INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/226

REPUBLIC OF ARMENIA

2017 ARTICLE IV CONSULTATION AND FIFTH AND FINAL REVIEW UNDER THE EXTENDED ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF ARMENIA

July 2017

In the context of the 2017 Article IV Consultation and Fifth and Final Review under the Extended Arrangement, the following documents have been released and are included in this package:

- Two **Press Releases** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its June 23, 2017 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 23, 2017, following discussions that ended on April 12, 2017, with the officials of Republic of Armenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 7, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Republic of Armenia.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Republic of Armenia*
Memorandum of Economic and Financial Policies by the authorities of Republic of Armenia*
Technical Memorandum of Understanding*
Selected Issues Paper
*Also included in the abovementioned Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 17/242
FOR IMMEDIATE RELEASE
June 23, 2017

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2017 Article IV Consultation and Completes Fifth and Final Review of Armenia's Extended Arrangement

- Armenia's authorities remain committed to maintaining a prudent medium-term fiscal path by enhancing revenue mobilization and increasing efficiency in spending.
- Economic activity is expected to pick up in 2017 and over the medium term though downside risks and significant structural challenges remain.
- Strengthening domestic competition and regulatory reforms are pivotal to promoting private sector development and diversifying the economy.

The Executive Board of the International Monetary Fund (IMF) completed today the fifth and final review of Armenia's economic performance under a three-year arrangement under the Extended Fund Facility (EFF). The completion of the review allows the authorities to draw the equivalent of SDR 15.69 million (about US$21.6 million). Armenia's three-year extended arrangement for SDR 82.21 million (about US$111.57 million at the time of approval of the arrangement) was approved on March 7, 2014 (See Press Release No. 14/88).

The Executive Board today also concluded the 2017 Article IV Consultation with Armenia. A respective press release will be issued separately.

Following the Executive Board discussion on Armenia, Mr. Tao Zhang, Deputy Managing Director and Acting Chair, said:

"Armenia has been facing challenging external conditions which have contributed to subdued domestic demand, weak fiscal revenues, and deflationary conditions. Nonetheless, program performance has been satisfactory. All end-December 2016 quantitative performance criteria, indicative targets, and structural benchmarks were met. Economic activity is expected to pick up in 2017 and over the medium term, however, downside risks and significant structural challenges remain.

"Given the fragile growth, the cyclical position of the economy, and a projected revenue overperformance, an increase in growth-friendly foreign-financed capital spending relative to the 2017 budget is justified. At the same time, the authorities remain committed to maintaining a prudent medium-term fiscal path by enhancing revenue mobilization and increasing efficiency in spending. The new Tax Code should be rigorously implemented by resisting pressures to water down its provisions. It is also essential to modernize the medium-term fiscal framework, given that the current fiscal rule lacks flexibility and consideration for cyclical conditions.

"The central bank's monetary policy easing over the past two years has helped reduce market interest rates and supported a nascent recovery in bank lending. Going forward, monetary policy should remain focused on bringing inflation back to its medium-term target. The central bank should monitor the impact of recent policy actions and assess the need for further easing. Also, the flexible exchange rate should continue to act as a shock absorber, helping support external adjustment and maintain policy buffers.

"Pursuing structural reforms remains essential for fostering sustainable and inclusive growth. Strengthening domestic competition and regulatory reforms are pivotal to promoting private sector development and diversifying the economy. In this context, the authorities' growth-promoting initiatives are welcome."

Table 1. Armenia: Selected Economic and Financial Indicators, 2014–19

	2014	2015	2016		2017		2018	2019
	Act.	Act.	CR 16/380 [1/]	Prel.	CR 16/380 [1/]	Proj.	Proj.	Proj.
National income and prices:								
Real GDP (percent change)	3.6	3.2	2.4	0.2	2.7	2.9	2.9	3.0
Gross domestic product (in billions of drams) 2/	4,829	5,044	5,151	5,076	5,405	5,362	5,710	6,117
Gross domestic product per capita (in U.S. dollars)	3,889	3,529	3,568	3,533	3,626	3,668	3,829	4,021
CPI (period average; percent change)	3.0	3.7	-1.4	-1.4	1.6	1.7	3.5	4.0
CPI (end of period; percent change)	4.6	-0.1	-0.5	-1.1	2.8	1.8	4.0	4.0
GDP deflator (percent change) 2/	2.3	1.2	0.0	0.5	2.2	2.6	3.5	4.0
Money and credit (end of period)								
Reserve money (percent change)	-0.1	3.9	4.9	13.1	8.8	3.0	11.3	8.0
Broad money (percent change)	8.9	10.7	13.9	16.6	10.5	8.4	10.3	8.0
Central government operations (in percent of GDP)								
Revenue and grants (in percent of GDP)	21.7	20.9	21.2	20.8	21.8	21.9	21.9	22.7
Of which: tax revenue (in percent of GDP)	8.3	7.5	19.5	6.7	20.2	7.2	7.2	7.9
Expenditure (in percent of GDP)	21.7	23.4	27.1	23.8	24.6	23.0	22.4	22.1
Overall balance on a cash basis (in percent of GDP)	-2.1	-4.8	-5.9	-5.6	-2.8	-3.3	-2.7	-1.7
Public and publicly-guaranteed debt (in percent of GDP)	43.6	48.7	54.7	55.1	56.4	55.7	57.0	56.4
Share of foreign currency debt (in percent)	86.2	86.9	85.5	84.4	85.0	87.1	88.0	87.7
External sector								
Exports of goods and services (in millions of U.S. dollars)	3,319	3,137	3,384	3,501	3,585	3,870	4,128	4,370
Imports of goods and services (in millions of U.S. dollars)	-5,487	-4,418	-4,327	-4,569	-4,672	-5,083	-5,273	-5,506
Exports of goods and services (percent change)	5.2	-5.5	7.9	11.6	5.9	10.6	6.7	5.9
Imports of goods and services (percent change)	0.2	-19.5	-2.0	3.4	8.0	11.2	3.8	4.4
Current account balance (in percent of GDP)	-7.6	-2.6	-2.9	-2.7	-4.0	-3.8	-3.2	-3.0
Debt service ratio (in percent of exports of G&S) 3/	8.6	12.5	7.2	6.6	8.1	7.3	7.5	7.8
Gross international reserves (in millions of U.S. dollars)	1,489	1,771	1,953	2,204	1,981	2,259	2,458	2,755
Import cover 4/	4.0	4.7	5.0	5.2	5.0	5.2	5.4	5.8
End-of-period exchange rate (dram per U.S. dollar)	475	484	...	484	...	...	...	...
Average exchange rate (dram per U.S. dollar)	416	478	...	480	...	...	...	...

Sources: Armenian authorities; and Fund staff estimates and projections

1/ Staff Report for the fourth review.

2/ In 2015 the authorities started calculating GDP using the SNA 2008 methodology. They have revised GDP series from 2012 on.

3/ Based on public and publicly-guaranteed debt.

4/ Gross international reserves in months of next year's imports of goods and services, including the SDR holdings.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 17/280
FOR IMMEDIATE RELEASE
July 13, 2017

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2017 Article IV Consultation for the Republic of Armenia

On June 23, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Armenia.

Since its independence, Armenia has made significant strides in enhancing macroeconomic stability. Growth has been satisfactory with inflation under control, the fiscal situation broadly well managed, and foreign exchange reserves enhanced. Since late 2014, the significant decline in remittances and the price of copper, Armenia's main export, have weighed heavily on growth, and adversely impacted the fiscal position. In 2016, GDP growth was only 0.2 percent, deflationary pressures persisted, and the fiscal deficit rose to 5.6 percent of GDP, while the current account deficit remained below 3 percent of GDP. Economic activity in 2017 has shown signs of recovery, accompanied by a pickup in inflation and private sector credit growth, supported by monetary policy easing.

With improving outlook in major trading partners and a pickup in private sector activity, real GDP is projected to grow by around 3 percent in 2017, while inflation would reach around 2 percent by end-2017. Medium-term growth is projected at 3.5-4 percent, with potential growth now estimated by staff to be 1 percentage point lower than in the pre-crisis period. Nevertheless, there are risks: the recent recovery in remittances and copper prices may not endure, and growth in key trading partners could be weaker than expected.

Looking ahead, Armenia continues to face significant challenges. Dependence on remittances leaves the economy vulnerable to external shocks, while a shrinking labor force associated with emigration makes it difficult to generate broad-based prosperity. The authorities' efforts to promote inclusive growth and increase resilience have focused on strengthening competition and governance, diversifying exports, and new initiatives to attract foreign direct investment (FDI). On the fiscal front, inadequate revenue base has limited the potential for much needed growth-enhancing investment and contributed to the increase in public debt. Against this background, the government is strengthening revenue mobilization through the introduction of a new tax code and renewed efforts to improve tax administration.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the Armenian authorities for their sustained efforts to enhance macroeconomic stability and satisfactory program implementation despite significant external challenges. Directors noted that the economy is expected to gradually recover in 2017, but significant risks and challenges remain, including those from a narrow growth base and a sharp increase in public debt. They called for continued commitment to sound policies and structural reforms to ensure macroeconomic stability, and foster sustainable inclusive growth.

Directors agreed that the previously planned large cut in foreign-financed capital spending to meet the budgeted fiscal deficit target, dictated by the fiscal rule, may not be prudent, given the fragile growth, the cyclical position, and the need to build productive capacity. In this context, and considering the higher projected revenues for 2017, they supported the authorities' plan to increase capital expenditure by 1 percent of GDP relative to the 2017 budget. Directors stressed that additional spending should be accompanied by intensified structural reforms to ensure sustainable growth.

Directors underscored the importance of maintaining a prudent medium-term fiscal path. To this end, they called for enhancing revenue mobilization and spending efficiency. Directors underscored that the new Tax Code should be rigorously implemented and that political pressures to dilute its provisions should be resisted. They commended the authorities' efforts to improve tax administration, which have contributed to the higher-than-projected revenue collection so far.

Directors agreed that the medium-term fiscal framework needs to be modernized, noting that the current fiscal rule lacks flexibility and consideration for cyclical conditions. They supported the authorities' intention to amend the rule, with IMF technical assistance, to help improve credibility and preserve debt sustainability. A few Directors, however, cautioned against the potential loss of credibility if the rule is breached.

Directors welcomed the Central Bank of Armenia's (CBA's) policy of monetary easing, which has helped reduce market interest rates and supported recovery in the private sector credit. They underscored that monetary policy should remain focused on bringing inflation back to its medium-term target. Directors stressed that the CBA should monitor the impact of recent policy actions and assess the need for further easing. They emphasized the importance of continued exchange rate flexibility in responding to external shocks and maintaining competitiveness.

---

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors called for further strengthening the monetary and financial sector policy framework. To increase the effectiveness of the inflation targeting framework and monetary transmission mechanism, they stressed the need to develop a well-functioning interbank market, enhance communication, and promote de-dollarization. Directors supported policy measures to build a more resilient financial sector and strengthen the macroprudential framework. They welcomed the smooth transition of the banking sector to comply with the new minimum capital requirement. Directors encouraged the authorities to continue to foster better financial intermediation by developing capital markets and strengthening financial literacy.

Directors called for continued efforts to advance structural reforms to foster sustainable and inclusive growth. They underscored the need to promote private sector development and diversify the economy by attracting FDI. In this context, they welcomed the authorities' growth-promoting initiatives to improve the business environment, encourage competition, and strengthen governance.

It is expected that the next Article IV consultation with the Republic of Armenia will be held on the standard 12-month cycle.

Armenia: Selected Economic and Financial Indicators, 2014–19

	2014	2015	2016		2017		2018	2019
	Act.	Act.	CR 16/380 1/	Prel.	CR 16/380 1/	Proj.	Proj.	Proj.
National income and prices:								
Real GDP (percent change)	3.6	3.2	2.4	0.2	2.7	2.9	2.9	3.0
Gross domestic product (in billions of drams) 2/	4,829	5,044	5,151	5,076	5,405	5,362	5,710	6,117
Gross domestic product per capita (in U.S. dollars)	3,889	3,529	3,568	3,533	3,626	3,668	3,829	4,021
CPI (period average; percent change)	3.0	3.7	-1.4	-1.4	1.6	1.7	3.5	4.0
CPI (end of period; percent change)	4.6	-0.1	-0.5	-1.1	2.8	1.8	4.0	4.0
GDP deflator (percent change) 2/	2.3	1.2	0.0	0.5	2.2	2.6	3.5	4.0
Money and credit (end of period)								
Reserve money (percent change)	-0.1	3.9	4.9	13.1	8.8	3.0	11.3	8.0
Broad money (percent change)	8.9	10.7	13.9	16.6	10.5	8.4	10.3	8.0
Central government operations (in percent of GDP)								
Revenue and grants (in percent of GDP)	21.7	20.9	21.2	20.8	21.8	21.9	21.9	22.7
Of which: tax revenue (in percent of GDP)	8.3	7.5	19.5	6.7	20.2	7.2	7.2	7.9
Expenditure (in percent of GDP)	21.7	23.4	27.1	23.8	24.6	23.0	22.4	22.1
Overall balance on a cash basis (in percent of GDP)	-2.1	-4.8	-5.9	-5.6	-2.8	-3.3	-2.7	-1.7
Public and publicly-guaranteed debt (in percent of GDP)	43.6	48.7	54.7	55.1	56.4	55.7	57.0	56.4
Share of foreign currency debt (in percent)	86.2	86.9	85.5	84.4	85.0	87.1	88.0	87.7
External sector								
Exports of goods and services (in millions of U.S. dollars)	3,319	3,137	3,384	3,501	3,585	3,870	4,128	4,370
Imports of goods and services (in millions of U.S. dollars)	-5,487	-4,418	-4,327	-4,569	-4,672	-5,083	-5,273	-5,506
Exports of goods and services (percent change)	5.2	-5.5	7.9	11.6	5.9	10.6	6.7	5.9
Imports of goods and services (percent change)	0.2	-19.5	-2.0	3.4	8.0	11.2	3.8	4.4
Current account balance (in percent of GDP)	-7.6	-2.6	-2.9	-2.7	-4.0	-3.8	-3.2	-3.0
Debt service ratio (in percent of exports of G&S) 3/	8.6	12.5	7.2	6.6	8.1	7.3	7.5	7.8
Gross international reserves (in millions of U.S. dollars)	1,489	1,771	1,953	2,204	1,981	2,259	2,458	2,755
Import cover 4/	4.0	4.7	5.0	5.2	5.0	5.2	5.4	5.8
End-of-period exchange rate (dram per U.S. dollar)	475	484	…	484	…	…	…	…
Average exchange rate (dram per U.S. dollar)	416	478	…	480	…	…	…	…

Sources: Armenian authorities; and Fund staff estimates and projections

1/ Staff Report for the fourth review.

2/ In 2015 the authorities started calculating GDP using the SNA 2008 methodology. They have revised GDP series from 2012 on.

3/ Based on public and publicly-guaranteed debt.

4/ Gross international reserves in months of next year's imports of goods and services, including the SDR holdings.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

June 7, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION AND FIFTH AND FINAL REVIEW UNDER THE EXTENDED ARRANGEMENT

KEY ISSUES

Context. Since its independence, Armenia has made significant strides in enhancing macroeconomic stability. Growth has been satisfactory with inflation under control and the fiscal situation broadly well managed. Lately, adverse external developments have led to significant falls in remittances and the price of copper, Armenia's main export. Following subdued growth in 2016, the economy is expected to gradually recover in 2017, but the outlook is clouded by downside risks and tough challenges remain: growth continues to be volatile and narrowly based, trade opportunities remain limited, and public debt has increased sharply. Following important reforms in the energy sector and the tax code, the government is determined to tackle corruption, improve competition, and promote sustainable growth.

Policy Discussions

- *An increase in growth-friendly foreign-financed capital spending in 2017 is warranted, given the fragile growth and expected revenue overperformance.* At the same time, the authorities should remain committed to putting debt on a declining path by 2019.
- *The medium-term fiscal framework needs to be modernized.* In particular, with technical assistance from the Fund, a reassessment of the fiscal rule is needed to ensures debt sustainability and efficient shock-smoothing.
- *Monetary policy should remain focused on bringing back inflation to its medium-term target.* The Central Bank of Armenia (CBA) should monitor the impact of recent policy actions and assess the need for further easing. The flexible exchange rate should remain a key shock absorber with intervention only used for reducing excessive volatility.
- *Growth-enhancing structural reforms should be accelerated to promote sustainable and inclusive growth.* This has become more urgent in light of continued weakness in growth, the likely persistence of shocks, and external vulnerabilities.

Program performance. Program implementation has been satisfactory. All quantitative performance criteria, indicative targets, and structural benchmarks were met.

Article IV issues. Discussions focused on: steadfast implementation of fiscal consolidation plans to deliver medium-term debt sustainability; continued modernization of the monetary policy framework; bolstering resilience to external shocks; and stronger pursuit of reforms to promote growth and address long-standing structural weaknesses.

Approved By:
Juha Kähkönen and Yan Sun

Discussions were held during March 29–April 12, 2017 with Prime Minister Karapetyan, Deputy Prime Minister Gabrielyan, Minister of Finance Aramyan, CBA Chairman Javadyan, Minister of Energy Manukyan, Minister of Agriculture Arakelyan, State Revenue Committee Chairman Harutyunyan, other senior officials, and representatives of the private sector, civil society. The team comprised H. Samiei (head), H. Tabarraei and S. Yoon (MCD), M. Perks (SPR), and Y. Xiao (FAD). T. Daban (Resident Representative) and M. Aleksanyan, A. Manookian, and V. Janvelyan (IMF Office) assisted. Y. Yakhin (OED) joined most of the meetings. M. Almalik and B. Laumann (MCD) provided assistance.

CONTENTS

TABLES

ANNEXES

APPENDIX

CONTEXT

1. **Over the past two decades, macroeconomic stability has been enhanced and growth performance has been satisfactory.** Policy frameworks have strengthened with inflation kept under control, the fiscal situation broadly well managed, and foreign exchange reserves enhanced. Armenia's 2013 graduation from PRGT eligibility and a debut Eurobond were important markers of progress. At the same time, growth has averaged 6½ percent, but it has been volatile, in part due to external shocks and the relatively undiversified export base.

2. **Fund engagement has been instrumental in anchoring the authorities' stabilization efforts.** Policies under the successive programs contributed to achieving low inflation and building buffers during the relative boom years of the 2000s, and helped stem the decline in economic activity resulting from recent external shocks, including by allowing for counter-cyclical fiscal policies. At the same time, monetary and financial policies have safeguarded financial stability, and the introduction of inflation targeting (IT) has allowed the exchange rate to operate more flexibly.

3. **Since the 2014 Article IV consultation and the commencement of the 2014–17 IMF-supported program, external conditions have deteriorated significantly, creating a challenging policy environment.** The government's response has helped mitigate the impact of the shocks on growth and macroeconomic stability, and four program reviews were completed under the program, albeit with some delays.

- The 2014 Article IV consultation, in line with the IMF-supported program, called for: (i) enhancing revenue mobilization to create fiscal space; (ii) anchoring monetary policy on the IT framework; (iii) pursuing greater exchange rate flexibility to support external adjustment; and (iv) strengthening financial sector policies. While the authorities have made serious efforts to implement these recommendations, adverse external shocks have hindered progress in some areas.
- These shocks led to a sharp deterioration in domestic demand and fiscal revenues, a large depreciation of the dram, significant tightening of monetary conditions, and a substantial increase in public debt. This created serious obstacles to meeting some program targets, especially on the fiscal side.
- Against this difficult backdrop, the authorities' policy adjustment helped restore macroeconomic stability and improved program performance. Higher fiscal deficits (mostly reflecting lower revenues and increased execution of concessional foreign-financed capital spending) prevented a further decline in growth, albeit at the expense of increasing public debt. Following the initial monetary policy tightening, which helped contain inflation and reduce pressure on the dram, the FX market has been more stable and the CBA reduced FX intervention, and reversed the emergency measures introduced in late-2014. More recently, greater exchange rate flexibility and higher export receipts have contributed to higher FX

reserves. Finally, financial policies helped safeguard financial stability, particularly, the significant increase in capital adequacy requirements.

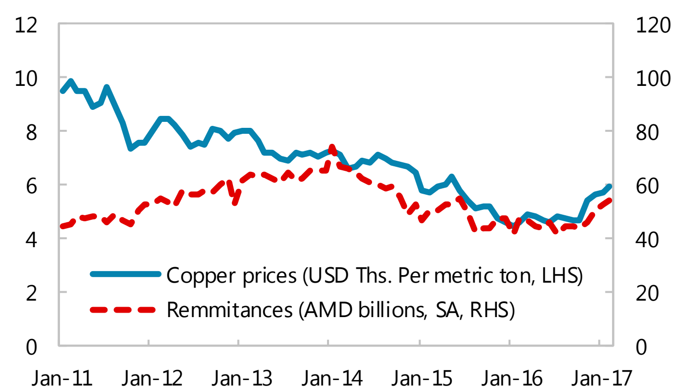
- Some progress has also been made in implementing structural reforms, including in the energy sector and the tax system. Measures were adopted to improve the financial position of the energy sector and a new Tax Code constituted a crucial step toward improving the tax environment and boosting medium-term revenues. The CBA adopted a review-based monetary policy conditionality to help support the IT framework and strengthened contingency planning to safeguard financial stability.

4. **Looking ahead, Armenia continues to face significant challenges, requiring strong structural reform efforts to ensure sustainable inclusive growth.** Given the small and aging population, difficult geography, and complex geopolitics, drivers of growth are limited. Dependence on remittances leaves the economy vulnerable to external shocks, while shrinking labor force associated with emigration makes it difficult to generate broad-based prosperity. In addition, competition in the domestic market is limited, with vested interests maintaining monopolies, and corruption and governance remain important impediments to growth. Poverty remains high with large disparities across regions, contributing to sizable emigration, especially to Russia. Low revenue mobilization and the narrow tax base have limited the potential for much needed growth-enhancing investment spending. Moreover, the recent deterioration of the fiscal and debt position has highlighted shortcomings in the fiscal framework.

RECENT DEVELOPMENTS

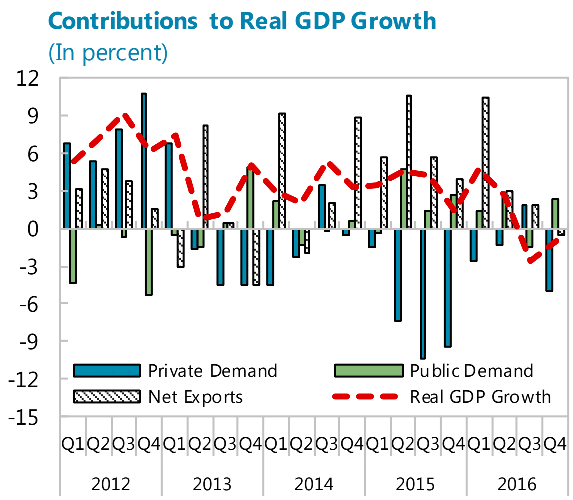
5. **Buffeted by the difficult external environment, economic performance has remained subdued.** Despite strong pick up in 2016H1, GDP grew by only 0.2 percent for the year as a whole, with agriculture and construction slowing in 2016H2,[1] and large declines in remittances and prices weighing heavily on domestic demand. Economic activity was unexpectedly strong in 2017Q1, mainly reflecting higher growth in industry and services. While headline CPI inflation turned positive in April 2017 partly driven by higher food prices, core inflation remains in negative territory.

Armenia: Copper Prices and Remittances

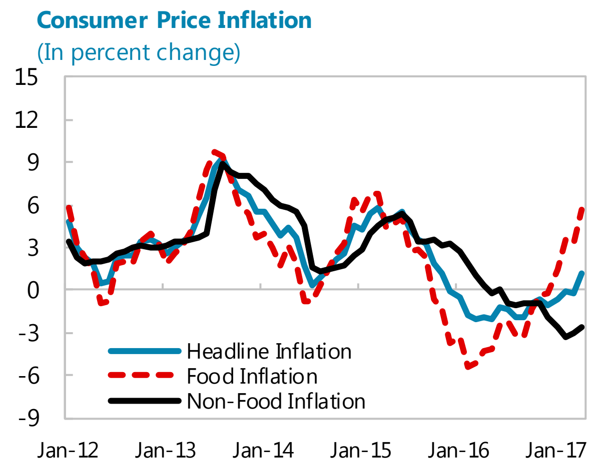


Sources: National authorities; and IMF databases.

[1] In the authorities' view, the real GDP growth outcome in 2016H2 (-1.8 percent, year-on-year) should be treated with caution because of statistical issues related to the agriculture sector.



Sources: National authorities; and IMF databases.



Sources: National authorities; and IMF databases.

6. **Improvement in the current account has been sustained.** The current account deficit remained broadly unchanged at 2.7 percent of GDP in 2016. Exports grew strongly in value terms (16 percent year-on-year), in part due to the new copper mine, some diversification, and a rebound in exports to Russia. This trend continued in 2017Q1, with exports growing by 17 percent, supported by higher copper prices. Despite weak domestic demand, growth in imports also resumed in 2016, strengthening through 2017Q1 (18 percent, year-on-year), driven by higher gas imports and increased foreign-financed capital spending. Remittances appear to have stabilized in 2016 and grew strongly in early 2017 (20 percent year-on-year), but prospects remain uncertain.

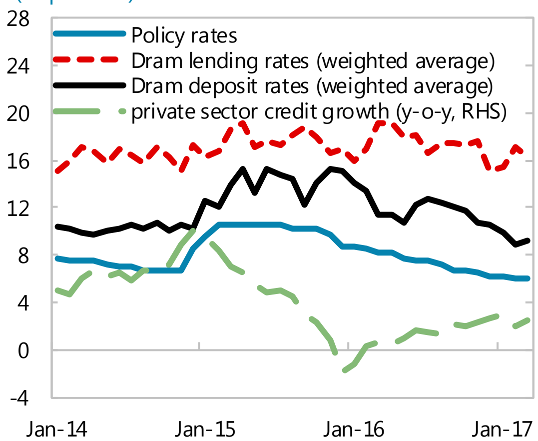
7. **The fiscal deficit widened significantly in 2016 but remained within the revised program target.** The widening deficit reflected weak tax revenues and a rise in foreign-financed capital expenditure relative to 2015. Nevertheless, the deficit (5.6 percent of GDP) was within the fourth review target (5.9 percent), owing to slightly lower-than-expected capital expenditures in 2016Q4. Supported by strengthened tax administration efforts, stronger economic activity, and a pickup in the collections from the Eurasian Economic Union's (EEU's) customs pool, tax revenues overperformed by ¼ percent of GDP in 2017Q1, while expenditures remained in line with the budget. Strong revenue performance continued into April.

8. **Nominal interest rates have fallen further.** Given persistently low inflation and weak domestic demand, the CBA continued to unwind past tightening. The policy rate has gradually been cut to 6 percent—below the level of 6¾ percent prevailing in late-2014. Deposit rates have come down somewhat, while lending rates have remained broadly unchanged. Nevertheless, private sector credit has picked up somewhat after a significant fall in 2014–15.

9. **Conditions in the FX market remain stable and CBA intervention has been limited.** Strong export receipts and large donor inflows in 2016Q4 allowed the CBA to rebuild reserve

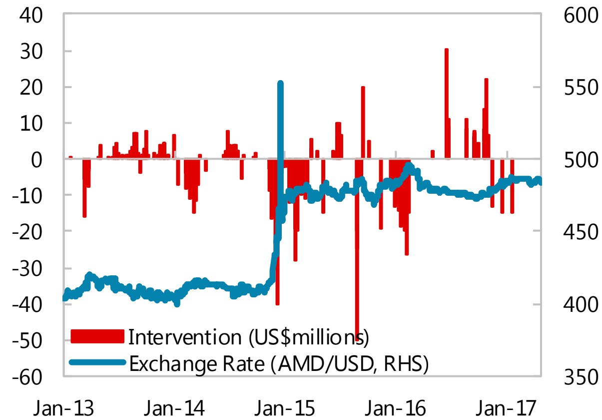
buffers—to around $2.2 billion (5.2 months of imports) by end-2016. There has been little intervention in 2017Q1, reflecting muted FX market pressures.

Armenia: Interest Rates and Credit Growth
(In percent)



Source: Central Bank of Armenia.

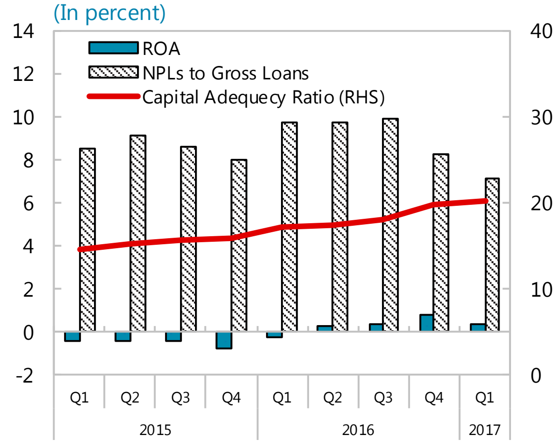
Armenia: FX Intervention and Exchange Rate



Sources: National authorities; and Bloomberg.

10. The banking sector is well capitalized and financial soundness indicators show signs of improvement. The sector's capital adequacy ratio is about 20 percent and all banks have achieved the new CBA-mandated minimum capital (30 billion drams) which came into effect in January 2017. To this end, three banks were merged or acquired in 2016 and new capital was injected mostly by Armenian diaspora and other foreign investors. Profitability has improved somewhat, and NPLs have fallen below 10 percent of total loans, notably in the watch category (up to 90 days past due), in part owing to write-offs associated with some bank mergers.

Financial Soundness Indicators
(In percent)



Source: Central Bank of Armenia.

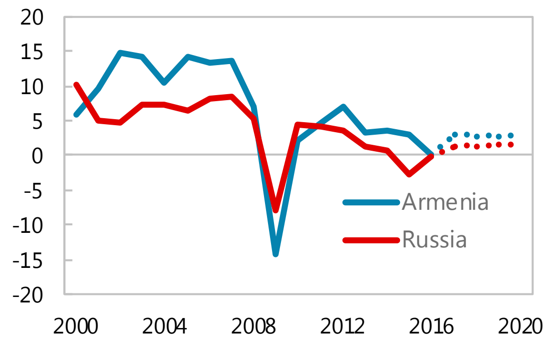
11. The transition to a parliamentary system is underway. The ruling Republican Party comfortably won the first election held in April 2017 after the switch from a semi-presidential to a parliamentary system. The new system will only fully come into operation once President Sargsyan's term ends in April 2018.

OUTLOOK AND RISKS

With a recovery of growth in trading partners, especially Russia, activity in Armenia is expected to pick up at a modest pace. Nonetheless, significant downside risks remain.

12. Economic activity is projected to pick up in 2017 and recover gradually over the medium term. Given the improving outlook in major trading partners, especially Russia (the major source of remittances for Armenia), and higher projected copper prices, real GDP is expected to grow by 2.9 percent in 2017, while inflation should reach 1.8 percent by end-2017. Medium-term growth is projected at 3½–4 percent, with potential growth now estimated to be 1 percentage point lower than in the pre-crisis period. With a pickup in growth in 2017, imports are expected to recover and the current account deficit to widen to 3.8 percent of GDP. The authorities project somewhat higher growth in 2017. They are also more optimistic on medium-term growth, expecting structural reforms to bear fruit.

