



# REPUBLIC OF ARMENIA

## FIRST REVIEW UNDER THE STAND-BY ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF ARMENIA

December 2019

In the context of the First Review under the Stand-By Arrangement, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its December 20, 2019 consideration of the Staff Report on issues related to the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 20, 2019, following discussions that ended on October 2, 2019 with the officials of Armenia on economic developments and policies underpinning the IMF arrangement under the Stand-By Arrangement. Based on information available at the time of these discussions, the staff report was completed on December 6, 2019.
- A **Statement by the Executive Director** for the 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 the Republic of Armenia\*  
Memorandum of Economic and Financial Policies by the authorities of the Republic of Armenia\*  
Technical Memorandum of Understanding\*

\*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.

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700 19<sup>th</sup> Street, NW  
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## **IMF Executive Board Concludes First Review under the Stand-By Arrangement for the Republic of Armenia**

- Armenia's economic performance is strong with healthy growth, low inflation, a stable financial system, with increasing foreign reserves and higher revenues.
- Despite fiscal overperformance, it is key to maintain the reform momentum to strengthen revenue mobilization, including by completing reforms to property taxation.
- Implementation of the authorities' reform agenda including efforts to improve governance by establishing a holistic anti-corruption framework, will bolster sustainable and inclusive growth.

On December 20, 2019, the Executive Board of the International Monetary Fund (IMF) completed the first review under of the Republic of Armenia's performance under the program supported by the [Stand-By Arrangement](#) (SBA). The 36-month SBA, with a total access of SDR 180 million (about US\$ 248.2 million), equivalent to 139.75 percent of Armenia's quota in the IMF, was approved by the IMF's Board on May 17, 2019 (see [Press Release No. 19/173](#)).

The Armenian authorities continue to view the SBA as precautionary until the program expires in May 16, 2022, an insurance policy against unforeseen economic shocks that could lead to a balance of payments need.

Following the Executive Board's discussion today, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair issued the following statement:

“Armenia's economic performance is strong with healthy growth, low inflation, a stable financial system, and improving external and fiscal buffers. Public debt remains on a declining trajectory, with Armenia expected to achieve its medium-term debt objective, several years earlier than expected. This favorable outlook provides an opportunity to accelerate reform efforts in support of more balanced and inclusive growth, declining poverty, and falling unemployment.

“The 2019 fiscal outturn overperformed the budget, reflecting both higher-than-expected revenues and lower-than-expected capital spending. Strengthening the implementation of capital spending, in line with a sound public investment management process, remains a priority.

Despite fiscal overperformance, reform momentum should be maintained to improve revenue mobilization, including by completing reforms to property taxation and further strengthening revenue administration. Bolstering the budgetary process would also further safeguard the credibility of the fiscal rule.

“The monetary policy framework’s focus on price stability has served Armenia well. The authorities’ implementation of Basel III measures will raise the resilience of the financial system, while their plans to develop the capital market and improve access to finance are also welcome.

“Implementation of the authorities’ reform agenda will bolster sustainable and inclusive growth. Efforts to improve governance by establishing a holistic anti-corruption framework are ongoing. The authorities also reaffirmed their commitment to protect the most vulnerable by expanding, and better targeting, their social safety net. Enhanced steps to strengthen human capital and increase female labor force participation are key focal points of the authorities’ longer-term structural agenda”

**Table 1. Armenia: Selected Economic and Financial Indicators, 2016–24**

	2016	2017	2018	2019	2020	2021	2022	2023	2024
	Act.	Act.	Act.			Proj.			
<b>National income and prices</b>									
Real GDP (percent change)	0.2	7.5	5.2	6.5	4.9	4.5	4.5	4.5	4.5
Final consumption expenditure, Contrib. to Growth	-0.9	7.4	2.7	8.3	3.3	1.3	1.7	1.7	1.8
Gross fixed capital formation, Contrib. to Growth	-2.4	1.5	0.8	2.1	2.5	3.0	2.3	1.9	1.5
Changes in inventories, Contrib. to Growth	0.7	1.1	4.0	-3.6	-1.0	0.0	0.0	0.0	0.0
Net exports of goods and services, Contrib. to Growth	3.1	-1.2	-1.8	-0.2	0.1	0.2	0.5	0.9	1.2
Gross domestic product (in billions of drams)	5,067	5,564	6,005	6,541	7,095	7,636	8,283	8,992	9,751
Gross domestic product (in millions of USD)	10,546	11,527	12,433	13,444	14,132	14,839	15,704	16,632	17,596
Gross domestic product per capita (in USD)	3,524	3,869	4,188	4,528	4,759	4,997	5,288	5,599	5,924
CPI (period average; percent change)	-1.4	1.0	2.5	1.6	2.5	3.3	4.0	4.0	4.0
CPI (end of period; percent change)	-1.1	2.7	1.8	1.5	3.3	3.8	4.1	4.0	4.0
GDP deflator (percent change)	0.3	2.1	2.5	2.3	3.4	3.0	3.8	3.9	3.8
Unemployment rate (in percent)	20.4	18.9	18.5	17.6	17.5	17.2	16.9	16.8	16.7
<b>Investment and saving</b> (in percent of GDP)									
Investment	18.0	19.3	22.4	22.9	24.1	25.2	25.3	25.3	25.3
National savings	16.0	16.3	13.0	14.9	16.2	17.7	18.2	18.9	19.3
<b>Money and credit (end of period)</b> (percent change)									
Reserve money	13.1	-1.0	17.8	9.0	8.8	8.0	8.3	8.5	8.7
Broad money	17.5	18.5	7.4	9.1	8.8	8.0	8.3	8.5	8.7
Private sector credit growth	6.0	16.5	17.2	16.0	11.5	11.0	10.5	9.0	8.5
<b>Central government operations</b> (in percent of GDP; unless otherwise indicated)									
Revenue and grants	21.4	21.2	22.3	23.5	23.9	23.8	24.0	24.2	24.3
<i>Of which: tax revenue</i>	20.1	20.2	20.7	21.8	22.3	22.5	22.7	22.9	23.1
Expenditure	27.0	26.0	24.1	25.0	26.2	25.7	25.9	26.1	26.2
Overall balance on a cash basis	-5.6	-4.8	-1.8	-1.5	-2.3	-1.9	-1.9	-1.9	-1.9
Public and publicly-guaranteed (PPG) debt	56.7	58.9	55.8	53.6	53.5	52.6	51.6	50.7	50.0
Central Government's PPG debt (in percent)	52.0	53.7	51.3	50.0	50.6	50.4	49.9	49.5	49.1
Share of foreign currency debt (in percent)	80.9	81.1	72.2	72.1	71.1	69.9	68.4	68.6	68.6
<b>External sector</b> (in millions of USD; unless otherwise indicated)									
Exports of goods and services	3,501	4,312	4,700	4,963	5,182	5,484	5,828	6,235	6,636
Imports of goods and services	-4,517	-5,723	-6,647	-6,887	-7,151	-7,505	-7,911	-8,343	-8,841
Exports of goods and services (percent change)	11.6	23.2	9.0	5.6	4.4	5.8	6.3	7.0	6.4
Imports of goods and services (percent change)	2.2	26.7	16.1	3.6	3.8	5.0	5.4	5.5	6.0
Current account balance (in percent of GDP)	-2.1	-3.0	-9.4	-8.0	-7.9	-7.5	-7.1	-6.4	-6.0
FDI (net)	263	222	247	296	318	341	369	399	440
Gross international reserves	2,204	2,314	2,259	2,357	2,363	2,405	2,457	2,646	2,669
Import cover 1/	4.6	4.2	3.9	4.0	3.8	3.6	3.5	3.6	3.4
End-of-period exchange rate (dram per USD)	484	484	484	...	...	...	...	...	...
Average exchange rate (dram per USD)	480	483	483	...	...	...	...	...	...

Sources: Armenian authorities, and IMF staff estimates and projections.

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



# REPUBLIC OF ARMENIA

## FIRST REVIEW UNDER THE STAND-BY ARRANGEMENT

December 6, 2019

### EXECUTIVE SUMMARY

**Context.** The Board approved a 36-month Stand-By Arrangement (SBA) with access of SDR 180 million (139.75 percent of quota or about US\$248.2 million) on May 17, 2019. Armenia's economic environment remains favorable: strong growth continued in the first half of the year, inflation is low, fiscal revenue performance is strong, the current account deficit is narrowing, foreign exchange reserves are improving, the financial system is stable, and external financing conditions have improved. Steadfast implementation of reforms to improve the business environment and strengthen governance are key to Armenia building credibility and transitioning to a more dynamic market economy.

**Focus.** Discussions centered on (i) maintaining fiscal prudence and strengthening public investment management; (ii) the 2020 budget; (iii) the Central Bank of Armenia's (CBA) efforts to further strengthen the monetary policy framework and reform FX reserve requirements to strengthen bank resilience; (iv) reforms to promote financial sector and capital market development; and (v) efforts to strengthening economic governance.

**Program Performance.** The program remains broadly on track and, after making a strong start implementing its program, the authorities remain committed to pursuing their reform agenda. All end-June quantitative performance criteria (QPCs) and all four end-June structural benchmarks (SBs) were met. All indicative targets (ITs) were observed, except for the one on social spending for end-June, which was marginally missed. A time-bound action plan and a communication strategy to reform the FX reserve requirement regime (an end-September SB) were completed. Two SBs were not observed for end-September 2019 and are proposed to be reset to December 2019, and March 2020 instead, and a new SB is proposed in line with the recent safeguards' assessment. The draft 2020 budget was submitted to Parliament in line with the program.

**Staff supports the authorities' request for completion of the first review.** Upon completion of the review, an additional SDR 25.714 million would be made available to Armenia, bringing the total accessible credit to about SDR 51.428 million. The Armenian authorities intend to treat the SBA as precautionary.

**Approved By**  
**Thanos Arvanitis and**  
**Mary Goodman**

Discussion took place in Yerevan during September 19–30. The mission met with Deputy Prime Minister Grigoryan, Governor of the Central Bank of Armenia Javadyan, Minister of Finance Janjughazyan, Minister of Economy Khachatryan, State Revenue Committee Deputy Chairman Mashadyan and other senior government officials, as well as representatives of the private sector and civil society. The team comprised A. Arvanitis (head), H. Tabarraei, and M. El Said (MCD), Y. Ustyugova (Resident Representative), F. Raei (SPR), and Y. Xiao (FAD). V. Janvelyan and L. Karapetyan (IMF Office) assisted the team. Sh. Harutyunyan (OED) attended most of the meetings. R. Al Farah and B. Laumann (MCD) provided assistance.

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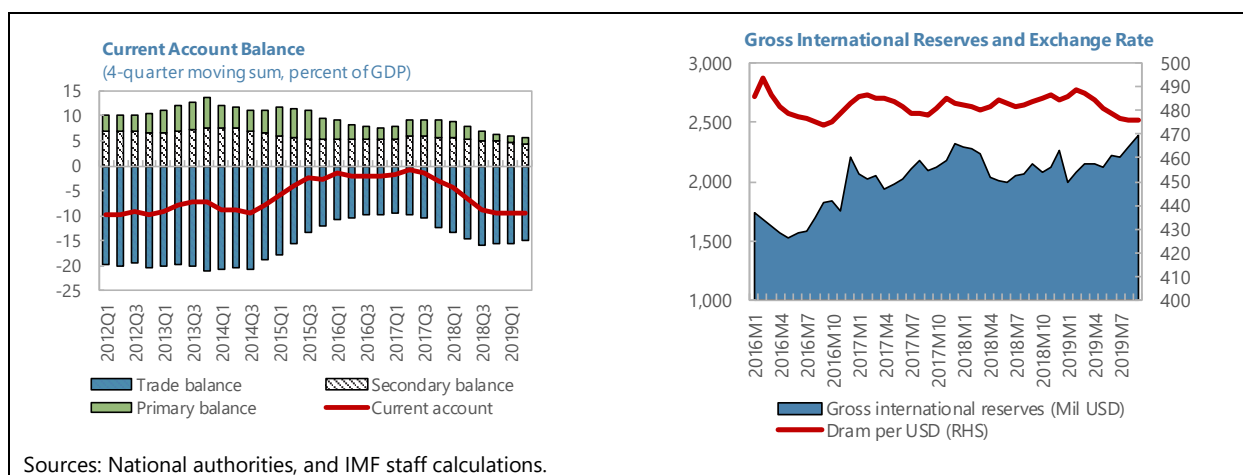


## RECENT DEVELOPMENTS AND OUTLOOK

**1. The post-velvet revolution government remains determined to move ahead with ambitious reforms.** By year-end they intend to have in place a national plan to modernize and transform the economy. The plan will lay-out 26 sectoral strategies which will aim to strengthen governance and the anticorruption framework, improve the business environment, develop human capital, and improve social protection. The authorities believe that steadfast reform implementation in these areas is key to revitalize the Armenian economy, create better opportunities for all citizens, and improve the standards of living.

**2. These efforts take place against a broadly favorable economic environment.** Real GDP grew by 7.1 percent in the first half of 2019. The better-than-expected performance was driven by strong private consumption growth and with manufacturing and services sectors leading economic activity (Figure 1 and Table 1). Preliminary indicators point to continued strong economic performance in the second half, with growth expected to exceed 6½ percent in 2019 overall. Driven partly by lower food prices, annual CPI inflation fell to 0.5 percent (y-o-y) in September (compared to 0.6 percent in August) and remains below the  $\pm 1.5$  percent band around the Central Bank of Armenia's (CBA) medium-term target of 4 percent.

**3. The current account deficit is expected to narrow in 2019.** In 2018 the current account deficit widened sharply (to 9.4 percent of GDP), owing to rapid import growth (Table 2). However, monthly trade data to end-August 2019 point to a deceleration of import growth on the back of a lower oil prices and a slowdown in imports of machinery and equipment (the driver of import growth in 2018). The impact of weaker imports was partly offset by weaker export growth due to lower commodity prices and weaker demand from major trading partners (Russia and EU).<sup>1</sup> Overall, the trade deficit is expected to decline relative to GDP in 2019. Against relatively strong private flows, the dram appreciated slightly in recent months, notwithstanding opportunistic FX purchases by the CBA (around \$500 million, net, in 2019 up to end-October), to build up its reserves position.



<sup>1</sup> Two copper mines were shut down and the development of a gold mine was put on hold in 2018 due to environmental concerns. One of the copper mines resumed operations recently.

**4. The fiscal position has been stronger than expected at program approval, but under-execution of foreign financed capital spending remains a concern.** Fiscal revenue overperformed the budget target in H1 by almost 1 percent of GDP due to better than expected growth and—reflecting stronger tax compliance and a reduced shadow economy—strong performance in VAT, income and excise tax revenues.<sup>2</sup> Spending remained lower than budgeted, mainly due to delays in the execution of planned capital expenditure (see below). As a result, assuming some catch-up in the implementation of investment projects—the end-2019 fiscal deficit is expected to be around 1½ percent of GDP, although if stronger-than-expected growth continues in 2019H2, the fiscal may overperform.

**5. Domestic financial conditions are stable and financial soundness indicators remain sound** (Tables 4 and 5). The banking sector remains well capitalized, liquid and its profitability has somewhat increased. Non-performing loans (NPLs) remain low despite a marginal increase to 5.5 percent of total loans, while the return on assets improved to 1.4 percent at end-July 2019. Reflecting ongoing macroeconomic and financial conditions stability, both credit and deposit dollarization declined somewhat (to 50.8 percent and 49.4 percent through August, respectively). Overall private sector credit growth moderated to 15.1 percent (yoy) at end-August (compared to 16.4 percent at end-2018), supported by robust demand for consumer loans and mortgages. Deposit growth accelerated to 9.7 percent (yoy) at end-August.

**6. The macro-economic outlook and external position remains positive.**

- *Growth* is projected to moderate to around 5 percent in 2020 although there may be some upside risk depending on the pace of capital spending execution in 2020. In line with current estimates of potential growth, growth is expected to remain around 4½ percent over the medium-term. Consumption growth is expected to moderate given that it was temporarily buoyed by preferential trade preferences, with investment strengthening as the execution of capital projects improves.
- *Inflation* is expected to gradually pick up in 2020 as the impact from lower food prices dissipates.
- *External position* is expected to strengthen somewhat in 2019, with the current account deficit narrowing. Over the medium term, the current account deficit is projected to gradually converge to its 6 percent of GDP norm, as export growth benefits from ongoing reforms.

## PROGRAM IMPLEMENTATION

**7. The program is broadly on track.** The authorities reiterated their commitments to all program objectives and targets (see Memorandum of Economic and Financial Policies (MEFP)).

<sup>2</sup> Strong collections also enabled the government to clear the bulk of their backlog with VAT refunds.

- **All end-June quantitative performance criteria (QPC) were met** (text table and MEFP Table 1). The QPCs for NIR<sup>3</sup> and fiscal balance target were met comfortably. While inflation is below CBA's target, it was within the band specified by the Monetary Policy Consultation Clause (MPCC). The end-June QPCs on the budget domestic lending and the ceiling on the accumulation of external public debt arrears by the consolidated general government were met. All indicative targets (ITs) were met except that the IT on social spending was marginally missed due to lower than expected demand for maternity-related benefits and improved targeting. The government is taking steps to strengthen social spending, including in the 2020 budget (see below).

<b>Armenia: Quantitative Performance Criteria 1/</b> (In billions of drams, at program exchange rates, unless otherwise specified)						
	2018	2019			Status	
	Dec.	Mar.	Jun. <sup>2/</sup>			
	Act.	Act.	EBS 19/27	Adj. Target	Est.	
<b>Performance Criteria</b>						
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,404	1,320	1,392	1,142	1439	Met
Program fiscal balance (flow, floor)	...	28	-99	-50	98	Met
Budget domestic lending (cumulative flow, ceiling)	...	0	15	15	0	Met
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	0	Met
<b>MPCC<sup>3/</sup></b>						
Inflation (upper-band, percent)	..	3.4	4.0	4.0	...	
Inflation (mid-point, percent)	1.8	1.9	2.5	2.5	2.5	Met
inflation (lower-band, percent)	..	0.4	1.0	1.0	...	
<b>Indicative Targets</b>						
Net domestic assets of the CBA (stock, ceiling)	449	471	574	695	371	Met
Avg. concessionality of newly contracted ext. debt (flow, floor, in percent) <sup>4/</sup>	...	...	30	30	...	Met
New government guaranteed external debt (stock, ceiling, in millions of USD) <sup>5/</sup>	...	0	100	100	0	Met
Social spending of the government (flow, floor) <sup>6/</sup>	...	15	30	30	27	Not Met
Sources: Armenian authorities; and Fund staff estimates.						
1/ All items as defined in the TMU, based on program exchange rates in the TMU.						
2/ Quantitative performance criteria at test dates.						
3/ If the end of period year-on-year headline inflation is outside the upper/lower bound, a formal consultation with the Executive Board as part of program reviews would be triggered.						
4/ Assessed on a calendar year basis, excluding the Eurobond and any similar refinancing instruments.						
5/ Includes both concessional and non-concessional debt, excluding the Eurobond and any similar refinancing instruments.						
6/ 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.						

- **Most structural benchmarks (SB) have been implemented.** The authorities have:
  - Submitted the draft PPP law prepared in cooperation with the IMF to the National Assembly (NA) in March 2019 and adopted in June 2019 (June 2019 SB). The law establishes reporting and monitoring and requires a ceiling on government exposure from such partnerships. The

<sup>3</sup> The NIR and NDA targets have been adjusted for June on account of budget and project actual disbursements of loans and grants.

authorities are currently working on the secondary legislation that would specify the ceiling on government exposure to PPPs.

- Developed and shared with staff an action plan for their 2020–24 Tax Administration Strategy that addresses key IMF TA recommendations on developing a compliance strategy and strengthening core taxation functions and processes (June 2019 SB).
- Submitted a draft law to establish a market evaluation procedure for real estate taxation to the NA (June 2019 SB).
- Adopted legislation to require the establishment of a registry of beneficial ownership information (June 2019 SB).
- Prepared and communicated to banks an action plan to gradually convert their holdings of FX required reserves from AMD to FX starting (September 2019 SB), with a 6 percent (out of 18) already this year and a further 3 percent every subsequent year (MEFP ¶16).

