

ANALYSIS OF THE INTERACTION OF REAL ESTATE AND FINANCIAL MARKETS OF THE REPUBLIC OF ARMENIA OVER THE PAST FIVE YEARS

Arine STEPANYAN

VSU lecturer, Ph.D. in Economics

Key words: real estate market, financial market, income tax refund, mortgage, transfers,
commercial banks

Introduction The real estate market plays an extremely important role for the economy. Through the ownership of real estate, financial organizations carry out lending, through which they create capital, thereby materializing the economic energy available in the economy. Thus, you just need to try to imagine how much investment in the real sector of the economy can provide real estate in the country, if, of course, it is sufficiently liquid and financial intermediaries are willing to accept it as collateral. It is this property that connects the market prices of real estate with the state of the financial system and the activity of the markets.

Methodology Modern economics uses a variety of analytical methods. Some of them are considered common and can be used in any branch of the economy, while others have special features and can only be used in a separate industry: The theoretical and informational basis for the analysis were scientific publications of Armenian and foreign theorists in the field of real estate analysis and financial markets, assessment approaches used in international practice of developing and analyzing financial strategy. Methods of financial and economic analysis, statistics, measurement and comparison were widely used during our analysis. In the first part of the analysis, a comparison method was applied, which concerns the comparison of the income tax received by the State Budget of the Republic of Armenia and the income tax returned for 2018-22. In the second part of the analysis, is applied the method of financial and economic analysis, when were the total mortgage loans provided to residents by commercial banks of the Republic of Armenia analyzed by spheres. In the third part of the analysis, a comparison method was applied concerning the dynamics of inflows and outflows of transfers by country.

Literature review In our study, we analyzed the current situation in the real estate market of the Republic of Armenia, laws and government decisions aimed at development. In particular, we have studied the tax law of the Republic of Armenia regarding the compensation of interest amounts paid for servicing a mortgage loan received by an employee for the purpose of purchasing an apartment or building an individual residential building [Legal information System of Armenia, Article 160]. In addition, we analyzed the data published by the Central Bank on the provision of loans in the follo-

wing areas: And finally, we have studied the volume of transfers by year and country [Central Bank of Armenia]. Within the framework of this study, The approach proposed by A.N. Asaul is noteworthy in the sense that one should try to imagine how much investment in the real sector of the economy can be provided by the country's real estate, if, of course, it is sufficiently liquid and financial intermediaries are ready to accept it as collateral. It is this property that puts the market prices of real estate in connection with the state of the financial system and the activity of the markets [Asaul, 2013, 26-29].

In the context of this study, the principles of the formation of market price factors and the market value of real estate are also particularly important. While evaluating an object, it is necessary to identify all factors related to pricing (technical, financial, economic, social and legal), on which the composition and size of income and expenses depend [Kolankov, 2019, 98-99].

Factors affecting the value of real estate were also taken into account, which can be divided into two types:

- macroeconomics related to general market conditions (taxes, duties, the dynamics of the dollar, inflation, unemployment, the level and conditions of wages, the need for real estate, etc.),
- microeconomic, characterizing the objective parameters of specific transactions (all terms of the contract: subject matter, validity period, rights and obligations of the parties, termination of the contract, etc.) [Hovhannisyan, et al., 2007, 55-57].

Scientific novelty As a result of analysis and research, it becomes clear that the vulnerability of financial stability from fluctuations in real estate prices is mainly considered from the point of view of lending to the construction industry and loans secured by real estate, the materialization of risks of changes in the value of collateral: Sharp fluctuations in supply/demand for real estate, and consequently prices, may adversely affect the security and quality of bank loans, creating risks in terms of financial stability.

Currently there is a number of problems in the real estate market in Armenia, the systematic solution of which will lead to the development of the real estate market. Analyzing and comparing the existing and possible trends in the development of the RA real estate market, we have justified that in the future the most optimal policy in the real estate market and financial markets should be based on a balanced, coordinated policy.

