INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/366

REPUBLIC OF ARMENIA

REQUEST FOR A STAND-BY ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE ALTERNATE EXECUTIVE DIRECTOR

December 2022

In the context of the Staff Report for the Request for a 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 12, 2022 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 12, 2022, following discussions that ended on October 6, 2022 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 7, 2022.
- A **Statement by the Alternate Executive Director** for 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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PRESS RELEASE

PR22/429

IMF Executive Board Approves New Stand-By Arrangement for Armenia

FOR IMMEDIATE RELEASE

- The Executive Board of the International Monetary Fund (IMF) approved SDR 128.8 million (about US$171.1 million) 36-Month Stand-By Arrangement (SBA) for Armenia to help maintain macroeconomic stability, provide insurance against downside risks, and support structural reform agenda.
- The Armenian authorities have indicated that they will treat the arrangement as precautionary. The new SBA will serve as insurance in case shocks generate balance of payments needs.
- The arrangement is based on the authorities' homegrown economic program that aims to achieve investment-driven, knowledge-based, and export-led growth, while preserving macroeconomic, fiscal, and financial stability and reducing poverty.

Washington, DC – December 12, 2022: The Executive Board of the International Monetary Fund (IMF) today approved a 36-month Stand-By Arrangement (SBA) for Armenia amounting to SDR 128.80 million (about US$171.1 million or about 100 percent of Armenia's quota in the IMF).

Upon the Board's approval, an amount equivalent to SDR 18.40 million (about US$24.4 million) becomes immediately available to Armenia, and the remaining amount will be made available, subject to six semi-annual reviews.

The Armenian authorities have indicated that they will treat the arrangement as precautionary. The new SBA will serve as insurance in case shocks generate balance of payments needs and will support the authorities' reform efforts.

Following the Executive Board discussion, Mr. Bo Li, Deputy Managing Director and Acting Chairman, issued the following statement:

"The Armenian economy has maintained a strong growth momentum, supported by robust consumption and a surge in inflows of income, capital, and labor. While growth is projected to be robust, inflation and the current account deficit have also increased, and the outlook is subject to significant uncertainty due to spillovers from Russia's war in Ukraine, global financial tightening, and a slowdown in major trading partners. Against this background, the authorities' program—supported by a Stand-by Arrangement, which the authorities intend to treat as precautionary—seeks to maintain economic and financial stability and advance structural reforms to promote sustainable and inclusive growth.

The authorities' fiscal policy framework is expected to keep debt on a declining path in line with Armenia's fiscal rules. In 2023, the fiscal stance will continue to provide targeted support to the economy while further strengthening fiscal resilience. Over the medium term, fiscal space for priority social and capital spending will be supported by revenue-enhancing tax policy measures and efforts to strengthen the revenue administration, as well as to improve government spending efficiency, the public investment management process, and fiscal risk management.

The CBA's monetary policy is appropriate and proactively aiming to stem inflationary pressures. Efforts to foster capital market development will help enhance monetary policy effectiveness. The CBA's commitment to exchange rate flexibility and maintaining healthy reserve buffers will continue to serve the economy well in the event of external shocks.

The financial system is in good health. Continued monitoring of financial sector risks and enhancing of macroprudential tools will help mitigate risks associated with the rapid rises in housing prices and mortgage lending. Strengthening the supervisory and resolution frameworks will further buttress financial system resilience.

Implementation of a strong package of structural reforms guided by the 2021–26 Government Program will help foster export-led, investment-driven, and knowledge-based growth. Reforms will promote access to finance, labor force participation, and trade diversification."

Table 1. Armenia: Selected Economic and Financial Indicators, 2019–27

	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Act.	Act.	Act.	Proj.					
National income and prices									
Real GDP (percent change)	7.6	-7.2	5.7	11.0	4.5	4.5	4.5	4.5	4.5
Consumption expenditure, Contrib. to Growth	10.7	-10.5	4.0	12.2	2.5	2.4	2.2	2.0	1.9
Gross fixed capital formation, Contrib. to Growth	0.7	-0.2	1.1	2.5	2.5	2.6	2.7	2.8	3.0
Changes in inventories, Contrib. to Growth	-3.9	0.1	0.7	-2.1	0.0	0.0	0.0	0.0	0.0
Net exports of goods and services, Contrib. to	0.1	3.4	-0.2	-1.7	-0.5	-0.5	-0.4	-0.3	-0.3
Gross domestic product (in billions of drams)	6,543	6,182	6,983	8,294	9,186	10,023	10,893	11,816	12,810
Gross domestic product (in millions of USD)	13,619	12,642	13,861	18,583	20,648	22,225	23,829	25,526	27,382
Gross domestic product per capita (in USD)	4,597	4,269	4,679	6,273	6,969	7,501	8,042	8,614	9,239
CPI (period average; percent change)	1.4	1.2	7.2	8.8	7.5	5.1	4.5	4.2	4.1
CPI (end of period; percent change)	0.7	3.7	7.7	10.0	6.0	4.5	4.0	4.0	4.0
GDP deflator (percent change)	1.0	1.8	6.9	7.0	6.0	4.5	4.0	3.8	3.7
Unemployment rate (in percent)	18.3	18.2	15.3	14.8	14.7	14.6	14.5	14.4	14.3
Investment and saving	(in percent of GDP)								
Investment	17.4	19.7	20.7	22.6	23.3	23.6	23.9	24.2	24.4
National savings	10.1	15.9	17.0	17.0	17.8	18.2	18.5	18.9	19.4
Money and credit (end of period)	(percent change)								
Reserve money	8.8	18.3	17.1	6.2	4.4	11.2	10.7	5.2	6.1
Broad money	11.2	9.0	13.1	11.8	10.2	12.0	9.7	7.5	7.6
Private sector credit growth	18.5	14.3	-3.9	3.0	4.0	5.3	5.3	5.0	4.9
Central government operations	(in percent of GDP; unless otherwise indicated)								
Revenue and grants	23.9	25.2	24.1	24.6	24.7	25.0	25.3	25.5	25.9
Of which: tax revenue	22.1	22.0	22.1	22.4	22.8	23.1	23.4	23.6	23.9
Expenditure	24.9	30.6	28.7	27.0	27.7	27.5	27.3	27.0	26.9
Overall balance on a cash basis	-1.0	-5.4	-4.6	-2.5	-3.0	-2.5	-2.0	-1.5	-1.0
Public and publicly-guaranteed (PPG) debt	53.7	67.4	63.4	55.3	53.9	52.4	51.1	49.7	48.3
Central Government's PPG debt (in percent)	50.1	63.5	60.3	51.3	50.0	48.7	47.8	47.1	46.3
Share of foreign currency debt (in percent)	80.6	77.0	72.6	67.7	65.4	63.6	61.8	60.6	59.9
External sector	(in millions of USD; unless otherwise indicated)								
Exports of goods and services	5,794	3,818	5,012	7,786	8,525	9,034	9,533	10,117	10,743
Imports of goods and services	-7,603	-5,082	-6,120	-9,244	-10,080	-10,660	-11,252	-11,905	-12,579
Exports of goods and services (percent change)	17.6	-34.1	31.3	55.3	9.5	6.0	5.5	6.1	6.2
Imports of goods and services (percent change)	13.8	-33.2	20.4	51.0	9.1	5.8	5.6	5.8	5.7
Current account balance (in percent of GDP)	-7.3	-3.8	-3.7	-5.6	-5.5	-5.4	-5.4	-5.3	-5.0
FDI (net)	233	86	342	649	376	470	541	562	579
Gross international reserves	2,850	2,616	3,230	3,746	3,547	3,491	3,377	3,262	3,178
Import cover 1/	6.7	5.1	4.2	4.5	4.0	3.7	3.4	3.1	2.9
End-of-period exchange rate (dram per USD)	480	523	480	…	…	…	…	…	…
Average exchange rate (dram per USD)	480	489	504	…	…	…	…	…	…

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

REQUEST FOR A STAND-BY ARRANGEMENT

December 7, 2022

EXECUTIVE SUMMARY

Context. The economy has maintained a strong momentum, driven by robust consumption and a surge in inflows of income, capital, business, and labor. Inflation has increased markedly due to the sharp rise in food and energy prices and the booming economy, but proactive monetary policy tightening and GDP growth deceleration are projected to bring inflation down in 2023. While robust growth should continue over the medium-term, uncertainty is elevated and downside risks are significant due to the ongoing war in Ukraine and sanctions on Russia, global financial tightening, slowdown in major trading partners, and high food and energy prices. Structural challenges also remain, including high unemployment, weak business environment, and low productivity growth.

Program request and objectives. Against this, the authorities have requested a new SBA to help maintain macroeconomic, financial, and fiscal stability, provide insurance against downside risks, and support their structural reform agenda. Specific policies under the program will include:

- A fiscal path for 2023–25 consistent with the cyclical position of the economy, anchored by the fiscal rules and keeping debt moderate throughout the program period. Fiscal structural reforms will help mobilize revenue and build fiscal space for growth-enhancing spending, improve expenditure planning, and strengthen fiscal risk management.
- A proactive and data dependent monetary policy stance in view of the evolution of inflation and inflation expectations. Exchange rate policy will preserve the existing two-way flexibility of the dram, while maintaining healthy reserve buffers and limiting foreign exchange interventions to mitigating disorderly market conditions.
- Financial sector measures to stem risks associated with the rapid rises in housing prices and mortgage lending, preserve banks' capital buffers, and strengthen the regulatory and supervisory framework.
- A package of structural reforms to facilitate trade and diversification, strengthen governance, improve the business environment, foster employment, advance digitalization, and build resilience against climate risks.

Access under the new SBA. A 36-month SBA is proposed with access of 100 percent of quota (SDR 128.8 million). The authorities intend to treat the arrangement as precautionary. In the event of a shock, access to IMF financing and donors' support will help maintain a reserve cover above 100 percent of the IMF reserve adequacy metric.

Approved By:
Thanos Arvanitis (MCD) and Martin Cihak (SPR)

Discussions were held during September 26–October 6, 2022, in Yerevan. The team comprised I. Petrova (head), M. Al Taj, M. Atamanchuk, M. El Said, G. Lisi (MCD), M. Raissi (Resident Representative), L. Chumo (MCM), M. Coelho (FAD), L. O'Sullivan (SPR). A. French, J. Garrido, and H. Gupta (LEG) joined virtually. M. Aleksanyan, V. Janvelyan and L. Karapetyan (IMF Office) supported the mission. M. Scholer (OED) participated in meetings with the authorities. N. Reyes and C. Segura Santana (MCD) provided research assistance and B. Laumann and S. Zolotareva (MCD) assisted with document preparation. The mission met with Deputy Prime Minister Grigoryan, Governor of the Central Bank of Armenia Galstyan, Minister of Finance Khachatryan, Minister of Economy Kerobyan, Chairman of the State Revenue Committee Badasyan, and other senior government officials.

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APPENDIX

CONTEXT

1. **Armenia's recent three-year Stand-By-Arrangement (SBA) supported macro-fiscal and financial stability and paved the way for further reforms**. It helped mitigate the adverse effects of the COVID-19 pandemic and the war in Nagorno Karabakh (NK) conflict zone, provided financing, and supported the authorities' policy efforts. The authorities managed to strike an appropriate balance between ensuring targeted health and social spending and fiscal sustainability, strengthened the monetary policy framework, and increased financial and external sector buffers. Important fiscal structural and governance reforms were also advanced.

2. **The economy still faces many challenges.** Armenia remains prone to external shocks, with high structural unemployment and low productivity growth. Ensuring durable and inclusive long-term growth requires greater diversification, export-orientation of the economy, and enhanced social safety nets. The war in Ukraine has also raised new risks, and its medium-term effects are highly uncertain (Annex I). Double-digit growth in trade and large foreign exchange inflows from Russia in 2022 have magnified Armenia's exposure to the Russian economy and increased the risk of overheating and capital flow reversal.

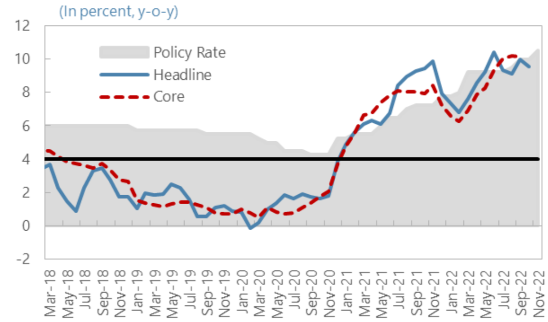
3. **The Armenian authorities have requested a new SBA that they intend to treat as precautionary.** The overarching objective of the new arrangement is to help maintain macroeconomic, financial, and fiscal stability amid the ongoing war in Ukraine, growing global economic fragmentation, and rising global financial market volatility. The authorities also seek to ensure policy continuity and advance structural reforms as outlined in the 2021–26 Government Program.

4. **The security situation remains fragile**. In September, border clashes that erupted mostly on the territory of Armenia resulted in considerable human loss and damage to houses and infrastructure. While ceasefire was agreed quickly, occasional skirmishes continue to take place. Discussions on a comprehensive peace treaty between Armenia and Azerbaijan, border delineation and demarcation, and road and railway connections are progressing slowly. Negotiations on normalization of relations between Turkey and Armenia are also ongoing.

RECENT DEVELOPMENTS

5. **The economy has maintained a strong growth momentum in 2022.** Despite global headwinds, GDP growth surprised on the upside in the first half of 2022 (11 percent y-o-y) due to strong domestic demand, boosted by capital inflows and foreign arrivals (mostly from Russia). Economic activity remained strong in July–September, and, particularly, the services sector

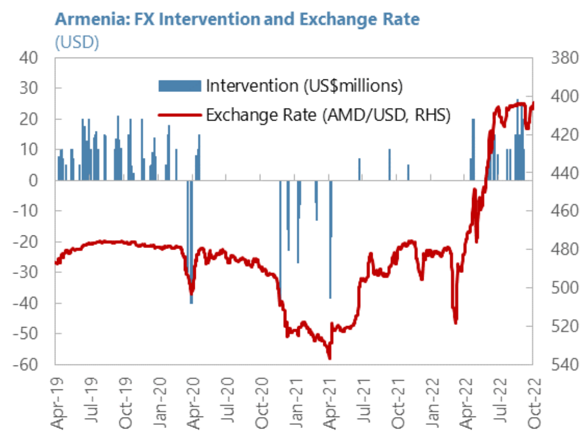
Armenia: Consumer Price Index, SA
(In percent, y-o-y)



Sources: National authorities and IMF staff calculations.

and construction have continued to gain momentum. At the same time, strong consumption in addition to higher commodity prices, increased inflationary pressures, despite significant policy rate hikes of about 225 bps in 2022, and a cumulative rise of 625 bps since December 2020. Headline inflation, at 9.5 percent (y-o-y) in October, remains above the CBA's 4-percent target and elevated core inflation suggests strong underlying price pressures due to the pickup in domestic demand.

6. Capital account inflows, including foreign direct investment, have more than offset a significant widening of the current account deficit. The 2021 external position was broadly in line with the level implied by fundamentals and desirable policies (Annex II). In 2022, imports increased rapidly by 58 percent in January–August (y-o-y, in US$ terms) due to recovering domestic demand, including demand by international visitors, higher commodity prices and strong base effects, while exports grew by less (Figure 2). A large merchandise trade deficit has been partly offset by a strong service trade surplus, while the widening current account deficit has been more than covered by FDI and private capital inflows. The dram appreciated against the US dollar by about 19 percent in January–September 2022, while the real effective exchange rate appreciated by about 12 percent. The CBA also intensified its US dollar purchases, with gross international reserves (GIR) rising to 150 percent of the ARA metric (US$3725 million) at end-September.



Sources: Central Bank of Armenia and Haver.

7. The fiscal outturn has been stronger than anticipated, with the overall surplus reaching 0.6 percent of GDP against a budgeted deficit of 2.5 percent of GDP in the first three quarters of 2022. Corporate income taxes, VAT, and export stamp duties overperformed, buoyed by strong growth and high inflation and commodity prices. An under-execution of spending (1.8 percent of GDP) is equally attributed to current spending restraint and slow progress with foreign financed capital expenditure.

8. Financial soundness indicators have improved, notwithstanding quickly rising mortgage lending. Banks' capital adequacy ratios (CAR) remain well above the current minimum requirement of 12 percent, liquidity is ample, and NPLs were low at 2.8 percent in August 2022 (Table 5, Figure 5). Since January 2022, banks have been required to maintain a capital conservation buffer (CCB) of 1.5 percent and additional 1.0 percent for systemically important institutions (SII)[1]. Albeit due to transitory factors, profitability of the banking sector has improved. Return on equity (ROE) reached 29.1 percent in August 2022 driven by non-interest income, including foreign exchange gains and lower provisioning. Mortgage lending grew by about 20 percent in January–August—following a 38-percent growth in 2021—partly due to the announcement of a gradual phase out of interest tax credits for

[1] The CCB and the buffer for SII will increase to 2.0 percent and 1.5 percent respectively in January 2023, and the CCB will increase further to 2.5 percent in January 2024.

new mortgages.[2] Growth in consumer loans, which account for one third of total loans, has been minor due to the limited demand and ample liquidity of households' balance sheets.

OUTLOOK AND RISKS

9. The growth outlook is generally positive, but highly susceptible to spillovers from regional and global economic developments. Real GDP growth is projected to reach 11 percent in 2022, supported by robust private consumption and a moderate increase in investments and despite a negative contribution from net exports. Growth is projected to decelerate to 4.5 percent in 2023, reflecting an anticipated global growth slowdown and weaker trading partners' demand, but also an assumed notable deceleration of capital inflows. Over the medium term, growth is projected to be at around 4.5 percent in line with current potential, but this is subject to high uncertainty due to the unknown long-term impact of the war in Ukraine and prospects for the recent influx of international visitors, businesses, and capital to settle permanently in Armenia. Also, stronger implementation of reforms (than assumed in the baseline) would have a positive impact on growth potential.

10. Inflation pressures are projected to gradually ease. This is due to the lagged effect of the ongoing monetary policy tightening, dram appreciation and a dissipating impact of imported food and energy inflation. After peaking at end-2022 to 10 percent y-o-y, inflation is projected to moderate to around 6 percent by end-2023, and provided that policies remain as expected under the baseline and inflation expectations remain anchored, inflation should converge to the CBA's target of 4 percent by 2025.

11. The current account deficit is projected to remain at around 5½ percent of GDP in 2023 before it converges to its norm in the medium term. Consumption deceleration is projected to sharply reduce import volume growth and—with a pickup in mining exports spurred by a revised tax regime and resumption of activity in a large mine—stabilize the deficit in 2023 despite the expected weakening in external demand and lower remittances amid slower global growth. The current account deficit is projected to converge gradually to 5 percent of GDP thereafter, given moderating growth of imports and stable growth of exports.