Growth Correlation with Russia
(In percent)



Source: World Economic Outlook

13. Risks to the outlook are weighted to the downside (Annex I: Risk Assessment Matrix). The recovery in remittances and in international copper prices may not endure. Rising international interest rates and dollar appreciation could initiate capital outflows and harm Armenia's highly dollarized banking system and economy. Further risks could arise from lower growth in major trading partners, the impact of the large fiscal adjustment (if fully implemented) on growth or potential slippages on debt sustainability, and a hardening of US policy toward Iran (a source of tourism).

FIFTH AND FINAL REVIEW

A. Program Performance

14. Program performance since the last review has been satisfactory.

- *All end-December and continuous performance criteria (PC)s were met*: The end-December net international reserve (NIR) PC was met with a comfortable margin on account of stable FX market conditions. The fiscal balance also overperformed slightly, owing to some under-execution of foreign-financed capital spending in 2016Q4. The budgetary lending PC and the two continuous PCs on public debt arrears and non-absorption by the government of losses/liabilities of companies were also met.

- *Inflation has been in line with the monetary policy consultation clause (MPCC)*. While it did not turn positive at end-December as envisaged, the inflation path has remained within the ±1½ percent band around the inflation forecast embedded in the MPCC.
- *All indicative targets were met*: The net domestic assets (NDA) of the central bank remained below the indicative ceiling, as the increase in private sector bank deposits led to falling demand for CBA repo operations. The social spending floor, as well as the ceiling on new government-guaranteed external debt and the concessionality floor for newly contracted external public debt, were also met. Preliminary data indicate that all March indicative targets were also met.
- *All SBs were met*: A mechanism to strengthen monitoring and prioritizing foreign-financed capital projects has been established (December 2016 SB) and a centralized database of all ongoing, planned, and pledged projects has been built (March 2017 SB). In addition, the 2017 budget secured funding for the Pension System Awareness Center (December 2016 SB) and the CBA has prepared a plan for the divestment of PanArmenian Bank (December 2016 SB).

B. Policy Discussions

Fiscal Policy

15. The 2017 budget envisaged an ambitious fiscal adjustment, primarily by delaying capital expenditure, to meet Armenia's fiscal rule. The corrective mechanism under the fiscal rule was triggered in 2016 for the first time.[2] As a result, the 2017 budget envisaged a cut in the overall deficit to 2.8 percent of GDP (an adjustment of around 3 percent of GDP) with a focus on delaying foreign-financed capital expenditure—given the tight current spending envelope (frozen at the 2016 level). In this context, the authorities introduced a moratorium on signing new foreign-financed projects and initiated negotiations with donors on postponement of projects.

16. However, in view of new developments, the budgeted reduction in capital spending appears inappropriate. GDP growth was considerably weaker (and the output gap larger) than forecasted at the time of the fourth review. In addition, delaying some of the projects turned out to involve significant penalties and operational costs. Against this background, and in view of limited impact of monetary easing on growth, staff and the authorities agreed that the budgeted large cut in capital spending would be excessively pro-cyclical and sub-optimal. Such a cut, in addition to exerting a sizable negative fiscal impulse at a time when the output gap is relatively large, would also harm future productive capacity.

[2] According to the rule, central government debt cannot exceed 60 percent of the previous year's GDP, and when it reaches 50 percent, the following year's budget deficit should be no more than 3 percent of the average GDP of the past 3 years. Central government's debt at end-2016 reached 51 percent of the 2015 GDP. Given that a large part of debt is concessional, however, its net present value stands at around 45 percent of GDP.

17. In this context and supported by a favorable revenue outlook, staff and the authorities agreed to additional capital spending of around 1 percent of GDP, which is projected to increase the fiscal deficit by up to ½ percent of GDP. The additional spending is based on an analysis conducted by the authorities to prioritize previously excluded ongoing

Text Table. Armenia: Fiscal Balance, 2016–22
(In percent of GDP or percent of potential GDP)

	2016	2017	2018	2019	2020	2021	2022
Overall fiscal balance	-5.6	-3.3	-2.7	-1.7	-1.3	-1.4	-1.3
Cyclically adjusted fiscal balance	-5.1	-2.6	-2.2	-1.3	-1.0	-1.2	-1.3
Cyclically adjusted primary fiscal balance	-3.0	-0.5	-0.2	0.7	0.9	0.3	0.0

foreign-financed investment projects (Box 1).[3] Furthermore, the strong revenue overperformance of ¼ percent of GDP in 2017Q1 has prompted staff to revise up revenue projections for the year by ½ percent of GDP. As a result, the budget deficit would increase to 3.3 percent of GDP (½ percent of GDP higher compared to the fourth review), which would still imply a sizeable fiscal adjustment—2½ percent of GDP in cyclically-adjusted primary balance (Text Table). The projected increase in the deficit implies a deviation from the existing fiscal rule in 2017, but the rule is being revised before end-2017 in the context of modernizing the authorities' medium-term fiscal framework (see below). In addition, despite the higher deficit in 2017, staff projects debt to start declining in 2019 as before. The authorities' medium-term fiscal framework is more ambitious, as they expect their revenue administration effort to yield even higher revenues than projected by staff in 2017 (another ½ percent of GDP). At the same time, they acknowledge revenue uncertainties and in the attached Letter of Intent they stress their commitment to fiscal consolidation and note their readiness to take additional measures if necessary.

Box 1. Improving the Prioritization of Foreign-Financed Capital Expenditure

Foreign-financed (FF) capital expenditures were significantly above budget plans in 2016. Realized FF capital expenditures were around $260 million—roughly $100 million or 1 percent of GDP over budget but slightly below the level projected at the time of the fourth review. This over-execution largely reflected: catch-up in implementation of the North-South Highway ($23 million); under-budgeting for the rehabilitation of the M6 Highway ($11 million) and rural financing ($20 million); and partial disbursement of a long-term, low-interest defense loan ($23 million).

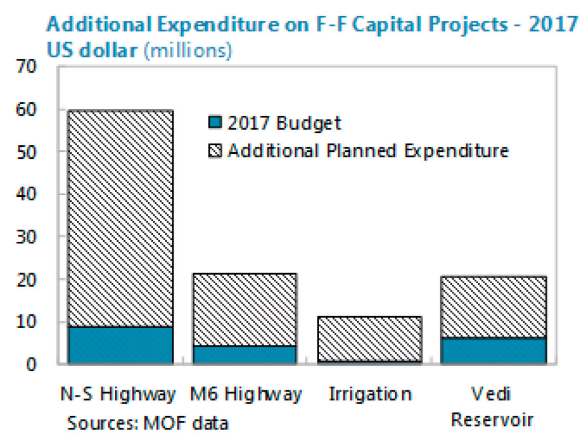
For 2017, the authorities have taken steps to contain and prioritize FF capital expenditures. Using the mechanisms established to strengthen project monitoring and prioritization, the authorities conducted a systematic assessment of around 40 projects that are active in 2017, i.e., either ongoing, planned or pledged. Based on this survey, the authorities identified around $100 million of high-priority FF project spending that was not included in the 2017 budget. At the same time, other projects were de-prioritized, most notably the Caucasus Electric Transmission Network, worth around $300 million. The authorities now plan to accommodate the high-priority projects by raising total capital spending in 2017 to $195 million. Most of these projects are concessional, with many involving multiple phases and donors, both bilateral and

[3] The exercise prioritized projects that: (i) are due to be closed by end-2017 or were already 75 percent or more complete as of January 2017; (ii) relate to national security; (iii) have significant growth and defense impact; and (iv) are not possible to delay/cancel without significant penalties.

multilateral. The bulk of the additional expenditure will be used to increase the pace of execution of the North-South and M6 Highways, the Vedi Reservoir and irrigation system modernization. While the

Box 1. Improving the Prioritization of Foreign-Financed Capital Expenditure (Concluded)

macroeconomic impact of capital spending is difficult to quantify, it is expected to have a positive impact on growth, both in the short and long terms. For example, the North-South and M6 Highway projects are estimated by donors to have a high economic internal rate of return (15–20 percent), and by improving border access they should, over time, help facilitate trade and improve economic resilience.

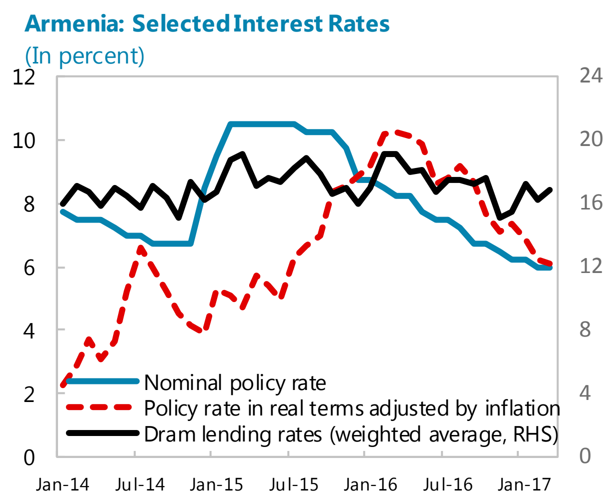


Sources: MOF data

The authorities are now extending the prioritization exercise to inform the medium-term fiscal plans. While the moratorium on signing new commitments currently remains in place, there is already a large pipeline of approved FF projects for implementation over the medium term. The management of the pipeline with be challenging, given its scale and the number of projects involved, particularly in the context of an ambitious fiscal consolidation plan. The authorities are now conducting a similar prioritization exercise to underpin the 2018 budget and their medium-term fiscal plans, balancing the potential positive impact on growth and development with the need to ensure debt sustainability.

Monetary and Exchange Rate Policies

18. Headline inflation has turned positive but monetary conditions remain relatively tight. Inflation expectations remain depressed despite a recent pickup. Real interest rates have started to fall but are still high for the current cyclical position. And lending rates are not responding well to lower policy rates, in part reflecting risk premia associated with the uncertain economic outlook.



Source: IMF staff calculations.

19. Staff noted that the CBA should remain open to further easing, if justified by data. The CBA argued that, following a series of interest rate cuts over the past 18 months, a pause was justified, especially in view of stronger activity in 2017Q1, subsiding deflationary pressures, and risks of capital outflows at lower dram interest rates. The CBA also expressed concern that lowering the policy rate further could lead to capital outflows and further deposit dollarization. While staff agreed with a data-dependent wait-and-see approach, it pointed to the still high real interest rates and the negative core inflation. Staff emphasized that further monetary easing may be needed as part of a broader adjustment in the macro policy mix to support fiscal policy, while macroprudential policies should continue to be used to address risks relating to dollarization. Monetary policy should also be supported by maintaining two-way exchange rate flexibility and adequate external buffers.

Financial Sector Policy

20. While the financial system remains sound, close monitoring is warranted given the difficult economic environment. Higher minimum capital has led to increased competition for lending, which could exert some downward pressure on lending rates and likely lead to further consolidation in the banking sector. However, conditions remain challenging with relatively high NPLs, extensive dollarization, low profitability, and high credit concentration.[4] Supported by bolstering capital adequacy and liquidity coverage ratios, the macro-prudential framework is being improved, with risk-based supervision, in line with Basel III, and is expected to become operational by end-2017.

21. The CBA remains committed to implementing the remaining recommendations of the 2014 Safeguards Assessment. Further legislative changes to the Central Bank Law to strengthen the CBA's autonomy are expected to be approved by the National Assembly in the second half of the year. The CBA reiterated its commitment to divesting PanArmenian Bank to a private investor by end-2017.

Structural Reforms

22. Reforms are underway, particularly those focused on improving the business climate and attracting FDI. There are encouraging signs of growing reform momentum under the current government, appointed in September 2016. A new entity (the Center for Strategic Initiatives) was established in January 2017 to foster public-private partnership (PPP), attract FDI, and align developmental goals between investors and line ministries. Other initiatives to attract FDIs include the establishment of an Armenian-Russian investment fund and the Armenia Investors Club, supported by the diaspora. The government is also stepping up efforts to tackle corruption, including by improving tax and customs administration. The law on centralized procurement has been strengthened to ensure a more competitive and transparent procurement process. In addition, negotiations with the EU for adopting a Single Support Framework are advancing, and amendments to economic competition law are expected to be approved by end-2017. The authorities are also leveraging the EEU membership to promote export diversification, improve standards, enhance domestic competition, and invest in infrastructure, while pursuing greater trade integration beyond the EEU.

C. Other Program Issues

23. The authorities are considering the possibility of a successor arrangement to consolidate and extend the progress made during the current extended arrangement. Amidst challenging shifts in the external environment, the current Fund-supported program

[4] Single largest borrower's exposures of 4 banks out of 17 exceeded 20 percent of individual banks' capital at end-2016.

helped Armenia to contain the impact of external shocks and restore domestic and external stability. Nonetheless, challenges remain. Particularly, despite some success, progress on the structural front has been slower than expected. Assuming balance of payments needs, in staff's view, a new arrangement can provide a strong policy framework to support the authorities' efforts to deal with ongoing external shocks, support medium-term fiscal consolidation, and enable implementation of reforms to promote inclusive growth. The authorities are considering the timing and modalities of future engagement.

ARTICLE IV DISCUSSIONS

Armenia faces a period of moderate growth. Lower potential growth in trading partners, sluggish domestic investment in recent years, the absence of strong growth drivers, and a still-weak business climate constrain the economy's capacity to grow rapidly, and generate sufficient jobs to stem emigration and reduce poverty. Moreover, the economy remains vulnerable to external shocks, financial dollarization continues to be high, and public debt has risen sharply. Discussions focused on more decisive implementation of reforms to reduce vulnerabilities, ensure sustainability, and boost potential growth.

A. Advancing Reforms to Preserve Fiscal Sustainability

24. The medium-term challenge for fiscal policy is to preserve debt sustainability while safeguarding essential capital and social spending. The authorities remain committed to medium-term fiscal consolidation (as described in their 2018–20 medium-term fiscal plans) through strengthened revenue mobilization and expenditure management, as well as structural fiscal reforms to help preserve debt sustainability. Staff's Debt Sustainability Analysis (DSA) suggests that, under the projected fiscal path, public debt should remain sustainable, but stay above 50 percent of GDP in the medium term (Annex II: Public DSA).

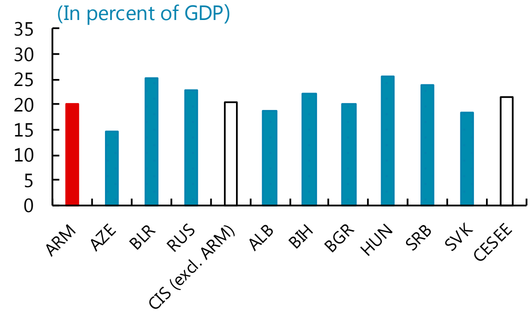
25. Staff urged the authorities to further enhance revenue mobilization. Despite progress over the past two decades, tax revenues remain low (Box 2) for Armenia's development needs, which require higher spending on both physical and human capital to enhance sustainable inclusive growth. A narrow tax base, policy loopholes, and weak administration have been the primary causes of weak revenue collection. To address these challenges, the new Tax Code enacted in 2016 is expected to raise revenues by about 2 percent of GDP in the medium term. Staff urged the authorities to rigorously implement the new Tax Code and resist political pressures to water down its provisions. It also welcomed the recent improvement in tax administration and noted that further efforts are needed to strengthen State Review Committee's (SRC) power to monitor compliance and fight fraud, and broaden the tax net to achieve a fairer sharing of the tax burden.

26. Staff and the authorities agreed on the need to improve expenditure management, especially for capital spending. In addition to the new mechanism for monitoring and prioritizing projects and completion of the new project database, the government has issued a decree to extend the strict controls over domestically-financed expenditure to future foreign-financed capital projects. Any future commitments will be subject to new registration procedures to ensure consistency with the budget and the medium-term framework, effectively shifting the fiduciary functions from the Project Implementation Units to the Treasury.

Box 2. Armenia's Tax Revenue Mobilization: Progresses and Challenges

In the last two decades, Armenia has made steady progress in mobilizing tax revenues. Tax revenues increased gradually from 15 percent of GDP in 2002 to 20 percent of GDP in 2016. This increase resulted mainly from the implementation of comprehensive tax policy and administration reforms. However, in the same period there were also several policy and administrative missteps, including a large accumulation of unpaid value added tax (VAT) refunds (4 percent of GDP), the delayed indexation of certain tax bases (e.g., excises), the expansion of presumptive taxation (e.g., increasing the VAT threshold), the elimination of minimum profit tax, and a reduction in turnover tax for traders.

Tax Revenue, 2015
(In percent of GDP)



Source: IMF staff estimates.

More recently, with Fund TA, Armenia adopted a new Tax Code to overhaul the tax system. The Code's principal goals are to shift the balance from direct to indirect taxation (e.g., by increasing excise tax rates on alcohol, tobacco, and fuel) and to improve equity (e.g., by broadening the base, including taxation of dividends received by individuals, and revising the rate schedule of the personal income tax (PIT)). In addition, the code aims at reducing the costs of tax compliance, by speeding up the payment of VAT refunds and clarifying rules for tax audits. It also strengthens SRC's power to fight fraud, including by reducing the scope of presumptive taxation (e.g., rolling back increases in the VAT threshold).

Nevertheless, tax collections remain low for Armenia, given infrastructure and development needs, which require additional reforms to fully realize revenue potential. With limited other revenue sources and FDI, Armenia relies heavily on taxation to finance infrastructure investment. Tax collections have been eroded in recent years by external shocks, while Armenia's tax effort is estimated to be still relatively low (IMF WP/13/244) and the tax base remains narrow. Thus, the authorities should resist political pressures to dilute the new Tax Code, including requests to provide certain sectors with preferential treatment and reduced penalties and fines. Political commitment is critical to ensure that the tax burden is shared in a fair and equitable manner among taxpayers. Further reforms should focus on: (i) broadening further the PIT base by including other forms of capital income such as capital gains and interest income; (ii) including large agribusiness activities in the PIT and corporate income tax bases; and (iii) increasing the property tax rates and aligning cadastral prices with market values under the property tax. On the administration side, reforms should focus on strengthening SRC's power to monitor compliance of individuals by (i) expanding the use of taxpayer identification numbers to individuals; (ii) implementing self-assessment tools; and (iii) allowing SRC to use third-party information and conduct audits on high net worth individuals.

27. **The authorities are in the process of revamping the fiscal rule with Fund technical assistance.** Armenia's fiscal rule, adopted in 2008, lacks many features embedded in the second-generation rules that have emerged since the global financial crisis (Box 3). It has no mechanism to mitigate the procyclical bias, smooth fiscal adjustment in the face of severe economic shocks, or cope with the volatility of foreign-financed projects. This could lead to abrupt short-term adjustments, destabilizing aggregate demand and limiting the space for capital spending. The

Fund is providing TA to assist the authorities in overhauling the existing fiscal rule to address these shortcomings. The revised rule will be submitted to the National Assembly in October 2017 together with the 2018 budget.[5] The authorities are committed to the rule-based fiscal management and need to clearly communicate to the public that the purpose of this reform is to improve fiscal management and enhance credibility.

Box 3. Fiscal Rules—Recent International Experience

Fiscal rules are increasingly used by governments to achieve fiscal credibility and debt sustainability. Between 1985 and 2015, 96 industrial, emerging, and low-income countries adopted some forms of formal fiscal rule by imposing long-lasting numerical limits on fiscal aggregates. Fiscal rules can take many forms: they could be imposed on different fiscal aggregates, such as overall budget balance, primary balance, cyclically-adjusted fiscal balance, government revenue, and government expenditure; they could specify escape clauses for factors beyond the authorities' control. Nonetheless, the principal goal in designing a fiscal rule is to strike a balance among various objectives based on country circumstances: although the primary objective is fiscal responsibility and sustainability, a good fiscal rule should also prove resilient to shocks and be credible to implement, while not aggravating economic volatility and hampering long-term economic development.

Prompted by the global financial crisis, many countries revisited their fiscal rules to make them more resilient and credible. During the crisis, they found that existing fiscal rules were not flexible enough to deal with severe economic shocks. In the absence of escape clauses, in many cases the limits imposed by the rules could not be feasibly achieved, while governments often desired to provide countercyclical stimuluses to maintain economic stability. As a result, the existing rules were temporarily relaxed to allow for smoother fiscal adjustments; eventually they were overhauled to create the second-generation fiscal rules (IMF WP/12/187). The new rules explicitly combine the sustainability objective with more flexibility to cope with exogenous shocks (e.g., by putting the rules in cyclically adjusted terms and introducing automatic corrective mechanisms). For example, during 2008–09, the U.K. departed from its budget balance and debt rules and adopted a temporary operating rule.

Armenia's fiscal rule, adopted in 2008, is due for an overhaul to align with international best practice. Armenia, a small landlocked economy heavily reliant on international trade, has very few tools to deal with unexpected external shocks such as a fall in international commodity prices. The existing fiscal rule provides an easy to understand link with public debt sustainability, while its predetermined adjustment magnitude lacks cyclical consideration and could aggravate economic difficulties, especially given the growth-enhancing infrastructure investment need. Consideration is also not given to factors beyond the government's control. With Fund technical assistance, a revised rule will need to be carefully calibrated to balance these considerations in a well-defined manner to provide a sustainable and credible anchor for the fiscal framework. Effective fiscal rule implementation also requires a strong PFM framework on coverage, reporting, accounting, independent assurance (including auditing), and expenditure controls.

28. Staff welcomed the authorities' progress in structural reforms aimed at enhancing long-term fiscal sustainability. With Fund TA, the Ministry of Finance has prepared comprehensive analyses of fiscal risks, which originate from the government's involvements in the utility sectors as well as its lending operations. Contingent liabilities appear to be limited by

[5] While staff expects the rule to be amended within 2017, in the event it is not, the authorities will continue with their fiscal consolidation plan, as described in the medium-term fiscal strategy, that will put debt on a declining path by 2019 in line with staff's projection.

the improvements in the banking sector, lack of public guarantees in the utility sectors, and the marginal role of PPPs. Energy sector reforms are advancing, including the implementation of the financial recovery plan for the electricity sector, and enhance the monitoring of fiscal risks, especially from state-owned enterprises (SOEs). At the beginning of 2017, the government contracted an international concessioner to handle water production and distribution in the country, replacing the loss-making SOEs.[6] The government remains committed to its flagship pension reform aimed at enhancing long-term fiscal sustainability, and is conducting outreach ahead of the full-scale implementation in 2018.

B. Modernizing the Monetary and Financial Frameworks

29. The CBA has made strides in establishing a transparent IT framework. The move toward an IT regime (with the inflation forecast as the intermediate target and the policy interest rate as the main operational target) started in 2006. Under this framework, CBA's independence has been strengthened considerably and direct financing of the government has been prohibited. The decisions and minutes of the CBA Board meetings are published regularly. In 2016 the CBA adopted a review-based monetary policy conditionality under the Fund-supported program to help strengthen the IT framework.

30. Efforts to incorporate financial stability considerations into the CBA's operational policy framework are on track. The macro-economic stress scenario builder is being strengthened with more focus on micro-level data and, with Fund TA, a structural macro-financial analytical framework is being developed. Relatedly, the CBA is strengthening the role of the forecasting and policy analysis system coordinator to establish structured internal communications, in particular to counter the risks from assigning dual objectives to one agency.

31. Armenia's financial system has been rapidly growing, albeit from a low base. Banking services have expanded, notably in branch penetration, which has doubled over the past decade[7]. Increased minimum capital requirement in the banking sector and further consolidation should help provision of financing and increase efficiency. Also, efforts are being made to further develop capital markets, including by modernizing the settlement and depository system: the share of foreign participation in domestic government's bond markets has increased from 0.2 percent at end-2015 to 2 percent at end-March 2017.

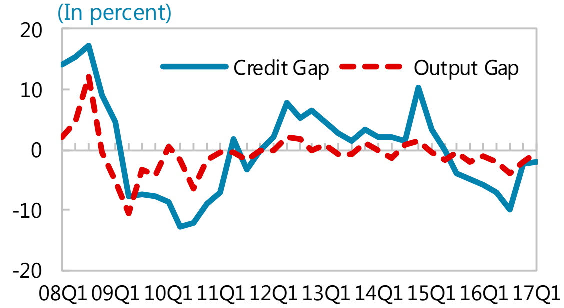
32. Macro-financial risks have been limited so far. On the financial-to-macro front, while the correlation between the credit gap (deviation of credit from trend) and the output gap is relatively strong, the credit-to-GDP ratio, at 45 percent, remains moderate. Moreover, the gap is currently in a negative territory, despite the recent pickup in credit. On the macro-to-financial

[6] These SOEs relied on government subsidies to service their debt to the central government. The government is considering options to improve their balance sheets with the aim of eliminating the need for subsidies.

[7] In view of limited access to finance in Armenia (see Box 4), the benefit of branch expansion should exceed l any costs such as possible negative impact on bank profitability.

front, the CBA's stress tests suggest that the resilience of the banking system has improved, with a falling number of banks facing liquidity and capital strains under the tests.

Armenia: Credit and Output Gaps
(In percent)



Source: IMF Staff Estimates

33. The authorities are determined to enhance the effectiveness of the IT regime further. Despite the CBA's efforts, the monetary transmission mechanism remains weak, as witnessed by the difficulties in managing excess liquidity in the system and market interest rates, and the fragmented interbank market that limits provision of liquidity in the banking system. Staff reiterated the importance of promoting a well-functioning interbank market, which would help strengthen the interest-based monetary transmission mechanism and more generally the effectiveness of macroeconomic policies. Also, the development of multi-maturity bond markets can improve the transmission channel by facilitating maturity transformation. Enhancing communication and promoting de-dollarization would further strengthen monetary policy effectiveness.

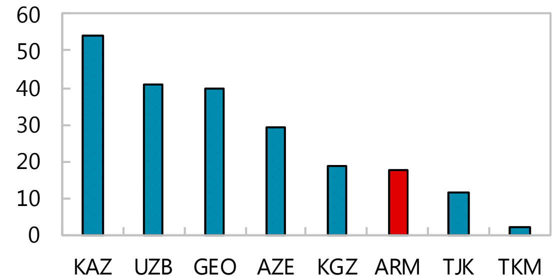
34. Staff discussed measures to help financial deepening while preserving financial stability. Despite some progress, overall financial depth and inclusion remain low relative to fundamentals and the region (Box 4). Staff welcomed the authorities' progress in implementing most of the 2012 FSAP recommendations, including amending deposit guarantee fund legislation and preparing regulations for broadening access to finance (bankruptcy reforms and collateral registration). In staff's view, there is room for further consolidation of the banking sector, which should facilitate competition and help accelerate the financial intermediation. At the same time, this may raise stability concerns, and therefore staff asked for close monitoring and further financial supervisory action. The authorities concurred with staff's view, but argued that at this stage the benefits arising from consolidation should exceed costs associated with possible "too-big-to-fail" incidents. Staff emphasized that further efforts to reduce informality and to increase financial education would be important complements. In light of ongoing shocks and increased risks, the CBA has requested an FSAP in 2018, which is expected to cover key issues such as capital market development, modernization of the payment system, and pension reform.

35. The authorities emphasized their commitment to address constraints on financial intermediation. The CBA intends to address these challenges by: (i) assessing the weaknesses and vulnerabilities of the financial sector; and (ii) jointly setting new goals and tasks with the government to improve financial intermediation, including by addressing the low level of financial literacy and inclusion.

Box 4. Financial Inclusion

Financial access has accelerated over the past decade, but there is still room for improvement. Banking services have expanded with the increase in number of ATMs, branches, loan and deposit accounts. However, only 17 percent of the adult population owns financial accounts. In addition, the informal borrowing channels are still popular. Only 20 percent of adults obtained loans from financial institutions in 2014, while 27 percent of adults received credit from their family/friends. Outstanding deposit and loans with commercial banks have continued to increase (28 and 40 percent of GDP respectively in 2015[1]), but fell behind the country's peers.

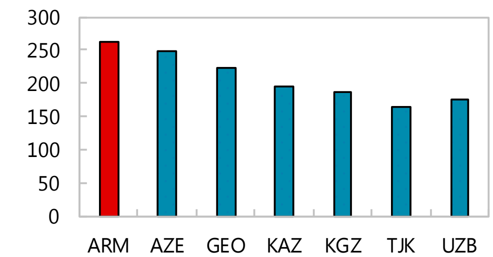
Account Ownership
(In percent of population, 15+, 2014)



Source: Global Financial Inclusion Database.

Access to finance for corporates remains limited. Only 46 percent of companies have loan or credit lines with banks and less than 10 percent of corporate investment is financed by banks. Collateral is commonly required (89 percent of loans) and appears excessive (264 percent of the loan value on average).

Value of Collateral Required for Loan
(In percent of the loan amount)



Sources: Enterprise Survey; and World Bank.

Structural challenges hinder financial deepening in Armenia. Banks' capacity to grant medium- and long-term financing is constrained by banks' limited funding structure which relies largely on short-term deposits. Also, given the absence of reliable firms' financial statements, lack of credit history, and deficiencies in the credit reporting system, banks apply high risk premium to lending rates and require substantial collateral.

A wide array of financial sector development actions and institutional improvements are needed to strengthen financial deepening. Reducing the participation cost and making financial services more affordable could foster financial inclusion. Also, removing unnecessary borrowing constraints and increasing the financial intermediation efficiency could increase medium-term lending. To strengthen the legal and regulatory framework, the authorities should improve the credit reporting systems and tackle transparency problems in the lending market.

1/ Financial Access Survey, IMF.

C. Addressing External Vulnerabilities and Enhancing Resilience

36. The external position has strengthened significantly since the last Article IV, but important vulnerabilities remain (Annex III: External Stability Assessment).

- Armenia's current account deficit has fallen from 7.6 percent of GDP in 2014 to 2.7 percent of GDP in 2016, driven by a large contraction in imports but also strong and more diversified export performance. The external position is assessed to be broadly in line with fundamentals and desirable policy settings. With the gradual expected recovery in imports, medium-term current account projections are broadly in line with the External Balance Approach (EBA)-lite estimates of a current account deficit norm between 4 to 5 percent of GDP. After the rapid drawdown of reserves in late-2014, buffers have slowly been rebuilt and are now judged to be adequate based on the Fund's Assessing Reserve Adequacy (ARA) metric for floating exchange rate regimes (Armenia's current *de facto* classification).

- Nevertheless, Armenia's large negative net international investment position is a source of concern. In particular, external public debt has risen substantially since the last Article IV, largely driven by the nominal exchange rate depreciation in 2015, and is projected to fall only gradually over the medium term. Also, the results of standardized shocks highlight vulnerabilities. Although sensitivity to interest rate shocks is limited, given the large share of concessional financing, external debt is highly sensitive to exchange rate depreciation, and shocks to growth or the current account would keep debt at an elevated level.

37. Continued exchange rate flexibility, fiscal consolidation, and structural reforms will help mitigate these risks. The exchange rate should continue to act as a key shock absorber and ensure the economy adjusts to changes in fundamentals. Given the vulnerability to external shocks and high dollarization, reserve buffers should be maintained, with intervention limited to dealing with disorderly conditions. More generally, shifting the relative composition of liabilities back from the public to the private sector and from debt to non-debt creating flows should boost resilience. The planned fiscal consolidation will help reduce the financing burden on public sector debt, and within these constraints the authorities need to maximize the impact of concessional donor financing by effectively managing the large pipeline of capital projects already in place. Staff and the authorities agreed that structural reforms to enhance non-price competitiveness and capitalize on the recent trade integration can help maintain the momentum behind the recent diversification of export markets and products. Importantly, improving the business environment and upgrading physical infrastructure would help boost FDIs and growth in the tradable sector. These efforts can help reduce the country's dependence on remittances and increase resilience to spillovers from trading partners.

