and Eastern Europe	4.6	6.5	4.3
CIS	7.9	8.4	6.0
Emerging Asia	8.1	8.2	7.8
China	9.5	9.5	9.3
India	7.4	7.3	7.1
Middle East	6.5	5.5	5.4
Western Hemisphere	2.2	5.6	4.1
Addendum:			
EU	*1.3*	*2.5*	*1.6*

In regional terms, economic growth in 2005 was greatly supported by the US economy (which grew by 3.5%), among developed countries, and by developing countries like China and India (9.3% and 7.1%, respectively). The Japanese economy is worth mentioning, as well: during the last three years, it has shown signs of revitalization (growing by 2.0% in 2005). In the euro-zone countries, growth slowed down, though certain improvements were observed in late 2005. Nevertheless, growth of the euro zone countries was rather low (1.2%) in 2005.

Strong growth (6.0%) was reported in the CIS countries, albeit much less than in 2004 (8.4%).[6] This decline was mainly due to slower growth of the Russian and Ukrainian economies (6.4% and 2.4%, respectively, compared to 7.2% and 12.1% in 2004). Another reason for the decline in growth momentum was the 0.6% economic recession of Kyrgyzstan in 2005, compared to 7.2% growth in 2004. Economic developments in both Kyrgyzstan and the Ukraine were very negatively affected by the political crises in these countries. The economy of Azerbaijan grew by an unprecedented 26.4% in 2005, which is not only the strongest performance in the CIS, but also among the countries of other regions.

In 2005, current account imbalances continued to increase in the world economy, especially in the US. The US current account deficit to GDP ratio was about 6.5% in 2005, due to the rising oil prices and ever-increasing demand in the US economy. Among the main countries that reported surplus are Japan, China, and countries of the Middle East and the CIS (the latter—due to the rising oil prices). However, despite all of these developments, capital inflow into the US economy is rather high—in fact, high enough to cover the current account deficit.

In any case, the fact that savings in the US are low remains a key medium-term challenge, which poses significant risks to sustainable development of world economy.

Despite the growing current account deficit in the US, the US dollar appreciated slightly in 2005 against the currencies of partner countries: however, many analysts[7] believe it to be a short-term phenomenon, mainly due to the increasing gap between interest rates in the US and other developed economies (such as the euro zone and Japan), as well as the short-term one-time impact of a number of administrative measures implemented by the US government (such as the

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[6] *CIS economic growth and inflation indicators are based on data provided by the CIS Statistical Committee.*

[7] *See, for instance, N. Roubini "Einstein and the US dollar: Is the currency rewriting the laws of gravity?", 21 Nov 2005, www.rgemonitor.com*

Price Change

	2003	*2004*	*2005*
Developed countries	1.8	2.0	2.2
USA	2.3	2.7	3.1
EU	2.1	2.1	2.1
Japan	-0.2	0.0	-0.4
Other developed countries	1.8	1.8	2.1
Developing countries	6.0	5.8	5.9
Africa	10.4	7.8	8.2
Central and Eastern Europe	9.2	6.5	4.8
CIS	12.0	10.3	12.6
Emerging Asia	2.6	4.2	4.2
Middle East	7.1	8.4	10.0
Western Hemisphere	10.6	6.5	6.3
Addendum:			
EU	*2.0*	*2.2*	*2.1*
Essential commodities			
Foodstuffs	5.1	14.3	-0.4
Beverages	4.9	3.0	21.0
Agriculture inputs	3.7	5.5	2.4
Metals	12.2	36.2	26.4
Energy carriers	16.7	30.9	38.8

statement about introducing a 5% profit tax on offshore capital, instead of the officially-set 25%). During this period, the position of the euro in world markets weakened, mainly due to the political issues in the euro zone, such as the rejection of the European Constitution by France and the Netherlands, the disagreements regarding the adoption of the medium-term EU budget, national and religious clashes in France, and etc.

China's currency policy reforms[8] also are worth mentioning here, although they did not lead to a considerable appreciation of the Chinese Yuan against the US dollar (only 2.4% during the year).[9] However, these reforms are expected to continue in 2006, which will contribute to overcoming global imbalances.

The prices of main commodities continued to grow in 2005, due to the higher world demand—as reflected in the oil product and metal markets. Rising oil prices were due to the several factors, including limited supply in the long run and geopolitical uncertainties in the short run. Although the consequences of Hurricane Katrina were overcome by means of using the strategic oil reserves of the US and increasing the Saudi oil supply (by 0.5 million barrels per day), the scarcity of oil processing capacity creates price pressures, especially in the US.

As a result, inflation in the world economy was slightly higher in 2005 than in 2004, although still remained within reasonable limits. This is especially the case in developed countries, where inflationary pressures (especially core inflation) remain manageable. The US economy is somewhat of an exception: here, two factors (high oil prices and higher unit labor costs) are worrisome in respect of growing inflationary pressures.[10]

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[8] *A 2.1% appreciation of the Yuan/USD fixed exchange rate on July 21, 2005, and broadening of the daily band to ± 0.3 percent in comparison to the exchange rate basket of other partner states.*

[9] *December-2005 average exchange rate over same period of previous year.*

[10] *HSBC experts believe that lighter oil produce taxation burden in the US in comparison with other developed countries results in a stronger impact of oil produce prices on the economy. In 2005, the unit cost of workforce in the US grew by 2.4 percent over 2004, compared to a 2.9 percent decline in 2004 over 2003. The average for developed countries (including the US) was 1.6% in 2005 over 2004, compared to a 1.7% decline in 2004 over 2003.*

Unlike developed countries, developing countries have seen much more articulate inflationary pressures. This was mainly due to both the stronger impact of rising oil prices and the unprecedented growth observed in some developing countries. This is particularly true for countries that had a large trade surplus in 2005, including the CIS and Middle Asia, the trade surplus of which grew by 66.9% and 18.0%, respectively.

Inflation accelerated in the CIS. Double-digit inflation was reported in four CIS countries, including the Ukraine, Russia, Kyrgyzstan, and Azerbaijan (average inflation of 14, 13, 12, and 10 percent, respectively). The lowest inflation was reported in Armenia—0.6%.

Financial market conditions remained favorable in 2005, although the Federal Reserve System continued to carry out a contractionary monetary policy. Such a policy was also adopted by the European Central Bank at yearend 2005. However, long-term real interest rates remain unusually low, which, according to Alan Greenspan, the former Chairman of the FRS, is a mystery. Although it partially reflects well-anchored inflationary expectations at the world level, it is difficult to relate to growing public and private debt.

In addition to financial market conditions, world investment and savings also matter here. Ben Bernanke, the current chairman of the Federal Reserve, stated in 2005 that unprecedented growth of savings in developing countries has resulted in a "surplus of savings," lowering world interest rates and, in this way, fueling an increase in the prices of assets, which has caused private sector savings in developed countries to fall.

As a consequence of shrinking savings in developed countries, the external balance of developing countries is improving and, due to the same external factors, their real exchange rate is appreciating. During the last several years, this trend has been observed in transition countries, as well: in Eastern Europe, for instance, it was explicit in 2003 and 2004, appearing in the CIS countries in 2004 and 2005 in relation to lesser mobility of capital flows.

Consequently, the real exchange rate in CIS countries continued to undergo appreciation pressures coming from the external sector in 2005, though, in the majority of Eastern European countries, it had balanced during 2004. Under such circumstances, CIS countries faced an ongoing dilemma: exchange rate appreciation vs. inflation. Countries that adopted more flexible exchange rate policies had lower inflation.

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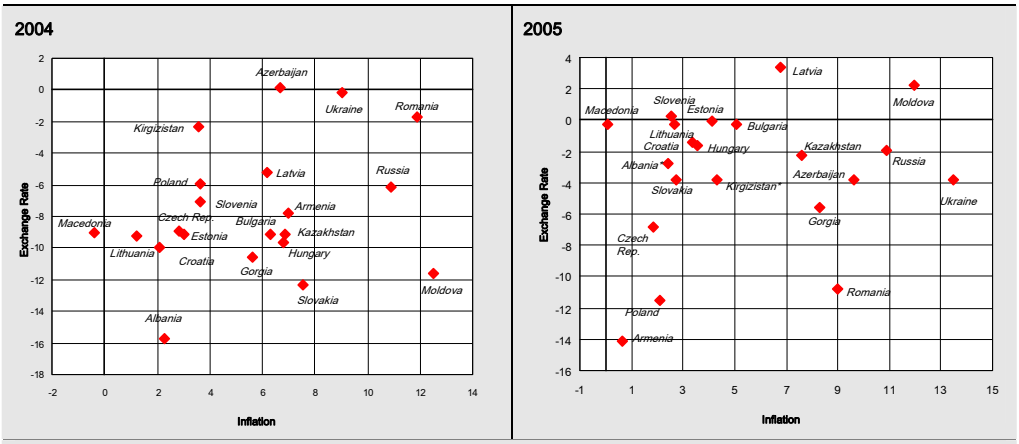


Chart 1.31
Inflation and Exchange Rate in Eastern Europe and CIS States in 2004 and 2005

** January-November 2005.*

1.4. MONETARY POLICY

Monetary Policy Objectives and Implementation Risks

In 2005, as in the years before, the Central Bank's monetary policy focused on maintaining price stability in the Republic of Armenia, i.e. achieving a below-3% inflation target. Economic growth was projected at 8%. In 2005, the Central Bank would remain committed to the earlier-adopted strategic principles of monetary targeting. As a peculiarity of 2005, the Monetary Program anticipated that confidence in the dram, which had emerged in 2004, would continue to strengthen in 2005, and that circulation of the dram would potentially expand. This could be facilitated, among other things, by the complete implementation of the Republic of Armenia Law on Currency Regulation and Currency Supervision and of the deposit guarantee scheme for natural persons, which had started in July 2005.

In view of these factors, the Central Bank estimated money demand to imply yearend increases of 18.5% and 15.5%, and average annual increases of 26% and 17.9%, in broad money and dram broad money, respectively. Management of the monetary base—as an operational objective—implied a yearend increase of 8.9% in the monetary base (with an average annual increase of 13.6%).

Virtually all the sectors of the economy were anticipated to pose risks to monetary policy implementation, potentially generating some pressure on prices, which could cause the Central Bank to consider revising the targets of monetary aggregates during the year. The risks projected for 2005 mainly materialized. Among such risks, it is necessary to mention the higher-than-projected growth, higher-than-expected remittances and exports, and, as the main characteristic development for 2005, the above-projected intensity of the monetization process and the ensuing above-planned expansion of money supply.

On the backdrop of these materialized risks and certain macro-environment developments during the first half of 2005, the CBA revised the monetary program targets during the second half of 2005-with a view to carrying out a more expansionary policy. One of the reasons why the latter was deemed feasible was the non-emergence of significant inflationary pressures during the year, which was mainly due to the strong growth in agricultural output (11.4%) and its contractionary impact on prices.

Money Demand

Yearend-2005 figures on the execution of the revised program indicate that broad money, dram broad money, and the monetary base grew by 28.2%, 54.2%, and 51.9%, respectively (compared to 22.3%, 9.2%, and 11.4% in 2004). Such considerable increases in money demand and, especially, its dram component, were partially due to consistent appreciation of the dram in the context of large-scale foreign currency inflows during the year, which further intensified the monetization process. Given such increases in the monetary aggregates, deflation of -0.2% was reported at yearend-2005, while average annual inflation was 0.6%.

In order to analyze trends of broad money and the behavior of its components, and to draw a comparison with previous years, the year 2005 can be considered in terms of two halves. First of all, broad money and dram broad money had declined during the first halves of previous years, while in 2005, both broad money and dram broad money grew in the first half by 6.1% and 12.9%, respectively (compared to average first-half decreases of 2.3% and 7.8% in 2003 and 2004, respectively). In terms of the components of broad money, this increase was due exclusively due to the 6.8% and 25.5% increases in cash in circulation and dram deposits, respectively, while foreign currency deposits fell by 1%. Possibly, this was due to the phenomenon of dedollarization which was observed from the beginning of the year onwards, as a result of which monetary aggregates did not decline during the first half of the year because of seasonality in money demand, unlike the previous years.

During the second half of 2005, as a result of the adjusted program, which contemplated a more expansionary monetary policy, cash in circulation grew by 37.1% compared to an average of 20.1% for the second halves of the previous two years; dram deposits grew by 36%, compared to 12.6%; and foreign currency deposits grew by 1.3%, compared to 26.4%.

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Dollarization in Several Transition Economies*

Country	Share of foreign currency deposits in broad money								
	1997	1998	1999	2000	2001	2002	2003	2004	2005
Armenia	29.4	38.3	46.8	51.8	47.0	38.8	42.9	49.0	38.5
Georgia	20.9	29.1	35.6	41.2	44.9	46.4	50.3	44.0	44.0
Azerbaijan	24.6	28.9	32.9	58.3	48.9	48.4	49.1	54.5	45.2
Estonia	12.7	14.9	15.9	17.2	31.5	30.9	15.8	15.5	20.3
Latvia	32.6	30.7	29.2	31.4	30.9	29.0	27.6	29.2	32.0
Lithuania	25.3	23.4	27.3	32.8	32.9	24.4	19.5	19.8	21.4
Russia	17.9	21.7	30.5	29.7	27.5	25.8	18.9	17.8	16.3
Ukraine	14.3	18.5	22.9	24.6	15.4	18.5	20.7	23.9	23.5
Czech Republic	10.3	11.2	10.8	10.5	9.9	9.7	9.3	9.4	12.1
Slovakia	10.7	12.0	14.4	15.3	11.5	12.4	10.9	10.6	11.4
Slovenia	31.5	27.2	25.9	28.9	31.6	28.3	28.1	28.5	28.7
Romania	32.0	29.7	37.4	39.7	42.8	40.4	37.1	33.8	30.0
Bulgaria	52.5	39.2	38.0	39.7	39.3	37.6	36.9	33.5	34.6

** Source: websites of national central banks.*

In general, the semi-annual trends indicate that dram components of broad money grew more than the other structural components of broad money. From AMD 47.0 billion in 2004, dram deposits reached AMD 80.2 billion (a 70.7% increase), while cash in circulation grew from AMD 98.6 billion in 2004 to AMD 144.3 billion in 2005 (a 46.4% increase). The growth in dram deposits came from both demand and time deposits.

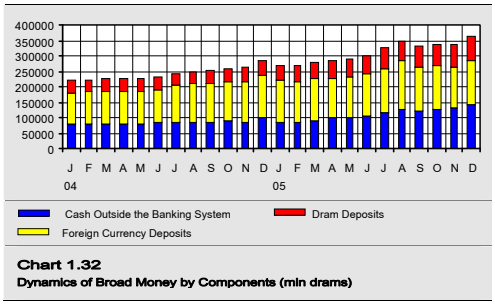


Chart 1.32
Dynamics of Broad Money by Components (mln drams)

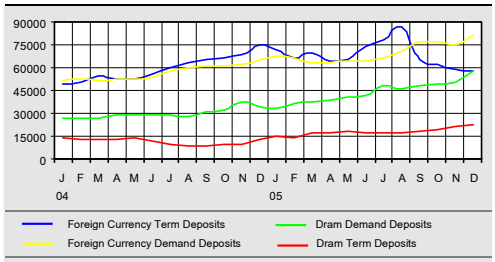


Chart 1.33
Dram and Foreign Currency Deposits by Maturity (mln drams)

Foreign currency deposit growth was extremely low (only 0.4%). For comparison, foreign currency deposits had grown by an average of about 34% in each of 2003 and 2004. Such small growth in foreign currency deposits was due to the 21.7% decline in foreign currency demand deposits, accompanied with a 25.7% increase in foreign currency time deposits. This shows that both the volume of foreign currency in circulation and its role have diminished during 2005.

On account of higher time deposits, there has been an AMD 9.9 billion (84.6%) increase in deposits of enterprises with state share and organizations. The bulk (AMD 6.2 billion) of this increase was attributable to foreign currency deposits.

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Thus, it is clear that, during 2005, structural disproportions of broad money changed mostly on account of higher dram components. Given this behavior of deposits, it is possible to assume that, during 2005, strong business activity was accompanied with increasing confidence in and expanded circulation of the national currency. This, in turn, brought down the level of dollarization in Armenia.

Money Supply

Similar to 2004, money supply expanded in 2005 on account of growth of both NFA and NDA of the banking system (24.9% and 35.4%, respectively, or 33.2% and 9.5% if measured

against the revised program). In absolute terms, NFA growth (AMD 51.1 billion) was higher, all of which was due to an increase (of more than AMD 88 billion, or 59%) in the CBA's NFA, while NFA of commercial banks declined by AMD 37 billion (67%). The decline in commercial bank NFA indicates that banks have become more active in placing their funds in the Armenian economy.

During 2005, banking system NDA grew by AMD 28 billion (35%), influenced by both higher net banking system claims on Government and growing lending to the economy. Net claims on Government fell during the first half due to the contractionary fiscal policy pursued in the first half, as well as the depositing with the CBA of the proceeds of additional issuance of T-bills with a view to absorbing excess liquidity. During the second half of 2005, these factors reversed (i.e. the Government carried out an expansionary fiscal policy, and the funds deposited with the CBA were redeemed), which caused an increase in net claims on Government.

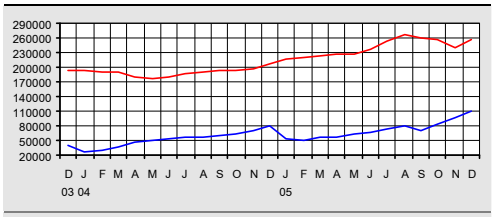


Chart 1.34
NFA and NDA of Banking System (mln drams)

Compared to yearend-2004, lending to the economy grew by 32.2% as of yearend-2005. Due to the dedollarization, dram loans grew faster in 2005 than before (72.4% growth in 2005, compared to 44.9% in 2004). The same factor slowed down the growth of foreign currency loans (18.6% in 2005, compared to 42.5% in 2004). Household loans continued to grow rapidly (48.2%), which is a sign of an active process of consumer lending.

During the year, net other assets of the banking system fell by about AMD 40 billion. The bulk of this decline was due to net other assets of commercial banks. This was due to the considerable increase in the statutory capital of the banking system, as well as its profitable performance, in 2005.

Level of Financial Intermediation

Indicators of the level of financial intermediation changed in different directions during 2005: monetization and dramization ratios grew, while the money multiplier and the dram multiplier fell. In the context of strong growth in 2005 and faster increases in the aforementioned components of broad money and dram broad money, the monetization grew from 12.6% at yearend-2004 to 14% at yearend of 2005, while the dram monetization grew from 6.6% to 7.7% during the same period. Due to these changes, the money and dram velocities declined during the year, by 9.7% and 14.8%, respectively.

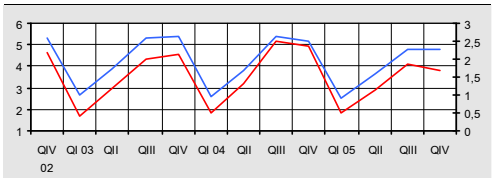


Chart 1.35
Velocity of Money

In the meantime, the money multiplier and the dram multiplier fell by 6.4% and 0.8% to 2.04 and 1.13, respectively, in 2005 over 2004. If these indicators are viewed on a semiannual basis, it becomes clear that despite their relatively stable behavior during the first half of 2005, compared to the same period of 2004, they declined abruptly during the second half of 2005. This decline of the money multiplier and the dram multiplier in the second half of 2005, however, cannot imply lower level of financial intermediation, because it was a consequence of a change in the regulations concerning reserves required by the CBA. The amendment raises the required reserve ratio by 2 percentage points to 8%, as well as differentiation of reserves by currency. As a consequence, about AMD 12 billion of excess liquidity built up in the banks' dram correspondent accounts with the CBA, which, coupled with an increase in cash in circulation due to the dram monetization process and the slackening of foreign currency deposit growth observed during the year, brought the multipliers down. The decline in the dram multiplier was smaller than that in the money multiplier, which was due to faster growth in dram deposits during the year.

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Comparative Table of Monetization Ratios for Several Transition Economies *

Country	(M2X)*/GDP x 100							
	1997	1998	1999	2000	2001	2002	2003	2004
Armenia	7.8	8.4	9.9	11.7	13.0	12.0	12.4	12.6
Georgia	8.1	7.3	7.9	10.4	11.1	11.7	12.5	15.4
Azerbaijan	13.8	10.7	11.7	16.3	12.9	13.0	14.4	18.0
Estonia	29.8	27.3	32.3	35.7	39.1	38.8	39.5	41.2
Latvia	25.2	24.6	24.6	27.8	30.3	32.9	39.5	48.9
Lithuania	18.5	18.8	20.7	22.8	26.1	28.6	30.9	34.9
Kyrgyzstan	13.7	14.5	13.6	11.3	11.1	14.6	17.5	20.6
Moldova	21.6	19.3	20.5	22.3	25.5	29.8	31.8	38.3
Russia	17.0	17.7	16.9	18.2	23.5	26.2	29.8	31.6
Ukraine	13.4	15.2	16.8	18.6	22.1	29.1	35.9	36.4
Czech Republic	65.8	61.9	61.1	67.2	69.4	71.2	72.2	69.6
Poland	34.2	36.7	39.6	39.6	43.5	40.8	41.3	40.4
Slovakia	62.6	59.9	61.9	64.4	66.7	63.8	64	61.9
Slovenia	39.2	42.2	43.3	46.6	54.5	54.8	53.6	53.6
Romania	24.6	24.8	24.6	23.0	23.2	24.7	24.2	27.0
Bulgaria	34.1	29.6	31.7	36.8	41.8	43.1	48.5	54.7

** M2 is broad money in local currency.*
M2X includes also foreign currency deposits.

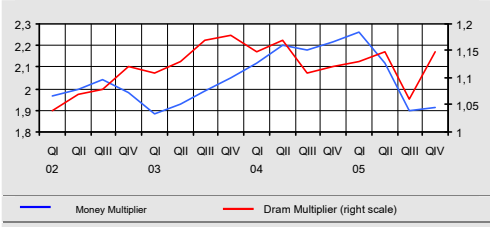


Chart 1.36
Money and Dram Multipliers

Effectively, a comparison of this behavior of the multipliers during the year over their performance in 2004 would not be as appropriate as an assessment of the level of financial intermediation in 2005 on the basis of the monetization and dramization ratios, which clearly indicate that they have increased during the year.

Nevertheless, as in the past, the Republic of Armenia remained behind many transition countries (especially Eastern Europe and the Baltic states) in terms of monetization in 2005.

Monetary Base

The evolution of the macroeconomic and monetary situation in the first half of 2005 led to materialization of the annual monetary policy program-contemplated risk, whereby the dram exchange rate continuously appreciated and demand for the dram increased on this background. Taking into account significant deviations of the monetary indicators from the program targets and the fact that they did not lead to significant inflationary pressures (semiannual inflation of 1.5%, compared to a program target of 4%), the CBA revised the monetary program targets in the second half of 2005, with a view to carrying out a more expansionary monetary policy. Under the revised program, the CBA contemplated a yearend increase of 41.4% in the monetary base, compared to an original target of 8.9%, as well as an average annual increase of 35.4%, compared to an original target of 13.6%.

During 2005, the increase in money demand exceeded the targets set in the revised program, mainly due to the aforementioned factors and the large Government spending during the last few days of the year. During the second and third quarters, the monetary base far exceeded the upper level of the band; throughout the fourth quarter, however, the monetary base was managed within the band—with the exception of the last few days of the year, when extensive

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The Money Multiplier in Several Transition Economies

Country	Money Multiplier								
	1997	1998	1999	2000	2001	2002	2003	2004	2005
Armenia	1.39	1.77	2.01	2.09	1.97	1.9	1.97	2.14	1.76
Georgia	1.35	1.42	1.45	1.59	1.71	1.69	1.81	1.72	1.91
Azerbaijan	1.44	1.56	1.62	2.17	1.91	1.92	2.04	1.81	2.07
Estonia	2.29	2.29	2.30	2.51	3.43	3.87	3.74	3.49	3.73
Latvia	2.03	2.03	1.97	2.33	2.46	2.49	2.87	3.06	2.93
Lithuania	2.20	1.95	2.19	2.65	2.97	2.87	2.68	3.11	3.24
Kyrgyzstan	1.37	1.50	1.53	1.53	1.53	1.44	1.45	1.57	1.38
Moldova	1.69	1.66	1.67	1.84	1.95	2.06	2.31	2.31	2.26
Russia	2.19	2.35	2.22	2.10	2.22	2.26	2.03	2.19	2.44
Ukraine	1.69	1.80	1.79	1.80	1.80	2.08	2.34	2.27	2.26
Czech Republic	3.41	2.88	2.71	2.94	3.12	6.61	6.61	6.67	6.72
Poland	3.84	4.11	4.98	6.03	5.32	5.31	5.25	5.35	5.69
Slovakia	4.64	5.15	4.79	5.31	4.85	4.96	5.87	6.22	
Slovenia	8.61	8.6	8.15	9.45	9.1	10.4	10.48	10.85	
Romania	2.92	3.6	2.71	2.42	2.21	1.97	2.03	1.64	1.39
Bulgaria	2.59	2.63	2.54	2.99	2.89	3.0	3.11	2.75	3.04

Government spending caused it once again to exceed the upper level of the band. As a result, the monetary base grew by 51.9% at yearend and by an average of 39% during the year.