12. Exceptional uncertainty clouds the outlook (Annex III). Tighter global financial conditions, and a slowdown in major trading partners, including Russia, the US, and Europe, could adversely affect remittances, trade, and financial flows. This could put depreciation pressures on the dram, increase inflationary pressures, and raise public debt vulnerabilities. Rising global food and energy prices and logistical bottlenecks for Armenia's trade through Georgia could also raise inflation and have stronger adverse impact on consumption. Risks also stem from intensified regional tensions. On the upside, this year's growth momentum could carry in 2023 and the medium term, especially if the influx of international visitors and businesses to Armenia supports business creation in high productivity sectors and increases high-skilled labor, raising potential growth. New regional

[2] The announced phase-out of fiscal incentives has accelerated buyers' decision-making efforts to purchase housing to benefit from the existing mortgage interest tax credit.

cooperation and transportation links, and the implementation of the government's ambitious 2021–26 reform agenda could also result in stronger medium-term growth.

13. In the event of potential negative shocks, Armenia may need to access Fund resources. In general, the authorities' commitment to prudent policies is strong, and public and external debt remain sustainable under plausible shocks (Annex II and V). Nonetheless, an illustrative adverse scenario, including a contraction in real growth of trading partners in combination with a large increase in food prices, would have an adverse impact on the economy, result in a deterioration in the trade balance, remittances, and capital flows. Alongside a significant depreciation of the dram to absorb the shock, financial support from the Fund and other multilateral creditors may become essential (Annex IV).

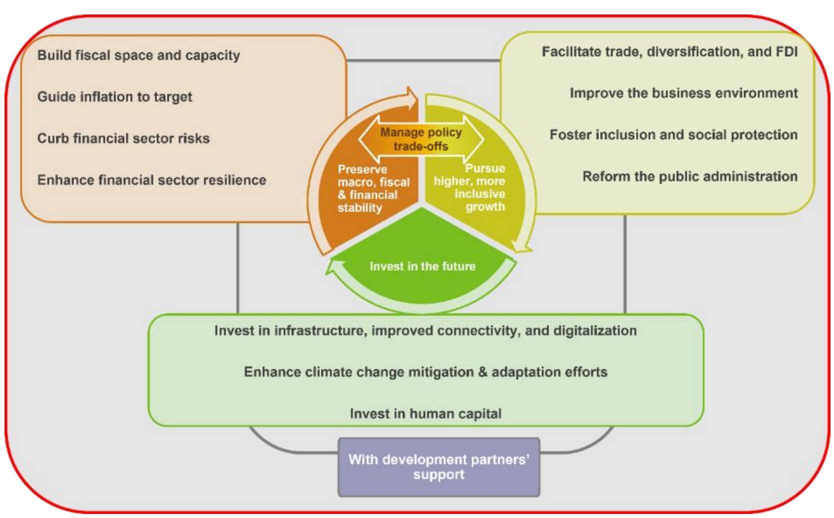
Armenia: Impact of a Plausible External Shock

	2022	2023		2024		2025	
	Baseline	Baseline	Adverse Scenario	Baseline	Adverse Scenario	Baseline	Adverse Scenario
National income and prices:							
Real GDP (percent change)	11.0	4.5	1.7	4.5	4.5	4.5	4.5
CPI (period average; percent change)	8.8	7.5	8.1	5.1	5.1	4.5	4.5
Overall balance on a cash basis	-2.5	-3.0	-3.8	-2.5	-3.0	-2.0	-2.0
Central Government's PPG debt (in percent)	51.3	50.0	58.8	48.7	51.5	47.8	49.5
Current account balance (in percent of GDP)	-5.6	-5.5	-7.7	-5.4	-5.2	-5.4	-5.2
Gross international reserves (in millions of U.S. dollars)	3,746	3,547	2,706	3,491	2,711	3,377	2,791

Sources: National authorities and Fund staff estimates and projections.

POLICY DISCUSSIONS

A new SBA would support macroeconomic stability and implementation of the authorities' ongoing reform agenda and provide a positive signal to IFIs and markets, as well as buffers should downside risks materialize. Policy discussions thus focused on the appropriate short- and medium-term policy stance and the authorities' reform commitments to create space for priority spending and foster an export-oriented, inclusive, and green growth.



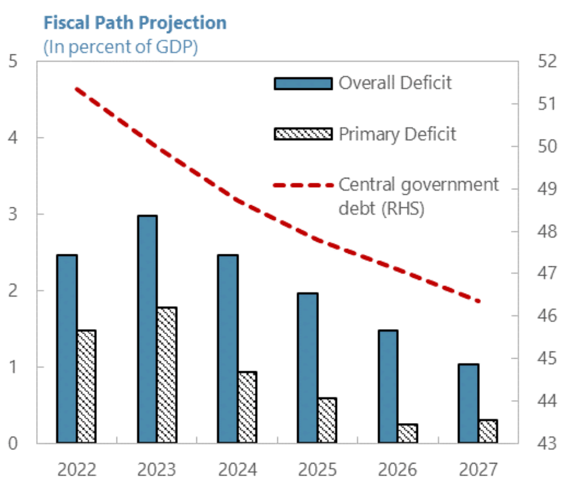
A. Building Fiscal Space and Capacity to Support Growth-Enhancing Policies

14. The headline fiscal deficit is projected to narrow to 2½ percent of GDP in 2022. Amidst robust GDP growth and high commodity prices, corporate income taxes, mining sector export stamp duties, and social contributions are expected to contribute to a revenue increase of 0.5 percent of GDP compared to 2021. Current expenditures are expected to decline by 3.2 percentage points of GDP, including due to the phasing out of COVID-19-related support. Capital spending is projected to increase by 1.6 percentage points of GDP despite under-execution of budgeted foreign-financed projects. Overall, the projected 2022 fiscal performance implies a significant deficit reduction of about 2 percentage points of GDP relative to 2021.

15. Given high uncertainty in 2023, fiscal policy needs to remain neutral and agile. The authorities' 2023 budget (**prior action**) assumes an overall deficit of 3.1 percent of GDP. This will support a large increase in capital spending (1.4 percentage points of GDP), including for priority development projects and rebuilding and protection of the southern regions, as well as for social protection (about 0.2 percentage points of GDP). With a primary deficit of 1¾ percent of GDP, the fiscal stance is projected to remain close to neutral, helping to ease inflation and bring debt close to 50 percent of GDP. If revenues continue to overperform the budgeted amount, the priority should be to build resilience further by strengthening fiscal buffers or through high-quality capital projects, while avoiding overheating of the economy. On the other hand, if adverse shocks materialize, the authorities should allow automatic stabilizers to operate fully.

Armenia: Fiscal Consolidation Path and Fiscal Rules

A fiscal consolidation of around 1 percent of GDP will bring debt below 50 percent of GDP by 2025,



Sources: National authorities and IMF staff calculations.

which is consistent with the fiscal rules.

Type of Rule	***Central Government Rules***
Fiscal deficit in T+1	• < 7.5 percent of GDP. • **if Debt in T-1 > 40 percent of GDP** Budget deficit </= capital expenditures

Current primary expenditure ceiling in T+1	• **if 50 < Debt in T-1 </= 60 percent of GDP:**
	  ○ Current primary expenditure growth </= average nominal GDP growth in previous 7 years.
	• **if Debt in T-1 > 60 percent of GDP:**
	  ○ Current expenditures </= tax revenues.
	  ○ Current primary expenditure growth </= average nominal GDP growth in previous 7 years – 0.5 pps.

Debt	• **if Debt > 60 percent of GDP:** Submit action plan to parliament to bring debt below 60 percent during next 5 years. • **if 50 percent < Debt </= 60 percent of GDP:** Present action plan in MTEF to bring debt below 50 percent during next 5 years.

Source: National authorities.

16. With growth projected to stabilize around its potential in 2024–25, a gradual fiscal consolidation will be appropriate and support the fiscal rules. The fiscal path envisages an annual deficit consolidation of about ½ percentage points of GDP in 2024–25, keeping debt on a gradual declining path in line with the fiscal rules. During the 3-year SBA, tax revenues are expected to increase by close to 1 percentage point relative to 2022, current expenditures will return to the 2019 pre-pandemic levels, while capital expenditures will increase considerably to support Armenia's large development needs.

17. The planned fiscal structural reforms would support this adjustment and the rules-based fiscal framework and create fiscal space for growth-friendly and inclusive expenditure. These include revenue-raising reforms and current spending restraint, as well as better budget costing and planning, and containing fiscal risks. Taking steps to modernize the public administration will be key to achieve long-term efficiency gains. The authorities' key reform objectives under the IMF-supported program include the following:

- ***More transparent, equitable, and efficient tax system.*** The authorities aim to increase the tax ratio to 25 percent of GDP by 2026 through growth-friendly base-broadening measures and strengthening revenue administration capacity. Armenia's budgeted tax expenditures of about 5 percent of GDP (excluding health and education) are higher than those of peer countries. Streamlining them following the publication of a detailed assessment and an action plan for their rationalization (***June 2023 SB***) could yield substantial additional tax revenue. Furthermore, limiting the fiscal cost of the mortgage interest tax credit—which benefits mainly taxpayers in the top 10 percent of the income distribution—would also improve the progressivity and efficiency of the PIT system. Other potential reforms include (i) introducing universal PIT declarations and taxing individual capital gains; (ii) leveling the tax burden across SME and general VAT/CIT regimes; (iii) introducing a financial activities tax to support adequate taxation of economic rents in the sector; (v) reforming excises on alcoholic and sugary beverages, and tobacco, and (vi) harmonizing environmental taxes into a carbon tax.

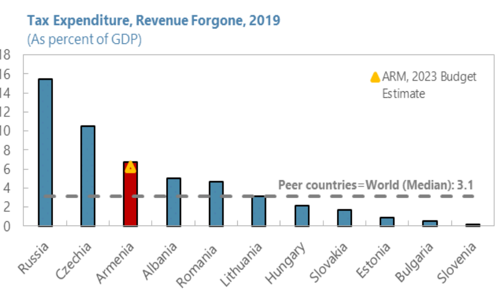
Armenia: Tax Expenditures

Tax expenditures, at more than 6 percent of GDP…

Tax Expenditure, Budget 2023	
Type of Tax Expenditure	**Share in GDP**
VAT	***4.40 percent***
Of which: Health Care and Education	*1.31 percent*
Profit tax	***0.87 percent***
Income Tax	***1.00 percent***
Of which: Mortgage Interest Tax Credit	*0.69 percent*
Total	***6.28 percent***

Source: National Authorities.

…are higher than the average of peer countries.



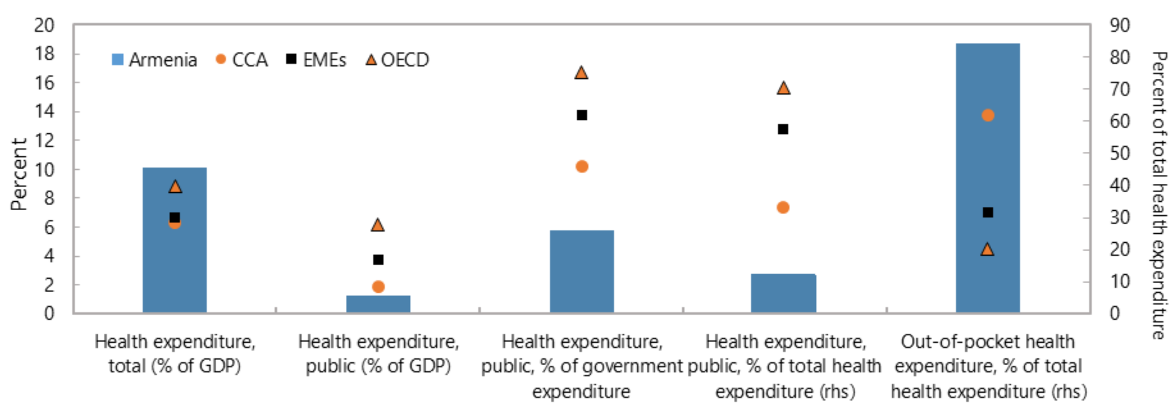
Sources: Global Expenditure Database (GTED) and Armenia Ministry of Finance.
Note: Countries use different methodologies to assess tax expenditures, which could result in inconsistencies when comparing tax expenditures across countries.

- ***Stronger revenue administration.*** The State Revenue Committee (SRC) has substantially improved its tax collection efficiency, streamlined administrative burdens, and raised tax compliance, with on-time CIT and VAT filings at 98.4 percent in 2021 and near 100 percent electronic filing rates. Amending the tax code to empower the SRC with authority to audit individuals (**March 2023 SB**) would strengthen compliance risk management in anticipation of the roll-out of universal PIT declarations. Improving the tax registry, managing arrears, addressing transfer pricing practices, and prohibiting high-value cash transactions[3] would also boost SRC's revenue raising capacity. These efforts hinge on ensuring that the SRC also has systematic access to bank information of legal entities and individual taxpayers. The authorities have committed to amending the legislation to allow exchange of bank account information for legal entities between the banks and the SRC (***March 2023 SB***).

- ***Greater spending efficiency.*** Statistical misclassifications and lack of systematic budget monitoring and execution processes have hampered effective expenditure prioritization and annual planning. Efforts need to focus on eliminating gaps in government wage data and assessing the efficiency of government programs, including SME support. Better expenditure planning would also help accommodate long-term spending pressures and social assistance needs, including the expansion of the coverage of the Family Benefit Program from 50 to 75 percent of the eligible population (indicative target). At 85 percent, Armenia's out-of-pocket share of healthcare spending is one of the highest in the world, suggesting significant public healthcare gaps and a need for ambitious health spending reforms. Medium-term plans to introduce universal healthcare—a concept note expected by end-2022—need to be carefully costed and planned. Plans to increase pension benefits by 2026 at a potential cost of 0.8–1.3 percent of GDP also need to be gradually phased in, while incentivizing later retirement.

Armenia: Health Expenditure Metrics
(Latest Value Available)

Despite overall high healthcare costs in Armenia, public contribution levels remain below peers.



Sources: IMF FAD Expenditure Assessment Tool (EAT), World Bank, World Health Organization.

[3] As of July 1, 2022, all business transactions exceeding 300,000 AMD (US$ 700) and transactions between individuals exceeding 500,000 AMD (US$ 1,100) have to be made electronically.

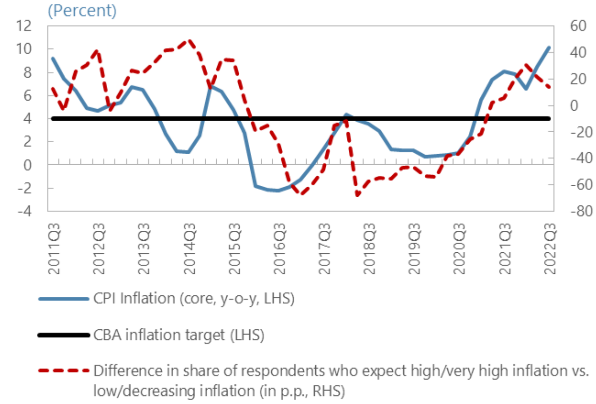
- ***Better public financial management.*** Despite plans to increase capital spending, actual project execution remains weak. Raising capital spending significantly above 3 percent of GDP would require addressing the institutional bottlenecks that have prevented the recently established PIM/PPP process to become fully operational. To this end, the authorities will develop an action plan to strengthen the PIM institutional framework (***June 2023 SB***). Improvements in MOF's fiscal risk analysis and reporting—related to climate change, on-lending, and PPPs— within a recently reinvigorated fiscal risks department have bolstered fiscal risk management. Further reforms need to focus on clarifying SOEs' mandate, reporting, transparency, and viability requirements, and adopting a government decree to clarify these requirements for the Armenian National Interest Fund (ANIF) (***March 2023 SB***). Priority also needs to be given to instituting a comprehensive monitoring, approval, and control framework of local government finances. Developing a concept note for such a framework will be a first step (***September 2023 SB***).

18. The new program will continue to support the improvement of government financial statistics. The publication of a public sector balance sheet by 2024 will leverage previous technical assistance on the sectorization of public enterprises. Efforts to strengthen cooperation across institutions would help improve fiscal data compilation and harmonization. The reclassification of Nagorno-Karabakh support as grants above the line would align fiscal statistics with the *Government Finance Statistics Manual 2014* and increase public transparency about central government expenditures, borrowing needs, and fiscal risks.

B. Ensuring Price Stability and Financial Sector Resilience

19. The current monetary policy stance is consistent with steering inflation back to target, while the exchange rate continues to be a key shock absorber. With rising inflation and inflation expectations, the CBA has continued its tightening cycle, raising the policy rate by 50 bps to 10.5 percent in November. The monetary policy stance is consistent with bringing inflation to single digits in 2023 and back to the CBA target of 4 percent by 2025, and further policy changes should remain data dependent on the evolution of inflation and inflation expectations. While maintaining two-way exchange rate flexibility, the CBA's intervention policy continues to be guided by the need to counter disorderly market conditions and to build up reserves to preserve a strong NIR position.

Armenia: Inflation and Inflation Expectations
(Percent)

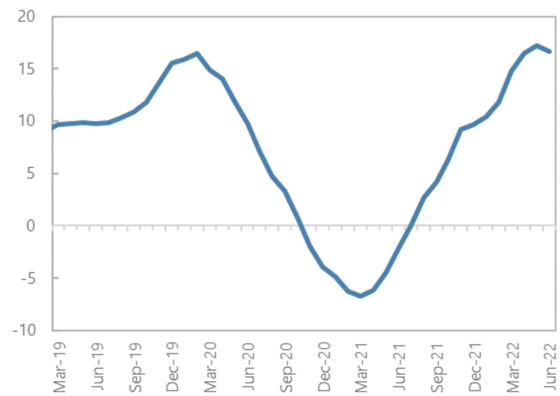


Sources: National authorities and IMF staff estimates.
Note: CBA 4% inflation target added for reference.

20. The CBA is strengthening its monetary policy framework. Ongoing implementation of the financial market development action plan and enhancements to the CBA's communication toolkit, surveys and data collection will help improve the effectiveness of monetary policy transmission. The CBA is also aiming to transition to a risk-based approach to monetary policy, focusing on a scenario-based analysis for policy decision making.[4] This approach is well suited for the current highly uncertain economic environment; it also underscores the need to preserve an operationally independent and highly professional CBA Board. To complement these initiatives, better information coordination between the CBA and the MOF would help strengthen liquidity management and forecasting.