38. The authorities broadly agreed with staff's assessment of external vulnerabilities and underscored the importance of ensuring a durable external adjustment. While they see little evidence of misalignment of the dram, the authorities reiterated their commitment to exchange rate flexibility and to limiting FX intervention to addressing large and disorderly swings. With external conditions expected to remain somewhat weaker for the foreseeable future, the authorities remain focused on ensuring that Armenia adjusts to the "new reality." They emphasized that strong fiscal consolidation and debt sustainability remain the priority, and stressed the need for higher and more sustainable private-sector led growth.

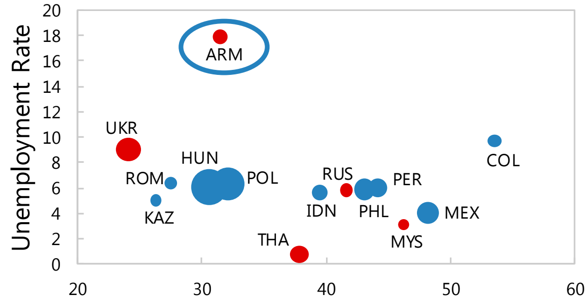
D. Achieving Sustainable Inclusive Growth

39. Income inequality is relatively low, but poverty and unemployment remain longstanding challenges (Selected Issues Paper).

- Poverty declined during the 2000s, supported by high growth, but it was partially reversed after the global crisis and remains on the high side, based on the national poverty lines, with significant regional disparities. Inequality, as measured by both the Gini index and the decile dispersion ratio, is relatively low, but has been worsening since the crisis. Moreover, as suggested by the growth incidence curve, growth in recent years has benefitted high-income groups more, partly owing to the fall in construction activity.

Unemployment and Inequality 1/

(Latest available observation) 2/



Sources: WEO; and WDI.
1/ Blue represents a decrease and red an increase in the unemployment rate in 2012–16. The bubble size illustrates the magnitude of the change in the unemployment rate.
2/ Gini Coefficient latest data varies per country.

- Unemployment reached 18 percent at end-2016, due to a combination of sluggish growth in recent years and structural weaknesses in the labor market. Even with a shrinking labor force due to the massive emigration, the economy could not generate enough jobs and high unemployment persisted. A large chunk of unemployment is concentrated in urban areas, and among youth and women.

40. Staff and the authorities agreed that lifting potential growth through decisive reforms is key to tackling high unemployment and poverty. Staff stressed that raising potential growth hinges on the capacity of the economy to close its infrastructure gap, diversify the production base, reduce economic informality, and deepen financial intermediation. Increased competition and reduced barriers to entry in the private sector would also provide more sustainable sources of growth and employment. Moreover, there is a need to increase public spending on education, health, and infrastructure to foster inclusive growth. The authorities reiterated the importance of decisive policies to improve labor market conditions, the quality of education, and the business environment. They pointed to progress in tackling corruption by strengthening centralized procurement, improving tax and customs administration, and reducing the informal economy through legislative amendments.

STAFF APPRAISAL

41. Armenia has faced significant external challenges since late 2014. These challenges have created serious obstacles to policy implementation and hampered program performance. Nevertheless, the authorities' efforts, backed by their Fund-supported program, have helped mitigate the impact of the shocks and restore macroeconomic stability. Higher fiscal deficits have reduced the negative impact on growth, while monetary and financial policies have safeguarded financial stability and helped rebuild external buffers. Looking ahead, the outlook is clouded by downside risks and tough challenges remain: growth remains volatile and narrowly based, trade opportunities are limited, and public debt continues to rise.

42. The economy's cyclical position, the need to build medium-term productive capacity, and higher-than-expected revenues justify an increase in capital expenditure relative to the 2017 budget. Given the fragile growth and the negative output gap, the planned large cut in capital spending, envisaged in the 2017 budget and triggered by the fiscal rule, is inappropriate. Staff supports the authorities' planned increase in concessional foreign-financed capital expenditure by about 1 percent of GDP. To ensure sustainable growth, however, higher spending should be accompanied by strengthened structural reforms (see below).

43. At the same time, it is essential to maintain a prudent medium-term fiscal path to ensure debt sustainability. To this end, it is imperative to enhance revenue mobilization and increase efficiency in spending. The new Tax Code should be rigorously implemented by resisting political pressures to water down its provisions. Tax administration should be enhanced by strengthening SRC's powers to monitor tax compliance. In this context, staff commends the authorities' renewed efforts to improve tax administration, which already contributed to the higher-than-projected revenue collection early this year.

44. Amending the existing fiscal rule credibly is a critical building block in ensuring fiscal sustainability. The current rule lacks flexibility and consideration for cyclical conditions. This could lead to abrupt adjustments in the short term, destabilizing aggregate demand and limiting capital spending. Against this background, staff supports the authorities' plan to amend the fiscal rule in a manner that improves credibility and preserves debt sustainability. A robust communication strategy is critical for justifying the revisions to domestic legislative bodies and the public.

45. Monetary policy should remain focused on bringing inflation back to its medium-term target, with the exchange rate acting as a key shock absorber. The CBA should monitor the impact of recent policy actions and assess the need for further easing. The external sector remains broadly in line with fundamentals and desirable policies and reserve buffers remain adequate. However, vulnerabilities remain, particularly given the sharp increase in external debt. Two-way exchange rate flexibility and limiting intervention to dealing with disorderly market conditions should ensure adjustment to changes in fundamentals.

46. Strengthening monetary and financial sector policies further remains a priority. Increasing the effectiveness of the IT framework requires improvement the monetary transmission mechanism, including through developing a well-functioning interbank market and enhanced communication. The CBA has made progress in developing the financial sector by implementing the 2012 FSAP recommendations, while strengthening financial sector resilience by increasing minimum capital requirement. However, further work is needed to foster better financial intermediation by developing the capital markets and strengthening financial literacy.

47. Structural reforms should be deepened and broadened to help support inclusive growth over the longer term, driven by a more diversified market economy. Lower potential growth in partner countries, sluggish investment in recent years, a still-weak business climate, and the absence of strong growth drivers constrain the capacity of the economy to generate sufficient jobs to stem emigration and reduce poverty. To promote private sector development and diversify the economy, the government should attract more and better FDI. This calls for measures to improve the business environment, encourage competition, and strengthen governance. In this context, staff welcomes the recent various growth-promoting initiatives, including to increase FDIs.

48. In view of satisfactory performance, staff supports the completion of the fifth and final review. All PCs, indicative targets, and structural benchmarks have been met. The capacity to repay the Fund is adequate. Increased buffers and the results of the DSA suggest that risks to the program going forward are manageable.

49. Staff recommends that the next Article IV Consultations be concluded on the standard 12-month cycle, in accordance with Decision No. 14747-(10/96), as amended.

Table 1. Armenia: Selected Economic and Financial Indicators, 2013–19

	2013	2014	2015	2016		2017		2018	2019
	Act.	Act.	Act.	EBS/16/120 1/	Prel.	EBS/16/120 1/	Proj.	Proj.	Proj.
National income and prices:									
Real GDP (percent change)	3.3	3.6	3.2	2.4	0.2	2.7	2.9	2.9	3.0
Final consumption expenditure, Contrib. to Growth	1.5	0.6	-5.2	-0.2	-0.3	2.5	1.5	1.4	1.9
Gross fixed capital formation, Contrib. to Growth	-1.7	-0.6	0.5	1.2	0.5	0.3	1.2	0.6	0.6
Changes in inventories, Contrib. to Growth	0.0	-0.7	-0.8	0.5	0.8	0.2	0.0	0.0	0.0
Net exports of goods and services, Contrib. to Growth	0.0	4.5	6.1	2.9	1.2	-0.3	0.1	0.9	0.5
Statistical Discrepancy in GDP, Contrib. to Growth	4.2	-0.8	2.6	-1.9	-2.0	0.0	0.0	0.0	0.0
Gross domestic product (in billions of drams) 2/	4,556	4,829	5,044	5,151	5,076	5,405	5,362	5,710	6,117
Gross domestic product per capita (in U.S. dollars)	3,732	3,889	3,529	3,568	3,533	3,626	3,668	3,829	4,021
CPI (period average; percent change)	5.8	3.0	3.7	-1.4	-1.4	1.6	1.7	3.5	4.0
CPI (end of period; percent change)	5.6	4.6	-0.1	-0.5	-1.1	2.8	1.8	4.0	4.0
GDP deflator (percent change) 2/	3.4	2.3	1.2	0.0	0.5	2.2	2.6	3.5	4.0
Investment and saving (in percent of GDP)									
Investment	20.7	20.8	20.9	21.7	21.2	21.8	22.2	22.3	22.3
National savings	13.4	13.2	18.3	18.7	18.5	17.8	18.4	19.2	19.3
Money and credit (end of period)									
Reserve money (percent change)	29.9	-0.1	3.9	4.9	13.1	8.8	3.0	11.3	8.0
Broad money (percent change)	15.2	8.9	10.7	13.9	16.6	10.5	8.4	10.3	8.0
Commercial banks' 3-month lending rate (in percent)	18.3	19.4	15.7	...	14.4	...	...	...	...
Central government operations (in percent of GDP)									
Revenue and grants	22.2	22.0	21.5	21.2	21.4	21.8	22.4	22.3	23.0
Of which: tax revenue 3/	21.0	21.1	20.1	19.5	20.0	20.2	20.7	20.8	21.4
Expenditure 4/	23.8	24.0	26.3	27.1	27.0	24.6	25.6	25.0	24.7
Overall balance on a cash basis	-1.0	-2.1	-4.8	-5.9	-5.6	-2.8	-3.3	-2.7	-1.7
Public and publicly-guaranteed debt (in percent of GDP)	40.8	43.6	48.7	54.7	55.1	56.4	55.7	57.0	56.4
Share of foreign currency debt (in percent)	85.2	86.2	86.9	85.5	84.4	85.0	87.1	88.0	87.7
External sector									
Exports of goods and services (in millions of U.S. dollars)	3,156	3,319	3,137	3,384	3,501	3,585	3,870	4,128	4,370
Imports of goods and services (in millions of U.S. dollars)	-5,476	-5,487	-4,418	-4,327	-4,569	-4,672	-5,083	-5,273	-5,506
Exports of goods and services (percent change)	8.2	5.2	-5.5	7.9	11.6	5.9	10.6	6.7	5.9
Imports of goods and services (percent change)	6.7	0.2	-19.5	-2.0	3.4	8.0	11.2	3.8	4.4
Current account balance (in percent of GDP)	-7.3	-7.6	-2.6	-2.9	-2.7	-4.0	-3.8	-3.2	-3.0
FDI (net, in millions of U.S. dollars) 5/	475	388	162	272	281	410	402	344	354
Debt service ratio (in percent of exp. of goods and serv.) 6/	27.9	8.6	12.5	7.2	6.6	8.1	7.3	7.5	7.8
Gross international reserves (in millions of U.S. dollars)	2,253	1,489	1,771	1,953	2,204	1,981	2,259	2,458	2,755
Import cover 7/	4.9	4.0	4.7	5.0	5.2	5.0	5.2	5.4	5.8
End-of-period exchange rate (dram per U.S. dollar)	406	475	484	...	484	...	...	...	...
Average exchange rate (dram per U.S. dollar)	410	416	478	...	480	...	...	...	...
Memorandum item:									
Population (in millions)	3.0	3.0	3.0	...	3.0	...	...	...	...

Sources: Armenian authorities; and Fund staff estimates and projections.

1/ Staff Report for the fourth review.

2/ In the first quarter of 2015 the authorities started calculating GDP using the SNA 2008 methodology. They have revised GDP series from 2012 onward.

3/ In 2013, tax revenue includes social contribution.

4/ In 2013 includes 1.5 percent of GDP related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom, and the transfer of the same amount from the gov't to ArmRusGazprom to liquidate liabilities. A surplus of 0.6 percent of GDP is obtained when this transaction is excluded.

5/ In 2013, a credit for $155 million is registered in FDI to reflect the acquisition by Gazprom of 20 percent of the shares of ArmRusGazprom, while an offseting debit is registered in other capital (net) to reflect the corresponding reduction in liabilities of the latter with the former.

6/ Based on public and publicly-guaranteed debt.

7/ Gross international reserves in months of next year's imports of goods and services, including the SDR holdings.

Table 2. Armenia: Balance of Payments, 2013–22

(In millions of U.S. dollars, unless otherwise indicated)

	2013	2014	2015	2016		2017	2018	2019	2020	2021	2022
	Act.	Act.	Act.	EBS/16/120	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	-813	-883	-279	-312	-285	-418	-362	-363	-466	-584	-677
Trade balance	-2,196	-2,055	-1,186	-880	-944	-1,050	-960	-926	-993	-1,115	-1,241
Exports, fob	1,636	1,698	1,624	1,856	1,891	2,212	2,420	2,610	2,701	2,770	2,844
Imports, fob 1/	-3,832	-3,754	-2,810	-2,736	-2,835	-3,262	-3,380	-3,537	-3,695	-3,885	-4,085
Services (net)	-124	-113	-95	-63	-124	-162	-185	-210	-236	-263	-254
Credits	1,520	1,621	1,513	1,528	1,610	1,658	1,708	1,759	1,812	1,866	1,988
Debits	-1,644	-1,734	-1,607	-1,591	-1,734	-1,821	-1,893	-1,969	-2,048	-2,130	-2,242
Income (net) 2/	683	541	435	124	221	189	158	126	92	97	91
Transfers (net)	825	744	566	506	561	606	625	647	671	698	727
Private	704	641	421	391	392	431	444	462	481	500	520
Official	121	104	146	115	169	175	181	185	191	198	207
Capital and financial account	1,758	346	720	385	945	432	612	718	641	773	677
Capital transfers (net)	84	70	65	78	35	64	69	70	72	73	75
Foreign direct investment (net) 2/	475	388	162	272	281	402	344	354	365	378	393
Portfolio investment (net)	-9	-42	-29	-35	49	-17	-20	-12	-5	-1	-11
Public sector borrowing (net)	376	216	635	347	499	294	298	385	271	364	312
Disbursements	914	257	898	426	571	380	404	512	916	530	489
Amortization	-537	-41	-262	-79	-72	-86	-106	-128	-646	-167	-178
Other capital (net)	832	-287	-113	-276	81	-312	-80	-80	-60	-40	-90
Errors and omissions	0	-33	-167	0	0	0	0	0	0	0	0
Overall balance	644	-650	290	72	660	14	249	355	176	189	0
Financing	-644	650	-290	-216	-425	-135	-249	-355	-176	-189	0
Gross international reserves (increase: -)	-454	764	-282	-182	-433	-88	-189	-284	-102	-121	41
Use of Fund credit, net	-190	-113	-9	-33	8	-47	-61	-71	-73	-68	-41
Purchases/disbursements	84	36	16	…	44	…	…	…	…	…	…
Repurchases/repayments	-274	-149	-25	-33	-36	-47	-61	-71	-73	-68	-41
Financing gap	0	0	0	144	0	121	0	0	0	0	0
IMF EFF	0	0	0	44	0	21	…	…	…	…	…
Other 3/	0	0	0	100	0	100	…	…	…	…	…
Memorandum items:											
Current account (in percent of GDP)	-7.3	-7.6	-2.6	-2.9	-2.7	-3.8	-3.2	-3.0	-3.7	-4.4	-4.8
Trade balance (in percent of GDP)	-19.7	-17.7	-11.2	-8.2	-8.9	-9.6	-8.4	-7.7	-7.9	-8.4	-8.8
Gross international reserves (end of period)	2,253	1,489	1,771	1,953	2,204	2,259	2,458	2,755	2,869	3,002	2,864
In months of next year's imports	4.9	4.0	4.7	5.0	5.2	5.2	5.4	5.8	6.0	5.7	5.3
Merchandise export growth, percent change	7.9	3.8	-4.4	14.3	16.4	17.0	9.4	7.9	3.5	2.5	2.7
Merchandise import growth, percent change	5.6	-2.0	-25.1	-2.6	0.9	15.1	3.6	4.6	4.5	5.1	5.1
Nominal external debt	8,682	8,274	8,902	9,402	9,803	10,189	10,396	10,690	10,898	11,231	11,478
o.w. public external debt	3,902	3,825	4,414	4,884	4,885	5,284	5,571	5,945	6,213	6,587	6,923
Nominal external debt stock (in percent of GDP)	78.1	71.3	84.4	88.1	92.8	92.9	90.8	88.9	86.3	84.3	81.1
External public debt-to-exports ratio (in percent)	123.6	115.3	140.7	144.3	139.5	136.5	134.9	136.1	137.6	142.1	143.3
External public debt service (in percent of exports)	27.9	8.6	12.5	7.2	6.6	7.3	7.5	7.8	19.0	7.2	6.5

Sources: Armenian authorities; and Fund staff estimates and projections.

1/ From 2014 on, imports of gas are calculated at the (lower) price of $189 per thousand cubic meter. In addition to reducing projected gas imports in 2014, this change also implies lower FDI (lower intercompany lending between parent and subsidiary)

2/ In 2013, a credit for $155 million is registered in FDI to reflect the acquisition by Gazprom of 20 percent of the shares of ArmRusGazprom, while an offseting debit is registered in other capital (net) to reflect the corresponding reduction in liabilities of the latter with the former.

3/ Financing from the Eurasian Fund for Stability and Development. First disbursement occurred in December 2015.

Table 3. Armenia: Monetary Accounts, 2013–18

(In billions of drams, unless otherwise indicated)

	2013	2014	2015	2016				2017				2018
	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Prel.	Proj.			Proj.
				Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	
Central Bank of Armenia												
Net foreign assets	655.8	437.4	566.2	486.8	450.5	564.4	764.3	689.8	711.2	698.9	750.3	733.4
Net international reserves	768.7	569.2	723.8	648.1	608.7	727.6	928.1	859.4	879.9	889.8	940.4	956.8
Other	-112.9	-131.8	-157.6	-161.3	-158.2	-163.2	-163.8	-169.5	-168.7	-190.9	-190.1	-223.4
Net domestic assets	232.2	449.4	355.1	363.0	326.5	333.6	278.0	280.6	265.8	302.8	323.7	461.9
Claims on general government (net)	-175.9	-102.1	-120.2	-98.7	-66.7	-92.9	-162.3	-142.1	-150.8	-152.6	-131.3	-162.0
Of which: central government (net)	-160.1	-83.9	-105.6	-77.9	-44.1	-68.9	-142.0	30.9	22.2	20.4	41.7	11.0
Claims on banks	174.0	312.5	225.0	194.0	120.8	147.1	153.3	147.6	142.1	174.3	193.5	226.8
CBA bills 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other items (net)	234.1	239.0	250.3	267.7	272.4	279.4	287.0	275.1	274.5	281.1	261.5	397.1
Reserve money	888.1	886.8	921.3	849.8	777.0	897.9	1,042.3	970.5	977.0	1,001.7	1,074.0	1,195.3
Currency issue	446.8	412.3	413.6	349.2	387.2	408.1	455.4	433.5	426.1	449.5	506.9	553.1
Deposits	441.2	474.4	507.7	500.6	389.8	489.8	586.9	537.0	550.9	552.2	567.1	642.1
Deposits in drams	202.4	337.7	324.6	337.3	281.0	298.7	326.7	332.6	333.9	334.0	347.9	384.2
Deposits in foreign currency	238.8	136.7	183.1	163.3	108.8	191.1	260.2	204.4	217.1	218.1	219.2	258.0
Banking system												
Net foreign assets	-58.8	-373.1	-160.6	-201.9	-217.4	-142.9	-94.1	-110.5	-89.2	-101.5	-50.1	-99.0
Net domestic assets	1,610.9	2,062.8	2,030.4	2,091.9	2,159.5	2,164.9	2,274.2	2,330.2	2,305.8	2,343.9	2,414.0	2,707.5
Claims on government (net)	-9.6	79.5	85.1	115.7	174.2	216.0	224.6	242.1	237.6	240.0	265.5	261.5
Of which: claims on central government (net)	6.1	97.8	99.8	136.4	196.8	240.0	244.9	415.1	410.6	413.0	438.5	434.5
Claims on rest of the economy	1,781.7	2,147.3	2,069.9	2,107.2	2,133.3	2,125.2	2,368.3	2,228.8	2,225.9	2,290.0	2,476.9	2,784.2
Other items (net)	-161.2	-163.9	-124.6	-130.9	-148.0	-176.3	-318.7	-140.6	-157.7	-186.0	-328.4	-338.2
Broad money	1,552.1	1,689.8	1,869.8	1,890.0	1,942.1	2,022.0	2,180.1	2,219.7	2,216.6	2,242.4	2,363.9	2,608.5
Currency in circulation	384.9	349.2	346.9	298.4	333.7	356.2	390.9	380.5	370.5	395.4	440.3	484.3
Deposits	1,167.2	1,340.6	1,522.8	1,591.7	1,608.3	1,665.8	1,789.2	1,839.2	1,846.1	1,847.0	1,923.6	2,124.2
Domestic currency	470.2	483.8	547.2	583.3	626.9	643.5	682.8	757.6	773.8	784.1	845.6	1,009.5
Foreign currency	697.0	856.7	975.7	1,008.4	981.5	1,022.3	1,106.4	1,081.6	1,072.3	1,062.9	1,078.0	1,114.7
Memorandum items:												
Exchange rate (in drams per U.S. dollar, end of period)	405.6	475.0	483.8	480.8	476.7	476.7	483.9	486.4	...	...	...	...
NIR, program definition, at program exchange rates (USD millions)	1,068	796	1,013	896	945	1,038	1,315	1,269	1,323	1,407	1,486	1,646
12-month change in reserve money (in percent)	29.9	-0.1	3.9	7.3	-5.0	2.3	13.1	14.2	25.7	11.6	3.0	11.3
12-month change in broad money (in percent)	15.2	8.9	10.7	15.4	12.7	15.5	16.6	17.4	14.1	10.9	8.4	10.3
12-month change in dram broad money (in percent)	15.5	-2.6	7.3	11.2	14.2	20.4	20.1	29.1	19.1	18.0	19.8	16.2
12-month change in private sector credit (in percent)	12.2	20.5	-3.6	1.7	3.7	4.3	14.4	5.8	4.3	7.8	4.6	12.4
Velocity of broad money (end of period)	2.9	2.9	2.7	2.7	2.6	2.5	2.3	2.3	2.3	2.4	2.3	2.2
Money multiplier	1.7	1.9	2.0	2.2	2.5	2.3	2.1	2.3	2.3	2.2	2.2	2.2
Dollarization in bank deposits 2/	59.7	63.9	64.1	63.4	61.0	61.4	61.8	58.8	58.1	57.5	56.0	52.5
Dollarization in broad money 3/	44.9	50.7	52.2	53.4	50.5	50.6	50.7	48.7	48.4	47.4	45.6	42.7
Currency in circulation in percent of deposits	33.0	26.0	22.8	18.7	20.8	21.4	21.8	20.7	20.1	21.4	22.9	22.8
Stock of foreign currency deposits (in millions of U.S. dollars) 4/	1,700	2,090	2,380	2,459	2,394	2,493	2,698	2,638	2,615	2,592	2,629	2,719
Banking system financing of the central government (cumulative)	-23.7	91.6	2.0	36.7	97.0	140.2	145.1	170.2	165.7	168.1	193.6	336.7
Banks' deposits at CBA to deposits in banking system (in percent)	37.8	35.4	33.3	31.5	24.2	29.4	32.8	29.2	29.8	29.9	29.5	30.2

Sources: Central Bank of Armenia; and Fund staff estimates and projections.

1/ Following the agreement between the CBA and the Ministry of Finance, the issue of new CBA bills was terminated in 2008.
2/ Ratio of foreign currency deposits to total deposits (in percent).
3/ Ratio of foreign currency deposits to broad money (in percent).
4/ At the program exchange rate.

Table 4. Armenia: Financial Soundness Indicators for the Banking Sector, 2013–17

(In percent, unless otherwise indicated)

	2013	2014	2015				2016				2017
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.
Capital adequacy											
Total regulatory capital to risk-weighted assets	16.7	14.5	15.1	15.4	15.7	16.2	17.3	17.4	18.4	20.0	20.0
Capital (net worth) to assets	15.3	14.0	14.4	14.6	14.2	14.7	15.0	15.7	15.9	16.2	16.3
Asset composition											
Sectoral distribution of loans (in billions of drams)											
Industry (excluding energy sector)	222.7	266.3	245.9	245.4	235.7	225.9	219.7	228.2	228.5	227.1	229.6
Energy sector	95.4	112.4	103.7	94.0	107.8	111.2	101.3	112.2	104.3	162.2	194.7
Agriculture	118.2	150.2	160.7	162.7	154.0	148.9	150.2	153.1	148.2	140.1	143.9
Construction	109.4	124.2	114.7	115.1	113.0	106.6	122.7	113.5	111.8	102.8	108.3
Transport and communication	54.0	52.0	52.6	54.9	81.0	77.1	77.1	72.0	71.7	79.7	68.9
Trade/commerce	352.3	386.3	363.3	352.2	333.8	345.5	373.0	369.2	376.4	335.8	343.9
Consumer credits	365.6	451.5	436.4	422.9	413.9	423.1	429.2	426.1	419.6	434.2	451.2
Mortgage loans	143.2	172.4	169.4	170.8	173.9	179.0	177.3	178.6	181.1	183.7	182.4
Sectoral distribution of loans to total loans (percent of total)											
Industry (excluding energy sector)	12.2	12.0	11.6	11.8	11.4	10.5	9.9	10.2	10.1	10.6	10.4
Energy sector	5.2	5.1	4.9	4.5	5.2	5.2	4.6	5.0	4.6	6.5	6.5
Agriculture	6.5	6.8	7.6	7.8	7.5	6.9	6.8	6.8	6.6	8.7	8.9
Construction	6.0	5.6	5.4	5.5	5.5	4.9	5.1	5.1	5.0	4.8	4.9
Transport and communication	3.0	2.3	2.5	2.6	3.9	3.6	3.5	3.2	3.2	3.7	3.1
Trade/commerce	19.3	17.4	17.2	16.9	16.2	16.0	16.8	16.5	16.7	15.7	15.6
Consumer credits	20.1	20.3	20.7	20.3	20.0	19.6	19.4	19.0	18.6	8.6	8.3
Mortgage loans	7.9	7.8	8.0	8.2	8.4	8.3	8.0	8.0	8.0	20.3	20.5
Other sectors	19.8	22.8	22.1	22.5	21.9	25.0	26.0	26.3	27.3	21.1	21.7
Foreign exchange loans to total loans	63.8	64.7	67.7	67.1	66.7	66.7	67.9	67.1	67.3	64.6	64.1
Asset quality											
Nonperforming loans (in billions of drams)	79.7	149.9	170.7	187.6	172.7	166.0	218.1	202.7	213.1	162.2	166.0
Watch (up to 90 days past due)	41.4	72.7	77.7	85.0	72.5	75.0	97.4	59.7	67.6	50.8	53.4
Substandard (91-180 days past due)	19.5	44.3	56.1	61.3	53.6	48.0	57.4	71.3	57.0	45.0	42.4
Doubtful (181-270 days past due)	18.8	32.9	36.9	41.2	46.6	43.0	63.3	71.6	88.5	66.4	70.1
Loss (>270 days past due, in billions of drams)	108.0	173.4	195.3	217.6	249.2	288.4	292.5	312.3	331.4	354.3	372.4
Nonperforming loans to gross loans	4.5	6.8	8.1	9.0	8.4	7.8	10.0	9.2	9.7	6.7	6.8
Provisions to nonperforming loans	49.5	41.3	39.1	38.1	40.7	42.9	40.6	46.0	47.5	52.0	52.5
Spread between highest and lowest rates of interbank borrowing in AMD	2.2	4.0	10.5	3.0	1.0	1.8	0.4	4.5	0.3	0.8	0.3
Spread between highest and lowest rates of interbank borrowing in FX	6.3	3.5	0.8	0.0	0.0	5.0	1.0	0.0	0.0	0.0	0.0
Earnings and profitability											
ROA (profits to period average assets)	1.9	1.0	-0.2	-0.3	-0.3	-0.5	0.2	0.5	0.5	1.1	1.1
ROE (profits to period average equity)	12.0	6.4	-1.7	-1.8	-2.4	-3.5	1.0	3.3	3.2	7.0	6.4
Interest margin to gross income	37.1	35.7	28.2	29.2	29.2	28.9	28.8	29.4	29.6	29.2	29.9
Interest income to gross income	79.1	77.3	78.2	77.9	77.2	76.5	78.4	78.0	77.5	76.7	78.9
Noninterest expenses to gross income	33.0	31.7	28.9	29.0	29.0	29.4	28.6	28.9	28.7	29.1	26.7
Liquidity											
Liquid assets to total assets	29.1	25.1	24.1	25.2	27.2	28.0	29.2	28.0	29.9	32.5	32.0
Liquid assets to total short-term liabilities	142.3	129.4	137.1	138.2	147.0	142.4	157.7	153.5	159.7	170.8	164.6
Customer deposits to total (non-interbank) loans	105.6	98.0	99.8	103.1	107.5	112.5	112.9	110.1	113.2	115.0	115.6
Foreign exchange liabilities to total liabilities	64.1	63.5	64.1	64.4	65.6	65.7	65.6	63.2	63.9	62.6	61.3
Sensitivity to market risk											
Gross open positions in foreign exchange to capital	3.7	14.6	8.6	7.5	5.8	6.5	5.2	5.6	5.6	6.9	4.9
Net open position in FX to capital	0.1	-11.1	-4.6	-3.3	-2.2	-2.8	-2.3	0.0	-3.3	-3.3	-1.2

Source: Central Bank of Armenia

Table 5. Armenia: Central Government Operations, 2013–19

(In billions of Armenian drams)

	2013	2014	2015	2016		2017		2018	2019
	Act	Act.	Act.	EBS/16/120	Prel.	EBS/16/120	Proj.	Proj.	Proj.
Total revenue and grants	1011.5	1064.6	1084.1	1090.3	1085.2	1180.5	1199.6	1276.0	1404.3
Total revenue	1000.7	1050.1	1056.3	1054.7	1056.9	1152.8	1171.9	1252.0	1390.8
Tax revenues	956.6	1018.4	1011.3	1003.5	1016.2	1091.1	1110.2	1185.2	1306.8
VAT	371.7	401.0	380.1	337.4	342.4	379.7	383.4	413.4	482.6
Profits, simplified and presumptive	167.6	120.9	106.8	123.2	130.4	129.3	133.3	136.3	146.0
Personal income tax	256.9	301.1	311.7	329.4	327.5	345.6	342.1	370.8	397.2
Customs duties	44.3	48.4	61.5	51.0	55.4	54.5	66.3	70.5	73.9
Other	116.1	147.0	151.2	162.5	160.5	182.0	185.1	194.3	207.1
Social contributions 1/	17.9	4.8	10.5	13.4	13.4	14.3	14.3	27.8	42.3
Other revenue	26.2	26.9	34.4	37.8	27.3	47.4	47.4	39.0	41.7
Grants	10.8	14.5	27.8	35.6	28.3	27.7	27.7	24.0	13.5
Total expenditure	1084.1	1158.4	1328.0	1395.6	1370.6	1330.6	1374.7	1429.8	1508.0
Expenses 2/	980.6	1048.7	1179.6	1207.3	1209.4	1235.0	1233.7	1278.9	1354.7
Wages	215.6	253.4	296.2	310.3	305.7	310.0	301.0	305.9	315.1
Social Contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments to individual pension accts.	0.0	9.5	20.8	26.8	25.6	28.7	28.7	55.6	84.5
Subsidies 3/	4.9	8.4	19.8	15.0	13.3	6.6	6.6	6.8	7.1
Interest	46.7	61.6	74.1	100.6	98.3	119.3	119.3	114.2	122.6
Social allowances and pensions	294.0	335.0	368.5	382.3	378.5	388.2	385.9	395.4	400.4
Pensions/social security benefits	198.4	218.1	246.8	250.3	249.4	249.7	249.7	258.9	258.7
Social assistance benefits	95.6	117.0	121.7	132.0	129.0	138.5	136.3	136.4	141.8
Employer social benefits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Goods and services 4/	140.9	112.2	125.3	117.1	122.4	122.8	129.3	134.0	143.5
Grants	78.2	82.9	102.2	105.6	102.4	103.6	101.1	103.4	108.5
Other expenditure 5/	200.3	185.6	172.8	149.7	163.3	155.9	161.8	163.8	173.1
Transactions in nonfinancial assets	103.5	109.7	148.4	188.3	161.2	95.6	141.0	150.9	153.2
Acquisition of nonfinancial assets 6/	105.0	111.2	150.5	188.2	166.0	95.5	145.9	150.9	153.2
Disposals of nonfinancial assets	1.6	1.6	2.1	-0.1	4.8	-0.1	4.8	0.0	0.0
Overall balance (above-the-line)	-72.6	-93.8	-244.0	-305.3	-285.4	-150.1	-175.1	-153.8	-103.7
Statistical discrepancy	28.6	-7.6	0.0	0.0	-10.2	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-43.9	-101.4	-244.0	-305.3	-295.6	-150.1	-175.1	-153.8	-103.7
Financing	43.9	101.4	244.0	305.3	295.6	150.1	175.1	153.8	103.7
Domestic financing	-43.9	75.7	33.6	129.9	102.4	59.5	25.4	40.6	-63.9
Banking system	-23.7	91.6	2.0	120.5	145.1	42.4	20.4	66.3	-42.8
CBA	-79.6	76.3	-21.7	-4.7	-42.1	8.2	-23.0	-9.7	-102.6
Commercial Banks	55.9	15.4	23.7	125.2	187.2	34.1	43.4	76.0	59.7
Nonbanks	-20.2	-16.0	8.6	9.4	-42.7	17.1	5.0	-25.7	-21.1
Privatization proceeds	0.0	0.0	7.7	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills/other	-62.7	7.3	-5.1	21.6	-14.8	5.9	-3.4	-6.0	-4.7
Promissory note/other	63.3	-6.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-20.9	-16.7	6.0	-12.2	-27.9	11.2	8.4	-19.7	-16.4
External financing	87.8	25.8	162.5	127.2	145.1	40.8	100.8	113.2	167.6
Gross inflow 5/	373.1	106.8	345.6	209.8	228.9	141.2	185.5	201.5	260.6
Amortization due	-246.4	-38.6	-118.7	-35.3	-33.7	-50.7	-35.1	-35.1	-41.3
Net lending	-38.9	-42.4	-64.3	-47.3	-50.0	-49.6	-49.6	-53.2	-51.8
Other financing 7/	0.0	0.0	47.8	48.3	48.0	49.8	48.9	0.0	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	4,556	4,829	5,044	5,151	5,076	5,405	5,362	5,710	6,117
Program balance 8/	-40.4	-160.5	-298.6	-357.6	-364.5	-177.6	-205.6	-199.3	-140.0
Primary balance 9/	-85.6	-91.2	-228.2	-264.2	-265.0	-69.3	-97.1	-112.5	-49.2
Debt-creating fiscal balance 10/	-48.2	-136.2	-308.3	-352.6	-335.4	-199.8	-224.7	-207.0	-155.4
Government securities issuance	0.0	0.0	0.0	108.0	0.0	40.0	40.0	70.0	55.0

Sources: Ministry of Finance, Central Bank of Armenia, and Fund staff estimates and projections.