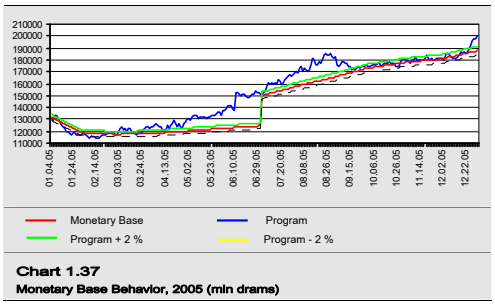


Chart 1.37
Monetary Base Behavior, 2005 (mln drams)

Foreign currency purchases served as the main instrument for meeting extensive demand for the dram: the choice of this instrument was also due to the objective of partially mitigating the impact of the large-scale foreign currency influx on the market. Moreover, active engagement of this liquidity injecting instrument was supported by an emerging deflationary environment; to compare, in 2004, inflationary pressures had left rather limited possibility of expanding money supply for the purpose of neutralizing the foreign currency inflow.

Due to the aforementioned factors, the CBA used the foreign currency purchase instrument to inject a total of about AMD 45 billion of liquidity during the year. Moreover, the CBA converted the foreign currency equivalent of AMD 14.6 billion from the Special Privatization Account of the Government, the spending of which by the Government contributed to higher dram excess liquidity. This was also facilitated by the change in the regulations concerning required reserves, which became effective on June 10, causing an additional AMD 12 billion (the amount of formerly-required reserves against foreign currency liabilities) of reserves to turn into excess liquidity.

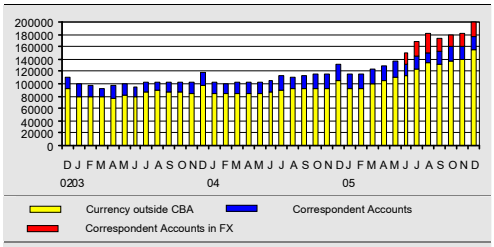


Chart 1.38
Monetary Base Behavior by Components, (mln drams)

During the year, the CBA dealt with large-scale dram excess liquidity by means of both liquidity absorbing dram instruments (reverse repo and deposit facilities) and new financial instruments (such as the depositing with the CBA of proceeds of additional placements of Government securities, and the issuance of CBA bonds).

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During this period, the CBA initiated the signing (and periodic rolling over) of reverse repo agreements of about AMD 6 billion, i.e. the whole volume of the T-bill portfolio.

In 2005, banks were rather active in using the standing deposit facility, which allowed them to deal with short-term (1-2-week) dram excess liquidity.

Prior to the issuance of CBA bonds, there was active use of mechanism of depositing with the CBA proceeds of additional T-bill placements: in this manner, AMD 15.6 billion of liquidity was absorbed during January-July, 2005. (All of these deposits were redeemed by yearend.)

On June 10, the Central Bank made the first issuance of its own bonds, which had a maturity of up to 1 year. In this manner, the CBA absorbed net liquidity of AMD 21.2 billion.

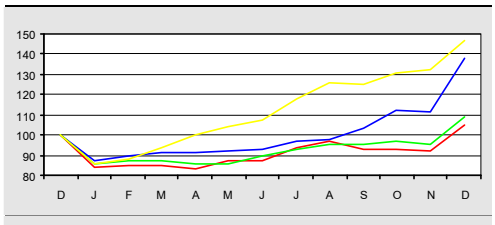


Chart 1.39
Currency outside the CBA, (%)

As a result of these operations, which were in line with the dramization process occurring in the economy, cash outside the CBA grew much faster (by 47.1% during the year).

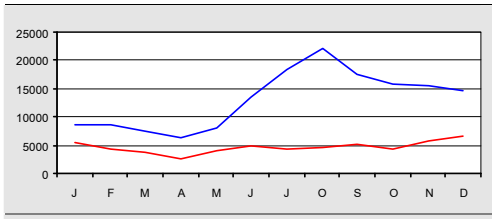


Chart 1.40
Excess Reserves Behavior, (mln drams)

In 2005, excess reserves of the banking system were rather high, which was mostly due to the mid-year change in the regulations concerning required reserves: from AMD 6.5 billion at yearend-2004, the average monthly balance reached AMD 13.6 in June 2005, growing further to AMD 14.5 billion at yearend. Banks maintained most of this balance for the purpose of their current transactions.

During 2005, the CBA's NFA grew by AMD 88.3 billion (59.2%), which was accompanied with an AMD 19.8 (more than 2-fold) decrease in the CBA's NDA. While NFA grew during both the first and second halves, due to large-scale purchases by the CBA in the currency market, the increase in foreign currency correspondent accounts with the CBA because of the change in the regulations concerning required reserves, and other foreign currency conversions, NDA fell by AMD 33.1 billion during the first half, and then grew by AMD 13.3 billion during the second (the influencing factors are covered in the section on Money Supply).

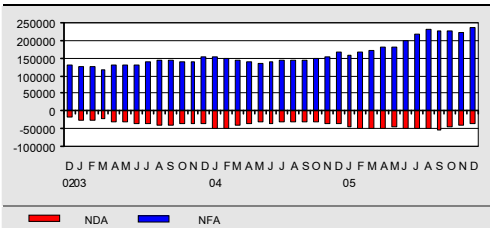
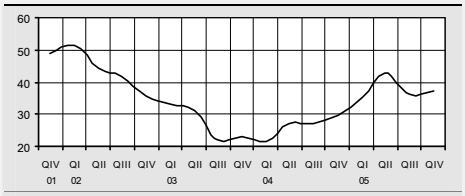


Chart 1.41
Monetary Base Behavior by NFA and NDA, (mln drams)

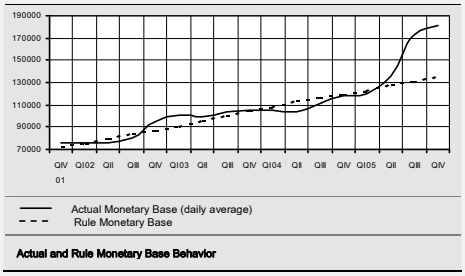
The market interest rate decline trend and the much higher growth of money supply during 2005 indicate that a more expansionary monetary policy was carried out than programmed. Nevertheless, the Monetary Conditions Index,[1] as a policy indicator, points to the contractionary focus of monetary policy during the first half of 2005, as it grew during this period-influenced mainly by the appreciation of the real effective exchange rate. During the second half, with a relatively stable real effective exchange rate, its impact on the Monetary Conditions Index weakened, and, mainly due to declining interest rates, the Index fell-testifying to the expansionary nature of monetary policy.

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Monetary Conditions Index Pattern in the Economy of Armenia

The higher-than-expected increase in money supply during 2005 is evidenced by the Monetary Rules Calculation[2]: during 2005 and, especially, during its second half, the actual monetary base largely exceeded the rule-derived target, which is mainly due to factors covered in the section on Money Supply. According to the rule calculation logic, the more expansionary nature of monetary policy is explained by the fact that the monetary base grew faster than nominal GDP during a 12-month period (51.9% and 13.9%, respectively, during 2005).



Actual and Rule Monetary Base Behavior

[1] *The "Monetary Conditions Index Strategy in the Republic of Armenia" paper is published in the "Central Bank Bulletin" for Q2 of 2001.*

[2] *The Monetary Rules Calculation Methodology is contained in the Republic of Armenia 2002 Monetary Policy Program, as a separate attachment.*

Transparency and Accountability of the Monetary Policy

In 2005, the Central Bank of Armenia remained committed to the principles of transparency and accountability of its activities and, especially, its monetary and exchange rate policies. The Central Bank made regular statements on the Monetary Policy implementation process and projections. It released statements interpreting the sessions of the CBA Board and Monetary Commissions, and published monthly (*CBA Bulletin*), quarterly (*CBA Newsletter*), semi-annual (*Inflation in Armenia*), and annual reports, as well as the Annual Monetary Policy Program. Moreover, quarterly meetings were held with commercial banks to present the main directions of monetary policy, quarterly progress of annual program implementation, the risks undermining the attainment of the CBA's primary objective, and the ensuing adjustments.

By means of the mass media, the public at large was, too, informed of the monetary policy trends, patterns, and present issues. Progress towards attainment of the CBA's primary objective and the implementation of the monetary policy were regularly presented to the public in a Q&A format.

Starting from the second half of 2005, in view of a change in the monetary policy strategy, i.e. the shift from a monetary targeting to an inflation targeting approach, the CBA made a number of publications and a statement. They mainly addressed the inflation targeting strategy, the justification for and feasibility of introducing it, and the expected outcomes.

In 2005, the Central Bank continued to conduct business surveys on various topics. Data generated in such surveys was taken into consideration for the CBA's development of financial and monetary policy programs for 2006, leading to better projections and more effective policies.

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1.5. INTERNATIONAL RESERVES: LEVEL AND MANAGEMENT

During 2005, the official international reserves of the Central Bank of Armenia[1] (excluding privatization proceeds) grew by US $122 million and amounted to US $669.8 million.

The growth in Central Bank international reserves was mostly due to the disbursement of the IMF Poverty Reduction and Growth Facility (PRGF) tranche (US $10.2 million), other grants (US $21.4 million), domestic market net purchases of foreign exchange (US $103 million), and reserve management revenue (US $23 million).

The balance in the Government's "Foreign Currency Proceeds from Privatization" special account grew by US $57.5 million during the year and amounted to US $85.6 million. As a result, Central Bank reserves, including privatization proceeds, grew by US $179.45 million during 2005 and amounted to US $755.35 million.

The Central Bank sustained its policy in managing the official international reserves of the Republic of Armenia during 2005, such as attaining highest return with low risk on investments and high liquidity. The Central Bank of Armenia invested mainly in foreign government T-bills and government-guaranteed bonds with sound credit rating, as well as foreign currency deposits.

During 2005, revenue from international reserve management was around US $23 million—over twice the 2004 figure of US $11.3 million. This increase was due to higher interest rate in international markets and the investment policies pursued by the Central Bank during the year.

Yield on US dollar-denominated assets grew by 2 percentage points during 2005,[2] while yield on Euro assets grew by 0.25 percentage points. Interest rates remained rather high in the UK. However, the faster growth of interest rates in the US compared to other countries caused the main investment currencies to depreciate against the US dollar during the year.[3]

In light of these trends, the Central Bank of Armenia increased the share of the US dollar in its reserves, while not breaching the bands set earlier for asset-liability currency matching, with a view to absorbing the impact of exchange rate fluctuation on the net foreign assets of the CBA.

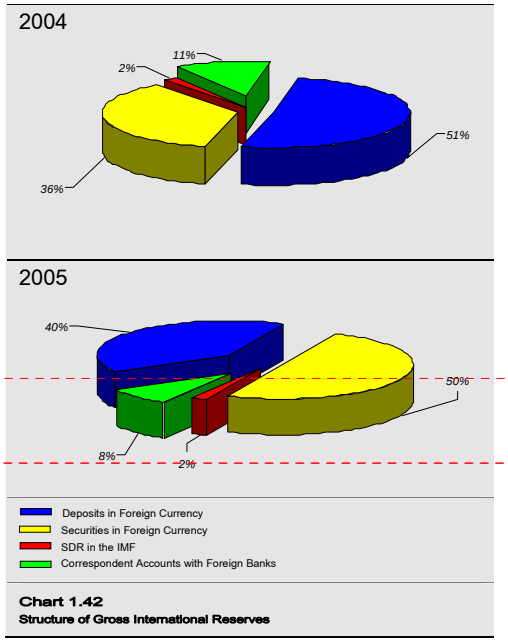


Chart 1.42
Structure of Gross International Reserves

During 2005, the CBA's gross external reserves fell by US $42.6 million. The main reason for lower liabilities was loan repayment of about US $50 million and, partially, the SDR and Euro depreciation against the US dollar.

As a result of these operations, the net foreign assets of the CBA (excluding privatization proceeds) increased by US $164.6 million during 2005 to reach US $472.6 million.

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[1] *The international reserves and liabilities figures are presented at actual exchange rates.*

[2] *The US Federal Reserve System increased interest rates in June 2005 by 2 basis points (to reach 4.25 percent at yearend 2005). In 2005, the Bank of England lowered the re-finance interest rate by 0.25% to reach 4.5%. The European Central Bank increased the interest rate by 0.25% during 2005 to reach 2.25% at yearend.*

[3] *The Euro and the British Pound depreciated by 12.6 and 10 percent, respectively.*

1.6. FINANCIAL MARKET

During 2005, declining trends of fluctuating interest rates were observed in virtually all the segments of the financial market.

Deposit and Lending Interest Rates

The average interest rate on dram deposits with commercial banks in December, compared to the same period of 2004, grew by 1.75 percentage points in 2005, reaching 6.45%. The average interest rate on US dollar deposits in December, compared to the same period of 2004, fell by 1 percentage points to 4.6%.

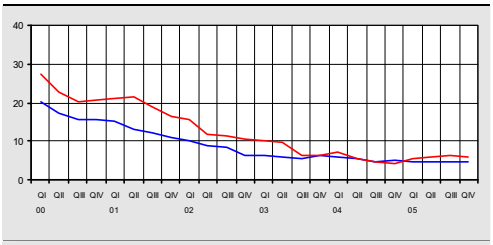


Chart 1.43
Commercial Bank Interest Rates on Dram and USD Deposits, (%)

The difference between interest rates on dram and US dollar deposits attracted by commercial banks was 1.85 percentage point, compared to 1 in 2004.

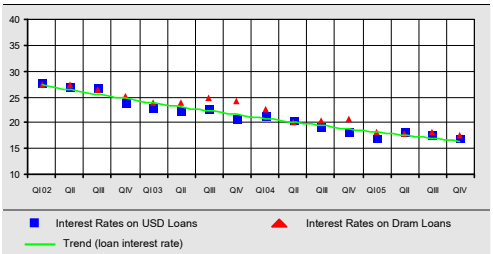


Chart 1.44.
Commercial Bank Lending Interest Rates in Dram and USD

Compared to December 2004, December 2005 average interest rates on commercial bank dram and US loans fell by 3.31 and 0.5 percentage points to 17.29% and 17.59%, respectively.

The difference between interest rates on dram and US dollar loans of commercial banks was -0.3 percentage points, compared to 2.5 in 2004. As a result, the spread between dram loan and deposit interest rates fell by 5.06 percentage points to 10.84%, while the US dollar loan and deposit interest spread grew by 0.5 percentage points to 13%, compared to 12.5% in 2004.

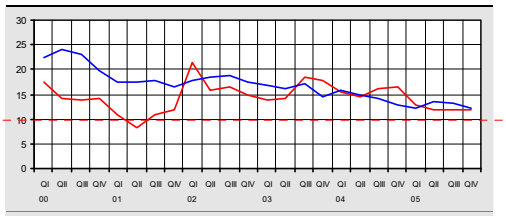


Chart 1.45
Trend of Spreads between AMD and USD Deposits and Lending (percentage points)

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Primary Market for T-Bills

Similar to other markets, interest rates in the primary market for T-bills fluctuated and remained on a decline trend that had emerged in the years before. At yearend, the average yield was 3.74% on short-term T-bills (representing a 0.57 percentage point decline over the beginning of the year) and 5.09% on medium-term T-bills (representing a 0.86 percentage point decline). Average yield on long-term T-bills increased, due to increased maturities, to reach 8.82% at yearend (for 15-year maturity T-bills) compared to 6.93% at the beginning of the year (for 8-year maturity T-bills).

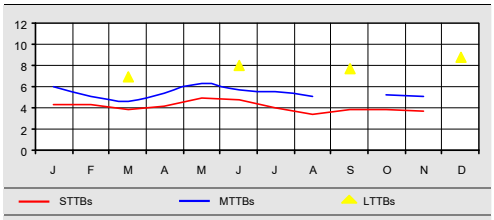


Chart 1.46
T-Bills Primary Market Interest Rates, (%)

In 2005, a total of AMD 22.5 billion short-term government securities (T-bills) were allocated in 29 issues; AMD 18.3 billion of medium-term T-bills

were issued in 14 issues; and AMD 6 billion of long-term T-bills were issued in 4 issues. Compared to 2004, the total volume of issues grew by AMD 2.9 billion, while the total volume of short-term T-bills grew by AMD 9.3 billion, that of medium-term T-bills fell by AMD 9.7 billion, and that of long-term T-bills grew by AMD 3.3 billion.

In 2005, strong aggregate demand for T-bills sustained in the primary market, though it fell, compared to the 249.34% demand in 2004, to about 229.2% of issuance (AMD 107.264 billion) in 2005. During 2005, the Ministry of Finance and Economy of Armenia bought back T-bills of AMD 5,559.758 million with average yield of 3.48%.

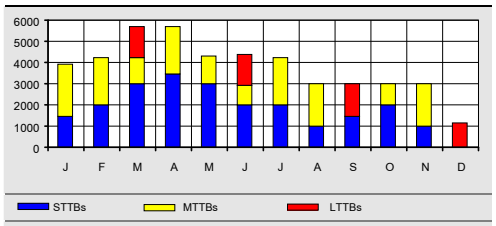


Chart 1.47
Volumes of Primary Allocation of T-Bills (mln drams)

At the end of the year, the portfolio of outstanding T-bills was AMD 57,555.5 million, representing an AMD 7,965.5 million increase compared to the same period of 2004. This increase has been accompanied with a growing average maturity of outstanding T-bills, from 629 days in 2004 to 839 days in 2005.

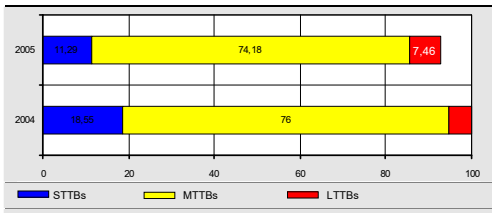


Chart 1.48
Structure of Circulating T-Bills, (%)

T-Bill Ownership Structure

During 2005, the share of T-bills owned by non-bank investors considerably decreased in the total ownership structure of T-bills. The volume of T-bills owned by resident non-bank investors fell by 5.72 percentage points, or AMD 2,203.756 million, and amounted to AMD 4,568.268 million, or 7.94%. The share of T-bills owned by non-residents has come very close to zero—in fact reaching AMD 0.13 million.

The share of resident bank (including Central Bank) investment in T-bills grew by AMD 7,234.893 million and reached AMD 46,779.093 million (81.27% of outstanding T-bills).

The volume of T-bills bought back by the Ministry of Finance and Economy reached AMD 6,208.009 million or 10.79% of outstanding T-bills at yearend 2005.

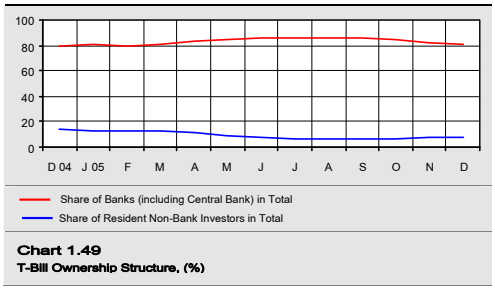


Chart 1.49
T-Bill Ownership Structure, (%)

Secondary Market for T-Bills

Compared to 2004, the T-bill secondary market players were rather active in 2005: as a result, the volume of transactions grew by AMD 36.17 billion to AMD 75.913 billion. Average weekly turnover in the secondary market for T-bills was about AMD 1.46 billion.

The yields curve shows that yields fell virtually all along the curve.

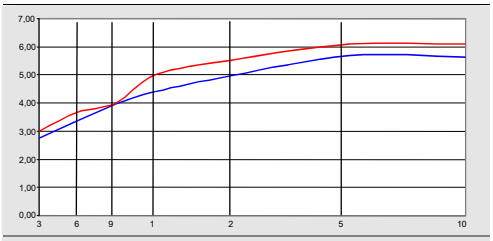


Chart 1.50
Spot Yield Curves

The bulk (96.4%) of the change in the yields curve position was due to the concurrent (parallel) shifting of the curve level, which amounted to 0.37

percentage point on account of lower yields. The scope of the curve changed by 6.5% (from 0.065 to 0.061), which confirms a smaller difference between long-term and short-term T-bill interest rates. Residual factors accounted for -2.9% of the curve change.

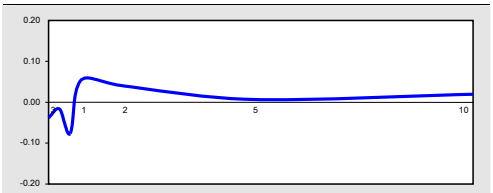


Chart 1.51
Deviation

Repo Market

During 2005, average interest rates also fell in the inter-bank repo market. Compared to 2004, average annual yields on transactions fell by 0.98 percentage points, reaching 3.45%. Unlike the secondary market for T-bills, the volumes of transactions in the inter-bank repo market fell compared to 2004 (by about AMD 5.4 billion, reaching AMD 98.254 billion). The average weekly turnover was AMD 1.890 billion.

During 2005, dram excess liquidity remained high at almost all times, due to the large influx of capital and the change in the arrangement concerning required reserves. The average annual amount of required reserves was AMD 11 billion in 2005, compared to AMD 4.7 billion in 2004.

In line with economic development, and with a view to managing excess liquidity of commercial banks, the Central Bank mostly engaged absorbing instruments in the dram market during 2005. However, other instruments were engaged in the foreign currency market. With a view to mitigating the pressures driven by the large influx of capital, the CBA purchased US $103.3 million in the inter-bank market during 2005; in July, the CBA executed a US $2.3 million foreign currency provision swap of 35-day maturity at 0.54%.

The CBA purchases of government securities in the secondary market were mainly aimed at replenishment of the T-bill portfolio. To this end, the CBA purchased foreign currency worth AMD 1,287.49 million at 4.5% yield.

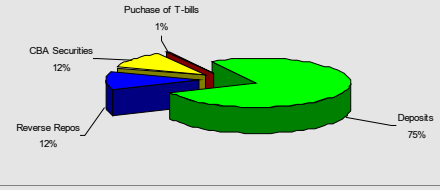


Chart 1.52
Shares of Dram Instruments used by the CBA

Parallel to this, with a view to reducing excess liquidity in the banking system, the CBA initiated engagement of reverse repo transactions during January-September 2005 for a total of AMD 23,231.674 million, at an average weighed yield of 3.75%.

In 2005, the use of the excess dram absorbing instrument introduced at yearend-2004 to coordinate CBA and MoFE policies was sustained: in this context, the Treasury made additional issues and placement of AMD 15,877.5 million of T-bills during 2005, the proceeds of which were fully deposited in a special deposit account with the CBA.

From June 2005, the CBA started to issue its own securities—as an alternative means of absorbing excess liquidity. The CBA has made 20 issues of under-1-year maturity bonds for a total volume of AMD 24,500 million, from which it placed AMD 22,964.275 million at an average weighed yield of 4.35%.

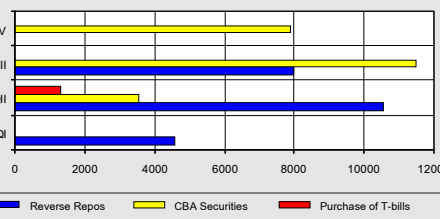


Chart 1.53
Dram Transactions carried out by the CBA, by Quarters

During the year, banks actively engaged the standing instrument of depositing with the Central Bank, which enabled banks possessing short-term excess liquidity to place such liquidity in the

Central Bank. During 2005, the Central Bank received bids for deposits of AMD 151,650 million with average annual weighed yield of 1.47%.