21. The rapid rises in house prices and mortgage lending should be carefully monitored. If not comprehensively addressed, they could increase banks' vulnerability to real estate price corrections, interest rate fluctuations, and other shocks. The authorities have introduced LTV limits for new mortgages (of 90 percent for AMD loans and 70 percent for FX loans), prepared draft legislation to ban mortgage lending in foreign currency, and set the countercyclical capital buffer at 1.0 percent effective May 2023 to improve the resilience of the financial system.[5] The risks from mortgage lending can be further mitigated through enhanced supervisory monitoring, and additional macroprudential tools.[6] Studies show that debt-service-to-income (DSTI) limits are a good complement to LTV ratios by ensuring the affordability of mortgage payments including during periods of severe income and interest rate shocks.[7] The use of multiple borrower-based measures should be considered to help improve the resilience of households' and banks' balance sheets and the risk profile of mortgage portfolios.[8] Introducing DSTI and debt-to-income (DTI) caps would require developing regulations to guide banks on how to account for borrowers' income from informal sources, including remittances.

Armenia: Average Prices of Apartments in Yerevan
(In percent change, y-o-y)



Sources: ARMSTAT and IMF staff calculations.

22. Improvements in CBA's regulatory and supervisory framework aim to bolster the resilience of the financial system. These include:

- ***Preserving capital buffers.*** The CBA plans to increase the capital conservation buffer (CCB) from 1.5 to 2.0 percent and the buffer for systemically important banks (SRB) from 1.0 to 1.5 percent in

[4] Archer D., Galstyan M., Laxton D, FPAS Mark II : Avoiding Dark Corners and Eliminating the Folly in Baselines and Local Approximations, Working Paper, Central Bank of Armenia, 2022.

[5] Banks may provide loans that do not meet the LTV requirements of up to 10 percent for AMD loans and 5 percent for FX loans.

[6] Additional measures could include sectoral capital requirements, Pillar 2 capital for concentration risk, higher risk weights for certain mortgages, loan-to-income (LTI) limits, etc.

[7] Dietsch M., and Welter_Nicol, Do LTV and DSTI caps make banks more resilient?, Banque de France, 2014.

[8] Jurca, P., et al, The Effectiveness of Borrower-Based Macroprudential Measures: A Quantitative Analysis for Slovakia, IMF Working Paper, 2020. DSTI and DTI caps reduce the probability of default (PDs), while the cap on LTV helps lower the Loss Given Default (LGD).

January 2023. This will compensate—partially for non-systemic banks—for the planned adjustment of minimum capital requirements from 12 to 11 percent. Maintaining the current higher risk weights (of 150–200 percent) for FX exposures and restrictions on dividend and other discretionary payments for banks that are unable to maintain CCB and SRB at the targeted levels would ensure that they build capital to cushion against unexpected losses. Furthermore, in the face of high uncertainty, banks have increased their government security holdings to reduce balance sheet risk and capital requirements.[9] While the credit risk from such holdings is low, the interest rate and market price risk is significant, and banks should be required to hold additional capital buffers where this risk is material.

- ***Further strengthening the regulatory and supervisory framework.*** The authorities are committed to developing a formal road map for the introduction of Pillar 2 capital buffers (**June 2023 SB**). Effective implementation of Pillar 2 capital buffers will help strengthen risk-based bank supervision and incentivize banks to improve their risk management capacity. Tightening the enforcement of large exposure and internal borrower limits is also needed to ensure banks' consistent compliance.

- ***Enhancing bank resolution***. The CBA has greatly increased its capacity to assess banks' business models and recovery plans. An effective resolution framework aligned with the Financial Stability Board's Key Attributes for Effective Resolution Regimes for Financial Institutions (**November 2023 SB** on the submission of draft law to parliament) would ensure an orderly resolution of weak banks without exposing taxpayers to loss or impacting availability of critical financial services. It will also provide the basis for cooperation, collaboration and information sharing with other domestic and foreign authorities before and during resolution. To this end, a review of the Memorandum of Understanding (MOUs) with home supervisors of foreign subsidiaries in Armenia would facilitate information sharing on resolution strategies for cross-border banking groups. Furthermore, steadfast implementation of CBA's exit strategy from involvement in non-core activities, including shareholding of a regulated entity, would mitigate moral hazard and alleviate potential concerns about CBA's effective supervision of the financial system.

23. The development of local capital markets will help increase the participation of private investors in the economy. To this end, the CBA will facilitate the introduction of an over-the-counter commercial trading platform for the overnight repo market (**March 2023 SB**). It is also undertaking a major review of the payment system to align the operation and oversight of the financial market infrastructure (FMI) in Armenia with the IOSCO Principles. This will ensure a safe, efficient, and resilient FMI, which is essential for maintaining financial stability.

C. Strengthening Growth Prospects

24. The new program will support the authorities' objective to pursue export-led, investment-driven, and knowledge-based growth. Specific structural reforms will be guided by

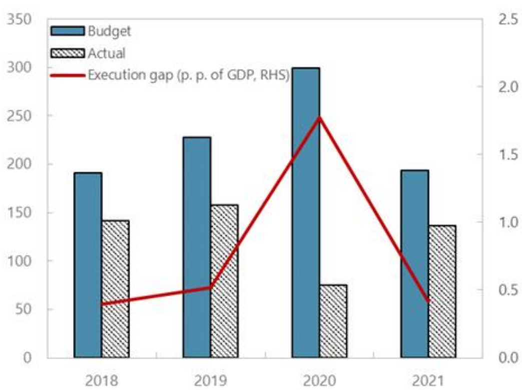
[9] Government securities are subject to zero risk weights.

the 2021–26 Government Program. In particular, expanding the existing infrastructure system is critical to support exports, attract foreign investments, and achieve more resilient long-term growth.[10] However, infrastructure development in Armenia remains severely constrained by low execution rates of foreign-financed projects. With a view to harness productivity-enhancing foreign investment, the authorities will conduct a review to identify and address bottlenecks preventing the completion of foreign-funded infrastructure projects (**June 2023 SB**). Continued efforts to ease customs procedures and reduce processing times, especially by integrating all public entities in the government's electronic customs system, could also contribute to increased trade volumes.

Armenia: Improving Infrastructure and the Investment Environment

Low execution of foreign-financed investment projects slows down critical infrastructure development.

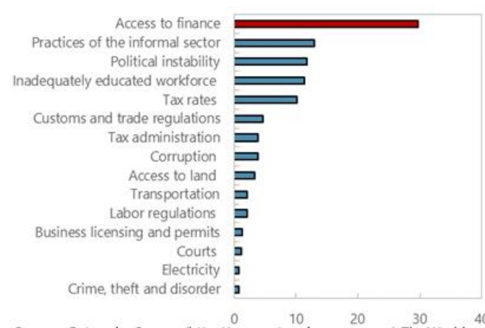
Budget Execution of Foreign-Financed Projects
(In millions of US dollars)



Sources: National Authorities and IMF staff calculations.

Access to finance is a key obstacle for private investment.

Main Business Environment Constraints
(In percent of firms choosing this factor as biggest obstacle)



Sources: Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank, Armenia (2020).
Note: the use of these indicators should be considered carefully, as they are derived from perception-base data.

25. Strengthening access to finance will be a key priority under the program. According to the 2020 World Bank Enterprise Survey, Armenian business executives identified access to finance as the main business environment constraint. Improving firms' access to finance would help stimulate private investments, including FDI. Alongside steps to develop capital markets and strengthen banks' risk management capacities, a robust insolvency regime will also help foster firms' access to finance (Annex VI). The completion of a review of the existing bankruptcy legislation in the first half of 2023 would pave the way for amendments to the insolvency framework (**September 2023 SB**).

26. Deep reforms are needed to unlock the potential of Armenia's agricultural sector, which has suffered from low growth, declining productivity, and vulnerability to extreme weather events (Annex VII). Extending the existing agricultural insurance scheme to cover additional risks, crops, and regions (**September 2023 SB**) would help build resilience against climate change. Other reforms envisaged in the government program, including an update of land registration systems,

[10] International Monetary Fund, "Republic of Armenia: Selected Issues". IMF Country Report No. 21/274, December 2021.

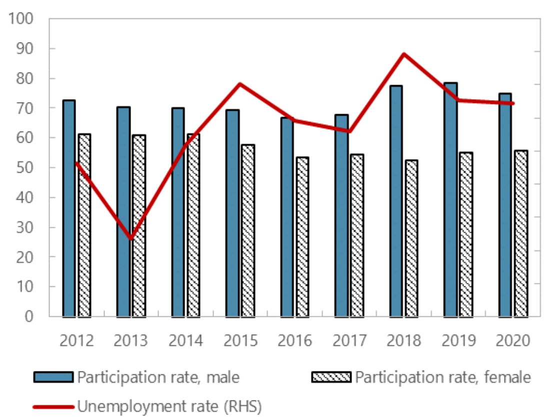
land market development, and improvement of agricultural sector statistics (e.g., by using digitized registries of agricultural assets) would also boost agriculture productivity and help address informality in the sector. Revenue enforcement efforts and well-designed tax reforms can also bring farmers into the formal economy. Better water management, especially through gradual modernization of distribution systems, would help increase efficiency of irrigation and improve the resilience of crops to increasing temperatures. Finally, developing a comprehensive climate mitigation and adaptation strategy could help Armenia achieve its international commitments and targets. It could also increase the agriculture sector's resilience, including through improvement of monitoring and forecast capacity and farmers' access to suitable agronomic technologies (e.g., by supporting the adoption of climate-tolerant seeds).

Armenia: Improving Labor Force Participation and Access to Public Services

More targeted ALMPs could reduce the large labor market gender gap.

Labor Market Trends, 2012–20

(Percentage points)

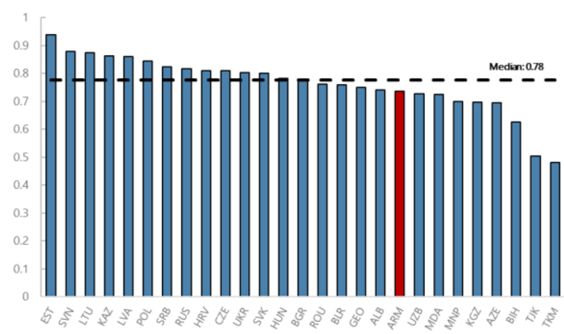


Sources: ARMSTAT and IMF staff calculations.

Digitalization could foster public administration reforms and access to more efficient public services.

2022 E-Government Development Index

(Index, 1=high)



Sources: United Nations Department of Economic and Social Affairs.
Note: The E-Government Development Index combines both official data and survey responses to measure the scope and quality of online services offered by the government; the level of development of telecommunication infrastructures used to access online public services; and the human capital of the population. Results should be considered carefully, as they are derived from perceptions-based data.

27. Progress is under way to address labor market frictions. Armenia's labor market is characterized by high and persistent unemployment, widespread informality, and large disparities in earnings and participation between male and female workers. A new employment strategy (**June 2023 SB**) should aim to encourage greater labor force participation, especially among vulnerable groups (e.g., young and female workers), including by enhancing targeting and efficiency of the existing set of active labor market policies. A new strategy for the education system, recently submitted to Parliament for approval, will inform measures to improve school-to-work transition and address skill mismatches in the labor market, including by (i) introducing a credit system to help students transfer to secondary and higher vocational education, and (ii) aligning professional and higher education with market requirements.

28. The authorities have launched an ambitious digitalization strategy. It aims at enhancing access to and efficiency of business, legal, and public services through the use of integrated digital platforms at all levels of society. Planned reforms include the development of an interoperability framework and a comprehensive strategy for electronic identity. The digitalization reforms will also spearhead public administration reforms and foster greater efficiency in public service delivery through e-government, where Armenia fares relatively high among CCA countries but lags compared to other peer countries. Increased digitalization will, however, result in new risks that will require adopting data protection standards and a mechanism for exchange of information on cybersecurity threats.

29. Ongoing efforts to strengthen AML/CFT implementation and governance would also improve the business environment and support public administration reforms. The legislation on the public beneficial ownership register (www.e-register.am) was amended to require registration of beneficial ownership of all legal entities, not only mining companies, and efforts should now focus on compliance, especially among SMEs, foreign companies, and entities owned by non-residents now registered in Armenia. By end-2023, the register is expected to include also non-governmental organizations, in line with MONEYVAL recommendations. Supporting the independence and resources of the Corruption Prevention Commission (CPC) will allow it to continue to operate as a specialized entity in charge of verification of income and asset declarations. Further legal amendments are needed to ensure that summaries of CPC's integrity checks are made publicly available. Public disclosure of asset declarations of senior leaders and those in at-risk positions would provide enhanced accountability.[11] Strengthening the detection and investigation of tax evasion would benefit from better use of financial intelligence, including more frequent dissemination of suspicious transactions and intelligence to the SRC by the FMC. Procuring and completing the planned ex-post audit of the authorities' COVID-19 on-lending business support scheme by end-2023 would demonstrate their commitment to transparency in the use and effectiveness of public money.

THE NEW STAND-BY ARRANGEMENT

30. Length and Access. A three-year Stand-by arrangement with semi-annual reviews to monitor progress under the program would fit Armenia's potential balance of payments needs and repayment capacity. The proposed length of the arrangement would allow the authorities to complete important structural reforms. The authorities intend to treat the SBA as precautionary, which is appropriate, given the availability of financing and the broadly adequate reserves under the baseline. The SBA would help catalyze support from other IFIs and provide insurance against potential external financing needs in the event of adverse shocks. Access is proposed to be set at 100 percent of quota (SDR 128.8 million) and be phased equally over the duration of the arrangement (Table 6). Under the adverse scenario described earlier (¶13), access to Fund financing,

[11] For further details on progress with the implementation of Armenia's anti-corruption strategy and its action plan, see the authorities' anti-corruption strategy report and the report on judicial and legal reforms.

together with additional financing provided by other development partners, will allow to maintain a reserve cover of at least 100 percent of ARA metric.

31. Monitoring progress. The program will be monitored through a monetary policy consultation clause (MPCC), quantitative performance criteria and indicative targets (MEFP Table 1). The program also envisages several structural benchmarks (MEFP Table 2) which will be further developed and built upon over the course of the program. Specifically:

- ***The MPCC*** is based on an inflation path consistent with staff's baseline projections and achieving the CBA's inflation target of 4 percent during the program horizon. The symmetric bands around the path reflect the uncertainty around the projections.
- ***Quantitative PCs and ITs*** include PCs on the floor of fiscal balance, a ceiling on cumulative budget domestic lending anchored by the fiscal rules, a continuous PC on the non-accumulation of external public debt arrears, and an indicative target (IT) on the stock of new public guarantees of external debt. The proposed program also includes a floor on net international reserves (NIR) to preserve accumulated buffers, while accommodating large debt amortizations. The social assistance IT sets a floor to ensure adequate government spending is appropriated through the budget to support vulnerable groups through the specified social programs.
- ***Structural benchmarks*** aim at greater revenue mobilization through tax policy and revenue administration reforms, removing obstacles to quality infrastructure spending, containing fiscal risks, improving the monetary policy transmission mechanism, strengthening bank supervision, improving access to finance, and fostering labor force participation.

32. Safeguards Assessment. An updated safeguards assessment of the CBA should be completed by the first review. Outstanding recommendations from the last assessment are in progress and pertain to strengthening the central bank's organic legal framework and establishing centralized operational risk management at the CBA.

33. Capacity to Repay. Armenia's outstanding credit stands at 289 percent of quota (as of September 2022) and is projected to decline to 278 by end-2022. Under the adverse scenario, repayments to the Fund would peak at 7.6 percent of GIR (2.3 percent of exports of goods and services) in 2024. Armenia's capacity to repay is deemed adequate and is supported by the downward debt trajectory in the medium term, and the authorities' track-record of reforms and sound macroeconomic management. Firm commitments for the next 12 months and good prospects for financing for the full period of the arrangement are in place.

34. Risks to the program are elevated but manageable. While global, regional, and domestic political economy risks might constrain the authorities' ability to follow through on their reform program, their long track record of sound macroeconomic policies is expected to continue, which should support reform implementation. Strong cohesiveness and good coordination among IFIs will also buttress the authorities' ownership of the program.

STAFF APPRAISAL

35. The new Stand-By Arrangement aims to support the authorities' efforts to maintain macroeconomic stability and promote sustainable and inclusive growth through a strong policy and structural reform agenda. Notwithstanding the strong performance under the previous SBA and the growth momentum this year, Armenia remains vulnerable to shocks. Risks are elevated stemming from the tightening of global financial conditions, an anticipated global growth slowdown, a possible weakening of trading partners' demand, and geopolitical tensions. The proposed arrangement would provide a strong signal on the authorities' policies, helping catalyze financial assistance from multilateral and bilateral creditors and markets. It will also provide financial support in the event of an adverse shock.

36. The 2023 fiscal stance is appropriate to support the country's development needs, while paving the way for a gradual fiscal consolidation over the medium term. If revenue overperformance persists in 2023 compared to the budget, the authorities should build fiscal buffers to meet future shocks or, subject to the cyclical position of the economy, finance high-quality fiscal or institutional reforms. The gradual fiscal consolidation under the program adheres to the fiscal rules, keeps debt on a declining path, and allows space for planned social and priority capital spending.

37. Fiscal institutional reforms will underpin the program's fiscal objectives. The authorities' efforts to adopt a more transparent, equitable, efficient, and environmentally friendly tax system and a stronger revenue administration will support the government's revenue raising objectives and create space for much needed development spending. Plans to improve the efficiency and effectiveness of government spending, enhance public financial management—including through robust fiscal risk management, transparency, and governance—and ensure higher-quality public investment are welcome.

38. The CBA's efforts to address inflationary pressures have been timely and proactive. The current monetary policy stance is appropriate, and further policy changes should remain dependent on the evolution of inflation and inflation expectations. Reforms to foster capital market development will continue to enhance the effectiveness of the monetary policy transmission mechanism.

39. Staff welcomes the CBA's intention to preserve the existing flexible exchange rate regime, while limiting foreign exchange interventions to mitigating disorderly market conditions and maintaining adequate reserve buffers. Exchange rate flexibility should remain a key shock absorber supported by other policies as needed. While international reserves are broadly adequate, some further reserve accumulation in the face of capital inflows will help provide additional cover against external shocks.

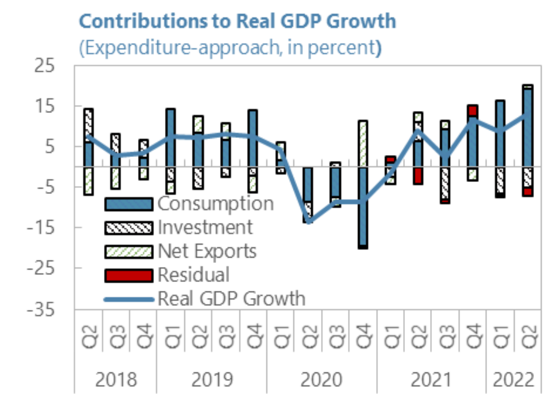
40. The banking system is well capitalized and liquid thanks to prudent risk management and strong supervision. Continued monitoring of financial sector risks and enhancing the macroprudential tools will help stem risks associated with the rapid rises in housing prices and mortgage lending. Efforts to strengthen the regulatory and supervisory framework, ensure that banks maintain adequate capital buffers, tighten enforcement practices, and enhance the resolution framework will further buttress the resilience of the financial system.