**8. The authorities requested modification of one SB, asked to reset two SBs that were not observed, and requested a new SB as well as an adjustment to the IT on social spending on technical grounds.** While a draft of a strategy to develop capital markets has been developed by the CBA, more time is needed for technical consultations, both internally and with Fund staff. Therefore, the authorities requested to reset the end-September 2019 SB to March 2020. The authorities also requested to reset the end-September 2019 SB on a draft law creating a single autonomous anti-corruption entity to end-December to align it with a new anticorruption strategy for 2019–23, which was approved by the government on October 3, 2019. In line with the recent safeguards’ assessment, the authorities agreed to a new SB to prepare an exit strategy to phase out the CBA involvement in non-core central bank activities such as development lending and subsidiaries (end-June 2020). The authorities requested adjusting the IT for end-2019 on social spending reflecting demand factors, while committing to increase the budgeted allocation in 2020. All continuous PCs, including on non-introduction/non-intensification of exchange restriction and multiple currency practices have been met.

## POLICY DISCUSSIONS

### A. Maintaining Fiscal Prudence while Strengthening Public Investment

**9. The authorities, guided by their 2017 upgraded fiscal rules, are on track to bring central government debt below 50 percent of GDP well before their 2023 target.** Following two years of fiscal overperformance, central government debt is already projected to fall to around 50 percent by end-2019. This is consistent with the government’s medium-term fiscal policy objective of preserving debt sustainability while maintaining space for investment and social spending.

**10. The authorities and staff agree that the draft 2020 budget—targeting a fiscal deficit of 2¼ percent of GDP—will appropriately continue this effort.** Tax revenues are expected to rise by

½ percent of GDP relative to 2019, reflecting continued efforts to strengthen tax administration and change taxpayer behavior under the government’s new anti-corruption initiatives. Current spending is set to remain a constant share of GDP, although social assistance spending will show a small increase in nominal terms, and capital spending rises to 4.1 percent of GDP as implementation bottlenecks are gradually resolved (see below). Such a fiscal stance allows public debt to continue its medium-term decline while providing support for growth. A budget in line with these objectives will be approved by the National Assembly (NA) by the end-year. In the event of any revenue shortfalls, the government is committed to take compensating measures while striving to protect social spending, including by reducing ad hoc VAT and income tax exemptions and further streamlining expenditures.

**11. Staff stressed the need for further revenue mobilization and completion of the remaining steps to reform property taxation.** In June, the NA approved the planned growth-friendly tax changes to become effective in 2020. The package includes measures to flatten the personal income tax, lower personal and corporate income tax rates, and simplify special tax regimes, as well as offsetting measures including the introduction of new taxes on tobacco and gambling, indexation of excise tax rates to inflation, removal of selected tax exemptions, and the increase in gambling and financial sector license fees. Although the changes are expected to be revenue neutral,<sup>4</sup> staff urge the authorities to take offsetting measures if revenues unexpectedly fall short. The government is finalizing its 2019–20 tax reform strategy which will—in line with program commitments—remove tax arbitrage opportunities and rationalize tax expenditures. The authorities have made good progress towards implementing market-price-based valuation for property taxation, including through the submission of the law “On Establishing Market Evaluation Procedure for Real Estate Taxation” to the NA (June 2019 SB). This law is expected to be approved by end-2019. The government is currently reviewing the rate structure and nontaxable threshold for property taxation. Staff stress the need to ensure that property tax implementation is effective and fair, and the authorities are, supported by IMF TA, developing mechanisms to mitigate the impact on the low-income population.

**12. The momentum for improved tax administration and compliance needs to be maintained.** The State Revenue Committee (SRC) has developed a comprehensive tax administration strategy for 2020–24, which sets strategic goals and deliverables aimed at implementing key recommendations from the recent IMF TA. This includes developing a compliance strategy, establishing procedures for cleansing and updating the taxpayer register, and developing a performance management process (June 2019 SB). Based on the authorities’ ongoing comprehensive tax-potential study, the government intends to develop an action plan by December to improve tax compliance and raise the tax-to-GDP ratio over the medium term (December 2019 SB). This effort is expected to be assisted by upcoming IMF TA on microdata-based tax gap analysis (Annex II). Continuing reforms to strengthen tax administration will enhance governance and reduce vulnerabilities to corruption.

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<sup>4</sup> The full impact of this package has already been incorporated in the program (see the last [staff report](#)).

**13. The budgetary process should be strengthened to safeguard the credibility of the new fiscal rules, with refinements considered to address identified shortcomings.** Early experience with the new rules suggests refinements to the budget process to improve their implementation and smooth functioning. Although the authorities have successfully followed the debt-based adjustment mechanism required by the rules to reduce public debt, the budgeted 2020 current expenditure level is higher than the path specified in the government's implementation decree.<sup>5</sup> This deviation reflects the fact that current spending has been very tight in recent years, and that the higher budgeted allocation for current expenditure in 2020 is driven mainly by capital grants and subventions to local governments and municipalities, the impact of the recent national minimum wage increase, necessary social spending and national defense. Nonetheless, such deviation could undermine the credibility of the fiscal rules. To avoid future deviations, the government should take actions to refine the fiscal rule regulations and require more transparency in the budget process, including by requiring: (i) the medium term expenditure framework (MTEF) to discuss available space for current expenditure increases consistent with the fiscal rules; and (ii) require draft budget laws and decisions to disclose any implications they have for compliance with the fiscal rules (and associated decrees).

**14. Staff and the authorities agree on the need to improve the implementation of foreign financed capital spending and develop a sound public investment management (PIM) process.** The recent under-execution of investment projects reflects (i) weaknesses in project planning and prioritization; (ii) uncertainties created by the existing project management structures; and (iii) delays in decision making by the implementation agencies in the context of the government's anti-corruption efforts. The authorities argue that resolving all the bottlenecks will take time, although with the assistance of World Bank TA, the Ministry of Economy is developing a template to prioritize public investment projects by economic returns and the government's objectives. Staff urged the authorities to clarify project management structures, aligning them with international best practice, and to review the viability projects with chronic delays to ensure project implementation is consistent with economic returns and national priorities. The follow-up IMF PIMA TA, planned for year-end, is expected to provide further recommendations which will be incorporated into the program.

**15. The authorities are working to enhance job participation and social spending.** Their main social spending strategy is to use active labor policies to encourage greater labor force participation, while using well targeted social benefits to eradicate extreme poverty. To this end, working closely with the World Bank, the government is studying ways to enhance the adequacy and targeting of social benefits. The government has also expanded maternity benefits, especially in the rural area, and plans to use a model developed by the WB to analyze the distributional effects of future fiscal reforms.

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<sup>5</sup> The decree governing the expenditure ceiling requires the growth rate of current primary expenditure to be lower than the average growth rate of nominal GDP in the past seven years when government debt is above 50 percent of GDP. The budgeted current expenditure level is around 1½ percent of GDP above the ceiling implied by the expenditure decree.

**16. The momentum of other fiscal structural reforms needs to be maintained.** The government has made progress in improving the budget process and increasing the efficiency of budget spending, adopted a PPP law which follows international best practice, and published the Fiscal Transparency Evaluation report. However, the authorities need to quickly clarify the functions and responsibilities related to fiscal risk management among the government entities and expand the role of the Ministry of Finance. An upcoming IMF TA mission will assist the government with GFS2014 implementation. In addition, as identified in the Fiscal Transparency Evaluation, the ability to allocate additional revenues to spending during the year and other broad powers of the government to change budgetary appropriations without the need for a supplementary budget, envisaged by law, hampers the transparency of the budget process, and the possibility for such in-year budgetary amendments should be regulated under well-defined criteria.

## B. Supporting Price Stability and Strengthening the Inflation Targeting Framework

**17. The CBA has loosened its policy stance in response to low inflation** (MEFP ¶13). After a modest pickup in Q1, core and headline inflation declined in Q2 and Q3, partly due to lower than expected public demand. In response, the CBA lowered the policy rate, for a second time in 2019, from 5¾ to 5½ in September. Given favorable FX conditions and still strong credit growth, the CBA authorities and staff agreed that the current monetary stance appears to be appropriate.<sup>6</sup> However, if inflation remains persistently low, further rate cuts should be considered, provided that they would not lead to capital outflow pressures.

**18. Given the favorable economic conjuncture, the CBA accelerated its effort to build international reserves buffers** (MEFP ¶14). De-dollarization and higher FX receipts coupled with the contractionary fiscal policy put appreciation pressure on dram. To build buffers and limit appreciation pressures on the dram (and resulting disinflationary pressures), the CBA purchased \$500 million by end-October 2019. However, staff and the authorities agreed that these factors remain transitory and the central bank's intervention should remain limited to smoothing excessive fluctuations to prevent disorderly market conditions. The authorities agreed that, should inflows reverse, the exchange rate should be the key shock absorber to protect competitiveness and maintain adequate international reserves.

**19. The inflation-targeting framework should be reinforced to better anchor inflation** (MEFP ¶15). Although the low-inflation, high-growth environment is an infrequent situation for Armenia, the CBA needs to guide monetary policy by responding to both demand shocks and supply shocks which generate second-round effects. To enhance monetary policy transmission, the CBA is working to prepare a strategy to develop domestic capital markets by end-March 2020 (SB). In addition, to support the effectiveness of CBA liquidity management, the MOF will step up its coordination efforts with line ministries to regularly provide accurate daily cash-flow forecasts to the

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<sup>6</sup> While CPI inflation fell to 0.5 percent (y-o-y) in September Armenia's inflation data shows strong seasonality with a considerable pickup in Q4, and the expectation is for end-year inflation to be within the MPC band.

CBA. The central bank will continue to provide seven-day repos, but the three-month repo instrument will be used for structural liquidity management purposes, and only on occasional basis.

## C. Reinforcing Financial Resilience and Guarding Stability

### 20. The authorities have strengthened their macroprudential toolkit and are making further progress on the implementation of FSAP recommendations (MEFP ¶16):

- The CBA has prepared a time-bound action plan and a communication strategy to reform the FX reserve requirement (RR) regime (Box 1). The plan allows for flexibility of re-denomination based on market conditions.
- The CBA will introduce separate LCR and NSFR for domestic and foreign currencies to boost liquidity buffers further (Box 1).

#### Box 1. Strengthening FX Liquidity Buffers

Due to high levels of dollarization, banks are highly vulnerable to FX liquidity risks. Based on the 2018 FSAP recommendations, the CBA is reinforcing the buffers of highly liquid FX assets in commercial banks by implementing standard Basel III liquidity ratios (LCR and NSFR) and re-denominating the reserve requirement (RR) for FX liabilities from dram to FX. Specific actions include:

- Drafting regulations for the introduction of LCR and NSFR, calibration of the limits, and a communication strategy to banks. The regulations, expected to come in force by 2020Q1, will set 100 percent ratios for dram liabilities and 50–60 percent for FX liabilities. The liquidity ratios will increase over 3 years until it satisfies the Basel III requirement.
- The RR regime was amended in October and commercial banks are required to convert their FX reserve requirements from AMD to FX, by an average of 3 percent annually. Given the favorable FX market conditions in 2019, the authorities have already completed the conversion of 6 percent of FX reserve requirements. For the remaining 12 percent, the re-denomination process is expected to be completed by mid-2024.

The re-denomination of RRs is subject to the favorability of market conditions, as specified in the action plan. The plan is designed to prevent the re-denomination from creating a negative market impact and depreciation pressures on dram. That said, the plan can be accelerated to opportunistically take advantage of favorable market conditions as was done in 2019. Staff also recommended an increase in dram reserve requirements, and the introduction of their remuneration, after this reform is complete.

- The central bank has also prepared regulations for bank recovery plans. According to the regulations, all commercial banks are required to develop recovery plans acceptable to the central bank. In addition, the CBA will prepare resolution plans (RRP) for all systemic banks. The CBA board also approved regulations to strengthen stress testing.
- Regulations requiring Basel III capital buffers have been adopted and became effective in 2019Q2, with a capital conservation buffer, a surcharge for domestic systemically-important banks, and a countercyclical capital buffer (calculated quarterly) all being introduced.
- In light of rapid credit growth, the authorities are considering whether to strengthen their macroprudential tools, including possibly by adopting a debt service-to-income ratio if the available data are sufficiently strong to support such a measure. In addition, as a measure to



address credit risk from unhedged FX exposures (and facilitate de-dollarization), the CBA is working towards adoption of a stressed Loan-To-Value (LTV) limit.

**21. The authorities have prepared a draft capital market development program (September 2019 SB), which is expected to be endorsed by all of the responsible entities by early 2020.** (MEFP ¶17). The plan reviews the legal, regulatory, and taxation frameworks for derivatives, and brings forward proposals to enhance development in this area. Enhanced coordination between the CBA and the MOF will also contribute to money market development. In this regard, the two institutions have collaborated closely to establish a favorable tax regime for securities and the removal of unfavorable tax conditions for foreign investors (Box 2). In order to allow enough time for the institutions preparing the plan to finalize their views, staff proposes to postpone this SB to March 2020.

### Box 2. Opportunities to Develop Capital Market

**Armenia's capital markets are relatively underdeveloped.** The primary market issuance is dominated by government bonds and a few big banks while corporate debt market is very small. Apart from reducing savings and fund-raising opportunities for savers and domestic businesses, high quality investors are reluctant to participate in local capital markets, due to the lack of market depth, limited transparency, as well as their confidence about the price discovery mechanism and the resulting impact on borrowing costs.

**Developing Armenia's capital market would bring many benefits.** From the supply side, deeper capital markets will offer more attractive investment opportunities, offering potentially higher return than bank deposits. This is particularly important for institutional investors, including Armenia's insurance companies and new pension funds. Indeed, a well-functioning capital market will facilitate the stability of the new pension scheme. From the demand side, deeper capital markets provide an alternative source of funding that can complement bank-financing for entities in need of funding. Well-developed capital markets are also essential for supporting strong monetary policy transmission, and can be important for financing fiscal deficit in local currency to bypass exchange rate risks.

**Several factors contribute to underdevelopment of local capital markets in Armenia.** Among others, it includes (i) absence of an effective regulatory and taxation regime; (ii) reluctant issuers and investors due to issuance size and related transaction costs; (iii) high cost of debt and equity capital market financing against bank-based financing (iv) insufficient transparency of the market and market-participants, in particular for international investors. The strategy the authorities develop should seek to address these factors.

## D. Strengthening Governance and Promoting Inclusive Growth

**22. Efforts are ongoing to improve governance and strengthen institutions.** The new government continues to demonstrate strong determination to tackle corruption. In line with staff's advice, the government has: (i) enacted a law to establish a registry of beneficial ownership information, prioritizing the extractive sector (June 2019 SB), which now requires consolidation with other laws to ensure compliance with the FATF standards' provisions on beneficial ownership; (ii) started work to revise the Criminal Code to eliminate the application of thresholds to embezzlement offences, and to introduce criminal liability for legal persons, review and amend the statute of limitations term for corruption cases so that it commences at the point of discovery (not at the time of the completion of the act) and is suspended/terminated at the time of the decision of the first instance court and retaining criminal liability in case of repayment for corruption crimes, notably in

tax cases; and (iii) drafted a comprehensive anticorruption strategy for 2019–23 (approved in October 2019). This strategy is set to guide the overall institutional anti-corruption framework, including the role of a single autonomous anti-corruption entity. As a result, the September 2019 SB for drafting a law for a single autonomous anti-corruption entity, which combines all detection and investigative functions, was not observed. As the law will be submitted to the NA with only a slight delay (by December 2019), staff proposes to postpone this SB to December 2019. Public procurement is another identified area of governance weakness. In this regard, the government has completed a diagnostic of the procurement system with help of the WB, but needs to move ahead with developing a strategic procurement framework.

**23. Efforts to remove impediments hindering investment and competitiveness are underway.** The authorities are actively working to create an investment support office within the Ministry of Economy to promote both domestic and foreign investment in an efficient and streamlined manner. Meanwhile, the authorities are developing a new business environment action plan, which should create an environment conducive to investment by addressing core issues with the current regulatory framework identified in the 2019 World Bank Doing Business Report (February 2020 SB). The authorities are conducting an efficiency review of existing SME support while consolidating these programs (April 2020 SB), and developing a framework for strengthening financial reporting and auditing. The reform should streamline SME financial reporting requirements and enhance financial transparency (March 2020 SB) by establishing a new public oversight body and the Chamber of Accountants and Auditors.

**24. Labor market reforms are critical for stronger job creation.** The authorities approved a gender strategy for 2019–2023 that focuses on raising female labor force participation and overcoming gender discrimination in various socio-economic fields. The employment strategy, as well as the action plan, is expected to be finalized and approved by the government by end-2019 (December 2019 SB). Separately, the NA approved an increase in the minimum wage by 25 percent effective January 1, 2020. The increase is aimed at reducing the size of the shadow economy and raising economic inclusion. While the minimum wage, currently at AMD 55,000 per month, has not been adjusted since 2015, staff noted that decisive progress on structural reforms would be critical to ensure that any impact on competitiveness from the increase would be offset by higher productivity.<sup>7</sup> In addition, the authorities are making progress in developing a comprehensive education reform strategy (June 2020 SB). A draft law has already been prepared that sets the legal ground to reform of the tertiary education management system as well as establish the organizational and financial autonomy of higher education institutions (December 2018 SB).<sup>8</sup>

**25. The authorities reaffirmed their commitment to strengthening the social safety net to ensure that the most vulnerable are protected.** Armenia has relatively well-functioning social safety net programs. However, their coverage could be further improved. In this context, with assistance from the World Bank, the authorities plan to adopt a social assessment system for

<sup>7</sup> Fiscal risks stemming from the increase are contained as the share of public employees with salaries close to the minimum wage is small (implying a direct impact of 0.01 percent of GDP) and the authorities intend to delink the public wage setting mechanism from changes in the minimum wage.

<sup>8</sup> Elaboration of the December 2019 SB description (MEFP, Table 2) reflects the authorities' employment strategy.

families, create integrated social centers across regions, and to conduct multi-dimensional surveys to strengthen the targeting of social assistance programs.

## PROGRAM MODALITIES AND RISKS

**26. Capacity to repay the Fund is adequate.** Although the authorities intend to treat the arrangement as precautionary, the full drawing of the proposed access would not significantly affect the level of total debt, which is mostly concessional, and Armenia would have adequate capacity to repay the Fund (Table 7).<sup>9</sup>

**27. A recent update Safeguards Assessment that was concluded in September 2019 found that the CBA has a strong safeguards framework** (MEFP ¶122). This includes well-established internal and external audit arrangements, and financial reporting practices. The CBA Law was amended in 2017 per previous safeguards recommendations and enshrines provisions of institutional autonomy. However, additional CBA Law reforms were recommended to strengthen financial and institutional autonomy, reinforce independent oversight of the CBA Board. To further strengthen the CBA's safeguard assessment, the authorities will prepare a 5–10-year strategy for the central bank to diminish and, in an orderly manner, eventually completely phase-out its involvement in non-core central banking activities, including development lending and association in mortgage companies, in collaboration with relevant stakeholders (September 2020 SB).

**28. Risks to the program are manageable.** Key risks include adverse geopolitical developments, a protracted slowdown in major trading partners, large swings in commodity prices, and stress resulting from global financial volatility or trade tensions (Annex I). On the domestic front, faster progress on the reform agenda could generate upside performance by expanding Armenia's economic potential. There is risk that inflation remains low and falls below +/- 1½ percentage point around the mid-point MPCC target for end-December, which would trigger a consultation with the IMF Board. While political economy risks might constrain the authorities' ability to follow through on their reform program, the authorities' long track record of sound macroeconomic policies is expected to continue, which should support reform implementation, and as discussed in ¶26, Armenia's repayment capacity is expected to remain strong. In addition, the authorities have committed to contingency measures in the event of fiscal revenue shortfalls (see ¶10).