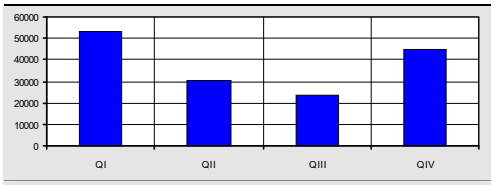


Chart 1.54
Volume of Deposits, by Quarters, (mln drams)

Interest Rates of the Central Bank of Armenia

In view of the aforementioned challenges, the CBA occasionally revised the interest rates on monetary instruments during 2005: the repo interest rate was revised four times—from 3.75% at the beginning of the year to 3.5% at yearend; the deposit interest rate was revised twice—reaching 1% at yearend; and the interest rate on lombard credits remained unchanged at 16%.

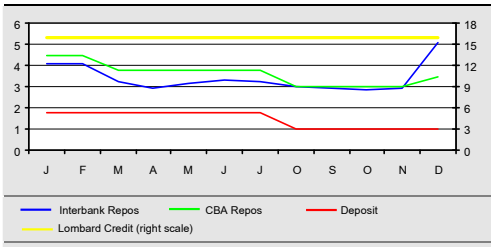


Chart 1.55
Interest Rates Set by the CBA, (%)

The Central Bank defined the repo interest rate on the basis of the inter-bank repo transaction interest rates, as well as the monetary policy program targets. In view of the virtually permanent need to reduce excess liquidity during 2005, the interest rate on repo transactions was set on average 0.4 percentage points higher than the average market interest rate. The spread between CBA and inter-bank repo interest rates fluctuated between 0.09 and 0.8 percentage points, with the exception of December, when the inter-bank repo interest rates increased abruptly, and the CBA revised the repo interest rate upward by 0.5 percentage points.

Currency Market

In 2005, a stable trend of appreciation emerged in the currency market. The dram appreciated by 7.92% over the US dollar, from AMD 485.84 at yearend-2004 to AMD 450.19 at yearend-2005 (a variation of 197.47, a standard deviation of 14.05 drams, a minimum exchange rate of 435.75 drams, and a maximum exchange rate of 501.80 drams. The average annual dram/dollar official exchange rate appreciated by 16.55 percent.

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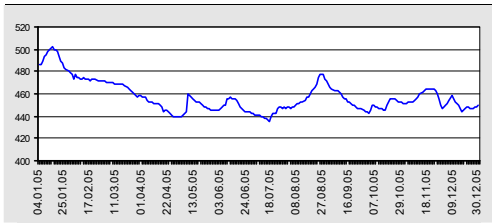


Chart 1.56
AMD/USD Exchange Rate Fluctuation

The gross volume of operations in the forex market grew by 31.44%, reaching US $3,025.40 million (compared to US $2,301.70 million in 2004).

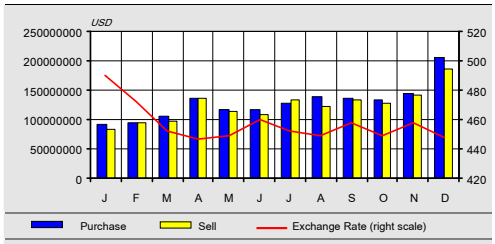


Chart 1.57
Operations in USD carried out in Armenian Currency Market

The gross volume of Euro-Dram purchase and sale operations grew by 40.43% and reached EUR234.50 million in 2005, of which EUR73.83 was bought and EUR 160.67 was sold. Sell operations outran buy operations due to closer economic ties between Armenia and the EU.

In November 2005, the Stock Exchange of Armenia was formed: it allows bringing together not only commercial banks that have supply or demand of foreign currency, but also commercial

organizations that have the right to buy and sell foreign currency. During the initial period, all the commercial banks of Armenia, as well as one currency dealer took part in the stock exchange trading. The number of participants tends to increase.

During two months, the gross volume of stock exchange transactions reached US $42.988 million and EUR0.4 million at average weighed exchange rates of AMD 450.28 and AMD 534.88, respectively.

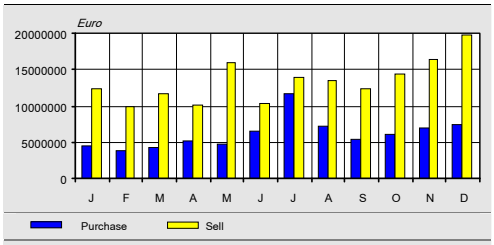


Chart 1.58
Operations in Euro carried out in Armenian Currency Market

2. FINANCIAL STABILITY IN THE REPUBLIC OF ARMENIA

To maintain financial stability means to safeguard the financial system against crashes or disruptions, so that the system continues to generate appropriate liquidity, smooth execution of transactions and transfers, and able to attract savings. In general terms, financial stability is an absence of financial crisis or ups and downs, when financial asset prices do not fluctuate much, and financial organizations are capable of honoring their commitments, including the attraction of deposits and making of loans, execution of payments and settlements, effective management of financial risks, and neutralization of potential risks.

Risks undermining financial stability of the economy can be conditionally divided into two main groups: (i) risks that emerge in the macro-environment and may later penetrate into the financial system, and (ii) risks that emerge within the financial system.

Therefore, analysis aimed at disclosing the potential risks undermining financial stability in the Republic of Armenia has covered both the macroeconomic environment and the three components of the financial system—the financial market, financial institutions, and financial infrastructures.

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2.1. FINANCIAL STABILITY IN THE MACROECONOMIC ENVIRONMENT

Financial system developments are very closely influenced by the macro-environment, as evidenced by improving financial stability on the backdrop of several years' economic growth in Armenia. However, the Armenian economy, like all other economies in similar condition, is also subject to the influence of certain macroeconomic factors (such as real estate prices, import and export volume concentration, price shocks affecting imports and exports, etc.), which can unexpectedly destabilize the financial system of the country.

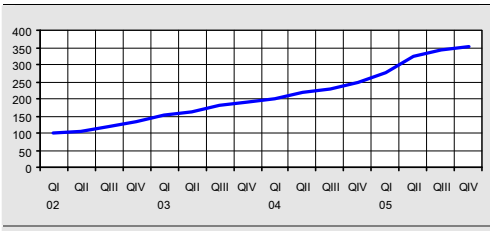


Chart 2.1
Average House Price Index (1 m2) in Yerevan* (Q1, 2002 = 100)

** Source: Armenian State Cadastre Committee's website: www.cadastre.am Because of a lack of unified average real estate price index in the website, the average house price index in Yerevan has been chosen as an indicator of real estate price changes.*

In Armenia, real estate prices have consistently increased over the last four years (an annual average increase of 37%). This increase has been both supply- and demand-driven. In terms of demand, robust growth and the influx of net transfers and net factor income have contributed to higher household income, which, coupled with the recent introduction of mortgage lending, decrease of interest rates, and growth of real estate renting rates, has driven an increase in real estate prices.

In terms of supply, the real estate prices have increased on account of the scarcity of vacant land resources (which has fueled an increase in land prices), the continuous increase in construction costs, and the diminishing stock of available real estate.

During last several years investment in real estate has been a "competitor" to bank savings in Armenia. This is due to the expectation that real estate prices will continue to increase stably. A

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Real Estate Prices

Prices of assets (in particular real estate) are important factors characterizing financial stability in a country. They are normally rather sensitive to market shocks and, in many cases, are early warning indicators of economic instability.

This factor is even more important for countries like Armenia, where the level of financial intermediation is low, and the public consider real estate as an alternative avenue of investment.

[1] *Source: "Central Bank Concept Paper on Financial Stability Framework in the Republic of Armenia."*

part of available cash is invested in real estate, because the annual increase in real estate prices and the income from the lease thereof are rather high.

The real estate market is not subject to a high degree of risk, because the Armenian economy is currently in the upward cycle of economic activity, all the macroeconomic indicators are manageable, and a decline in real estate prices in the near future is hardly possible.

However, even if real estate prices do fall, the banking system will not suffer major losses in terms of deteriorating quality of loans securitized with real estate or revaluation of fixed assets. According to some estimates, a till 50% decline in real estate prices will have an insignificant impact on financial market stability, and banks will be able to overcome any losses incurred.[2]

Nevertheless, the consistent increase in real estate prices may, in a sense, have an unfavorable impact on banking sector developments, because expectations of real estate price increases cause funds to be invested in the real estate market, bypassing the banking system.

Income and Indebtedness

Developmet trends of indicators like gross national disposable income and indebtedness of natural persons and legal entities are essential indicators in the view of financial stability. Normally, when lending to the economy, i.e. indebtedness of natural persons and legal entities, grows faster than their disposable income, there may be concerns that, at a certain point in time, households and business entities will run out of income to serve their debt.

Recently, the loan portfolio of the banking system of Armenia has grown much faster than gross national disposable income.

	2004	2005
Increase in bank lending to the economy	39%	39%
Increase in gross national disposable income	16%	17%
Bank lending to economy / Gross national disposable income	6%	8%

[2] *Detailed findings of real estate price stress-scenarios are presented in the section containing the analysis of market risks.*

However, the aforementioned trends do not undermine financial stability in the Republic of Armenia, because the "Lending to economy / Gross national disposable income" ratio is low, and financial system of Armenia has potential of fast growth compared to the growth of gross disposable income. In other words, households still have rather large potential to accumulate high-quality debt.

External Sector Issues

Net transfers and net factor income. The increase in gross national disposable income is also due to growth of net transfers from abroad and net factor income.

The Armenian economy can be characterized with large-scale net transfers from abroad and the influx of net factor income: in 2005, net transfers (including official transfers) were AMD 174.5 billion, and net factor income—AMD 43 billion. It is worth mentioning that both net transfers and net factor income are rather concentrated in terms of source countries.

Russia, for instance, is both an important trade partners of, and the main source of private remittances and factor income flowing into Armenia: in 2004, Russia accounted for 74.2% of net transfers and net factor income, which grew further to 81.3% in 2005.

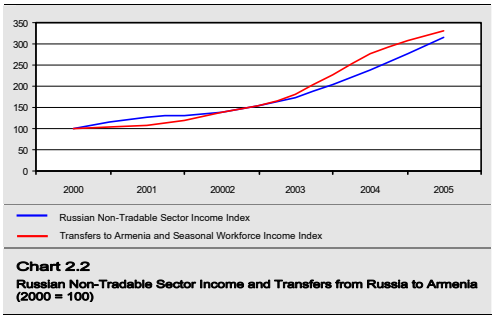


Chart 2.2
Russian Non-Tradable Sector Income and Transfers from Russia to Armenia (2000 = 100)

Armenian citizens in Russia are mainly engaged in the non-exportable sectors of trade and construction,[3] in which, according to estimates, income is not expected to decrease in the near

[3] *See the Results of Survey Conducted by CBA to Identify the Structure of Non-Business Remittances to Republic of Armenia Natural Persons from Abroad.*

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future. Such estimates are due to the fact that the growth of income in non-exportable sectors in Russia is driven mostly by the increase in the international prices of oil and, consequently, the increase in Russia's exports of oil.

The Russian economy has recently become much more dependant on the international oil prices. The correlation between oil exports and income in non-exportable sectors is 0.97. During 2003-2005, the average elasticity of income in non-exportable sectors to the volumes of oil export was 0.67.[4]

The correlation of Russia's oil exports and the international oil prices is very close to 1 (in fact, it is 0.986). During 2003-2005, the average elasticity of Russia's oil exports to international oil prices was 1.7.

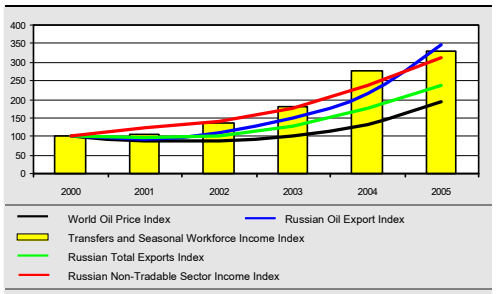


Chart 2.3
Oil Prices and Transfers from Russia to Armenia (2000 = 100)

For purposes of financial stability, it is important to maintain uninterrupted supply of net factor income and net transfers from Russia. IMF experts project[5] the price of 1 barrel of oil to reach US $61.75 in 2006 (compared to US $56.75 in 2005). The projected slower increase in oil prices may somewhat slow down the growth in private remittances during 2006; however, despite it being a factor of oil prices, there are no concerns regarding the inflow of net factor income and net transfers from Russia.

Nevertheless, unless the uninterrupted supply of net factor income and net transfers from Russia is maintained, the Armenian economy will encounter risks in the long run. Therefore, it is essential to closely monitor developments in Russia.

[4] *For details, see the 2006 Monetary Policy Program of the Republic of Armenia.*
[5] *See IMF, World Economic Outlook, Sep., 2005.*

Export and Import Concentration. Financial system stability is also greatly influenced by external market developments and changes in ties with the external world.

This factor is even more important for the Armenian economy in view of significant concentration in both Armenia's imports and exports: unfavorable changes in the prices of certain commodities in international markets may destabilize the financial situation.

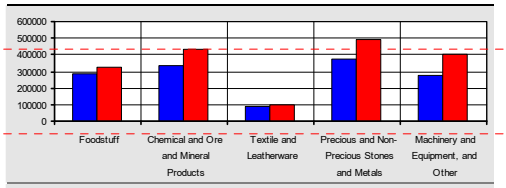


Chart 2.4
Armenia's Imports by Groups of Commodity, 2004 2005, (thousand USD)

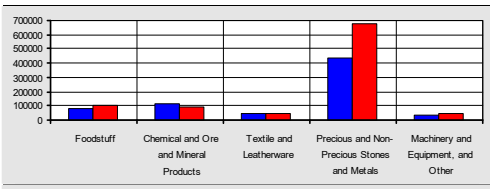


Chart 2.5
Armenia's Exports by Groups of Commodity, 2004 2005, (thousand USD)

Diamond trade accounts for a large share of the volume of both imports into and exports from Armenia. According to estimates, diamond prices are not expected to fluctuate significantly in international markets in the near future, which, perhaps, will keep the Armenian economy free of undesirable shocks.

Copper, molybdenum, and gold export prices are important, too, due to the fact that precious and non-precious stones and metals account for 70% of the commodities exports.

During the last three years, copper prices have increased about 2.5-fold in the international market, while the molybdenum price has increased about 9-fold. However, similar trends are not anticipated in 2006: it is projected that international prices of copper and molybdenum will decline insignificantly.

Most probably, this decline will be offset by an expected increase in the volume of exports, which

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will mitigate the negative impact of the price slight decline.[6]

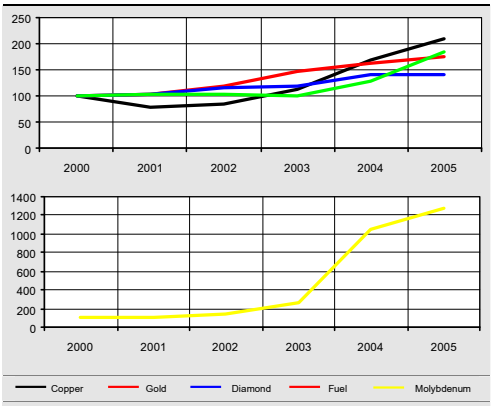


Chart 2.6
Prices of Copper, Gold, Diamond, Fuel and Molybdenum, 2000-2005, (2000 = 100)

Major fluctuations in the volume of gold exports are not expected, if the increase of gold prices and the volume of gold exported remains virtually stable.

As for changes in import volumes, imports of minerals are expected to grow due to both higher prices and projected higher consumption of oil products (gasoline).

Imports of other commodity groups are projected to grow, as well. An increase in income, external transfers, and external net factor income will indirectly contribute to higher imports into Armenia.

In general, the international prices of commodities that account for a large share of Armenia's foreign trade are not expected to fluctuate considerably in 2006, which, most probably, will have a rather neutral impact on the financial stability of the country.

Greater propensity to import is not significant for financial stability as well, because it is due to the large influx of foreign currency, and import growth is a logical next step to absorb the influx.

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[6] *See the "External Sector" part of the 2006 Monetary Policy Program of the Republic of Armenia.*

2.2. STABILITY OF FINANCIAL MARKETS IN ARMENIA

During 2005, interest rates were volatile in virtually all the segments of the Armenian financial market, with an observed declining trend. Though government securities are considered risk-free securities with their yields being the least subject to the influence of various factors, they are still affected by interest rate fluctuation in the financial market. The average indicator of modified duration (D_M) estimated for the purpose of interest risk assessment, which shows the price change level on the backdrop of changing yields, was 2.16 for government securities circulating at yearend 2005, excluding CBA securities (compared to 1.65 in 2004). The higher D_M for government securities was mainly the result of longer duration of government securities, which is a positive profitability phenomenon for investors with expectations of declining interest rates. In view of the increase in the volume of outstanding short-term securities on account of CBA securities, the average indicator of modified duration grew by only 0.03 percentage points over 2004 to reach 1.68, which means that, with a 1% change in yields, the price of a securities increases or decreases on average by about 1.68%.

D_M	
Under 3 months	0.23
3-6 months	0.48
6-9 months	0.69
9 months to 1 year	1.20
1-2 years	2.12
2-5 years	4.71
5-10 years	6.99

The commercial banks' portfolio of government securities (including CBA securities) purchased for the purpose of selling, as at end-December 2005, is presented below. The magnitude of the profit or loss in the event of a 1% change in yields has been estimated.

Though financial market interest rates fluctuated during 2005, the government securities market stability is confirmed by the lower average standard deviation of transaction yields. In 2003, it was 3.09, falling to 2.37 in 2004, and 1.54 in 2005. The same holds true for inter-bank repurchase interest rates. Parallel to the decline in interest rates, the average standard deviation fell to 0.58 in 2005.

	GS volume (AMD million)	DM	Price change (+) (AMD million)
Under 3 months	4,446.9	0.24	10.45
3-6 months	11,408.8	0.48	53.98
6-9 months	5,053.4	0.68	34.17
9 months to 1 year	8,104.7	1.14	98.94
1-2 years	10,330.0	2.30	255.36
2-5 years	4,119.6	4.79	207.13
5-10 years	3,441.1	6.95	286.66
Total	46,904.5	1.85	946.7

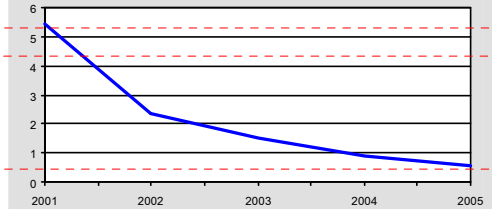


Chart 2.7
Average Variance of Repurchase Interest Rates

Financial market stability is considerably influenced by exchange rate fluctuation, which stretches the currency risk zone of the Armenian banking system.

Volatility growth has been high in the domestic currency market of Armenia in recent years (2003-2005).

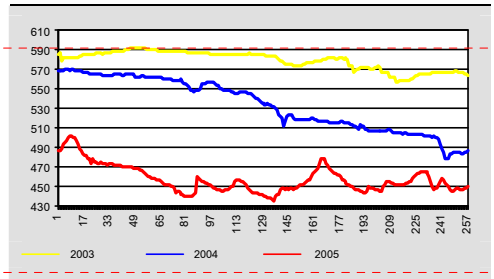


Chart 2.8
AMD/USD Exchange Rate, 2003 - 2005

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With increasing volatility, the factor influence causes a higher deviation of exchange rate than it would in a stable market. Starting from the second half of 2003, the currency market has seen a stable exchange rate appreciation trend, which formed appropriate expectations, with the banks trying to maintain squared positions in order to reduce their currency risk.

In terms of volatility, the year 2005 was more favorable than 2004 (variation of 735.41): variation was 197.83 in 2005, with volatility falling to 77 in the second half (compared to first half volatility of 279).

2.3. FINANCIAL INSTITUTIONS IN THE REPUBLIC OF ARMENIA

Banking System[1] Development Trends

I. General Overview

Financial stability in the Republic of Armenia has greatly benefited from recent years' improvements in the banking system, such as the increase in assets, liabilities, capital, and revenues, as well as an improved risk management system that has consistently lowered the risks.

At the beginning of 2005, 20 banks (with a total of 233 branches) operated in the Republic of Armenia. In 2005, ArmSwissBank CJSC obtained a banking license. At yearend, 21 commercial banks (with a total of 269 branches) operated in Armenia—all under general supervision.

Total capital, liabilities, and assets of the banking system grew during 2005.

Assets, Liabilities, and Capital of the Banking System (*AMD thousand*)

	31.12.2004	31.12.2005	2005 percentage increase
Assets	363567544	440674145	21.2%
Liabilities	298935905	345913389	15.7%
Capital	64631639	94760756	46.6%

Banking System Capital and Profitability. Total capital of the banking system grew by AMD 30.1 billion, compared to AMD 17.0 billion projected at the beginning of the year.[2] Such growth was due to an unprecedented increase in the statutory fund of the banking system.

The only major deviation was that from the projected growth of total statutory fund (projected AMD 7.3 billion at the beginning of the year, whereas actually grew by AMD 20.2 billion). This large difference between the projected and actual numbers was due to the fact that statutory fund projections had been based on strategic plans submitted by banks, which had not contemplated such an increase.

The statutory fund grew in 14 banks—on account of both internal and external sources. The share of non-residents in the statutory fund of banks grew only by 0.2 percentage points to 52.8% at yearend.

Projected total dividend payment out of previous year's profit was AMD 2.7 billion in 2005. During the year, six banks paid dividends [out of their 2004 profits] totaling AMD 2.9 billion (i.e., slightly above the projected level).

Net profit of the banking system grew by 16.5%[3] to AMD 12.0 billion, which was only AMD 0.4 billion off the projected figure of AMD 12.4 billion. During the year, 17 banks made profits, while four incurred losses.

Banking system return on assets (the ratio of retained earnings to average annual assets) was 3.0%, while return on equity (retained earnings to average annual capital) was 15.3% (compared to 3.2% and 18.4%, respectively, in 2004).

Banking system revenue and capital increase trends have had a directly positive influence on financial stability, improving the capacity of the banking system to absorb possible risk-related losses.

Banking System Liabilities. In 2005, total liabilities of the Armenian banking system grew by AMD 47.0 billion, which fell short of the AMD 51.0 billion target set at the beginning of the year. This deviation was caused by the failure to meet the non-resident deposit growth target. Actual growth of liabilities was mainly fueled by an increase in deposits (by AMD 34.4 billion) and bank claims (AMD 7.3 billion).

Within the overall structure, dram liabilities grew by 44.2%, while foreign currency ones only grew by 5.4%. The share of dram liabilities in total liabilities grew by 6.5 percentage points to 33.2%.

At the beginning of 2005, total deposits were projected to grow by AMD 41 billion: deposits of

[1] *Reference is made to the 21 banks operating in the general supervision framework as of December 31, 2005, and 20 banks as of December 31, 2004.*

[2] *In the context of financial stability assessment, the CBA makes regular forecasts of banking system development, which are based on commercial banks' strategic plans and estimates of CBA experts. The results are incorporated into annual Monetary Policy Programs of the Republic of Armenia.*

[3] *2004 profit excluding "ArmCommunications" ("Haykap") Bank.*

residents were projected to grow by AMD 33.4 billion, with non-residents' deposits growing by AMD 7.6 billion. The yearend growth of residents' deposits was AMD 34.1 billion, while non-residents' deposits grew by AMD 0.3 billion.

Total deposits grew only on account of dram deposits: dram deposits grew by 71% (AMD 34.9 billion), while foreign currency deposits fell by 0.3% (AMD 0.5 billion).

As for other liabilities, Government claims grew by 22% (AMD 2.9 billion), other bank claims grew by 32% (AMD 7.2 billion), claims of other financial organizations grew by 30% (AMD 1.9 billion), and other liabilities grew by 5% (AMD 1.0 billion) during 2005.

Banking System Assets. As a result of banking system liabilities and capital deviating from their projected levels, total assets grew by AMD 77.1 billion, which was above the projected AMD 68 billion.

As of December 31, 2005, total banking system assets were 19.8% of GDP (compared to 19.2% in 2004). Lending to the economy reached 8.3% of GDP (compared to 7.0% in 2004).

The loan portfolio accounted for 67% of the growth of total banking system assets.