41. Structural reforms rightly focus on improving the business environment, fostering productivity, reducing unemployment, and addressing climate-related challenges. Achieving these objectives requires developing stronger trade links, building infrastructure, improving resource management, fostering access to finance and labor force participation, completing governance reforms, and reducing informality. Ambitious digitalization efforts should spearhead public administration reforms and improve public service quality and delivery.

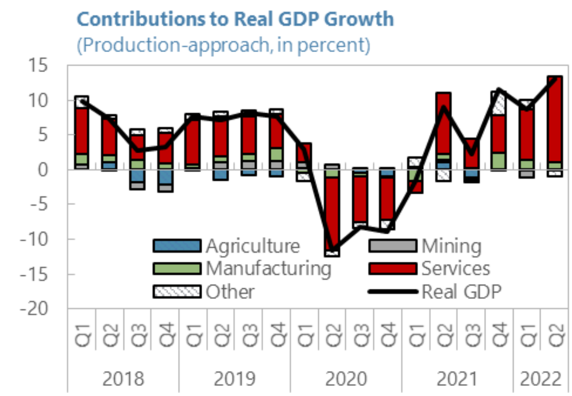
42. Staff supports the authorities' request for approval of a three-year Stand-by Arrangement. The attached Letter of Intent and MEFP provide a strong set of policies to pursue the objectives of the program.

Figure 1. Armenia: Real Sector Developments

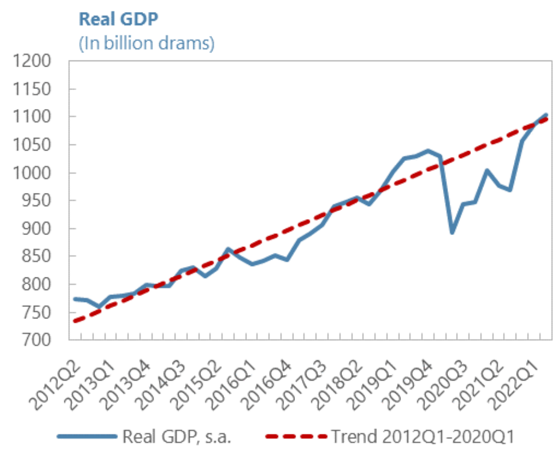
Real GDP growth has been driven by consumption…



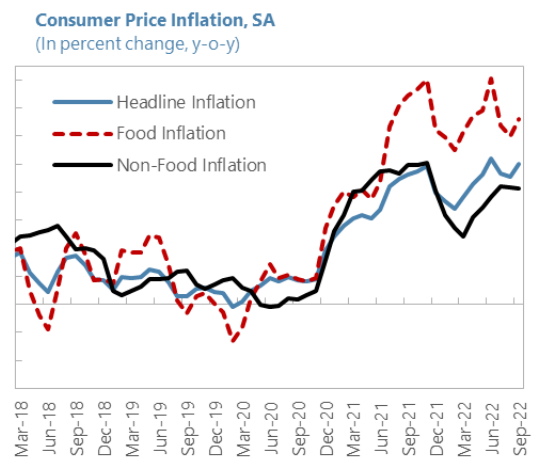
…boosting the performance of the services sector….



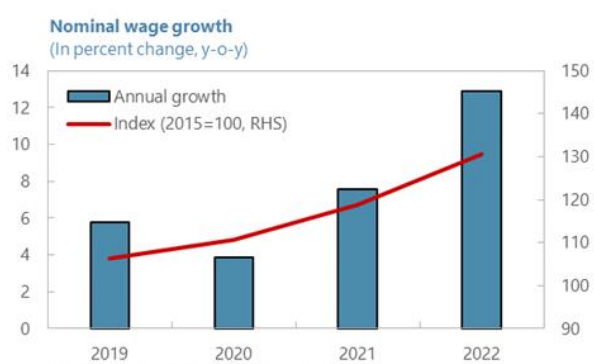
…and supporting output to fully recover to its pre-COVID trend.



However, strong demand and high food prices keep inflation pressures high.

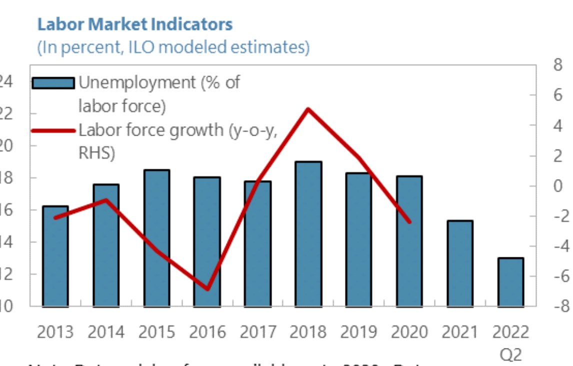


Nominal wage growth has been strong…



Note: Data for 2022 available up to August.

…but unemployment—albeit declining rapidly—is still high.

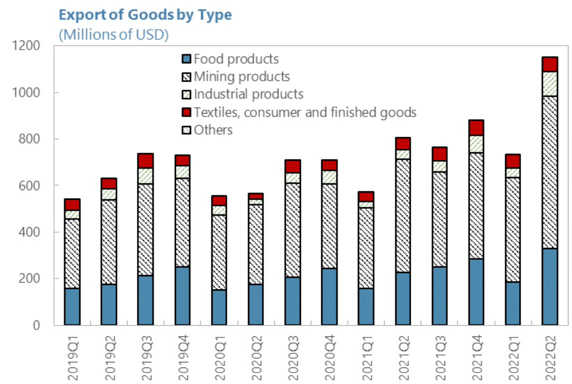


Note: Data on labor force available up to 2020. Data on unemployment for 2022 available up to Q2.

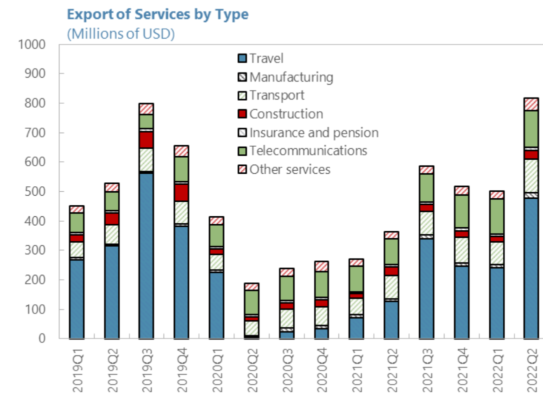
Sources: National authorities, Haver, IMF World Economic Outlook, and IMF staff calculations.

Figure 2. Armenia: External Developments

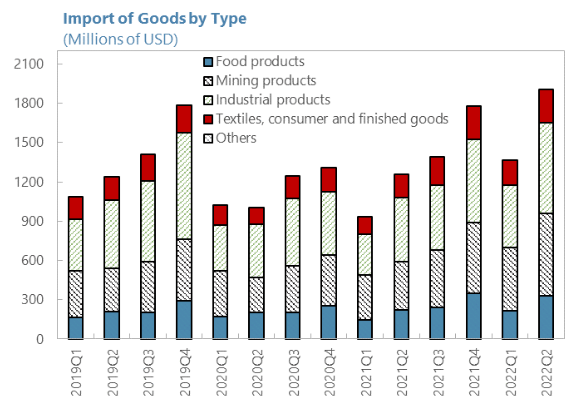
Armenia's exports are dependent on commodities…



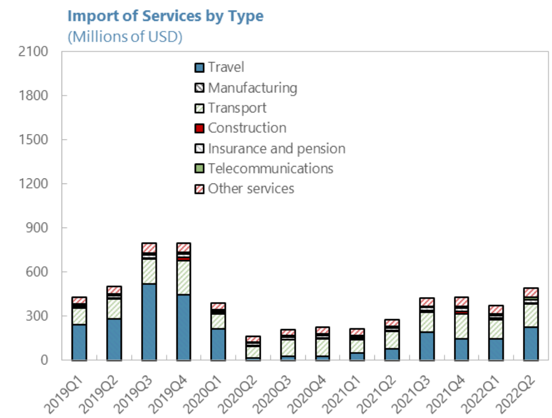
…and tourism, which has picked up in 2022.



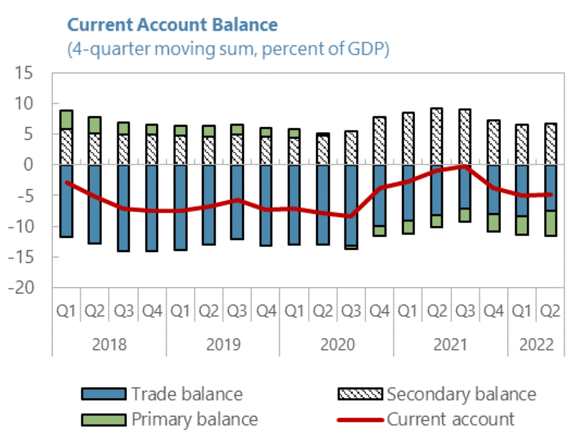
Domestic demand has boosted merchandise imports …



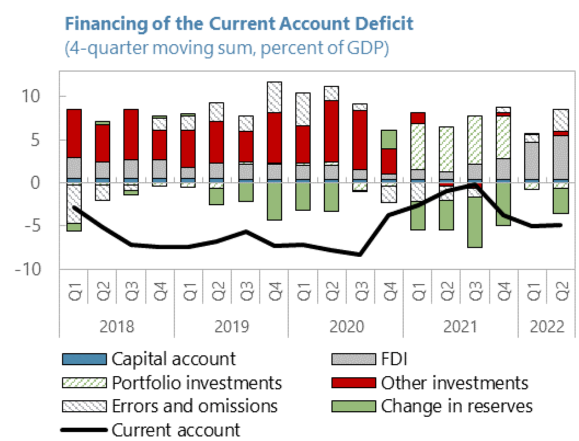
…and imports of services.



The current account deficit has widened…



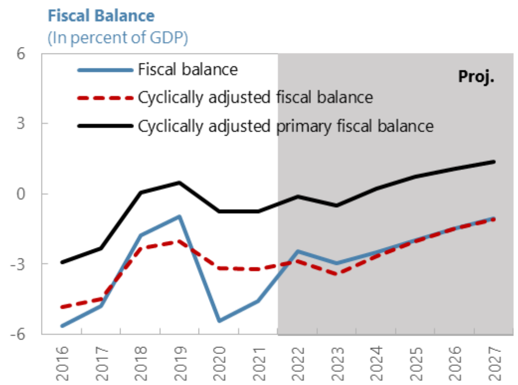
…but is mostly financed by FDI.



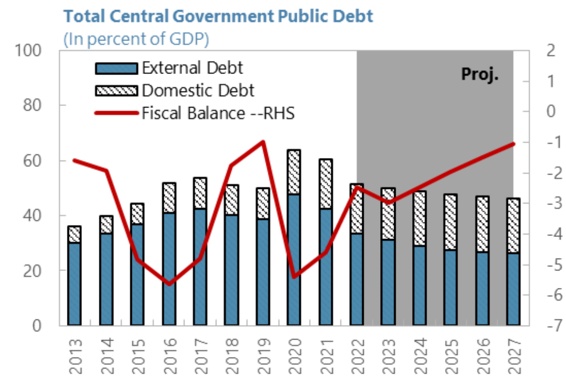
Sources: National authorities, IMF Information Notice Systems Database, and IMF staff calculations.

Figure 3. Armenia: Fiscal Developments

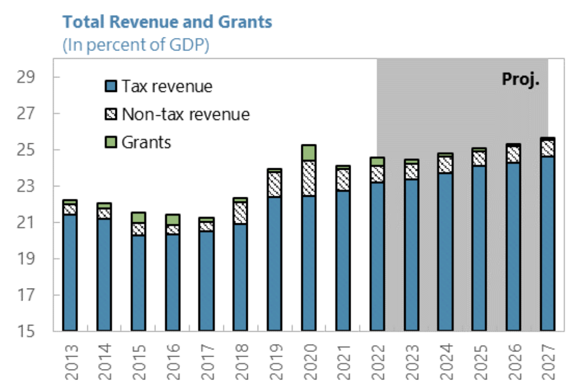
A gradual fiscal consolidation…



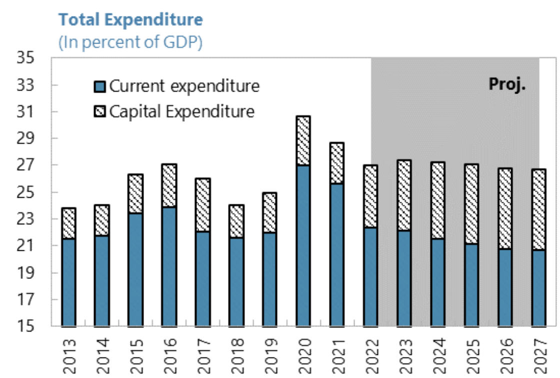
…will keep debt on a declining path in line with the fiscal rules.



Tax reforms will put tax revenues on a gradual path towards the authorities' target of 25 percent of GDP.



Capital expenditures are projected to grow in line with the authorities' plan to spur public investment.

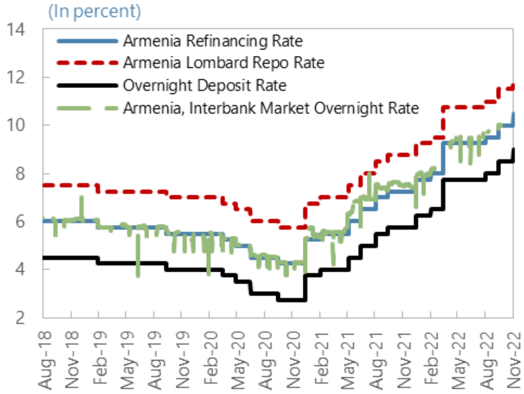


Sources: National authorities and IMF staff calculations.

Figure 4. Armenia: Monetary Developments

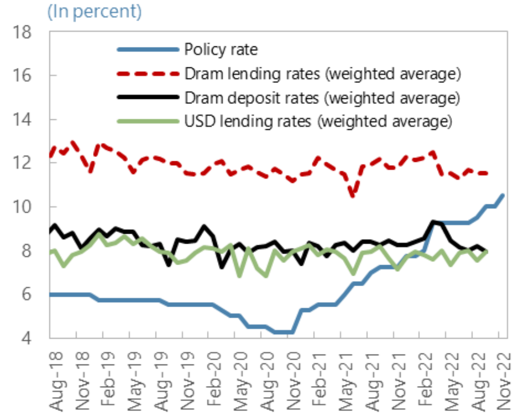
The CBA has proactively raised the policy rate, reaching 10.5 percent in November…

Interest Rate Corridor
(In percent)



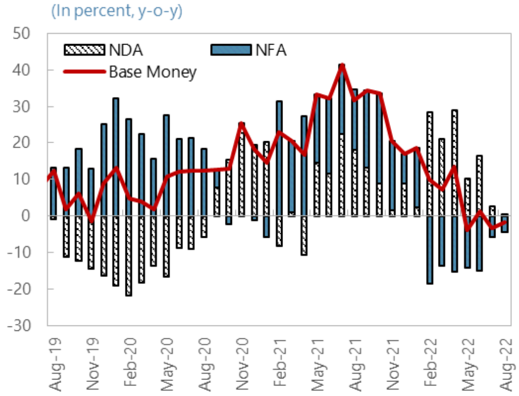
…but lending and deposit rates—already high—have been affected little.

Interest Rates
(In percent)



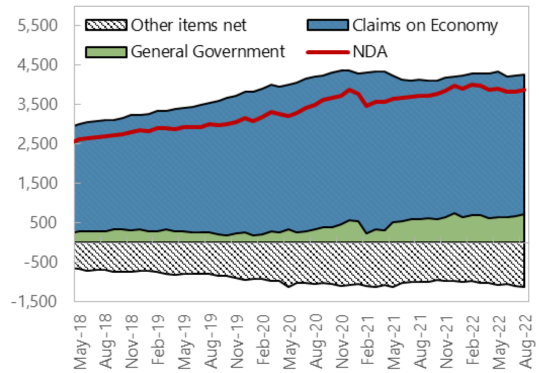
Base money growth in 2022 has been driven by net domestic assets.

Contribution to Base Money Growth
(In percent, y-o-y)



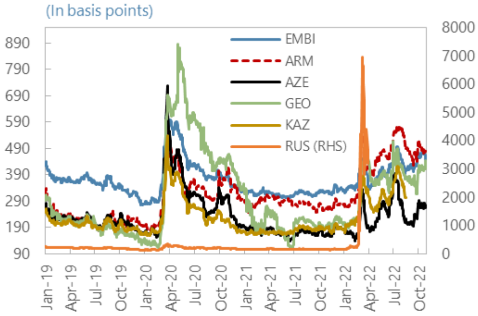
…and reflected in growing claims on the economy.

Composition of NDA
(In billion drams, monetary survey)



The volatility of sovereign spreads has been high…

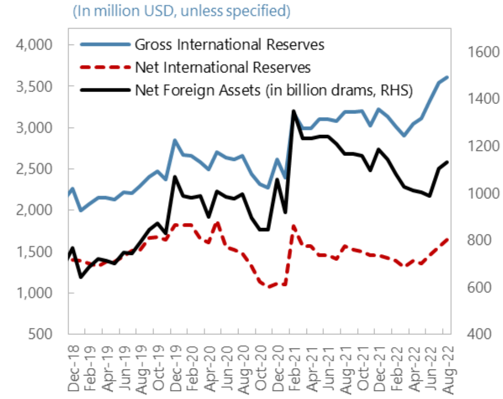
Sovereign Spreads
(In basis points)



Note: On March 30, 2022 JP Morgan removed Russia's instruments from the indices and benchmarks. Thus, The EMBIG spread for Russia has not changed since then.

…underscoring the need to keep solid reserve buffers.