1/ From 2014, social contributions include contributions to the second pillar of the pension system.

2/ Composition of expense reclassified in November 2013 to account for wage bill more accurately. A further reclassification of expenses was made in 2015 whereby some spending on goods and services was classified in other categories.

3/ In 2015 reflects the payment of wage arrears for Nairit and the electricity subsidy to households and SMEs. In 2016, an additional subsidy of AMD 2 billion is assumed to cover the electricity tariff differential for households and SMEs.

4/ Changes in expense on goods and services relative to the Third Review reflect classification issues. In particular, spending on education which was previously reflected in "other expenditure" is now classified under "goods and services."

5/ In 2013 includes AMD 63 billion related to the acquisition by Gazprom from the gov't of 20 percent of the shares of ArmRusGazprom (gross inflow), and the transfer (other exp.) of the same amount from the gov't to ArmRusGazprom to liquidate liabilities. Excluding this transaction, the deficit amounts to AMD 43.6 bil.

6/ Includes acquisition of military equipment.

7/ EFSD financing ($100 million in 2015-17). First disbursement occurred in December 2015.

8/ The program balance is measured as below-the-line overall balance minus net lending.

9/ Sum of overall balance (above the line), interest expense, and domestic and external net lending.

10/ Sum of overall balance (above-the-line) and external net lending. In 2013, it excludes the transfer associated to the acquisition of ArmRusGazprom by Gazprom, since it was financed with the sale of the government's shares in the company.

Table 6. Armenia: Central Government Operations, 2013–19
(In percent of GDP, unless otherwise specified)

	2013	2014	2015	2016		2017		2018	2019
	Act.	Act.	Act.	EBS/16/120	Prel.	EBS/16/120	Proj.	Proj.	Proj.
Total revenue and grants	22.2	22.0	21.5	21.2	21.4	21.8	22.4	22.3	23.0
Total revenue	22.0	21.7	20.9	20.5	20.8	21.3	21.9	21.9	22.7
Tax revenues	21.0	21.1	20.1	19.5	20.0	20.2	20.7	20.8	21.4
VAT	8.2	8.3	7.5	6.6	6.7	7.0	7.2	7.2	7.9
Profits, simplified and presumptive	3.7	2.5	2.1	2.4	2.6	2.4	2.5	2.4	2.4
Personal income tax	5.6	6.2	6.2	6.4	6.5	6.4	6.4	6.5	6.5
Customs duties	1.0	1.0	1.2	1.0	1.1	1.0	1.2	1.2	1.2
Other	2.5	3.0	3.0	3.2	3.2	3.4	3.5	3.4	3.4
Social contributions 1/	0.4	0.1	0.2	0.3	0.3	0.3	0.3	0.5	0.7
Other revenue	0.6	0.6	0.7	0.7	0.5	0.9	0.9	0.7	0.7
Grants	0.2	0.3	0.6	0.7	0.6	0.5	0.5	0.4	0.2
Total expenditure	23.8	24.0	26.3	27.1	27.0	24.6	25.6	25.0	24.7
Expense 2/	21.5	21.7	23.4	23.4	23.8	22.8	23.0	22.4	22.1
Wages	4.7	5.2	5.9	6.0	6.0	5.7	5.6	5.4	5.2
Social Contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments to individual pension accts.	0.0	0.2	0.4	0.5	0.5	0.5	0.5	1.0	1.4
Subsidies 3/	0.1	0.2	0.4	0.3	0.3	0.1	0.1	0.1	0.1
Interest	1.0	1.3	1.5	2.0	1.9	2.2	2.2	2.0	2.0
Social allowances and pensions	6.5	6.9	7.3	7.4	7.5	7.2	7.2	6.9	6.5
Pensions/social security benefits	4.4	4.5	4.9	4.9	4.9	4.6	4.7	4.5	4.2
Social assistance benefits	2.1	2.4	2.4	2.6	2.5	2.6	2.5	2.4	2.3
Employer social benefits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Goods and services 4/	3.1	2.3	2.5	2.3	2.4	2.3	2.4	2.3	2.3
Grants	1.7	1.7	2.0	2.0	2.0	1.9	1.9	1.8	1.8
Other expenditure 5/	4.4	3.8	3.4	2.9	3.2	2.9	3.0	2.9	2.8
Transactions in nonfinancial assets	2.3	2.3	2.9	3.7	3.2	1.8	2.6	2.6	2.5
Acquisition of nonfinancial assets 6/	2.3	2.3	3.0	3.7	3.3	1.8	2.7	2.6	2.5
Disposals of nonfinancial assets	0.0	0.0	0.0	0.0	0.1	0.0	0.1	0.0	0.0
Overall balance (above-the-line)	-1.6	-1.9	-4.8	-5.9	-5.6	-2.8	-3.3	-2.7	-1.7
Statistical discrepancy	0.6	-0.2	0.0	0.0	-0.2	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-1.0	-2.1	-4.8	-5.9	-5.8	-2.8	-3.3	-2.7	-1.7
Financing	1.0	2.1	4.8	5.9	5.9	2.8	3.3	2.7	1.7
Domestic financing	-1.0	1.6	0.7	2.5	2.0	1.1	0.5	0.7	-1.0
Banking system	-0.5	1.9	0.0	2.3	2.9	0.8	0.4	1.2	-0.7
CBA	-1.7	1.6	-0.4	-0.1	-0.8	0.2	-0.4	-0.2	-1.7
Commercial Banks	1.2	0.3	0.5	2.4	3.7	0.6	0.8	1.3	1.0
Nonbanks	-0.4	-0.3	0.2	0.2	-0.8	0.3	0.1	-0.4	-0.3
Privatization proceeds	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills/other	-1.4	0.2	-0.1	0.4	-0.3	0.1	-0.1	-0.1	-0.1
Promissory note/other	1.4	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-0.5	-0.3	0.1	-0.2	-0.5	0.2	0.2	-0.3	-0.3
External financing	1.9	0.5	3.2	2.5	2.9	0.8	1.9	2.0	2.7
Gross inflow 5/	8.2	2.2	6.9	4.1	4.5	2.6	3.5	3.5	4.3
Amortization due	-5.4	-0.8	-2.4	-0.7	-0.7	-0.9	-0.7	-0.6	-0.7
Net lending	-0.9	-0.9	-1.3	-0.9	-1.0	-0.9	-0.9	-0.9	-0.8
Other financing 7/	0.0	0.0	0.9	0.9	0.9	0.9	0.9	0.0	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	4,556	4,829	5,044	5,151	5,076	5,405	5,362	5,710	6,117
Program balance 8/	-0.9	-3.3	-5.9	-6.9	-7.2	-3.3	-3.8	-3.5	-2.3
Primary balance 9/	-1.9	-1.9	-4.5	-5.1	-5.2	-1.3	-1.8	-2.0	-0.8
Debt-creating fiscal balance 10/	-1.1	-2.8	-6.1	-6.8	-6.6	-3.7	-4.2	-3.6	-2.5
Government securities issuance	0.0	0.0	0.0	2.1	0.0	0.7	0.7	1.2	0.9

Sources: Ministry of Finance, Central Bank of Armenia, and Fund staff estimates and projections.
1/ From 2014, social contributions include contributions to the second pillar of the pension system.
2/ Composition of expense reclassified in November 2013 to account for wage bill more accurately. A further reclassification of expenses was made in 2015 whereby some spending on goods and services was classified in other categories.
3/ In 2015 reflects the payment of wage arrears for Nairit and the electricity subsidy to households and SMEs. In 2016, an additional subsidy of AMD 2 billion is assumed to cover the electricity tariff differential for households and SMEs.
4/ Changes in expense on goods and services relative to the Third Review reflect classification issues. In particular, spending on education which was previously reflected in "other expenditure" is now classified under "goods and services."
5/ In 2013 includes AMD 63 billion related to the acquisition by Gazprom from the gov't of 20 percent of the shares of ArmRusGazprom (gross inflow), and the transfer (other exp.) of the same amount from the gov't to ArmRusGazprom to liquidate liabilities. Excluding this transaction, the deficit amounts to 1 percent of GDP.
6/ Includes acquisition of military equipment.
7/ EFSD financing ($100 million in 2015-17). First disbursement occurred in December 2015.
8/ The program balance is measured as below-the-line overall balance minus net lending.
9/ Sum of overall balance (above the line), interest expense, and domestic and external net lending.
10/ Sum of overall balance (above-the-line) and external net lending. In 2013, it excludes the transfer associated to the acquisition of ArmRusGazprom by Gazprom, since it was financed with the sale of the government's shares in the company.

Table 7. Armenia: Medium-Term Macroeconomic Framework, 2013–22

(In percent of GDP, unless otherwise specified)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Act.	Act.	Act.	Prel.			Projections			
National income and prices										
Real GDP (percent change)	3.3	3.6	3.2	0.2	2.9	2.9	3.0	3.1	3.4	4.0
Gross domestic product (in millions of U.S. dollars)	11,121	11,610	10,553	10,565	10,969	11,453	12,028	12,632	13,319	14,153
Gross national income per capita (in U.S. dollars)	3,961	4,070	3,675	3,607	3,731	3,882	4,063	4,253	4,484	4,761
CPI inflation, period average (percent change)	5.8	3.0	3.7	-1.4	1.7	3.5	4.0	4.0	4.0	4.0
CPI inflation, end of period (percent change)	5.6	4.6	-0.1	-1.1	1.8	4.0	4.0	4.0	4.0	4.0
Investment and saving										
Investment	20.7	20.8	20.9	21.2	22.2	22.3	22.3	22.2	22.6	22.6
Private	18.5	18.6	18.0	18.0	19.6	19.7	19.8	19.9	20.0	20.0
Public	2.3	2.3	2.9	3.2	2.6	2.6	2.5	2.2	2.6	2.6
National savings	13.4	13.2	18.3	18.5	18.4	19.2	19.3	18.5	18.2	17.9
Private	12.7	12.9	20.2	20.9	19.1	19.2	18.5	17.5	16.9	16.4
Public	0.7	0.3	-1.9	-2.4	-0.6	-0.1	0.8	1.0	1.3	1.5
Central government operations										
Revenue and grants	22.2	22.0	21.5	21.4	22.4	22.3	23.0	23.1	23.2	23.3
Of which: tax revenue	21.0	21.1	20.1	20.0	20.7	20.8	21.4	21.6	21.7	21.8
grants	0.2	0.3	0.6	0.6	0.5	0.4	0.2	0.1	0.1	0.1
Expenditure	23.8	24.0	26.3	27.0	25.6	25.0	24.7	24.3	24.5	24.5
Current expenditure	21.5	21.7	23.4	23.8	23.0	22.4	22.1	22.1	21.9	21.8
Capital expenditure	2.3	2.3	2.9	3.2	2.6	2.6	2.5	2.2	2.6	2.6
Overall balance on a cash basis	-1.0	-2.1	-4.8	-5.6	-3.3	-2.7	-1.7	-1.3	-1.3	-1.1
Domestic financing	-1.0	1.6	0.7	2.0	0.5	0.7	-1.0	-0.4	-1.0	-0.4
External financing	1.9	0.5	3.2	2.9	1.9	2.0	2.7	1.7	2.3	1.5
Other financing	0.0	0.0	0.9	0.9	0.9	0.0	0.0	0.0	0.0	0.0
Public and publicly-guaranteed debt	40.8	43.6	48.7	55.1	55.7	57.0	56.4	54.6	53.6	52.4
External sector										
Exports of goods and services	28.4	28.6	29.7	33.1	35.3	36.0	36.3	35.7	34.8	34.1
Imports of goods and services	49.2	47.3	41.9	43.2	46.3	46.0	45.8	45.5	45.2	44.7
Current account (in percent of GDP)	-7.3	-7.6	-2.6	-2.7	-3.8	-3.2	-3.0	-3.7	-4.4	-4.8
Current account (in millions of U.S. dollars)	-813	-883	-279	-285	-418	-362	-363	-466	-584	-677
Capital and financial account (in millions of U.S. dollars)	1,758	346	720	945	432	612	718	641	773	677
Of which: direct foreign investment	475	388	162	281	402	344	354	365	378	393
public sector disbursements	914	257	898	571	380	404	512	916	530	489
Arrears and debt relief (in millions of U.S. dollars)	0	0	0	0	0	0	0	0	0	0
Financing gap (in millions of U.S. dollars)	0	0	0	0	121	0	0	0	0	0
Of which: IMF	0	0	0	0	21	…	…	…	…	…
Other	0	0	0	0	100	…	…	…	…	…
Gross international reserves in months of imports	4.9	4.0	4.7	5.2	5.2	5.4	5.8	6.0	5.7	5.3
Memorandum items:										
Debt-creating fiscal balance 1/	-1.1	-2.8	-6.1	-6.6	-4.1	-3.5	-2.5	-2.1	-2.1	-1.9

Sources: Armenian authorities; and Fund staff estimates and projections.

1/ Includes prospective EFSD financing ($100 million in 2015, 2016, and 2017).

Table 8. Armenia: Indicators of Capacity to Repay the Fund, 2013–21 1/

					Projections				
	2013	2014	2015	2016	2017	2018	2019	2020	2021
Fund obligations based on existing credit (in millions of SDRs)									
Principal	180.2	98.1	17.9	25.7	33.1	45.2	52.8	54.6	49.4
Charges and interest	5.5	2.4	1.6	1.9	1.5	2.8	2.4	2.0	1.6
Fund obligations based on existing and prospective credit (in millions of SDRs)									
Principal	180.2	98.1	17.9	25.7	33.1	45.2	52.8	54.6	50.7
Charges and interest	5.5	2.2	1.6	1.9	1.7	3.1	2.7	2.3	1.8
Total obligations based on existing and prospective credit									
In millions of SDRs	185.7	100.5	19.5	27.6	34.8	48.2	55.5	56.9	52.5
In millions of U.S. dollars	282.2	152.6	27.3	38.4	46.8	64.7	74.6	76.5	70.6
In percent of gross international reserves	12.5	10.2	1.5	1.7	2.1	2.6	2.7	2.7	2.4
In percent of exports of goods and services	8.9	4.6	0.9	1.1	1.2	1.6	1.7	1.7	1.5
In percent of debt service 2/	32.0	53.5	7.0	16.7	16.7	20.8	21.9	8.9	21.1
In percent of GDP	2.5	1.3	0.3	0.4	0.4	0.6	0.6	0.6	0.5
In percent of quota	201.9	109.2	21.2	21.5	27.0	37.4	43.1	44.2	40.8
Outstanding Fund credit based on existing credit 2/									
In millions of SDRs	379.7	305.1	299.0	304.6	269.6	224.4	171.6	117.0	67.6
In millions of U.S. dollars	577.0	463.4	418.3	423.3	362.3	301.1	230.5	157.2	90.9
In percent of gross international reserves	25.6	31.1	23.6	19.2	16.0	12.3	8.4	5.5	3.0
In percent of exports of goods and services	18.3	14.0	13.3	12.1	9.4	7.3	5.3	3.5	2.0
In percent of debt service 2/	65.4	162.4	107.0	184.0	128.9	96.9	67.8	18.3	27.2
In percent of GDP	5.2	4.0	4.0	4.0	3.3	2.6	1.9	1.2	0.7
In percent of quota	412.8	331.6	325.0	236.5	209.3	174.2	133.2	90.8	52.5
Net use of Fund credit based on existing and prospective credit (in millions of SDRs)	-125.2	-74.6	-6.1	5.6	-19.3	-45.2	-52.8	-54.6	-50.7
Disbursements	55.0	23.5	11.7	31.3	15.7	0.0	0.0	0.0	0.0
Repayments and repurchases	180.2	98.1	17.9	25.7	35.0	45.2	52.8	54.6	50.7
Memorandum items:									
Nominal GDP (in millions of U.S. dollars)	11,121	11,610	10,553	10,565	10,969	11,453	12,028	12,632	13,319
Exports of goods and services (millions of U.S. dollars)	3,156	3,319	3,137	3,501	3,870	4,128	4,370	4,513	4,636
Gross international reserves (millions of U.S. dollars)	2,253	1,489	1,771	2,204	2,259	2,458	2,755	2,869	3,002
Debt service (in millions of U.S. dollars) 2/	881.7	285.4	391.1	230.1	281.2	310.7	339.9	858.0	334.5
Quota (in millions of SDRs)	92.0	92.0	92.0	128.8	128.8	128.8	128.8	128.8	128.8

Source: Fund staff estimates and projections.

1/ Indicators cover both GRA and ECF credit.

2/ Total debt service includes IMF obligations.

Table 9. Armenia: External Financing Requirements and Sources, 2014–18

(In millions of U.S. dollars, unless otherwise indicated)

	2014	2015	2016	2017	2018
	Act.	Act.	Prel.	Proj.	
Gross Financing Requirements	1,054	1,414	1,387	1,245	1,343
External current account deficit (excl. transfers) (excluding official transfers)	1,628	846	847	1,024	987
Debt amortization and Fund repurchases	190	287	107	133	167
Gross international reserve accumulation	-764	282	433	88	189
Of which: IMF repurchases and repayments	149	25	36	47	61
Available financing	1,054	1,414	1,387	1,123	1,343
Capital Account and Current Transfers	1,018	1,383	1,369	1,123	1,343
of which: Capital transfers (net)	70	65	35	64	69
Foreign Direct Investment	388	162	281	402	344
Public Borrowing	216	635	499	294	298
Private transfers	641	421	392	431	444
Commercial banks net flows	-39	-313	-53	20	40
Financing gap	0	0	0	121	0
Exceptional Financing	0	0	0	121	0
Of which: IMF EFF program	0	0	0	21	0
Other 1/	0	0	0	100	0
Memorandum item:					
Current Account deficit, percent of GDP	-7.6	-2.6	-2.7	-3.8	-3.2
Net International Reserves	1,215	1,533	1,987	2,017	2,232
Gross Reserves	1,489	1,771	2,204	2,293	2,481
In months of prospective imports	4.0	4.7	5.2	5.2	5.4

Sources: Armenian authorities; and Fund staff estimates and projections.

1/ Financing from EFSD.

Table 10. Armenia: Purchases from the Fund and Timing of Reviews Under a Three-year EFF

Date of Availability	Conditions	Amount (millions of SDRs) EFF	Percent of Quota 1/ EFF
March 7, 2014	Board approval of the arrangement	11.74	12.76
September 30, 2014	Observance of end-June 2014 performance criteria and continuous performance criteria, and completion of first review	11.74	12.76
March 30, 2015	Observance of end-December 2014 performance criteria and continuous performance criteria, and completion of second review 2/	11.74	12.76
March 30, 2016	Observance of end-December 2015 performance criteria and continuous performance criteria, and completion of third review	15.65	12.15
September 30, 2016	Observance of end-June 2016 performance criteria and continuous performance criteria, and completion of fourth review	15.65	12.15
March 30, 2017	Observance of end-December 2016 performance criteria and continuous performance criteria, and completion of fifth review	15.69	12.18
	Total	82.21	63.83

Source: Fund staff estimates and projections.

1/ Armenia's quota increased from SDR 92 million to SDR 128.8 million in February 2016.

2/ This review was based on end-June 2015 PCs, which became the controlling PCs.

Annex I. Risk Assessment Matrix[1]

Nature/source of risk	Relative likelihood	Possible impact if risk is realized	Policy response
		Global Risks	
Policy and geopolitical uncertainties: • **Policy uncertainty and divergence.** Two-sided risks to U.S. growth with difficult-to-predict policies and global spillovers. In Europe, uncertainty associated with negotiating post-Brexit arrangements and with upcoming major elections. Policy divergence could lead to rising global imbalances and exacerbate exchange rate and capital flow volatility. • **Intensification of the risks of fragmentation/security dislocation in part of the Middle East, Africa, and Europe,** leading to a sharp rise in migrant flows, with negative global spillovers.	High High	**Staff assessment: High/ Medium** Lower global growth and trade, and move toward protectionism could create a hostile environment for trade, which could adversely affect Armenia. Intensification of tension in neighboring countries in the Middle East and renewed sanctions on Iran could also reduce trade and investment.	Prepare and implement contingency plans for potential trade and financial spillovers. Maintain exchange rate flexibility. Strengthen social safety nets to cushion impact of shocks on most vulnerable sectors.
Financial conditions: • **Significant further strengthening of the US dollar and/or higher rates.** As investors reassess policy fundamentals, as term premia decompress, or if there is a more rapid Fed normalization, leveraged firms, lower-rated sovereigns and those with un-hedged dollar exposures could come under stress. Could also result in capital account pressures for some economies.	High	**Staff assessment: Medium** A stronger US dollar could harm Armenia's highly dollarized banking system with an expected increase in NPLs in dollar. An appreciation of the dollar against other currencies could also harm the trade balance in case the dram does not depreciate.	Continue the de-dollarization efforts. Maintain exchange rate flexibility. Strengthen banking supervision and provision in the event of higher NPLs in dollar.
Weaker-than-expected global growth: • **Significant China slowdown and its spillovers:** Key near-term risks are disruptive drying up of liquidity for weaker borrowers in the interbank market and increasing pressure on the Renminbi, which could lead to overcorrection. Weak domestic demand	Low/Medium	**Staff assessment: Medium** Mining exports, an important area for export growth and source of foreign exchange earnings and tax revenue, would be	Diversify export destination and products. Accelerate structural reforms to improve the business climate for FDI. Strengthen social safety nets to

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability.

further suppresses commodity prices, roils global financial markets, and reduces global growth (Likelihood: low in short-term, medium thereafter). • **Significant slowdown in other large EMs/frontier economies.** Turning of the domestic credit cycle in addition to lower trend productivity and potential growth generates disorderly household and corporate deleveraging, with potential spillbacks to advanced economies. • **Structurally weak growth in key advanced and emerging economies:** Low productivity growth (U.S., the Euro Area, and Japan), a failure to fully address crisis legacies and undertake structural reforms, and persistently low inflation (the Euro Area, and Japan) undermine medium-term growth in advanced economies (high likelihood). Resource misallocation and policy missteps, including insufficient reforms, exacerbate declining productivity growth in emerging markets (medium likelihood).	 Medium High/ Medium	hit. Remittances could fall further, in case economic growth in major trading partners remains sluggish.	cushion the impact of shocks.
• **Lower energy prices**, Production cuts by OPEC and other major producers may not materialize as agreed while other sources of supply could increase production.	Low	**Staff assessment: Medium/High** Negative indirect effects via major trading partners.	Diversify trade partners. Improve the business climate for international investors.
Country-Specific Risks			
Large fiscal adjustment: • Large fiscal adjustment can adversely impact growth at the time when fiscal policy needs to support the nascent recovery. At the same time, slippages could endanger debt sustainability.	**Assessment**: Low	**Staff assessment: Low** The impact of the adjustment could be partly offset by recovery in private sector activity. The planned backloading of the adjustment should also mitigate the impact on growth and could reduce the possibility of slippages.	Modify the current fiscal rule to preserve the debt sustainability while allowing a smoother adjustment in the event of shocks to protect short-term growth.
Regional conflict: Risks from sharp, renewed Nagorno-Karabakh-related tensions.	**Assessment**: High/Medium	**Staff assessment: High/Medium** Conflict would involve severe impacts, including possible regional military action.	Prepare and implement contingency plans.

Annex II. Public Debt Sustainability Analysis

Results from an updated DSA using staff's baseline projections indicate that Armenia's public debt remains sustainable but the high share of foreign currency debt and debt held by foreign residents continues to be an important source of vulnerability. The relatively large fiscal adjustment needed to stabilize debt is a risk. Alternative scenarios and stress tests suggest that an adverse growth shock would have the largest impact on debt dynamics and government financing needs.

Background

1. **Widening of the fiscal deficit on the back of subdued economic activity has been the main driver of Armenia's public debt increase in the last few years.** The gross debt-to-GDP ratio rose to 55 percent in 2016 due to weaker-than-budgeted revenue, combined with stepped up capital spending. Excluding the central bank, debt exceeded the 50 percent threshold set in the Law on State Debt which triggered the corrective mechanism under the fiscal rule. According to this rule, the fiscal deficit next year should be no more than 3 percent of the average GDP of the previous three years (equivalent to about 2.8 percent of 2017 GDP). Unlike 2014, the debt dynamics in 2015–16 was driven by fiscal loosening rather than exchange rate developments, while the share of external debt decreased slightly in 2016 to 84 percent of total debt. In 2016, the issuance of dram-denominated government securities increased significantly, including due to more favorable market conditions, and as a result domestic debt rose by 36 percent in 2016.

2. **The DSA is based on an updated set of macroeconomic assumptions.** Real GDP growth projection for 2017 is revised up slightly relative to the fourth review on the back of additional capital spending, while inflation projection is also revised up somewhat consistent with the monetary policy stance. The path of real GDP growth in the medium term has been revised down with potential growth now 1 percent lower than the pre-crisis period, while inflation is expected to return slowly to the authorities' 4 percent target over the medium term, as previously assumed. Tax collection is expected to be ½ percent of GDP higher than budgeted in 2017 owing to strong collections from the EEU customs pool and strengthened tax administration efforts. At the same time, foreign-financed capital expenditure is expected to be 1 percent of GDP higher than budgeted which would bring the overall fiscal deficit to around 3.3 percent of GDP. After sharp increases in the previous two years, the primary deficit (including net lending) is projected to but cut to 1.8 percent of GDP in 2017 (see below).

Public DSA results

3. **Government debt will continue to rise this year and in 2018, albeit at a much slower pace than in the previous two years.** Armenia's total public debt as a share of GDP is projected to reach 56 percent in 2017 and increase further in 2018 before starting to decline. However, as the government has initiated the consolidation process, debt growth will decelerate.

4. **Debt dynamics improve over the medium term.** As consolidation gains momentum, debt stabilizes and starts to decline after 2019, reflecting also favorable macroeconomic

developments captured in the interest-growth differential. Under the baseline, the increase in the share of FX-denominated debt in total debt decelerates due to a more rapid increase in amortization relative to new disbursements. Government's gross financing needs are expected to decline gradually from around 6 percent of GDP in 2017 as consolidation continues. External financing will continue to be contracted primarily on concessional terms, in the form of project-related loans and budget support from multilateral donors. Domestic financing, although increasing, is expected to remain relatively small with an increasing average maturity.

5. **Baseline projections are subject to significant uncertainty.** Historically, growth rates, interest rates, and exchange rates in Armenia have been quite volatile, which implies wide confidence bands around the central projection. Assuming a symmetric distribution of shocks, a fan chart for the public debt-to-GDP ratio points to a range between 41 and 73 percent (corresponding to the 10^{th}–90^{th} percentile) in 2017 and between 25 and 94 percent in 2022. An asymmetric fan chart, which rules out real exchange rate appreciation, suggests that debt could range between 40 and 108 percent of GDP (10^{th}–90^{th} percentile) in the end of the projections horizon.

Structure of government debt (percent of total)

	Dec-15	Mar-17
By initial maturity		
Short-term	1.0	1.7
Medium-term	6.9	8.6
Long-term	92.1	89.7
By type of interest rate		
Floating	10.5	12.5
Fixed	89.5	87.5

Source: RA Ministry of Finance.

6. **There are risks to fiscal consolidation under the baseline.** As noted above, the fiscal adjustment in 2017 is sizeable and the debt path under the baseline requires continued consolidation effort in the medium term. Adjustment of such magnitude is challenging, both politically and economically. The government has shown determination to freeze or reduce non-interest current spending in 2017 and rein in capital expenditure, while revenue performance in 2017 so far has been encouraging. Consolidation over the medium term will rely on a combination of expenditure restraints and revenue increases, underpinned by a rigorous implementation of the new Tax Code which became effective in 2017.