As in 2004, highly-liquid assets grew more slowly than total assets. Loans to the economy grew almost twice faster than total assets. Highly-liquid assets grew by 16.4%, while loans to the economy grew by 39.1%. This was the reason why liabilities increased mainly on account of term liabilities, as banks, having achieved high current liquidity, returned to a situation where loans were growing faster than highly-liquid assets. It should be noted that rapid growth of the loan portfolio did not cause the quality of bank loans to deteriorate; consequently, financial vulnerability did not increase.

II. Credit Risk

Among the risks found in the Armenian banking sector, the credit risk is worth being mentioned, though losses due to credit risk have tended to decline in recent years.

While the level of banking system financial intermediation remains low, it has tended to grow in recent years (the ratio of bank loans to the economy to GDP increased from 6.2% in 2002 to 8.3% in 2005).

Banking system loans to the economy grew at a stable pace. In recent years, the increase in bank lending to the economy has surpassed the pace of total asset growth. As a result, the share of loans in total assets grew to 41.8% at yearend 2005.

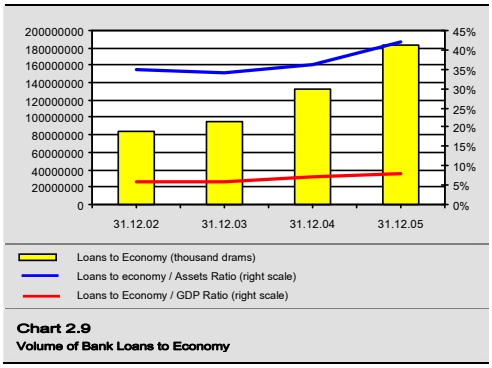


Chart 2.9
Volume of Bank Loans to Economy

An important indicator of banking system financial intermediation is the ratio of loans to the economy to total deposits. In a broad sense, this indicator reflects the transmission of savings to investments. In recent years, this indicator has increased, reaching 70.4% at yearend 2005.

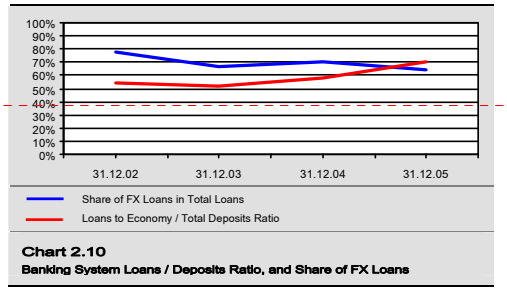


Chart 2.10
Banking System Loans / Deposits Ratio, and Share of FX Loans

The share of foreign currency loans in total banking system loans to the economy has declined in recent years: the decline was rather acute in 2005 (6.3 percentage points, to reach 63.6%).

Total loan portfolio (loans plus accounts receivable) grew by 34% (AMD 52.4 billion) in 2005: loans to non-residents grew by 23% (AMD 3.7 billion), while loans to residents grew by 35% (AMD 48.7 billion).

As in the past, a large part of the increase in loans to residents was due to consumer loans (58%, or AMD 22.6 billion) and loans to trade

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(35% of AMD 11.0 billion). Among consumer loans, mortgage lending is worth special attention: though only 6% of the total loan portfolio, it has considerable growth potential. Loans to other sectors of the economy grew, as well.

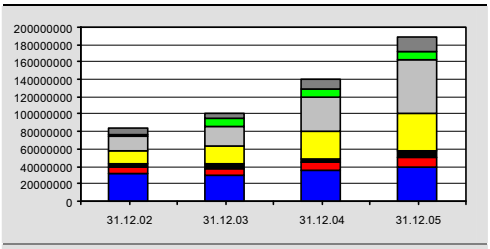


Chart 2.11
Bank Loans to Residents, by Branches of Economy, (thousand drams)

The share of long-term (1 year and above) loans in total loans has grown significantly in recent years, mainly due to longer maturities of consumer loans.

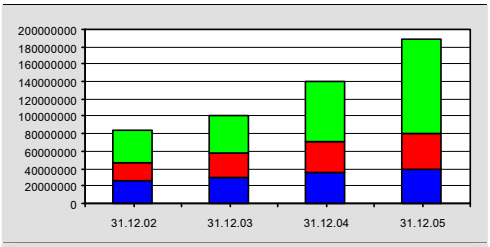


Chart 2.12
Bank Loans to Residents, by Maturity, (thousand drams)

As far as credit risk is concerned, it is worth noting that the share of standard loans and accounts receivable of the Armenian banking system has increased in recent years.

As of December 31, 2005, non-performing assets amounted to AMD 4.2 billion, of which non-residents accounted for 4.6%, and residents-95.4%. As for sectors of the economy, the share of non-performing loans to residents is relatively high in the construction sector (6.9%), as well as in public catering and other service sectors (3.2%).

The ratio of net provisions to assets is an important indicator of credit risk: in a broad sense, it reflects the credit risk-caused average loss per asset unit. Having declined in 2004 and 2005, this indicator reached 0.4%.

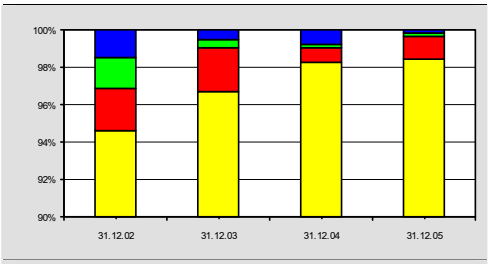


Chart 2.13
Shares of Banking System Loans and Receivables, By Category

These indicators confirm that credit risk management within the banking system has improved, partially due to the activities of the Credit Registry, from which banks receive information on the credit history of borrowers.

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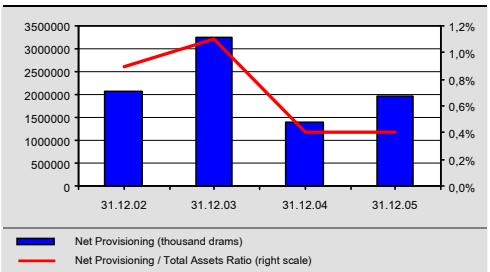


Chart 2.14
Ratio of Net Provisioning to Total Assets of the Banking System

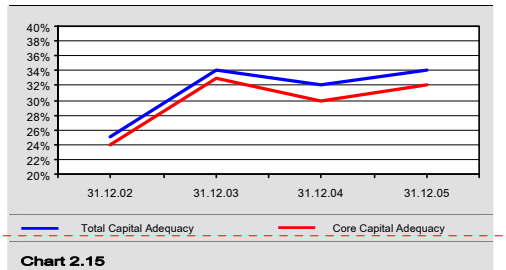


Chart 2.15
Banking System Capital Adequacy Indicators

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The Central Bank-established prudential standards are aimed at risk minimization: as of

December 31, 2005, total capital and tier-one capital adequacy ratios for banks (i.e. N1[1]—the ratio of total capital to risk-weighted assets, and N1[2]—the ratio of tier-one capital to risk-weighted assets, respectively) were 33.7% and 31.7%, respectively, being significantly higher than the required minimum standards of 12% and 8%, respectively.

As of December 31, 2005, no bank was found to be in breach of the capital adequacy requirements.

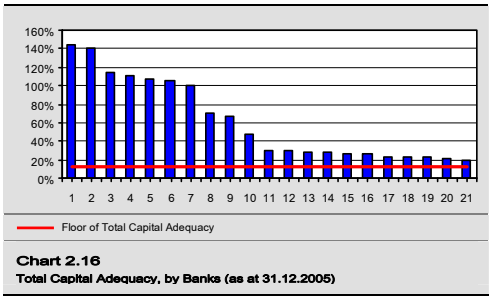


Chart 2.16
Total Capital Adequacy, by Banks (as at 31.12.2005)

Regulatory capital exceeded AMD 5 billion in six of the banks, was between AMD 3 and 5 billion in another nine banks, between AMD 2.4 and 3 billion in five banks, and between AMD 2 and 2.4 billion in one bank.

In the context of ensuring financial stability, the international experience in the field of risk projection, identification, and evaluation emphasizes the application of stress tests to elaborate various stress scenarios, including highly unlikely hardly possible ones, and to evaluate their potential impact on financial stability.

Credit risk stress tests are used to evaluate the impact of changes in loan classifications on capital adequacy. Loans are classified into the following categories: standard, watch, substandard, doubtful, and loss loans. The following assumptions are made in the stress tests: 1) loan portfolio of banks does not change, and 2) collateral is disregarded.

It has been evaluated that, if the worst stress scenarios addressed in the below mentioned matrix materialize, no bank would be in breach of the N1[1] and N1[2] requirements. It has also been evaluated that banking system losses in the event of the worst scenario would not have a negative impact on financial stability in the Republic of Armenia.

Stress Scenarios

31.12.05	25% of watch, substandard, and doubtful loans classified as loss	75% of doubtful loans classified as loss	30% of standard loans classified as watch loans
Banking system N1[1]	33.4 %	33.6 %	32.3 %
Banking system N1[2]	31.4 %	31.6 %	30.2 %

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III. Liquidity Risk

During the year, highly-liquid assets grew by 16.4% to reach AMD 184.2 billion. Highly-liquid assets grew somewhat more slowly than total assets did. As a consequence, their share in total assets fell by 1.7 percentage points to 41.8%.

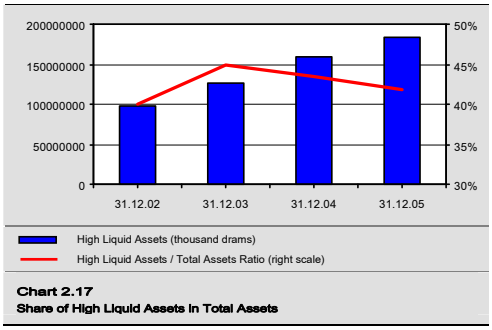


Chart 2.17
Share of High Liquid Assets in Total Assets

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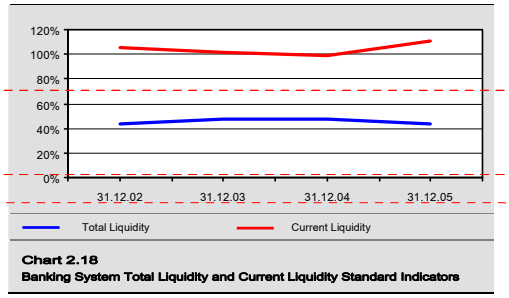


Chart 2.18
Banking System Total Liquidity and Current Liquidity Standard Indicators

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In 2005, highly-liquid assets grew faster than demand liabilities, but slower than total assets, which somewhat decreased the total liquidity ratio of the banking system, while the current liquidity ratio increased. In general, banking system total and current liquidity ratios have not fluctuated

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much in recent years, and have remained far above the required minimums (of 20% and 80%, respectively).

Thus, highly-liquid assets have grown faster than demand liabilities in 2005: however, it has not created instant liquidity problems for the banks. In terms of maturity-to-repayment bunches, banking system assets surpassed liabilities, which leads to the projection that, other conditions equal, the banking system will avoid liquidity risk-related alternative losses in 2006.

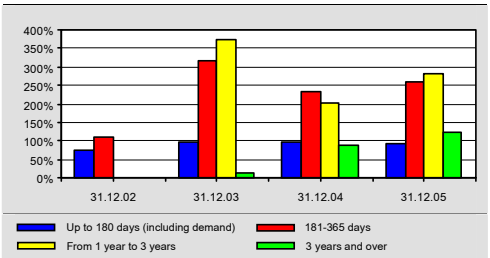


Chart 2.19
Banking System Assets / Liabilities Ratio, by Days left to Maturity [4]

Concentration of banking system liabilities declined in 2005. The share of "large" liabilities[5] in total liabilities somewhat declined, reaching 27.1%.

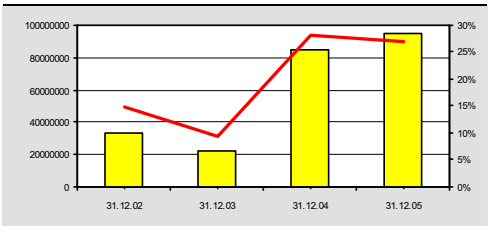


Chart 2.20
Banking System Major Liabilities / Total Liabilities Ratio

It has been estimated that, in the event the worst of below mentioned stress scenarios materializing, some banks might slightly breach the N2[1] total liquidity and N2[2] current liquidity requirements; however, the system would not face a liquidity problem, and such scenarios would not affect financial stability in the Republic of Armenia.

Stress Scenarios

31.12.2005	25% of time deposits of natural persons are repaid[6]	25% of demand accounts are repaid	25% of demand accounts and 25% of time deposits of natural persons are repaid
N1[1] of banking system	41.8 % (no bank would be in breach)	37.9 % (no bank would be in breach)	35.0 % (4 banks would be in breach)
N1[2] of banking system	99.3 % (1 bank would be in breach)	112.3 % (no bank would be in breach)	99.0 % (3 banks would be in breach)

IV. Market Risks

In 2005, the Armenian dram appreciated by an annual average of 16.6% and by a yearend 7.9% against the US dollar.

As a consequence of the Armenian dram fluctuations against other currencies during the year, foreign currency revaluations incurred total losses of AMD 395 million in the banking system, which accounted for 0.5% of regulatory capital of the banking system (compared to 0.7% in 2004). Foreign currency revaluation caused losses to 13 and gains to 8 banks. Banking system income from forex trading in 2005 was AMD 6 billion, which is 64% higher than the 2004 figure.

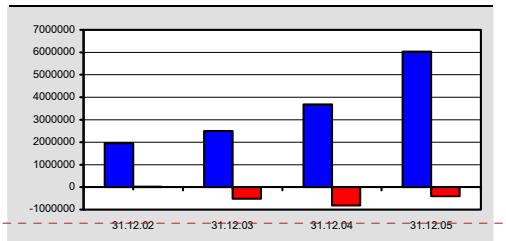


Chart 2.21
Net Proceeds from FX Purchase and Sale and FX Revaluation

[4] *In the calculation of indicators as of December 31, 2002, assets and liabilities with one year or longer maturity are included in the "181-365 days maturity" category.*

[5] *The sum of all amounts that, taken separately, exceed 5% of the bank's total liabilities, excluding related parties.*

[6] *Article 905(2) of the Republic of Armenia Civil Code provides: "Under the contract of bank deposit of any type, the bank undertakes the duty to release the sum of the deposit or part of it on the first demand of the depositor, with exception of deposits made by legal persons on other conditions of return provided by the contract."*

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As of December 31, 2005, the gross forex position of the convertible currencies of the banking system was 4.9%, while that of non-convertible currencies was 1.0% (compared to caps of 15% and 5%, respectively).

It has been estimated that, under the worst-case scenarios presented in the table below, banks would not incur significant losses, and there would be no impact on financial stability in the Republic of Armenia.

Stress Scenarios[7]

31.12.2005	10% appreciation/depreciation of the Armenian dram against the US dollar	10% appreciation/depreciation of the Armenian dram against the euro	Maximum possible loss in 2006, estimated under the VaR model
Banking system gain/loss in the event of foreign currency revaluation	-70 mln AMD (+70 mln AMD)	AMD 90 mln (- 90 mln AMD)	-107 mln AMD

Interest rate risk in the banking system is currently rather low. Market interest rates on loans and deposits have consistently declined in recent years.

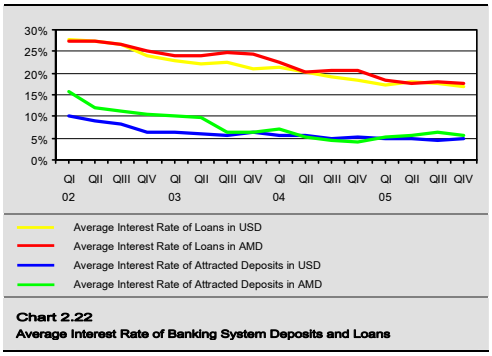


Chart 2.22
Average Interest Rate of Banking System Deposits and Loans

Average weighed maturity of banking system assets exceeded that of liabilities, as a result of which a general decline (i.e. a decline in interest rates of both loans and deposits) would not harm the system. Considering that the gap between average weighted maturities of assets and liabilities is not significant (currently, about 0.5 year), fluctuation of market interest rates would not inflict much harm upon the banking system.

It has been estimated that, under the worst-case scenarios presented in the table below, losses incurred by banks as a share of banking system capital would not be significant and would not influence financial stability in the Republic of Armenia.

Stress Scenarios

31.12.2005	Impact of a 2 percentage point increase (decrease) in market interest rates on total portfolio, estimated using the *duration method*	In the event of a 2 percentage point increase (decrease) in market interest rates, deviation from net interest income anticipated in the next three months, estimated using the GAP method[8]
Banking system gains/losses	AMD 1.4 billion, or 1.5% of banking system capital (-1.4 billion AMD or 1.5% of banking system capital)	AMD 42 million (-42 mln AMD)

Price risk is currently rather low in the banking system, and there are virtually no losses caused by price risk.

Nevertheless, the table below addresses the banking system losses under the worst-case scenario, which, though significant, would not have a tangible impact on financial stability in the Republic of Armenia.

Stress Scenario

31.12.2005	Price of real estate falling by 50%
Banking system loss caused by revaluation of real estate owned by the bank (*price risk*)	AMD 12.5 billion (or, 13% of banking system capital)
Banking system loss caused by non-repayment of 30% of the vulnerable loan portfolio[9] under the stress scenario (taking into account foreclosure of collateral against such loans) (*credit risk*)	3.5 billion (or, 3.7% of banking system capital)
Banking system loss caused by non-repayment of 50% of the vulnerable loan portfolio under the stress scenario (taking into account foreclosure of collateral against such loans) (*credit risk*)	5.8 billion (or, 6.5% of banking system capital)

[7] For purposes of loss calculation under these stress scenarios and the VaR model (which is not considered a stress scenario, because the VaR calculation takes into account historical series of exchange rates), it has been assumed that the foreign exchange position of the banking system does not change during the year.

[8] Under this methodology, it is assumed that the structure and the volume of assets and liabilities remain unchanged during the considered period (3-month), i.e. redeemed assets and liabilities are again allocated and attracted, but already with new interest rates.

[9] Vulnerable loan portfolio is the sum of balances of a bank's loans, which have balances that exceed devaluated value of real estate pledged as collateral against such loans.

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Development Trends of Credit Organizations

During 2005, the number of credit organizations increased by one: the "Washington Capital Universal Credit Organization" Closed Joint-Stock Company obtained a credit organization license. At yearend, 10 credit organizations (with two branches) were active in Armenia, two of which were leasing organizations, one—a credit union, and seven—universal credit organizations.

Total capital, liabilities, and assets of credit organizations grew in 2005.

Assets, Liabilities, and Capital of Credit Organizations, 2004-2005
(AMD thousand)

	31.12.2004	31.12.2005	2005 percentage increase
Assets	5646115	7872259	39.4%
Liabilities	2381020	3481501	46.2%
Capital	3265094	4390758	34.5%

Capital growth was mainly achieved on account of the AMD 1.1 billion increase in the statutory fund of four credit organizations. Total credit organization retained earnings reached AMD 80 million in 2005. Return on assets was 1.0%, and return on equity—1.8%.

Liabilities mainly grew on account of the increase in liabilities to other financial organizations (by AMD 460 million) and borrowings from legal entities (by AMD 576 million). Liabilities to legal entities and natural person-members were AMD 1.7 billion at yearend (legal entities—69.3%, and natural person-members—30.7%). Liabilities to banks and other financial organizations reached AMD 1.2 billion (33.9% of total liabilities) at yearend 2005.

The share of loans (including leasing) in the total assets of credit organizations grew considerably (by 89.9% or AMD 2.9 billion) to reach AMD 6.2 billion. The sharp increase in the loan portfolio of credit organizations caused their share in total assets to grow by 20.7 percentage points. At yearend, loan portfolio accounted for 78.4% of total assets. Consumer loans and industry lending accounted for a significant share of the loan portfolio of credit organizations.

In terms of risks, it is worth mentioning that, in 2005, the share of standard loans and accounts receivable in total loans and accounts receivable grew by 1.3 percentage points to 90%. 58% of non-performing assets are consumer loans.

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Development Trends of Insurance Companies

In 2005, two insurance companies ("Goba" LLC and "Inorient" LLC) were licensed to carry out insurance activities. At yearend, there were 23 licensed insurance companies in Armenia.

Total capital, liabilities, and assets of insurance companies grew in 2005.

Assets, Liabilities, and Capital of Insurance Companies (AMD thousand)

	31.12.2004	31.12.2005	2005 percentage increase
Assets	6357112	9891075	55.6%
Liabilities	3561319	5462748	53.4%
Capital	2795793	4428328	58.4%

The capital increase was mainly due to AMD 1.8 billion growth of statutory fund. Total losses of insurance companies making losses in 2005 were AMD 169.1 million, whereas the profitable insurance companies made a total profit of AMD 468.1 million.

The liabilities increase was mainly supported by AMD 1.2 billion increase in the "Claims Reserve and Other Technical Reserves" item. The share of short-term liabilities of insurance companies in total liabilities was 99.6%, while long-term liabilities were only 0.4%.

Sums insured of insurance companies' insurance contracts in force reached AMD 1.73 trillion at yearend 2005, of which AMD 1.69 trillion had been reinsured (i.e. 97% of risks have been reinsured). The loss ratio—as an indicator of risk, which is the ratio of insurers' compensations to insurance premiums raised during the same period, was 11.3% as at December 31, 2005.

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Foreign Exchange Bureaus, Currency Dealers, Securities Market Participants, and Pawnshops Operating in Armenia

At the beginning of 2005, 343 foreign exchange bureaus (including branches) had licenses to buy and sell foreign exchange in the Republic of Armenia. This number had increased to 375 by yearend 2005. During the year, the licenses of 103 exchange offices were revoked (of which 71 - for violations of the currency legislation). Foreign exchange buy and sell licenses were issued to 135 offices. Compared to 2004, the total volume of foreign exchange trading in foreign exchange offices grew in 2005.

Buy and Sell Volumes of Foreign Exchange Offices

	31.12.2004	31.12.2005	2005 percentage increase
US dollar purchases (USD million)	173.9	255.6	47%
US dollar sales (USD million)	173.9	260.9	50%
Euro purchases (USD million)	9.9	19.4	97%
Euro sales USD million)	8.7	19.0	119%

As of December 31, 2005, six legal entities had foreign currency dealer licenses, two of which temporarily suspended their activities. New dealers did not enter into the market during 2005. Foreign currency dealers bought a total of US $15.9 million and sold a total of US $14.9 million: both of these indicators were more than thrice higher than those in 2004. During 2005, foreign currency dealers concluded 729 brokerage transactions totaling AMD 939.6 million, as well as 185 dealership transactions totaling AMD 8.8 billion, and 264 repo transactions worth a total of AMD 20.7 billion.

As of December 31, 2005, 18 companies were carrying out specialized activities in the Armenian securities market (of which four were foreign exchange dealers). During 2005, the 18 specialized entities performing specialized activities in the Armenian securities market (including the foreign exchange dealers) concluded 2,696 brokerage transactions totaling AMD 3.0 billion, 530 dealership transactions totaling AMD 35.4 billion, and 704 repo transactions totaling AMD 63.9 billion.

At yearend 2005, 61 pawnshops were active in Armenia. During the year, 23 companies and sole entrepreneurs received pawnshop licenses. The sum of pawnshops' cash, bank accounts, and loans reached AMD 2.0 billion as at December 31, 2005 (of which loans were AMD 1.1 billion).

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2.4. FINANCIAL INFRASTRUCTURES IN THE REPUBLIC OF ARMENIA

Development of Payments and Settlements

During 2005, the Central Bank of Armenia achieved its objectives regarding the payments and settlements system under the Monetary Policy Program. In particular, the following legal acts were drafted in accordance with the Republic of Armenia Law on Payment and Settlement Systems and Organizations[1] to regulate the payment and settlement systems in Armenia, as well as the activities of payments and settlements organizations:

Regulation 16: "Licensing of Organizations Performing Money Transfers, Registration of Their Branches and Representative Offices, Regulation of Activities, and Qualification of Managers."

Regulation 17: "Licensing of Processing and Clearing Organizations, Registration of Their Branches and Representative Offices, and Qualification of Managers."

Regulation 18: "Authorizing Creation and Operation of Payment and Settlement Systems in Armenia."

Regulation 19: "Authorizing Participation in Foreign Payment and Settlement Systems."