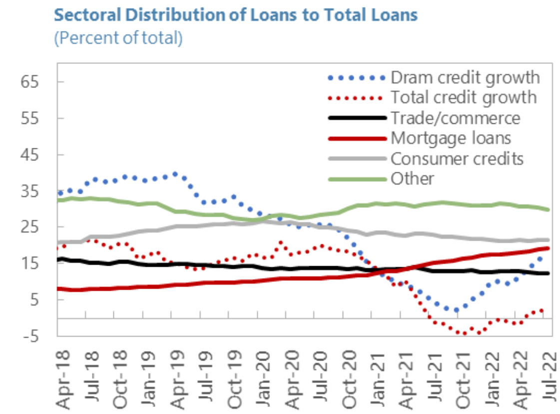
CBA Balance Sheet
(In million USD, unless specified)



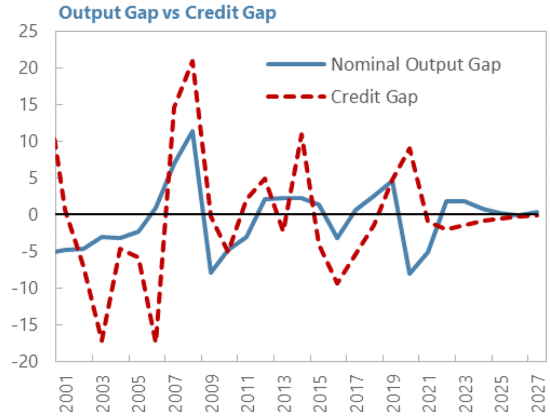
Sources: Central Bank of Armenia and IMF staff calculations.

Figure 5. Armenia: Financial Developments

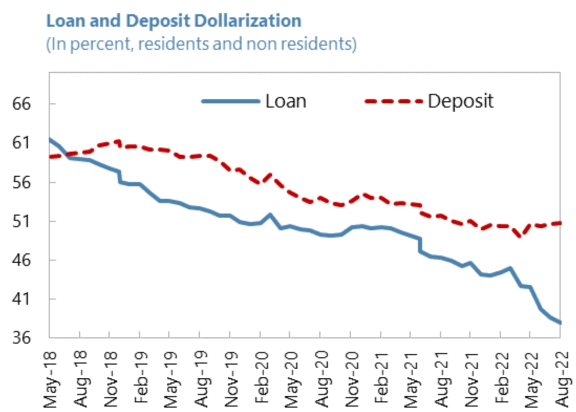
The recent pick-up in credit growth has been driven by an increase in dram mortgage loans…



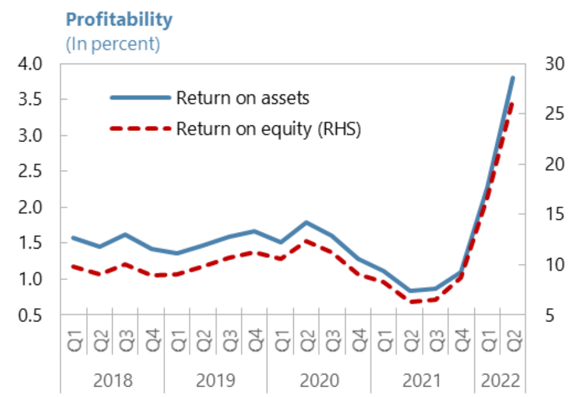
…which helps close the marginally negative credit-to-GDP gap.



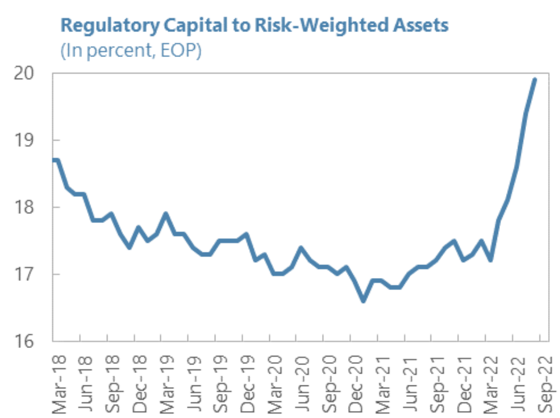
Loan and deposit dollarization, albeit declining, remains high.



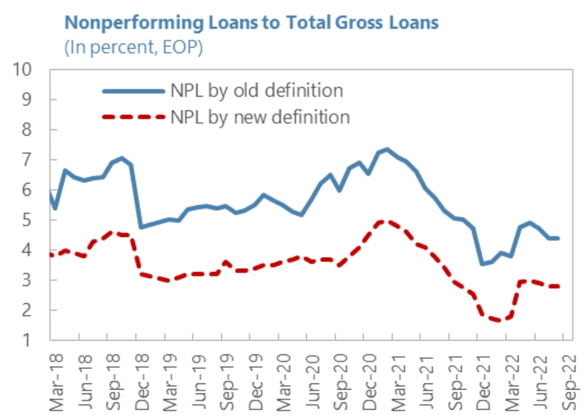
Banks' profitability has improved driven by non-interest income, including foreign exchange gains and lower provisioning.



Banks' capital buffers are solid.



NPLs—excluding watch loans— have risen but remain low.



Sources: National authorities, Central Bank of Armenia, Bloomberg, and IMF staff calculations.
1/ In July 2021, the Central Bank of Armenia aligned the NPL definition with the BCBS regulation identified in the 2019 FSAP recommendations. The new NPL definition only considers exposures which are more than 90 days past due (doubtful and substandard loans).

Table 1. Armenia: Selected Economic and Financial Indicators, 2019–27

	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Act.	Act.	Act.			Proj.			
National income and prices:									
Real GDP (percent change)	7.6	-7.2	5.7	11.0	4.5	4.5	4.5	4.5	4.5
Final consumption expenditure, Contrib. to Growth	10.7	-10.5	4.0	12.2	2.5	2.4	2.2	2.0	1.9
Gross fixed capital formation, Contrib. to Growth	0.7	-0.2	1.1	2.5	2.5	2.6	2.7	2.8	3.0
Changes in inventories, Contrib. to Growth	-3.9	0.1	0.7	-2.1	0.0	0.0	0.0	0.0	0.0
Net exports of goods and services, Contrib. to Growth	0.1	3.4	-0.2	-1.7	-0.5	-0.5	-0.4	-0.3	-0.3
Gross domestic product (in billions of drams)	6,543	6,182	6,983	8,294	9,186	10,023	10,893	11,816	12,810
Gross domestic product (in millions of U.S. dollars)	13,619	12,642	13,861	18,583	20,648	22,225	23,829	25,526	27,382
Gross domestic product per capita (in U.S. dollars)	4,597	4,269	4,679	6,273	6,969	7,501	8,042	8,614	9,239
CPI (period average; percent change)	1.4	1.2	7.2	8.8	7.5	5.1	4.5	4.2	4.1
CPI (end of period; percent change)	0.7	3.7	7.7	10.0	6.0	4.5	4.0	4.0	4.0
GDP deflator (percent change)	1.0	1.8	6.9	7.0	6.0	4.5	4.0	3.8	3.7
Unemployment rate (in percent)	18.3	18.2	15.3	14.8	14.7	14.6	14.5	14.4	14.3
Investment and saving (in percent of GDP)									
Investment	17.4	19.7	20.7	22.6	23.3	23.6	23.9	24.2	24.4
National savings	10.1	15.9	17.0	17.0	17.8	18.2	18.5	18.9	19.4
Money and credit (end of period)									
Reserve money (percent change)	8.8	18.3	17.1	6.2	4.4	11.2	10.7	5.2	6.1
Broad money (percent change)	11.2	9.0	13.1	11.8	10.2	12.0	9.7	7.5	7.6
Private sector credit growth (percent change)	18.5	14.3	-3.9	3.0	4.0	5.3	5.3	5.0	4.9
Central government operations (in percent of GDP)									
Revenue and grants	23.9	25.2	24.1	24.6	24.7	25.0	25.3	25.5	25.9
Of which : tax revenue	22.1	22.0	22.1	22.4	22.8	23.1	23.4	23.6	23.9
Expenditure	24.9	30.6	28.7	27.0	27.7	27.5	27.3	27.0	26.9
Overall balance on a cash basis	-1.0	-5.4	-4.6	-2.5	-3.0	-2.5	-2.0	-1.5	-1.0
Public and publicly-guaranteed (PPG) debt (in percent of GDP)	53.7	67.4	63.4	55.3	53.9	52.4	51.1	49.7	48.3
Central Government's PPG debt (in percent)	50.1	63.5	60.3	51.3	50.0	48.7	47.8	47.1	46.3
Share of foreign currency debt (in percent)	80.6	77.0	72.6	67.7	65.4	63.6	61.8	60.6	59.9
External sector									
Exports of goods and services (in millions of U.S. dollars)	5,794	3,818	5,012	7,786	8,525	9,034	9,533	10,117	10,743
Imports of goods and services (in millions of U.S. dollars)	-7,603	-5,082	-6,120	-9,244	-10,080	-10,660	-11,252	-11,905	-12,579
Exports of goods and services (percent change)	17.6	-34.1	31.3	55.3	9.5	6.0	5.5	6.1	6.2
Imports of goods and services (percent change)	13.8	-33.2	20.4	51.0	9.1	5.8	5.6	5.8	5.7
Current account balance (in percent of GDP)	-7.3	-3.8	-3.7	-5.6	-5.5	-5.4	-5.4	-5.3	-5.0
FDI (net, in millions of U.S. dollars)	233	86	342	649	376	470	541	562	579
Gross international reserves (in millions of U.S. dollars)	2,850	2,616	3,230	3,746	3,547	3,491	3,377	3,262	3,178
Import cover 1/	6.7	5.1	4.2	4.5	4.0	3.7	3.4	3.1	2.9
End-of-period exchange rate (dram per U.S. dollar)	480	523	480	...	...	...	...	...	...
Average exchange rate (dram per U.S. dollar)	480	489	504	...	...	...	...	...	...

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, 2019–27
(In millions of U.S. dollars, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Act.	Act.	Act.	Proj.					
Current account	-997	-478	-515	-1,036	-1,142	-1,201	-1,288	-1,346	-1,377
Trade balance	-1,722	-1,382	-1,505	-2,280	-2,223	-2,189	-2,181	-2,162	-2,134
Exports	3,361	2,719	3,277	4,661	5,069	5,377	5,727	6,105	6,514
Imports	-5,083	-4,101	-4,781	-6,941	-7,292	-7,566	-7,908	-8,267	-8,648
Services (net)	-87	118	397	822	668	563	462	374	298
Credits	2,434	1,099	1,735	3,125	3,456	3,658	3,806	4,011	4,229
Debits	-2,521	-981	-1,338	-2,303	-2,789	-3,095	-3,344	-3,638	-3,931
Income (net)	180	-196	-406	-521	-466	-427	-396	-360	-319
Transfers (net)	632	983	999	942	879	853	827	802	778
Private	487	760	924	929	882	856	830	805	781
Official	145	223	75	14	-3	-3	-3	-3	-3
Capital and financial account	1,181	229	927	1,465	1,036	1,317	1,309	1,310	1,295
Capital transfers (net)	54	45	50	65	39	24	19	18	17
Foreign direct investment (net)	233	86	342	649	376	470	541	562	579
Portfolio investment (net)	29	-44	6	100	0	0	0	0	0
Public sector borrowing (net)	292	-223	666	362	284	306	244	245	261
Disbursements	859	90	912	620	570	608	1,061	650	575
Amortization	-568	-312	-246	-258	-286	-302	-817	-406	-316
Other capital (net)	573	364	-137	289	336	517	505	486	439
Errors and omissions	480	-250	93	0	0	0	0	0	0
Overall balance	663	-499	505	429	-106	116	21	-36	-82
Financing	-663	499	-505	-429	106	-116	-21	36	82
Gross international reserves (increase: -)	-590	234	-614	-517	200	56	114	115	84
Use of Fund credit, net	-73	264	-66	88	-93	-172	-134	-80	-2
Of which: IMF (SBA) budget support	0	334	0	72	0	0	0	0	0
SDR allocation	0	0	175	0	0	0	0	0	0
Financing needs	0	0	0	0	0	0	0	0	0
IMF (SBA)	0	0	0	0	0	0	0	0	0
IMF (SBA) BOP support	0	0	0	0	0	0	0	0	0
Memorandum items:									
Current account (in percent of GDP)	-7.3	-3.8	-3.7	-5.6	-5.5	-5.4	-5.4	-5.3	-5.0
Trade balance (in percent of GDP)	-12.6	-10.9	-10.9	-12.3	-10.8	-9.8	-9.2	-8.5	-7.8
Gross international reserves (end of period)	2,850	2,616	3,230	3,746	3,547	3,491	3,377	3,262	3,178
In months of next year's imports	6.7	5.1	4.2	4.5	4.0	3.7	3.4	3.1	2.9
In percent of IMF's Reserve Adequacy Metric (ARA)	121	122	143	151	136	128	120	113	108
Goods export growth, percent change	23.3	-19.1	20.5	42.3	8.7	6.1	6.5	6.6	6.7
Goods import growth, percent change	13.3	-19.3	16.6	45.2	5.1	3.8	4.5	4.5	4.6
Nominal external debt	12,121	12,659	13,609	14,239	14,805	15,420	16,004	16,626	17,243
o.w. public external debt	5,785	6,059	6,757	7,113	7,295	7,421	7,525	7,706	7,945
Nominal external debt stock (in percent of GDP)	89.0	100.1	98.2	76.6	71.7	69.4	67.2	65.1	63.0
External public debt-to-exports ratio (in percent)	99.8	158.7	134.8	91.4	85.6	82.1	78.9	76.2	73.9
External public debt service (in percent of exports)	14.4	14.7	9.2	6.2	6.6	7.2	11.7	5.8	4.1

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

Table 3a. Armenia: Central Government Operations, 2019–27

(In billions of Armenian drams)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Act.	Act.	Act.			Proj.			
Total revenue and grants	1,565.5	1,560.7	1,683.8	2,036.5	2,271.5	2,505.6	2,755.2	3,016.5	3,313.4
Total revenue	1,553.1	1,507.5	1,671.5	1,998.8	2,252.7	2,486.9	2,736.4	2,997.7	3,294.6
Tax revenues 1/	1,445.6	1,360.5	1,543.9	1,857.8	2,096.0	2,316.5	2,551.2	2,785.0	3,064.1
VAT	506.5	471.6	556.0	680.1	771.6	842.0	915.0	992.5	1,088.8
Profits, simplified and presumptive	234.0	148.8	158.6	228.1	266.4	300.7	337.7	389.9	422.7
Personal income tax	440.8	411.5	426.3	472.7	514.1	555.3	603.5	654.6	709.7
Customs duties	95.1	68.3	84.8	58.1	73.5	110.3	141.6	153.6	179.3
Other	169.2	260.3	318.2	418.8	470.4	508.3	553.4	594.3	663.5
Social contributions	18.7	24.7	43.0	66.3	76.2	80.2	98.0	106.3	115.3
Other revenue	88.8	122.2	84.6	74.6	80.5	90.2	87.1	106.3	115.3
Grants	12.4	53.2	12.4	37.7	18.8	18.8	18.8	18.8	18.8
Total expenditure	1,629.4	1,894.6	2,004.3	2,240.2	2,545.1	2,753.4	2,969.8	3,191.7	3,446.1
Expenses	1,437.1	1,668.5	1,788.0	1,854.5	2,029.6	2,160.0	2,302.2	2,455.0	2,646.6
Wages	327.0	380.8	394.8	421.3	454.7	491.1	528.3	567.2	614.9
Payments to individual pension accts.	49.4	59.9	58.7	58.1	66.1	72.2	76.3	85.1	94.8
Subsidies	4.4	1.7	12.4	15.9	9.2	10.0	10.9	11.8	12.8
Interest	157.6	164.6	180.8	225.6	263.5	288.1	298.0	300.9	316.5
Social allowances and pensions	403.9	499.9	564.3	516.3	587.4	627.0	700.8	772.8	832.6
Pensions/social security benefits	269.9	297.1	317.9	327.5	355.3	398.9	441.1	484.5	525.2
Social assistance benefits	134.0	202.9	246.4	188.8	232.2	228.1	259.6	288.3	307.4
Goods and services	128.1	114.1	131.6	146.0	165.3	175.4	192.3	209.1	237.0
Grants	150.0	185.5	202.9	226.0	227.8	235.5	239.7	248.1	269.0
Other expenditure 2/	216.8	261.9	242.5	245.3	255.5	260.6	256.0	260.0	269.0
Transactions in nonfinancial assets	192.3	226.2	216.3	385.7	515.4	593.4	667.6	736.8	799.6
Acquisition of nonfinancial assets	193.0	227.7	218.4	385.7	525.4	603.4	677.6	746.8	809.6
Disposals of nonfinancial assets	0.7	1.5	2.1	0.0	10.0	10.0	10.0	10.0	10.0
Overall balance (above-the-line)	-63.9	-334.0	-320.5	-203.7	-273.6	-247.7	-214.6	-175.3	-132.7
Statistical discrepancy	-4.3	18.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-68.2	-315.3	-320.5	-203.7	-273.6	-247.7	-214.6	-175.3	-132.7
Financing	68.2	315.3	320.5	203.7	273.6	247.7	214.6	175.3	132.7
Domestic financing	-13.3	342.3	101.2	192.8	340.0	381.5	353.2	227.2	162.4
Banking system	-39.1	306.7	183.5	231.4	404.3	431.0	419.2	222.9	201.1
CBA	-96.5	59.2	-133.6	-76.8	114.0	125.0	100.0	0.0	0.0
Commercial Banks	57.5	247.5	317.2	308.1	290.3	306.0	319.2	222.9	201.1
Nonbanks	25.7	35.7	-82.3	-38.6	-64.4	-49.5	-66.0	4.2	-38.7
T-Bills/other	41.5	55.2	-61.0	-59.3	-55.9	-58.9	-61.4	-42.9	-38.7
Promissory note/other	0.0	0.0	-12.7	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-15.8	-19.6	-8.6	20.7	-8.5	9.4	-4.6	47.1	0.0
External financing	81.6	-27.0	219.3	10.9	-66.3	-133.7	-138.6	-51.9	-29.6
Gross disbursement	412.8	207.2	465.9	276.5	219.8	198.0	425.7	283.7	269.0
of which : IMF budget support	0.0	162.5	0.0	32.1	0.0	0.0	0.0	0.0	0.0
Amortization due	-274.2	-152.4	-115.0	-101.2	-141.7	-188.3	-420.8	-192.2	-155.2
Net lending	-57.1	-81.8	-131.7	-164.5	-144.5	-143.5	-143.5	-143.5	-143.5
Other financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	6,543.3	6,181.9	6,983.0	8,293.7	9,185.6	10,023.3	10,893.3	11,816.1	12,809.6
Program balance 3/	-90.1	-398.0	-432.5	-358.4	-434.3	-381.9	-362.7	-271.6	-276.2
Primary balance 4/	20.7	-270.8	-279.9	-121.8	-163.1	-93.7	-64.6	29.3	40.3

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

1/ From 2018, the temporary tax credits used to cover tax obligations are not included in total tax revenues and are also not netted out from individual tax

2/ Includes acquisition of military equipment.