7. **The heat map highlights vulnerabilities stemming from the large external public debt.** The high share of FX debt and debt held by non-residents remains an important risk factor for debt sustainability. A depreciation of the exchange rate would worsen the debt outlook as indicated by the relevant stress test (see below). This can be a risk in light of the potential further monetary policy loosening. However, this risk is mitigated by the fact that over 90 percent of the debt is long-term, mostly provided by official creditors, and at fixed interest rates (see table).

8. **Scenarios assuming a constant primary balance and key variables at their historical averages underscore the need for consolidation.** The paths of public debt and gross financing needs deviate significantly from the baseline under the constant primary balance and historical scenarios; the debt ratio rises to over 60 percent and financing needs to close to 10 percent of GDP in 2022 if the primary balance remains at the current level. This implies that without active policy measures aimed at reducing the fiscal deficit, debt sustainability would be jeopardized.

9. Stress tests suggest that real GDP growth shocks have the largest impact on debt indicators. An adverse shock to growth,[1] whereby real GDP contracts by 4 percent in 2018–19, respectively, causes public debt to increase to 77 percent of GDP, and public gross financing needs exceed 7 percent of GDP by 2019. This scenario, however, is based on historical GDP growth which, as noted above, has been characterized by quite high volatility, and the realization of shocks of such magnitude is relatively unlikely. Stress tests based on standardized primary balance, real interest and exchange rate shocks reveal a moderate deterioration relative to the baseline, with real exchange rate depreciation having a somewhat larger impact.

[1] The shock assumes that real GDP growth is reduced by 1 standard deviation of real GDP growth rates over the past 10 years.

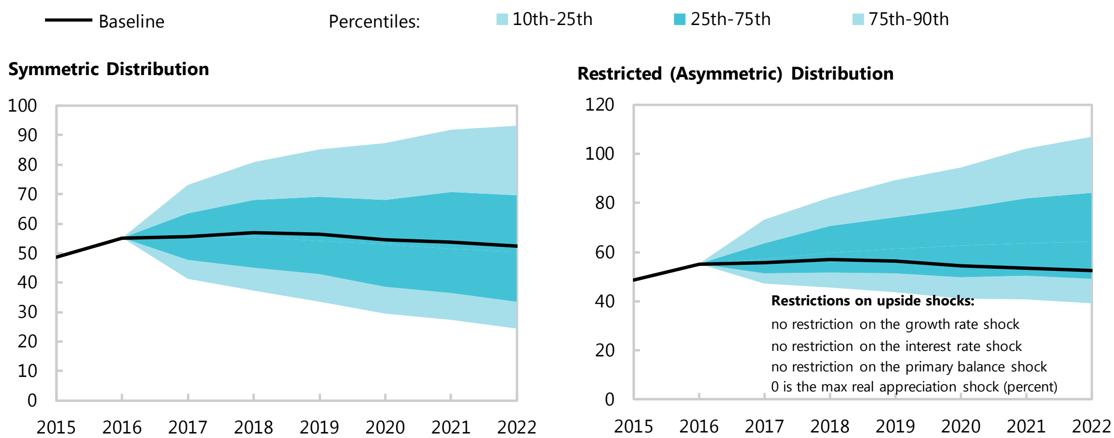
Armenia Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

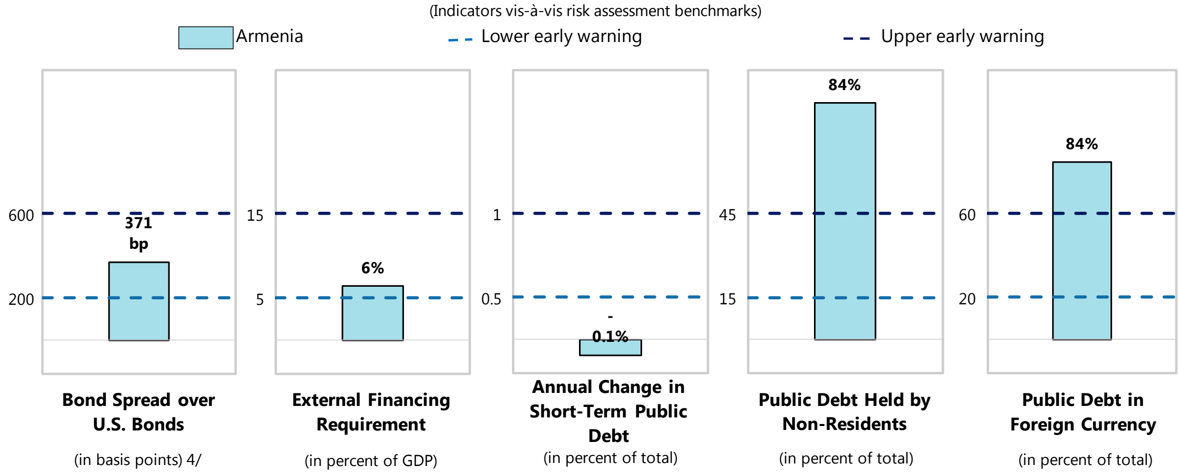
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

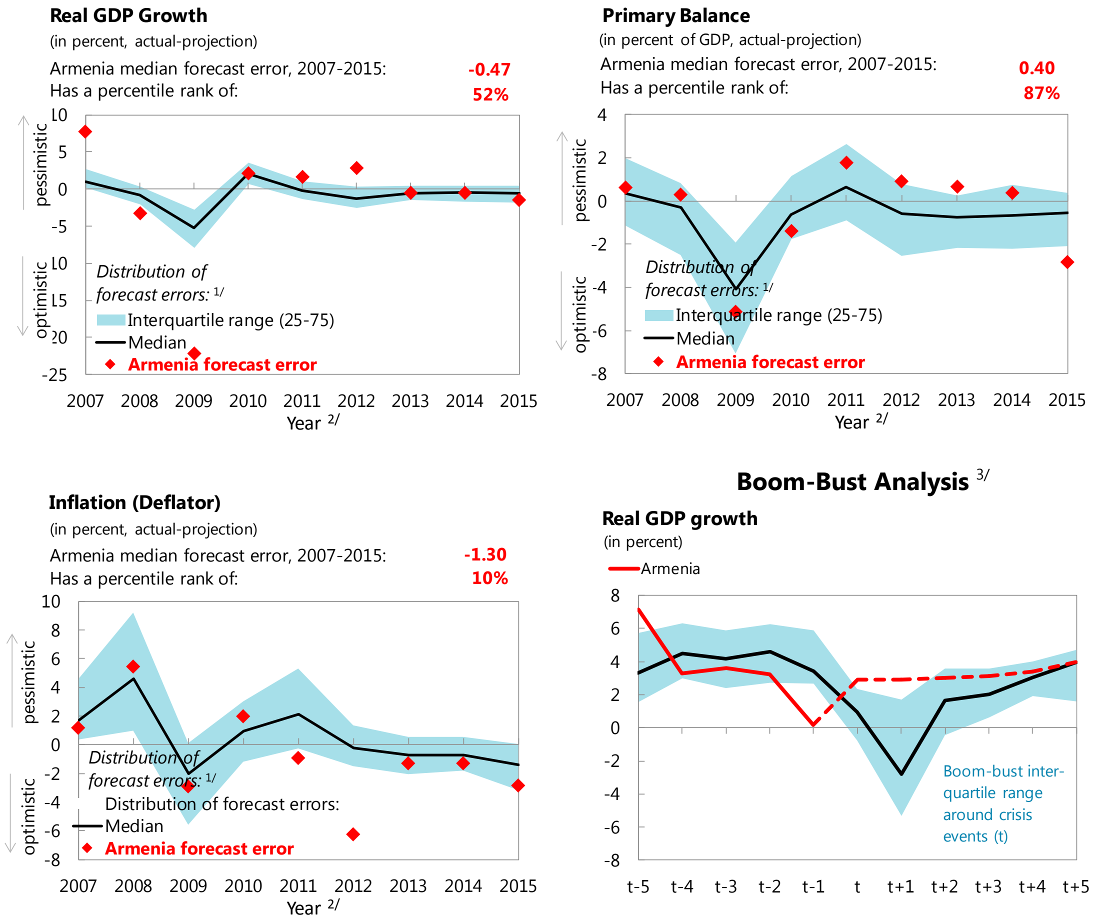
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ An average over the last 3 months, 03-Feb-17 through 04-May-17.

Armenia Public DSA – Realism of Baseline Assumptions

Forecast Track Record, versus all countries



Source: IMF staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries
2/ Projections made in the spring WEO vintage of the preceding year
3/ Armenia has had a positive output gap for 3 consecutive years, 2014-2016 and a cumulative increase in private sector credit of 8 percent of GDP, 2013-2016.
For Armenia, t corresponds to 2017; for the distribution, t corresponds to the first year of the crisis.

Armenia Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

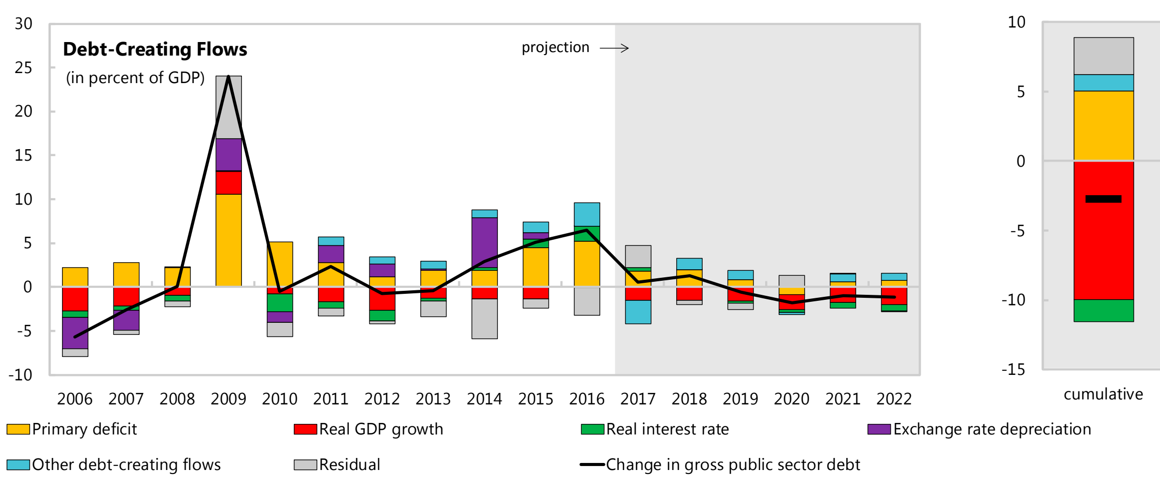
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2006-2014 [2]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	33.2	48.7	55.1	55.7	57.0	56.4	54.6	53.6	52.4
Public gross financing needs	6.5	9.7	9.3	5.3	4.2	2.4	3.6	1.5	3.3
Net public debt		41.2	47.7	48.8	50.2	49.7	49.4	48.8	48.0
Real GDP growth (in percent)	4.5	3.3	0.2	2.9	2.9	3.0	3.1	3.4	4.0
Inflation (GDP deflator, in percent)	4.5	1.2	0.5	2.6	3.5	4.0	4.0	4.0	4.0
Nominal GDP growth (in percent)	9.3	4.5	0.6	5.6	6.5	7.1	7.2	7.5	8.2
Effective interest rate (in percent) [4]	2.4	3.5	4.0	3.5	3.7	3.6	3.5	2.8	2.6

As of May 04, 2017		
Sovereign Spreads		
Spread (bp) 3/		369
CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	B1	n.a.
S&Ps	BB-	n.a.
Fitch	B+	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	2.1	5.06	6.45	0.6	1.3	-0.6	-1.8	-1.0	-1.2	-2.7	
Identified debt-creating flows	2.6	6.08	9.54	-1.1	2.7	1.0	-2.1	-0.1	-0.3	0.1	
Primary deficit	3.4	4.5	5.2	1.8	2.0	0.8	-0.9	0.6	0.8	5.1	-1.1
Primary (noninterest) revenue and grants	20.9	21.5	21.4	22.4	22.3	23.0	23.1	23.2	23.3	137.2	
Primary (noninterest) expenditure	24.3	26.0	26.6	24.2	24.3	23.8	22.1	23.8	24.1	142.3	
Automatic debt dynamics [5]	-1.2	0.3	1.6	-0.2	-0.6	-0.9	-0.9	-1.6	-1.9	-6.1	
Interest rate/growth differential [6]	-1.9	-0.4	1.6	-1.1	-1.5	-1.9	-2.0	-2.4	-2.7	-11.6	
Of which: real interest rate	-0.6	1.0	1.7	0.4	0.0	-0.3	-0.3	-0.7	-0.8	-1.6	
Of which: real GDP growth	-1.2	-1.4	-0.1	-1.5	-1.5	-1.6	-1.6	-1.7	-2.0	-10.0	
Exchange rate depreciation [7]	0.7	0.7	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.4	1.3	2.7	-2.7	1.3	1.1	-0.2	0.8	0.8	1.1	
Domestic net lend./drawdown of gov. dep. (r	0.0	0.0	1.7	-3.6	0.3	0.3	-1.1	0.0	0.0	-4.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
External net lending	0.4	1.3	1.0	0.9	0.9	0.8	0.8	0.8	0.8	5.2	
Residual, including asset changes [8]	-0.4	-1.0	-3.1	2.5	-0.5	-0.7	1.3	0.0	0.0	2.7	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Bond Spread over U.S. Bonds.

4/ Defined as interest payments divided by debt stock at the end of previous year.

5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

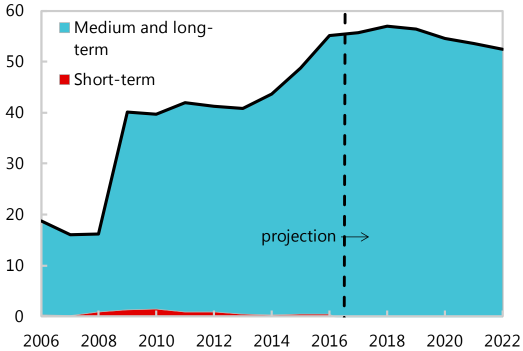
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

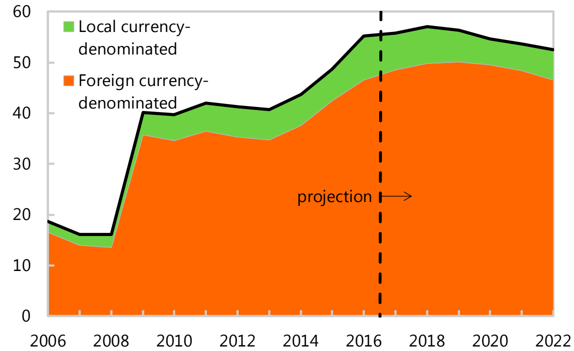
Armenia Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



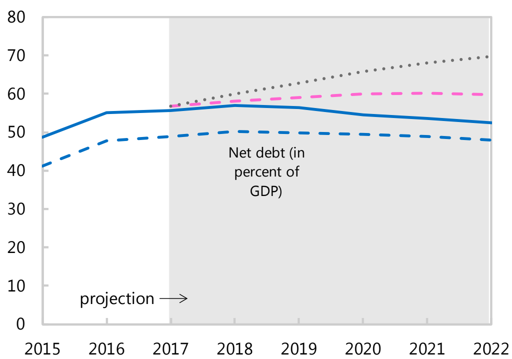
By Currency
(in percent of GDP)



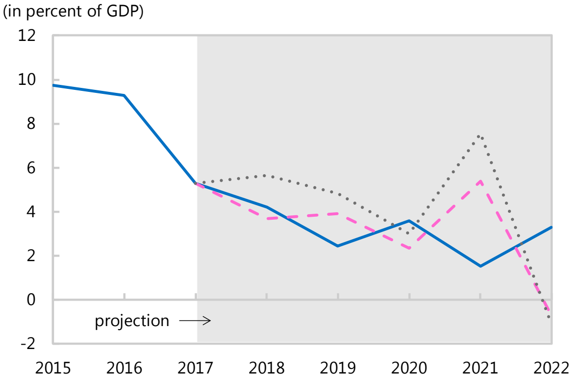
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.9	2.9	3.0	3.1	3.4	4.0
Inflation	2.6	3.5	4.0	4.0	4.0	4.0
Primary Balance	-1.8	-2.0	-0.8	0.9	-0.6	-0.8
Effective interest rate	3.5	3.7	3.6	3.5	2.8	2.6
Constant Primary Balance Scenario						
Real GDP growth	2.9	2.9	3.0	3.1	3.4	4.0
Inflation	2.6	3.5	4.0	4.0	4.0	4.0
Primary Balance	-1.8	-1.8	-1.8	-1.8	-1.8	-1.8
Effective interest rate	3.5	3.7	3.6	3.7	3.0	2.5

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.9	3.1	3.1	3.1	3.1	3.1
Inflation	2.6	3.5	4.0	4.0	4.0	4.0
Primary Balance	-1.8	-3.8	-3.8	-3.8	-3.8	-3.8
Effective interest rate	3.5	3.7	3.7	3.7	2.9	2.2

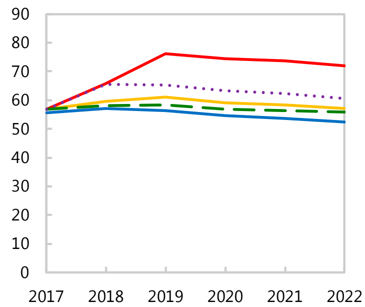
Source: IMF staff.

Armenia Public DSA – Stress Tests

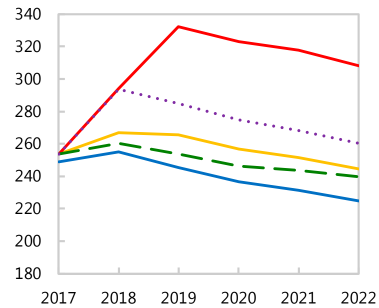
Macro-Fiscal Stress Tests

Baseline
Real GDP Growth Shock
Primary Balance Shock
Real Exchange Rate Shock
Real Interest Rate Shock

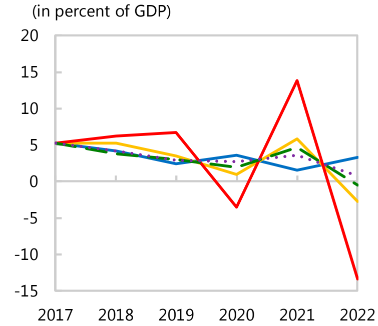
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



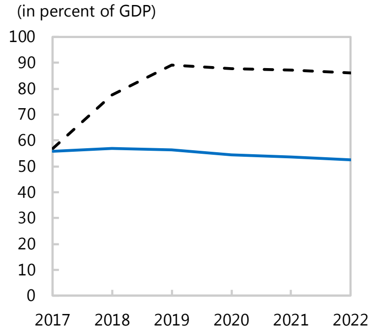
Public Gross Financing Needs
(in percent of GDP)



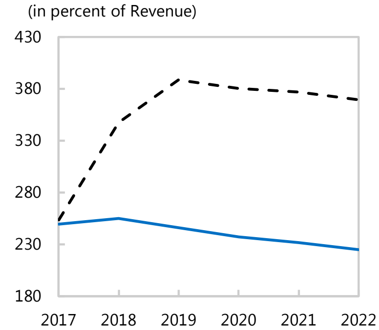
Additional Stress Tests

Baseline
Combined Macro-Fiscal Shock

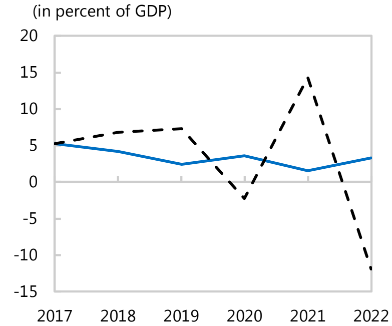
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions

(in percent)

Primary Balance Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	2.9	2.9	3.0	3.1	3.4	4.0
Inflation	2.6	3.5	4.0	4.0	4.0	4.0
Primary balance	-1.8	-3.4	-2.2	0.9	-0.6	-0.8
Effective interest rate	3.5	3.7	3.7	3.8	3.2	2.6
Real Interest Rate Shock						
Real GDP growth	2.9	2.9	3.0	3.1	3.4	4.0
Inflation	2.6	3.5	4.0	4.0	4.0	4.0
Primary balance	-1.8	-2.0	-0.8	0.9	-0.6	-0.8
Effective interest rate	3.5	3.7	3.9	4.2	4.1	3.9
Combined Shock						
Real GDP growth	2.9	-4.2	-4.1	3.1	3.4	4.0
Inflation	2.6	1.7	2.2	4.0	4.0	4.0
Primary balance	-1.8	-4.2	-5.4	0.9	-0.6	-0.8
Effective interest rate	3.5	4.2	3.9	4.6	4.5	3.9

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	2.9	-4.2	-4.1	3.1	3.4	4.0
Inflation	2.6	1.7	2.2	4.0	4.0	4.0
Primary balance	-1.8	-4.2	-5.4	0.9	-0.6	-0.8
Effective interest rate	3.5	3.7	3.8	4.0	3.7	2.6
Real Exchange Rate Shock						
Real GDP growth	2.9	2.9	3.0	3.1	3.4	4.0
Inflation	2.6	9.1	4.0	4.0	4.0	4.0
Primary balance	-1.8	-2.0	-0.8	0.9	-0.6	-0.8
Effective interest rate	3.5	4.2	3.5	3.5	2.8	2.5

Source: IMF staff.

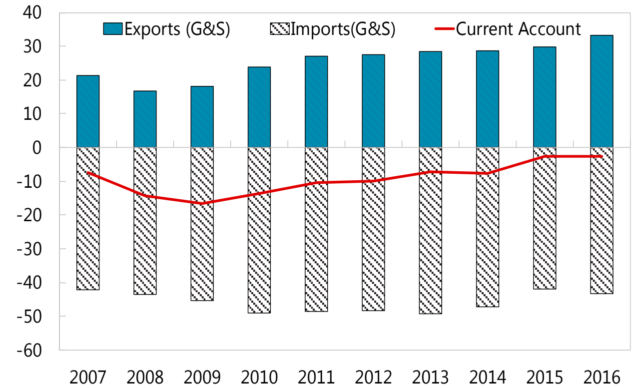
Annex III. External Stability Assessment

Current Account

1. Since the global financial crisis, Armenia has experienced significant current account consolidation. Armenia's current account deficit peaked in 2009 at around 16 percent of GDP and fell steadily to around 7 percent of GDP in 2014, driven first by a substantial fiscal consolidation in 2009–11 and then by rising remittances in 2012–13. Since the last Article IV, Armenia's current account deficit has fallen significantly again to below 3 percent of GDP, driven by a strengthening of the trade balance. Imports have declined dramatically, reflecting a combination of factors, particularly, reduced remittances and weak domestic demand. In contrast, export growth has been relatively strong, despite the difficult external environment and falling international prices, largely due to the opening of a new copper mine in 2015 and a broader diversification into non-traditional markets and products. Armenia's recent entry into the EEU also represents an important structural change that may have had some impact on trade, particularly during this period of transition.[1]

Current Account

(In percent of GDP)



Source: Balance of Payments data.

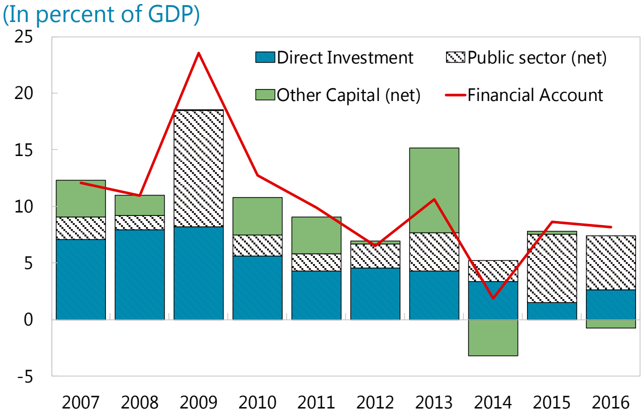
2. Looking ahead, the current account deficit is projected to rise gradually. The current pace of export growth is likely to slow in the near term, given that the weak external environment is expected to persist. However, the opening of a new gold mine should provide a significant boost to exports from 2018 onwards. At the same time, imports have begun to recover, driven by the pick-up in remittances and domestic demand. Together, this is expected to drive a gradual widening of the current account deficit to around 5 percent of GDP by 2022. However, the impact of EEU membership increases the uncertainty of the outlook—it is still unclear how much of a role this has played in recent trade developments, and whether the impact will be temporary or permanent.

[1] See annexes in the third and fourth review staff reports for possible impacts on imports and export, respectively, during this period.

Capital and financial account

3. **Since the last Article IV, the composition of financial flows has evolved in line with weaker external and domestic conditions.** Financing flows in 2015–16 were dominated by a Eurobond issuance ($500m in March 2015) and increased government borrowing from multilateral and bilateral donors, mostly on concessional terms. In contrast, FDI dropped off significantly in 2015 to around a third of the 2012–14 average. While there was a partial recovery in investment flows in 2016, this is largely explained by inflows into financial institutions to fulfil the new mandatory capital requirements, rather than flows to the real economy. The general weakness in FDI reflects lower reinvested earnings and large sales in the telecommunications and mining sectors, as well as lower "fresh" flows—all of which are likely to have been affected, to some extent, by the weak growth environment and uncertain outlook.

Financial Account
(In percent of GDP)



Source: Balance of Payments data.

4. **While there are no immediate financing concerns, managing concessional government borrowing efficiently and boosting FDI would help reduce potential future pressures.** Looking ahead, donor financing for a large $2 billion pipeline of capital projects is already in place. As discussed above, the challenge will be to manage and prioritize this pipeline, balancing growth and development objectives with debt sustainability. Repayment of the large Eurobond is also due in 2020. FDI flows are likely to be boosted in the short term by the large investment in the new gold mine, but are projected to remain somewhat lower than in recent years. Broader structural reforms to improve the business environment and, crucially, to upgrade transportation infrastructure would help facilitate non-debt creating flows and further growth in the tradable sector, which would increase resilience to shocks.

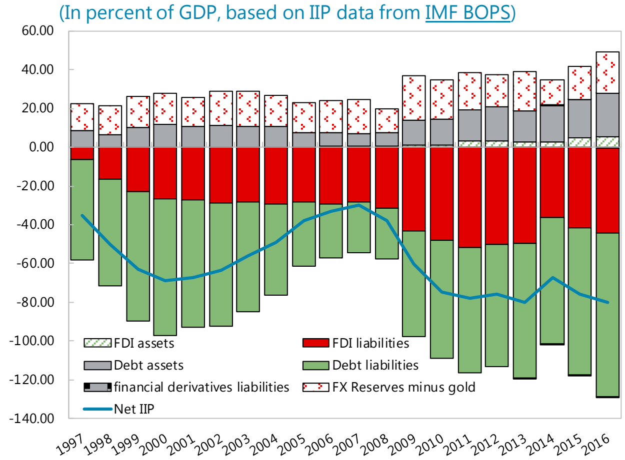
Net International Investment Position (NIIP)

5. **Armenia's large and negative NIIP, dominated by debt liabilities, remains an important source of external vulnerability.** At end-2016, Armenia's NIIP reached -80 percent of GDP, up from -30 percent of GDP in 2007. External liabilities have also tilted towards debt, which now amount to over 60 percent of GDP.[2] There are a number of important mitigating factors: (i) most of Armenia's debt liabilities are long-term, and the majority of government liabilities are also concessional, reflecting Armenia's relatively recent transition from low-income

[2] Catao and Milesi Ferretti (2013) conclude that net foreign liabilities exceeding 50 percent of GDP are a significant predictor of crisis and that the risks rise as debt liabilities reach a tipping point of 35 percent of GDP. Other important factors include the speed at which foreign liabilities accumulate, as measured by the size of current account deficits, and reserve accumulation, which has a significant crisis-prevention role.

to emerging market economy; (ii) the NIIP position has been relatively stable since the large deterioration in 2009 (averaging around 75 percent of GDP); (iii) the current account balance and reserve buffers—other important predictors of external crisis—have strengthened significantly since the last Article IV in 2014. Nevertheless, the size and composition of the NIIP, as well as the recent trajectory of flows, indicate the potential for future external vulnerabilities. In this context, efforts to attract FDI and generate private sector-led growth will help reduce the dependence on external government borrowing and improve balance sheet resilience.

IIP Composition, by Instrument
(In percent of GDP, based on IIP data from IMF BOPS)

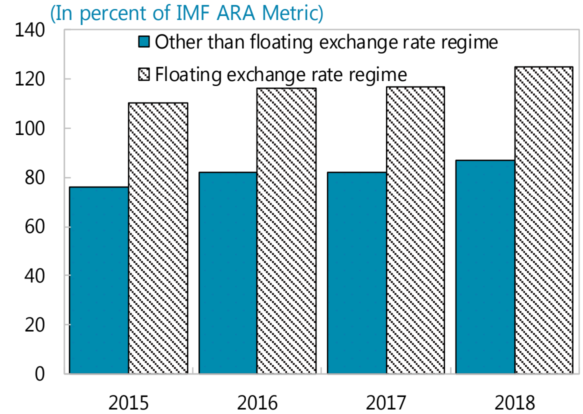


Sources: IMF Balance of Payments Statistics; and IMF World Economic Outlook

Reserve Adequacy

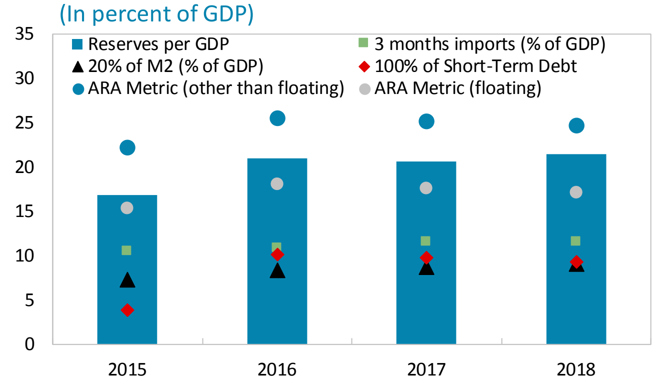
6. Armenia's foreign exchange reserves remain adequate. After the drawdown of reserves in late-2014, buffers have been rebuilt. Gross international reserves increased to $2.2 billion at end-2016, reflecting strong export receipts, large multilateral and bilateral donor disbursements to the government and limited FX sales by the CBA. Reserve coverage appears adequate by most standard metrics. Under the Fund's reserve adequacy metric (ARA) for floating exchange rate regimes—the current de facto classification—reserves were within the adequate range at around 116 percent at end-2016 and projected to remain stable through 2018. In contrast, reserves would only be at around 80 percent of the ARA metric for "non-floating" regimes, highlighting the importance of the authorities' commitment to continued two-way exchange rate flexibility. Looking ahead, the exchange rate should continue to act as the key shock absorber to facilitate adjustment. The authorities should aim to retain reserve buffers, given

International Reserves
(In percent of IMF ARA Metric)



Sources: National Authorities; and IMF staff calculations.