Analysis The real estate market is an extremely important economic player. Real estate, in addition to meeting one of the most important needs of society, is one of the main "reserves" of wealth in the economy. Thus, in developing countries, the market value of shared real estate is usually many times higher than the capitalization of financial markets and the volume of investments coming into the country. This is a unique source of economic "energy" [Asaul, 2013, 26-29]. At the same time, the real estate market is

influenced by the development of the real and financial sectors, since supply and demand in this market depend on the state of the economy and the financial system of the country. Usually, prices in this market determine the financial and business cycles, in a certain sense also becoming an economic barometer and giving very important information about future economic developments [Hilbers, et al., 2001, 3-8].

Changes in the value of any real estate depend on a number of factors that manifest themselves at different stages of the valuation process: All factors affecting the value of real estate can be divided into objective and subjective. Subjective factors are related to the behavior of a particular seller, buyer or intermediary at the stage of concluding a transaction (for example, awareness, sincerity, personal preferences, etc.), that is, these are mainly psychological factors [Kolankov, 2019, 98-99]. Objective factors are primarily economic factors that ultimately determine the average price level for specific transactions. Objective factors are divided into two groups: macroeconomic and microeconomic. Macroeconomic factors include taxes, duties, inflation, low demand for real estate, the exchange rate, the level and conditions of wages, unemployment, the development of export-import operations, etc. Microeconomic factors characterize the objective parameters of specific transactions and are related to the characteristics of real estate, which is the object of sale, and the legal nature of the transaction. For a short-term period, macroeconomic factors can be conditionally considered constant (they change quite slowly), and the overall structure of the market is fixed.

All these factors have an impact on the real estate market, however, we will look at how mortgage loans issued by Armenian banks have affected the real estate market [Hovhannisyan, et al., 2007, 55-57]. As of the end of December 2022, the total loan portfolio of Armenian banks increased up to AMD 4 trillion 168 billion. This amount includes mainly loans provided by banks to residents, which also include loans issued to financial and insurance companies. Over the year, compared to the end of December 2021, the total volume of loans increased by AMD 378 billion or 10%. Based on the data of the Central Bank of the Republic of Armenia, it becomes clear that not all types of loans recorded growth. Moreover, lending has declined in some areas of the economy.

The absolute leader in growth is the mortgage market. If as of the end of December 2021, the volume of mortgage loans in all banks of Armenia together reached AMD 655 billion, then a year later it is AMD 195 billion or 30% more – AMD 849 billion. This sharp increase in the mortgage market was predictable. Since the end of 2021, it has already been known that the income tax refund program in Yerevan is gradually being discontinued. Under the program, which has been in effect since 2015, borrowers are given the opportunity to return the income tax they have paid in order to pay mortgage interest. However, since the budget lost income tax amounts as a result of this, and construction in Yerevan became over-centralized, the authorities decided in 2021 to

gradually and phased refuse from this program, providing developers and those preparing to take out a new mortgage loan for a period of 1 year for the center of Yerevan, and then gradually, until 2025, for the whole of Yerevan. The program will continue to work in the regions [www.arlis.am]. From this point of view, let's consider how much income tax was paid to the state budget and how much income tax was refunded. In total, income tax in the amount of AMD 36,502.00 million was refunded in 2022, which is 60% more than in 2021, and AMD 22,743 million were refunded in 2021, which is 70% more than last year. And in 2022, AMD 475,038 million of income tax were collected, which increased by only 10% compared to last year. This is quite a large indicator, since according to the new law, income tax is reduced to 20%, and in 2022 it amounted to 21%, having decreased by 1% since last year. What should have had a negative impact on the income taxes collected. However, the exact opposite was true, and income tax was collected more. These trends are shown in Figure 1 [https://www.petekamutner.am].