Regulation 22: "Reports of Payment Organizations, Their Presentation, and Publication."

"Procedure of Issuing, Servicing, and Circulating Checks in the Republic of Armenia."

"Procedure of Notifying about Service and/or Sale (Distribution) of Payment Instruments in the Republic of Armenia."

"Procedure Defining Moment of Payment and Settlement Document Entry into and Irreversibility in Payment and Settlement System."

"Procedure of Payment and Settlement Service Recording by Organizations Performing Money Transfers."

Questionnaires for the written and oral exams of payment and settlement organization managers have been developed, as well.

The aforementioned legal acts regulate the licensing of payment and settlement organizations in the Republic of Armenia and the process by which the CBA authorizes payment and settlement organizations to join payment and settlement systems. A significant part of the funds flow through payment and settlement systems, and the Central Bank's objective is to ensure their security and effective and smooth operation, which can strengthen financial stability in the whole economy. Therefore, the Central Bank acts within the frameworks of its mandate to collect information on the operation of the payment and settlement system and supervises it, thereby preventing the operation of systems that might jeopardize financial stability in the Republic of Armenia. To this end, legal acts have set criteria for distinguishing payment and settlement systems of economy-wide importance from others. These criteria allow differentiating between well-known and risk-free foreign systems and others.

The licensing and operational supervision of payment and settlement organizations by the CBA has minimized the risk of losing transferred money, which existed when money was transferred through organizations not licensed by the CBA. Regulatory requirements have been set for payment and settlement organizations performing money transfers, including requirements to deposit cash or securities or to present irrevocable bank guarantees. Assets deposited by an organization may be used by the CBA only for the purpose of covering outstanding money transfer obligations.

To minimize the operational risk in the CBA's payment systems, backups to the CBA's payment systems have been regularly tested. To ensure smooth transition to the backup system in case of emergency, there has been regular piloting of backups, in which a number of commercial banks, as well as the Treasury took part. To increase the reliability and to ensure the uninterrupted operation of the unified payment system of "ArCa" plastic cards, the CBA, the banks participating in the system, and the ArCa Processing Center have jointly created a backup system. The CBANet inter-bank computer network has been used to provide interconnection of plastic card service devices with the ArCa Processing Center, which has further improved the reliability of this system.

Under the aforementioned law, "ArmPost" CJSC received in 2005 a license of an "Organization that Performs Money Transfers," which

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[1] *Effective from June 28, 2005.*

authorizes it to make money transfers for customers without opening an account. "Armenian Card" CJSC—as a card transaction processing center, received a license of an "Organization that Performs Processing and Clearing of Payment Instruments and Payment and Settlement Documents." In accordance with the Law, payment and settlement organizations have applied to and been authorized by the CBA to join and operate international payment systems.

The CBA has developed an appropriate legal framework for the issuance and circulation of CBA's own securities; amendments have been made to the Government Securities Accounting and Settlement System.

In view of the importance of the transparency, accessibility, and development of stock exchange foreign currency operations in Armenia, the CBA initiated in 2005, with the involvement of the Armenian Stock Exchange and commercial banks, to design and implement a procedure of foreign currency purchase and sale in the Armenian Stock Exchange. In this connection, the appropriate legal framework has been developed, as well.

With a view to ensuring transparency and active Central Bank oversight of foreign exchange office transactions, a technological and hardware-software complex was developed in 2005, to be implemented in foreign exchange offices.

In 2005, the CBA developed and adopted the Principles of Constructing a Hybrid Payment System by the CBA, which contains the conceptual architecture of a new payment system and incorporates state-of-the-art technologies.

Moreover, the CBA's internal systems have been developed: the "Counterfeit Banknote Information System," which allows collecting and recording information on counterfeit banknotes, was developed and piloted.

Considering the importance of risk identification, management, and supervision in the financial sector, the CBA developed in 2005 a Timetable of Payment and Settlement System Oversight Activities, under which payment system oversight documents will be further developed and applied during 2006.

One of the Central Bank's strategic aims is to encourage non-cash turnover in Armenia. During 2005, non-cash payment turnover in Armenia grew to AMD 4,872 billion (a total of 2,011,138 transactions), including AMD 2,997 billion (858,478 transactions) through the CBA's payment systems.

Compared to 2004, the non-cash payment turnover grew 1.38-fold (by AMD 1,356 billion), while their number grew 1.25-fold (by AMD 410,664). Compared to 2004, payments through the CBA's payment systems grew 1.55-fold (by AMD 1,074 billion) in terms of turnover, or 1.3-fold in terms of the number of transactions (202,106 transactions).

The average daily value of transfers using the Central Bank's payment systems was about AMD 11.7 billion (3,353 transfers). Compared to 2004, the volume increased by AMD 4,194 million (the number of transfers grew by 789).

During 2005, transfers initiated by and destined to the Treasury held a large share (46.65% of the total volume, representing a 72.8% or AMD 589 billion increase compared to 2004, and 46.13% of the total number of transactions, representing a 28.2% or 87,131-transaction increase over 2004) of payments executed through the CBA.

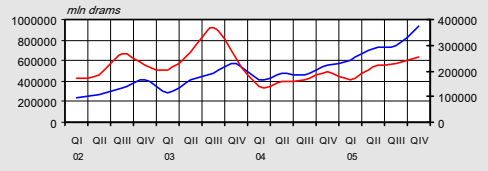


Chart 2.23
Volume and Value of Payments via the CBA

During 2005, a total of 2,184,492 transactions worth AMD 90,136 million were executed using plastic cards in Armenia; of this amount, non-cash card payments were about AMD 6,866 million. Compared to 2004, the volume of card transactions fell 0.9-fold (by AMD 8,635 million), while the number of transactions grew 1.24-fold (by 421,402 transactions). The total number of cards in circulation was 137,186 at yearend, representing a 1.26-fold (28,321 cards) increased compared to 2004. The commercial banks' card payment system now offers a longer list of services: cardholders can make e-payment (via the Internet) for utilities using their plastic cards, as well as become engaged in Internet commerce and make card-to-card payments.

With a view to minimizing the plastic card encashment risks in Armenia, the CBA Board

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introduced in 2005 additional requirements on ATM placement and operation, and restricted the withdrawal of foreign currency cash from ATMs.

Electronic Payment System

As of yearend 2005, the total number of participants in the CBA's electronic payment system was 182, including the Central Bank and its three territorial cash centers, the Treasury of the Republic of Armenia with its 44 branches, 21 commercial banks with 110 branches, the "Armenian Card" Processing Center, and the Inter-State Bank (Moscow, Russia).

The vast majority of payments via the Central Bank's payment systems were executed using the electronic payments system: 72.93% of the total payments volume and 96.3% of the total number of transactions, representing increases over 2004 of 34.6% (AMD 558,932 million) and 29.6% (188,939 transactions), respectively. In the structure of total payments by commercial banks, the volume of electronic payments was about 81.59%, and the number was about 99.30% of the total.

The average daily number of transfers using the electronic payments system increased over 2004 to about 3,229, while the volume of such transfers grew by AMD 2,183 million, reaching AMD 8,540 million. The average size of one electronic transfer in the electronic payment system grew by about AMD 93,000 compared to 2004, and reached AMD 2.6 million.

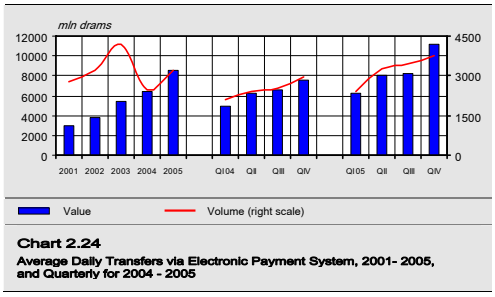


Chart 2.24
Average Daily Transfers via Electronic Payment System, 2001- 2005, and Quarterly for 2004 - 2005

During 2005, rejections in the electronic payment system were 0.06% of the number and 0.5% of the volume of initiated payments (553 transfers with a total amount of AMD 12,033 million); rejections due to insufficient liquidity were 0.01% of the number and 0.12% of the volume of initiated payments (102 transfers with a total amount of AMD 2,713 million).

Gross Paper-Based Payments System

During 2005, the Central Bank of Armenia, the commercial banks operating in the country, and the Treasury of the Republic of Armenia made paper-based payment transactions through the Central Bank.

Paper-based payments by commercial banks during the year accounted for 9.5% of the total value of bank payments (a 2.9% increase compared to 2004) and 0.5% of their number (a 0.31 percent decline compared to 2004).

The number of average daily paper-based payments through the CBA was 111 (an increase over 2004 by 45 transfers), while their volume grew by AMD 1,445 million, reaching AMD 2,275 million. Compared to 2004, the average size of a paper-based payment grew by about AMD 7.8 million and reached AMD 20.4 million. The increase in paper-based transfers has been mostly due to financial transactions. During 2005, 93 paper-based transfers with a total volume of AMD 21,527 million were carried out between commercial banks.

Government Securities Accounting and Settlement System

During 2005, an updated version of the Government Securities Accounting and Settlement System was implemented, which supports the issuance and circulation of CBA securities.

As of yearend, 6 agent banks and 14 dealer banks operating in Armenia were members of this system, together with one non-bank dealer, the Ministry of Finance and Economy ("issuer" status), the Treasury Direct, and the Central Bank of Armenia ("Central Depository" status).

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During 2005, the system generated 2,011 instructions for a total volume of AMD 87,823 million regarding primary allocation and redemption of government securities—an AMD 4,735 increase over 2004. Banks transferred AMD 45,702 in return for government securities

Payments Executed by the Central Bank of Armenia, Commercial Banks Operating in Armenia, and the Treasury of Armenia Using Payment Systems of the Central Bank of Armenia

Period	Gross				Government Securities Accounting and Settlement System		Total	
	Electronic		Paper-Based					
	Value (AMD mln)	Number	Value (AMD mln)	Number	Value (AMD mln)	Number	Value (AMD mln)	Number
2004								
Q 1	318649	134340	82982	3639	15731	350	417362	138329
Q 2	404239	152858	57732	4054	21003	378	482974	157290
Q 3	422186	162106	20967	4186	24092	463	467245	166755
Q 4	482120	188496	50812	4998	22797	504	555729	193998
Total	1627194	637800	212493	16877	83623	1695	1923310	656372
share of total payments (in %)	84.59	97.17	11.05	2.57	4.35	0.26	100	100
2005								
Q 1	429654	158131	150806	5188	20993	471	601453	163790
share of total payments (in %)	71.44	96.54	25.07	3.17	3.49	0.29	100	100
Q 2	515359	207423	123228	6062	74161	901	712748	214386
share of total payments (in %)	72.31	96.75	17.29	2.83	10.40	0.42	100	100
Q 3	524899	219123	153970	8315	60841	909	739710	228347
share of total payments (in %)	70.96	95.96	20.81	3.64	8.23	0.40	100	100
Q 4	716214	242062	154294	8951	72601	942	943109	251955
share of total payments (in %)	75.94	96.07	16.36	3.55	7.70	0.37	100	100
Total	2186126	826739	582298	28516	228596	3223	2997020	858478
share of total payments (in %)	72.94	96.30	19.43	3.32	7.63	0.38	100	100

purchased at the primary allocation, while the Treasury transferred AMD 42,121 for redeemed government securities.

Treasury Direct has made payments of AMD 1,054 million for government securities, of which AMD 631 million for allocation, and AMD 423 million for redemption of government securities.

During 2005, the participants' operations in the secondary market for government securities have become more active: the volume of such operations reached AMD 341,674 million (at face value), including purchase and sale of AMD 162,079 million, free delivery of AMD 151,287 million, and pledges of AMD 28,308 million. 1,212 DVP purchase and sale transactions worth AMD 140,773 million were performed.

During 2005, as a result of operations in the secondary market for government securities, the increase in government securities registered on "depo" accounts was 1.68-fold (AMD 31,484 million), amounting to AMD 77,200 million (at face value), while the total number of transactions grew 1.3-fold to reach 979.

Plastic Cards Market

As of yearend 2005, 18 commercial banks were issuing plastic cards and offering service to customers. 16 commercial banks were members of the unified payment system of "ArCa" plastic cards. During 2005, the number of banks-members of ArCa grew by three (Prometey Bank, Cascade Bank, and BTA Investbank).

During 2005, 45 new ATMs were installed to serve plastic cards, bringing the total number of ATMs to 116 at yearend. 88 of these ATMs serve "ArCa" plastic cards. Commercial banks installed 352 POS terminals and 20 imprinters, the total number of which reached 981 and 76, respectively.

Types of Cards Issued by Banks Operating in Armenia

Bank	ArCa	MASTERCARD	VISA	Other Cards
Anelik Bank	+	+		
ArdShinInvestBank	+	+		
ArmImpExBank	+	+		
ArmEconomBank	+	+		
Armenian Development Bank	+	+		
Converse Bank	+		+	+
HSBC Bank Armenia	+	+	+	+
ACBA	+		+	
Artsakh Bank	+			
"ITB" International Trade Bank	+			
Unibank	+		+	
Ineko Bank	+	+	+	
Mellat Bank	+			
Prometey Bank	+			
Cascade Bank	+			
BTA Investbank	+			
ArExImBank			+	
ArmSavingsBank			+	

At yearend, the number of active "ArCa" cards grew about 1.18-fold compared to yearend 2004 (8,482 new cards) to reach 55,697. The number of international system cards grew 1.3-fold (19,839 new cards), of which VISA international cards grew 1.3-fold (17,079 cards) to reach 62,839, while MasterCard international cards grew 1.96-fold (2,898 new cards) to reach 5,901.

A total of 1,023,304 transactions with a total volume of AMD 27,821 million were carried out using "ArCa" cards in circulation. The volume and number of transactions with ArCa cards grew about 1.47-fold and 1.33-fold over 2004 (by AMD 8,926 million and by 258,965, respectively).

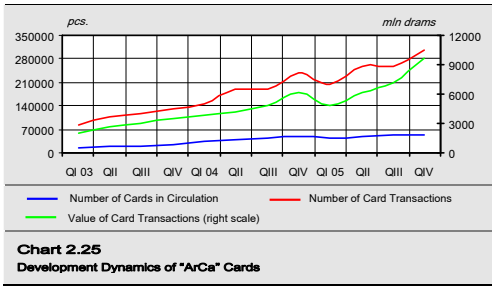


Chart 2.25
Development Dynamics of "ArCa" Cards

The volume of transactions using VISA international cards reached AMD 39,595 million (692,100 transactions), while MasterCard international cards were used in a total of 89,937 transactions for a total volume of AMD 7,689 million. The volume of transactions using VISA and MasterCard cards grew 1.29-fold and 0.15-fold, respectively (by AMD 8,951 million and AMD 1,456 million, respectively).

Other international cards were used in 379,151 transactions for a total of AMD 15,030 million, representing an AMD 25,057 million decline over 2004.

On average, one "ArCa" card was used to carry out two transactions per month, and the average volume of a transaction remained about the same as in 2004 at AMD 27,000.

As of yearend, each ATM served an average of 633 "ArCa" cards.

"ArCa" Cards Transactions via Accepting Devices

	Amount (AMD mln)	Number
ATMs	19565.8	767941
of which, non-cash	695	31956
POS terminals	8255.6	255355
of which, non-cash	382.2	36626
Imprinters	0.6	8
of which, non-cash	0.6	8
Total	27822	1023304
of which, non-cash	1077.8	68590

International Transfer Systems

In order to expedite wire transfers, commercial banks operating in Armenia have acceded to Western Union, Money Gram, Anelik, Unistream, Express, and other systems. During 2005, the influx of funds into Armenia through these systems amounted to AMD 244,243 million (971,632 remittances), which exceeds the volume of outgoing transfers 7.5-fold. Compared to 2004, the volume of inward remittances grew 1.3-fold (by AMD 54,276 million). The average size of a remittance was AMD 251,000 during 2005, which remained virtually the same as in 2004.

During the second half of 2005, payment and settlement organizations performing money transfers disbursed AMD 918 million to their customers, while outbound transfers reached AMD 38 million.

During 2005, the volume of inbound remittances via S.W.I.F.T. was AMD 2,933 billion (a total of 281,881 remittances). The average remittance via S.W.I.F.T. was AMD 10 million in 2005, representing an AMD 0.4 million increase over 2004.

Cash Circulation

In 2005, the process of dramization in the economy, including the sharp increase in demand for the dram, influenced the pace by which cash outside the CBA grew. The volume of cash drams in circulation increased, as well: as of December 31, 2005, cash drams outside the Central Bank of Armenia grew by AMD 49,741 million (47.1%) over 2004, reaching AMD 155,275 million. Cash outside the CBA had increased by 9.0% during 2004, 5.2% during 2003, 38.1% during 2002, and 7.8% during 2001.

The behavior of cash drams outside the Central Bank was seasonal in 2005. As in the past, the volume of cash sharply declined in January 2005 (by 13.5%) to reach AMD 91,268 million at the end of the month. Thereafter, cash in circulation grew at a relatively stable pace (on average, by 4.5% per month).

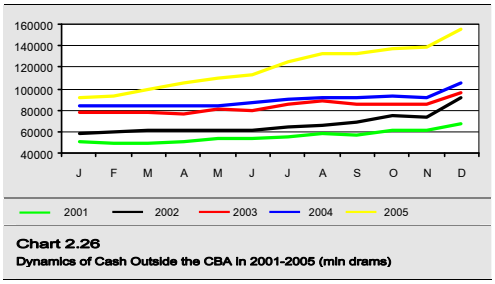


Chart 2.26
Dynamics of Cash Outside the CBA in 2001-2005 (mln drams)

The pace of growth accelerated in July-August, and deteriorated in September-November. In December, the volume of cash drams grew by 11.6% due to the seasonal demand for the dram.

During 2005, the cash reserves of the CBA were sufficient to meet the demand for cash in the economy.

In order to meet additional demand for cash caused by significant deviations from the Monetary Policy Program, emergencies, and other contingencies, the Central Bank compiles cash reserves. In other words, the CBA has capacity to mitigate potential risks arising out of an abrupt increase in demand for liquidity in various situations.

Parallel to an increase in cash in circulation, the share of cash in broad money increased, as well. At yearend, cash outside the banking system was 39.6% of broad money, compared to 34.6% at yearend 2004.

Share of Cash in Broad Money (in %)

Country	2003	2004	2005
Kyrgyzstan	63.5	57.4	61.4
Armenia	39.5	34.6	39.6
Georgia	41.6	40.7	38.5
Ukraine	35.1	33.7	31.2
Azerbaijan	40.1	31.8	29.7
Moldova	32.2	31.6	28.9
Russia	29.0	29.0	27.8
Bulgaria	23.4	22.7	21.4
Lithuania	26.4	23.5	21.1
Latvia	26.6	22.5	19.7
Belarus	15.1	15.2	16.0

As opposed to broad money, the share of cash in dram broad money shrunk by 3.4 percentage

points to reach 64.3% at yearend 2005. Stable appreciation of the dram and a considerable intensification of the dramization process were reflected in the very high increase of the dram component of broad money. However, this indicator still remains below what is found in a number of developing countries.

Parallel to an increase in the volume of cash outside the Central Bank during 2005, cash circulation through the Central Bank vault grew to AMD 114.8 billion at yearend, representing a 27% increase compared to 2004. Cash entering the CBA's vault grew by 18% to AMD 243.7 billion, while cash exiting it grew by 36% to AMD 293.4 billion.

The Central Bank of Armenia rendered cash services to banks and bank branches in regions of Armenia and in the Republic of Nagorno Karabagh by means of Regional Cash Centers of the Central Bank in Goris, Vanadzor, and Hrazdan (Tsaghkadzor).

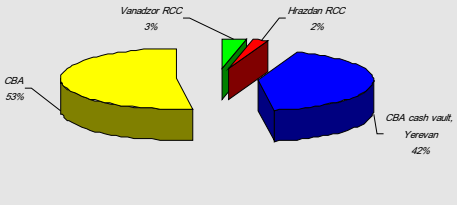
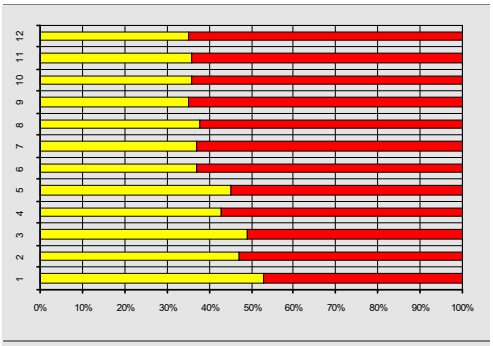


Chart 2.27
The CBA Cash Circulation

During 2005, Regional Cash Centers covered 18.9% of the total cash circulation of the Central Bank, compared to 17.9% in 2004. Regional cash centers were mainly used for provision of cash to banks and branches in the regions of Armenia and the Republic of Nagorno Karabagh. Regional cash centers' cash outflow was about 12-fold higher than cash inflow.

The commercial bank vault turnover followed similar patterns.

In 2005, cash outflow from vaults of commercial banks and branches in Armenia and the NKR exceeded cash inflows. As in the past, there was surplus of cash circulating in Yerevan in 2005, as a result of which commercial bank cash vault inflows exceeded outflows.



1. Yerevan, 2. Ararat, 3. Armavir, 4. Kotayk, 5. Vayotz Dzor, 6. Shirak, 7. Tavush, 8. Lori, 9. Aragatsotn, 10. Gegharkunik, 11. Syunik, 12. Republic of Nagorno Karabagh

Chart 2.28
Commercial Banks in Regions of Armenia and in the Republic of Nagorno Karabagh: Share of Cash in and out, %

Some changes have taken place in the banknote structure of cash in circulation.

From July 1, 2005, the Central Bank extracted 500-dram banknotes of the 1993 model; from August 1, the 1995-model 5,000-dram banknotes were extracted, as well.

The significant increase in cash in circulation has also influenced the type structure of cash. Since the increase was mainly achieved on account of high face value, the shares of 10,000-dram, 20,000-dram, and 50,000-dram banknotes in cash circulating outside the CBA grew by 3.8, 6.0, and 0.1 percentage points, respectively. During the year, the volume of circulating 10,000-dram and 50,000-dram face value banknotes grew 1.7-fold, while the volume of 20,000-dram face value banknotes almost doubled.

Despite the growth in the circulating volume of the aforementioned banknotes, the Central Bank has managed to meet the demand for such banknotes in the economy, i.e. commercial bank requests for cash.

The shares of all other face value banknotes fell: the share of 1,000-dram banknotes fell by 3.2 and that of 5,000-dram ones—by 4.4 percentage points.

Compared to 2004, the process of replacing extracted 10-dram, 25-dram, 50-dram, 100-dram, and 200-dram coins with banknotes slowed down considerably in 2005. As of December 31, 2005, their total circulating volume was AMD 538 million (i.e. 0.3% of the volume of cash circulating outside the CBA).

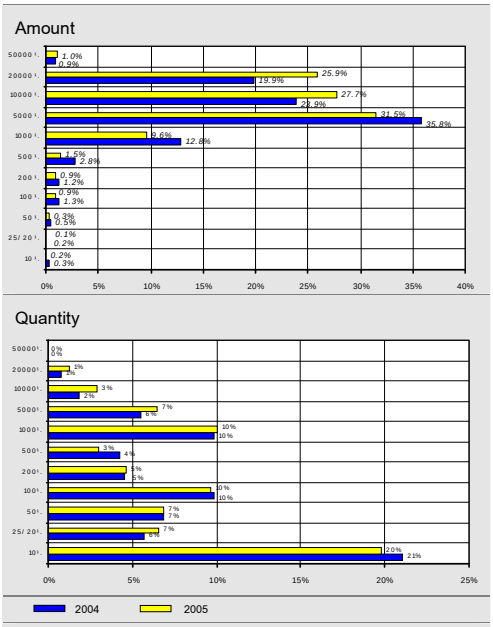


Chart 2.29
Banknote Type and Structure of Cash outside the CBA, 2004-2005

The share of 10-500-dram coins in circulation fell by 0.4 percentage points during 2005 to reach 2.6% of total cash outside the Central Bank at yearend. The volume of 500-dram coins almost quadrupled, as the coin replaced the 500-dram banknote. As a result, the total volume of 500-dram coins and banknotes in circulation fell by 23% to reach 1.4% of total circulating cash.