## STAFF APPRAISAL

**29. The Armenian economy continued to grow strongly in 2019, supported by a stable macroeconomic environment.** GDP growth is projected to exceed 6½ percent and inflation

<sup>9</sup> Since drawing would typically occur after a shock, the macroeconomic variables in the table would likely be worse than under the baseline presented in the table; for example, based on the illustrative scenario used to determine access at the time of the SBA arrangement request, reserves and exports may be respectively 25 and 3 percent lower, suggesting peak IMF payment obligation ratios of 5.6 percent and 1.8 percent of gross reserves and exports, instead of 4.2 percent and 1.7 percent in the table. These considerations suggest caution in interpreting Table 7, but do not materially impact staff's current view of Armenia's capacity to repay.

remains low. Budget revenue performance is strong, financial conditions are stable, and the exchange rate has appreciated somewhat on the back of private inflows. The medium-term macroeconomic outlook remains positive, with economic growth projected to moderate in line with the current estimate of potential growth, inflation to gradually pick up towards the official target, the current account deficit to narrow, and public debt to fall below 50 percent of GDP.

**30. The 2020 budget maintains the effort to reduce public debt while supporting growth in 2020.** Tax revenues are expected to rise reflecting continued effort to strengthen tax administration and tackle the shadow economy. Current spending remains a constant share of GDP compared with 2019, while allowing a nominal increase in social spending. Capital spending is expected to rise as implementation bottlenecks are gradually resolved.

**31. Despite fiscal overperformance, the momentum for reforms needs to be maintained.** Continued revenue mobilization efforts and completion of the remaining steps to reform property taxation remain priorities. The budgetary process should be strengthened, to safeguard the credibility of the recently revised fiscal rules and avoid future deviations, and the government should keep spending plans aligned with the fiscal rule, including by requiring greater transparency in the budget process, and refining the institutional framework as needed. Strengthening the implementation of foreign-financed capital spending projects, and development of a sound public investment management (PIM) process, are essential for future growth.

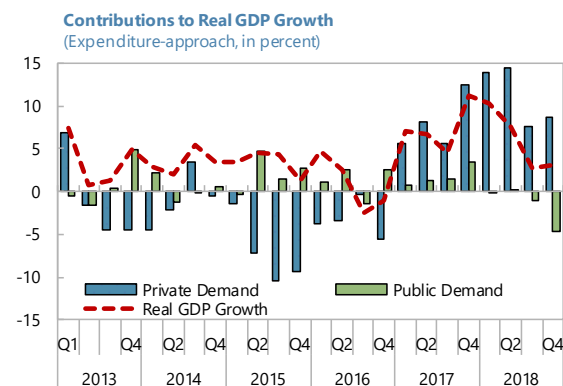
**32. Monetary policy should continue its focus on anchoring inflation expectations, while ensuring two-way exchange rate flexibility.** The CBA's IT framework has served Armenia well, and remains an appropriate anchor for monetary policy. But, the effectiveness of the monetary policy could be further strengthened by deeper capital markets, greater exchange rate flexibility, and improved liquidity management. Favorable FX market conditions allowed the CBA to reinforce reserve buffers. Allowing two-way exchange rate flexibility and limiting intervention to periods of disorderly market conditions should help Armenia ensure its ongoing adjustment to external shocks.

**33. The authorities' financial sector reform plans will enhance Armenia's resilience to shocks and promote financial deepening.** Drawing on FSAP recommendations, the CBA is strengthening bank resilience by implementing: (i) Basel III capital buffers; (ii) greater liquidity buffers including through reform to FX reserve requirements; and (iii) clearer commercial bank recovery plans. At the same time, deeper capital markets and improved financial literacy remain important to foster better financial intermediation. In this context, the authorities' commitment to prepare a plan to develop capital markets and to review existing SME assistance schemes is welcome.

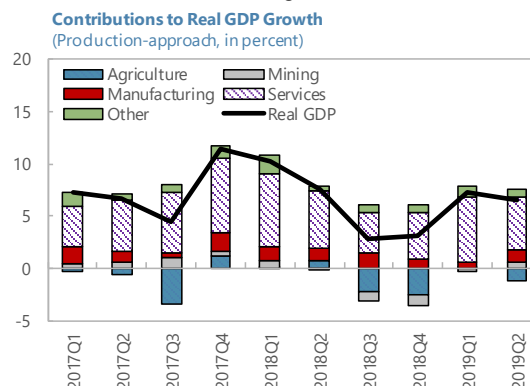
**Staff supports authorities' request for completion of the first review.** Upon completion of the review, an additional SDR 25.714 million would be made available to Armenia, bringing the total accessible credit to about SDR 51.428 million. The Armenian authorities continue to view the SBA as precautionary.

**Figure 1. Armenia: Real Sector Developments**

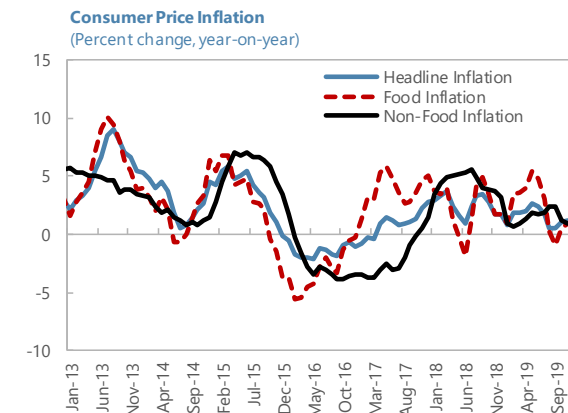
Growth in 2018 was mainly driven by private demand



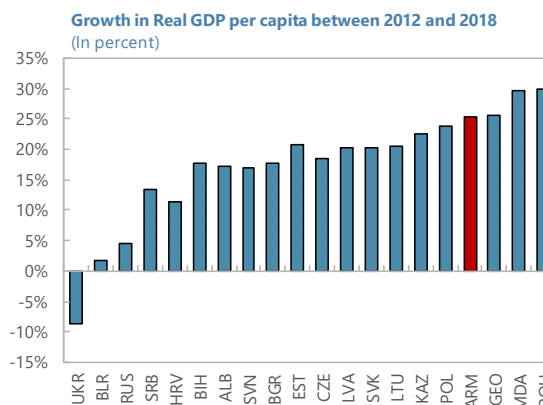
Preliminary data show strong growth performance in 2019H1 on the back of stronger than anticipated activity in the Service and manufacturing sectors



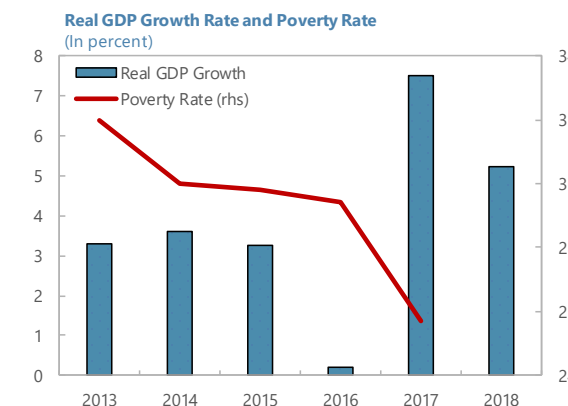
Both food and non-food inflation are below expectations.



Armenia's per capita income growth is high, compared with peers



Robust GDP growth helped poverty rates fall significantly.



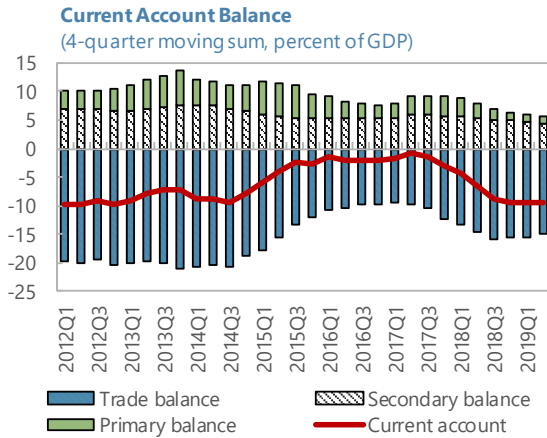
Employment growth increased in recent years, although unemployment remains high.



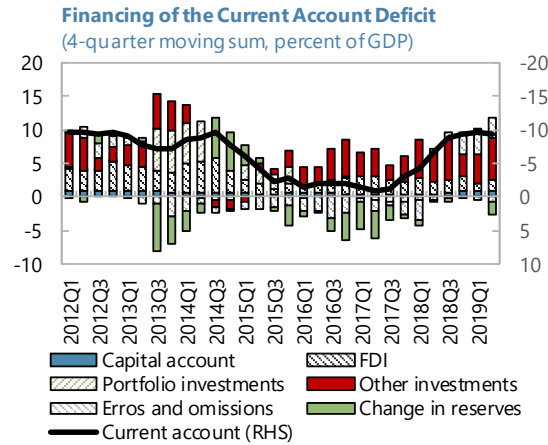
Sources: National authorities, IMF World Economic Outlook, and IMF staff calculations.

**Figure 2. Armenia: External Developments**

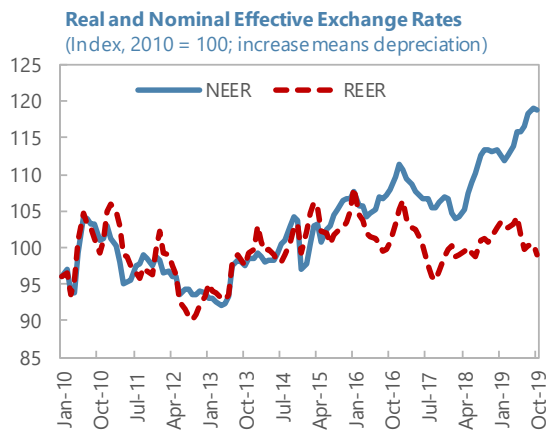
The current account deficit which widened in 2018, seems to have stabilized recently.



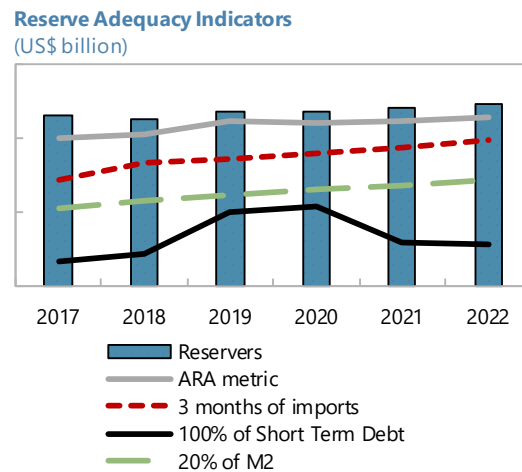
Current account has been financed mainly by private inflows recently, while loan disbursements to public sector were significantly lower as project execution slowed.



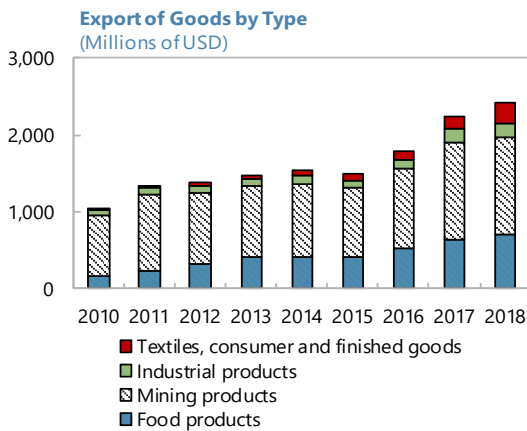
Exchange rate has appreciated somewhat recently.



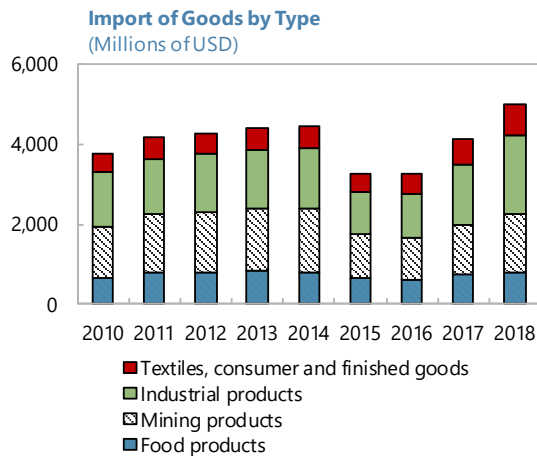
Reserve coverage has been adequate according to various metrics and is expected to remain as such.



Exports have more than doubled since 2010 and are somewhat more diversified.



The imports of capital goods and durables which had declined over 2015–16 picked up again in 2018.

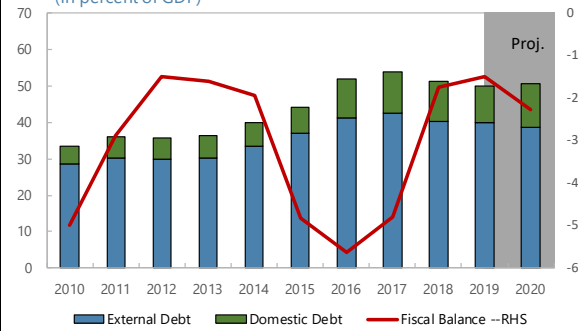


Sources: National authorities, IMF Information Notice Systems Database, and IMF staff calculations.

**Figure 3. Armenia: Fiscal Developments**

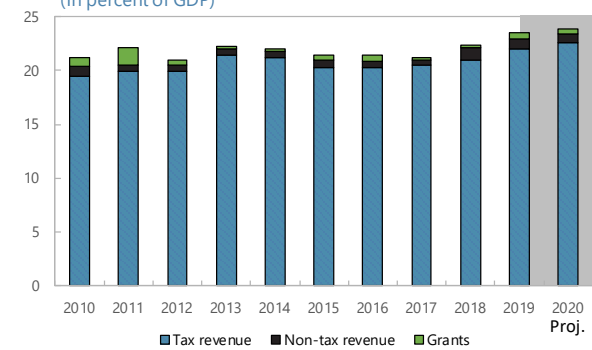
Following the 2014 external shock, central government public debt peaked at end-2017 before falling in 2018–19.

**Total Central Government Public Debt**  
(In percent of GDP)



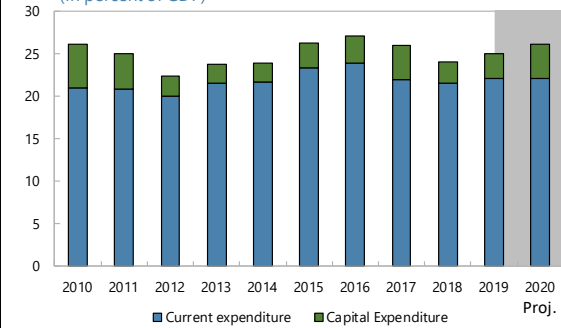
Revenues had been stable and started to increase following the 2016 tax code change and tax administration efforts.

**Total Revenue and Grants**  
(In percent of GDP)



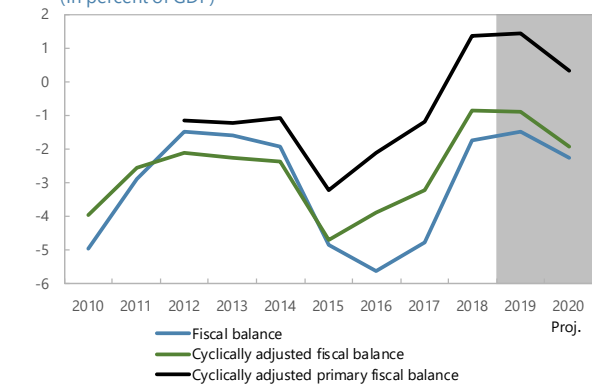
Current expenditure had been contained recently, while capital expenditure under-executed during 2017–19.

**Total Expenditure**  
(In percent of GDP)



Cyclically adjusted deficit shrunk as a result of the recent consolidation.

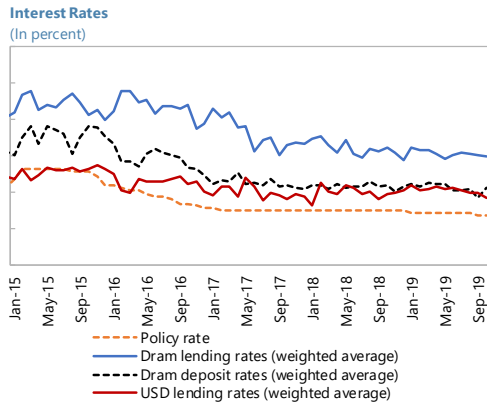
**Fiscal Balance**  
(In percent of GDP)



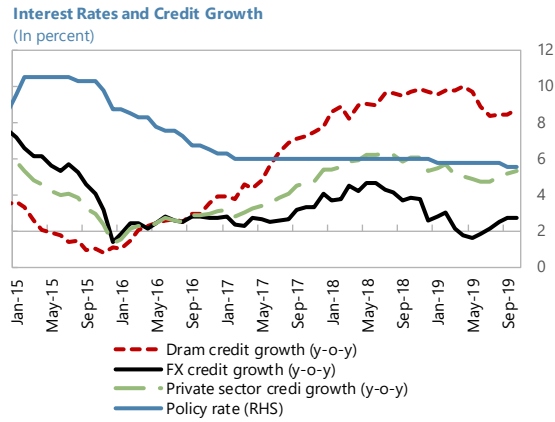
Sources: National authorities and IMF staff calculations.

**Figure 4. Armenia: Monetary Developments**

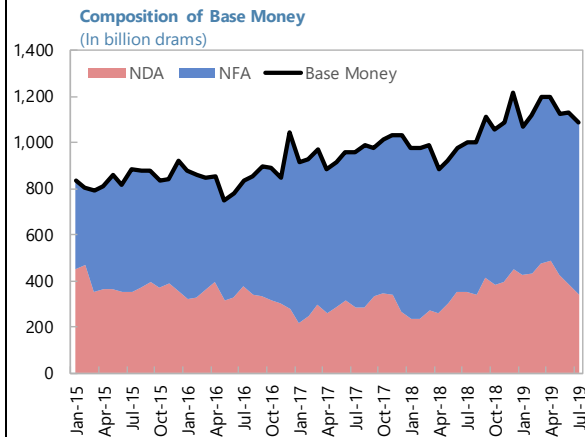
A fall in both deposit and lending rates has been moderating since the second half of 2018–19.



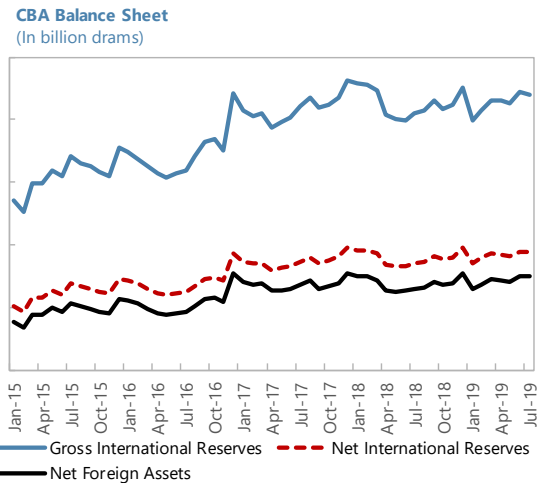
Credit growth, which had picked up, has been moderating since the second half of 2018.



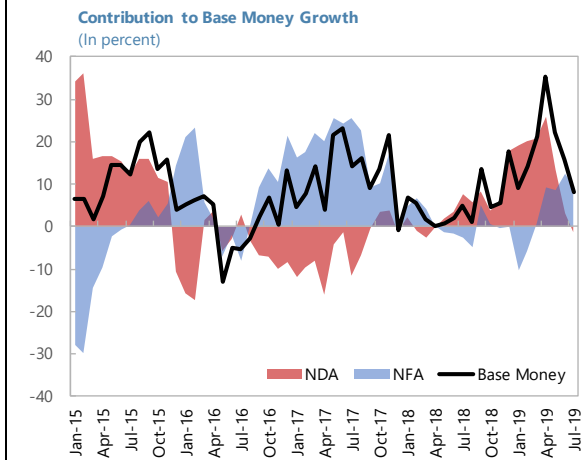
The money base has increased in 2018.