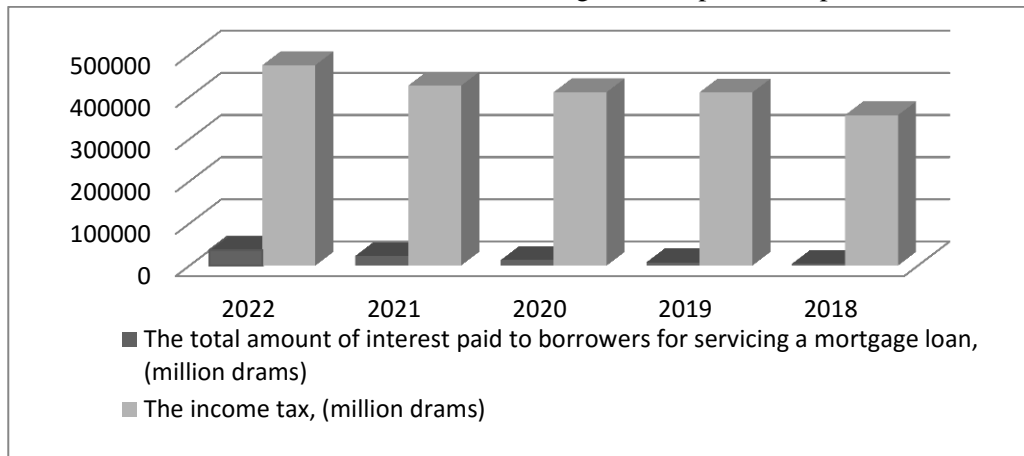


Figure 1. Comparison of income tax received by the RA State budget and returned income tax in 2018-2022. [www.arlis.am]

After the decision to discontinue this program in Yerevan, developers gave a new impetus to the construction, and those who were preparing to buy an apartment hurried to complete the transactions. As a result, both construction and the volume of mortgage loans increased. Another question is how long-term this growth is and whether it has stable grounds for contributing to the economy in the coming years. This growth in mortgage loans significantly contributed to the growth of the overall loan portfolio of banks. However, it should be noted that such a pace of mortgage loans growth poses a serious threat to the financial market. Since the vulnerability of financial stability from fluctuations in real estate prices is mainly considered from the point of view of lending to the construction industry and loans secured by real estate, the materialization of risks of changes in the value of collateral: Sharp variations in supply/demand for real estate, and consequently prices, may adversely affect the security and quality of bank loans,

creating risks in terms of financial stability. In the real estate market of the Republic of Armenia in 2021, during this period, an acceleration in the growth rate of the price index was recorded due to the recovery of economic activity, as well as the applied income tax refund mechanism and the factor of its phasing out. In 2022, this acceleration increased even more, because as a result of the Russian-Ukrainian war, many Russian and Ukrainian citizens came to Armenia and rented real estate, which in a short period of time very quickly increased the demand for real estate in Armenia. In 2021, compared with last year, there was an increase in activity in the real estate market, which resulted in an increase in total transactions by 27.0%, with the most significant growth in the part of multi-apartment residential buildings, the number of transactions for the purchase and sale of which increased by 21.4%: By the end of 2021, the prices of apartments in multi-family residential buildings as a whole remained unchanged: In particular, the decrease in prices for apartments in 10 apartment buildings in Yerevan in 2020 remained until 2021. June, then prices rose again. In December 2021, there was an increase of 9.7%.

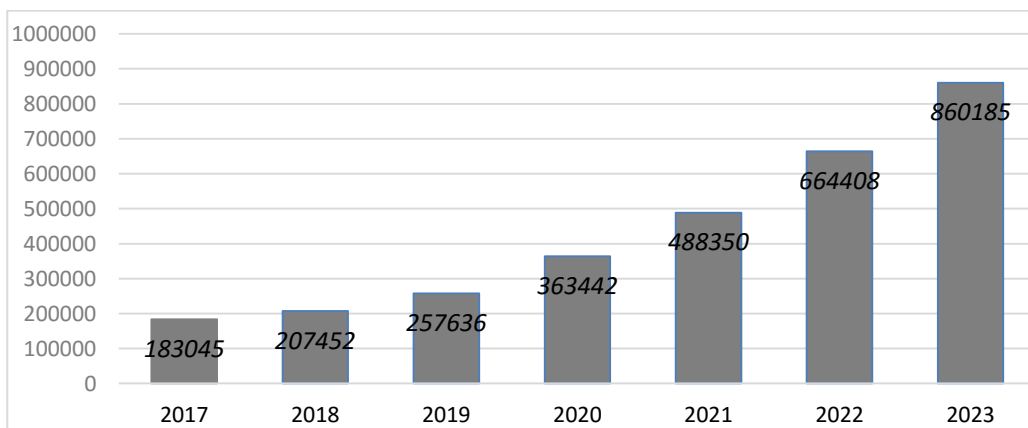


Figure 2. Total mortgage loans issued by commercial banks of the Republic of Armenia to residents by spheres as of January (million AMD) [www.cba.am]

Figure 2 shows that the amendments to the income tax Law had a very serious impact on the mortgage market. People began to acquire real estate at a rapid pace, which had a great impact on the financial market, increasing the volume of mortgage loans issued by banks. Thus, in 2021, banks provided AMD 488350 million loans, and in January 2023, a total amount of AMD 860185 million loans were provided, which increased by 56% in two years, which in general makes up the entire volume of mortgage loans provided by banks in January 2020.