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

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

Table 3b. Armenia: Central Government Operations, 2019–27

(In percent of GDP, unless otherwise specified)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Act.	Act.	Act.			Proj.			
Total revenue and grants	23.9	25.2	24.1	24.6	24.7	25.0	25.3	25.5	25.9
Total revenue	23.7	24.4	23.9	24.1	24.5	24.8	25.1	25.4	25.7
Tax revenues 1/	22.1	22.0	22.1	22.4	22.8	23.1	23.4	23.6	23.9
VAT	7.7	7.6	8.0	8.2	8.4	8.4	8.4	8.4	8.5
Profits, simplified and presumptive	3.6	2.4	2.3	2.8	2.9	3.0	3.1	3.3	3.3
Personal income tax	6.7	6.7	6.1	5.7	5.6	5.5	5.5	5.5	5.5
Customs duties	1.5	1.1	1.2	0.7	0.8	1.1	1.3	1.3	1.4
Other	2.6	4.2	4.6	5.1	5.1	5.1	5.1	5.0	5.2
Social contributions	0.3	0.4	0.6	0.8	0.8	0.8	0.9	0.9	0.9
Other revenue	1.4	2.0	1.2	0.9	0.9	0.9	0.8	0.9	0.9
Grants	0.2	0.9	0.2	0.5	0.2	0.2	0.2	0.2	0.1
Total expenditure	24.9	30.6	28.7	27.0	27.7	27.5	27.3	27.0	26.9
Expense	22.0	27.0	25.6	22.4	22.1	21.5	21.1	20.8	20.7
Wages	5.0	6.2	5.7	5.1	4.9	4.9	4.9	4.8	4.8
Payments to individual pension accts.	0.8	1.0	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Subsidies	0.1	0.0	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Interest	2.4	2.7	2.6	2.7	2.9	2.9	2.7	2.5	2.5
Social allowances and pensions	6.2	8.1	8.1	6.2	6.4	6.3	6.4	6.5	6.5
Pensions/social security benefits	4.1	4.8	4.6	3.9	3.9	4.0	4.0	4.1	4.1
Social assistance benefits	2.0	3.3	3.5	2.3	2.5	2.3	2.4	2.4	2.4
Goods and services	2.0	1.8	1.9	1.8	1.8	1.8	1.8	1.8	1.9
Grants	2.3	3.0	2.9	2.7	2.5	2.4	2.2	2.1	2.1
Other expenditure 2/	3.3	4.2	3.5	3.0	2.8	2.6	2.4	2.2	2.1
Transactions in nonfinancial assets	2.9	3.7	3.1	4.7	5.6	5.9	6.1	6.2	6.2
Acquisition of nonfinancial assets	2.9	3.7	3.1	4.7	5.7	6.0	6.2	6.3	6.3
Disposals of nonfinancial assets	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Overall balance (above-the-line)	-1.0	-5.4	-4.6	-2.5	-3.0	-2.5	-2.0	-1.5	-1.0
Statistical discrepancy	-0.1	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-1.0	-5.1	-4.6	-2.5	-3.0	-2.5	-2.0	-1.5	-1.0
Financing	1.0	5.1	4.6	2.5	3.0	2.5	2.0	1.5	1.0
Domestic financing	-0.2	5.5	1.4	2.3	3.7	3.8	3.2	1.9	1.3
Banking system	-0.6	5.0	2.6	2.8	4.4	4.3	3.8	1.9	1.6
CBA	-1.5	1.0	-1.9	-0.9	1.2	1.2	0.9	0.0	0.0
Commercial Banks	0.9	4.0	4.5	3.7	3.2	3.1	2.9	1.9	1.6
Nonbanks	0.4	0.6	-1.2	-0.5	-0.7	-0.5	-0.6	0.0	-0.3
T-Bills/other	0.6	0.9	-0.9	-0.7	-0.6	-0.6	-0.6	-0.4	-0.3
Promissory note/other	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-0.2	-0.3	-0.1	0.2	-0.1	0.1	0.0	0.4	0.0
External financing	1.2	-0.4	3.1	0.1	-0.7	-1.3	-1.3	-0.4	-0.2
Gross disbursement	6.3	3.4	6.7	3.3	2.4	2.0	3.9	2.4	2.1
Amortization due	-4.2	-2.5	-1.6	-1.2	-1.5	-1.9	-3.9	-1.6	-1.2
Net lending	-0.9	-1.3	-1.9	-2.0	-1.6	-1.4	-1.3	-1.2	-1.1
Other financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	6,543	6,182	6,983	8,294	9,186	10,023	10,893	11,816	12,810
Program balance 3/	-1.4	-6.4	-6.2	-4.3	-4.7	-3.8	-3.3	-2.3	-2.2
Primary balance 4/	0.3	-4.4	-4.0	-1.5	-1.8	-0.9	-0.6	0.2	0.3

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

1/ From 2018, the temporary tax credits used to cover tax obligations are not included in total tax revenues and are also not netted out from individual tax categories.

2/ Includes acquisition of military equipment.

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

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

Table 4. Armenia: Monetary Accounts, 2019–23

(In billions of drams, unless otherwise indicated)

	2019	2020	2021	2022				2023			
	Act.	Act.	Act.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
				Act.		Proj.		Proj.			
Central Bank of Armenia											
Net foreign assets	1071.8	1058.3	1186.6	1039.8	1041.6	1180.5	1245.1	1226.5	1246.3	1186.4	1182.4
Net international reserves 1/	865.4	603.9	694.2	628.0	566.0	611.1	668.1	642.1	654.5	617.1	613.2
Other	206.3	454.4	492.3	411.8	475.6	569.5	576.9	584.4	591.8	569.3	569.3
Net domestic assets	250.5	505.3	644.2	567.6	650.8	681.7	698.9	737.8	767.1	806.8	846.9
Claims on general government (net)	-314.1	-254.9	-393.8	-494.4	-521.3	-504.2	-487.0	-458.5	-430.0	-401.5	-373.0
Of which : central government (net)	-252.8	-189.6	-323.6	-410.7	-434.7	-417.5	-400.4	-371.9	-343.4	-314.9	-286.4
central government deposits	327.3	266.5	403.5	503.7	530.5	426.7	409.5	381.0	352.5	324.0	295.5
Claims on banks	231.7	467.9	696.4	706.4	750.2	750.2	750.2	760.6	761.5	782.7	784.3
Other items (net)	332.9	292.3	341.6	355.6	421.9	435.6	435.6	435.6	435.6	425.6	435.6
Reserve money	1,322.2	1,563.7	1,830.7	1,607.4	1,692.4	1,862.2	1,943.9	1,964.3	2,013.4	1,993.2	2,029.3
Currency issue	607.2	751.5	747.2	676.5	708.1	745.3	768.8	776.0	783.2	795.8	827.2
Banks' reserves	674.3	758.7	1,043.9	889.5	944.5	1,057.3	1,115.4	1,128.6	1,170.5	1,142.7	1,157.5
In drams	304.8	275.4	408.8	369.9	387.6	383.9	432.1	435.2	467.1	459.3	474.1
In foreign currency	369.4	483.3	635.1	519.6	556.9	673.4	683.4	693.4	703.4	683.4	683.4
Other accounts	40.8	53.6	39.7	41.4	39.7	59.7	59.7	59.7	59.7	54.7	44.7
Banking system											
Net foreign assets	-70.0	-504.3	-178.0	-166.8	9.9	-17.6	6.9	-61.7	-61.9	-111.7	-135.7
Net domestic assets	3,155.5	3,866.4	3,980.6	3,970.8	3,804.1	3,976.0	4,230.1	4,444.5	4,485.5	4,606.6	4,807.8
Claims on government (net)	259.3	565.7	744.0	690.3	643.5	801.2	958.9	1,060.0	1,161.1	1,262.2	1,363.3
Of which : claims on central government (net)	342.0	631.0	814.2	774.0	730.1	887.8	1,045.6	1,146.7	1,247.8	1,348.8	1,449.9
Claims on rest of the economy	3,830.6	4,378.5	4,208.7	4,339.8	4,219.4	4,238.6	4,335.0	4,448.3	4,388.2	4,408.2	4,508.4
Other items (net)	-934.5	-1,077.8	-972.1	-1,059.3	-1,058.8	-1,063.8	-1,063.8	-1,063.8	-1,063.8	-1,063.8	-1,063.8
Broad money	3,085.5	3,362.0	3,802.6	3,804.0	3,814.0	3,958.4	4,237.0	4,382.8	4,423.6	4,494.8	4,672.1
Currency in circulation	502.3	648.4	636.1	584.8	610.6	623.8	637.7	639.6	645.6	656.0	681.8
Deposits	2,583.2	2,713.6	3,166.5	3,219.2	3,203.4	3,334.7	3,599.3	3,743.2	3,778.1	3,838.9	3,990.3
Domestic currency	1,400.8	1,535.5	1,826.7	1,830.2	1,877.6	1,993.7	2,238.1	2,361.7	2,376.3	2,416.8	2,547.9
Foreign currency	1,182.3	1,178.1	1,339.8	1,389.0	1,325.7	1,340.9	1,361.2	1,381.5	1,401.8	1,422.1	1,442.4
Memorandum items:											
Exchange rate (drams per U.S. dollar, end of period)	479.7	522.6	480.1	485.9	407.2	405.7	...	...	...	...	...
12-month change in reserve money (in percent)	8.8	18.3	17.1	7.3	1.2	8.8	6.2	22.2	19.0	7.0	4.4
12-month change in broad money (in percent)	11.2	9.0	13.1	11.1	9.2	9.8	11.4	15.2	16.0	13.6	10.3
12-month change in dram broad money (in percent)	21.5	14.8	12.8	12.0	10.8	14.7	16.8	24.3	21.4	17.4	12.3
12-month change in private sector credit (in percent)	18.5	14.3	-3.9	0.0	2.0	3.0	3.0	2.5	4.0	4.0	4.0
Velocity of broad money (end of period)	2.1	1.8	1.8	1.9	2.0	2.0	2.0	1.9	2.0	2.0	2.0
Money multiplier	2.3	2.2	2.1	2.4	2.3	2.1	2.2	2.2	2.2	2.3	2.3
Private sector credit (in percent of GDP)	58.5	70.8	60.3	62.1	60.4	60.7	62.1	63.7	62.8	63.1	64.6
Dollarization in bank deposits 2/	45.8	43.4	42.3	43.1	41.4	40.2	37.8	36.9	37.1	37.0	36.1
Dollarization in broad money 3/	38.3	35.0	35.2	36.5	34.8	33.9	32.1	31.5	31.7	31.6	30.9
Currency in circulation in percent of deposits	19.4	23.9	20.1	18.2	19.1	18.7	17.7	17.1	17.1	17.1	17.1
NIR (U.S. dollars, program exchange rate)	1,811.5	1,131.2	1,452.7	1,307.9	1,444.5	1,506.4	1,647.1	1,582.9	1,613.4	1,521.4	1,511.5
NIR (U.S. dollars, actual exchange rate)	1,804.1	1,155.6	1,445.9	1,292.4	1,389.9	1,506.4	1,647.1	1,582.9	1,613.4	1,521.4	1,511.5

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

1/ In line with the TMU definition.

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

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

Table 5. Armenia: Financial Soundness Indicators for the Banking Sector, 2019–22

(In percent, unless otherwise indicated)

	2019	2020				2021				2022		
	Dec	Mar	Jun	Sept	Dec	Mar	Jun	Sep	Dec	Mar	June	Aug
Capital adequacy												
Total regulatory capital to risk-weighted assets	17.6	17.0	17.4	17.1	16.9	17.0	17.0	17.2	17.2	17.2	18.6	19.9
Capital (net worth) to assets	14.1	14.1	14.6	14.0	13.1	13.3	13.0	12.8	13.0	14.8	15.2	15.8
Asset composition												
Sectoral distribution of loans (in billions of drams)												
Industry (excluding energy sector)	357.4	375.2	371.8	404.5	436.3	435.2	418.2	389.3	390.2	415.7	375.7	374.4
Energy sector	134.0	153.5	154.0	180.8	209.0	195.9	127.5	136.5	120.8	132.8	122.1	121.0
Agriculture	161.4	171.6	177.7	189.4	198.0	200.6	190.6	196.3	222.3	230.4	227.5	222.2
Construction	192.7	213.8	225.1	247.6	269.1	275.0	304.2	325.1	315.2	333.7	328.4	336.1
Transport and communication	101.7	114.7	108.4	110.4	141.8	139.8	129.6	121.8	126.9	116.7	101.4	88.1
Trade/commerce	508.6	501.1	513.4	537.7	533.9	532.8	501.3	481.0	482.4	504.9	472.1	470.6
Consumer credits	915.9	951.9	955.5	960.9	929.0	915.6	871.2	833.2	824.8	834.4	824.6	835.6
Mortgage loans	358.8	395.0	404.6	441.2	481.2	517.2	551.5	587.3	654.7	698.0	721.9	761.2
Sectoral distribution of loans to total loans (percent of total)												
Industry (excluding energy sector)	10.1	10.3	10.0	10.4	10.8	11.0	11.2	10.5	10.3	10.6	9.9	9.6
Energy sector	3.8	4.2	4.1	4.6	5.2	4.9	3.4	3.7	3.2	3.4	3.2	3.1
Agriculture	4.6	4.7	4.8	4.9	4.9	5.1	5.1	5.3	5.9	5.9	6.0	5.7
Construction	5.5	5.9	6.1	6.3	6.7	6.9	8.1	8.8	8.3	8.5	8.6	8.7
Transport and communication	2.9	3.2	2.9	2.8	3.5	3.5	3.5	3.3	3.3	3.0	2.7	2.3
Trade/commerce	14.4	13.8	13.8	13.8	13.2	13.4	13.4	13.0	12.7	12.9	12.4	12.1
Mortgage loans	10.2	10.8	10.9	11.3	11.9	13.0	14.8	15.8	17.3	17.8	18.9	19.6
Consumer credits	26.0	26.2	25.7	24.6	23.0	23.1	23.3	22.4	21.8	21.3	21.6	21.5
Foreign exchange loans to total loans	52.4	53.1	51.4	50.6	51.7	51.5	48.4	47.3	45.5	46.0	40.5	38.5
Asset quality												
Nonperforming loans (in billions of drams)	200.0	211.0	217.8	241.7	272.1	290.0	236.8	113.6	74.1	72.6	113.9	111.9
Watch (up to 90 days past due)	75.1	73.9	81.6	100.6	84.0	95.2	75.4	82.6	64.8	82.5	72.7	62.8
Substandard (91-180 days past due)	68.3	79.9	85.3	89.6	129.0	121.5	90.4	66.7	46.4	39.9	37.3	38.9
Doubtful (181-270 days past due)	56.6	57.2	50.8	51.4	59.1	73.3	71.0	46.9	27.7	32.8	76.5	73.0
Loss (>270 days past due, in billions of drams)	286.5	313.5	315.5	328.5	360.1	357.8	394.0	428.8	440.6	455.2	434.9	435.4
Nonperforming loans to gross loans	5.5	5.5	5.7	6.0	6.6	7.1	6.1	2.9	1.9	1.8	2.9	2.8
Provisions to nonperforming loans	49.9	48.7	46.2	41.8	45.0	45.2	49.4	84.1	99.7	91.2	76.5	77.2
Spread between highest and lowest rates of interbank borrowing in AMD	0.9	0.9	0.9	1.1	2.5	0.9	1.8	0.3	1.6	6.5	1.2	1.5
Spread between highest and lowest rates of interbank borrowing in FX	1.7	0.6	0.1	1.5	2.1	0.4	0.3	0.0	0.6	1.8	1.3	0.5
Earnings and profitability												
ROA (profits to period average assets)	1.7	1.52	1.79	1.60	1.28	1.12	0.84	0.9	1.1	2.3	3.7	4.2
ROE (profits to period average equity)	11.2	10.6	12.4	11.3	9.0	8.3	6.3	6.6	8.7	16.7	26.3	29.1
Interest margin to gross income	31.8	33.3	33.7	33.6	33.7	35.2	34.5	33.5	32.3	26.2	24.2	24.5
Interest income to gross income	73.4	74.7	75.5	75.4	74.7	76.7	76.5	76.3	75.5	65.0	58.2	57.6
Noninterest expenses to gross income	30.6	28.8	27.6	27.1	27.1	26.7	28.7	28.6	29.3	26.9	25.3	24.8
Liquidity												
Liquid assets to total assets	27.1	27.0	26.9	27.7	25.6	28.1	30.8	31.7	32.0	31.1	32.6	34.9
Liquid assets to total short-term liabilities	111.7	118.5	119.3	117.0	108.8	117.6	122.1	120.1	122.7	117.5	111.8	113.0
Customer deposits to total (non-interbank) loans	112.1	109.7	107.1	105.2	106.9	108.7	115.3	117.3	119.7	114.3	118.2	121.4
Foreign exchange liabilities to total liabilities	55.4	56.0	52.6	52.5	52.8	52.1	49.8	48.4	47.4	47.7	46.8	48.1
Sensitivity to market risk												
Gross open positions in foreign exchange to capital	4.0	4.3	3.1	3.1	4.5	4.2	3.6	5.5	5.9	12.4	9.3	6.8
Net open position in FX to capital	0.3	-3.6	0.3	1.1	1.3	-2.1	-0.1	1.5	4.6	11.1	7.2	5.0

Source: Central Bank of Armenia.

Note: In July 2021, the CBA aligned the NPL definition with the BCBS regulation. New NPL definition only takes into account exposures that are more than 90 days past due (doubtful and substandard loans)

Table 6. Armenia: Proposed Fund Credit Available and Timing of Reviews Under the Standby Arrangement

Date of Availability	Conditions	Amount (millions of SDRs)	Percent of Quota	Percent of Quota (cumulative)
December 12, 2022	Board approval of the arrangement	18.400	14.29	14.29
June 9, 2023	Observance of end-Dec 2022 performance criteria and continuous performance criteria, and completion of first review	18.400	14.29	28.57
December 11, 2023	Observance of end-June 2023 performance criteria and continuous performance criteria, and completion of second review	18.400	14.29	42.86
June 10, 2024	Observance of end-December 2023 performance criteria and continuous performance criteria, and completion of third review	18.400	14.29	57.14
December 11, 2024	Observance of end-June 2024 performance criteria and continuous performance criteria, and completion of fourth review	18.400	14.29	71.43
June 9, 2025	Observance of end-December 2024 performance criteria and continuous performance criteria, and completion of fifth review	18.400	14.29	85.71
November 21, 2025	Observance of end-June 2025 performance criteria and continuous performance criteria, and completion of sixth review	18.400	14.29	100.00
	Total	128.8	100.00	100.00

Sources: Fund staff estimates and projections.