Projected Reserve Adequacy Indicators, end-year
(In percent of GDP)

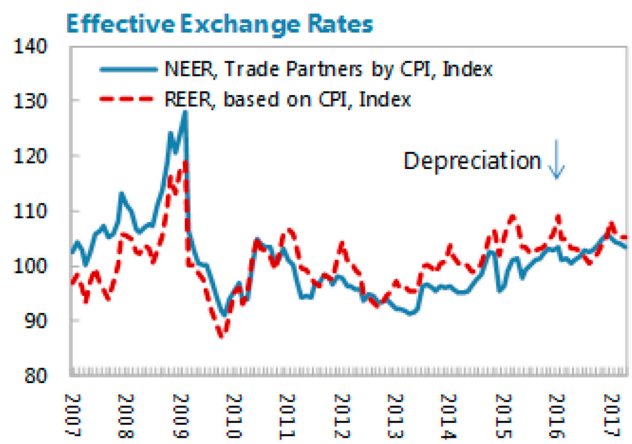


the vulnerability to shocks and the high degree of dollarization, only drawing down to counteract excessive exchange rate volatility.

External Balance Assessment

7. The external position remains broadly in line with fundamentals and desirable policy settings, based on the IMF's External Balance Approach-lite (EBA-lite):

- The *external sustainability* (ES) approach estimates a current account norm of -4.7 percent of GDP to stabilize the ratio of Net IIP to GDP over a 20-year period at the end-2016 level of -79.8 percent of GDP. When compared with the medium-term projection for the current account of -4.8 percent of GDP, this implies a current account gap of -0.1 percent. Stabilizing the IIP at the -75 percent of GDP (the average level since 2008) would suggest a current account norm of -4.5 percent of GDP, a current account gap of -0.3.
- The *current account* (CA) approach, suggests a current account norm of -6.7 percent of GDP for 2016, relative to the actual balance of -2.7 percent of GDP. This suggests a current account gap of 4 percent of GDP (± 1 percent) with a policy gap of -0.3 percent of GDP.[3] However, the staff view is that a stronger current account norm is required to mitigate external vulnerabilities, and that the actual underlying current account balance reflects temporary factors not fully captured by the model, particularly the large contraction in imports.



Source: IMF Information Notice System.

- The *REER* approach implies an overvaluation of 13 percent (±4 percent).The CPI-based real effective exchange rate remained relatively stable in 2016, ending the year at roughly the same level as 2015.

Given the large negative NIIP position, staff puts special emphasis on the ES approach. The staff assessment is that the ES approach's CA norm of - 4.7 percent of GDP is more appropriate than the CA approach norm of -6.7 percent of GDP, given external vulnerabilities, and that the medium-term CA projection of -4.8 percent of GDP is a more useful reference point than the underlying current account of -2.7 percent of GDP, considering the temporary factors not captured by the model. This implies a staff-assessed current account gap of -0.1 percent of GDP,

[3] The policy gap is composed of a large -0.9 percent of GDP fiscal policy gap, partially offset by a private credit gap of -0.5 percent of GDP. This reflects the necessary fiscal consolidation and the sustainable increase in private credit that are recommended over the medium term.

which equates to a slight REER overvaluation of 0.4 percent (±4 percent), indicating that the current account and REER remain broadly in line with fundamentals and desirable policies.

Estimated of EBA-Lite Current Account and Real Exchange Rate Misalignment
(In percent of GDP, unless indicated otherwise)

	External Sustainability (EBA-lite)	Current Account (EBA-lite)	REER (EBA-lite)	Staff-assessment
CA norm	-4.7	-6.7		-4.7
CA actual 1/	-4.8	-2.7		-4.8
CA gap	-0.1	4.0		-0.1
o/w policy gap		-0.3		-0.3
Elasticity	-0.27	-0.27		-0.27
Real exchange rate gap 2/	0.4	-14.7	13.0	0.4

1/ end-2016 actual for the MB approach, and 2022 projection for the external sustainability approach and staff-assessment.

2/ Movement in real exchange rate needed to close the gap between norm and underlying current account. REER approach uses REER projection for 2016.

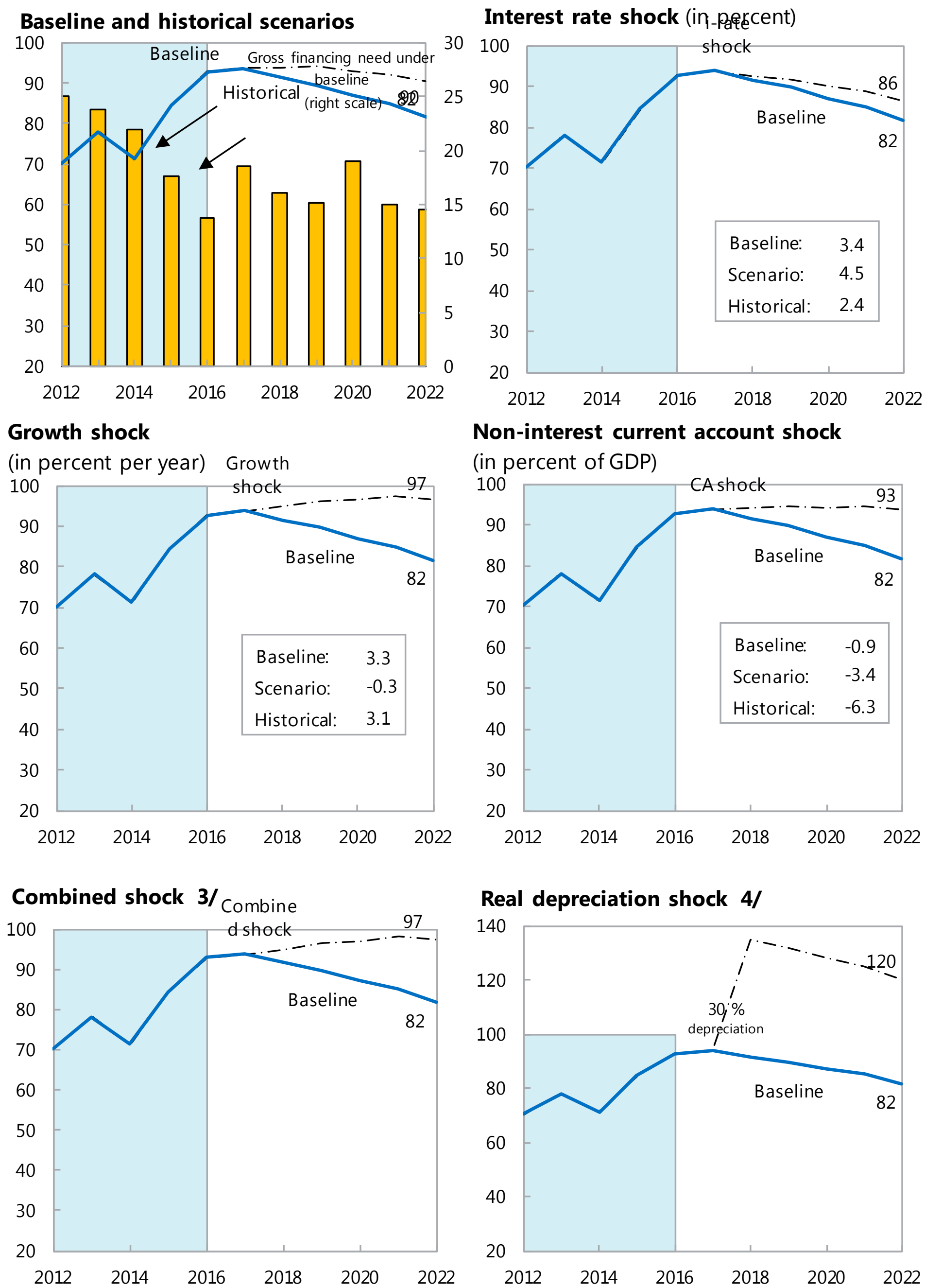
External Debt Sustainability

8. **Armenia's external debt-to-GDP ratio is high but is projected to fall in the medium-term.** The external debt ratio rose to 93 percent of GDP at end-2016—up significantly from 70 percent at end-2014 and a low of 30 percent in 2008. After the global crisis, the external debt-to-GDP ratio increased significantly, due to larger external current account deficits combined with lower growth. The large increase in external debt since 2014 reflects a sizable nominal depreciation and an increase in external public borrowing, including the 2015 issuance of the Eurobond and higher multilateral donor disbursements. Looking ahead, the debt profile remains broadly consistent with the December 2016 assessment— debt is projected to peak in 2017 (albeit at a slightly higher level) before gradually falling back to around 82 percent by end-2022. Public sector debt is projected to grow more quickly than private sector debt. The key driver of the improvement over the medium term is the stronger current account, with the non-interest current account deficit projected to remain significantly below the estimated debt-stabilizing level of 5.4 percent of GDP. While imports are projected to recover in the medium term, non-debt creating flows are expected to continue offsetting the non-interest current account deficit. Debt dynamics have a limited impact but should help lower debt, with the projected pickup in growth and fall in nominal external interest rates.

9. **External debt remains sensitive to standardized shocks.** Shocks to growth, the non-interest current account and the combined shock scenario all result in a significant increase in external debt to between 93 and 97 percent of GDP by the end of the projection period. A one-time 30 percent real ER depreciation would increase the debt ratio to over 120 percent of GDP by 2022, reflecting the high share of foreign currency debt. The impact of interest rate shocks remains limited due to the large share of concessional financing in external public debt.

Armenia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2017

Armenia External Debt Sustainability Framework, 2012–22

(In percent of GDP, unless otherwise indicated)

	Actual 2012	2013	2014	2015	2016	10-Year Historical Average	10-Year Standard Deviation	Projections 2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
Baseline: External debt	70.2	78.1	71.3	84.4	92.8			**93.7**	**91.5**	**89.6**	**87.0**	**85.0**	**81.7**	**-5.4**
Change in external debt	-8.1	7.9	-6.8	13.1	8.4			0.9	-2.2	-1.9	-2.6	-2.0	-3.3	
Identified external debt-creating flows (4+8+9)	2.1	-0.1	1.0	8.2	-0.1			-2.5	-2.4	-2.5	-1.9	-1.3	-1.2	
Current account deficit, excluding interest payments	7.8	5.1	5.0	-0.5	-0.7			0.2	-0.2	-0.1	0.7	1.9	2.5	
Deficit in balance of goods and services	20.8	20.9	18.7	12.1	10.1			11.1	10.0	9.4	9.7	10.4	10.6	
Exports	27.5	28.4	28.6	29.7	33.1			35.3	36.0	36.3	35.7	34.8	34.1	
Imports	48.3	49.2	47.3	41.9	43.2			46.3	46.0	45.8	45.5	45.2	44.7	
Net non-debt creating capital inflows (negative)	-4.5	-4.3	-3.3	-1.5	-2.7			-3.7	-3.0	-2.9	-2.9	-2.8	-2.8	
Automatic debt dynamics 1/	-1.2	-0.9	-0.7	10.2	3.3			1.0	0.8	0.5	0.3	-0.3	-0.9	
Contribution from nominal interest rate	2.4	2.2	2.6	3.1	3.4			3.6	3.4	3.1	2.9	2.5	2.3	
Contribution from real GDP growth	-5.3	-2.2	-2.7	-2.6	-0.2			-2.6	-2.6	-2.6	-2.6	-2.8	-3.2	
Contribution from price and exchange rate changes 2/	1.8	-1.0	-0.6	9.7	0.1			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-10.2	8.0	-7.8	4.8	8.5			3.4	0.3	0.6	-0.8	-0.7	-2.1	
External debt-to-exports ratio (in percent)	255.5	275.1	249.3	283.8	280.0			265.6	254.0	246.7	243.4	244.2	239.4	
Gross external financing need (in billions of US dollars) 4/	2.7	2.6	2.5	1.9	1.4			2.0	1.8	1.8	2.4	2.0	2.1	
in percent of GDP	25.1	23.8	21.9	17.6	13.7			18.5	16.0	15.1	19.0	15.0	14.5	
Scenario with key variables at their historical averages 5/								**93.7**	**93.5**	**94.1**	**93.1**	**92.3**	**90.3**	**-8.0**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	7.1	3.3	3.6	3.3	0.2	3.1	7.1	2.9	2.9	3.0	3.1	3.4	4.0	
GDP deflator in US dollars (change in percent)	-2.3	1.4	0.8	-12.0	-0.1	2.9	12.3	0.9	1.5	2.0	1.9	2.0	2.2	
Nominal external interest rate (in percent)	3.1	3.3	3.4	4.0	4.1	2.4	2.3	4.0	3.7	3.6	3.5	3.1	2.9	
Growth of exports (US dollar terms, in percent)	6.4	8.2	5.2	-5.5	11.6	9.5	8.9	10.6	6.7	5.9	3.3	2.7	4.2	
Growth of imports (US dollar terms, in percent)	4.3	6.7	0.2	-19.5	3.4	8.8	18.8	11.2	3.8	4.4	4.3	4.7	5.2	
Current account balance, excluding interest payments	-7.8	-5.1	-5.0	0.5	0.7	-6.3	4.9	-0.2	0.2	0.1	-0.7	-1.9	-2.5	
Net non-debt creating capital inflows	4.5	4.3	3.3	1.5	2.7	4.9	2.1	3.7	3.0	2.9	2.9	2.8	2.8	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Appendix I. Letter of Intent

Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Yerevan, May 26, 2017

Dear Madam Lagarde:

1. The IMF-supported 2014–17 arrangement has helped mitigate the impact of the persistent external shocks hitting Armenia in recent years. In response to these shocks, in particular, the sharp drop in copper prices and remittances, and the resulting large depreciation of the dram in late-2014, we took decisive policy actions to mitigate inflationary and FX pressures, and secure additional resources for the emerging fiscal gap. These actions prevented a disorderly adjustment and maintained stability. While the weak domestic demand and moderation of imports that followed helped calm FX markets and reduce current account imbalances, it also weighed heavily on growth and tax revenues, resulting in a serious deterioration in the fiscal position. Over the course of the program, most targets have been met (albeit with large successive revisions to fiscal targets), external buffers have been rebuilt, emergency monetary policy measures have been unwound and capital levels in the banking sector have been raised substantially. We have also made progress on the structural front, most notably with the passage of the new Tax Code in October 2016 and strengthened reform efforts. Parliamentary elections were held in April 2017 under the new constitution, with the full transition to the new parliamentary system scheduled for 2018. The new government remains committed to the policies agreed under the EFF arrangement and a continued strong dialogue with the IMF, following the end of the current arrangement.

2. Economic performance has remained subdued due to the continued adverse external environment and the slow recovery of domestic demand. In 2016, our economy grew by only 0.2 percent on account of languishing consumption and investment, reflecting weak remittances and low international copper prices. As a result, deflationary pressures persisted with CPI inflation at -1.1 percent at end-2016. External adjustment endured with the current account deficit remaining at 2.7 percent, as a result of continued strong export performance (reflecting one-off factors and diversification efforts) and lower imports. The fiscal deficit widened to 5.6 percent in 2016—compared with the revised program target of 5.9 percent of GDP—due to a combination of weak revenues and the countercyclical over-execution of foreign-financed capital spending, particularly the “catch-up” of previously delayed projects. The CBA continued to ease monetary conditions, cutting the policy rates to 6 percent, although this has not been fully reflected in lending and deposit rates due to increased risks in the private non-financial sector. While the banking sector is well-capitalized, with all banks satisfying the higher minimum capital requirement, low profitability and high dollarization remain concerns.

3. The economic outlook remains challenging. We expect activity to pick up in 2017 and to recover gradually over the medium-term. Economic indicators for the first three months of the year have been promising: exports continue to grow strongly; remittances appear to be picking up; imports and domestic demand are recovering; and tax revenues are rising. Headline CPI inflation turned positive in April 2017, although non-food price inflation remains negative. This seems to reflect signs of improvement in external conditions— rising copper price and a better growth outlook in major trading partners, especially Russia, which has resulted in higher remittances—as well as the impact of monetary and fiscal stimuli in 2016. Our tax revenue collection also overperformed in Q1, while expenditure remained in line with the budget. Nonetheless, the loss of growth momentum in 2016 indicates the fragility of the recovery. In particular, Armenia continues to be vulnerable to external shocks, including setbacks in key trading partners' growth and the uncertain outlook for commodity markets, which would have an impact through remittances and copper prices.

4. Performance since the last review has been satisfactory. We have met all end-December and continuous performance criteria (PCs), along with the program inflation target. The end-December indicative ceiling for net domestic assets of the central bank and the social expenditure floor were also met, as were the December and March structural benchmarks (SBs). Regarding the latter, we have established a mechanism to strengthen monitoring and prioritizing foreign-financed capital projects (December 2016 SB) and built a centralized database of all ongoing, planned, and pledged projects (March 2017 SB). In addition, the 2017 budget secured funding for the Pension System Awareness Center (December 2016 SB) and the CBA has prepared a plan for the divestment of PanArmenian Bank (December 2016 SB).

Fiscal Policy

5. In light of the weak 2016 fiscal performance, the 2017 budget envisaged a large fiscal adjustment, consistent with the fiscal rule. In 2016, tax revenues were undermined by a combination of factors: weak domestic demand; a change in the composition of imports that reduced the taxable base; declining receipts from the EEU customs pool; and the larger-than-anticipated effects of past policy changes. Together with the countercyclical over-execution of foreign-financed capital projects, this resulted in a much higher fiscal deficit in 2016 than budgeted, which in turn pushed general government debt above 50 percent of GDP and triggered the debt brake mechanism in our fiscal rule. In compliance with the fiscal rule, our 2017 budget envisaged a large and abrupt cut in the overall deficit to 2.8 percent of GDP, mostly through a substantial reduction in foreign-financed capital expenditure. We also introduced a moratorium on signing new foreign-financed projects and entered into detailed discussions with donors on the scope to postpone or restructure some projects.

6. Since then, our assessment of the likely revenue performance in 2017 has improved considerably. Collection in the first quarter of 2017 over-performed by AMD 13 billion (around 0.25 percent of GDP) compared to budget projections. This was mainly due to efforts by the State

Revenue Committee—under its new leadership—to target the informal sector, better-than-envisaged economic activity, and larger distributions from the EEU customs pool, reflecting the strength of imports to the union as a whole. We strongly believe that these trends will continue and have, therefore, revised up our revenue projections for the year by around AMD 50 billion (1 percent of GDP).

7. Additional projected tax revenue enables us to raise the level of the already ongoing or planned foreign-financed capital expenditure, while still complying with the budget deficit target of 2.8 percent of GDP. We have conducted a comprehensive survey of all ongoing foreign-financed projects and identified around $100 million (1 percent of GDP) of additional high-priority spending for 2017 that would be economically inappropriate to discontinue or delay. Proceeding with these projects would allow for a less dramatic cut in capital spending than envisaged in the 2017 budget. This would not only protect ongoing high-return projects but also avoid significant penalties and operational costs**.** The implementation of growth-friendly capital spending would also play a crucial role in helping close the negative output gap and raising future potential growth. Under this plan, the domestically-financed deficit would not increase relative to the 2017 budget.

8. At the same time, we acknowledge the significant downside risks to our revenue projections and the potential for additional shocks, and stand ready to implement contingency plans in the event that these risks materialize. Given recent growth volatility and the risks to the fiscal forecast, we will continue to monitor fiscal developments closely and identify contingency measures to offset potential revenue shortfalls (should downside risks materialize) and keep the fiscal deficit in line with the 2017 target. Social spending on education, health, and social benefits will be protected to maintain support for the poor and vulnerable groups.

9. In parallel, we will support our revised plans by launching reforms to modernize our fiscal framework and the fiscal rule. Our existing fiscal rule, which was enacted in 2008, has proven inflexible to shocks: it has a pro-cyclical bias and lacks a smooth correction mechanism and escape clauses to cope with factors outside government control. As a result, it risks aggravating an economic downturn and undermining the credibility of the fiscal anchor. In this context, we have requested IMF TA (scheduled for June 2017), with a view to revising the fiscal rule and strengthening the credibility of the fiscal framework. Our goal is to complete the necessary technical work and consultation with stakeholders, in time to send a draft fiscal rule to the National Assembly, alongside the draft budget for 2018 by October 2017.

10. We remain committed to fiscal consolidation in the medium term to ensure debt sustainability. Our key objective is to put debt on a downward path by 2019 and maintain central government debt below 60 percent of GDP in the medium term. This will be reflected in the government's Medium-Term Expenditure Framework, which will be updated in May 2017 and will require a fiscal deficit in 2018 of less than 3 percent of GDP. We are committed to the implementation of the Tax Code and will also implement other necessary revenue—enhancing tax policy measures, including by improving property taxation. At the same time, we will continue to strengthen revenue administration by improving compliance and reducing the size of the informal economy.

Monetary and Financial Sector Policies

11. Monetary policy has continued to ease. Since the second half of 2015, the CBA has cut the policy rate by 450 basis points to 6 percent, of which 150 basis points have been cut since the second half of 2016. As a result, lending rates have come down somewhat and there are early signs of recovery in private sector credit. However, the monetary policy transmission remains weak, given the high level of dollarization and the elevated risk premium in the real sector of the economy.

12. The CBA remains open to further monetary policy adjustment, consistent with its inflation targeting framework. Our focus remains on stabilizing inflation within the CBA's medium-term 4±1.5 percent target by the end of 2017. Given stronger-than-expected economic activity in the first two months of 2017, we are now reviewing the impact of recent policy actions, but stand ready to adjust monetary policy to ensure that our inflation path remains on track. We will also step up efforts to strengthen the policy transmission channel and enhance the effectiveness of the inflation-targeting regime. The shallow interbank market and lack of diversified financial instruments in the market are important constraints on the provision and distribution of liquidity in the banking system. The CBA is therefore developing a plan to promote a well-functioning interbank market with assistance from IFIs.

13. We remain committed to maintaining a flexible exchange rate regime and strong reserve buffers. Since the fourth review, strong export receipts, large donor financial flows, and limited FX sales have enabled the CBA to rebuild reserves to $2.2 billion at end-2016. The current account deficit was 2.7 percent of GDP in 2016—the same level as 2015. In this context, we assess that the dram exchange rate likely remains close to its equilibrium level. Looking ahead, we are committed to allowing the dram to adjust flexibly in both directions, while using limited intervention only to smooth excessive fluctuations and mitigate transitory pressures. Exchange rate flexibility will also play an important role in improving the monetary policy transmission mechanism.

14. The CBA remains committed to strengthening the resilience of the banking system, improving the macroprudential policy framework, and addressing constraints on financial intermediation. All banks have achieved the new CBA-mandated minimum capital (30 billion drams) without financial support from the CBA. The banking sector's capital adequacy ratio is now around 20 percent. Nevertheless, challenges remain. Given the post-crisis increase in NPLs (despite a modest fall recently) and low profitability, as well as high dollarization, the CBA is focused on developing an enhanced macroprudential framework. A risk-based supervision framework will be fully operationalized in late 2017, in line with international best practice and Basel III guidance. We will continue to monitor financial sector vulnerabilities, enhance regulation and supervision, and, jointly with the government, improve financial intermediation, including by increasing financial literacy and inclusion. Against this background, we have requested a Financial Sector Assessment Program (FSAP) in 2018 to help us better monitor and assess risks, and take comprehensive action to ensure the soundness of the financial system. In the context of strengthening the CBA's independence and operations, we remain committed to selling PanArmenian Bank to a private investor, or following an appropriate resolution mechanism, no later than end-2017.

Structural Policy

15. We are focused on progressing reforms to attract investment and improve the business climate, with the goal of raising Armenia's potential growth and making it more inclusive. A large and diverse set of initiatives are underway:

- ***Domestic competition.*** We are continuing to work on a new amendment to the economic competition law. The draft legislation was submitted to the National Assembly in December 2016 and we expect it to be adopted by the end of the year;
- ***Energy sector.*** Our priorities are to strengthen the financial position of the sector, improving the electricity distribution system, and increasing the affordability of energy provision. We have put in place longer-term concessional donor financing, restructured short-term loans, and adopted a business-friendly tariff scheme with no cost to the budget.
- ***Pension reform and capital market development.*** In order to promote long-term savings, the government remains committed to the full implementation of the pension reform by July 2018, as well the adoption of a donor-supported strategy to speed up the development of capital markets. The newly established Armenia Investors Club—with help from the Armenian diaspora—is also helping financial and capital market development.
- ***Tackling corruption.*** As part of our action plan for 2015-2018, we have recently strengthened the law on procurement, including by reducing procurement procedures, expanding the e-procurement system framework, and publishing winning bids on the official procurement website to help enhance public awareness and transparency. We have also: improved tax and customs administration (e.g. speeding up tax refunds for exporters); criminalized illicit enrichment and established a new investigatory approach to corruption crimes; and developed legislative amendments to reduce cash transactions of citizens, tackle the shadow economy and increase financial intermediation.
- ***Connectivity and international integration.*** An Open Sky Agreement with the EU is scheduled for later this year. The negotiations on the EU-Armenia New Framework Agreement were concluded and the agreement was initialed in March 2017. The negotiations on the EU-Armenia Common Aviation Area Agreement and the Single Support Framework for Armenia—2017-20 are ongoing.
- ***FDI.*** In January 2017, the government established the Center for Strategic Initiatives, to encourage key reforms to attract FDI, particularly in the tradable sector. We have also launched initiatives to foster public-private partnerships and established an Armenian-Russian investment fund.

16. We will consider the possibility of a successor arrangement in due course. Despite the significant achievements of the current EFF-supported program, challenges remain. We believe that Armenia would benefit from a new arrangement as we move ahead with our long-term objectives of achieving the status of a more dynamic emerging market economies. We look forward to initiating discussions later in the year.

Conclusion

17. We request that the IMF Executive Board complete the Fifth Review of the EFF-supported program and approve the associated disbursement in an amount equivalent to SDR 15.69 million. The program's PCs, indicative targets and SBs—as defined in the attached Technical Memorandum of Understanding—as well as projections for end-December 2017, are included in Tables 1 and 2. We authorize the IMF to publish this Letter of Intent and its attachments, as well as the accompanying staff report.

18. We will maintain a close policy dialogue with the Fund and stand ready to take additional measures, as appropriate, to ensure the achievement of our social and economic objectives. We will continue to consult with the Fund on the adoption of measures and provide the Fund with information it requests for monitoring our policies.

Very truly yours,

/s/

Karen Karapetyan

Prime Minister

Republic of Armenia

/s/

Vardan Aramyan

Minister of Finance

Republic of Armenia

/s/

Artur Javadyan

Chairman of the Central Bank

Republic of Armenia

Table 1. Armenia: Quantitative Targets, 2015–17 1/

(In billions of drams, at program exchange rates, unless otherwise specified)

	2015	2016										2017			
	Dec.	Mar.	Jun.			Sep.			Dec.			Mar.			Dec.
	Act.	Act.	EBS 16/51	Adj. Prog.	Act.	EBS 16/51 2/	Adj. Prog.	Act.	EBS 16/120	Adj. Prog.	Act.	Prog. 2/	Adj. Prog.	Prel.	Proj.
Performance Criteria															
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,013	896	955	903	945	984	887	1,038	1,055	1,106	1,315	1,018	1,072	1,269	1,486
Net domestic assets of the CBA (stock, ceiling) 3/	395	395													
Program fiscal balance (flow, floor) 4/	-299	-55	-135	-129	-129	-195	-200	-196	-358	-374	-365	-31	-29	-21	-206
Budget domestic lending (cumulative flow, ceiling)	21	3	23	23	18	23		23	23	23	23	15		15	15
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	0	0		0	0	0	0	0		0	0
Absorption of losses or liabilities and making of payments on behalf of utilities and other companies (flow, ceiling, continuous criterion)	0	0	0	0	0	0		0	0	0	0	0		0	0
MPCC															
Inflation (mid-point, percent) 5/			-1.7	-1.7	-1.1	-1.2	-1.2	-1.9	0.4	0.4	-1.1	1.2	1.2	0.1	1.8
Indicative Targets															
Inflation (mid-point, percent) 5/	-0.1	-2.0	3.3												
Net domestic assets of the CBA (stock, ceiling) 3/			426	446	363	400	434	366	464	416	322	390	374	333	362
Avg. concessionality of newly contracted ext. debt (flow, floor, in percent) 6/	19								30	30	33	30		30	30
New government guaranteed external debt (stock, ceiling, in millions of USD) 7/	0	0	50	50	0	50		0	50	50	0	50		1	50
Social spending of the government (flow, floor) 8/	55	13	27	27	28	42		42	57	57	59	13		13	48
Memorandum items:															
Budget support grants (cumulative from end of previous year)	64	66	66		66	66		69	70		75	70		75	83
o.w. EU MFA grant	19	19	19		19	19		19	19		19	19		19	19
Budget support loans (cumulative from end of previous year)	381	381	401		381	418		381	459		486	471		486	576
o.w. non-IMF loans	343	343	363		343	379		343	420		448	433		448	538
Project financing (cumulative during the same year)	91	17	54		47	82		99	109		149	17		20	87
KFW and IBRD loan disbursements (cumulative from end of prevous year)	70	72	75		75	83		80	88		85	87		90	118
Reserve money	921	850	888		777	912		898	975		1042	915		970	1074

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU.

2/ At program exchange rates.

3/ Refers to the review at which the perfromance criteria and indicative targets were set.

4/ Below-the-line overall balance excluding net lending.

5/ End of period, year-on-year headline inflation. Mid-point within a +/- 1.5 range.

6/ Assessed on a calendar year basis.

7/ Includes both concessional and non-concessional debt.

8/ Defined as spending on the family benefit program and lump-sum financial aid, one-time childbirth benefits, and childcare benefits for children less than two years of age.

Table 2. Armenia: Structural Benchmarks Under the Fund-Supported Program

Area	Measure	Time Frame (End of Period)	Responsible Agency	Status/comment
Public Financial Management	Complete a review of lending operations, including operations related to real estate projects in Yerevan, to identify risks and	Sep. 2016	Ministry of Finance	Met
	Issue a Minister of Finance decree establishing a strong coordination and monitoring system for foreign-financed projects to ensure execution remains consistent with the budget and MTEF, including through: (i) improving coordination between the budget block, Treasury and the External Relations unit; and (ii) preparing monthly execution reports that assess risks to implementation and inform discussions with the Office of the Prime Minister and relevant government agencies on	Dec. 2016	Ministry of Finance	Met
	Build a centralized database of all ongoing, planned and pledged foreign-financed projects to underpin stronger monitoring and coordination and inform future development strategies, MTEFs and budgets.	Mar. 2017	Ministry of Finance	Met
	Complete review of budgetary lending operations to identify risks and management improvements.	Sep. 2016	Ministry of Finance	Met
Tax Policy	Adopt a Tax Code consistent with the prior action for the Third Review of the EFF Arrangement.	Sep. 2016	Ministry of Finance	Met
	Secure parliamentary approval of further excise tax rate increases from 2017 to bring gradually them in line with rates in other EEU member countries.	Mar. 2016	Ministry of Finance	Not Met (but it was included in the the Tax Code)
	Submit to the National Assembly final proposed tax code containing reduction/elimination of exemptions (VAT, income tax) and of other tax policy gaps (sectoral coverage, tax types) to deliver revenue gains.	Mar. 2016	Ministry of Finance	Not Met (Completed with delay to enable incorporation of IMF staff recommendations)

Table 2. Armenia: Structural Benchmarks Under the Fund-Supported Program (Concluded)

Area	Measure	Time Frame (End of Period)	Responsible Agency	Status/comment
Financial sector	Prepare contingency plans specifying a strategy to deal with banks that may not potentially manage to comply with the new minimum capital requirement.	Sep. 2016	Central Bank	Met
	Submit to the National Assembly the draft laws to ensure implementation of ISDA Master Agreements.	Sep. 2016	Central Bank	Met
	Prepare a comprehensive plan for full divestment of the CBA shares in PanArmenian Bank (currently fully owned	Dec. 2016	Central Bank	Met
Energy Sector	Adopt by Cabinet of energy sector financial recovery plan involving new loans from IFIs to restructure expensive short-term debt; agreement on a repayment plan for accumulated debt to energy suppliers; a strict prohibition on expenses, borrowing and lending by energy companies outside of their core mandate; tariff adjustments, where needed; and a new tariff mechanism to more quickly transfer the risk of deviations from the planned energy-generation mix to consumers, in line with best international practices.	Mar. 2016	Ministry of Energy	Met
Pension Reform	Maintain support for the Pension System Awareness Center and the pension reform outreach campaign in the 2017 budget.	Dec. 2016	Ministry of Finance	Met
Regulatory and competition policy	Submit to the National Assembly amendments to the law on domestic competition, specifying higher penalties for anti-competitive behavior, the possibility of penalties for public and private sector officials, and clarifying the main definitions of the law (abuse of dominance, unfair competition, among others)	Sep. 2016	Ministry of Economy	Not Met. Authorities have prepared amendments, but will delay submission to the NA to seek more ambitious reforms

Attachment I. Technical Memorandum of Understanding

1. This memorandum sets out understandings between the Armenian authorities and the IMF staff regarding the definition of performance criteria (PCs) and indicative targets (ITs), adjusters, and data reporting requirements for the Extended Arrangement as per the Letter of Intent and Memorandum of Economic and Financial Policies (LOI/MEFP) dated [x, 2017] and previous letters of intent dated November 15, 2016, May 30, 2016, October 22, 2015, February 17, 2014 and December 3, 2014.