One of the main incentives for the development and growth of the mortgage market was also the procedure for the refund of income tax amounts paid by employees,

individual entrepreneurs and notaries in the amount of interest paid for servicing a mortgage loan.

It should be noted that this program was introduced at one time in order to revitalize the field of capital construction. The program, in fact, has fulfilled the task set for itself, the best proof of which is the new apartment buildings in different parts of Yerevan. However, to continue this policy according to the same rules will mean to give an impetus to the development of the non-exported sector, which is not justified from three points of view. Firstly, the construction boom can turn the real estate market into a "air balloon", significantly reducing the resilience of the economy to shocks.

The best proof of this was the reaction of the RA economy to the 2008 - 2009 global financial crisis in the form of an economic downturn of 14.1%. Secondly, from a purely fiscal point of view, the construction sector has a short-term impact on state budget revenues. Thus, a construction company pays taxes only during construction work in the event that the "life expectancy" of the object under construction is significantly longer. Moreover, if the above-mentioned regulation of income tax refund is applied, the state incurs tax losses in the period after construction works. Thirdly, international experience shows that stimulating the export sector is most favorable for small open economies, since it opens the way to long-term stable economic growth. Thus, the application of this law makes it clear how the interaction between real estate and financial markets occurs, and how changes in one market have a direct impact on another market. Commenting on this influence, we are compelled to note that the influence between the two markets is mutual. That is, a small change in another market, as well as in this market, causes big shifts.

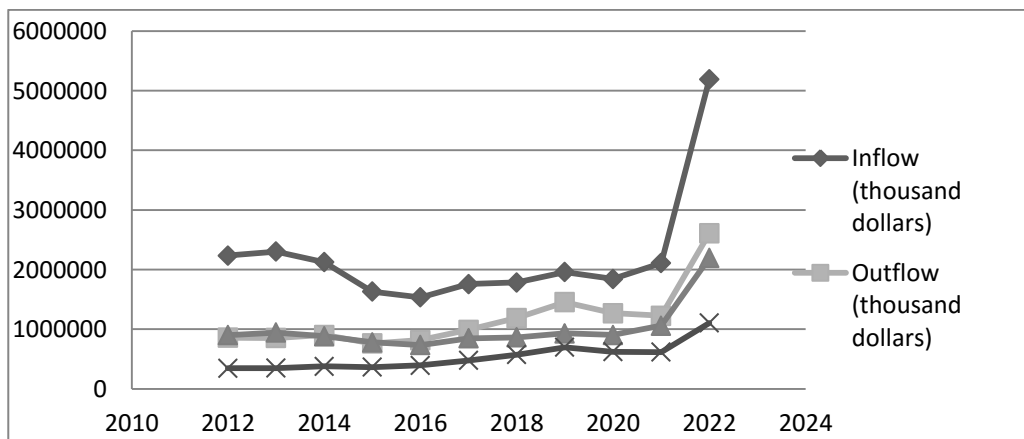


Figure 3. Transfer flows in 2012-2022 [6]

The financial market is also greatly influenced by transfers, through which the real estate market is also activated, since the flow of large transfers also has a positive impact

on the real estate market, activating the sphere. Now let's look at the dynamics of transfers in Armenia over the past 10 years.

Figure 3 shows that a very large increase in transfers was recorded in 2022, largely due to the Russian-Ukrainian war and EU and US sanctions against the Russian Federation. The impact of sanctions had a very negative impact on the Russian Federation, as a result of which most of the transactions were carried out through different countries, one of which is Armenia. However, it should be noted that with the transfer of these transactions to Armenia, the outflow of transfers should have increased to the same extent, but in reality the inflow of transfers increased more than the outflow. This indicates that the residents who migrated to Armenia due to the Russian-Ukrainian war moved their financial resources to Armenia and began to settle in Armenia, as a result, there was a big leak of transfers. In 2022, Armenia received USD 5,190,411 million, of which only USD 2,606,767 million came from the country, and the rest remained in the Armenian economy. Which, of course, could not but have their influence. For comparison, it should be noted that in 2021 Armenia received USD 2,108,936 thousand of transfers, of which only USD 1,225,622 thousand flowed away. In 2022, the net inflow increased by USD 1,700,330 thousand US dollars compared to 2021, approximately compared to last year, transfers increased by 2.5 times [www.cba.am].