Table 7. Armenia: Indicators of Capacity to Repay the Fund, 2022–30 1/

	2022	2023	2024	2025	2026	2027	2028	2029	2030
					Projections				
Fund obligations based on existing credit									
(in millions of SDRs)									
Principal	14.0	70.2	128.6	99.9	45.1	14.2	0.0	0.0	0.0
Charges and interest	0.0	19.5	14.1	9.2	6.6	5.1	4.9	4.9	4.9
Fund obligations based on existing and prospective credit 1/									
In millions of SDRs	14.1	91.3	146.4	112.7	69.8	55.2	44.2	38.3	19.0
In millions of US$	19.6	127.9	206.1	158.6	98.3	77.7	62.3	54.0	26.7
In percent of Gross International Reserves	0.5	4.7	7.6	5.7	3.6	2.9	2.3	2.0	1.0
In percent of exports of goods and services	0.3	1.7	2.3	1.9	1.0	0.7	0.5	0.4	0.2
In percent of external public debt service	4.1	22.7	31.5	14.2	16.2	15.8	13.9	5.8	7.8
In percent of GDP	0.1	0.8	0.9	0.7	0.4	0.3	0.2	0.2	0.1
In percent of quota	10.9	70.9	113.6	87.5	54.2	42.9	34.3	29.8	14.7
Outstanding Fund credit based on existing drawings									
In millions of SDRs	357.9	287.7	159.1	59.3	14.2	0.0	0.0	0.0	0.0
In billions of US$	0.5	0.4	0.2	0.1	0.0	0.0	0.0	0.0	0.0
In percent of Gross International Reserves	13.3	11.4	6.4	2.5	0.6	0.0	0.0	0.0	0.0
In percent of exports of goods and services	6.4	4.7	2.5	0.9	0.2	0.0	0.0	0.0	0.0
In percent of external public debt service	103.9	71.4	34.3	7.5	3.3	0.0	0.0	0.0	0.0
In percent of GDP	2.7	2.0	1.0	0.4	0.1	0.0	0.0	0.0	0.0
In percent of quota	277.9	223.3	123.5	46.0	11.0	0.0	0.0	0.0	0.0
Outstanding Fund credit based on existing and prospective drawings 1/									
In millions of SDRs	376.3	342.9	251.1	188.1	129.2	82.8	46.0	13.8	0.0
In billions of US$	0.5	0.5	0.4	0.3	0.2	0.1	0.1	0.0	0.0
In percent of Gross International Reserves	13.9	17.7	13.0	9.5	6.7	4.3	2.4	0.7	0.0
In percent of exports of goods and services	6.7	6.5	3.9	3.1	1.8	1.1	0.5	0.1	0.0
In percent of external public debt service	109.2	85.1	54.1	23.6	29.9	23.7	14.5	2.1	0.0
In percent of GDP	2.8	2.9	1.6	1.3	0.8	0.5	0.2	0.1	0.0
In percent of quota	292.1	266.2	195.0	146.0	100.3	64.3	35.7	10.7	0.0
Net use of Fund credit (millions of SDRs) existing and prospective 1/	82.2	-52.8	-107.6	-73.6	-69.8	-55.2	-44.2	-38.3	-19.0
Disbursements	96.3	38.6	38.8	39.0	0.0	0.0	0.0	0.0	0.0
Repayments and Repurchases	14.1	91.3	146.4	112.6	69.8	55.2	44.2	38.3	19.0
Memorandum items (adverse scenario)									
Nominal GDP (in millions of US$)	18,583	16,396	22,061	21,154	22,661	24,308	29,807	32,885	36,275
Exports of goods and services (in millions of US$)	7,786	7,425	9,040	8,463	10,117	10,743	13,173.4	14,534.2	16,032.2
Gross international reserves (in millions of US$)	3,771	2,706	2,711	2,791	2,706	2,706	2,706	2,706	2,706

Sources: IMF staff estimates and projections.

1/ Assumes access of 128.8 million SDR over 2022-2025 and semi-annual disbursements. The ratios in the corresponding lines use GDP, reserves, exports, and debt service in the adverse scenario case.

Annex I. Spillovers from the War in Ukraine

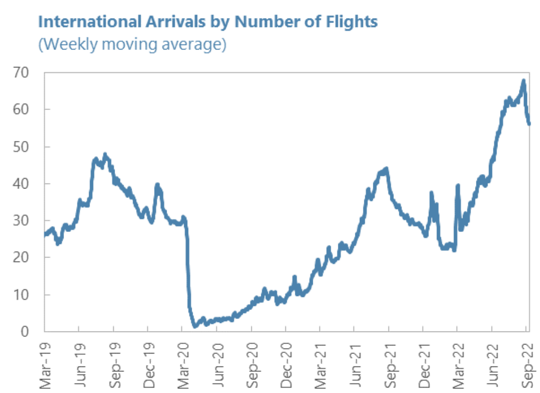
An influx of international visitors, enterprises, and money transfers have boosted aggregate demand, while the authorities' efforts to absorb the arrivals, preserve financial stability, and ensure compliance with international sanctions have worked well. Nonetheless, medium-term risks remain substantial due to price pressures and Armenia's strong trade, remittances, and financial links with Russia. This underscores the need for structural reforms to diversify Armenia's trade destinations, develop infrastructure, improve the business environment, and raise the quality of public services.

1. The war in Ukraine triggered a slew of cross-border developments:

- **International arrivals in Armenia**. The number of international flights has increased by about 150 percent since March, and hotel occupancy rates in Armenia are at record highs. The number of tourists in Armenia have doubled in January–September 2022 compared to the same period of 2021. Spending per tourist increased by 50 percent in 2022H1 y-o-y.

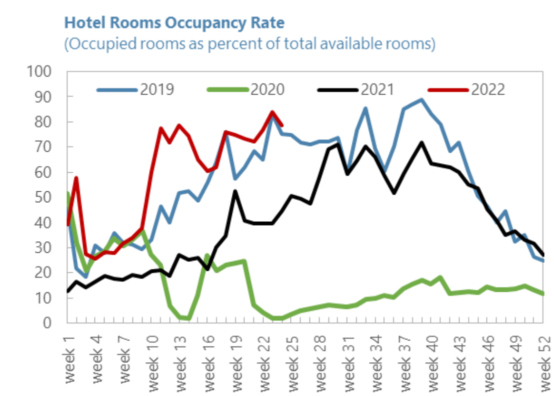
Figure AI.1. Armenia: International Arrivals

International arrivals in Armenia have skyrocketed…



Source: FlightRadars

…and hotel occupancy has exceeded pre-COVID19 levels.

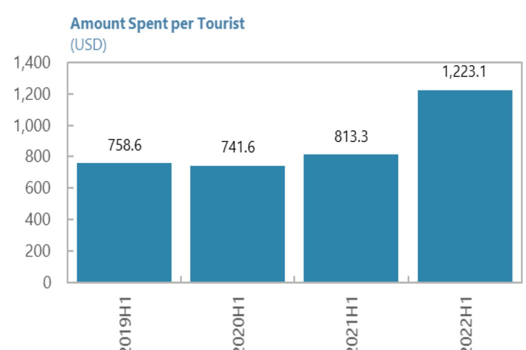


Source: STRHotels

The number of tourists has risen sharply…

Sources: National authorities and IMF staff calculations.
Note: Data for 2022 available through September.

…as has the amount tourists spent in Armenia.

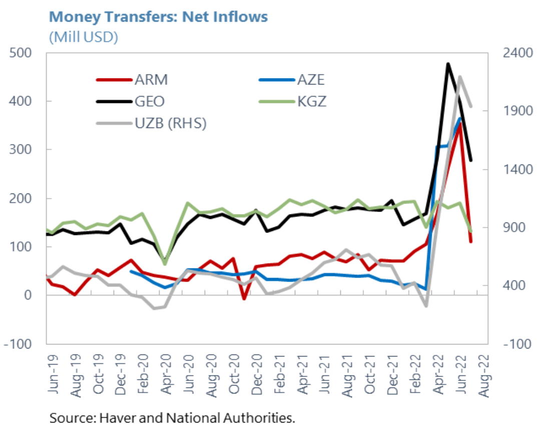


Sources: National authorities and IMF staff calculations.

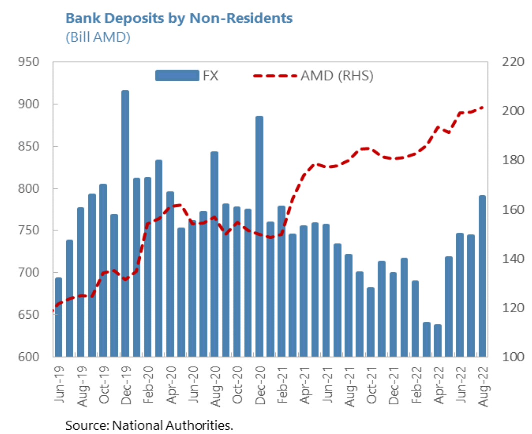
- **Relocation of businesses and individuals**. Over the period February–August 2022, around 35 thousand people moved from Russia to Armenia. Moreover, the State Register of Legal Entities of Armenia recorded a sharp increase in the number of newly created foreign-owned companies (1784) and non-resident individual entrepreneurs (3132), particularly in the IT sector (810 and 2235, respectively). The number of registered non-resident employees in Armenia increased by 6332 persons over the same period.

Figure AI.2. Armenia: Trade and Financial Spillovers from the War in Ukraine

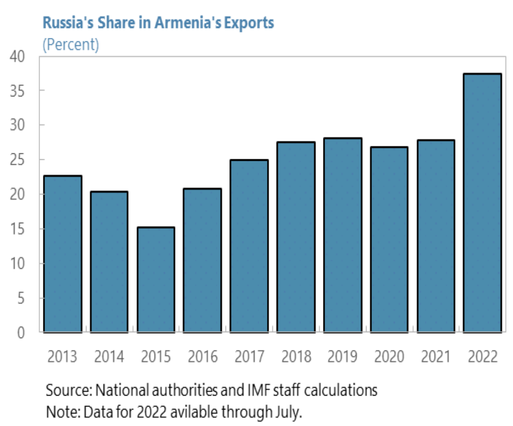
The inflow of money transfers…



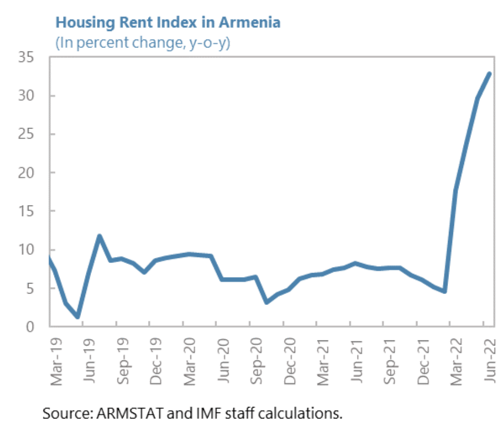
…caused non-resident deposits to rise.



Armenia's exports are now more dependent on Russia.



Demand has pushed rent prices to historic levels.



- **Money transfers** have increased by more than 130 percent y-o-y in January–August 2022, reflecting inflows of capital and remittances (which more than doubled to $1.3 billion in 2022Q2), contributing to dram appreciation against the US dollar by almost 20 percent since March 2022 and a 5-fold increase in the number of bank accounts of Russian residents in

Armenia to about 61 thousand in February–July 2022.[1] Non-resident current deposits in Armenian commercial banks increased by AMD 460 billion over the same period.

- **Trade with Russia** increased by almost 71.6 percent y-o-y in January–August 2022. Exports to Russia had the largest positive contribution of 28.3 percent to the overall export growth of 52.9 percent y-o-y in January–August. Overall, the share of exports to Russia increased to about 36 percent in January–August from 27 percent in the same period of 2021.

2. These developments have played a major role in boosting Armenia's 2022 economic growth. Services grew by unprecedented rates in 2022H1: accommodation, transportation, and financial services grew by 35–40 percent in real terms y-o-y; IT services grew by 26 percent. Construction grew by 20 percent, while the stock of FDI grew by 25 percent y-o-y in 2022H1, driving an investment growth of 17 percent.

3. At the same time, excess demand has exerted great pressure on prices. Inflation, which had started moderating at the beginning of 2022, picked up quickly when the war in Ukraine broke out despite monetary policy tightening and rapid dram appreciation. Wages grew by 12.9 percent y-o-y—15.3 percent in the private sector—in January-August. Rental prices skyrocketed by 34 percent y-o-y by September 2022.

4. Nonetheless, the effects on the financial sector have been limited. The number of correspondent banking relationships in ruble and renminbi with Russian and Chinese banks increased during May–August. Sanctioned bank VTB remains operational but has downsized significantly from 8th at end-2021 to 14th by asset size now.

5. Yet, there is great uncertainty about the short and medium-term impact of these developments on Armenia's economy.

- **Labor**. Survey data[2] suggests that 90 percent of international visitors are of working age (18–45 years), with a high level of education (77.4 percent) and employed (76.3 percent) mainly in the IT sector (70.2 percent). It bodes well for potential output and growth should these individuals remain in Armenia permanently. In fact, more than half of surveyed individuals indicate that they intend to stay in Armenia for at least six months. However, they also indicate that they face challenges with high prices and quality of accommodation, difficulties with opening bank accounts, transferring money from Russia, and accessing healthcare, education, childcare, and employment (for those who are unemployed). Integrating these individuals in the labor force permanently would require that they have access to quality public and private services in Armenia.

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[1] Source: The Central Bank of Armenia.

[2] Source: Rapid assessment among Russian, Belarusian, and Ukrainian Migrants in the Republic of Armenia, prepared by Prisma LLC and International Organization for Migration in Armenia, August 2022.

- **Capital flows**. Significant gross capital inflows (about US$ 1.4 billion) are projected for 2022. Growth of FDI and newly registered companies is another sign that potential output may grow faster than projected. It also provides some comfort that any abrupt reversal of capital flows would be limited. Nonetheless, an increase of some US$ 0.6 billion of deposits since the beginning of the war in Ukraine could potentially trigger disorderly market conditions in the event of a reversal. It is critical to maintain adequate reserve buffers to respond to potential balance of payments shocks.[3]

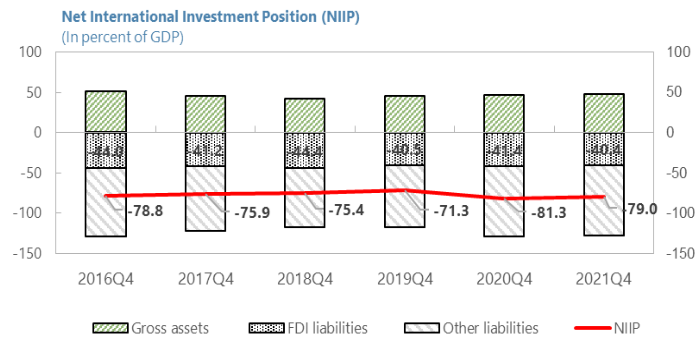
- **Trade**. Russia's growing share in Armenia's exports increases the economy's exposure to weaker economic activity prospects in Russia. This underscores the urgency to complete reforms that will diversify Armenia's export basket and trading partners as well as policies that increase absorption capacity. It also highlights the importance of continued stringent monitoring of observance of international sanctions by companies and banks.

[3] Information is based on balance of payment statistics for 2022Q2, corresponding to the most recent available data point.

Annex II. External Sector Assessment

Overall Assessment and Policy Responses: *The external position of Armenia in 2021 was broadly in line with the level implied by fundamentals and desirable policies. In the near term, prudent fiscal policy remains important to contain excessive current account expansion amid robust growth and buoyant domestic consumption. Over the medium term, implementation of structural reforms would help improve exports and attract foreign investment, supporting the external position.*

Foreign Assets and Liabilities: Position and Trajectory



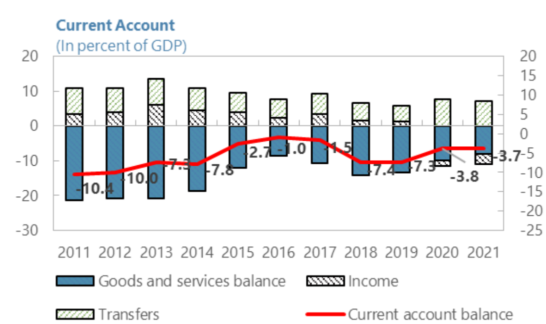
Sources: National authorities and IMF staff calculations.

1. Background. The net international investment position (NIIP) improved to around -78.9 percent of GDP at the end of 2021, from -81.3 percent in December 2020, reflecting both a narrower current account balance in 2021 and an improvement in the nominal GDP in US dollar terms (as a result of positive real growth). Under staff's baseline projections, the NIIP is expected to worsen slightly in 2022, in line with a wider current account deficit, and remain stable at around -80 percent of GDP in the medium-term.

2. Assessment. The negative IIP does not pose immediate risks to external sustainability. The NIIP has remained broadly stable over the past five years (Text Chart) and is consistent with the economy's need for investment-related imports, as envisaged in the government's program. Nonetheless, the share of foreign direct investments (FDI) over total liabilities has declined from 44 percent of GDP at end-2016 to close to 40 percent at end-2021. This suggests some increase in vulnerability from the composition of the IIP, as debt flows replace more stable FDI as a source of external financing.

2021 (percent GDP)	NIIP: -79.0	Gross Assets: 48.5	Debt Assets: 21.6	Gross Liab.: 127.4	Debt Liab.: 87.0

Current account



Sources: National authorities, and IMF staff calculations and projections.

3. Background. In 2021, the current account balance (CAB) narrowed slightly to -3.7 percent of GDP, from -3.8 percent in 2020. This reflects a rebound in external demand; robust service exports following the recovery in tourism; and strong remittances inflows. In 2022, the current account is expected to widen to around -5.6 percent of GDP on account of increased imports (amid strong private consumption); relative strength of the dram against the US dollar (which is expected to stimulate imports); and higher non-fuel commodity prices. The CA deficit is expected to remain around 5½ percent of GDP in 2023, reflecting import compression, before gradually converging to its norm of 5 percent of GDP (see next paragraph) in the medium-term.

4. Assessment. The EBA-Lite current account (CA) model estimates a cyclically adjusted current account norm of -5 percent of GDP for 2021, against an adjusted CA deficit of 4.1 percent of GDP; this implies a small positive gap of about 0.9 percent of GDP and a small REER undervaluation of 3 percent. The assessment includes adjustments to the current account to reflect risks arising from natural disasters and conflicts but excludes additional COVID-19 adjustors for tourism exports and remittances, which rebounded in 2021. Therefore, based on the CA model, Armenia's 2021 external position is assessed as broadly in line with the level implied by fundamentals and desirable policies. Results obtained using the EBA-Lite Real Effective Exchange Rate (REER) and External Stability (ES) models are consistent with this assessment.

