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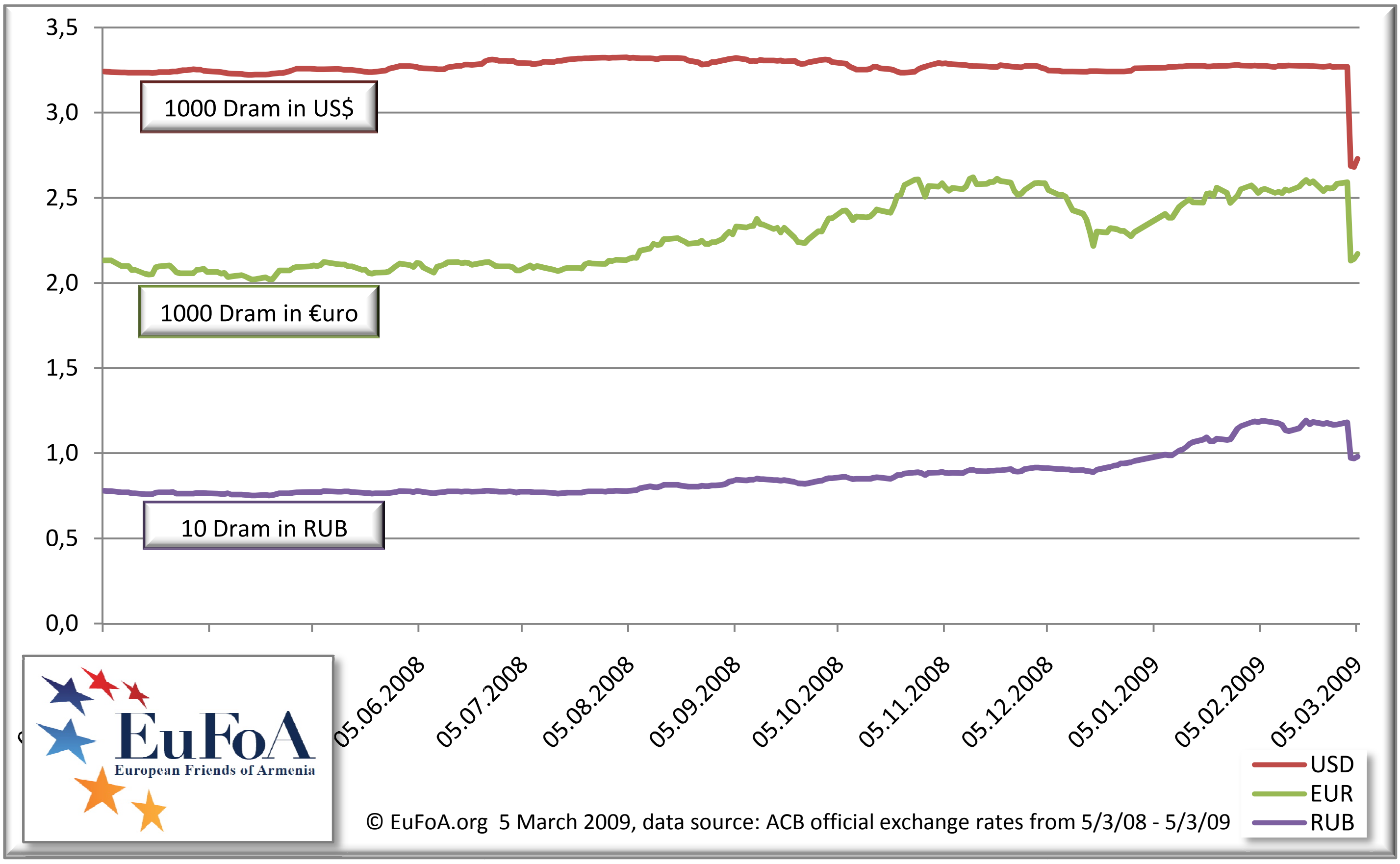
The depreciation of the Armenian Dram of 3 March 2009

A short paper by EuFoA

The unexpected depreciation of the Armenian Dram on 3 March 2009 caught many observers inside and outside the country by surprise. Pending a more thorough analysis by international economic institutions, the aim of this paper is to provide a quick overview of the immediate consequences of this development especially possible consequences for the relations between Armenia and Europe.

What happened?

On 3 March, the Armenian Dram depreciated by more than 20 % within hours. No warning had been given to markets or consumers and as a result, reactions close to panic could be observed. Some shops temporarily closed, not knowing how to price their products. The board of the Armenian Central Bank (ACB) merely issued a statement saying that they have decided to "revert to the policy of a floating exchange rate." Before this move, it was not publically communicated that the Dram is being fixed against the dollar. However, a simple look at the exchange rate chart shows that the uncommon stability of the Dram/Dollar-rate was apparent for a long time. The ACB's move was part of a deal struck with the international Monetary Fund (IMF) for a US$ 540 million emergency loan in the light of the worsening effects of the financial and economic crisis.



What does this mean for Armenia?

First, it is remarkable that the US$ rate is the only one that loses a significant long-term value. By contrast, the Euro rate is only back to where it was half a year ago. The Rouble rate even only corrects the development of the last three months. And at least for now, three days after the switch to a "free float" policy, the rates do not seem to fall further. Despite this, it seems likely that Armenia has not just let the steam out of the kettle and put the lid back on. The IMF generally monitors closely whether the conditions for such deals are continuously met. However, Central bank chief Artur Javadyan was quoted by Bloomberg that the central bank may still intervene to avoid "sharp currency fluctuations".

This could mean that the drastic depreciation, while it seems severe for the buying power of the Armenian people, only triggered an overdue correction of the overvalued Dram vis-a-vis the US$. Therefore, this depreciation, if it does not speed up in the coming days, may not trigger very drastic price increases because most of the Armenian imports do not come from the US, they come from Russia and Europe. And even though many contracts are made in US$, even trade contracts with Russia and Europe, importers could find it relatively easy to negotiate adapted prices with their Russian and European trade partners, switching to a Rouble or Euro base and effectively turning back the clock to where they were half a year ago.

Meanwhile, all monetary help coming into the country is now much cheaper and more effective. If a foreign investor wanted to invest in Armenia one week ago, he would have had to pay 20% more than today to buy the same factory or goods. Armenian exporters are now 20% more competitive than before, which will strongly help reduce the immense trade deficit.

The badly needed investments into struggling Armenian companies and the ever so important monetary influx from the Diaspora in the US, in Russia and in Europe (especially France) are also 20% more valuable. Not least does this count for foreign aids provided by the IMF, Russia, the US and the EU. It seems likely that this was one of the reasons why the IMF insisted on free floating before granting the aid package worth $540 million in emergency loans.

All in all, this means that the Armenian economy, which as any economy is badly hit by the global financial and economic crisis, now is rid of its major obstacles for recovery.

What does this mean for Europe?

Europe has a strong interest in the stability and economic recovery of Armenia. This recovery has now become much more likely. The EU is now in a good position to exercise the earmarked increased aids, although their actual spending can be expected to be too late to help the recovery. However, the ongoing European investments and commitments are now immediately 20% more effective and the long-term signal going out from them provides a stability anchor badly needed these days.

What lessons to learn?

The communication around such moves is always very difficult but also crucial. It is not known how co-ordinated the ACB's move was and how much, for example, the IMF, the ECB and the European Commission knew about it. To prepare the markets and to avoid confusion or even panic reactions, a more concerted communication policy would have been preferable. The ACB could have communicated and explained their right move in a better way and an informed and prepared ECB and European Commission could have publically welcomed the move, reassuring markets and consumers.

Brussels, 5 March 2009

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