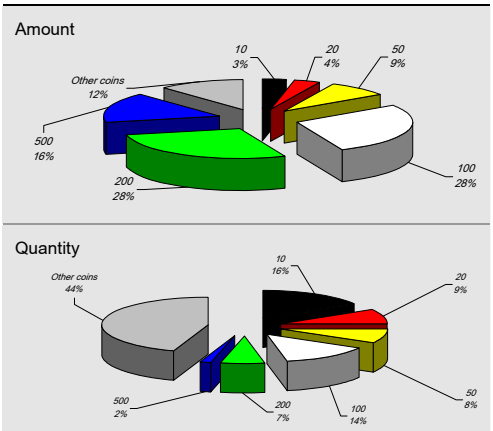


Chart 2.30
Type Structure of Coins in Circulation as at 31.12.2005

In addition to the 10-500-dram coins that are actively circulating, there are also 10-dram, 20-dram, 50-luma, 1-dram, 3-dram, 5-dram, and 100-dram ("Charentz-100", "32nd Chess Olympiad") face value coins, as well as a 25,000-dram face value "Anahit" gold coin in circulation. At yearend, their total circulating volume reached AMD 550 million (0.35% of total cash circulating outside the Central Bank).

As a result of the aforementioned changes in the types and structure of cash in circulation, the "notional average weighed money value"[2] grew from AMD 1,068 at the beginning to AMD 1,442 at the end of the year.

Substitution of Worn-out Banknotes

In 2005, the Central Bank of Armenia extracted and replaced with new ones about AMD 38.6 billion worth of, or 17.2 million old banknotes, which amounted to 33% of the annual average cash in circulation, or 16% of the total banknotes returned to the Central Bank during the year.

Compared to 2004, the volume of banknotes extracted by the Central Bank grew by 70% in 2005, which was mainly due to the refreshing of the 5,000-dram and 20,000-dram face value banknotes in circulation. Though the Central Bank has considerably updated the stock of 10,000-dram banknotes, it still remains rather low. It is worth mentioning here that this banknote was introduced 26 months ago.

Except for the aforementioned banknotes, replacement volumes of all other face value banknotes fell. Compared to 2004, the replacement of extracted 10 - 200-dram banknotes with coins has declined considerably. During 2005, about AMD 21 million worth of 10 - 200-dram banknotes were extracted, compared to AMD 891 million in 2004.

As a result, the average "age" of banknotes in circulation grew by two months and reached 14 months.

Issuance of Commemorative Coins

In 2005, the Central Bank of Armenia continued issuing commemorative coins made of

[2] *The "notional average weighed money value" calculation includes Armenian coins and banknotes between 10-dram and 50,000-dram face value.*

precious metals, all devoted to various memorable events.

In 2005, the Central Bank of Armenia issued the following coins:

- 10,000-dram face value "Arshil Gorky" gold coin on the 100th birthday of Arshil Gorky (born 1904, died 1948);
- 100-dram face value silver coin devoted to the Gandzasar Monastery;
- 10,000-dram face value "Martiros Saryan" gold coin on the 125th birthday of Martiros Saryan (born 1880, died 1972);
- 100-dram face value "Ananya Shirakatzi" silver coin on the 1,400th birthday of Ananya Shirakatzi;
- 50,000-dram face value gold and 5,000-dram face value "Armed Forces of the Republic of Armenia" silver coins devoted to the Armed Forces of the Republic of Armenia;
- 100-dram face value "Sahak A. Partev" silver coin devoted to Sahak A. Partev; and
- 100-dram face value "King Vramshapuh" silver coin devoted to King Vramshapuh.

Traveling exhibitions were organized in the cities of Vanadzor and Stepanakert with the purpose of raising public awareness of the history of Armenia's coins and moneys. The Central Bank of Armenia issued a book called "Money Issued by Armenia," which presents the main stages of money circulation in Armenia, as well as all the banknotes, coins, and commemorative coins issued by the CBA.

Measures against Counterfeiting

During the year, the Central Bank of Armenia notified banks operating in Armenia and the law-enforcement authorities of every case of discovered counterfeit banknotes.

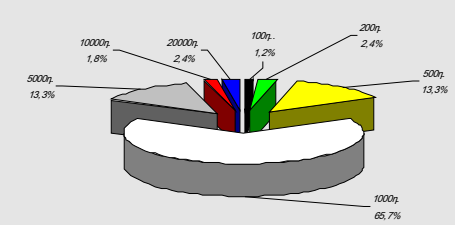


Chart 2.31
Types of Counterfeit Banknotes Discovered in Armenian Banking System in 2005

During 2005, the number of counterfeit banknotes discovered in the banking system grew by 8% compared to 2004. As in 2004, the banknote most frequently found among counterfeit ones was the 1,000-dram (67%) face value banknote. In addition to counterfeit banknotes, 100-dram and 200-dram face value counterfeit coins, too, were discovered within the banking system.

Credit Registry

A Credit Registry has been operating within the Central Bank of Armenia since January 1, 2003. The Registry has been collecting, structuring, and sharing [with commercial banks, credit organizations, and borrowers] data on borrowers. The Registry records loans in excess of AMD 1.5 million and non-performing and classified loans under AMD 1.5 million. At yearend 2005, the Registry had 111,706 credit history entries, of which 106,780—on natural persons, and 4,926—on legal entities. The number of credit history entries grew by 51,448 during 2005.

At yearend 2005, the Registry had information on 43,514 outstanding and 134,099 repaid loans. Compared to 2004, the total number of loans recorded in the Credit Registry doubled, which is a sign of increased lending activity. Parallel to this increase, the volume of information received by the Registry also increased—to an average of 3,500 records per day, which is a 75% increase over 2004

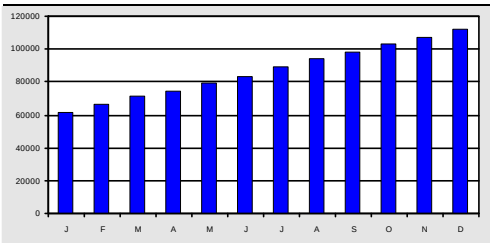


Chart 2.32
Number of Credit History, by Month

During 2005, the information processing procedures have been amended to require reporting to the Credit Registry foreign currency swaps of lenders with economic agents and the purchases of securities subject to repurchase. As a result, the oversight information has become complete—making more effective assessment of borrower credit risk possible. Credit Registry information can also be used by the CBA to evaluate enterprise creditworthiness.

The majority of commercial banks and credit organizations have automated their processes of data provision to the Credit Registry, which has increased system operation speed. Due to improvements of the CBA's Credit Registry software, credit histories can be provided to banks and credit organizations within one day of receiving an inquiry. The number of mistakes in the data submitted to the Credit Registry has been minimized.

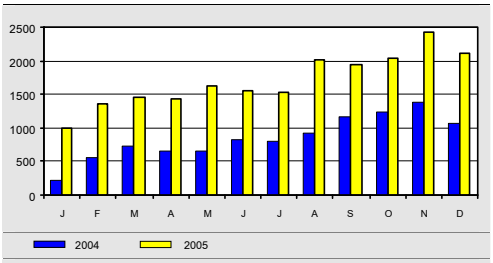


Chart 2.33
Number of Inquiries Received by Credit Registry, by Month

During 2005, the Credit Registry continued to make quarterly publication of lists of the names of delinquent borrowers in the press and the Internet. Compared to 2004, the number of delinquent borrowers (either in breach of the CBA-established requirement concerning 5% of minimum capital, or having 180-day overdue obligation) fell by 11.

Compared to 2004, the number of credit histories inquired by banks and credit organizations has almost doubled. Due to an increase in consumer lending, there is growing demand in the banking system for customer credit histories. Customer creditworthiness assessment by means of checking the customer's credit history reduces the time required for underwriting and allows reducing credit risk by avoiding irresponsible borrowers. The majority of commercial banks and credit organizations consider credit history important, especially for new customers. In 2005, banks have dismissed loan applications of 950 borrowers (for a total amount of AMD 1.32 billion) that had negative credit reports in the Credit Registry, which helped the banks avoid from lending to such customers.

Another outcome of the activities of the Credit Registry is enhanced borrower discipline and less frequent delays in loan service: this is because customers have come to realize the importance of sound credit history.

The volume of information reported to and accessed from the Credit Registry during 2005 will apparently continue to grow in 2006. Based on activities carried out by commercial banks and credit organizations, one can conclude that lenders will automate the provision of information to the Credit Registry. Methodological improvement will continue in order to reduce the likelihood of error and to increase performance speed.

Amendments to Armenian financial system legislation and sub-legislation

Amendments to Financial System Legislation

The Central Bank of Armenia continued to improve the legislation regulating the financial system of the Republic of Armenia. During 2005, amendments were enacted by the National Assembly of Armenia to laws regulating the activities of banks, as well as to laws on foreign currency regulation.

On November 15, 2005, the National Assembly of Armenia adopted the Republic of Armenia Laws on Amending the Law on Banks and Banking, the Law on Bank Secrecy, the Law on Accounting, the Law on Limited Liability Companies, and the Civil Code.

The Republic of Armenia Law on Amending and Supplementing the Republic of Armenia Law on Banks and Banking and a number of related laws are adopted to achieve the following goals:

1. The primary goal is to implement new principles of corporate governance in banks. The

Law introduces provisions on the activities of bank management bodies, including the General Meeting of Shareholders, the Board of Directors, the Executive Body, the Chief Accountant, and the Internal and External Auditors, as well as their legal statuses, the criteria for their formation and operation, and the like. The Law also sets forth the procedure by which banks may enter into large transactions or transactions in which there is an interest, as well as provisions to ensure transparency of the bank's activities and fiduciary responsibility of bank managers.

2. Implementation of Basle Principles on Consolidated Banking Supervision. The Law has drawn a line between the definitions of direct and indirect significant shareholders, and their rights and responsibilities in the context of consolidated bank supervision.

3. The Law has defined the procedures of bank liquidation. The bank liquidation chapter in the Law on Banks and Banking has been revised to clarify matters of government control over bank liquidation, especially from the standpoint of protecting the rights and lawful interests of creditors and depositors.

On December 8, 2005, the National Assembly of Armenia adopted the ***Republic of Armenia Law on Implementing a Unified System of Financial Regulation and Supervision***, as well as a number of amendments to related laws. This package is designed to ensure stability of and increased confidence in the financial system in the Republic of Armenia, as well as to safeguard the interests of financial market customers.

The Republic of Armenia Law on Implementing a Unified System of Financial Regulation and Supervision regulates the activities required to implement a unified system of financial regulation and supervision in Armenia, including the measures needed to transfer the functions of regulation and supervision of other participants of the financial system to the CBA, matters arising out of the implementation of such measures, and the powers of the financial system regulatory and supervision body. The Law defines that the ***financial system*** is the whole relationship in which financial system participants are involved (the "participants" are the banks and credit organizations operating in Armenia, other entities licensed by the CBA, the securities market participants, investment companies, investment funds, cumulative pension insurance organizations, insurers, and pawnshops, which carry out specialized activities). The Law provides that the licensing, regulation, and supervision of the activities of the aforementioned participants of the financial system shall be carried out by the Central Bank of Armenia.

With a view to addressing the shortcomings identified in the enforcement of the ***Republic of Armenia Law on Currency Regulation and Supervision***, the National Assembly of Armenia adopted, on December 8, 2005, the ***Republic of Armenia Law on Amending and Supplementing the Republic of Armenia Law on Currency Regulation and Supervision***. This Law provides that banks shall act as currency agents and shall report to the Central Bank in accordance with the procedure established by the latter. The Law clarifies the grounds based on which licensees may be sanctioned by the CBA.

Amendments to Banking Sector Regulatory Framework

During 2005, the following amendments were made to the banking sector regulatory framework:

To meet the requirements of the Law on Currency Regulation and Supervision and the Law on Introduction of Cash Registers, and to improve the quality of services rendered by foreign exchange offices, a Manual for Auditing Exchange Offices was developed, and relevant amendments were made to Regulation 10 on Licensing and Regulation of Foreign Currency Purchase and Sale Transactions.

An updated version of Regulation 13 ("Credit Organization Registration and Licensing Procedure; Credit Organization Branch and Representative Office Recording Procedure; Procedure of Authorizing the Acquisition of a Significant Share in the Statutory Capital of Credit Organizations; Credit Organization Managers Qualification Procedure; Rules of Credit Organization Operation; and Requirements on the Place of Operation and Technical Capacity of Credit Organizations"). The updated Regulation has softened some of the requirements on credit organizations, so that the foundations engaged in micro-lending in Armenia have the chance to obtain credit organization

licenses. In particular, less stringent requirements on space and technical capacity have been set for credit organization branches that have small volumes of operations. Credit organization board members will not be required to take qualification and professional conformity exams in the form of an interview. The procedure of acquiring ownership in the capital of credit organizations has been simplified for foreign organizations with strong rating.

The revised text of Regulation 15 ("Credit Organization Reports, Their Presentation and Publication") has been approved. Its revision is due to the amendments made in Regulation 14 at yearend 2004, and has the purpose of simplifying the accounting forms. Together with the Regulation, the Guide for Preparing Reports of Credit Organizations to the CBA has been approved.

Regulation 14 ("Regulation of Credit Organization Activities and Prudential Requirements") now contains a provision whereby universal credit organizations are allowed to issue their own securities, at least 30% of which must be guaranteed by organizations with prime rating (AAA(Aaa1) to A-(A3)). This change will allow credit organizations to access the securities market. Taking into account the lack of credit organization plans to issue securities, the need for protection of investor interests, and the underdeveloped state of the securities market, such securities are required to have prime security. Depending on future demand for securities issued by credit organizations, the behavior of such securities, and the ability (and history) of credit organizations to repay their debt, the prime security requirement may later be abolished.

The amendments to Regulation 1 ("Registration and Licensing of Banks and Foreign Bank Branches; Registration of Bank Branches and Representative Offices; Qualification and Registration of Bank and Foreign Bank Branch Managers") have made it possible to require more complete information on a bank's significant shareholders, with a view to identifying the real beneficial owners. Requirements on economic plans of banks (and bank branches) have been intensified, which will allow banks (and bank branches) to operate an adequate system of internal controls and risk management. The procedure by which banks can nominate managers for qualification and professional conformity exams has been streamlined. If a person nominated by a bank to take part in the qualification exam has received a conformity certificate, but has not been presented by the bank to the CBA for registration, and a new candidate is nominated by the bank for the same office, then it must justify to the CBA the nomination of the new candidate. The possibility of candidates appealing against the results of exams has been introduced.

The Guide on Treating as Bank Management the Staff that are Related to the Core Activities of a Bank, Report Directly to the CEO of the Bank, or Have Influence on Decisions Made by the Bank's Management Bodies have been approved. According to the Guide, effective oversight of the bank requires compliance with certain criteria that can serve as a basis for the CBA Board to treat an employee of the Bank as bank management under Article 22(1) of the Republic of Armenia Law on Banks and Banking.

The Criteria on Establishing Significant Participation of Persons that Have the Possibility of Determining the Areas of Operation of Legal Entities, or Predetermining Decisions of Its Management Bodies, or Significantly Influencing Its Decision-Making or Implementation have been approved, with a view to creating specific grounds for the effective enforcement of Article 9(b) of the Republic of Armenia Law on Banks and Banking.

Regulation 2 ("Regulation of Bank Activities and Main Prudential Requirements on Bank Activities") has been amended. This Regulation has been harmonized with the Republic of Armenia Law on Currency Regulation and Supervision, which provides that the statutory fund of banks operating in Armenia may be paid up only in Armenian drams.

Due to the need to absorb the expected large-scale inflow of foreign currency, the minimum reserve required to be kept in the CBA has been changed from 6 to 8%. The procedure of calculating the prudential standard has been modified, as well: reserves against dram liabilities now must be kept in drams, whereas reserves against US dollar liabilities must be kept in US dollars, reserves for euro liabilities—in euros, and reserves against liabilities in other currencies—in US dollars.

According to the amendments in Regulation 2, the securities of organizations rated high ("A," "B," or "C") by the CBA, as well as other claims on and

claims guaranteed by such organizations will be included in the bank capital adequacy calculation with a 20% risk weight for ratings "A" and "B," and with a 50% risk weight for the "C" rating. Moreover, the CBA intends to use securities of organizations rated high "A," "B," and "C" in the CBA's market transactions. The aforementioned changes will improve enterprise transparency and reliability, resulting to better cooperation between the banking system and the real sector.

Regulation 3 ("Bank Reports, Their Presentation and Publication") has been amended to become consistent with Regulation 2.

The Procedure of Specialized Entities Issuing to Customers Documents Confirming Securities Buy and Sell Transactions has been developed: this Procedure defines a unified form of receipt confirming the purchase and sale of foreign currency throughout Armenia.

Fighting Money Laundering and Terrorism Financing

The Republic of Armenia is fighting against money laundering and terrorism financing in accordance with the Republic of Armenia Law on Fighting Money Laundering and Terrorism Financing, which was adopted by the National Assembly of Armenia on December 14, 2004. The designated agency for the fight against money laundering and terrorism financing in Armenia is the CBA. Under the Law, banks, credit organizations, foreign currency dealers, foreign currency trading specialized entities, organizations performing money transfers, processing and clearing organizations, specialized participants of the securities market, pawnshops, bodies registering property rights, entities endorsing transactions in cases provided by law, organizers of lotteries and gambling activities, casinos, trusts, insurers, investment companies, and non-for-profit organizations making donations in accordance with the procedure defined in the Republic of Armenia legislation (including grant-making organizations) are required to report to the CBA. Under the Law, these reporting entities are required to notify the CBA of all suspicious transactions and all transactions in excess of AMD 20 million (for real estate purchase and sale transactions—AMD 50 million).

In April 2005, a Financial Monitoring Center was created within the CBA. The FMC has the following main functions:

- Create and develop databases needed to fight money laundering and terrorism financing;
- Processing and analysis of data needed to fight money laundering and terrorism financing;
- Information sharing and cooperation with state law-enforcement bodies of the Republic of Armenia;
- Information sharing and cooperation with foreign financial intelligence bodies and international organizations fighting money laundering and terrorism financing;
- Regulating the fight against money laundering and terrorism financing;
- Ensuring compliance with (oversight of enforcement) legislation on money laundering and terrorism financing; and
- Counseling and training on money laundering and terrorism financing.

The Central Bank Board has approved a Three-Year Strategic Plan of the Financial Monitoring Center. Reporting forms are being approved, and regulations required by law are being drafted and adopted in order to start the reporting process.

The Republic of Armenia is a member of the Council of Europe's Special Committee against Money Laundering and Terrorism Financing (MONEYVAL). The Committee makes regular assessments of member states. The first assessment of Armenia was carried out in July 2004, and the legislation against money laundering and terrorism financing was adopted in order to comply with the recommendations made on the basis of this first assessment.

The German-Armenian Fund ("GAF"): Small and Medium-Sized Enterprise Promotion Lending Project

In 2005, the implementation of the German-Armenian Fund Small and Medium-Sized Enterprise Promotion Lending Project continued: in this framework, the German KfW allocated a total grant of EUR 16.8 million (with a repayment term of 40 years, at 0.75% per annum). An additional EUR 2.2 million grant was provided for consultancy services.

Throughout the project, which started in 1999, the project partner banks have received a total of AMD 11.7 billion from the Central Bank, of which:

- AMD 5.7 billion to "Agriculture Cooperation Bank of Armenia" Cooperative Bank;
- AMD 2.4 billion to "Anelik Bank" LLC;
- AMD 1.8 billion to "ArmEconomBank" OJSC;
- AMD 1.5 billion to "Converse Bank" CJSC; and
- AMD 0.3 billion to "Ineko Bank" CJSC.

During 2005, the partner banks extended 5,991 loans in the frameworks of this project for a total amount of AMD 22,489,179.1 thousand. Throughout the project, a total of 19,886 loans have been extended for a total amount of AMD 78,608,467.5 thousand.

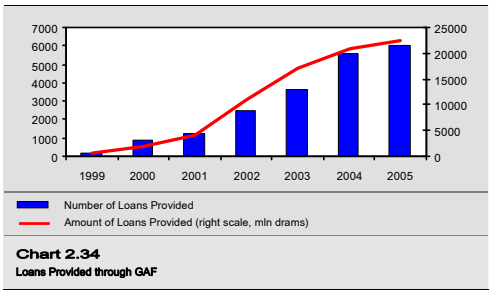


Chart 2.34
Loans Provided through GAF

The current loan portfolio of partner banks as of December 31, 2005 amounted to AMD 15,982,535.6 thousand drams in 5,030 loans, which shows that the efficiency of the new lending technology implemented under this project has motivated banks to extend AMD 4,282,535.6 thousand of SME loans out of their own resources, in addition to the resources made available to them by the Central Bank.

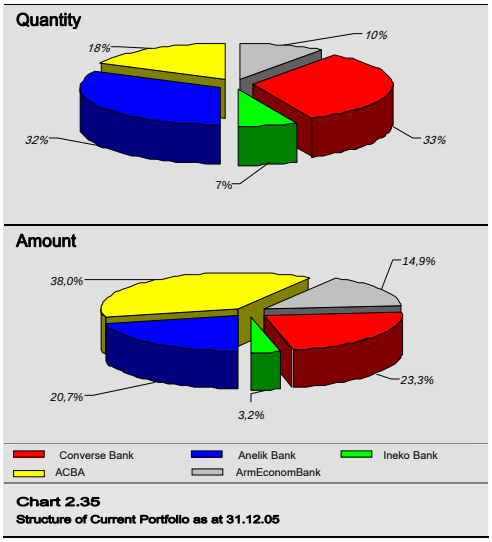
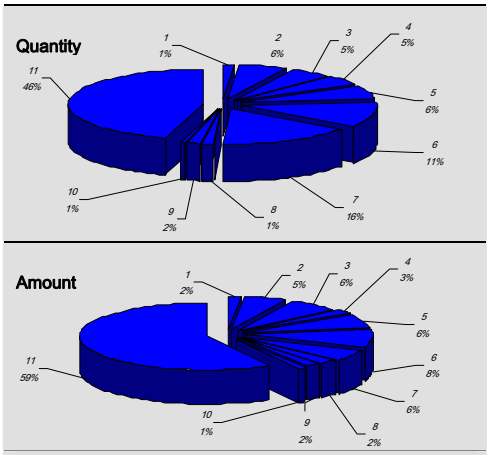


Chart 2.35
Structure of Current Portfolio as at 31.12.05

Project efficiency is also confirmed by the fact that the EBRD also made loans through ACBA and Anelik Bank using the same lending technology during 2005 (a total of 5,642 loans in the amount of AMD 7,837,490.1 thousand).

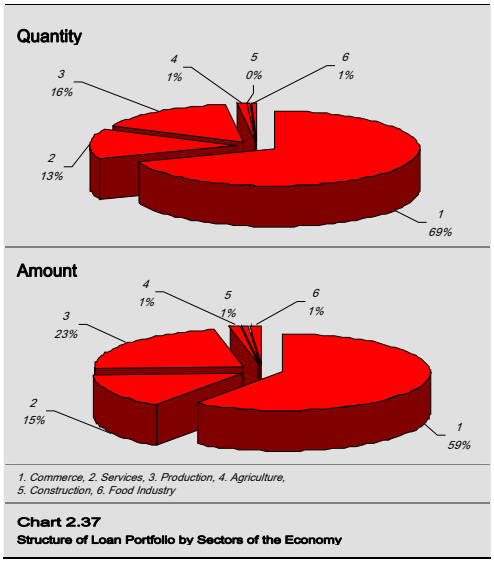
During the year, bank branches have facilitated an expansion of this lending to the regions of Armenia, as well.



1. Aragatsotn, 2. Ararat, 3. Armavir, 4. Gegharkunik, 5. Kotayk, 6. Lori, 7. Shirak, 8. Syunik, 9. Tavush, 10. Vayotz Dzor, 11. Yerevan

Chart 2.36
Structure of Loan Portfolio, by Regions

In 2005, the consulting company IPC completed its mission in respect of "Ineko Bank" CJSC.



1. Commerce, 2. Services, 3. Production, 4. Agriculture, 5. Construction, 6. Food Industry

Chart 2.37
Structure of Loan Portfolio by Sectors of the Economy

During the last six years, this company has successfully accomplished its mission: IPC has introduced new lending technologies in the partner banks and has trained 235 loan officers. Moreover, the partner banks have created special units for lending under the GAF, which are currently a part of their structure.