2. For program monitoring purposes, all foreign currency-related assets, liabilities, and flows in the monetary accounts will be evaluated at program exchange rates. The program exchange rate of the Armenian dram to the U.S. dollar is set at 410 dram per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

A. Quantitative Targets

3. The program sets PCs, ITs, and the Monetary Policy Consultation Clause (MPCC) for defined test dates (see Table 1 in the LOI/MEFP).

The program sets the following PCs:

- Floor on the net official international reserves (NIR) of the Central Bank of Armenia (CBA); Ceiling on external public debt arrears (continuous);
- Floor on the program fiscal balance;
- Ceiling on domestic budgetary lending; and,
- Ceiling on absorption of losses or liabilities and making of payments on behalf of utilities and other companies (continuous).

The program sets the following Its:

- Ceiling on the net domestic assets (NDA) of the CBA; Floor on average concessionality of newly contracted external debt;
- Ceiling on new government guaranteed external debt; and,
- Floor on social spending of the government.

The program sets the following MPCC:

- Headline inflation.

4. **The net official international reserves** (NIR) (stock) of the Central Bank of Armenia (CBA) will be calculated as the difference between total gross official international reserves (excluding commercial bank required and excess reserves at CBA in FX) and gross official reserve liabilities.

- Gross official international reserves are defined as the CBA's holdings of monetary gold (excluding amounts pledged as collateral), holdings of Special Drawing Rights (SDRs), including the August 28, 2009 General Allocation and the September 9, 2009 Special Allocation, the country's reserve position at the IMF, and holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments).[1] Gross reserves held in the form of securities and other financial instruments are marked to market. Excluded from gross reserves are the balance on the government's Special Privatization Account (SPA), capital subscriptions in foreign financial institutions and illiquid foreign assets, any assets that are pledged, collateralized, or otherwise encumbered, claims on residents, claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options), precious metals other than gold, assets in nonconvertible currencies, and illiquid assets.

- Official reserve liabilities shall be defined as the total outstanding liabilities of the government and the CBA to the IMF and convertible currency liabilities of the CBA to nonresidents with an original maturity of up to and including one year, as well as commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options).

NIR is monitored in U.S. dollars, and, for program monitoring purposes, assets and liabilities in convertible currencies other than the U.S. dollar shall be converted into dollar-equivalent values using the convertible exchange rates as specified in Table 1.

5. **MPCC headline inflation** is defined as the year-on-year rate of change of the Consumer Price Index as measured by Armenia's National Statistics Service. The MPCC will be considered met if headline inflation falls within a range of +/- 1½ percentage point around the mid-point target specified in Table 1 in the LOI/MEFP.

6. **Net domestic assets** are defined as reserve money minus NIR, minus other assets not included in gross official international reserves, minus commercial bank required and excess reserves at CBA in FX, plus medium and long-term foreign liabilities (i.e., liabilities with a maturity of one year or more) of the CBA, plus other foreign liabilities not included in official reserve liabilities, minus the balance of outstanding Fund purchases credited to the government account at the CBA. NDA is composed of net CBA credit to the general government plus outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money and other items net. The ceiling will be considered as met if the outcome is within AMD 15 billion of the targets sets in Table 1 attached to the LOI/MEFP.

[1] Convertible currencies are limited to: U.S. dollar, U.K. pound, euro, Japanese yen, SDR, Australian dollar, Canadian dollar, and Swiss franc.

7. **External public debt arrears** are defined as all unpaid debt-service obligations (i.e., payments of principal and interest) arising in respect of public sector loans contracted or guaranteed to non-residents, including unpaid penalties or interest charges associated with these obligations that are overdue beyond 30 days after the due date.[2] The ceiling on external payment arrears is set at zero.

8. **The program fiscal balance** is cumulative from the beginning of the fiscal year and is measured from the financing side as the negative of the sum of net domestic banking system credit to the central government, net domestic nonbank financing, and net external financing to the central government. Should a general subsidy or any other fiscal transaction be introduced off-budget, the overall balance will be measured including the subsidy and other fiscal transactions as part of government spending.

- **Net banking system credit to the central government** equals the change during the period of net credit to the central government.

- **Net nonbank financing** equals the sum of: (1) the change during the period of outstanding treasury bills and bonds to nonbanks (including accrued interest for treasury bills and excluding accrued interest for treasury bonds);[3] (2) any other disbursement or transaction that increases nonbanks' claims on the central government plus withdrawals from the Special Privatization Account (SPA) or the treasury sub-account containing privatization proceeds in drams, less amortization paid by the central government to private resident nonbank agents.

- **Net external financing** equals total debt-increasing disbursements from non-residents to the central government (including Fund net purchases credited directly to the government accounts at the CBA) less total amortization from the central government to non-residents. Net external financing also includes any privatization proceeds received from non-residents in foreign currency and not held in the SPA.

- **A budgetary ER** of 475.4 drams per one US dollar will be used for foreign currency-denominated transactions included in the 2017 budget with the exception of the amounts received for project implementation units (PIU) for which the prevailing ER at the time of the transaction was used. Any additional unbudgeted transactions for 2017 will take place at the market exchange rate. In addition, if new foreign currency-denominated transactions are introduced at any time, these will take place at the prevailing ER at the time of the transaction. The framework arrangement will not be modified (in substance), but may be clarified as this would imply noncompliance with the program continuous PC on ER arrangements and multiple-currency practices.

[2] The public sector is here defined following the *Government Financial Statistics Manual* (GFS 2001) and *System of National Accounts* (1993 SNA). It includes the general government and nonfinancial public enterprises (as defined in paragraph 14).

[3] Domestic nonbank holdings of treasury bills and treasury bonds are defined as total outstanding treasury bills and bonds less holdings by the banking system and the State Fund for Social Insurance.

9. External and domestic net lending, which are recorded as financing items, are *excluded* from the calculation of the program fiscal balance, which is calculated from the financing side (see ¶8). This effectively treats net lending as an expenditure item when loans are made and as a revenue item when the loans are repaid.

10. Transactions related to the extension of the operating life of the Metsamor nuclear power station—which will take place via lending from the Russian Federation to the Ministry of Finance of Armenia and from the MoF of Armenia to the Armenian Nuclear Power Plant JSC—will be excluded from the measure of the program fiscal deficit.

11. Some project implementation units maintain accounts at the CBA. Grants received by these units are recorded in the fiscal accounts as external grants on the revenue side and as foreign-financed expenditure on the expenditure side. In addition, any loans to finance investments that are intermediated through the banking system are recorded in the financial accounts as a financing item below the line and are thus excluded from net lending.

12. Foreign currency proceeds from selling enterprises are credited to the SPA and their use is reflected in the state budget. In addition, the Government will ensure full transparency of revenues and spending from the sales of major assets (beyond regular day-to-day operations) of enterprises with state ownership. This will include presentation of use of funds from the sale of the hydroelectric assets of the Vorotan Cascade Company, including for electricity subsidies and payment of wage arrears of Nairit. The SPA is held at the CBA and the proceeds are invested abroad together with the CBA's international reserves. These proceeds are included in the definition of the monetary accounts of the CBA as part of net foreign assets with a counter entry in other items net. Any withdrawal from the SPA will be accounted for as privatization proceeds used to finance the budget and will be recorded below the line. Domestic currency proceeds from selling enterprises to residents are deposited in a sub-account of the treasury single account and are also treated as a financing item and recorded below the line. Finally, as noted in ¶8, privatization proceeds received from non-residents in foreign currency and not held in the SPA are also treated as a financing item (sale of financial assets) and recorded below the line.

13. **Domestic budgetary lending** is defined as the gross amount of new loans made to resident individuals, enterprises, or entities financed from the state budget or other general government resources. This includes, but is not limited to, loans financed from the Economic Stabilization Fund and lending under existing or prospective government programs, such as agricultural sector support and real estate development programs, among others. Lending operations related to targeted projects financed with external loans and grants will be excluded from the calculation of the ceiling on budget domestic lending.

14. **Absorption of losses or liabilities and making of payments on behalf of utilities and other companies**. The program sets a continuous ceiling on absorption by the public sector of losses or liabilities from outside the budgetary sector. The public sector is defined as institutions covering the state budget and state debt—including the central and local governments—plus the CBA and enterprises or other entities with state ownership or control. Absorption of losses or liabilities is defined as direct payment by the public sector of the losses or liabilities of other parties or coverage of losses or liabilities by other transactions, such as debt-for-equity swaps or a write-off of tax obligations or other state claims. The ceiling is set at zero, and excludes AMD 9.7 billion, (approximately $20.3 million) of subsidies in the 2017 budget for Yerevan Metro, Yerevan Electric Transport, Irrigations Systems, Armenian Water and Sanitation, Nor Akunk, Lori Water and Sanitation, Shirak Water and Sanitation, and irrigation water intake entities.

15. Floor on average concessionality of newly contracted external debt. The program sets an annual indicative floor of 30 percent on the average concessionality of new debt on a contraction basis with nonresidents with original maturities of one year or more as contracted and guaranteed by the public sector. The concessionality floor is calculated on a calendar-year basis.

- The grant element is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rate used for this purpose is a unified discount rate set at 5 percent.

- The public sector here comprises the general government (central, plus local governments and covering the state budget and state debt), the central bank, and nonfinancial public enterprises (enterprises and agencies in which the government holds a controlling stake—typically owns more than 50 percent of the shares, but which are not consolidated in the budget).

- For program purposes, the guarantee of a debt arises from any explicit legal obligation of the public sector to service a debt in the event of nonpayment by the debtor (involving payments in cash or in kind), or from any implicit legal or contractual obligation of the public sector to finance partially or in full any shortfall incurred by the debtor.

16. Ceiling on government guaranteed external debt. In addition to the indicative floor on average concessionality, a separate, cumulative ceiling (IT) of $50 million for the program period applies to new government guarantees of the total of concessional and non-concessional external financing. The issuance of debt guarantees will be measured at the exchange rates listed in Table 1. The above limit covers debt guarantees issued by the general government to entities outside the general government (excluding the CBA). Guarantee issuance will be monitored on a monthly basis and the Ministry of Finance will provide data within 21 days from the end of the month.

17. The program sets a floor on **social spending of the government**. For the purposes of the program, social spending of the government is defined as 95 percent of the budgeted amount of the family benefit program and maternity benefits, one-time childbirth benefits, and childcare benefits for children less than two years of age.

18. The quantitative performance criteria and indicative targets under the program are subject to the following **adjusters**, calculated, where relevant, using program exchange rates:

- **Changes in reserve requirements**: The ceiling on the NDA of the CBA will be adjusted downward (upward) by the amount of banks' reserves freed (seized) by any reduction (increase) of the reserve requirement ratio on both domestic currency and foreign currency liabilities relative to the baseline assumption as per the following formula: $\Delta NDA = \Delta rB$, where B denotes the level of liabilities subject to reserve requirements in the initial definition and Δr is the change in the reserve requirement ratio.

- **KfW, Asian Development Bank, and World Bank loan disbursements**: the ceiling on the NDA of the CBA will be adjusted upward (downward) by the full amount of any excess (shortfall) of disbursements from the KfW, Asian Development Bank, and World Bank loans directed at SME financing compared to programmed amounts (Table 2). The floor on NIR will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of these disbursements compared to program amounts.

- **Budget support grants to the public sector** are defined as grants received by the general government for direct budget support from external donors and not related to project financing.

- **Budget support loans to the public sector** are defined as disbursements of commercial loans (e.g., Eurobonds), loans from bilateral and multilateral donors for budget support, and Fund purchases credited directly to the government accounts at the CBA.

- **Project financing to the public sector** is defined as disbursements of loans from bilateral and multilateral donors for public sector projects.

- **The floor on NIR** will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants (excluding Fund purchases by the government) compared to program amounts (Table 3). The floor on NIR will be adjusted downward for any external public debt amortization amounts in excess of program amounts. The floor on NIR will be adjusted upwards by the amount of any funds received in respect of deposits held at the Inter State Bank as well as for privatization proceeds received from non-residents in foreign currency and not held in the SPA.

- **The ceiling on NDA** will be adjusted downward (upward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants compared to program amounts (Table 3).

- **The floor on the program fiscal balance on a cash basis** will be adjusted upward (downward) by the cumulative total amount of the budget support grants received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $50 million per year in either direction. The floor on the program fiscal balance on a cash basis will also be adjusted downward (upward) by the cumulative total amount of the project financing received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $50 million in either direction.

- **The ceiling on domestic budgetary lending** will be adjusted upward by the amount of undisbursed funds under domestic budgetary lending programs approved in the previous year.

B. Data Reporting

19. The government and the CBA will provide the IMF the information specified in the following table.

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA	CBA balance sheet	Summary	Daily	The following working day
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within seven days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks by chart of accounts at actual official exchange rates	Monthly	Within 25 days of the end of each month
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Daily	The following working day
	Foreign exchange market	Official exchange rates (buying and selling); daily trade volume, and weighted average exchange rate of the interbank, intrabank and Nasdaq-OMX	Daily	Within 1 day
	Foreign exchange market	CBA foreign exchange operations, (exchange rate, volume)	Daily	Within 1 day
	Foreign exchange market	Exchange rate (buying and selling)	Daily	Within 1 day
	Interest rates	Refinance rate	At least monthly	Within 1 days of the CBA Board decision
	Interbank money market	Daily interbank repo volume and interest rate and number of trades	Daily	Within 1 day
	CBA operations	Repo (reverse repo) operations, open market operations, Lombard	Daily	Within 1 day

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		credits, deposit facility, and foreign exchange swaps (volumes, maturity, yields, exchange rates)		
	Bank liquidity	Reserves and excess reserves, by currency	Monthly	Within 15 days of the end of each reference period
	Interest rates and flows of the funds attracted and allocated by commercial banks	By currency and maturity	Weekly	Last working day of the week
	T-bill and coupon bond financing, CBA securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Weekly	Last working day of the week
	Banking data	Sectoral distribution of loans and deposits; dollarization of loans and deposits; loan maturities; interbank rate, by volume and maturity; T-bill rate, bond yield; deposit and lending rates, by maturity; monthly weighted average interest rate on government bonds	Monthly	Within 25 days of the end of each month
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Monthly	Within 30 days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Monthly	Within 30 days of the end of each month
	On-lending via commercial banks	On lending via the CBA and government (from the Russian loan, KfW, WB, ADB, etc.) by type of on-lending projects (including loan disbursements and repayments)	Monthly	Within 10 days of the end of each month.
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Transfers	Non-commercial transfers of individuals	Monthly	Within 31 of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
	Balance of payments	Detailed balance of payments data	Quarterly	Within 92 days of the end of each quarter
	T-bill and coupon bond financing	By holders, i.e., CBA, resident banks, resident nonbanks, and nonresidents	Monthly	Within 7 days of each month
	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the CBA, and state-owned companies (by company); any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears	Monthly	Within 21 days of the end of each month. For project implementation units, within 21 days of the end of each month (preliminary data) and within 45 days of the end of each month (final data)
Ministry of Finance	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions	Monthly	Within 7 days of the end of each month
	Domestic expenditure arrears	All unpaid claims outstanding at the end of the month which includes wages, social contributions (including for pensions), family allowances, and amortization and domestic interest payments	Monthly	Within 45 days of the end of each month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	Treasury single account (TSA)	Detailed breakdown of central treasury account, including deposits at the central treasury, community budgets, off budget account, monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.	Monthly	Within 7 days of the end of each month
	Consolidated central government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Central and local governments, and Non-Commercial Enterprises that belong within the general government (NCEs)	Quarterly	Within 60 days of the end of each quarter
	Consolidated general government	Central and local governments, and NCEs that belong within the general government	Annual	Within 180 days of the end of each year
	Budget execution	All cash receipts, cash expenditures, including domestic and external debt-service payments, external and domestic borrowing and lending operations, and inflow of grants to the central government; expenditure data will be provided according to both economic and functional classifications, consistent with the GFSM2001 methodology	Monthly	Within one month following the end of each quarter.
	Financial information on utilities and other major companies with a state interest	Profit and loss indicators for regulated utilities, for companies with state shareholding of 50 percent or greater, and for companies with state shareholding of 0–50 percent and annual sales or outstanding liabilities of AMD 10 billion.	Quarterly	Within 60 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
National Statistical Service	Balance of payments	Detailed export and import data (issues that have arisen in 2015 with EEU trade data need to be overcome as soon as possible)	Monthly	Within 28 days of the end of each month
		Detailed export and import data	Quarterly	Within 45 days of the end of each quarter
	CPI	By category	Monthly	Within 5 days of the end of each month
State Revenue Committee	Tax arrears	By type of tax	Monthly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)
		For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	Tax credits	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues, in both net and gross terms	Monthly	Within 45 days of the end of each (monthly data provided on a quarterly basis)
	Tax Revenues	Tax Revenue by type of tax	Monthly	Within 45 days of the end of each quarter (monthly data provided on a quarterly basis)
	VAT and turnover tax	Number of registered taxpayers	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	VAT refund claims in arrears	Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90 day statutory processing period. Number of refund applications processed per month.	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax inspectorate	Monthly	Within 45days after the end of each month
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty free recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving non-duty free recorded imports 5. Value of recorded imports where customs value was assessed using transaction prices, breaking out raw diamond imports; 6. Value of non-duty free recorded imports where customs value was assessed using transaction prices; 7. Number of transactions involving recorded imports where customs value was assessed using transaction prices; 8. Number of transactions involving non duty free recorded imports where customs value was assessed using transaction prices	Quarterly	Within 30 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	Automated VAT refunds	Number of refunds that were processed automatically (share of total refunds); total value of automated and automatic refunds and offsets; average waiting time (days) to receive refund	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Risk-based selection approach	Percentage of selected companies chosen on the basis of risk-based approach, identified revenue from risk-based audits	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Pension system	Number of participants in the pension second pillar, social payments and funded contributions	Monthly	Within two months of the end of each quarter (monthly data provided on a quarterly basis)

Table 1. Armenia: (Program) Exchange Rates of the CBA

(As of July 31, 2013 in U.S. dollars per currency rates)

Country	Drams Per Currency	Dollars Per Currency
Australian dollar	371.95	0.9072
Canadian dollar	398.33	0.9715
Swiss franc	440.91	1.0754
Danish krone	73.06	0.1782
Euro	544.28	1.3275
Pound sterling	627.83	1.5313
Japanese yen	4.18	0.0102
Norwegian krone	69.14	0.1686
Russian ruble	12.47	0.0304
Swedish krone	62.47	0.1524
SDR	621.04	1.5147

Table 2. Armenia: KFW, AsDB, and IBRD SME Loan Disbursements [1]

(In millions of U.S. dollars)

Dec-15	Mar-16	Jun-16	Sep-16	Dec-16		Mar-17	
Act.	Act.	Act.	Act.	EBS/16/380	Prog.	EBS/16/380	Prog.
171	176	183	196	204	208	213	220

1/ Cumulative from end of the previous year.

Table 3. Armenia: External Disbursements to the Public Sector [1]

(In millions of U.S. dollars)

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16		Mar-17	
	Act.	Act.	Act.	Act.	EBS/16/380	Prog.	EBS/16/380	Prog.
Project financing	223	31	95	241	352	364	40	48
Budget support loans	929	929	929	929	1,149	1,185	1,149	1,185
Budget support grants	157	161	161	168	172	183	172	183
of which: EU MFA	47	47	47	47	47	47	47	47

1/ Budget support cumulative from the end of the previous year. Project financing cumulative during the same year.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

June 7, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION AND FIFTH AND FINAL REVIEW UNDER THE EXTENDED ARRANGEMENT—INFORMATIONAL ANNEX

Prepared By

The Middle East and Central Asia Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(April 30, 2017)

Membership Status:
Joined 05/28/1992; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	128.80	100.00
Fund holdings of currency	306.85	238.24
Reserve Tranche Position	0.00	0.00

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	87.99	100.00
Holdings	7.10	8.07

Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
ECF Arrangements	124.68	96.80
Extended Arrangements	178.05	138.23

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	03/07/2014	08/31/2017	82.21	66.52
ECF	06/28/2010	07/02/2013	133.40	133.40
EFF	06/28/2010	06/24/2013	133.40	133.40

Projected Payments to Fund
(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2017	2018	2019	2020	2021
Principal	33.14	45.17	52.83	54.63	49.35
Charges/interest	2.14	2.66	2.31	1.92	1.51
Total	**35.28**	**47.83**	**55.14**	**56.55**	**50.86**

Safeguards Assessment

An update safeguards assessment was concluded in August 2014 with respect to the Extended Fund Facility approved in March 2014. The assessment found that the CBA maintains safeguards in its financial reporting practices, external audit mechanism, and internal audit function. However, the assessment recommended amendments to the central bank law to strengthen the CBA's governance arrangements, and also to provide the CBA with marketable, interest-bearing government securities to cover its losses. In addition, the assessment noted that the CBA has investments in enterprises engaged in financial sector development and infrastructure, including a credit card processing company, a mortgage finance company, and a cash collection agency. In its audited financial statements, the CBA now presents a consolidated position inclusive of these enterprises, and is in the process of implementing the safeguards recommendation to provide details on risks, risk-mitigation efforts, and divestment strategies.

The CBA and Ministry of Finance (MoF) have made progress in implementing the recommendations of the most recent Safeguards Assessment, but further work remains. The CBA has adopted a charter for its board members to clarify roles and responsibilities. The CBA has investments in enterprises engaged in financial sector development and infrastructure, including a credit card processing company, a mortgage finance company, and a cash collection agency. The CBA has worked with its external auditors to present a consolidated position inclusive of these enterprises and an annex to its annual report describing the rationale for the investments and management of the enterprises. In the future, the annex should cover risks, risk-mitigation efforts, or divestment strategies. Also, pending legislation to provide the CBA with marketable, interest-bearing government securities to cover losses has not advanced in parliament.

Exchange Rate Arrangement

The de jure arrangement is "free floating." The de facto arrangement was reclassified to "floating" from a "stabilized arrangement," effective March 3, 2009. Following a sequence of interventions to rebuild reserves in the last three quarters of 2013, the de facto exchange rate arrangement was reclassified from floating to crawl-like arrangement, effective March 12, 2013. More recently, the de facto exchange rate arrangement has been reclassified to floating from a crawl-like arrangement, effective November 4, 2014. The official exchange rate is quoted daily as a weighted average of the buying and selling rates in the foreign exchange market.

Armenia maintains one multiple currency practice, which arises from a 2007 agreement between the MoF and CBA to settle some budgetary transactions at an agreed accounting ER throughout the fiscal year. The authorities are not requesting and staff does not recommend the Board's approval to maintain this MCP.

Armenia maintains no other multiple currency practices or exchange restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons and notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Article IV Consultations

The previous Article IV consultation with Armenia was concluded on December 22, 2014.

FSAP Participation and ROSCs

A joint World Bank-IMF mission assessed Armenia's financial sector as part of a Financial Sector Assessment Program (FSAP) update during February 1–14, 2012. The Financial Sector Stability Assessment report was approved by the Executive Board in June 2012. The most recent previous FSAP Update took place in 2005.

Resident Representative

Ms. Teresa Daban Sanchez, since August 2013.

Technical Assistance

The following table summarizes the Fund's technical assistance (TA) to Armenia since 2010.

Armenia: Technical Assistance from the Fund, 2010–17

Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Tax administration	Short-term	March –May 2010	MoF, SRC
Tax administration	Short-term	August - November 2010	MoF, SRC
Tax administration	Short-term	September 2010	MoF, SRC
Tax administration	Short-term	November 2010	MoF, SRC
Tax policy	Short-term	February 2011	MoF
Tax administration	Short-term	February–March 2011	MoF, SRC
Tax administration	Short-term	May–June 2011	MoF, SRC
Tax policy (mining)	Short-term	June 2011	MoF
Budget process	Short-term	October 2011	MoF
Public financial management	Short-term	November 2012	MoF
Tax administration	Short-term	April 2013	MoF, SRC
Tax administration	Short-term	September 2013	MoF, SRC
Public finance management	Short-term	October 2013	MoF
Tax administration	Short-term	December 2013	MoF, SRC
Public finance management	Short-term	March 2014	MoF
Fiscal risk	Short-term	November 2014	MoF
Tax administration (LTI)	Short-term	April 2015	MoF
Customs administration	Short-term	May 2015	MoF
Public financial management	Short-term	May-June-September 2015, February, May 2016	MoF
Tax Policy	Short-term	November 2015	MoF
Fiscal Risk	Short-term	April-May 2017	MoF
Legal Department			
Banking Law	Short-term	June 2011	CBA
AML/CFT	Short-term	Various	MoF
Monetary and Capital Markets Department			
Contingency planning, crisis preparedness	Short-term	March–April 2010	CBA
Workshop on inflation targeting (with IMF Research Dept.)	Workshop	April–May 2011	CBA
Bank resolution framework	Short-term	June 2011	CBA

Armenia: Technical Assistance from the Fund, 2010–17 (concluded)

Medium-term debt management strategy	Short-term	December 2011	CBA
FSAP update	Short-term	February 2012	CBA
Inflation targeting (with IMF Research Dept.)	Short-term	February-March 2012	CBA
Inflation targeting	Short-term	November 2012	CBA
Inflation targeting	Short-term	January 2013	CBA
Bank prudential framework	Short-term	April 2013	CBA
Monetary and foreign exchange policy	Short-term	June 2013	CBA
Safeguard assessment	Short-term	March 2014	CBA
Central Bank communication	Short-term	April 2014	CBA
Inflation targeting	Short-term	April 2014	CBA
Inflation targeting	Short-term	April, November 2015	CBA
TA needs assessment for the Central Bank	Short-term	August 2016	
Inflation targeting	Short-term	March, September 2016	CBA
Statistics Department			
National accounts	Short-term	September 2010	NSS
BOP and external debt statistics	Short-term	October 2011	CBA
National accounts	Short-term	April 2012	NSS
Monetary statistics	Short-term	April 2012	CBA
National accounts	Short-term	May 2012	NSS
Monetary statistics	Short-term	October 2012	CBA
Construction Price Index	Short-term	September 2013	NSS

WORLD BANK AND IMF COLLABORATIONS—JMAP IMPLEMENTATION

(As of April 30, 2017)

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
World Bank's Country Partnership Strategy (CPS) for Armenia (2013–17)	Country Partnership Strategy Performance and Learning Review for Armenia (extending the CPS until 2018)		Completed in May 2016
1. Bank program in the next 12 months	***Selected Ongoing and New Operations***		
	Public Sector Modernization Project II (US$9 million)	Semi Annual	Project implementation started in September 2010 and was completed in January 2017. the draft Implementation Completion Report is being prepared.
	Tax Administration Modernization Project (US$12 million)	Semi Annual	Board approval in July 2012, effective since December 2012, expected completion in December, 2017
	DPO series to support competitiveness and ensure sustainability (US$197 million)	Quarterly	Board for DPO-2 (US$75 million): November 2014 DPO-3 (US$50 million): December 2015 DPO-4 (US$50 million): December 2016
	New Health Project for Disease Prevention and Control (US$30 million)	Semi Annual	Board approval in March 2013
	Public Sector Modernization (III) and PFM project (US$26.5 million)	Quarterly	Board approval in September 2015, effective since March 2016
	Power Sector Financial Recovery Project (US$32 million)	Continuous	Board approval in April 2016
	Analytic Work		
	Programmatic Poverty work	Completed	Annual Series (2015 report) Completed in June 2015 and disseminated in November 2015.
	Programmatic Fiscal work (fiscal incidence assessment, public sector wage assessment, review of social assistance programs)	Completed	The 2015 report was completed June 2015, disseminated in November, 2015
	PER on Quasi-fiscal activities, Macro-Fiscal sustainability and fiscal Subsidies	Completed	Completed in June 2016 and disseminated in November 2016

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
	New Country Economic Memorandum on Drivers of Dynamism	Completed	Completed in June 2015
	Assessment of EEU membership on Armenia's economy	On-going	Completed and disseminated in December 2014
	Promoting Productive employment in Armenia – a note on labor market activation	On-going	Started in June 2016 with expected completion in June 2017
	Systematic Country Diagnoses (SCD)	On-going	Concept Note prepared in February 2017 with expected completion in July 2017
	Selected Technical Assistance		
	IDF grant for guillotine exercise		Completed in June 2015
	Macro-monitoring		Completed in June 2016
	One-stop shop for providing construction permits		Completed in June 2015
	CGE model-based technical assistance to simulate trade and growth projections (US$120K)		Completed in June 2016
	Technical Assistance on Tax Policy (US$150K)		Completed in June 2016
	Technical Assistance on Tax Policy (US$75K)		Commenced in June 2016 and expected completion in June 2017
2. IMF work program in the next 12 months	Fifth EFF Review and 2017 Article IV Consultation	March 2017	June 2017
	Technical Assistance/Training		
	FAD (fiscal rule)	June 2017	2nd half of 2017
	ICD/RES (macro modeling to include financial stability consideration in inflation targeting framework)	Ongoing	Ongoing

RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

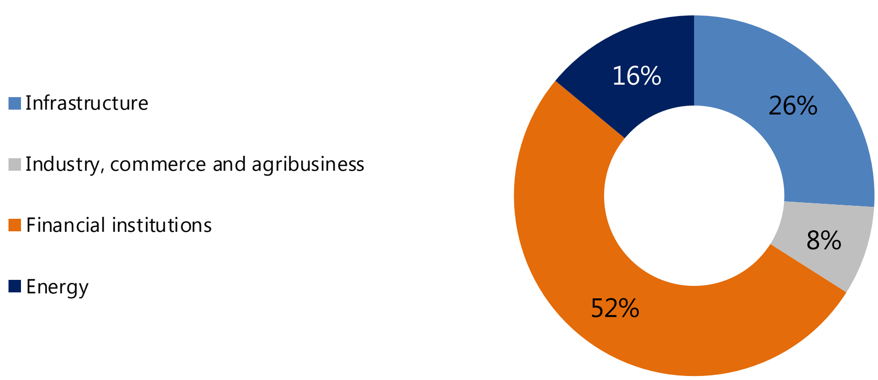
(As of April 30, 2017)

EBRD Scorecard

1. **The EBRD is the largest single investor in Armenia.** To date, the Bank has committed almost €1,112million in over 158 projects in all major sectors of the economy.