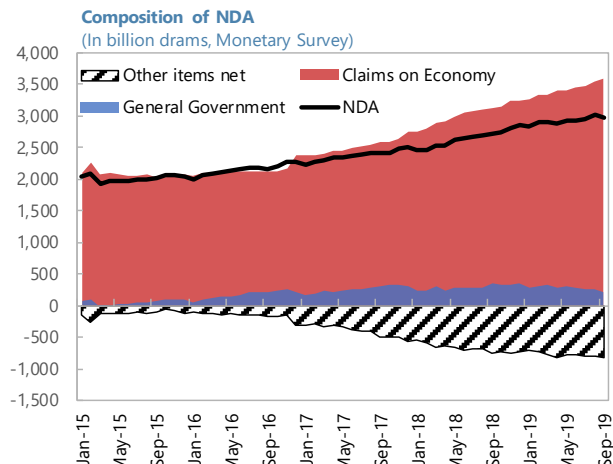
The CBA's foreign assets have been increasing after a temporary decline following the revolution.



The base money growth in 2018 was mainly due to the increase in NDA.



The main component in the rise of NDA was the growth in claims on economy.



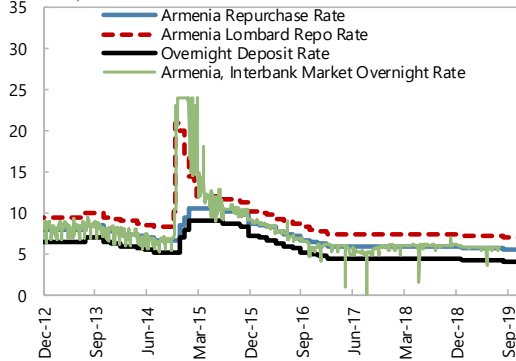
Sources: Central Bank of Armenia, and IMF staff calculations.



**Figure 5. Armenia: Financial Developments**

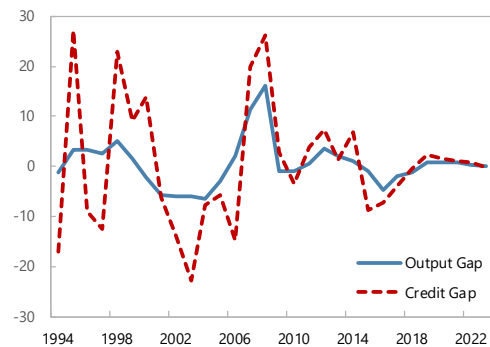
The CBA has lowered its policy rate by 25 basis points in January for the first time since January 2017.

**Interest Rate Corridor**  
(In percent)



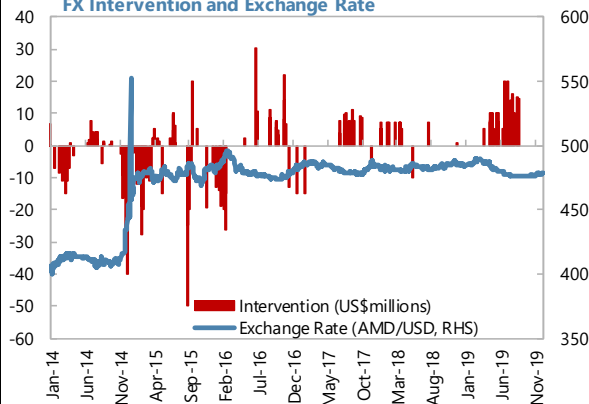
The credit-to-GDP gap is estimated to be marginally negative.

**Output Gap vs Credit Gap**



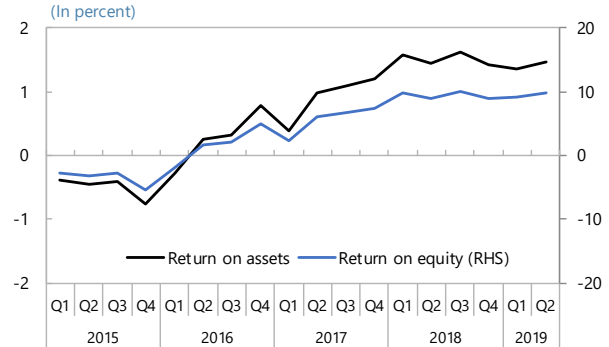
The exchange rate slightly appreciated in 2019H1 despite CBA's intervention.

**FX Intervention and Exchange Rate**



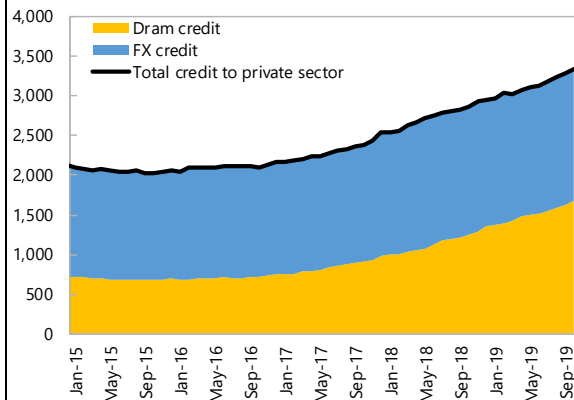
With stable monetary and financial conditions, profitability is increasing.

**Financial Soundness Indicators**  
(In percent)



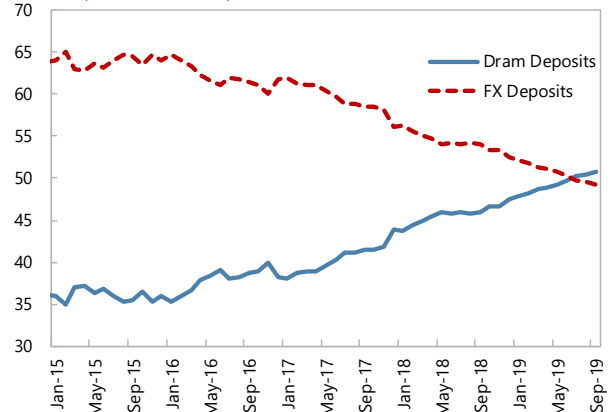
Given stable exchange rates, credit dollarization has fallen.

**Private Sector Credit**  
(In billion drams)



Deposit dollarization has declined as well.

**Deposit dollarization**  
(In percent of total deposits)



Sources: National authorities, Central Bank of Armenia, Bloomberg, and IMF staff calculations.

Table 1. Armenia: Selected Economic and Financial Indicators, 2016–24

	2016	2017	2018	2019	2020	2021	2022	2023	2024
	Act.	Act.	Act.	Proj.					
National income and prices:									
Real GDP (percent change)	0.2	7.5	5.2	6.5	4.9	4.5	4.5	4.5	4.5
Final consumption expenditure, Contrib. to Growth	-0.9	7.4	2.7	8.3	3.3	1.3	1.7	1.7	1.8
Gross fixed capital formation, Contrib. to Growth	-2.4	1.5	0.8	2.1	2.5	3.0	2.3	1.9	1.5
Changes in inventories, Contrib. to Growth	0.7	1.1	4.0	-3.6	-1.0	0.0	0.0	0.0	0.0
Net exports of goods and services, Contrib. to Growth	3.1	-1.2	-1.8	-0.2	0.1	0.2	0.5	0.9	1.2
Gross domestic product (in billions of drams)	5,067	5,564	6,005	6,541	7,095	7,636	8,283	8,992	9,751
Gross domestic product (in millions of U.S. dollars)	10,546	11,527	12,433	13,444	14,132	14,839	15,704	16,632	17,596
Gross domestic product per capita (in U.S. dollars)	3,524	3,869	4,188	4,528	4,759	4,997	5,288	5,599	5,924
CPI (period average; percent change)	-1.4	1.0	2.5	1.6	2.5	3.3	4.0	4.0	4.0
CPI (end of period; percent change)	-1.1	2.7	1.8	1.5	3.3	3.8	4.1	4.0	4.0
GDP deflator (percent change)	0.3	2.1	2.5	2.3	3.4	3.0	3.8	3.9	3.8
Unemployment rate (in percent)	20.4	18.9	18.5	17.6	17.5	17.2	16.9	16.8	16.7
Investment and saving (in percent of GDP)									
Investment	18.0	19.3	22.4	22.9	24.1	25.2	25.3	25.3	25.3
National savings	16.0	16.3	13.0	14.9	16.2	17.7	18.2	18.9	19.3
Money and credit (end of period)									
Reserve money (percent change)	13.1	-1.0	17.8	9.0	8.8	8.0	8.3	8.5	8.7
Broad money (percent change)	17.5	18.5	7.4	9.1	8.8	8.0	8.3	8.5	8.7
Private sector credit growth (percent change)	6.0	16.5	17.2	16.0	11.5	11.0	10.5	9.0	8.5
Central government operations (in percent of GDP)									
Revenue and grants	21.4	21.2	22.3	23.5	23.9	23.8	24.0	24.2	24.3
<i>Of which</i> : tax revenue	20.1	20.2	20.7	21.8	22.3	22.5	22.7	22.9	23.1
Expenditure	27.0	26.0	24.1	25.0	26.2	25.7	25.9	26.1	26.2
Overall balance on a cash basis	-5.6	-4.8	-1.8	-1.5	-2.3	-1.9	-1.9	-1.9	-1.9
Public and publicly-guaranteed (PPG) debt (in percent of GDP)	56.7	58.9	55.8	53.6	53.5	52.6	51.6	50.7	50.0
Central Government's PPG debt (in percent)	52.0	53.7	51.3	50.0	50.6	50.4	49.9	49.5	49.1
Share of foreign currency debt (in percent)	80.9	81.1	72.2	72.1	71.1	69.9	68.4	68.6	68.6
External sector									
Exports of goods and services (in millions of U.S. dollars)	3,501	4,312	4,700	4,963	5,182	5,484	5,828	6,235	6,636
Imports of goods and services (in millions of U.S. dollars)	-4,517	-5,723	-6,647	-6,887	-7,151	-7,505	-7,911	-8,343	-8,841
Exports of goods and services (percent change)	11.6	23.2	9.0	5.6	4.4	5.8	6.3	7.0	6.4
Imports of goods and services (percent change)	2.2	26.7	16.1	3.6	3.8	5.0	5.4	5.5	6.0
Current account balance (in percent of GDP)	-2.1	-3.0	-9.4	-8.0	-7.9	-7.5	-7.1	-6.4	-6.0
FDI (net, in millions of U.S. dollars)	263	222	247	296	318	341	369	399	440
Gross international reserves (in millions of U.S. dollars)	2,204	2,314	2,259	2,357	2,363	2,405	2,457	2,646	2,669
Import cover 1/	4.6	4.2	3.9	4.0	3.8	3.6	3.5	3.6	3.4
End-of-period exchange rate (dram per U.S. dollar)	484	484	484	...	...	...	...	...	...
Average exchange rate (dram per U.S. dollar)	480	483	483	...	...	...	...	...	...

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

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

**Table 2. Armenia: Balance of Payments, 2016–24**

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

	2016	2017	2018	2019	2020	2021	2022	2023	2024
	Act.	Act.	Prel.			Proj.			
Current account	-217	-344	-1,165	-1,075	-1,112	-1,117	-1,114	-1,068	-1,052
Trade balance	-945	-1,376	-1,789	-1,753	-1,789	-1,833	-1,884	-1,896	-1,982
Exports, fob	1,891	2,385	2,630	2,725	2,829	3,013	3,213	3,466	3,707
Imports, fob	-2,836	-3,761	-4,420	-4,478	-4,618	-4,846	-5,097	-5,363	-5,688
Services (net)	-71	-36	-158	-171	-179	-188	-199	-211	-223
Credits	1,610	1,926	2,070	2,238	2,353	2,471	2,615	2,769	2,929
Debits	-1,681	-1,962	-2,228	-2,409	-2,532	-2,659	-2,814	-2,980	-3,153
Income (net)	245	407	161	190	215	241	268	296	309
Transfers (net)	553	660	620	658	641	663	702	744	844
Private	412	497	479	476	473	517	514	575	687
Official	141	163	141	182	168	146	187	169	157
Capital and financial account	452	572	810	1,243	1,197	1,224	1,208	1,286	1,094
Capital transfers (net)	35	46	125	67	70	70	70	70	70
Foreign direct investment (net)	263	222	247	296	318	341	369	399	440
Portfolio investment (net)	34	-87	-33	42	53	12	12	13	14
Public sector borrowing (net)	499	493	168	294	61	247	379	338	294
Disbursements	571	585	320	853	361	476	624	595	555
Amortization	-72	-92	-152	-558	-299	-229	-245	-257	-261
CBA	0	0	0	0	0	0	0	0	0
Other capital (net)	-379	-101	303	543	694	554	377	466	276
Errors and omissions	-235	-228	356	0	0	0	0	0	0
Overall balance	0	0	0	167	85	106	94	219	42
Financing	-421	-139	-13	-167	-85	-106	-94	-219	-42
Gross international reserves (increase: -)	-429	-110	55	-98	-6	-42	-52	-189	-24
Use of Fund credit, net	8	-29	-68	-69	-79	-64	-42	-30	-18
Memorandum items:									
Current account (in percent of GDP)	-2.1	-3.0	-9.4	-8.0	-7.9	-7.5	-7.1	-6.4	-6.0
Trade balance (in percent of GDP)	-9.0	-11.9	-14.4	-13.0	-12.7	-12.4	-12.0	-11.4	-11.3
Gross international reserves (end of period)	2,204	2,314	2,259	2,357	2,363	2,405	2,457	2,646	2,669
In months of next year's imports	4.6	4.2	3.9	4.0	3.8	3.6	3.5	3.6	3.5
In percent of IMF's Reserve Adequacy Metric (ARA)	118	115	101	106	108	108	108	114	112
Merchandise export growth, percent change	16.4	26.2	10.3	3.6	3.8	6.5	6.6	7.9	6.9
Merchandise import growth, percent change	0.9	32.6	17.5	1.3	3.1	4.9	5.2	5.2	6.1
Nominal external debt	9,725	10,228	10,568	11,338	12,018	12,748	13,463	14,237	14,789
o.w. public external debt	4,806	5,495	5,533	5,760	5,745	5,922	6,259	6,567	6,843
Nominal external debt stock (in percent of GDP)	92.2	88.7	85.0	84.3	85.0	85.9	85.7	85.6	84.1
External public debt-to-exports ratio (in percent)	137.3	127.4	117.7	116.0	110.9	108.0	107.4	105.3	103.1
External public debt service (in percent of exports)	6.6	6.7	7.9	16.4	10.7	8.1	7.3	6.7	6.1

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

**Table 3a. Armenia: Central Government Operations, 2016–24**

(In billions of Armenian drams)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
	Act.	Act.	Act.						
				Proj.					
Total revenue and grants	1,085.2	1,181.9	1,340.9	1,538.5	1,695.0	1,817.5	1,987.5	2,172.2	2,373.6
Total revenue	1,056.9	1,168.6	1,330.4	1,499.0	1,659.7	1,804.0	1,974.4	2,159.5	2,361.3
Tax revenues	1,016.2	1,123.9	1,240.5	1,426.9	1,582.3	1,718.2	1,881.2	2,058.4	2,251.7
VAT	342.4	392.1	438.2	503.4	560.6	610.9	673.5	731.1	802.6
Profits, simplified and presumptive	130.4	113.6	170.4	196.7	223.1	228.7	248.1	269.3	301.8
Personal income tax	327.5	341.3	356.6	372.4	401.0	435.3	472.2	512.5	555.8
Customs duties	55.4	72.6	80.2	95.6	87.5	94.1	102.1	110.8	120.2
Other	160.5	204.4	195.1	258.8	310.1	349.1	385.4	434.6	471.3
Social contributions	13.4	15.8	17.4	17.0	20.0	21.5	23.3	25.3	27.5
Other revenue	27.3	28.9	72.5	55.1	57.4	64.4	69.8	75.8	82.2
Grants	28.3	13.3	10.5	39.5	35.3	13.5	13.1	12.7	12.3
Total expenditure	1,370.6	1,448.3	1,446.3	1,636.3	1,855.7	1,959.0	2,144.7	2,346.2	2,554.2
Expenses	1,209.4	1,225.7	1,298.2	1,445.0	1,568.0	1,568.3	1,713.1	1,876.8	2,033.6
Wages	305.7	299.1	306.8	340.4	376.7	399.3	423.2	454.6	492.5
Payments to individual pension accts.	25.6	13.0	29.0	56.8	52.5	64.8	68.0	71.4	75.0
Subsidies 1/	13.3	1.5	24.3	23.4	17.1	18.4	19.9	21.6	23.4
Interest	98.3	119.8	139.0	158.1	168.1	178.5	186.2	186.2	190.5
Social allowances and pensions	378.5	397.9	419.3	454.2	501.6	537.2	582.7	650.0	714.8
Pensions/social security benefits	249.4	267.3	294.7	310.4	350.2	374.2	405.9	449.6	487.5
Social assistance benefits	129.0	130.6	124.6	143.8	151.4	163.0	176.8	200.4	227.2
Goods and services	122.4	104.4	123.8	133.2	147.2	137.5	152.8	179.8	199.9
Grants	102.4	109.1	111.5	97.7	158.9	149.7	166.4	185.2	205.8
Other expenditure 2/	163.3	180.8	144.5	181.2	145.9	83.2	113.9	127.9	131.8
Transactions in nonfinancial assets	161.2	222.6	148.1	191.3	287.7	390.7	431.6	469.4	520.6
Acquisition of nonfinancial assets	166.0	223.5	152.0	191.3	287.8	390.7	431.6	469.4	520.6
Disposals of nonfinancial assets	4.8	1.0	3.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-285.4	-266.3	-105.4	-97.9	-160.7	-141.5	-157.2	-174.0	-180.6
Statistical discrepancy	-55.7	-7.7	28.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-341.1	-274.0	-77.4	-97.9	-160.7	-141.5	-157.2	-174.0	-180.6
Financing	341.1	274.0	77.4	97.9	160.7	141.5	157.2	174.0	180.6
Domestic financing	102.5	86.5	42.2	13.4	194.9	73.8	12.4	49.4	82.0
Banking system	145.2	80.4	42.8	41.0	271.2	70.8	15.4	61.1	101.3
CBA	-42.1	18.0	-28.0	24.4	30.2	-20.4	0.0	0.0	0.0
Commercial Banks	187.2	62.4	70.8	16.6	241.0	91.2	15.4	61.1	101.3
Nonbanks	-42.7	6.1	-0.6	-27.6	-76.3	3.0	-2.9	-11.7	-19.4
T-Bills/other	-14.8	-7.5	-13.5	-3.2	-46.0	-17.4	-2.9	-11.7	-19.4
Promissory note/other	0.0	-94.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-27.9	107.7	12.9	-24.4	-30.2	20.4	0.0	0.0	0.0
External financing	190.6	187.5	35.2	84.5	-34.3	67.7	144.8	124.6	98.6
Amortization due	-33.7	-47.8	-68.5	-273.4	-150.2	-110.5	-116.1	-122.8	-128.4
Net lending	-50.0	-46.8	-50.8	-57.1	-65.0	-66.7	-68.5	-74.3	-80.6
Other financing 3/	48.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	5,067.3	5,564.5	6,005.1	6,541.0	7,095.1	7,636.3	8,283.4	8,991.8	9,750.9
Program balance 4/	-410.0	-202.5	-156.9	-128.4	-241.0	-187.8	-225.7	-248.3	-261.2
Primary balance 5/	-265.0	-85.7	-4.2	-21.3	-87.8	-9.3	-39.5	-62.1	-70.7

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

1/ In 2016, an additional subsidy of AMD 2 billion is assumed to cover the electricity tariff differential for households and SMEs.

2/ Includes acquisition of military equipment.

3/ EFSF financing (\$100 million in 2015-17).