3. HUMAN RESOURCES POLICIES

During 2005, the personnel management policy of the Central Bank of Armenia was aimed at promoting the core activities of the Central Bank by means of management schemes and catering to the social and professional development needs of staff.

A flexible scheme of remuneration and career advancement based on outputs and experience is in place, which focuses on a new arrangement for competence and performance appraisal.

Similar to the past, vacancies in the Central Bank have been filled mostly by competition. The selection prioritized the use of the Central Bank's internal human resources, while the selection of young staff from outside primarily focused on those candidates who had attended the "Republic of Armenia Central Bank: Introductory Course" organized by the Central Bank.

The Central Bank of Armenia sustained a policy of recruiting young experts, making the best use of their potential, and improving their competence. During 2005, 23 young experts worked in functional subdivisions of the Central Bank under term contracts, 16 of whom joined the Central Bank as staff.

In order to promote outstanding students of the Economics Department at Yerevan State University and of the Yerevan State Institute of Economics, the Central Bank awarded the Isahak Isahakyan stipend to the top 9 students.

During 2005, 30 students of higher academic institutions of the country undertook their academic and pre-diploma internship in the Central Bank.

In order to assess the competence and professional conformity of staff, periodic tests have been conducted.

During 2005, a Code of Ethics for CBA Staff was developed with a view to enhancing the CBA's reputation and forming a coherent moral and legal framework to ensure the efficient performance of staff.

The average number of Central Bank staff in 2005 was 532 (298 women and 234 men). The average age of Central Bank staff is 39.5.

Staff Training

During 2005, the Central Bank of Armenia developed and carried out programs aimed at improving staff competence and professional skills.

175 specialists of the Central Bank of Armenia attended training courses conducted by training centers of foreign central banks and other banks. In this respect, the Central Bank enjoyed close cooperation with the IMF, the CCBS (Bank of England), the Bank of France, the German Bundesbank, the Central Banks of the Netherlands and the Russian Federation, the Bank for International Settlements, the National Bank of Switzerland, the Czech National Bank, the Financial Stability Institute, and the like. Several of the courses were carried out under technical assistance provided by the US Agency for International Development.

The Central Bank focused in particular on expanding its bilateral cooperation with foreign banks, which resulted in the development and implementation of rather productive and unique training programs.

Regional development of the banking system has greatly benefited from two international seminars held in Yerevan: one was at the initiative of the Federal Reserve Bank, on "Risk Management and Internal Control," and the other, at the initiative of the Bank of the Netherlands, on "Cash Management." Each of these seminars was attended, in addition to CBA representatives, by representatives of over a dozen foreign banks. The Bank of the Netherlands was the leader in terms of organizing specialized training courses.

In December 2005, the Central Bank took part in the Second Meeting of the Coordinator Board in the frameworks of the Economic Cooperation for Eurasia, which addressed the current and 2006 training programs to be organized in this framework. As a result, 16 of the Central Bank's staff were able to attend training programs on various banking topics conducted for central banks of the CIS countries.

The Central Bank of Armenia initiated and carried out in-country seminars and workshops on urgent topics aiming at enhancing the perfor-

mance of the Armenian banking industry. They were attended by 495 individuals, including 243 staff members of the Central Bank and 252 employees of commercial banks and credit organizations operating in Armenia.

With a view to promoting the recruitment of young staff for vacancies in the Central Bank, 120 graduates of Armenian universities were trained in the "Republic of Armenia Central Bank: Introductory Course" program. The top nine trainees were competitively recruited as staff of the Central Bank.

Over four dozen seminars were organized with a view to experience sharing. Another 38 were held on the Central Bank's regulatory framework. These seminars were attended by a total of 494 staff of the Central Bank.

The Introductory Course for newly-recruited staff of the Central Bank was organized twice during the year.

20 CBA senior officials took part in a special course on Management Skills.

International Cooperation of the Central Bank of Armenia

During 2005, the Central Bank of Armenia sustained its multilateral and bilateral cooperation with international and foreign financial organizations. In particular, within the framework of IMF/WB technical assistance, various IMF missions and advisors on monetary policy, banking supervision, and financial operations were hosted by and worked with the Central Bank.

Staff of the Central Bank of Armenia attended international conferences, fora, round tables, workshops, exhibitions, and other meetings on banking and finance, where they made presentations and reports. It is worth mentioning the European Banking and Financial Forum (Prague, Czech Republic), the KfW-organized international conference on "Credit Business and Credit Organisation" (Kiev, Ukraine), the International Conference on "Hawala" System (Abu-Dhabi, UAE), the Seminar on Maximising the Value of Economic Analysis for Central Banks (Windsor, GB), the Conference on Early Response System: Implementation Methods and Ways (Almaty, Kazakhstan), the 18th International Conference of Banking Supervisors from Central and Eastern Europe (Kiev, Ukraine), the IMF and World Bank Netherlands Constituency Annual Meeting (Tbilisi, Georgia), the Meeting of Coordinators of Technical Cooperation and Training from G-10, IMF, ECB and CIS central banks (Saint-Petersburg, Russia), the SWIFT Chairpersons Meeting and Sibos annual event (Copenhagen, Denmark), the IMF and World Bank Annual Meeting of Boards of Governors (Washington DC, USA), and the Seminar on Bank Crisis Management held by the Bank of Russia jointly with the EBRD and the Bank of England (Moscow, Russia).

During 2005, the Central Bank of Armenia actively cooperated with structures of the European Union and took part in conferences held by the Council of Europe on issues of combating money laundering and terrorism financing (MONEYVAL, Strasbourg, France).

For the purpose of enhancing business links and conducting negotiations, delegations of the Black Sea Trade and Development Bank, ING Bank, and the OMX Group visited the Central Bank of Armenia in 2005. On June 9 and 10, 2005, a delegation from the Netherlands led by Minister of Finance Gerrit Zalm visited Armenia. During the visit, the Government of Armenia and the Government of the Netherlands signed several memoranda of understanding and agreements. In the frameworks of this visit, members of the Dutch delegation H. J. Brouwer and C. van den Berg visited the Central Bank of Armenia and discussed technical cooperation projects between the CBA and the Netherlands Bank, as well as the outlook for 2006.

On July 20 (in Yerevan) and August 20 (in Minsk), an Agreement on Organizing Settlements between the Central Bank of the Republic of Armenia and the National Bank of the Republic of Belarus was signed.

During 2005, the Central Bank continued to sign agreements and memoranda of understanding with other central banks in the frameworks of inter-governmental commissions, including, in particular, the Memorandum of Understanding on Banking Cooperation between the Central Bank of the Republic of Armenia and the Bank of Thailand of the Kingdom of Thailand, the Memorandum of Understanding between the Central Bank of the Republic of Armenia and the Central Bank of Cyprus on Co-operation in the Field of Banking Supervision, and the Agreement between the Central Bank of the Republic of Armenia and the

Central Bank of the Islamic Republic of Iran on Co-operation in the Field of Banking Supervision

During September 25-30, an official of the Central Bank of Armenia visited the People's Bank of China in the frameworks of the Armenian-Chinese Inter-Governmental Committee. As a result of negotiations, understanding was reached on carrying out preparatory work for a banking cooperation agreement between the two banks during 2006.

During February 2 - 4, 2005, the Central Bank of Armenia organized the 15th Conference of the Regional Group of the Basle Committee on Banking Supervision of the States of Transcaucasia, Central Asia and Russian Federation. Summarizing the two years' work carried out during the chairmanship of the National Bank of Tajikistan in the Regional Group, the conference participants discussed and voted to transfer the regional group chairmanship to the Central Bank of Armenia; the Chairman of the Central Bank of Armenia T. Sargsyan took over the position of the Chairman of the Regional Group.

During October 12-14, 2005, the Central Bank of Armenia organized the 16th Conference of the Regional Group of the Basle Committee on Banking Supervision of the States of Transcaucasia, Central Asia and Russian Federation, which was attended by 18 representatives of 12 countries and organizations.

Central Bank of the Republic of Armenia

Income statement for the year ended December 31

In thousands of AMD

	Notes	2005	2004
Interest income	3, 4	11,092,460	7,102,630
Interest expense	6, 7	(2,829,108)	(1,975,484)
Net interest income		**8,263,352**	**5,127,146**
Fee and commission income		5,936	7,794
Fee and commission expense		(468,894)	(257,875)
Net fee and commission expense		**(462,958)**	**(250,081)**
Net gain/(loss) from foreign currency translation and transactions			
- Realised		(4,017,129)	(2,674,503)
- Unrealised		(12,453,849)	(15,600,767)
Net gain/(loss) from purchase and sale of numismatic coins and securities		(50,192)	(61,894)
Other operating income	5	380,069	471,104
Salaries and employment benefits		(1,859,515)	(1,690,957)
Administrative expenses		(401,036)	(402,146)
Banknotes and coins production expenses		(1,588,825)	(309,539)
Depreciation and amortization		(760,402)	(657,144)
Provision (charges)/recovery	13	180,622	(30,052)
Other expenses	8	(804,887)	(670,087)
Loss for the year		**(13,574,750)**	**(16,748,920)**
Loss for the year		(13,574,750)	(16,748,920)
Transfer from /(to) foreign currency and precious metals revaluation reserve		-	7,663,642
Profit available for distribution		**-**	

The accompanying notes form an integral part of the financial statements.

Central Bank of the Republic of Armenia

Balance sheet as of December 31

In thousands of AMD

	Notes	2005	2004
ASSETS			
Foreign currency assets			
Cash		269,956	263,649
Due from foreign banks and credit institutions	9	203,034,141	200,665,499
Special drawings rights in IMF	10	63,808,889	74,997,910
Investment securities	11		
- available for sale securities		1,301	1,514
- held to maturity securities		135,171,386	74,091,282
Other foreign currency assets		422,267	1,228,824
		402,707,940	**351,248,678**
Domestic currency assets			
Loans and other claims	12	11,949,866	13,020,001
Investment securities			
- available for sale securities	11	8,077,077	8,442,489
Fixed assets	14	6,088,280	5,546,100
Intangible assets	15	77,914	75,245
Held-for-sale fixed assets		1,393	107,687
Other domestic currency assets	16	325,472	362,842
		26,520,002	**27,554,364**
Total assets		**429,227,942**	**378,803,042**
LIABILITIES			
Foreign currency liabilities			
Amounts owed to:			
- Banks and credit institutions	17	31,206,005	11,088,132
- IMF	10	79,411,892	104,337,934
- RA government		39,493,293	13,878,092
Other deposit accounts in foreign currency	18	1,990,006	154,751
Other foreign currency liabilities	19	101,068	43,970
		152,202,264	**129,502,879**

Domestic currency liabilities			
Notes and coins in circulation	20	155,274,723	105,533,669
Amounts owed to			
- Banks and credit institutions	17	30,359,201	28,436,945
- IMF	10	59,199,628	70,244,915
- RA government	21	21,993,849	42,610,033
Other deposit accounts in domestic currency	18	1,199,662	1,184,367
Debt securities in issue	22	21,482,856	-
Other domestic currency liabilities	23	149,996	225,823
		289,659,915	**248,235,752**
Total liabilities		**441,862,179**	**377,738,631**
EQUITY			
Authorized capital		100,000	100,000
General reserve		9,870,486	9,870,486
Accumulated loss and other reserves		(22,604,723)	(8,906,075)
Total equity		**(12,634,237)**	**1,064,411**
TOTAL EQUITY AND LIABILITIES		**429,227,942**	**378,803,042**

The accompanying notes form an integral part of the financial statements.

The financial statements were approved by the members of the Board of the CBA on 28 March 2006 and were signed on its behalf by:

Tigran SARGSYAN
Chairman



Haykanush HAKOBYAN
Chief accountant



Central Bank of the Republic of Armenia

Statement of Changes in Equity
For the year ended December 31, 2005

In thousands of AMD

	Authorized capital	General reserve	Foreign currency revaluation reserve	Available-for-sale investments revaluation reserve	Accumulated profit/(loss)	Total
Balance as of December 31, 2003	100,000	9,335,186	7,663,642	-	2,676,502	19,775,330
Loss for the year					(16,748,920)	(16,748,920)
Net gains from changes in fair value	-	-	-	179,203	-	179,203
Transfer from foreign currency revaluation reserve	-	-	(7,663,642)	-	7,663,642	-
Transfer to reserves	-	535,300	-		(535,300)	-
Transfer to government	-	-	-	-	(2,141,202)	(2,141,202)
Balance as of December 31, 2004	**100,000**	**9,870,486**	**-**	**179,203**	**(9,085,278)**	**1,064,411**
Loss for the year	-	-	-	-	(13,574,750)	(13,574,750)
Net losses from changes in fair value	-	-	-	(123,898)	-	(123,898)
Balance as of December 31, 2005	**100,000**	**9,870,486**	**-**	**55,305**	**(22,660,028)**	**(12,634,237)**

Central Bank of the Republic of Armenia

Cash flow statement
for the year ended December 31

In thousands of AMD

	2005	2004
Cash flow from operating activities		
Loss for the year	(13,574,750)	(16,748,920)
Provision charges/(recovery)	(180,622)	30,052
Depreciation and amortization	760,402	657,144
Cash flow from operating activities before changes in operating assets and liabilities	(12,994,970)	(16,061,724)
(Increase)/decrease in operating assets		
IMF related assets	9,977,736	7,910,102
Foreign currency assets	(23,684,111)	66,893,333
Government securities and other investments	241,515	(7,654,574)
Loans and deposits with banks	1,187,567	(4,229,030)
Other assets	143,877	155,250
Increase/(decrease) in operating liabilities		
Liabilities to banks	24,199,945	7,213,733
Deposits and accounts of Armenian government	4,999,017	18,988,956
Other liabilities	1,895,011	167,704
Net cash from operating activities	**5,965,587**	**73,383,750**
Cash flow from investing activities		
Purchase of fixed and intangible assets	(1,307,457)	(1,241,331)
Proceeds from disposal of fixed assets	2,206	3,637
Sale/(purchase) of other investments	(33,159,622)	6,141,689
Net cash from/(used in) investing activities	**(34,464,873)**	**4,903,995**
Cash flow from financing activities		
Notes and coins in circulation	49,741,054	8,695,498
Issued securities	21,482,856	-
IMF loans repayments	(35,971,330)	(23,597,588)
Loans from banks	(2,159,816)	2,470,263
Transfer to RA government	-	(2,141,202)
Net cash from/(used in) financing activities	**33,092,764**	**(14,573,029)**
Net increase/(decrease) in cash and cash equivalents for the period	**4,593,478**	**63,714,716**
Cash and cash equivalents at the beginning of period (note 24)	179,985,585	116,270,869
Cash and cash equivalents at the end of period (note 24)	**184,579,063**	**179,985,585**

Notes to the Financial Statements

Note 1. Legal Framework

The CBA is a legal entity established by the act of the National Assembly of the Republic of Armenia. The financial statements of the CBA are presented to the National Assembly. The statutory capital of the CBA is the property of the Republic of Armenia and shall not be pledged, sold or otherwise disposed of.

The primary objective of the CBA is price stability. It is achieved through formulation and implementation of monetary policy. In addition to its primary objective, the CBA is also responsible for:

- ensuring in stability, liquidity, solvency and other necessary conditions for sound functioning of the banking system as a whole; and
- creation and development of an effective payment and settlement system.

The CBA also:

- issues the national currency (Armenian dram) and regulates its circulation;
- is the banker of the RA government (further in the text Government);
- is the financial agent and consultant of the Government;
- licenses commercial banks and, if so provided by law, other persons and supervises and regulates their business;
- is the lender of last resort to commercial banks;
- supervises and regulates the payment and settlement system;
- possesses, uses and administers international reserves of the Republic of Armenia; and
- regulates foreign currency transactions.

Note 2. Summary of significant accounting policies

(a) Basis of preparation

These financial statements have been prepared in conformity with International Financial Reporting Standards (“IFRS”) approved by the International Accounting Standards Board (“IASB”).

The Bank is required to maintain its books of accounts in Armenian Drams (“AMD”), which is the functional currency for the Bank. The financial statements are presented in thousands of AMD. AMD is not convertible outside Armenia.

The financial statements have been prepared on a fair value basis for available for sale assets, except those for which a reliable measure of fair value is not available. Other financial assets and liabilities and non-financial assets and liabilities are stated at amortized cost or historical cost, except for certain fixed assets, which were revalued in 1995.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts. The most significant estimates with regards to those financial statements relate to the allowances of impairment of assets, depreciation and amortization and other provisions, which are disclosed in the respective notes of the Bank's accounting policy. These estimates are based on information available as of the date of the financial statements. Actual results, therefore, could differ from these estimates.

Where necessary, comparative figures have been adjusted to confirm to changes in presentation in the current year.

The following accounting policies have been applied consistently during the period in dealing with items which are considered material in relation to the CBA's financial statements.

(b) Income and expense recognition

Interest income and expense items are recognized on an accrual basis using the effective interest rate method.

Commissions and fees as well as all other major income and expense items are credited and/or charged to the statement of income when the related transactions are completed.

(c) Cash and cash equivalents

Cash and cash equivalents are recognized and measured at the fair value of consideration received.

Cash and cash equivalents consist of foreign currency cash, foreign currency correspondent accounts with foreign credit institutions, SDR holdings, deposits and securities that mature within ninety days of the date of origination and are free from contractual encumbrances.

(d) Foreign currency translation and transactions

Foreign currencies transactions are translated into AMD using the exchange rates defined by the CBA ruling at the dates of transactions.

Monetary assets and liabilities denominated in foreign currencies are translated at the rates defined by the CBA ruling at the balance sheet date. Exchange rates used for translation of foreign currency assets and liabilities are the official exchange rates of the CBA from 30.12.2005 and the effect on the financial statements as at 31.12.2005 is not material.

Assets and liabilities denominated in SDR are translated on the basis of IMF quoted exchange rates ruling at the balance sheet date.

Foreign exchange gains and losses resulting from settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement as a net gain or loss from foreign currency translation and transactions.

(e) Balances with IMF

The CBA is the fiscal agent of Government in respect to its relationship with the International Monetary Fund. As the agent, the

CBA reflects in its balance sheet the membership quota of the Government in the IMF ("Quota") and long-term debt securities issued in favour of the IMF, and is the depository for these securities.

The CBA's assets include the Government`s Quota contributions and holdings of Special Drawing Rights ("SDR"). Amounts owed to IMF consist of loans issued under various credit facility agreements signed between the Government and IMF, together with securities issued by Ministry of Finance end Economy ("MOFE") and the CBA to the IMF in settlement of Quota amounts. Loans are initially recognized at initial cost and subsequently re-measured at amortized cost.

Interest expenses in respect to the credit facilities provided by the IMF are included in the CBA's statement of income. Interest on the credits is paid by the CBA and is shown as interest expense, and differences arising from the translation of the SDR balances into AMD are included in translation gains and losses.

(f) Financial instruments

The CBA recognizes that it is exposed to risks inherent in financial instruments.

(I) Risk

Interest rate risk

Changes in market interest rates have a direct effect on the contractually determined cash flows associated with specific financial assets and financial liabilities, which interest rates are periodically reset to market, as well as the fair values of other instruments on which the interest rates are fixed throughout the period of the contract.

Note 27 shows the maturity analysis of assets and liabilities. Substantially all financial assets, and most financial liabilities with the exception of notes and coins in circulation, are interest bearing. Rates are set at or about current market levels.

Amounts due to and from the IMF are subject to special interest arrangements and it is not practicable to assess the fair value of such relationships, which are confined to central banks. As there is no market for such debt, it is not practicable to determine its fair value.

Credit risk

Disclosure of credit risk enables the user of financial statements to assess the extent to which failures by counter-parties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the balance sheet date.

This information can be obtained directly from the balance sheet and related notes in respect of credit exposures such as loans and deposits. Credit risk also exists in respect of guarantees, which are disclosed in Note 25.

Fair value

Fair value information is widely used in determining an enterprise's overall financial position and in making decisions about individual financial instruments. The concept of fair value is relevant to many

decisions made by users of financial statements since, in many circumstances, it reflects the judgment of the financial markets regarding the present value of expected future cash flows of an instrument.

In the context of the CBA, the principal determinants of fair value are exchange rates, interest rates and credit risk. To the extent that fair values are not already reflected in balance sheet valuations as a matter of accounting policy, the exchange rate element is specifically taken into account in the determination of carrying value. The fair value of loans and deposits, insofar as this is determinable by interest rates, is not considered to be materially different from their carrying values. Where credit risk is considered to be relevant, it is recognized as impairment in respect of bad and doubtful debts. There are no other off balance sheet financial instruments other than guarantees disclosed in Note 25.

(II) Classification

Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the bank has the intent and ability to hold to maturity. These assets include securities issued by the governments of different countries.

Available-for-sale assets are financial assets that are not held for trading purposes, originated by the bank or held to maturity. Available-for-sale instruments include certain debt and equity investments.

(III) Recognition

Available-for-sale assets, held-to-maturity securities and originated loans and receivables are recognized on the trade date.

(IV) Measurement

Financial instruments are measured initially at cost, including transaction costs.

Subsequent to initial recognition all available-for-sale assets are measured at fair value, except any instrument that does not have a quoted price in an active market and which fair value cannot be reliably measured, is stated at cost including transaction costs and less any impairment losses.

All non-trading financial liabilities, originated loans and receivables and held-to-maturity assets are measured at amortized cost less impairment losses. Amortized cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortized based on the effective interest rate of the instrument.

(V) Fair value measurement principles

The fair value of financial instruments is based on their quoted market price at the balance sheet date without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument is estimated using pricing models.

(VI) Gains and losses on subsequent measurement

Gains and losses arising from a change in the fair value of available-for-sale assets are recognized directly in equity, until the financial asset is impaired or disposed.

(VII) Specific instruments

Repurchase agreements

Securities sold under repurchase agreements are accounted for as available-for-sale securities and funds received under these agreements are included into amounts due to other banks.

Funds granted against securities, which were purchased under repurchase agreements, are recorded as amounts due from other banks.

Securities purchased are not recognized in the financial statements, unless these are sold to third parties. The obligation to return them is recorded at fair value as a trading liability.

Any related income or expense arising from purchase and sale of the underlying securities is recognized as interest income or expense, accrued during the period that the related transactions are open.

Securities of RA government

Securities of Government are issued by the RA government and comprise Discounted Bills and Coupon Bills. Both are carried in the balance sheet at fair value, or where a quoted market price is not available, fair value is estimated using pricing models.

Government securities of other countries

Securities of the Government of Germany, State and Government guaranteed agencies of England and Federal agencies of the USA have maturities of 1 to 5 years and the CBA holds these investments till maturity. They are carried in the balance sheet at nominal value less an unamortized discount or plus unamortized premium, calculated on the basis of effective interest rate method.

(g) Provisions

Provisions are recognized in the statement of income when the CBA has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

(h) Numismatic coins

The numismatic coins are recorded in the balance sheet at the lower of cost and their net realisable value. Upon sales, difference between estimated net proceeds and carrying value is recognized as gain or loss in the current year income statement.

(i) Fixed and intangible assets

Fixed and intangible assets are stated at cost less accumulated depreciation and accumulated impairment losses, if any, except for the CBA building, which was revalued in 1995 on the basis of the Ministry of Construction guidelines.

Depreciation and amortization of fixed and intangible assets are calculated with linear method at the following annual percentage rates:

	2005	2004
Buildings	5-10%	5-10%
Furniture and other equipment	20%	20%
Computer equipment	20%	20%
IT software	20-33.33%	20-33.33%
Motor vehicles	20%	20%
Other fixed assets	20%	20%

The CBA established following percentage rates for residual values of fixed and intangible assets:

	2005	2004
Buildings	1%	1%
Furniture and other equipment	5%	5%
Computer equipment	5%	5%
IT software	0.5-1%	0.5-1%
Motor vehicles	5%	5%
Other fixed assets	1-5%	1-5%

The assets' residual values and useful lives are reviewed, and adjusted as appropriate, at each balance sheet date.

Fixed assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. No impairment loss was recognized in 2005. Gains or losses arising from the disposal of fixed assets are determined as the difference between the estimated net disposal proceeds and the carrying amount of the assets, and are recognized as gain or loss in the income statement.

Repairs and maintenance are charged to the income statement during the period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits in excess of the originally assessed standard of performance of the existing asset will flow to the Bank. Major renovations are depreciated over the remaining useful life of the related asset.