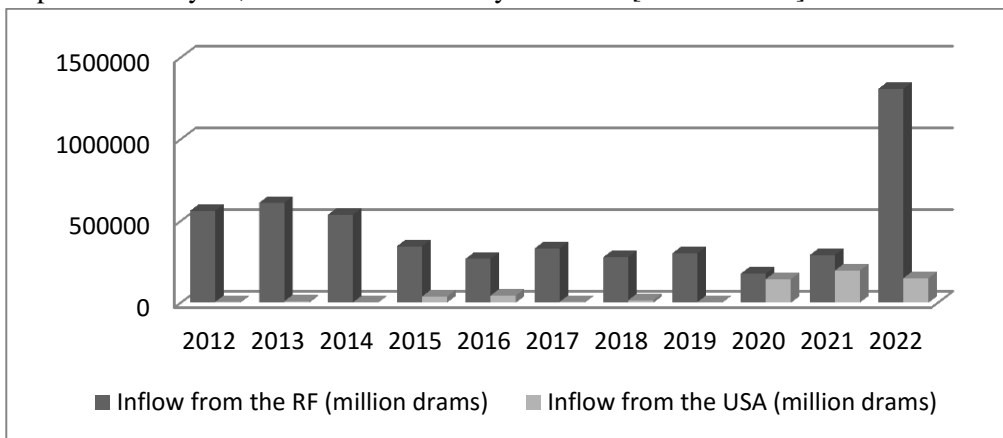


Figure 4. Transfers received to Armenia from Russia and the USA in 2012-2022

Conclusion As it can be seen from our analysis of obtained financial and economic indicators, the transfers increased mainly due to transfers sent from the Russian Federation. And the net inflow of transfers from the USA to Armenia in 2022 decreased from AMD 196 127 million to AMD 150 561 million compared to 2021. And the inflow of net transfers from Russia to Armenia increased by AMD 1,077,572 million. Of course, the net inflow of transfers of this volume could not but affect the financial market of the Republic of Armenia, and consequently, the real estate market of the Republic of Armenia.

Arine STEPANYAN

Analysis of the interaction of real estate and financial markets of the Republic of Armenia over the past five years

Key words: real estate market, financial market, income tax refund, mortgage, transfers, commercial banks

The real estate market is influenced by the development of the real and financial sectors, as supply and demand in this market depend on the state of the economy and the financial system of the country. The vulnerability of financial stability from fluctuations in real estate prices is mainly considered from the point of view of lending to the construction industry and loans secured by real estate, the materialization of risks of changes in the value of collateral. Sharp fluctuations in supply/demand for real estate, and consequently prices, may adversely affect the security and quality of bank loans, creating risks in terms of financial stability. The real estate market is an extremely important economic player. Real estate, in addition to meeting one of the most important needs of society, is one of the main "reserves" of wealth in the economy. Thus, in developing countries, the market value of shared real estate is usually many times higher than the capitalization of financial markets and the volume of investments coming into the country. This is a unique source of economic "energy". The evaluation and analysis of real estate in Armenia, the use of weak analysis methodology, are considered to be the causes of problems in the real estate market with incorrect versions and procedures, the lack of high-quality data on local markets, unreasonable market research and investment decisions based on them.

References

1. Hovhannisyan V., Grigoryan A., Stepanyan S "Economics and Real Estate Management", Yerevan 2007
2. Asaul A.N., "Real Estate Economics", St. Petersburg 2013
3. Kolankov S.V., "Real estate valuation", Saratov 2019
4. Paul Hilbers, Qin Lei, Lisbeth Zacho, «Real estate market developments and financial sector soundness», IMF 2001
5. www.arlis.am
6. www.cba.am
7. <https://www.petekamutner.am>