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

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

**Table 3b. Armenia: Central Government Operations, 2016–24**

(In percent of GDP, unless otherwise specified)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
	Act.	Act.	Act.	Proj.					
Total revenue and grants	21.4	21.2	22.3	23.5	23.9	23.8	24.0	24.2	24.3
Total revenue	20.9	21.0	22.2	22.9	23.4	23.6	23.8	24.0	24.2
Tax revenues	20.1	20.2	20.7	21.8	22.3	22.5	22.7	22.9	23.1
VAT	6.8	7.0	7.3	7.7	7.9	8.0	8.1	8.1	8.2
Profits, simplified and presumptive	2.6	2.0	2.8	3.0	3.1	3.0	3.0	3.0	3.1
Personal income tax	6.5	6.1	5.9	5.7	5.7	5.7	5.7	5.7	5.7
Customs duties	1.1	1.3	1.3	1.5	1.2	1.2	1.2	1.2	1.2
Other	3.2	3.7	3.2	4.0	4.4	4.6	4.7	4.8	4.8
Social contributions	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other revenue	0.5	0.5	1.2	0.8	0.8	0.8	0.8	0.8	0.8
Grants	0.6	0.2	0.2	0.6	0.5	0.2	0.2	0.1	0.1
Total expenditure	27.0	26.0	24.1	25.0	26.2	25.7	25.9	26.1	26.2
Expense	23.9	22.0	21.6	22.1	22.1	20.5	20.7	20.9	20.9
Wages	6.0	5.4	5.1	5.2	5.3	5.2	5.1	5.1	5.1
Payments to individual pension accts.	0.5	0.2	0.5	0.9	0.7	0.8	0.8	0.8	0.8
Subsidies 1/	0.3	0.0	0.4	0.4	0.2	0.2	0.2	0.2	0.2
Interest	1.9	2.2	2.3	2.4	2.4	2.3	2.2	2.1	2.0
Social allowances and pensions	7.5	7.2	7.0	6.9	7.1	7.0	7.0	7.2	7.3
Pensions/social security benefits	4.9	4.8	4.9	4.7	4.9	4.9	4.9	5.0	5.0
Social assistance benefits	2.5	2.3	2.1	2.2	2.1	2.1	2.1	2.2	2.3
Goods and services	2.4	1.9	2.1	2.0	2.1	1.8	1.8	2.0	2.1
Grants	2.0	2.0	1.9	1.5	2.2	2.0	2.0	2.1	2.1
Other expenditure 2/	3.2	3.2	2.4	2.8	2.1	1.1	1.4	1.4	1.4
Transactions in nonfinancial assets	3.2	4.0	2.5	2.9	4.1	5.1	5.2	5.2	5.3
Acquisition of nonfinancial assets	3.3	4.0	2.5	2.9	4.1	5.1	5.2	5.2	5.3
Disposals of nonfinancial assets	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-5.6	-4.8	-1.8	-1.5	-2.3	-1.9	-1.9	-1.9	-1.9
Statistical discrepancy	-1.1	-0.1	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-6.7	-4.9	-1.3	-1.5	-2.3	-1.9	-1.9	-1.9	-1.9
Financing	5.9	4.9	1.3	1.5	2.3	1.9	1.9	1.9	1.9
Domestic financing	2.0	1.6	0.7	0.2	2.7	1.0	0.1	0.5	0.8
Banking system	2.9	1.4	0.7	0.6	3.8	0.9	0.2	0.7	1.0
CBA	-0.8	0.3	-0.5	0.4	0.4	-0.3	0.0	0.0	0.0
Commercial Banks	3.7	1.1	1.2	0.3	3.4	1.2	0.2	0.7	1.0
Nonbanks	-0.8	0.1	0.0	-0.4	-1.1	0.0	0.0	-0.1	-0.2
T-Bills/other	-0.3	-0.1	-0.2	0.0	-0.6	-0.2	0.0	-0.1	-0.2
Promissory note/other	0.0	-1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-0.6	1.9	0.2	-0.4	-0.4	0.3	0.0	0.0	0.0
External financing	3.8	3.4	0.6	1.3	-0.5	0.9	1.7	1.4	1.0
Amortization due	-0.7	-0.9	-1.1	-4.2	-2.1	-1.4	-1.4	-1.4	-1.3
Net lending	-1.0	-0.8	-0.8	-0.9	-0.9	-0.9	-0.8	-0.8	-0.8
Other financing 3/	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	5,067	5,564	6,005	6,541	7,095	7,636	8,283	8,992	9,751
Program balance 4/	-8.1	-3.6	-2.6	-2.0	-3.4	-2.5	-2.7	-2.8	-2.7
Primary balance 5/	-5.2	-1.5	-0.1	-0.3	-1.2	-0.1	-0.5	-0.7	-0.7

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

1/ In 2016, an additional subsidy of AMD 2 billion is assumed to cover the electricity tariff differential for households and SMEs.

2/ Includes acquisition of military equipment.

3/ EFSF financing (\$100 million in 2015-17).

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

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

**Table 4. Armenia: Monetary Accounts, 2016–20**

(In billions of drams, unless otherwise indicated)

	2016 Act.	2017 Act.	2018				2019				2020 Proj.
			Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	
			Act.				Est.				
<b>Central Bank of Armenia</b>											
Net foreign assets	764.3	766.6	716.0	625.0	697.1	765.8	721.4	747.0	754.3	761.5	790.6
Net international reserves	928.1	977.0	928.1	828.5	906.0	971.6	927.1	946.3	953.5	960.8	989.8
Other	-163.8	-210.4	-212.1	-203.6	-208.9	-205.8	-205.7	-199.2	-199.2	-199.2	-199.2
Net domestic assets	278.0	265.4	270.6	350.9	413.9	449.8	474.2	381.9	456.7	563.4	645.4
Claims on general government (net)	-162.3	-144.3	-166.0	-177.8	-161.6	-172.3	-216.2	-275.9	-277.4	-279.9	-313.3
<i>Of which</i> : central government (net)	-142.0	-121.0	-132.1	-119.1	-119.9	-137.8	-179.6	-168.8	-170.3	-172.8	-206.3
Claims on banks	153.3	107.6	126.4	184.0	266.0	299.1	364.3	325.2	325.2	325.2	325.2
Other items (net)	287.0	302.1	310.2	344.7	309.5	323.0	326.1	332.5	408.9	518.1	629.5
Reserve money	1,042.3	1,032.0	975.8	986.6	1,111.0	1,215.6	1,195.6	1,128.9	1,211.0	1,325.0	1,441.8
Currency issue	455.4	516.1	463.1	506.0	524.5	566.7	503.3	515.3	589.5	670.8	701.5
Deposits	586.9	515.9	523.5	469.8	586.5	648.9	692.3	613.6	621.6	654.2	734.5
Deposits in drams	326.7	329.2	375.9	374.9	396.6	392.7	443.9	386.5	386.8	410.7	445.0
Deposits in foreign currency	260.2	186.8	147.6	94.9	189.9	256.2	248.4	227.0	234.8	243.4	289.4
<b>Banking system</b>											
Net foreign assets	-94.1	61.8	32.8	-73.3	-80.1	-78.7	-147.5	-142.4	-143.1	-143.9	-156.8
Net domestic assets	2,274.2	2,521.0	2,531.5	2,636.7	2,715.5	2,853.8	2,897.7	2,935.2	3,004.0	3,171.3	3,451.1
Claims on government (net)	224.6	302.0	293.4	261.2	330.6	333.6	325.5	262.1	265.9	269.7	271.5
<i>Of which</i> : claims on central government (net)	244.9	325.3	327.4	320.0	372.3	368.1	362.1	369.2	373.0	376.8	378.6
Claims on rest of the economy	2,368.3	2,758.5	2,884.6	3,047.8	3,117.9	3,232.0	3,345.7	3,448.3	3,616.8	3,749.1	4,180.2
Other items (net)	-318.7	-539.6	-646.5	-672.4	-733.0	-711.8	-773.5	-775.2	-878.7	-847.5	-1,000.6
Broad money	2,180.1	2,582.8	2,564.4	2,563.4	2,635.5	2,775.1	2,750.1	2,792.8	2,860.9	3,027.4	3,294.3
Currency in circulation	390.9	425.8	403.2	444.9	458.3	477.0	434.4	442.1	508.7	529.5	587.7
Deposits	1,789.2	2,140.7	2,161.2	2,118.5	2,177.2	2,298.1	2,315.7	2,350.7	2,352.1	2,498.0	2,706.6
Domestic currency	682.8	940.6	972.3	968.5	1,000.2	1,089.8	1,129.7	1,168.3	1,121.2	1,222.3	1,371.0
Foreign currency	1,106.4	1,200.1	1,188.8	1,150.0	1,177.0	1,208.3	1,186.0	1,182.4	1,230.9	1,275.7	1,335.6
<b>Memorandum items:</b>											
Exchange rate (drams per U.S. dollar, end of period)	483.9	484.1	480.1	482.2	482.7	483.8	486.4	477.1	492.8	495.8	508.2
12-month change in reserve money (in percent)	13.1	-1.0	0.6	3.1	13.5	17.8	22.5	14.4	9.0	9.0	8.8
12-month change in broad money (in percent)	17.5	18.5	15.4	13.6	10.8	7.4	7.2	8.9	8.6	9.1	8.8
12-month change in dram broad money (in percent)	20.1	27.3	25.7	29.1	27.8	14.7	13.7	13.9	11.8	11.8	11.8
12-month change in private sector credit (in percent)	6.0	16.5	20.0	22.4	20.6	17.2	16.0	13.1	16.0	16.0	11.5
Velocity of broad money (end of period)	2.3	2.2	2.2	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.2
Money multiplier	2.1	2.5	2.6	2.6	2.4	2.3	2.3	2.5	2.4	2.3	2.3
Dollarization in bank deposits 1/	61.8	56.1	55.0	54.3	54.1	52.6	51.2	50.3	52.3	51.1	49.3
Dollarization in broad money 2/	50.7	46.5	46.4	44.9	44.7	43.5	43.1	42.3	43.0	42.1	40.5
Currency in circulation in percent of deposits	21.8	19.9	18.7	21.0	21.1	20.8	18.8	18.8	21.6	21.2	21.7

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

1/ Ratio of foreign currency deposits to total deposits (in percent).

2/ Ratio of foreign currency deposits to broad money (in percent).

**Table 5. Armenia: Financial Soundness Indicators for the Banking Sector, 2015–19**

(In percent, unless otherwise indicated)

	2015	2016	2017	2018	2019		
	Dec.	Dec.	Dec.	Dec.	Mar	June	July
<b>Capital adequacy</b>							
Total regulatory capital to risk-weighted assets	16.2	20.0	18.6	17.7	17.9	17.4	17.3
Capital (net worth) to assets	14.7	16.2	15.7	15.0	15.0	14.7	14.8
<b>Asset composition</b>							
Sectoral distribution of loans (in billions of drams)							
Industry (excluding energy sector)	225.9	227.1	256.3	327.9	337.7	340.5	336.7
Energy sector	111.2	162.2	191.4	182.2	158.3	130.8	130.4
Agriculture	148.9	140.1	144.2	143.3	146.6	155.1	154.1
Construction	106.6	102.8	143.8	161.2	170.8	172.6	174.8
Transport and communication	77.1	79.7	73.8	106.4	105.4	102.9	99.6
Trade/commerce	345.5	335.8	419.6	441.1	443.5	460.9	458.4
Consumer credits	423.1	434.2	511.4	701.1	744.4	795.4	811.0
Mortgage loans	179.0	183.7	209.0	255.2	270.2	295.3	304.6
Sectoral distribution of loans to total loans (percent of total)							
Industry (excluding energy sector)	10.5	10.6	8.8	11.1	11.2	10.8	10.7
Energy sector	5.2	6.5	7.4	6.3	5.2	4.2	4.1
Agriculture	6.9	8.7	5.6	4.8	4.8	4.9	4.9
Construction	4.9	4.8	5.6	5.6	5.6	5.9	5.5
Transport and communication	3.6	3.7	2.9	3.6	3.5	3.3	3.2
Trade/commerce	16.0	15.7	16.3	14.7	14.7	14.7	14.5
Mortgage loans	8.3	8.6	8.1	8.7	8.9	9.4	9.6
Consumer credits	19.6	20.3	19.9	24.1	24.6	25.3	25.7
Other sectors	44.6	21.1	25.3	21.1	21.4	21.5	21.9
Foreign exchange loans to total loans	66.7	64.6	63.5	57.1	55.8	54.5	54.2
<b>Asset quality</b>							
Nonperforming loans (in billions of drams)							
Watch (up to 90 days past due)	75.0	50.8	40.7	48.0	64.5	71.6	75.4
Substandard (91-180 days past due)	48.0	45.0	58.3	40.9	42.5	49.0	45.9
Doubtful (181-270 days past due)	43.0	66.4	47.7	57.5	51.6	57.1	60.6
Loss (>270 days past due, in billions of drams)	288.4	354.3	442.5	495.8	509.8	514.3	
Nonperforming loans to gross loans	7.8	6.7	5.5	4.8	5.0	5.4	5.5
Provisions to nonperforming loans	42.9	52.0	51.5	56.6	52.1	50.9	51.1
Spread between highest and lowest rates of interbank borrowing in AMD	1.8	0.8	0.8	1.5	0.9	0.4	0.7
Spread between highest and lowest rates of interbank borrowing in FX	5.0	0.0	0.3	3.8	1.3	1.0	0.5
<b>Earnings and profitability</b>							
ROA (profits to period average assets)	-0.5	1.1	1.2	1.2	1.6	1.4	1.4
ROE (profits to period average equity)	-3.5	7.0	7.7	7.6	10.4	9.6	9.7
Interest margin to gross income	28.9	29.2	30.6	32.1	32.1	31.8	31.7
Interest income to gross income	76.5	76.7	77.2	75.1	75.7	75.2	74.7
Noninterest expenses to gross income	29.4	29.1	29.9	33.4	30.9	30.0	30.0
<b>Liquidity</b>							
Liquid assets to total assets	28.0	32.5	32.1	27.3	27.2	27.2	27.0
Liquid assets to total short-term liabilities	142.4	170.8	141.7	116.6	116.0	111.4	112.0
Customer deposits to total (non-interbank) loans	112.5	115.0	117.0	111.9	110.4	109.3	109.2
Foreign exchange liabilities to total liabilities	65.7	62.6	60.0	58.3	56.9	56.6	56.8
<b>Sensitivity to market risk</b>							
Gross open positions in foreign exchange to capital	6.5	6.9	4.0	6.1	3.71	3.7	3.4
Net open position in FX to capital	-2.8	-3.3	-1.4	-3.2	-0.13	0.5	-1.4

Source: Central Bank of Armenia.

**Table 6. Armenia: Fund Credit Available and Timing of Reviews Under the Stand-By Arrangement**

Date of Availability	Conditions	Amount (millions of SDRs)	Percent of Quota (cumulative)
May 17, 2019	Board approval of the arrangement	25.714	19.96
September 30, 2019	Observance of end-June 2019 performance criteria and continuous performance criteria, and completion of first review	25.714	39.93
March 31, 2020	Observance of end-December 2019 performance criteria and continuous performance criteria, and completion of second review	25.714	59.89
September 30, 2020	Observance of end-June 2020 performance criteria and continuous performance criteria, and completion of third review	25.714	79.86
March 31, 2021	Observance of end-December 2020 performance criteria and continuous performance criteria, and completion of fourth review	25.714	99.82
September 30, 2021	Observance of end-June 2021 performance criteria and continuous performance criteria, and completion of fifth review	25.714	119.79
March 31, 2022	Observance of end-December 2021 performance criteria and continuous performance criteria, and completion of sixth review	25.716	139.75
	Total	180.000	139.75

Source: Fund staff estimates and projections.



**Table 7. Armenia: Indicators of Capacity to Repay the Fund, 2018–24 1/**

	2018	2019	2020	2021	2022	2023	2024
		Projections					
<b>Fund obligations based on existing and prospective credit</b>							
<i>(in millions of SDRs)</i>							
Principal	47.8	50.2	57.3	46.5	30.3	60.0	77.0
Charges and interest	3.2	2.6	3.8	4.1	4.2	3.7	2.9
<b>Total obligations based on existing and prospective credit</b>							
In millions of SDRs	51.0	52.7	61.1	50.6	34.5	63.7	79.9
In millions of US\$	72.2	72.9	84.2	70.1	48.0	89.0	112.2
In percent of Gross International Reserves	3.2	3.1	3.6	2.9	2.0	3.4	4.2
In percent of exports of goods and services	1.5	1.5	1.6	1.3	0.8	1.4	1.7
In percent of debt service	26.4	24.5	10.5	26.3	20.2	39.9	53.3
In percent of GDP	0.6	0.5	0.6	0.5	0.3	0.5	0.6
In percent of quota	39.6	40.9	47.4	39.3	26.8	49.4	62.0
<b>Outstanding Fund credit based on existing and prospective drawings</b>							
In millions of SDRs	234.1	237.3	231.4	236.3	231.7	171.8	94.8
In billions of US\$	0.33	0.33	0.32	0.33	0.32	0.24	0.13
In percent of Gross International Reserves	14.7	13.9	13.5	13.6	13.1	9.1	5.0
In percent of exports of goods and services	7.1	6.6	6.2	6.0	5.5	3.8	2.0
In percent of debt service	121.0	110.1	39.7	122.9	135.6	107.6	63.2
In percent of GDP	2.7	2.4	2.3	2.2	2.1	1.4	0.8
In percent of quota	181.8	184.2	179.7	183.5	179.9	133.4	73.6
<b>Net use of Fund credit (millions of SDRs) existing and prospective</b>							
Disbursements	-47.8	1.3	-5.9	4.9	-4.6	-60.0	-77.0
Repayments and Repurchases	0.0	51.4	51.4	51.4	25.7	0.0	0.0
	47.8	50.2	57.3	46.5	30.3	60.0	77.0

Sources: IMF staff estimates and projections.

1/ Prospective credit assumes access of 180 million SDR over 2019–22 and semi-annual disbursements.