(j) Grants

Grants relating to fixed and intangible assets are treated as deferred income and recognized in the income statement over the period of the estimated useful lives of those fixed and intangible assets.

(k) Pension fund

There is a State pension scheme in operation whereby the CBA contributes a percentage of total salaries paid to employees into the scheme, according to the statutory legislation. Pension costs are directly charged to the income statement.

(l) Notes and coins in circulation

Notes and coins issued represent an unserviced liability of the CBA and are recorded at face value. Notes printing costs are treated as current expenditure in the year of occurrence.

(m) Debt securities in issue

Debt securities in issue are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Subsequently, debt securities in issue are stated at amortised cost and difference between proceeds net on transaction costs and the redemption value is recognised in the income statement over the period of the security issue using the effective interest method.

If the Bank purchases its own debt securities in issue, they are removed from the balance sheet and the difference between the carrying amount of the liability and the consideration paid is included in the net trading income.

(n) Capital and reserves

The Capital of the Central Bank includes the statutory capital, general reserve, revaluation reserves of securities, fixed and other assets, retained earnings and profit (the change about the reserves in the Law “On the Central Bank of Armenia” is adopted on 03.03.2005).

The capital of the Central Bank completely belongs to the RA and cannot be pledged, confiscated against the obligations of the country or otherwise alienated according to the Law “On the Central Bank of Armenia” adopted by the National Assembly on 30 June 1996.

The general reserve is formed out of profits and is used to cover future unforeseeable losses. The general reserve should be less than 25% of money supply in compliance with the Republic of Armenia Legislation.

According to the Law “On the Central Bank of Armenia”, 80% of annual profit is distributed to the Government and the remaining 20% is transferred to the general reserve.

The calculation of the profit of the Central Bank of Armenia to be distributed does not include positive balance of income and expense, generated from revaluation and purchase of gold, SDR, foreign currency and their equivalents, refined with the amounts used for settlement of negative balances of previous period (the change about the distribution of profit in the Law “On the Central Bank of Armenia” is adopted on 14.12.2004)

(o) Taxation

The CBA is not subject to any taxes, with the exception of taxes, duties or customs fees collected in the border of the Republic of Armenia for imported goods.

Note 3. Foreign currency operations interest income

In thousands of AMD

	2005	2004
Foreign currency deposits	4,626,547	2,794,230
Trust accounts	1,076,363	833,552
Correspondent accounts	701,145	355,344
Foreign securities	3,116,911	1,768,677
Other	103,883	150,206
	9,624,849	**5,902,009**

Note 4. Domestic currency operations interest income

In thousands of AMD

	2005	2004
Domestic securities	535,938	328,400
Loans and repurchase agreements with banks	919,860	847,241
Other	11,813	24,980
	1,467,611	**1,200,621**

Note 5. Other operating income

In thousands of AMD

	2005	2004
Donations to the CBA	31,461	30,257
Penalties received	7,573	4,656
Other income	341,035	436,191
	380,069	**471,104**

Note 6. Foreign currency operations interest expense

In thousands of AMD

	2005	2004
Interest accrued on IMF loans	436,595	642,380
Other accrued interest	87,300	79,220
	523,895	**721,600**

Note 7. Domestic currency operations interest expense

In thousands of AMD

	2005	2004
Interest paid on bank accounts, deposits, loans and reverse repurchase agreements	124,738	499,196
Interests paid on securities issued by CBA	279,940	-
Interest paid on deposits and accounts of Government	1,811,279	638,092
Other	89,256	116,596
	2,305,213	**1,253,884**

Note 8. Other expense

In thousands of AMD

	2005	2004
Expense on repairs and maintenance of fixed assets	259,327	229,950
Maintenance and security expense	271, 931	212,175
Other	273,629	227,962
	804,887	**670,087**

Note 9. Due from foreign banks and credit institutions

In thousands of AMD

	31.12.2005	31.12.2004
Correspondent accounts (note 24)	28,700,242	30,888,632
Deposits in cash and cash equivalents (note 24)	98, 477,370	118,411,006
Other deposits	26,692,413	23,557,024
Trust accounts	48,643,421	27,365,676
Accrued interest	520,695	443,161
	203,034,141	**200,665,499**

As at December 31, 2005 the CBA invested 17.9 billion AMD into overnight repurchase agreements (as at December 31, 2004: 32.6 billion AMD).

All the risks associated with the repurchase agreements are borne by the counterparty.

As at December 31, 2005 and December 31, 2004 fair values of amounts due from foreign credit institutions approximate their carrying amounts.

The bank holds trust accounts with western financial institutions. These institutions have discretionary management of the portfolio of financial instruments (cash and cash equivalents, government and federal agency securities, debt securities of multinational companies) based on the investment benchmarks specified by the CBA. These accounts are carried in the balance sheet at their fair value.

The following investments were held by the trusts as at 31 December 2005 and 31 December 2004:

In thousands of AMD

	31.12.2005	31.12.2004
Cash and cash equivalents	1,308,508	2,691,639
Debt and other fixed income instruments issued by:		
Foreign governments and public sector issuers	35,768,851	22,092,252
Other issuers	11,833,601	2,581,785
Forward agreements	(267,539)	-
	48,643,421	**27,365,676**

Note 10. Balances with IMF

IMF related assets

In thousands of AMD

	31.12.2005	31.12.2004
IMF SDR holdings (note 24)	4,581,721	5,793,006
IMF subscription	59,196,581	69,184,089
Accrued interests	30,587	20,815
	63,808,889	**74,997,910**

IMF pays interests on IMF SDR holdings using floating rates.

IMF AMD liabilities

In thousands of AMD

	31.12.2005	31.12.2004
Securities account	61,128,553	74,089,020
AMD adjustment account of liabilities to IMF	(2,128,875)	(4,044,662)
Number 1 Account	196,796	196,796
Number 2 Account	3,154	3,761
	59,199,628	**70,244,915**

Number 1 Account reflects operations with IMF, including membership quota payments, purchase and repurchase of assets, payment of loans and AMD sale.

Number 2 Account reflects AMD denominated local administrative expenses and proceeds of IMF.

IMF SDR liabilities

In thousands of AMD

	31.12.2005	31.12.2004
Loans	79,411,892	104,323,214
Accrued interest	-	14,720
	79,411,892	**104,337,934**

Under the financial structure rules of the IMF, RA is required to maintain a quota of 59.2 billion AMD (31 December 2004: 69.2 billion AMD). The IMF places this quota in IMF accounts with the CBA in accordance with IMF rules. These balances may be withdrawn by the IMF on demand.

Poverty Reduction and Growth Facility (PRGF) loan is granted for 15 years term and bears 0.5% annual interest. PRGF loan is denominated in SDR.

As at 31 December 2005, loans received from the IMF of 61.1 billion AMD (2004: 74.1 billion AMD) were guaranteed by the Government through issuance of securities in respect of these loans.

As at December 31, 2005 and December 31, 2004 fair values of IMF accounts approximate their carrying amounts.

Note 11. Investment securities

Foreign currency investment securities

In thousands of AMD

	31.12.2005	31.12.2004
Available for sale securities		
- Equity investments	**1,301**	**1,514**
Held to maturity securities		
- Securities of other governments included in cash and cash equivalents (note 24)	52,549,774	24,629,292
- Other securities of other governments	80,049,585	48,835,767
- Accrued interest	2,572,027	626,223
	135,171,386	**74,091,282**

Investment in the capital of other parties is one share capital contribution in SWIFT system (Belgium).

Held to maturity securities are Euro, US Dollar and Grate Britain Pound denominated bonds issued by German Government, Federal agencies of the US Government and State and Government guaranteed agencies of England. Held to maturity securities carry annual fixed rates.

Domestic currency investment securities

In thousands of AMD

	31.12.2005	31.12.2004
Available for sale securities		
- Securities of Government	5,572,816	5,904,476
- Equity investments	2,400,369	2,424,655
- Accrued interest	103,892	113,358
	8,077,077	**8,442,489**

Available for sale securities of Armenian Government are AMD denominated government securities issued by MOFE.

The CBA share holdings in "Arminkassatia" CJSC (money transportation) and "Armenian Card" CJSC (card processing company) in AMD exceed 50% of the issued share capital of these companies and the CBA exercises control over the operations of the companies. The CBA does not consolidate these subsidiaries, as the financial effect of these investments is immaterial to the Bank's financial statements. These investments are accounted at their acquisition cost.

Note 12. Loans and other claims

Domestic currency loans

In thousands of AMD

	31.12.2005	31.12.2004
Loans to commercial banks	11,700,000	11,700,000
Loans to employees	21,604	43,219
Repurchase agreements	-	1,156,935
Accrued interests	228,262	237,279
	11,949,866	13,137,433
Allowance for impairment of loans	-	(117,432)
	11,949,866	**13,020,001**

Loans provided to commercial banks relate to the loans received from KfW within the framework of German-Armenian Foundation (note 17).

Note 13. Allowance for impairment of loans and guarantees

Allowance for impairment of loans

In thousands of AMD

	31.12.2005	31.12.2004
Opening balance	117,432	87,380
Increase/(decrease) in provision	(117,432)	30,052
Closing balance (Note 12)	**-**	**117,432**

Allowance for impairment of guarantees

In thousands of AMD

	31.12.2005	31.12.2004
Opening balance	63,190	63,190
Decrease in provision	(63,190)	-
Closing balance (Note 23)	**-**	**63,190**
Total increase/(decrease)	**(180,622)**	**30,052**

Note 14. Fixed assets

In thousands of AMD

	Land and buildings	Computer equipment	Other fixed assets	Total
Cost				
As of January 1, 2004	4,296,221	1,721,336	2,572,853	8,590,410
Reclassification	(105,985)	-	(11,218)	(117,203)
As of January 1, 2004, reclassified	4,190,236	1,721,336	2,561,635	8,473,207
Additions	582,381	143,142	466,800	1,192,323
Disposals	-	(62,585)	(36,975)	(99,560)
As of December 31, 2004	**4,772,617**	**1,801,893**	**2,991,460**	**9,565,970**
Additions	865,889	147,025	265,710	1,278,624
Disposals	(4,193)	(79,757)	(39,199)	(123,149)
Reclassification	(99,867)	-	99,867	-
As of December 31, 2005	**5,534,446**	**1,869,161**	**3,317,838**	**10,721,445**
Accumulated depreciation				
As of January 1, 2004	688,992	1,351,143	1,432,635	3,472,770
Additions	207,600	80,454	354,969	643,023
Disposals	-	(62,585)	(33,338)	(95,923)
As of December 31, 2004	**896,592**	**1,369,012**	**1,754,266**	**4,019,870**
Additions	205,468	108,961	419,808	734,237
Disposals	(4,193)	(79,758)	(36,991)	(120,942)
Reclassification	(20,178)	-	20,178	-
As of December 31, 2005	**1,077,689**	**1,398,215**	**2,157,261**	**4,633,165**
Net book values:				
As of December 31, 2005	**4,456,757**	**470,946**	**1,160,577**	**6,088,280**
As of December 31, 2004	**3,876,025**	**432,881**	**1,237,194**	**5,546,100**

Other fixed assets include granted equipment at a cost of 84 million AMD as of December 31, 2005 (December 31, 2004: 115 million AMD).

The amount of income from fixed assets received gratuitously and their respective depreciation recognized in 2005 was 30.7 million AMD (2004: 29 million AMD).

The amount of fixed assets for 2005 includes construction in progress and other fixed assets under installation amounting to 1,591.1 million AMD (2004: 612.8 million AMD), which are not used and accordingly, are not subject to depreciation.

Fixed assets amounting to 542.7 million AMD (December 31, 2004: 564.9 million AMD) are given to an operating lease without any charge.

A building was given to an operating lease. The lease payments on this building made up 370 KAMD before September 2005, and 1,933 KAMD after September 2005. There were also other fixed assets given to an operating lease with lease payments amounting to 6 KAMD.

The balance of fixed assets includes assets with residual amount of 66 million AMD as of December 31, 2005. The historical cost of these assets was 1,787 million AMD. Their useful lives have expired; however, they are still used by the Bank.

As of December 31, 2005 and December 31, 2004 The Central Bank of Armenia does not have any fixed assets pledged as collaterals.

Note 15. Intangible assets

In thousands of AMD

	IT software
Cost	
As of January 1, 2004	141,369
Additions	49,008
As of December 31, 2004	**190,377**
Additions	28,835
As of December 31, 2005	**219,211**
Accumulated amortisation	
As of January 1, 2004	101,011
Additions	14,121
As of December 31, 2004	**115,132**
Additions	26,165
As of December 31, 2005	**141,297**
Net book values:	
As of December 31, 2005	**77,914**
As of December 31, 2004	**75,245**

IT software include granted software at a cost of 25.5 KAMD (2004: 547 KAMD).

The amount of income from grants related to IT software during 2005 was 521.5 KAMD (2004: 652 KAMD); the same amount has been expended as an amortisation.

Note 16. Other domestic currency assets

In thousands of AMD

	31.12.2005	31.12.2004
Accounts receivable	47,452	20,256
Numismatic coins	152,574	201,611
Other assets	125,446	140,975
	325,472	**362,842**

Note 17. Amounts owed to banks and credit institutions

Foreign currency liabilities

In thousands of AMD

	31.12.2005	31.12.2004
Correspondent accounts *	22,277,775	86
Loans	8,928,045	11,087,815
Accrued interests	185	231
	31,206,005	**11,088,132**

Loans amounting to 8.9 billion AMD relate to the loans received from KFW within the framework of German-Armenian Foundation during 1999-2004, which are distributed through commercial banks (note 12). The loans mature from 2008 through 2043, and bear annual interest of 0.75% for used part of loan, and 0.25% for unused part of loan.

Domestic currency liabilities

In thousands of AMD

	31.12.2005	31.12.2004
Correspondent accounts *	30,355,814	28,436,362
Accrued interests	3,387	583
	30,359,201	**28,436,945**

* *Correspondent accounts include obligatory reserves of commercial banks. The obligatory reserves do not bear any interest (2004: 3%).*

As of December 31, 2005 and December 31, 2004 the fair value of amounts owed to banks and credit institutions approximate their carrying amounts.

Note 18. Other deposit accounts

Foreign currency liabilities

In thousands of AMD

	31.12.2005	31.12.2004
Deposits	112,620	154,751
Guarantee fund for deposits of physical entities*	1,863,225	-
Accrued interests	14,161	-
	1,990,006	**154,751**

Domestic currency liabilities

In thousands of AMD

	31.12.2005	31.12.2004
Deposits	649,634	561,404
Guarantee fund for deposits of physical entities*	542,607	616,251
Accrued interests	7,421	6,712
	1,199,662	**1,184,367**

* *The fund was created and operates at the expense of transfers made by commercial banks under the Law "On guarantee of remuneration of bank deposits of physical entities".*

Note 19. Other foreign currency liabilities

In thousands of AMD

	31.12.2005	31.12.2004
Accounts payable	84,070	43,970
Trust accounts liabilities	16,998	-
	101,068	**43,970**

Note 20. Notes and coins in circulation (31.12.2005)

Notes *Coins*

In thousands of AMD

Face value	Quantity	Amount	Face value	Quantity	Amount
10 AMD	14,035,409	140,354	10 lumas	8,770,783	877
25 AMD	1,607,108	40,178	20 lumas	10,863,312	2,173
50 AMD	2,424,411	121,221	50 lumas	5,708,144	2,854
100 AMD	1,531,642	153,164	1 drams	9,180,841	9,181
200 AMD	424,292	84,858	3 drams	4,177,946	12,534
500 AMD	3,025,776	1,512,887	5 drams	4,267,327	21,337
1,000 AMD	16,725,145	16,725,145	10 drams	16,555,000	165,550
5,000 AMD	10,769,795	53,848,975	20 drams	8,872,000	177,440
10,000 AMD	4,412,000	44,120,000	50 drams	8,625,000	431,250
20,000 AMD	2,087,898	41,757,960	100 drams	13,810,000	1,381,000
50,000 AMD	38,000	1,900,000	200 drams	6,885,000	1,377,000
			500 drams	2,152,000	1,076,000
			100 drams “Chess Olympiad”	129,380	12,938
			100 drams “Charents”	51,000	5,100
			25,000 drams	19,355	483,875
Total notes		**160,404,742**	**Total coins**		**5,159,109**
Total notes and coins in circulation					**165,563,851**
Cash in cash box					**(10,289,128)**
Notes and coins in circulation					**155,274,723**

Notes and coins in circulation (31.12.2004)

Notes *Coins*

In thousands of AMD

Face value	Quantity	Amount	Face value	Quantity	Amount
10 AMD	14,122,908	141,229	10 lumas	8,526,783	853
25 AMD	1,635,597	40,890	20 lumas	10,624,312	2,125
50 AMD	2,558,300	127,915	50 lumas	5,570,544	2,785
100 AMD	1,696,531	169,653	1 drams	8,515,341	8,515
200 AMD	440,781	88,157	3 drams	3,902,946	11,709
500 AMD	6,354,051	3,177,025	5 drams	4,180,327	20,902
1,000 AMD	15,259,196	15,259,196	10 drams	19,054,700	190,547
5,000 AMD	8,610,672	43,053,360	20 drams	8,249,000	164,980
10,000 AMD	2,756,000	27,560,000	50 drams	7,650,000	382,500
20,000 AMD	1,132,614	22,652,280	100 drams	12,255,000	1,225,500
50,000 AMD	23,000	1,150,000	200 drams	6,005,000	1,201,000
			500 drams	444,000	222,000
			100 drams “Chess Olympiad”	116,380	11,638
			100 drams “Charents”	33,000	3,300
			25,000 drams	19,320	483,000
Total notes		**113,419,705**	**Total coins**		**3,931,354**
Total notes and coins in circulation					**117,351,059**
Cash in cash box					**(11,817,390)**
Notes and coins in circulation					**105,533,669**

Note 21. Accounts and deposits of Government

In thousands of AMD

	31.12.2005	31.12.2004
Government accounts and deposits	21,962,471	42,511,960
Accrued interests	31,378	98,073
	21,993,849	**42,610,033**

Note 22. Debt securities in issue

In thousands of AMD

	31.12.2005	31.12.2004
Securities issued by CBA	21,215,186	-
Accrued interests	267,670	-
	21,482,856	-

Securities are AMD denominated short-term discount securities.

Note 23. Other domestic currency liabilities

In thousands of AMD

	31.12.2005	31.12.2004
Accounts payable	43,629	25,126
Allowance for impairment of guarantees	-	63,190
Other	106,367	137,507
	149,996	225,823

Note 24. Cash and cash equivalents

In thousands of AMD

	31.12.2005	31.12.2004
Cash in foreign currency	269,956	263,649
Foreign currency correspondent accounts (note 9)	28,700,242	30,888,632
Deposits (note 9)	98,477,370	118,411,006
IMF SDR assets (note 10)	4,581,721	5,793,006
Investments (note 11)	52,549,774	24,629,292
	184,579,063	179,985,585

Note 25. Commitments and contingencies

Credit related commitments

Guarantees represent irrevocable assurance that the bank will make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Guarantees outstanding as at 31 December 2005 amount to 4.5 billion AMD in respect of two Armenian banks for 10 years and 658 million AMD in respect of earthquake zone provided in 1994-1995.

Note 26. Related party transactions

Parties are considered to be related if one party has ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. For the purpose of the present financial statements, related parties include the following Bank officials: the Chairman, the Deputy Chairman, the Board members of the CBA and parties related to them respectively, as well as companies controlled by the CBA.

A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits, salaries and employment benefits, expenses and incomes from other transactions with controlled companies.

As of December 31, 2005 and December 31, 2004 the CBA had the following balances with related parties:

In thousands of AMD

	31.12.2005	31.12.2004
Loans to related parties	-	-
Interest income	-	24
Deposits of related parties	91,659	86,358
Interest expense	13,089	16,814
Expense from other transactions	185,522	132,725

As of December 31, 2005 the aggregate remuneration and employment benefits paid to the CBA officials was 104,303 KAMD (as of December 31, 2004: 102,006 KAMD).

Note 27. Maturity analysis

2005 *In thousands of AMD*

	Less than one month	Between one and three months	Between three months and one year	Between one and five years	More than five years	Total
Financial assets						
Cash and correspondent accounts	28,970,198	-	-	-	-	28,970,198
IMF related assets	4,581,721	-	-	-	59,196,581	63,778,302
Deposits	84,664,652	13,812,718	26,692,413	-	-	125,169,783
Loans	300,000	300,000	1,200,000	9,921,604	-	11,721,604
Trust accounts	48,643,421	-	-	-	-	48,643,421
Securities	19,948,324	32,601,450	47,518,451	38,052,590	51,360	138,172,175
Other assets and accrued interests	2,788,372	389,135	2,819,183	-	-	5,996,690
Total	**189,896,688**	**47,103,303**	**78,230,047**	**47,974,194**	**59,247,941**	**422,452,173**
Financial liabilities						
Bank notes in circulation	155,274,723	-	-	-	-	155,274,723
Securities issued by CBA	-	963,439	20,251,747	-	-	21,215,186
Correspondent accounts	44,744,054	-	-	-	-	44,744,054
Deposits	8,538,209	253,400	1,863,225	-	-	10,654,834
Loans	-	-	-	133,371	8,794,674	8,928,045
RA government	61,455,764	-	-	-	-	61,455,764
IMF	59,199,628	2,171,614	11,825,982	40,691,922	24,722,374	138,611,520
Other liabilities and accrued interest	413,595	57,893	272,499	-	-	743,987
Total	**329,625,973**	**3,446,346**	**34,213,453**	**40,825,293**	**33,517,048**	**441,628,113**
Gap	**(139,729,285)**	**43,656,957**	**44,016,594**	**7,148,901**	**25,730,893**	**(19,175,940)**

2004 *In thousands of AMD*

	Less than one month	Between one and three months	Between three months and one year	Between one and five years	More than five years	Total
Financial assets						
Cash and correspondent accounts	31,152,281	-	-	-	-	31,152,281
IMF related assets	5,793,006	-	-	-	69,184,089	74,977,095
Deposits	51,646,844	66,764,163	25,557,023	-	-	141,968,030
Loans	-	601,130	1,212,591	9,929,498	-	11,743,219
Trust accounts	27,365,676	-	-	-	-	27,365,676
Securities	15,071,536	9,557,756	23,807,082	30,880,393	52,768	79,369,535
Other assets and accrued interests	3,842,573	482,577	752,433	-	-	5,077,583
Total	**134,871,917**	**77,405,626**	**49,329,129**	**40,809,891**	**69,236,857**	**371,653,419**
Financial liabilities						
Bank notes in circulation	105,533,669	-	-	-	-	105,533,669
Correspondent accounts	26,435,945	-	-	-	-	26,435,945
Deposits	2,458,631	-	-	-	-	2,458,631
Loans	-	-	-	66,254	11,021,561	11,087,815
RA government	55,990,052	-	400,000	-	-	56,390,052
IMF	69,187,414	5,380,567	12,123,196	51,780,907	36,096,046	174,568,129
Other liabilities and accrued interest	975,711	14,720	4,165	-	-	994,597
Total	**260,581,422**	**5,395,287**	**12,527,361**	**51,847,161**	**47,117,607**	**377,468,838**
Gap	**(125,709,505)**	**72,010,339**	**36,801,768**	**(10,037,270)**	**22,119,250**	**(5,815,419)**

The maturity analysis excludes non-financial assets that by their very nature do not have maturity.

Note 28. Currency Concentration

(2005) *In thousands of AMD*

	Assets	Liabilities	Net currency position
US Dollars	225,998,713	57,833,461	168,165,252
IMF SDRs	63,808,889	79,411,892	(15,603,003)
EUR	68,781,909	14,956,825	53,825,084
GBP	44,028,307	36	44,028,271
RF roubles	55,128	38	55,090
Other	34,994	12	34,982
Total	**402,707,940**	**152,202,264**	**250,505,676**

(2004) *In thousands of AMD*

	Assets	Liabilities	Net currency position
US Dollars	163,995,709	14,059,756	149,935,953
IMF SDRs	74,997,910	104,337,934	(29,340,024)
EUR	61,717,427	11,105,090	50,612,337
GBP	50,497,116	44	50,497,072
RF roubles	39,888	42	39,846
Other	628	13	615
Total	351,248,678	129,502,879	221,745,799