EBRD Activity in Armenia to Date (As of April 2017)	
158 Numbers of projects to date	**€1,112m** Cumulative EBRD investment
€771 million Cumulative disbursements	**88 percent** Private sector share of portfolio

Portfolio Composition
Current portfolio: 305 million euro*



Source: European Bank for Reconstruction and Development (EBRD)
*Includes undisbursed commitments

EBRD activities in Armenia for 2014–16

Financial Institutions

2. **In the financial sector, the Bank has enhanced access to finance, particularly for SMEs, through an array of dedicated credit lines to commercial banks and micro-credit organizations, direct debt, mezzanine and equity investments, as well as complementary technical assistance, with a special focus on local currency.** Armenia is also one of the countries where the Bank's Local Currency and Capital Markets Development Initiative has delivered its best and most visible results, setting the stage for further development of local capital markets. Notable achievements include:

- Signing of 29 deals channelling €200.5 million to Armenian commercial banks and micro financing institutions for on-lending primarily to SMEs, of which approximately €100 million has been disbursed in local currency, helping reduce vulnerability to exchange rate risk.
- With respect to energy efficiency, the Bank continues to support investments through CEEP, and will look to boost energy efficiency in existing building stock. Since 2013, five Armenian banks, one credit organisation and one financial leasing company have joined the programme, signing more than €35 million in loans for on-lending to industrial and residential EE sub-projects.
- EBRD is supporting bank consolidation through strategic capital participation in support of stronger, more efficient bank leaders – which in turn will boost access to finance for corporate borrowers. In 2015, the Bank has participated in equity investment of AMD 9.8 billion for up to 22.7 percent of shares in Inecobank, a specialist small and medium-sized enterprises (MSME) and retail bank in Armenia. The proceeds of the EBRD investment were channelled to finance the acquisition of ProCredit Bank Armenia, another local bank oriented towards MSMEs.
- In 2015, EBRD invested $40 million in the acquisition of an equity stake (20%) in Ameriabank, the largest commercial bank in Armenia. This is the largest single-ticket equity deal EBRD has signed in Armenia to date, and helps set the stage for further bank consolidation.
- EBRD is supporting development of female entrepreneurship in Armenia by extending a local currency loans, equivalent to €12.3 million, to Ameriabank and ACBA bank for on-lending to women-led small and medium-sized businesses. The loans come under the expansion of the Bank's Women in Business programme to include the Eastern Partnership countries—Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine.
- Building on prior efforts to develop the local institutional and regulatory framework, in 2014 the Bank issued its first bond in Armenian dram, with the proceeds on-lent to MSMEs through dram credit lines in the local banking system. As of December 2016, the Bank had issued €44.1 million equivalent in drams of local currency bonds.

Infrastructure

3. The Bank has been active in municipal and environmental infrastructure and urban transport, where the Bank has provided nearly about €59 million in private sector and €19 million in sovereign loans during 2014–16.

- Yerevan Street Lighting pilot project was signed in 2015 (€3.7 million) to provide energy efficient lighting technologies in the 28 streets of the City along with modern control system to serve the wider city during the years to come. This project is an important landmark as it is the first project that benefited from the Eastern Europe Energy Efficiency and Environmental Partnership (E5P) grant facility in Armenia.
- In 2014, the Bank signed a €3.5 million loan for Kotayk Solid Waste Management project with the Armenian government to construct the first EU compliant solid waste landfill in Armenia. The loan was complemented by capital grant financing of €3.5 million provided by the European Union Neighbourhood Facility and represents the first project under the National Solid Waste Strategy of Armenia. Later in 2016 the loan was extended by €2 million, now involving a total of 12 small municipalities.

- In 2015, EBRD provided a €8 million loan to Armenia to finance the construction of a solid waste landfill in Yerevan that complies with EU regulations. The loan is co-financed by a €8 million credit line from the European Investment Bank and a capital grant of €8 million from the European Union. The new landfill will meet international standards and operate as a commercially sustainable unit with modern solid-waste management systems, covering the collection and disposal of municipal solid waste. The facility, located on the outskirts of Yerevan, will provide major environmental and social benefits for the 1.1 million residents.
- In 2015, EBRD participated in a landmark international syndication (€28.3 million) for Zvartnots International Airport which will provide significant additional resources for further investment in Armenia. Prior to this in 2014 the Bank signed the Armenian International Airport Phase II in the total amount of €30.8 million.
- In 2015, EBRD and the Ministry of Energy and Natural Resources of Armenia signed an agreement on Armenia's participation in the E5P.
- In 2016, EBRD financed an energy efficient street lighting and city street rehabilitation programme in Gyumri, the second largest city in Armenia, with a €14.6 million sovereign loan. The project consists of three tranches with the first tranche currently under implementation. The first and second tranches are for the rehabilitation of 15–20 km urban roads, including energy efficient street lighting of those selected roads, and a third trance will modernization the street lighting system of the whole city.

Sustainable energy and mining

4. **In sustainable energy and mining, EBRD has signed 3 deals—a loan of €3.3 million to Dundee Precious Metals, and two equity investments totalling €9.8 million with the Toronto-listed mining company, Lydian International.** In addition to these investments, the Bank has engaged in a multi-faceted dialogue with Armenian government to develop a more comprehensive understanding of international standards, requirements and best practices in the global mining industry in Armenia. Lydian's Amulsar mine project in Armenia was permitted in late 2014 under a new Mining Code. The Bank's financing will be earmarked for financing key components recommended by the Environmental and Social Impact Assessment, such as for the biodiversity off-set programme and construction of a passive water treatment facility.

Industry, Commerce and Agribusiness

5. **EBRD supports agribusiness and high value-added corporates through direct investment (debt, equity, mezzanine), typically combined with significant hands-on capacity building assistance, helping smaller clients grow their businesses by providing crucial financial and technical support to implement capex intensive business plans.** During the last 3 years, EBRD has signed 8 deals totalling €22.4 million in support of agribusiness, manufacturing and services companies.

Small Business Initiative

6. **EBRD supports the economic development of Armenia through provision of tailored business advice and know-how to SMEs on a cost-sharing basis through local consultants and international industry advisers, covering areas such as strategy, operations, financial**

reporting, marketing, and energy efficiency. With Advise for Small Business (ASB) support, clients are expanded and improving their businesses, often employing more people and accessing external finance. Since 2014, EBRD ASB team has implemented 264 local advisory and 15 international advisory projects for SMEs.

7. **Recently EBRD secured €15 million via an EU-NIF Grant to establish the Armenian SME Finance & Advice Facility.** The facility will include €4 million for ASB advice to corporates, and €11 million to assist in the establishment of an Armenia-only private equity fund managed by a high quality, private sector, equity fund manager.

Policy dialogue

8. **EBRD continues to support Investment Council, serving as a platform for policy dialogue between the Government and the private sector.** A number of reforms aimed at creating an enabling favourable environment for the SME sector development has been implemented in tax, customs, business registration and other areas, covering specific achievements, such as introduction of a simplified taxation regime for SMEs, a special phased tax regime for IT start-ups, and simplification of customs clearance procedures. EBRD is providing technical assistance to enhance the business environment, such as improvements in the legal/regulatory frameworks for leasing and factoring and implementation of the legal framework for collateral recovery and liquidation.

9. **In 2016, the Central Bank of Armenia (CBA), the Ministry of Finance, and EBRD signed an updated Memorandum of Understanding (MOU) on local currency and capital market development.** Under the original 2012 MOU, key achievements were (i) implementation of inflation targeting, (ii) creation of a private pension fund system with two international asset managers, and (iii) improvement of the regulatory and market framework for local bond issuance. Under the renewed MOU, a detailed action plan has been defined and is under implementation. To coordinate the effort, a high-level steering committee has been formed which is co-chaired by the CBA and EBRD.

10. **In 2016, the Armenian parliament has passed a package of laws regulating the local financial markets and amendments to the law on the securities market, following close cooperation with the EBRD.** The new law provides for the enforceability of derivatives transactions, including netting, close-out netting and financial collaterals, amends over 17 laws and introduces more than 15 new regulations to Armenia's financial legislation, including settlement finality. The EBRD provided technical cooperation to the CBA for the drafting of the package. Experts, funded by the EBRD-managed Shareholder Special Fund, worked with the Central Bank on the legal reform. This project was also coordinated with, and supported by ISDA. Also, through policy dialogue with the CBA, and outreach with investors, traders and market infrastructure providers, EBRD supports a more robust money market, the emergence of domestic hedge instruments, and more international investment into Armenian debt instruments. Strengthening the local capital market and increasing local currency lending were the main themes of a workshop organised by EBRD and CBA in 2016.

11. **In agribusiness sector the EBRD is supporting the development of innovation and the knowledge economy in the dairy sector of Armenia.** A forum entitled 'Innovation and Knowledge-Sharing in the Dairy Sector' was organised by the EBRD with the support of the Armenian Ministry of Agriculture in 2016.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ASDB)

(As of April 30, 2017)

1. **Armenia joined the AsDB in September 2005.** AsDB's first Country Partnership Strategy for Armenia for 2014–18 (endorsed by AsDB's Board on 27 January 2015) focuses on three sectors: (i) transport, (ii) water supply and other municipal services, and (iii) energy. As of January 1, 2017, Armenia was reclassified as a Group C country eligible for market-based ordinary capital resources only.

2. **As of April 30, 2017, the AsDB cumulative sovereign lending amounted to $1,050.3 million for 18 loans.** In 2016, AsDB approved a Policy-Based Loan of $90 million for phase 2 of the Infrastructure Sustainability Support Program, which focuses on improvements in infrastructure operations and sustainability. In 2016, AsDB also approved financing of $50 million for the Armenia-Georgia Border Regional Road (M6 Vanadzor-Bagratashen) Improvement Project. The road project will support the rehabilitation and upgrading 51.5 kilometers of the two-lane highway in northern Armenia and will enhance international connectivity, reduce the cost of transport, and improve facilities and safety. It has collaborative cofinancing of $56.4 million from the European Investment Bank (EIB).

3. **In 2015 AsDB approved a Results-Based Loan of $88.5 million for the Seismic Safety Improvement Program.** The program supports the government in seismic strengthening and renovation of priority school buildings and will improve seismic safety planning and management competencies.

4. **In 2014, AsDB approved a $37 million loan for the Power Transmission Rehabilitation Project** to help the government diversify energy sources, and rehabilitate and upgrade electricity transmission and distribution networks**.** The Infrastructure Sustainability Support Program ($49 million) was approved in August 2014 and helped improve road and water service provision through results-based public management and financing reforms.

5. **In 2012, AsDB approved two public sector loans.** The Women's Entrepreneurship Support Sector Development Program, approved in October 2012, promotes gender-inclusive growth by improving the enabling environment and capacity of women entrepreneurs and micro, small, and medium-sized enterprises (MSMEs). The program includes two components: (i) a program loan ($20 million) supporting reforms to improve the business environment for women; and (ii) a financial intermediation loan ($20 million) through the German-Armenian Fund in which medium-term local currency loans will be made by participating financial institutions to MSMEs,

with at least 50% of the loans going to women's MSMEs. In 2012, AsDB provided $40 million as additional financing for the Water Sector and Sanitation Sector Project, approved in 2007, for improving access to safe, reliable, and sustainable services in 18 towns and 92 project villages, managed on commercial principles and with environmentally sound practices.

6. **In 2011, ADB approved a $400 million multi-tranche financing facility (MFF) for the Sustainable Urban Development Investment Program,** which aims to help Armenia upgrade its urban transport services, to improve living conditions, and bolster economic opportunities in selected secondary cities. The Tranche 1 for $48.64 million (approved in 2011) and the tranche 2 for $112.97 (approved in 2015) of the MFF will help improve and extend the urban infrastructure and to strengthen the institutional capacity in Yerevan.

7. **In 2009, ADB approved a $500 million MFF to fund the North–South Road Corridor Investment Program.** In 2009 AsDB approved Tranche 1 ($60 million) for improving the Yerevan-Ashtarak section of the road. Tranche 2 ($170 million) approved in 2010 finances the upgrade of the road between Ashtarak and Talin. In 2013 AsDB approved Tranche 3 for $100 million to finance continuing construction of the road to Gyumri (additional co-financing is provided by the European Investment Bank).

8. **ADB has approved $136 million in non-sovereign financing in Armenia for four private sector transactions**. In 2016, AsDB approved a $6 million loan to a universal credit organization to expand lending to small and medium-size enterprises and the agriculture sector, primarily outside of the capital Yerevan. In 2013, ADB signed a $25 million loan with International Energy Corporation to rehabilitate and improve the reliability and safety of Sevan-Hrazdan Cascade Hydropower, in a program cofinanced with the European Bank for Reconstruction and Development (EBRD). In November 2011, AsDB approved a non-sovereign lending program totaling $65 million for four commercial banks to expand lending to small and medium-size enterprises. In 2010, a non-sovereign loan for $40 million was provided to Armenia International Airports for the Zvartnots Airport Expansion Project (Phase 2). The loan financed the construction of a new terminal building and purchase of equipment to supplement the existing concourse building, in a program cofinanced with EBRD and DEG (German Investment and Development Corporation). AsDB's Trade Finance Program works with four banks in Armenia and has supported over $47 million in trade through 103 transactions.

9. **In addition to financing projects and programs, the AsDB is also involved in advisory services and capacity development.** These include technical assistance (TA) programs for urban development in secondary cities, export- and innovation- led industrial development, schools seismic strengthening and infrastructure sustainability. Armenia is also included in a number of AsDB's multi-country TA projects, providing assessments and development plans on topics of common interest across countries.

STATISTICAL ISSUES

(As of May 15, 2017)

Background

1. **Data provision by Armenia has shortcomings, but is broadly adequate for surveillance.** In November 2003, Armenia subscribed to the Special Data Dissemination Standard (SDDS), and the overall quality, timeliness, and coverage of macroeconomic statistics have improved significantly since then. The IMF has supported this process through TA from the Statistics Department (STA), the Fiscal Affairs Department (FAD), and the Monetary and Capital Markets Department (MCM). An April 2008 data ROSC mission prepared a detailed evaluation of the quality of macroeconomic statistics. A multi-topic statistics mission visited Yerevan in February 2010 to review progress with implementation of past recommendations and follow up on outstanding issues in national accounts, balance of payments, and monetary and financial statistics. A follow up STA mission in September 2010 provided further guidance, focusing on improving the accuracy of annual and quarterly GDP estimates. Further improvements in real, fiscal, and external sector statistics would be desirable to facilitate enhanced design and monitoring of economic policies.

2. **Data provision is adequate and sufficient for program monitoring.** Program series, as defined in the Technical Memorandum of Understanding (TMU) are provided with the required timeliness. Monetary statistics include data on one bank's headquarters and some branches in Nagorno-Karabakh (as identified in the above-mentioned data ROSC). The program monetary variables specified in the TMU (based on these statistics) have been defined on a consistent manner over the program period since the program's approval by the Board.

Real sector statistics

3. **The National Statistics Service (NSS) compiles and disseminates annual and quarterly national accounts.** The NSS also compiles and disseminates annually a full set of accounts (up to financial accounts) for the total economy and by institutional sectors. As of 2015, the NSS has been preparing the national accounts under the methodology of the *System of National Accounts 2008 (2008 SNA)*. GDP under this new methodology have been extended back to 2012, and there are plans to also cover earlier years.

4. **The accuracy of the annual estimates of the national accounts is undermined by the lack of exhaustive source data for informal activities and of appropriate price and volume indicators, particularly for construction activities.** Construction output volume measures are derived by deflating current values with a price index for output, which uses weights and base year prices from a survey in 1984. To improve volume measures of construction, the NSS has started compiling a new construction output price index based on more sound methodology. Until the new construction price index becomes available, the NSS should use other indicators for deriving

construction aggregates at constant prices. The NSS should also implement new surveys to derive a proper benchmark for informal activities.

5. The production-side estimates at current prices are derived partially from cumulative source data (from business statistics surveys) and partially from discrete data sources. The NSS validates and reconciles data from different sources, but underlying problems associated with de-cumulating the cumulative output data distort the quarterly pattern. The NSS is currently working to produce GDP data at current and at constant prices to be fully in accordance with the SNA. The NSS received IMF TA on estimating quarterly GDP from discrete data sources only and is using statistical techniques that conform to international standards. Recent publications of the NSS have reflected this effort. The NSS has discontinued compiling GDP volume measures at the prices of the corresponding quarter of the previous year and instead adopted the recommendation of the IMF STA mission to compile only one set of quarterly GDP estimates—quarterly GDP at previous-year average prices—and derive time series through chain-linking. These estimates would be conceptually consistent with the annual data. They would also allow comparisons between different periods, which are essential for analysis of the business cycle. Since 2012, NSS has discontinued compiling GDP on average prices of 2005 and instead they just published GDP for 2009–12 on average prices of year 2008. As of January 2011, the NSS also started compiling a monthly indicator of economic activity (IEA), following international best practices. The monthly GDP compilation was discontinued. The monthly IEA is an implicit volume index compiled by aggregation of monthly volume indices of output using gross output weights. The CPI covers 11 large population centers and Yerevan. The CPI is currently computed using 2015 weights. Concepts and definitions used in the compilation of the CPI are broadly in line with international standards; source data and compilation techniques are generally adequate. The NSS compiles a ten-day and a monthly CPI. The ten-day index and the monthly index are disseminated jointly. A February data 2009 ROSC mission recommended development of an approach to include household expenditure on owner-occupied dwellings in the CPI calculations.

Government finance statistics

6. The budget execution reporting system compiles government finance data on a cash basis, supplemented with monthly reports on arrears and quarterly reports on receivables and payables. Daily revenue and cash expenditure data for the central government are available with a lag of one to two days and monthly data on central government operations are disseminated one month after the reporting period. The MoF is undertaking a comprehensive reform of the treasury system, including the introduction of an internal auditing system in line ministries and their respective budgetary institutions. A treasury single account (TSA) was introduced in 1996, and all bank accounts held by budgetary institutions were closed, except for project implementation units (PIU) that are required by donors to operate with commercial bank accounts. Since 2010 these PIU accounts also are being moved gradually to the TSA. Starting in 2002, some budgetary institutions have been converted into "noncommercial organizations" (NCOs). These units have been taken out of the treasury system and have their own bank accounts, but since 2003 report data on cash flows and balances to the MoF. The February 2009 ROSC report recommended including NCOs in the government finance statistics data published on national websites. These exceptions notwithstanding, all government receipts and payments are processed through the TSA, although there are still shortcomings on the timeliness and quality of data on the operations of local governments.

7. The budget presentation and the classification of items under the economic and functional classification of expenditures need to be made more transparent; for instance, the data have been subject to frequent reclassification, and wages for military personnel, teachers, and doctors are reported in the category of goods and services and other expense, rather than as a wage item. The February 2009 ROSC report recommended using market value rather than face value for financial assets other than loans, and for nonfinancial assets. The reconciliation of central government with general government operations is done by the NSS in cooperation with the MoF.

8. Since 2008, government finance statistics meet the classification requirements of the *Government Finance Statistics Manual 2001* (*GFSM 2001*) for the central government.

Monetary and financial statistics

9. Monetary and financial statistics are provided on a timely basis. Data on the accounts of the CBA are provided daily with a one-day lag, while monthly data on the monetary survey are provided with a three-week lag (and preliminary weekly data with a one-week lag). The balance sheets of the CBA and of the deposit money banks follow IAS methodology. Monthly interest rate data are provided with a one-week lag.

10. Responding to an IMF STA request, the CBA has compiled and submitted a complete set of monetary data beginning from December 2001 using standardized report forms (SRF). STA validated the resulting monetary aggregates, and the data have been published since the December 2006 issue of *IFS Supplement* and are used to update IFS. An integrated monetary database has also been established by STA to share the SRF data with the IMF's Middle East and Central Asia Department. The CBA also produces the financial soundness indicator table every month, published on both the IMF and CBA websites.

External sector statistics

11. In 2009, the Armenian authorities decided to transfer the responsibility for compiling the balance of payments, international investment position (IIP), and external debt statistics from the NSS to the CBA. The February 2010 STA mission provided advice on an action plan aimed at ensuring a smooth institutional transfer of responsibility, as well as consistency and continuity in the production of the external sector statistics. The responsibilities of compiling external sector statistics were de facto transferred to the CBA in January 2011, and since then, the CBA has compiled balance of payments, external debt, and IIP data for 2011. The transfer of responsibilities was smooth and during the short period after the transfer, the CBA undertook a number of important actions aimed at improving the compilation system. A follow up IMF STA mission in October 2011 undertook a comprehensive assessment of the institutional arrangements, data sources, methodology, and compilation practices for external sector statistics employed by the CBA, and advised on areas for improvement including further developing data sources and compilation practices.

12. The coverage of external sector data has improved in recent years, although some recent delays have emerged with the transitions towards the Eurasian Economic Union (EEU). Trade statistics are provided on a timely basis, and trade data by origin, destination, and commodity are generally available within a month. However, reporting problems have arisen in 2015 with EEU trade data. Price data for exports and imports are less readily available. Quarterly balance of payments statistics are generally available with a three-month lag. However, for remittances, there are considerable discrepancies among available source data. Remittance data obtained from surveys are considerably lower than data obtained through the money transfer system. The absence of a comprehensive, continuously updated business register hampers the coverage of transactions and institutional units; in particular, the coverage of the financial account items for the private nonbank sector. There are also concerns with regard to the collection of data on international trade in services, specifically on import of services. The CBA is currently considering the implementation of an international transactions reporting system that would allow for collecting data on all cross-border payments and receipts going through the banking system.

13. Quarterly data on the international investment position are published by the CBA within one quarter after the reference period, and the annual data within two quarters; and are also provided for publication in IFS.

Armenia: Common Indicators Required for Surveillance

(As of May 15, 2017)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	April 2017	5/1/2017	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	April 2017	5/1/2017	D	D	M
Reserve/Base Money	April 2017	5/1/2017	D	D	D
Broad Money	April 2017	5/1/2017	M	M	M
Central Bank Balance Sheet	April 2017	5/1/2017	D	M	M
Consolidated Balance Sheet of the Banking System	April 2017	5/1/2017	M	M	M
Interest Rates[2]	April 2016	5/1/2017	W	W	M
Consumer Price Index	April 2017	5/5/2017	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]— General Government[4]	Q1 2017	5/5/2017	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Q1 2017	5/5/2017	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	March 2017	4/30/2017	M	M	Q
External Current Account Balance	Q4 2016	3/31/2017	Q	Q	Q
Exports and Imports of Goods and Services	Q1 2017	5/10/2017	M	M	Q
GDP/GNP	Q4 2016	3/2/2017	Q	Q	Q
Gross External Debt	Q4 2016	3/31/2017	Q	Q	Q
International Investment Position[6]	Q4 2016	3/31/2017	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA).

Statement by Richard Doornbosch, Alternate Executive Director, and Yosef Yakhin, Advisor for the Republic of Armenia
June 20, 2017

On behalf of the Armenian authorities we thank the IMF team, headed by Mr. Hossein Samiei, for the candid, constructive and friendly dialogue during their mission in Yerevan, and for their valuable advice.

The authorities broadly agree with staff's assessment and recommendations in the report. They recognize that strengthening the fiscal position, modernizing the fiscal framework, improving the business environment and reducing poverty are among the main challenges they face ahead. Progress along these fronts and improvement of the external conditions will pave the way for putting the Armenian economy on a viable growth path.

Program performance since the previous review was satisfactory, and all quantitative performance criteria, indicative targets and structural benchmarks were met. In particular, the authorities have established a mechanism to strengthen the monitoring and prioritizing of foreign-financed capital projects (December 2016 SB) and built a centralized database of all ongoing, planned, and pledged projects (March 2017 SB); the 2017 budget secured funding for the Pension System Awareness Center (December 2016 SB), and the CBA has prepared a plan for the divestment of PanArmenian Bank (December 2016 SB).

Economic Activity
Economic recovery is underway, but the economy remains vulnerable to external shocks.

With exports accounting for 30 percent of GDP and domestic consumption relying heavily on remittances income, external conditions play a major role in the performance of the Armenian economy. In 2016 remittances inflow fell 6.9 percent (in dollar terms) relative to 2015, and by 34.3 percent relative to 2014 prior to the external shock. Remittances are a significant source of income that finance domestic consumption (12.6 percent of GDP in 2016). In 2016 the economy grew by only 0.2 percent, reflecting weak domestic consumption and investment demand due to low remittances and low international copper prices. As a result, deflationary pressures persisted with CPI inflation at -1.1 percent in 2016. Nevertheless, the external balance remained robust, with a current account deficit of 2.7 percent of GDP, due to lower import demand and diversification efforts and one-off factors supporting exports. Against this subdued economic environment, the fiscal deficit widened to 5.6 percent in 2016, and the CBA continued to ease monetary conditions.

Going forward, the authorities and staff expect economic activity to accelerate in 2017. This is already reflected in the recovery of the economic activity index since late 2016 and in better-than-expected tax revenues since the beginning in 2017. In addition, exports have continued growing and remittances appear to be picking up. Headline CPI inflation turned positive and reached 1.5 percent yoy in May. Rising copper price and a better economic outlook in major trading partners, especially Russia, also support the positive outlook.

Fiscal Policy

In 2017 a debt-brake mechanism was activated, imposing sharp fiscal consolidation measures. The fiscal framework is now reevaluated with the support of an IMF TA.

Lower-than expected tax revenues and countercyclical over-execution of foreign-financed capital expenditures have led to widening of the fiscal deficit to 5.6 percent of GDP in 2016, relative to the (revised) program target of 5.9 percent of GDP. This brought the general government debt over 50 percent of GDP and activated the debt-brake mechanism. The Law on Public Debt prevents general government debt from exceeding 60 percent of GDP, and once the debt ratio reaches 50 percent a braking mechanism limits the fiscal deficit in the following year to three percent of the average GDP in the previous three years. Accordingly, the 2017 budget envisages a substantial fiscal consolidation with a target deficit of 2.8 percent of 2017 GDP.

With already thin public expenditures, to meet the consolidation requirements the authorities have initiated a substantial reduction in foreign-financed capital expenditure. They have also introduced a moratorium on signing new foreign-financed projects and entered discussions with donors on the scope to postpone or restructure some projects. Nevertheless, overperformance in tax collection since the beginning of the year (around 0.25 percent of GDP in the first quarter) may allow for milder cuts in capital expenditure. The favorable revenue performance is due to efforts by the State Revenue Committee aimed to improve tax administration and target the informal sector, and improved economic activity. The authorities now estimate overperformance of tax collection for the year to reach 1 percent of GDP. This allows raising the level of foreign-financed capital expenditure already in the pipeline, while complying with the target deficit. Nevertheless, the authorities recognize the downside risks for their estimate of tax revenues and stand ready to scale down expenditure in case adverse risks materialize.

While being constrained by the Law on Public Debt, the authorities agree with staff that the implementation of the fiscal rule is overly contractionary at this conjunction. From legislative perspective, the current fiscal framework relies only on a debt ceiling, which is quite a unique arrangement in the international landscape.[1] We note that such a framework does not provide a useful anchor when debt is sufficiently below the ceiling and, as indicated by staff, is likely to bind when economic activity is weak, resulting in a procyclical bias – as experienced in the current episode. This may therefore aggravate the economic downturn and thereby undermine the credibility of the fiscal framework. The authorities are currently being assisted by an IMF TA to revise and modernize their fiscal rule and strengthen the credibility of the fiscal framework. Their objective is to send a draft of a new fiscal rule to the National Assembly by October 2017 alongside the draft budget for 2018.

Monetary and Financial Sector Policies

The CBA balances monetary expansion to increase inflation and financial stability considerations.

---

[1] Per the IMF Fiscal Rules Dataset only two countries, Armenia included, rely only on a debt ceiling as their fiscal framework.

Since the last review, the CBA has continued to cut the policy interest rate gradually in order to ease monetary conditions in face of subdued economic activity, low inflation rate and fiscal consolidation headwinds. In mid-February, the CBA's governing board cut the policy rate by additional 0.25 percentage points to 6.0 percent, the lowest level in seven years. While inflation (1.5 percent YoY in May) is still below the target (4 percent), it has pick-up relatively fast from negative territory and economic activity has been stronger than expected since the beginning of 2017. Against this background, the CBA is evaluating the impact of the recent rate cuts and policy actions, and stands ready to adjust monetary conditions as needed to ensure that the inflation path remains on track. Furthermore, there is a concern that a too fast rate reduction would result in a rapid exchange rate depreciation and a fast rise in inflation expectations that would undermine long-term price stability and financial stability objectives and aggravate dollarization.

The authorities continue to ensure two-way flexibility of the exchange rate, while using limited intervention to smooth excessive fluctuations and to offset transitory pressures. Exchange rate flexibility is also important for improving the monetary policy transmission mechanism. Narrowing current account deficit and favorable external developments have created comfortable conditions for the CBA to rebuild its foreign reserves to $2.2 billion at end-2016 (5.2 months of 2017 projected imports), and reserves are now considered at an adequate level.

The CBA is taking steps to build a coherent and coordinated policy framework that will integrate its dual mandate of price and financial stability. The banking system is well capitalized, and while NPL ratio and banks' profitability remain a challenge, both have been improving over the past year. High dollarization level is also a challenge for financial stability and effective monetary policy. To improve its monitoring and risk assessment practices and to ensure the soundness of the financial system, the CBA has requested a Financial Sector Assessment Program (FSAP) for 2018.

Structural Reforms

The authorities have made progress in promoting competition, improving Armenia's integration in the global economy, fighting corruption, and strengthening the energy sector.

Improving the business environment is placed high on the authorities' agenda and they are taking directed measures to strengthen identified areas of weakness. Specifically, the authorities continue to strengthen the electricity sector by encouraging greater involvement of the private sector, strengthening the financial soundness of the sector, move forward with the modernization of the nuclear power plant and explore options for building new thermal power plants to replace maturing facilities. These measures will improve supply reliability and reduce electricity costs.

To improve competition and regulatory framework, the authorities have submitted amendments to the law on protection of economic competition to the National Assembly in late 2016, which are expected to be adopted by the end of this year.

The authorities continue to make progress on international integration by improving Armenia's connectivity via "open skies" policy and through economic cooperation with its main trade partners, the EEU and the EU. The government has also recently established the Center for Strategic Initiatives, to encourage and analyze key reforms to attract FDI and to foster public-private partnerships.

Finally, to fight corruption the authorities have strengthened the law on procurement and improved substantially procurement transparency; they improved tax and customs administration; criminalized illicit enrichment and established a new investigatory approach to corruption crimes; the authorities have also developed legislative amendments to reduce cash transactions and tackle the shadow economy.

Conclusion
Armenia has made substantial progress under the EFF program: public financial management has improved through a review of lending operations and the strengthening of the monitoring system of foreign financed projects; a pension reform to enhance long-term fiscal sustainability is underway; a new tax code was adopted; progress has been made in legislation for promoting domestic competition and developing the financial markets; the CBA is in the process of incorporating financial stability considerations into the operational policy framework, and the inflation targeting regime has been strengthen.

Nevertheless, challenges remain, including a revision of the medium-term fiscal framework, reducing dollarization, further integration into the global economy and reducing poverty. The authorities greatly appreciate the long-lasting cooperation with the Fund and its valuable advice and are considering the possibility of a successor program. They look forward to initiating discussions on this matter later this year.