Annex I. Risk Assessment Matrix<sup>1</sup>

Nature/source of risk	Relative likelihood	Possible impact if risk is realized	Policy response
<b>Global Risks</b>			
<p><b>Rising protectionism and retreat from multilateralism.</b> In the near term, escalating and unpredictable trade actions and a WTO dispute settlement system under threat imperil the global trade system and international cooperation. Additional barriers, including investment and trade restrictions in technology sectors, and the threat of new actions reduce growth both directly, and through adverse confidence effects and financial market volatility. In the medium term, geopolitical competition, protracted tensions, and fraying consensus about the benefits of globalization lead to economic fragmentation and undermine the global rules-based order, with adverse effects on investment, growth, and stability.</p>	<b>High</b>	<p><b>Low/Medium</b> Russia as Armenia’s main trading partner and other EEU member countries have the ambition to expand the EEU, Furthermore, Armenia has recently signed a treaty for more cooperation with the EU. Economic relationship with China and Iran is also expanding.</p>	<p>Prepare and implement contingency plans for potential trade and financial spillovers. Maintain exchange rate flexibility.</p>
<p><b>Sharp rise in risk premia.</b> An abrupt deterioration in market sentiment (e.g., prompted by policy surprises, renewed stresses in emerging markets, or a disorderly Brexit) could trigger risk-off events such as recognition of underpriced risk. Higher risk premia cause higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; disruptive corrections to stretched asset valuations; and capital account pressures—all depressing growth.</p>	<b>High</b>	<p><b>Low</b> DSA suggests that Armenia’s external debt is not sensitive to interest shocks given that most of debt is concessional.</p>	<p>Continue the de-dollarization efforts. Maintain exchange rate flexibility. Strengthen banking supervision and provision in the event of higher NPLs in dollar.</p>
<p><b>Further build-up of financial vulnerabilities.</b> Although the turn in the monetary policy cycle toward easing provides a reprieve for risky assets, it encourages risk taking through underpricing of risk and reduces financial resilience to shocks and risk-off events.</p>	<b>High</b>	<p><b>Low</b> Recurrence of banking stress, including deterioration in asset quality.</p>	<p>Continue to implement financial reforms, including strengthening banking regulation and supervision, and conduct asset quality reviews and adjust provisioning accordingly</p>
<p><b>Weaker-than-expected global growth.</b> Idiosyncratic factors in the U.S., Europe, China, and stressed emerging markets feed off each other to result in a synchronized and prolonged growth slowdown:</p> <ul style="list-style-type: none"> <li>• <b>U.S.:</b> Confidence wanes against a backdrop of a long expansion with stretched asset valuations, rising</li> </ul>	<b>Medium</b>	<p><b>Medium</b> Mining exports, a source of foreign exchange earnings and tax revenue, would be hit. Remittances could fall after recent recovery, in case</p>	<p>Diversify export destination and products. Accelerate structural reforms to improve the business climate for FDI. Strengthen social safety</p>

<sup>1</sup> 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 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 between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

<p>leverage, and policy uncertainty, leading to weaker investment and a more abrupt closure of the output gap.</p> <ul style="list-style-type: none"> <li>• <b>Europe:</b> Weak foreign demand, Brexit, or concerns about some high-debt countries makes some euro area businesses delay investment, while faltering confidence reduces private consumption. Inflation expectations drift lower, and the region enters a prolonged period of anemic growth and low inflation.</li> <li>• <b>China:</b> In the near term, further escalation in trade tensions not only reduce external demand, disrupt supply chains, and depresses confidence and investment, but potentially also trigger tighter financial conditions, a sharp downturn in the property market, renewed PPI deflation, and a drop in commodity prices. In the medium term, weaker external demand, the potential reversal of globalization, and the increasing role of the state could weigh on growth prospects. Moreover, excessive policy easing—reversing progress in deleveraging and rebalancing—increases risks over time of a disruptive adjustment or a marked growth slowdown.</li> <li>• <b>Large stressed emerging economies:</b> Policy missteps, idiosyncratic shocks and/or contagion prevent expected stabilization or recovery in stressed economies from materializing, generating negative spillovers and reducing global growth.</li> </ul>	<p><b>High</b></p> <p><b>High</b></p> <p><b>Medium</b></p>	<p>economic growth in major trading partners slows down.</p>	<p>nets to cushion the impact of shocks.</p>
<p><b>Intensification of geopolitical tensions and security risks</b> (e.g., in the Middle East) cause socio-economic and political disruption, disorderly migration, volatile commodity prices, and lower confidence.</p>	<p><b>High</b></p>	<p><b>Medium</b> Intensification of tension in neighboring countries in the Middle East and renewed sanctions on Iran could potentially also reduce trade and investment.</p>	<p>Accelerate structural reforms and prepare contingency plans for potential spillovers. Strengthen social safety nets to mitigate shocks on vulnerable sectors.</p>
<p><b>Large swings in energy prices.</b> Risks to prices are broadly balanced, reflecting offsetting—but large and uncertain—supply and demand shocks. In the near term, uncertainty surrounding the shocks translates to elevated price volatility, complicating economic management and adversely affecting investment in the energy sector. As shocks materialize, they may cause large and persistent price swings. While, on aggregate, higher oil prices would harm global growth, they would benefit oil exporters.</p>	<p><b>Medium</b></p>	<p><b>Medium/High</b> Negative indirect effects via major trading partners.</p>	<p>Diversify trade partners. Improve the business climate for international investors.</p>
<p><b>Cyber-attacks</b> on critical global financial systems, infrastructure and institutions trigger systemic financial instability or widespread disruptions in socio-economic activities.</p>	<p><b>Low</b></p>	<p><b>Low/Medium</b> A widespread cyber-attack has not been reported in Armenia yet. However, in such an event, a deeper analysis is needed to</p>	<p>A risk-based regulatory approach should ensure that no relevant risks remain unregulated—either stemming from</p>

		determine the system's interconnectedness and vulnerabilities.	traditional banks or created by technology.
<b>Higher frequency and severity of natural disasters</b> cause severe economic damage to smaller economies susceptible to disruptions (medium probability). A sequence of severe events in large economies reduces global GDP and prompts recalculation of risk and growth prospects. Disasters hitting key infrastructure or disrupting trade raise commodity price levels and volatility (low probability).	<b>Medium/Low</b>	<b>Medium</b> Natural disasters would negatively impact infrastructure, agriculture and water resources, increasing Armenia's vulnerability to climate variability.	Address infrastructure gaps; further develop private insurance markets; and instituting appropriate social safety nets.
<b>Country-Specific Risks</b>			
<b>Regional conflict:</b> Risks from sharp, renewed regional tensions.	<b>Low</b>	<b>High/Medium</b> Conflict would have severe impacts, including possible regional military action.	Continue with dialogue. Prepare and implement contingency plans.

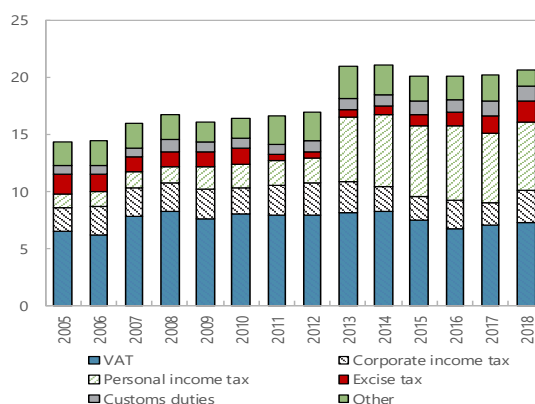
## Annex II. Tax Revenue Potentials<sup>1</sup>

This annex assesses Armenia's tax capacity potential and discusses policies to increase revenues and create room for social spending and investment in human and physical capital. To this end, it takes stock of recent revenues mobilization efforts, compares Armenia's tax performance with its regional and development peers, and estimates Armenia's tax capacity through a stochastic frontier analysis suggesting a tax gap of around 4 percent of GDP.

### Background and Recent Developments

**1. For the last two decades, Armenia has made steady progress in mobilizing tax revenues, but significant challenges remain.** Tax collections increased from 14.3 percent of GDP in 2005 to 20.7 percent of GDP in 2018 (Figure 1). This progress resulted mainly from the implementation of comprehensive tax policy and administration reforms, including a change of the personal income tax (PIT) system in 2013. However, in the same period there were several policy and administrative missteps, including a large accumulation of unpaid value added tax (VAT) refunds, delayed indexation of certain tax bases (e.g., excises), expansion of presumptive taxation (e.g., increasing the VAT threshold), elimination of minimum profit tax, and a reduction in turnover tax for traders. While it is estimated that tax revenues increase by 1 percentage point in 2019, tax revenues remained largely stagnant since 2013 because of these problems and external shocks.

**Figure 1. Armenia: Tax Revenues**  
(In percent of GDP)



**2. There has been an ongoing attempt to reform the tax policies.** Following the adoption of a new tax code in 2016, the government is introducing a new tax reform, starting on 2020, aimed at enhancing competitiveness and medium-term growth while also promoting tax compliance. The main elements include the flattening of the PIT system, reducing the PIT and corporate income tax (CIT) rates, streamlining micro-enterprise taxation, and cancelling the

<sup>1</sup> Prepared by Hatim Bukhari, Hamid Reza Tabarraei, and Yuan Xiao.

scheduled reduction of VAT threshold. To offset the shortfall in revenues, it includes a set of offsetting tax changes such as introducing new excise taxes on tobacco and gambling, indexing excise tax rates to inflation, and removing selected tax exemptions. Along with tax administration efforts and increases in some government fees, the net impact on revenues is expected to be broadly neutral.

**3. The SRC is strengthening its tax administration capacity with the support of development partners.** In recent years, the SRC has been focusing on integrating the shadow economy into the formal system and improving its tools and capacity to enhance compliance, strengthen governance and reduce the scope for corruption. In May 2019, the SRC developed a medium-term comprehensive tax administration strategy, with an action plan to eliminate bottlenecks in revenue administrations, and to implement IMF TA recommendation (MEFP, ¶18). In June 2019, the MoF submitted a law to modernize Armenia’s real estate taxation.

### **Benchmarking Armenia’s Tax Revenue Performance and Efficiency**

**4. Overall, Armenia’s tax revenues compare well with its regional and development peers, with higher PIT but lower CIT, VAT and excises.** In 2018, Armenia had a tax to GDP ratio of 20.7 percent of GDP, close to the average of its peer group (20.7 percent of GDP) (Figure 2), which includes countries in the region and at a broadly similar stage of development. However, Armenia’s relative performance varies across the various components of tax revenues. PIT is relatively high, near the top end of the country distribution, with custom duties are higher than average. CIT, VAT, and excises are below the respective average levels seen in peers. Armenia’s CIT productivity appears to be below the average of peers.<sup>2</sup> As Figure 3 shows, Armenia’s CIT productivity is toward the lower end of the distribution, and somewhat below the average of its peers (Figure 3).

### **Estimating Armenia’s Tax Capacity**

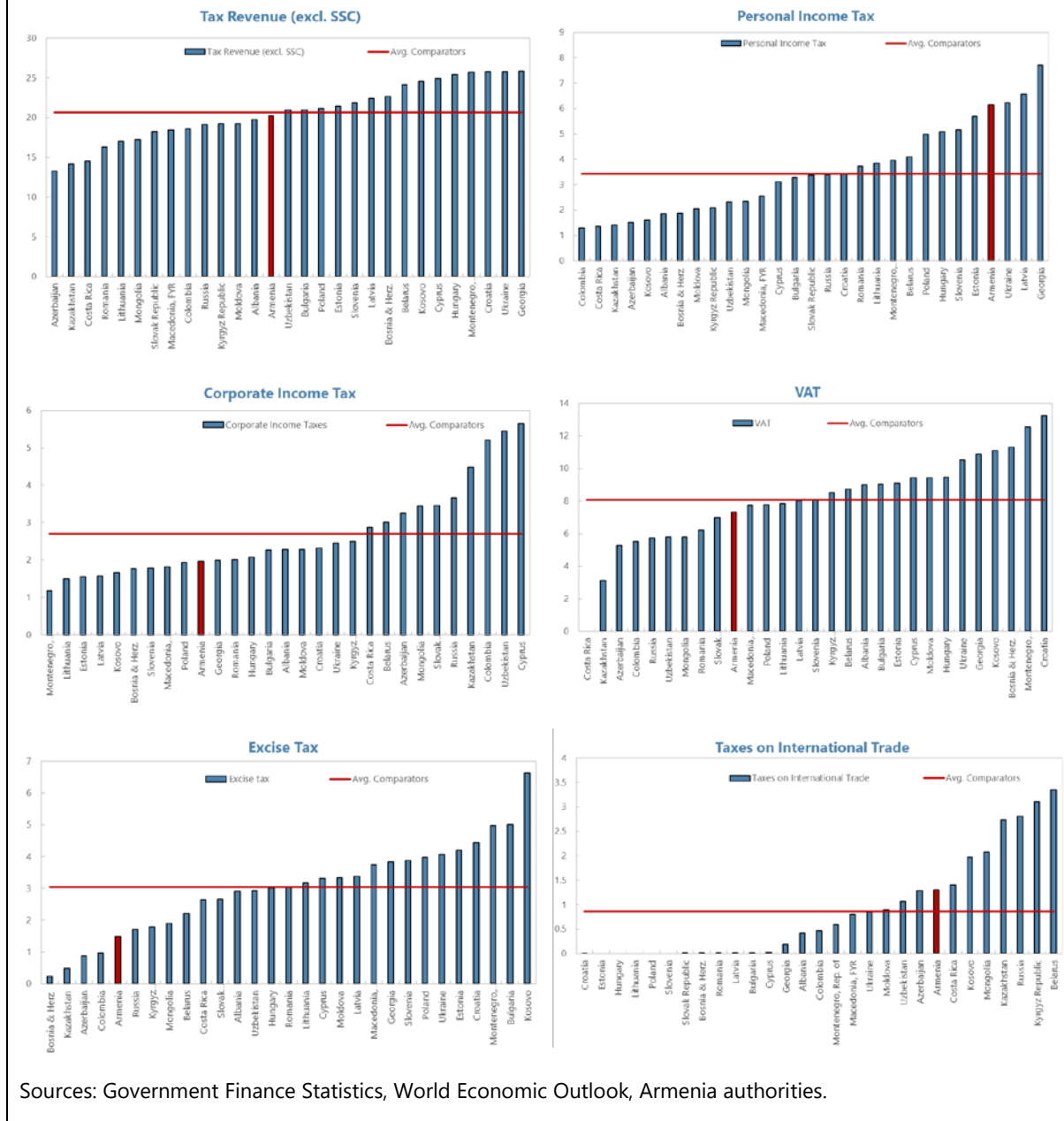
**5. To gain a sense of Armenia’s tax capacity, we undertake a frontier analysis using a sample of middle-income economies with panel data covering 2001–15.**<sup>3</sup> Similar to Fenochietto and Pessino (2010), the model specification for the frontier analysis is as follows:

$$T_{it} = \alpha + \beta x_{it} + e_{it} - u_{it}$$

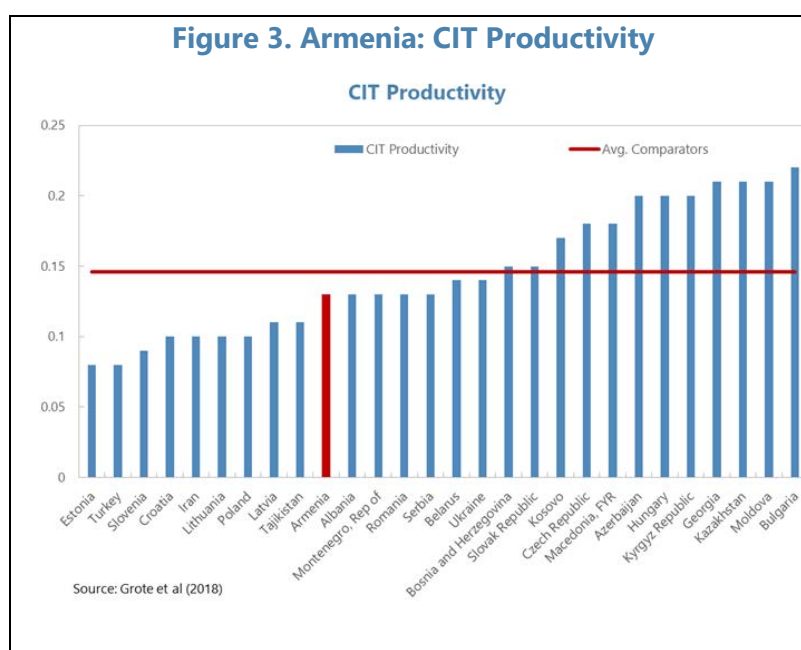
<sup>2</sup> CIT productivity is a measure of the efficiency in collecting CIT revenues and is defined as the ratio of CIT revenue as a share of GDP to a country’s CIT rate. The higher the ratio, the more efficient a country is at collecting CIT revenues. Similar to the CIT productivity, Armenia’s VAT productivity shares a similar relative position compared to peers.

<sup>3</sup> The sample includes 70 middle-income countries for which data were available. Net oil-exporting countries are excluded from the sample.

**Figure 2. Armenia: Cross-Country Comparison of Armenia's Tax Revenues, 2017**  
(In percent of GDP)



Sources: Government Finance Statistics, World Economic Outlook, Armenia authorities.



where  $T_{i,t}$  represents tax revenue to GDP ratio for country  $i$  at time  $t$ ;  $\alpha$  refers to the constant term,  $X_{i,t}$  is the vector that represents control variables for country  $i$  at time  $t$ ;  $u_{i,t}$  represents the inefficiency, the “failure” to produce the relative maximum level of tax collection or production; and  $e_{i,t}$  is the statistical noise. The country specific characteristics used in the estimation are the degree of openness of the economy, the level of education, and institutional factors such as corruption and governance<sup>4</sup>. Tax capacity is the predicted value for tax revenues from the econometric model. The difference between the actual tax revenue and tax capacity of a country is the tax gap.

**6. The results suggest that the authorities can raise revenues by about 4 percent of GDP if the estimated tax gap is closed, for example, through stronger tax policy and tax administration reforms.** The stochastic frontier analysis shows that all control variables except the old-dependency ratio are significant with the expected signs: less dependence on agriculture and higher trade openness, better control of corruption, and higher public education spending increase tax potential. Given Armenia’s characteristics, its tax potential as represented by the estimated tax revenue frontier is 24.7 percent of GDP, which implies a tax gap of around 4 percent of GDP. Reforms in tax policy and tax administration factors can help close the estimated tax gap and even raise Armenia’s tax potential if those reforms improve institutional fundamentals.

<sup>4</sup> See Aigner, Lovel and Schmidt (1977), Haneda (2017) and Fenochietto and Pessino (2013), for papers that use similar methodology.



**Table 1. Armenia: Regression Results of the Stochastic Frontier Model**

<b>Dependent variable: Log of Tax Revenue/GDP</b>		
	<b>Coefficients</b>	<b>P-Value</b>
Trade Openness	.002	0.000*
Share of agriculture in value-added	-.022	0.000*
Old-dependency ratio	.006	0.168
Control of Corruption	.094	0.036*
Public Education Spending	.031	0.001*
Constant	3.11	0.000*
Number of observations		263
Number of countries		70
Armenia's estimated tax potential (percent of GDP)		24.7
Tax Policy and Administration Gap (percent of GDP)		4.0

\* Significant at 1, 5 or 10 percent level

Source: Author's estimate, Government Finance Statistics, World Development Indicators, World Economic Outlook, and Worldwide Governance Indicators.

**7. While the results are in line with other studies for peer countries, some caveats remain.** Tax capacity in this analysis represents the maximum tax revenue that could be collected in the country given its economic, social, institutional and demographic characteristics. However, if the shadow economy in Armenia shrinks and macroeconomic fundamentals improve along with institutional governance, the tax capacity can increase further. In addition, due to data limitation, we do not make a distinction between the two sources of tax gaps (tax policy gap and tax administration gap).<sup>5</sup> Moreover, the methodology of estimating the tax gap in this analysis should be regarded from the macroeconomic perspectives and is complementary microdata-based analysis, which could indicate even greater tax potential than indicated here.<sup>6</sup>

### **Reforms Areas for Increasing Revenues in Armenia**

**8. Revenue-enhancing policies are essential to creating the space for necessary social spending and investments in human and physical capital.** As Armenia seeks to transition towards an emerging middle-income country, the government will need to focus on creating

<sup>5</sup> The tax gap can be explained by the tax policy gap and the tax administration gap. The tax policy gap refers to the design of tax policy including tax rates, exemptions, tax deductions, etc. The tax administration gap is the difference between the tax potential (tax that can be collected according to the tax legislation) and the actual tax revenue (tax paid). Nonetheless, this section does not attempt to make a distinction between the two sources empirically due to limitations in data, which is typical for studies using such a methodology.

<sup>6</sup> An upcoming IMF TA mission will help the authorities to estimate the VAT tax gap using microdata.

the fiscal resources through higher revenues to cover the requisite public investments in human capital and infrastructure without jeopardising debt sustainability.

- Future directions in tax policy reforms could focus on broadening the tax base and levelling the playing field by eliminating exemptions. The IMF's 2018 tax policy TA to Armenia made comprehensive recommendations on making the tax system more growth friendly while preserving revenues and strengthening fairness.<sup>7</sup> Armenia's existing CIT system features a narrow tax base, nonuniform effective tax rates, and tax exemptions. The investment incentive regime provides a wide range of attractive options. By far, the agricultural sector enjoys the lion share of all preferential treatment. A tax system with a uniformly applied tax rate is less susceptible to aggressive tax-planning opportunities such as domestic transfer pricing.
- On the tax administration side, sustained efforts are needed to fight evasion and reduce the shadow economy. SRC drafted the action to implement the Fund TA recommendations to enhance risk management compliance and strengthen fundamental functions and processes for the delivery of effective tax administration.<sup>8</sup> In the past two years, the authorities had some success to reduce shadow economy, as demonstrated by the government's overperformance in tax collections.
- The taxation of real estate in Armenia has the potential to generate more revenue. Although real estate taxes are collected by the local governments in Armenia, the draft law on establishing market evaluation system on real estate taxation will have positive impact on resources for public goods provision and inclusive growth when implemented.

**9. Over time, improving economic and institutional fundamentals will further enlarge Armenia's tax revenue capacity.** Armenia's tax revenue frontier can be further enlarged by strengthening institution and fighting corruption and improving other economic fundamentals. For example, if Armenia could improve, a further gain of 1 percentage points in the control of corruption indicator can improve the tax to GDP ratio by 0.09 percent based on the econometric analysis.

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<sup>7</sup> See Martin et al (2018).

<sup>8</sup> Koukpaizan et al (2019).

## Appendix I. Letter of Intent

Ms. Kristalina Georgieva  
Managing Director  
International Monetary Fund  
Washington, DC 20431

Yerevan, December 3, 2019

Dear Ms. Georgieva:

1. In the attached update to the Memorandum of Economic and Financial Policies (MEFP) from May 2, 2019, we confirm our commitment to the policies and objectives of the economic program supported by an IMF Stand-by Arrangement. We also describe progress and further policy steps toward building an export-led competitive and inclusive economy.
2. Our economic program is off to a good start. Economic activity grew robustly in the first 8 months of the year, inflation is subdued, the foreign exchange market has remained broadly stable, and our gross official reserves have continued to increase. Notable progress has also been made in the areas of revenue mobilization, financial sector stability, and governance.
3. Our actions ensured that all performance criteria (PC) and structural benchmarks for end-June 2019 were met, and we are on track to meeting most policy objectives for 2019. To give some more time for technical consultations both internally and with IMF staff, we request to reset the end-September 2019 structural benchmarks on developing a capital market strategy and on an anticorruption body. A revised list of structural benchmarks is attached to this letter.
4. Our efforts will continue to focus on advancing our reform agenda to ensure more inclusive and resilient growth which is critical for the Armenian people, including by maintaining fiscal sustainability, safeguarding social spending, bolstering financial sector resilience, and enhancing business climate and governance through ambitious structural reforms. To ensure continued progress toward fiscal sustainability, we plan to adopt the 2020 budget by end-December consistent with program targets, aiming to improve the efficiency and equity of our tax system by broadening the tax base and strengthening revenue administration while also creating space for higher capital and social spending.
5. On the basis of steps that we have already taken and commitments under the program, we request completion of the first review. Given Armenia's relatively comfortable international reserve position and continued access to external financing, we intend to treat the arrangement as precautionary.
6. We believe that the policies set forth in the attached MEFP are adequate to achieve the macroeconomic and financial objectives of the program, but we will take any additional measures that may be appropriate for this purpose. We will consult with the IMF on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in

accordance with the IMF's policies on such consultation. We will provide IMF staff with the data and information requested for the purpose of monitoring program implementation. Reaffirming our commitment to transparency, we consent to the IMF's publication of this letter, along with the attached MEFP and the Technical Memorandum of Understanding (TMU), as well as the IMF staff report on the first review of the SBA, subject to Executive Board approval.

Yours sincerely,

/s/

Nikol Pashinyan  
Prime Minister

/s/

Atom Janjughazyan  
Minister of Finance

/s/

Arthur Javadyan  
Chairman, Central Bank of Armenia

## Attachment I. Memorandum of Economic and Financial Policies (MEFP)

**1. This memorandum supplements our memorandum of May 2, 2019, provides information on recent developments, and sets out our key policies for the remainder of 2019 and 2020.**

### RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

**2. Economic performance has been strong and macroeconomic policy implementation has been generally sound.** Armenia's economy posted 7.1 percent growth in 2019H1 with manufacturing and services sectors leading economic activity. Inflation declined to 0.6 percent in August, somewhat below our target, prompting the Central Bank of Armenia (CBA) to lower its policy rate by 25 basis points to 5.5 percent in September. Financial conditions have been stable. The exchange rate has appreciated somewhat on the back of private inflows, and de-dollarization continued. The 2019H1 fiscal balance is estimated to have been in surplus. Tax revenue exceeded the budget target by almost 1 percent of GDP, in part due to efforts to strengthen compliance and reduce the shadow economy. Spending, however, remained well below plans, mainly due to delays in the execution of capital expenditure. Preliminary figures point to narrowing of the current account deficit.

**3. We expect our policy actions and reforms to continue to deliver visible economic benefits.** Real GDP growth is projected at somewhat above 6½ percent in 2019. Although robust growth could continue in the near-term, we have prudently built our program on conservative assumptions assuming that growth will gradually moderate to around 4½–5 percent in 2020. Inflation is projected to gradually pick up in 2020, as the impact from food prices dissipates and the public demand restores. The current account deficit is expected to gradually converge to around 6 percent of GDP in the medium term, as exports continue to benefit from ongoing reforms, and imports growth moderates on the back of prudent policies.

### ECONOMIC POLICIES

#### Fiscal Policy

**4. In 2019, we expect the central government deficit to be well below the budget target of 2¼ percent of GDP.** The 1 percent of GDP revenue overperformance in H1 will be sustained, enabling us to accelerate clearing VAT refund backlogs. Foreign financed capital spending is unlikely to be fully executed, although some catching up is expected in 2019H2. The government has reallocated part of the resulting space to other priority sectors, such as education, health, infrastructure, and defense. Overall, the end-year fiscal deficit is expected to be around 1½ percent of GDP, depending on the pace with which capital spending moves towards programed execution.

**5. We remain committed to our medium-term fiscal policy objective of preserving debt sustainability, while maintaining space for investment and social spending.** The preliminary draft 2020 budget, as well as the MTEF, have been drawn with the objective of reducing public debt below 50 percent of GDP over the medium-term. In this regard, the 2020 budget fiscal deficit will be limited to 2.3 percent of GDP. Tax revenues are expected to rise by ½ percent of GDP compared to 2019, reflecting our continued effort to strengthen tax administration. Investment spending is planned to increase significantly to AMD 288 billion (4.1 percent of GDP) following our efforts to address challenges in the implementation of capital projects. Such an increase in capital spending is critical to increasing Armenia's growth potential. Current spending will increase to AMD 1568 billion (22.1 percent of GDP), with particular attention to raising social spending. In the event of any revenue shortfall, we stand ready to take compensating measures while striving to protect the social spending envelope. A budget in line with these elements will pass formal procedures in National Assembly (NA) and is expected to be approved by the end of the year.

### **Structural Fiscal Policies**

**6. We will continue modernizing and simplifying our tax system to promote compliance and medium-term growth.** In June, the NA adopted our tax reform package, which will take effect in January 2020. Looking ahead, we will finalize our ambitious tax reform strategy for 2019–23 aiming to remove tax arbitrage opportunities and rationalize tax expenditures (MEFP, May 2, 2019). We also remain committed to preparing an action plan by December 2019 on the steps required to introduce individual tax returns by end-2021.

**7. We have made progress towards implementing market-price-based valuation in property taxation.** In June 2019, we submitted a law "On Establishing Market Evaluation Procedure for Real Estate Taxation" to the NA (June 2019 SB), which we expect to be approved by end-2019. Now we are reviewing the rate structure and nontaxable threshold, as well as devising the mechanism to help the low-income population, taking into account IMF TA recommendations (MEFP, May 2, 2019). We remain committed to start tax collections under the new regime in 2021 and are working to enhance the electronic tax management system with a new module for the calculation and collection of property tax by September 2020.

**8. Our efforts to improve taxpayer compliance and combat deep-seated tax evasion continues.** The State Revenue Committee (SRC) has developed a comprehensive tax administration strategy for 2020–24, which identifies the main challenges of the revenue administration, and sets strategic goals and deliverables. It also includes an action plan to implement key recommendations from the recent IMF TA, including developing a compliance strategy, establishing procedures for cleansing and updating the taxpayer register, and for developing a performance management process (MEFP, May 2, 2019; June 2019 SB). Furthermore, we are conducting a comprehensive study to identify tax potential as well as factors preventing tax collection reaching this potential. We look forward to the upcoming IMF TA to assist us in microdata-based tax gap analysis. Based on the findings of this study, we will design

an action plan (December 2019 SB) to improve tax compliance and raise the tax-to GDP ratio in the medium term.

**9. We are strongly committed to improving the implementation of foreign financed capital spending projects and developing a sound public investment management (PIM) process.** We will work to address the various factors underlying the recent under-execution of investment projects, including uncertainties in project management structures and delays in decision making by the implementation agencies, as well as weaknesses in the PIM planning and prioritization. We have already established a department in the MOE tasked with developing a template to prioritize public investment projects by economic returns and government objectives. We welcome the forthcoming IMF TA on PIMA follow-up to further assist us in establishing a PIM process following best international practice.

**10. Other expenditure reforms to support fiscal sustainability and inclusive growth remain our priority.**

- **Budget process.** We are making progress in various areas to increase the efficiency of budget spending, including by: (i) transitioning to program budgeting in the 2020 budget cycle and (ii) introducing rolling-base budgeting to enhance the credibility of the MTEF and its role in fiscal policy implementation. We have also streamlined the budget process to eliminate repetition and possible inconsistencies between the MTEF and annual budget cycles.
- **Fiscal risks management.** In June, we submitted to the NA a PPP law that follows best international practice (June 2019 SB), which was approved. Now we are drafting secondary legislation that would allow for the PPP Law's implementation. In parallel, we are creating a database of all PPPs which is expected to be finalized by June 2020. We remain committed to clarifying the functions and responsibilities related to fiscal risk management among the government entities and expanding the functions of the Ministry of Finance (MOF).
- **Fiscal transparency.** In line with our commitment to transparency, we have published the Fiscal Transparency Evaluation report. We welcome the upcoming IMF TA mission to help us with GFS2014 implementation. Regarding our commitment to strengthen public procurement, we have completed a diagnostic of the procurement system with the WB help, which is a first step to developing a strategic procurement framework.

**11. We are working to enhance the adequacy and targeting of social spending.** To this end, the government established a working group to study ways to enhance the adequacy and targeting of social benefits. We have also started training the MOF staff to use a model developed by the WB to analyze the distributional effects of fiscal reforms. In the meantime, we are expanding maternity benefits, especially in the rural area. In line with our previous commitment, we increased funding for the education and health sectors in the 2020 budget.

**12. We will further enhance our public debt management.** On domestic front, we are preparing a capital market development strategy, as detailed below (¶17). On external front, we successfully placed a \$500 million 10-year Eurobond in September to rollover the Eurobond maturing in 2020H2 and further cement Armenia's international market access. The oversubscribed issuance suggests strong investor confidence bolstered by our continued commitment to reforms and fiscal sustainability.

## Monetary Policy

**13. The CBA will continue balancing its dual mandate of price and financial stability.** In this regard, we consider the policy rate appropriate for the current conditions and expect inflation to gradually return to the CBA's target of 4 percent on the back of strong domestic demand growth. We will continue to monitor closely economic developments and stand ready to take any policy actions necessary to achieve this target and maintain financial stability.

**14. In line with the inflation targeting framework, we remain committed to a flexible exchange rate regime, while aiming to strengthen international reserves adequacy.** Taking advantage of higher than previously anticipated private FX inflows, we reinforced our international reserve buffers. The FX purchases also helped combat disinflationary trends amid appreciation pressures. Once the transitory factors limiting AMD liquidity dissipate, the CBA interventions will be limited to smoothing excessive volatility and mitigating transitory pressures.

**15. We are also committed to strengthening the inflation targeting framework further.** We will work on supporting the CBA to improve liquidity management and enhance the monetary policy transmission. Specifically, the MOF will continue sharing with the CBA cash flow forecast data and improve the provided data trying to highlight main flows influencing on liquidity management. While the CBA will continue using seven-day repos, it will offer the three-month repo instrument on occasional basis and for structural liquidity management purpose only.

## Financial Sector Policy

**16. We continue to strengthen our policy framework to support financial sector stability in line with FSAP recommendations:**

- We prepared a time-bound action plan and communication strategy to reform the FX reserve requirement regime. In October, the CBA amended the reserve requirements and commercial banks are required to convert their FX reserve requirements from AMD to FX. The newly adopted action plan envisages conversion of the remaining 12 percentage points, by an average of 3 percentage points a year, to be completed by mid-2024, and subject to admissible market conditions as specified in the action plan.
- In line with Basel III, we introduced a capital conservation and a countercyclical capital buffers, as well as a surcharge for domestic systemically-important banks. The board



decision is effective from April 2019 and sets gradual timeline for the full implementation for respective buffers. Countercyclical capital buffer was enforced starting from July 2019, conservation and systemic buffers will become effective starting from January 2020.

- We are in the process of finalizing regulations to introduce LCR and NSFR for all currencies to boost liquidity buffers further. A draft regulation has been communicated to commercial banks for their feedback and comments. The regulation, expected to come in force by March 2020, will set 100 percent ratios for LCR in all currencies and 50 percent for FX liabilities which will increase over 3 years to reach 100 percent.
- We introduced regulations on the recovery plans for banks and amended the regulation on stress testing in order to strengthen the stress testing framework in banks. The CBA board decision is effective from November 11, 2019.
- To mitigate risks from the recent rapid retail credit growth and to address credit risk from unhedged FX exposures, we are considering strengthening our macro prudential framework. To this end, we expect to take decisions by end-year.

**17. We remain committed to promoting capital market development.** We have made some progress in preparing a draft capital market development program (September 2019 SB), but further work is ongoing to comprehensively review the framework for securities, conduct a diagnostic analysis of existing challenges, and bring forward proposals for concrete actions. However, to allow sufficient time to consolidate views of all the institutions responsible for capital market development and thoroughly flesh out all the necessary elements of the program, we request to postpone this SB to March 2020.

**18. The CBA and MoF will work closely to have market determined exchange rates for budget transactions.** For this objective MOF and CBA are committed to change 2007 agreement between them to settle foreign currency denominated government budget inflows and outflows at market ER throughout the fiscal year.

## Structural Reforms

**19. We are on track to implement the structural benchmarks designed to tackle the weaknesses in the business environment, strengthen human capital development and enhance social protection to tackle poverty and unemployment.**

- **Business environment.** We are actively working on creating an Investment Support Office within the MOE to promote both domestic and foreign investment in an efficient and streamlined manner. In this context, we will rely on the finding of the efficiency review of the existing SME support programs while consolidating the existing support mechanisms and programs.
- **Labor market and social policies.** We have already adopted a gender strategy for 2019–23 that focuses on promoting female labor force participation and overcoming

gender discrimination in various socio-economic fields. The employment strategy, as well as the action plan, is expected to be finalized and approved by the government by end-2019. Separately, we have decided to raise the minimum wage by about 25 percent with the objective to reduce the size of the shadow economy and bolster inclusiveness, effective from January 1, 2020. We have carefully assessed the short- and long-term effects of such a measure, including fiscal costs and negative impact on competitiveness and labor market.

- **Education.** We have drafted a Law on Higher Education and Science that allows for reforming the tertiary education management system to improve human resource management as well as organizational and financial autonomy of higher education institutions. Our plan is to submit the draft law to the NA by end-2019 (December 2019 SB).
- **Health.** With the aim of introducing the universal health coverage financing system, we are working on developing a concept note to set the structure of the system.

**20. We are making good progress in strengthening our anti-corruption framework.** In this regard, we have: (i) delivered on the June 2019 SB related to the establishment of a registry of beneficial ownership information; (ii) started working on revising the Criminal Code to eliminate threshold amounts on embezzlement and introducing criminal liability for legal persons, in line with the Fund advice; review and amend the statute of limitations term for corruption cases so that it commences at the point of discovery (not at the time of the completion of the act) and is suspended/terminated at the time of the decision of the first instance court and retaining criminal liability in case of repayment for corruption crimes, notably in tax cases and (iii) drafted a comprehensive anticorruption strategy for 2019–23 which is expected to be approved by the government by October 2019. This strategy is set to guide the overall institutional anti-corruption framework, including the role of a single autonomous anti-corruption entity. As a result, a draft law on a single autonomous anti-corruption entity, which combines all detection and investigative functions, will be submitted to the NA with a slight delay, by December 2019 (September 2019 SB). We have also ensured continuity of asset declaration system in 2019 while we are finalizing the legal arrangements for the transfer of functions from CEHRO to the newly created CPC.

## PROGRAM MONITORING AND SAFEGUARDS

**21. The program will continue being monitored through quantitative performance criteria, indicative targets (Table 1), a monetary policy consultation clause, and structural benchmarks (Table 2).** The second review is expected to be completed on or after March 31, 2020 and will assess performance as of end-December 2019. The third review is expected to be completed on or after September 30, 2020 and will assess performance as of end-June 2020.

**22. The CBA will continue maintaining a strong safeguards framework and internal controls environment.** The IMF safeguards assessment mission completed in September 2019

confirmed that the CBA maintains a strong safeguards framework and has well established safeguards in its external and internal audit arrangements, and sound financial reporting practices. To further strengthen CBA's safeguards assessment, we will prepare a medium to long-term exit strategy for the CBA to phase out its involvement in non-core central banking activities in an orderly manner and in collaboration with relevant stakeholders (September 2020 SB).

**Table 1. Armenia: Quantitative Performance Criteria 1/**

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

	2018		2019					2020							
	Dec.	Mar.	Jun. <sup>2/</sup>		Sep. <sup>3/</sup>	Dec. <sup>2/</sup>	Mar. <sup>3/</sup>	Jun. <sup>2/</sup>		Sep. <sup>3/</sup>	Dec. <sup>3/</sup>	IT	IT		
	Act.	Act.	EBS 19/27	Adj. Target	Est.	Status	EBS 19/27	EBS 19/27	Rev. Prog	EBS 19/27	Rev. Prog			EBS 19/27	Rev. Prog
<b>Performance Criteria</b>															
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,404	1,320	1,392	1,142	1,439	Met	1,408	1,444	1,444	1,446	1,506	1,462	1,501	1,528	1,563
Program fiscal balance (flow, floor) <sup>4/</sup>	...	28	-99	-50	98	Met	-157	-196	-196	-50	-61	-70	-113	-176	-241
Budget domestic lending (cumulative flow, ceiling)	...	0	15	15	0	Met	15	15	15	15	15	15	15	15	15
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	0	Met	0	0	0	0	0	0	0	0	0
<b>MPCC 5/</b>															
Inflation (upper-band, percent)	..	3.4	4.0	4.0	4.0	Met	3.4	4.0	4.0	4.2	4.2	4.3	4.3	4.5	4.8
Inflation (mid-point, percent)	1.8	1.9	2.5	2.5	2.5	Met	1.9	2.5	2.5	2.7	2.7	2.8	2.8	3.0	3.3
inflation (lower-band, percent)	..	0.4	1.0	1.0	1.0	Met	0.4	1.0	1.0	1.2	1.2	1.3	1.3	1.5	1.8
<b>Indicative Targets</b>															
Net domestic assets of the CBA (stock, ceiling)	449	471	574	695	371	Met	713	831	831	673	519	689	438	514	629
Avg. concessionality of newly contracted ext. debt (flow, floor, in percent) <sup>6/</sup>	...	...	30	30	...	Met	30	30	30	30	30	30	30	30	30
New government guaranteed external debt (stock, ceiling, in millions of USD) <sup>7/</sup>	...	0	100	100	0	Met	100	100	100	100	100	100	100	100	100
Social spending of the government (flow, floor) <sup>8/</sup>	...	15	30	30	27	Not Met	46	62	54	20	14	40	28	42	56
<b>Memorandum items:</b>															
Budget support grants (cumulative from beginning of each year)	...	0	0	0	0		9	9	4	0	0	9	4	0	8
o.w. EU MFA grant	...	0	0	0	0		9	9	4	0	0	9	4	0	8
Budget support loans (cumulative from beginning of each year)	...	0	48	0	0		72	104	71	0	0	59	0	0	0
Project financing loans (cumulative from beginning of each year)	...	10	87	22	22		130	166	99	0	0	98	79	126	172
Project financing grants (cumulative from beginning of each year)	...	0	10	1	1		22	30	14	0	0	12	17	23	28
KFW and IBRD loan disbursements (cumulative from beginning of each year)	...	0	13	3	3		21	43	39	0	0	13	3	16	39

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU, based on program exchange rates in the TMU.

2/ Quantitative performance criteria at test dates.

3/ Indicative target.

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

5/ If the end of period year-on-year headline inflation is outside the upper/lower bound, a formal consultation with the Executive Board as part of program reviews would be triggered.

6/ Assessed on a calendar year basis, excluding the Eurobond and any similar refinancing instruments.

7/ Includes both concessional and non-concessional debt, excluding the Eurobond and any similar refinancing instruments.

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.

<b>Table 2. Armenia: Structural Benchmarks</b>				
<b>Measures</b>	<b>Responsible Agency</b>	<b>Time Frame</b>	<b>Status</b>	<b>Macro Criticality</b>
<b>Fiscal</b>				
Create an action plan to implement key recommendations from IMF TA on tax administration on developing a compliance strategy and strengthening core functions and processes	State Revenue Committee (SRC)	June 2019	Met	Improve tax administration and compliances
Submit a draft law "On Establishing Market Evaluation Procedure for Real Estate Taxation" to the National Assembly to implement a value-based recurrent property tax with appraised property values closely aligned to market prices	Deputy Prime Minister's Office	June 2019	Met	Enhance revenue mobilization and fairness
Submit a public-private partnership (PPP) law to the National Assembly, establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships	Ministry of Economic Development and Investments (MoE)	June 2019	Met	Incentivize FDI and investment in infrastructure projects
Design an action plan to improve tax compliance and raise tax-to GDP ratio in the medium term, based on a study identifying tax potential and factors preventing tax collection reaching this potential	Deputy Prime Minister's Office	December 2019		Improve tax administration and compliances
<b>Monetary and Financial</b>				
Prepare a time-bound action plan and communication strategy to boost foreign currency liquidity buffers as described in the 2018 FSAP recommendations (paras 19, 21 and 32) through a combination of liquidity tools	Central Bank of Armenia (CBA)	September 2019	Met	Enhancing macro prudential measures

Develop a capital market development program	CBA, MoF, MoE	September 2019	Not observed Dates proposed to be reset to March 2020	Create access to long-term, local-currency finance and improve monetary policy transmission
Develop a framework for strengthening financial reporting and auditing to establish the public oversight body and the Chamber of Accountants and Auditor, focusing on improving corporate financial information and reducing SME financial reporting requirements with assistance by the World Bank	MOF	March 2020		Strengthen transparency and improve SME's access to finance
Prepare a medium-term exit strategy to phase out the CBA involvement in non-core central bank activities (i.e. development lending and subsidiaries)	CBA	September 2020	Newly proposed benchmark	Curtail engagement in quasi-fiscal activities that do not relate to core central bank's mandate; eliminate potential financial and reputational risks.
<b>Structural</b>				
Submit to the National Assembly a draft law on a single autonomous anti-corruption entity in line with international standards, which combines all detection and investigative functions	Ministry of Justice (MoJ)	September 2019	Not observed Dates proposed to be reset to December 2019	Combat against corruption

Adopt a legislation to require the establishment of a registry of beneficial ownership information, which is adequately resourced and staffed, and can conduct verification, first beginning with companies in the extractive industry, as identified in the EITI 2016 Standard	MoJ	June 2019	Met	Combat against corruption
Prepare an annual action plan to improve the business environment to address core issues identified by the 2019 Doing Business	MoE	February 2020		Improve business climate
Conduct an efficiency review of the existing government SME support programs and consolidate support mechanisms, tools and programs	MoE with support from the CBA	April 2020		Improve effectiveness of the SME state support activities and enhance access to finance
Develop Armenia's employment strategy for 2019–23	Ministry of Labor and Social Affairs (MoL)	December 2019		Reduce unemployment and enhance inclusiveness of vulnerable groups in the labor market
Submit to the National Assembly a draft law on Higher Education and Science which sets the legal ground for (i) reforming the tertiary education management system; (ii) upgrading licensing and accreditation requirements, state financing principles, supervision mechanisms for quality of education services.	Ministry of Education and Science	December 2019	The SB was spelled out to clarify the deliverables	Improve growth inclusiveness
Develop a comprehensive education reform strategy	Ministry of Education and Science	June 2020		Enhance equitable access to education and improve physical conditions.

## Attachment II. Technical Memorandum of Understanding (TMU)

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 Standby Arrangement as per the Letter of Intent and Memorandum of Economic and Financial Policies (LOI/MEFP) dated April 26, 2019.
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 483.75 dram per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

### QUANTITATIVE TARGETS

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

The program sets the following PCs:

- Floor on the net official international reserves (NIR) of the Central Bank of Armenia (CBA);
- Floor on the program fiscal balance;
- Ceiling on domestic budgetary lending; and,
- Ceiling on the stock of external public debt arrears (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). 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. Consultation with IMF Board would be triggered for end December 2019 test date if inflation falls below 1 percent or is above 4 percent. The consultation with the Board will be on the reasons for the deviation and the proposed policy response before further purchases could be requested under the SBA. Specifically, the consultation will explain (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for deviations from the specified band, taking into account compensating factors; and (iii) on proposed remedial actions, as deemed necessary.

**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.

**7. External public debt arrears** are defined as external debt obligations of the government that have not been paid when due in accordance with the relevant contractual terms (taking into account any contractual grace periods). This PC excludes arrears on external financial obligations of

the government subject to rescheduling.<sup>1</sup> This PC is to be monitored continuously by the authorities and any occurrence of new external arrears should be immediately reported to the Fund. 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);<sup>2</sup> (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 476.46 drams per one US dollar will be used for foreign currency-denominated transactions included in the 2020 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 2020 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.

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<sup>1</sup> 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).

<sup>2</sup> 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. 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. **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, but excludes the Eurobond issuance and any similar refinancing instruments. 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.

**15. Ceiling on government guaranteed external debt.** In addition to the indicative floor on average concessionality, a separate, cumulative ceiling (IT) of \$100 million for the program period applies to new government guarantees of the total of concessional and non-concessional external financing, excluding the Eurobond and any similar refinancing instruments. 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.

**16.** The program sets a floor on **social spending of the government**. For the purposes of the program, social spending of the government comprises the family benefit program and maternity benefits, one-time childbirth benefits, and childcare benefits for children less than two years of age in the budget.

**17.** 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  $\Delta r$  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.
- **Project support grants** are defined as grants received by the general government for public sector projects.
- **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, budget support grants or project financing grants compared to program amounts (excluding Fund purchases by the government) (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 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, budget support grants or project financing 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 \$100 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 loans received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of \$100 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.

## DATA REPORTING

18. 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 credits, deposit facility, and foreign exchange swaps (volumes, maturity, yields, exchange rates)	Daily	Within 1 day
	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	By currency and maturity	Weekly	Last working day of the week	

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	attracted and allocated by commercial banks			
	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, 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
	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	By holders, i.e., CBA, resident banks,	Monthly	Within 7 days of

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	bond financing	resident nonbanks, and nonresidents		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
	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	State budget	Monthly	Within 30 days of



Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	government			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.
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	Monthly	Within 45 days of

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		outstanding tax credits for all types of tax revenues, in both net and gross terms		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)
	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	Quarterly	Within 30 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		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		
	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 December 28, 2018 in U.S. dollars per currency rates)

		USD	AMD
<b>AMD</b>	Armenian Dram	0.002	1.00
<b>XDR</b>	SDR	1.387	670.79
<b>USD</b>	U.S. Dollar	1.000	483.75
<b>CHF</b>	Swiss Franc	1.015	491.12
<b>GBP</b>	Pound Sterling	1.264	611.61
<b>JPY</b>	Japanese Yen	0.009	4.38
<b>EUR</b>	EURO	1.144	553.65
<b>RUB</b>	Russian Ruble	0.014	6.97

**Table 2. Armenia: KfW, AsDB, and IBRD SME Loan Disbursements in 2019–20<sup>1</sup>**  
(In millions of U.S. dollars)

Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Act.	Proj.	Prog.	Prog.	Prog.	Proj.	Proj.
203.3	10.5	26.6	52.7	117.9	20.5	48.4

1/ Cumulative from end of the previous year.

**Table 3. Armenia: External Disbursements to the Public Sector in 2019–20<sup>1/</sup>**  
(In millions of U.S. dollars)

	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	
	Proj.	Prog.	Prog.	Prog.	Proj.	Proj.	Proj.	Proj.	
Project financing loans		21	46	126	205	63	164	260	361
Project financing grants		2	4	33	62	20	34	46	58
Budget support loans		0	0	0	148	0	0	0	0
Budget support grants		9	9	9	18	0	0	0	16
of which: EU MFA		9	9	9	18	0	0	0	16

1/Cumulative during the same year.

**Statement by Mr. Doornbosch, Executive Director  
and Ms. Harutyunyan, Advisor on the Republic of Armenia  
December 20, 2019**

On behalf of the Armenian authorities, we would like to thank staff for their constructive and in-depth policy discussions in Yerevan in the scope of the first review of the program. **The authorities have made a strong start with the three-year Fund-supported economic program under the precautionary SBA arrangement.** Strong macroeconomic performance has been maintained, with considerable progress made in many policy areas including revenue mobilization, financial sector stability, and governance.

**The authorities reaffirm their strong ownership of the economic program** and remain committed to pursuing their comprehensive reform agenda to promote an export-led competitive and inclusive economy. The strategic priorities remain focused on maintaining fiscal sustainability, strengthening financial sector resilience, developing human capital, fighting corruption, enhancing governance and improving infrastructure. **The authorities agree with the thrust of staff’s appraisal and recommendations.**

**Program Performance: Request for Completion of the First Review**

**Armenia’s program performance remains broadly on track. All end-June 2019 quantitative performance criteria (QPCs) and structural benchmarks (SBs) were met,** some by a large margin. **Most importantly,** the tax reform package and the draft public-private partnership (PPP) law were adopted by the National Assembly (NA). Furthermore, the 2020–2024 Tax Administration Strategy was developed, the draft law on establishing a market evaluation procedure for real estate taxation was approved by the NA, the legislation requiring the establishment of a registry of beneficial ownership was adopted by the NA, a time-bound action plan and a communication strategy was prepared to reform the FX reserve requirement regime, and the macro-prudential toolkit had been further strengthened. **All indicative targets (ITs) were observed** except the IT on social spending was missed by a very small margin.

Progress has been made in preparing a draft capital market development program. The draft 2019-2023 comprehensive anti-corruption strategy has been approved by the government on October 3, 2019. That said, the authorities need more time for technical consultations both internally and with the IMF, and request to reset the end-September 2019 SBs on capital market development program and on a single autonomous anti-corruption entity to December 2019 and March 2020, respectively. Also, on the back of lower than expected demand factors and improved social targeting, the authorities are requesting to adjust the end-December IT on social spending.

Against this background, and with strong determination to push forward the reforms and policies under the program, **the Armenian authorities request for the completion of the first review of the SBA.** They **continue to treat the arrangement as precautionary** due to the country’s continued access to external financing and adequate foreign exchange reserves. The authorities reiterate their strong commitment to the economic policies, quantitative targets and structural benchmarks set under the program and stand ready to further adjust these policies in accordance with the program objectives.

## Macroeconomic Developments and Outlook

**Macroeconomic performance remains strong supported by sound economic and financial policies.** After stronger-than-expected economic growth in the first half of 2019 (7.1 percent), Armenia's economy maintained its growth momentum in the second half, posting 7.9 percent growth in 2019 Q3, driven by manufacturing and services sectors, and high consumption growth. Inflation, albeit remaining low, rebounded moderately to 1.0 percent in November 2019, after falling to 0.5 percent in end-September. In response, the Central Bank of Armenia (CBA) cut its policy rate by 25 basis points to 5.5 percent in September, its second reduction this year. On December 6, 2019, the CBA Board decided to leave the policy rate unchanged, at 5.5 percent.

**The financial system remains well-capitalized and liquid;** profitability has somewhat increased, and financial soundness indicators, including dollarization, have continued to improve. Credit growth remained strong at 16.5 percent in end-October, and NPLs remained low at 5.2 percent. **International reserves continued to increase,** remaining adequate. The current account deficit is narrowing, after a sharp increase in 2018, on the back of decelerating import growth rates and higher exports.

The fiscal deficit is expected to be around 1.5 percent of GDP, below the 2019 budget target of 2.2 percent of GDP. This reflects the overperformance of tax revenues, supported by **the upgraded fiscal rules and strong tax administration efforts,** and lower than budgeted spending due to some delays in the execution of capital expenditures. To this end, the central government debt is expected to fall to around 50 percent in 2019. In the light of these developments, the authorities successfully placed a \$500 million 10-year Eurobond in September with oversubscribed issuance.

Against this background, **international credit rating agencies upgraded Armenia's sovereign rating in 2019.** In August, Moody's Investors Service upgraded the country's credit rating to 'Ba3' from 'B1' with a stable outlook. Later on, in November, Fitch Ratings upgraded Armenia's sovereign rating to 'BB-' from 'B+' again with a stable outlook. In their report, Fitch emphasized the government's commitment towards stable macroeconomic policies and the implementation of structural reforms, including the fight against corruption and monopolies.

**Looking ahead,** economic growth is expected at somewhat above 6.5 percent in 2019. While the robust growth is likely to continue in the near-term, under the scope of the IMF program, the authorities assume a more conservative scenario for 2020 at around 4.5–5.0 percent. That said, the authorities believe that their comprehensive reform agenda will deliver substantial economic benefits, raising the medium-term growth to 5.0–5.5 percent. Inflation is expected to run below the 4.0 percent target in 2019 and gradually converge towards the target over the medium-term. The external position is expected to strengthen in 2019, with the current account deficit gradually converging to its 6.0 percent of GDP norm over the medium-term.

## Fiscal Policy and Reforms

**The authorities remain strongly committed to preserving medium-term debt sustainability while protecting investment and social spending.** On December 6, **the Parliament adopted the 2020 state budget** targeting a fiscal deficit of 2.3 percent of GDP. The 2020 budget has been designed with the fiscal objective of bringing down public debt below 50 percent of GDP by 2023. To this end, the authorities are determined to further enhance their tax administration and compliance efforts and take measures to address the bottlenecks in the implementation of capital spending. The 2020 budget puts particular emphasis on protecting the social spending

envelope to promote sustainable and inclusive growth. **The authorities fully recognize the importance of safeguarding the credibility of fiscal rules** and are determined to take actions to further strengthen the budgetary process and address shortcomings.

**Structural fiscal reforms have been advancing.** In June 2019, the Parliament adopted the planned growth-friendly tax reform package, which will become effective in January 2020. The adopted tax package introduces a number of measures to promote export-oriented inclusive growth, including flattening of the personal income tax (PIT) structure, reducing the PIT and corporate income tax (CIT) rates, and simplifying the special tax regimes. Meanwhile, the package includes a range of measures to fully offset the potential revenue losses by introducing new taxes on tobacco and gambling, indexing excise tax rates to inflation, removing selected tax exemptions, and increasing gambling and financial sector license fees. The authorities are determined to take additional compensation measures in case of any revenue shortfalls.

**The authorities have made notable progress on property taxation reform.** In November 2019, the Parliament approved the law on Establishing Market Evaluation Procedure for Real Estate Taxation. The authorities remain committed to starting tax collections under the new regime in 2021 and are working on developing mechanisms to mitigate the impact on the low-income population and enhancing the electronic tax management system.

**Notable progress has been made in enhancing tax administration and structural expenditure reforms.** On December 12, 2019, the cabinet approved the comprehensive tax administration strategy for 2020–2024 aimed at enhancing taxpayer compliance and combating tax evasion. The strategy includes an action plan to implement the key recommendations from the recent IMF TA, including developing a compliance strategy and establishing procedures for cleaning and updating the taxpayer register. The authorities are currently finalizing their tax reform strategy for 2019-2023 aimed at removing tax arbitrage opportunities and rationalizing tax expenditures in line with the program commitments. To this end, the authorities are looking forward to the upcoming IMF TA on microdata-based tax gap analysis to help design an action plan to improve tax compliance and raise tax-to GDP ratio in the medium term. They remain committed to the introduction of an individual tax return system by end-2021 including an action plan on the required steps.

**On the expenditure reforms,** in June 2019 the Parliament adopted the PPP law, in line with best international practice. The authorities are now working on drafting the secondary legislation and creating a database for all PPPs. They are determined to improve the implementation of foreign-financed capital spending projects and to develop a sound public investment management (PIM) process. The recent IMF follow-up TA on PIMA, which took place in early December, was well-tailored to this objective.

### **Monetary Policy and Financial Stability**

**The CBA will continue to balance the dual mandate of price and financial stability.** The CBA considers the current monetary policy stance appropriate to stabilize the inflation around the 4.0 percent target over the medium-term. At the same time, the CBA closely monitors the macroeconomic developments and stands ready to adjust its policy actions to ensure price and financial stability, in line with the IT framework and MPCC clause under the program. Going forward, the CBA will continue to adhere to the **two-way exchange rate flexibility under the IT framework** while enhancing international reserves buffers.

**The CBA remains committed to further strengthening the IT framework.** The monetary authorities continue to explore policy actions to enhance the liquidity management system and improve the monetary policy transmission mechanism, in coordination with the MOF. In this context, **capital market development remains a key priority** and a draft capital market development program has been prepared and shared with staff. That said, more time is needed to comprehensively review all necessary elements of the program and consolidate the views of responsible entities. To this end, the authorities are requesting to postpone the SB on capital market development to March 2020.

**Significant progress has been made in strengthening financial resilience in line with FSAP recommendations.** The CBA has prepared a time-bound action plan and communication strategy to **reform the FX reserve requirement regime**. The conversion of 6 percent of FX reserve requirements has already been completed and the remaining re-denomination is expected to be completed by mid-2024. **Liquidity buffers have been further strengthened.** These include introducing regulations on the recovery plans for banks, introducing capital conservation and countercyclical capital buffers, and a surcharge for domestic systemically-important banks. Moreover, the draft regulations on introducing LCR and NSFR for all currencies are being finalized and expected to come in force by March 2020. Going forward, the monetary authorities are determined to further strengthen their macro-prudential toolkit, including working towards adopting a stressed LTV ratio.

### **Structural Reforms**

**The authorities continue to put structural reforms high on their agenda to promote sustainable and inclusive growth.** The 2019-2023 government program and the National Plan, expected to be put in place by end-2019, are well-tailored to this objective.

**Efforts to tackle the weaknesses in the business environment are ongoing.** The authorities are working diligently on creating an Investment Support Office within the Ministry of Economy (MOE) to facilitate investments in an efficient and streamlined manner. The efficiency review of the existing SME support programs and the development of a framework for strengthening SME financial reporting and auditing are underway. Also, the authorities are preparing an action plan to address the core issues identified in the 2019 WB Doing Business Report.

**The authorities adhere to pursuing their social and human capital development reforms.** The focus is on the labor market, education, health, and social protection. To promote female labor force participation and to overcome gender discrimination in various socio-economic fields, the gender strategy for 2019–23 has been adopted, while the employment strategy is expected to be finalized and approved by the government by end-2019. The reforms in the education system focus on operationalizing the tertiary education management system and establishing the organizational and financial autonomy of higher education institutions. To this end, a draft law on Higher Education and Science has been prepared which is expected to be submitted to the NA by end-2019. On social policies, the government remains strongly determined to further strengthen existing social and family benefit schemes in cooperation with the WB and is working on developing a concept note to introduce a universal health coverage financing system.

**Fighting corruption and enhancing governance remain top priorities.** Notable progress has been made in strengthening the anti-corruption framework. Most importantly, in June 2019, the NA adopted a law to establish a registry of beneficial ownership information, prioritizing the extractive sector. The implementation of the CPC



law on asset declarations is underway, and the revision of the Criminal Code is in the process. All five members of the CPC were appointed in November, and the seamless continuity of the currently existing asset declaration system had been ensured in the course of the year. Also, in October 2019, the cabinet approved the comprehensive anti-corruption strategy for 2019–23. However, since the strategy is set to guide the overall institutional anti-corruption framework, including the role of a single autonomous anti-corruption body, the draft law on a single autonomous anti-corruption entity will be submitted to the NA with a slight delay by end-December 2019.

Against this background, Armenia's composite **WB governance indicator improved substantially in 2018** to 46% ranking, from 42.2% in 2017, reflecting a marked improvement in the control of corruption, political stability, government effectiveness, and voice and accountability sub-indicators.

## **Conclusion**

**Armenia's economic program is off to a good start.** Macroeconomic performance remains strong, monetary and financial conditions are stable. All PCs and SBs for end-June 2019 have been met, and most policy objectives for 2019 are broadly on track. Notable progress has been made in many areas and the new government remains determined to push forward its comprehensive reform agenda.

Against this background, **the Armenian authorities request the completion of the first review of the program and intend to treat the arrangement as precautionary.** The authorities remain strongly committed to the full and timely implementation of the policies set under the program and stand ready to consult with the Fund in advance of any revisions. They acknowledge the crucial role that the Fund has played in the country through its continuous support in addressing macro-critical issues and enhancing capacity building. The authorities restate their strong determination to maintain the well-established cooperation and close policy dialogue with the IMF. They look forward to further broadening the support from the Fund to achieve their economic objectives.