Armenia: EBA-lite Model Results, 2021

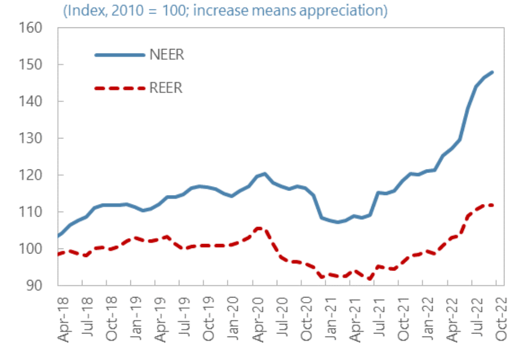
	CA model 1/	**REER model** 1/	**ES model**
		(in percent of GDP)	
CA-Actual	**-3.7**		
Cyclical contributions (from model) (-)	0.6		
Natural disasters and conflicts (-)	-0.2		
Adjusted CA	**-4.1**		
CA Norm (from model) 2/	**-5.0**		
Adjustments to the norm (-)	0.0		
Adjusted CA Norm	**-5.0**		
CA Gap	**0.9**	**1.6**	**0.9**
o/w Relative policy gap	4.5		
Elasticity	-0.29		
REER Gap (in percent)	**-3.0**	**-5.4**	**-3.2**

1/ Based on the EBA-lite 3.0 methodology
2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

5. Background. The REER appreciated on average by 1.1 percent in 2021 relative to 2020, reflecting a moderate increase in inflation differentials with respect to trading partners (approximately 3.6 percent) and nominal appreciation. Between January and September 2022, the REER further appreciated by about 12 percent,

Real and Nominal Effective Exchange Rates
(Index, 2010 = 100; increase means appreciation)



Source: National authorities

mainly because of sustained nominal appreciation of the Armenian dram against the US dollar since the beginning of the war in Ukraine. In the same period, the dram appreciated on average by 19 percent in nominal terms against the US dollar, on account of (i) greater demand for dram from foreign nationals who relocated to Armenia and (ii) greater use of the ruble and dram instead of the US dollar for trade invoicing with Russia, including for payment of gas imports.

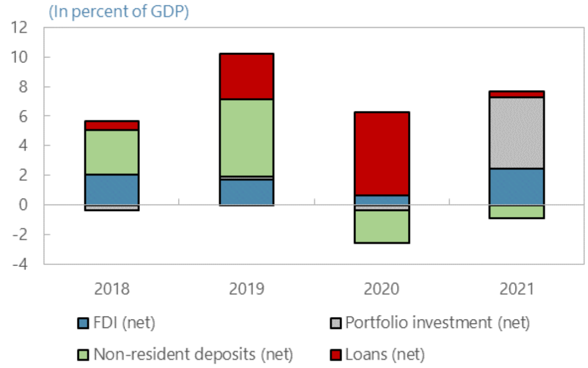
6. Assessment. The EBA-Lite CA model (see above) estimates a small REER gap of -3.0 percent for 2021 based on an elasticity of the REER to the current account of -0.28 percent. This is consistent with a small undervaluation of about 5.4 percent for 2021 produced by the REER model for the same year (Text Table), as well as with estimates produced by the ES model, which suggests an undervaluation of approximately 3.2 percent of GDP.

Capital and Financial Accounts

7. Background. Net capital flows to Armenia increased to approximately 0.9 billion US dollars in 2021, up from 0.6 billion in 2020. The increase was the result of higher portfolio inflows (on account of Eurobond issuances), as well as a rebound in foreign direct investments relative to 2020. Other capital inflows declined to -0.2 billion US dollars (from a positive inflow of 0.4 billion in 2020), reflecting a contraction in loan inflows.

8. Assessment. Spreads on Armenia's Eurobond increased by more than 200 basis points between end-January and end-September 2022, suggesting worsening sovereign risk perceptions after the beginning of the war in Ukraine as well as tightening of global financial conditions. Given elevated deposit dollarization and high share of non-resident foreign currency deposits in the banking system, Armenia remains potentially vulnerable to sudden shifts in global financial conditions. Continued de-dollarization efforts and policies aimed at increasing the share of FDI in external financing (including through timely implementation of structural reforms) will be important to mitigate these vulnerabilities over the medium-term.

Capital Flows
(In percent of GDP)



Sources: ARMSTAT and IMF staff calculations.

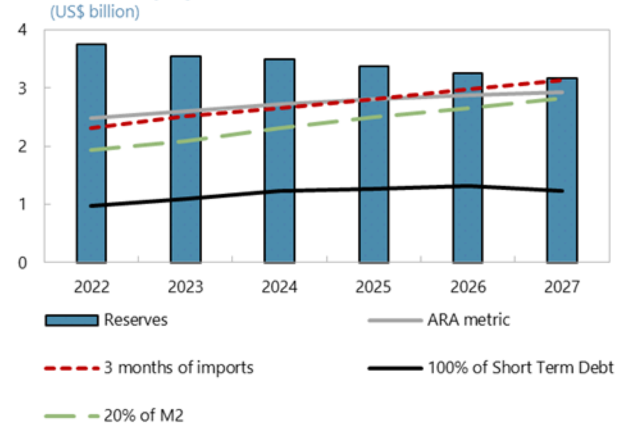
Armenia: Sovereign Spreads
(In basis points)

Sources: JP Morgan EMBIG, and IMF staff calculations.

FX Intervention and Reserves Level

9. Background and assessment. Gross international reserves increased from US$ 2.6 billion at end-2020 to approximately US$ 3.2 billion at the end-2021, roughly equivalent to 4.8 months of prospective imports. In 2021, the reserve position was supported by a recovery in FDI inflows; external public borrowing through Eurobond issuances; and the SDR allocation (approximately US$ 176 million in August 2021). In the first three quarters of 2022, the authorities carried out US$ purchases to build external buffers, for a total of approximately US$ 0.3 billion. Based on the IMF's reserve adequacy (ARA) metric, Armenia's gross international reserves are estimated to be adequate at over 140 percent of the ARA metric at end-2021, strengthening to 150 percent of the projected 2022 ARA metric at end-September 2022, and are expected to remain above 110 percent throughout the forecast horizon.

Reserve Adequacy Indicators
(US$ billion)



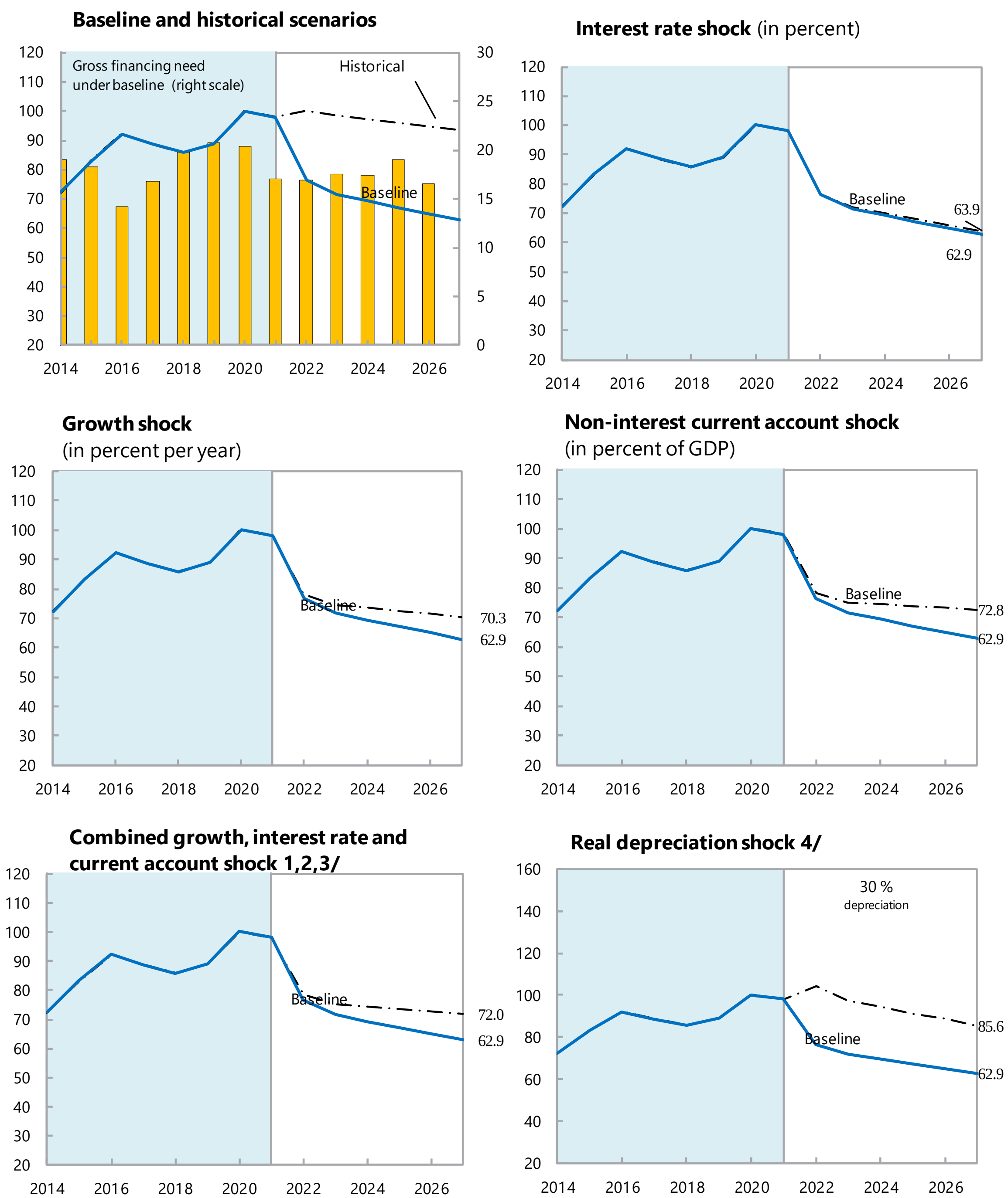
Source: National authorities and IMF staff calculations and projections.

External Debt Sustainability

10. Armenia's external debt-to-GDP ratio has improved in 2021 and is expected to decline further under staff's baseline scenario. The debt-to-GDP ratio declined to 98.1 percent at end-2021, from 100.1 percent at end-2020. External debt is expected to decline substantially in 2022, given the large dram appreciation against the US dollar (see above), and to continue declining over the medium term in line with the projected gradual fiscal consolidation. Nevertheless, results from standardized shocks highlight significant vulnerabilities, especially from variations in the exchange rate, with the external debt-to-GDP ratio increasing to above 100 percent following a one-time 30-percent real depreciation. Shocks to growth and the current account would also lead to higher external debt in the medium-term relative to the baseline. Nonetheless, external debt remains broadly resilient to interest rate shocks given the relatively high share of concessional financing in external public debt.

Figure AII.1. Armenia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2022

Figure AII.2. Armenia: External Debt Sustainability Framework, 2018–27

(In percent of GDP, unless otherwise indicated)

	2018	2019	2020	2021	10-Year Historical Average	10-Year Standard Deviation	2022	2023	2024	2025	2026	2027	Debt-stabilizing non-interest current account 6/
Baseline: External debt	85.9	89.0	100.1	98.1			**76.6**	**71.7**	**69.3**	**67.1**	**65.1**	**62.9**	**-4.2**
Change in external debt	-2.9	3.1	11.1	-2.0			-21.5	-4.9	-2.3	-2.2	-2.0	-2.2	
Identified external debt-creating flows (4+8+9)	-1.4	-1.7	10.5	-7.6			-23.3	-4.0	-1.9	-1.7	-1.5	-1.6	
Current account deficit, excluding interest payments	3.4	3.7	-0.6	-0.3			2.4	2.6	2.6	2.7	2.8	2.6	
Deficit in balance of goods and services	13.6	13.2	9.9	8.3			8.2	7.8	7.5	7.4	7.2	6.9	
Exports	39.7	42.0	29.8	35.2			40.8	40.2	39.6	38.9	38.6	38.2	
Imports	53.3	55.2	39.7	43.5			49.0	48.0	47.1	46.4	45.8	45.0	
Net non-debt creating capital inflows (negative)	-1.8	-1.8	-0.2	-2.4			-4.0	-1.9	-2.2	-2.4	-2.3	-2.2	
Automatic debt dynamics 1/	-3.0	-3.6	11.2	-4.9			-21.7	-4.7	-2.3	-2.0	-2.0	-2.1	
Contribution from nominal interest rate	3.6	3.7	4.4	4.0			3.2	2.9	2.8	2.7	2.4	2.3	
Contribution from real GDP growth	-4.3	-6.0	6.9	-5.2			-8.0	-3.1	-3.0	-2.9	-2.8	-2.7	
Contribution from price and exchange rate changes 2/	-2.3	-1.3	0.0	-3.6			-16.8	-4.6	-2.1	-1.8	-1.7	-1.7	
Residual, incl. change in gross foreign assets (2-3) 3/	-1.5	4.9	0.7	5.6			1.8	-0.9	-0.4	-0.6	-0.5	-0.5	
External debt-to-exports ratio (in percent)	216.5	212.0	336.4	278.6			187.7	178.3	175.2	172.3	168.7	164.8	
Gross external financing need (in billions of US dollars) 4/	2.5	2.8	2.6	2.4			3.2	3.6	3.9	4.5	4.2	4.2	
in percent of GDP	19.8	20.7	20.3	17.1			17.0	17.6	17.4	19.0	16.5	15.5	
Scenario with key variables at their historical averages 5/							**100.0**	**98.4**	**97.3**	**96.0**	**94.8**	**93.5**	**-2.2**
Key Macroeconomic Assumptions Underlying Baseline													
Real GDP growth (in percent)	5.2	7.6	-7.2	5.7	3.7	4.5	11.0	4.5	4.5	4.5	4.5	4.5	
GDP deflator in US dollars (change in percent)	2.7	1.6	0.0	3.8	-0.3	4.4	20.8	6.3	3.0	2.6	2.5	2.7	
Nominal external interest rate (in percent)	4.4	4.7	4.6	4.3	4.3	0.5	4.3	4.2	4.2	4.1	3.9	3.9	
Growth of exports (US dollar terms, in percent)	12.1	15.7	-34.2	29.7	7.5	17.6	55.3	9.5	6.0	5.5	6.1	6.2	
Growth of imports (US dollar terms, in percent)	17.5	13.1	-33.2	20.3	3.7	18.2	50.8	8.9	5.7	5.5	5.7	5.6	
Current account balance, excluding interest payments	-3.4	-3.7	0.6	0.3	-1.7	3.6	-2.4	-2.6	-2.6	-2.7	-2.8	-2.6	
Net non-debt creating capital inflows	1.8	1.8	0.2	2.4	3.0	2.4	4.0	1.9	2.2	2.4	2.3	2.2	

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

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

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

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

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

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

Annex III. Risk Assessment Matrix[1]

Risk Assessment Matrix				
Risk	**Description**	**Likelihood**	**Possible Impact**	**Policy Advice**
Conjunctural risks				
Intensifying spillovers from Russia's war in Ukraine.	Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility, with Europe, LICs, and commodity-importing EMs among the worst hit.	High	Broader sanctions on Russia could adversely affect Armenia's trade—including tourism—remittances and investment inflows, increase food prices and inflation further, and put pressure on the dram. The sanctions may also pose financial stability and compliance risks, potentially exacerbating CBR pressures.	Maintain a tight monetary policy stance to keep inflation expectations anchored. Maintain a flexible exchange rate to act as a shock absorber. Build fiscal buffers and provide targeted support to the most vulnerable, especially to address potential food insecurity. Mobilize external official financing in case the available resources prove insufficient to provide an adequate response. Enhance supervision of the financial sector to ensure implementation of AML/CFT preventive measures that also mitigate sanctions evasion risk.
Commodity price shocks.	A combination of continuing supply disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.	High	Rising food and energy prices could build further inflationary pressures, lead to food and energy insecurity, hamper economic activity, and cause social discontent.	Maintain adequate monetary policy stance to curtail inflationary pressures. Build fiscal and external buffers, reprioritize spending and provide necessary, targeted support to the most vulnerable.
Systemic social unrest.	Rising inflation, declining incomes, and worsening inequality amplify social unrest and political instability, causing capital outflows from EMDEs, slowing economic growth, and giving rise to economically damaging populist policies (e.g., preserving fossil fuel subsidies).	High	Negative spillovers from the war in Ukraine, rise in food and energy prices, shortage of food supplies, and new pandemic waves may lead to social discontent and political instability in Armenia.	Build fiscal cushions, strengthen social safety nets, undertake labor market reforms, and put in place necessary administrative and policy measures to help secure food and energy supplies.
Abrupt global slowdown or recession.	Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright	Medium	A slowdown in trading partners will affect economic activity and	Strengthen and diversify trade channels/markets. Enhance diplomacy.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path.

Risk Assessment Matrix				
Risk	**Description**	**Likelihood**	**Possible Impact**	**Policy Advice**
	recessions in some countries, spillovers through trade and financial channels, and downward pressures on some commodity prices. • **U.S.:** Amid persistently high inflation driven by tight labor markets, supply disruptions and continued commodity price shocks, the Fed tightens policies faster and by more than anticipated, resulting in a "hard landing", housing market correction, and a stronger U.S. dollar. • **Europe:** The fallout from the war in Ukraine is exacerbated by a gas shutoff by Russia, resulting in acute gas shortages and further supply disruptions, which triggers an EU recession. • **China:** Covid-19 lockdowns, rising geopolitical tensions, a sharper-than-expected slowdown in the property sector, or inadequate policy responses result in a sharp slowdown of economic activity. **EMDEs:** Sharp tightening of global financial conditions combined with volatile commodity prices leads to spiking risk premia, widening of external imbalances and fiscal pressures, capital outflows, sudden stops, and debt and financial crises across EMDEs.	 Medium High Medium High	result in an abrupt bout of risk aversion for Armenia.	Allow the exchange rate to operate as a shock absorber, intervene in the fx market to address disorderly market conditions.
Local Covid-19 outbreaks.	Outbreaks in slow-to-vaccinate countries or emergence of more contagious vaccine-resistant variants force new lockdowns or inhibit commerce. This results in extended supply chain	Medium	Renewed lockdowns would affect economic activity, may trigger capital outflows and dram depreciation, and cause debt defaults.	Provide fiscal measures to ensure adequate vaccine rollout for the population, and targeted support to households and companies that are most adversely affected and vulnerable to the pandemic.

Risk Assessment Matrix				
Risk	**Description**	**Likelihood**	**Possible Impact**	**Policy Advice**
	disruptions, slower growth, capital outflows, and debt distress in some EMDEs.			
De-anchoring of inflation expectations and stagflation.	Supply shocks to food and energy prices sharply increase headline inflation and pass through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged leading to weaker global demand, currency depreciations in EMDEs, and sovereign defaults. Together, this could lead to the onset of stagflation.	Medium	Armenia' economic outlook could worsen due to lower export demand and remittances and depreciation of the dram. Armenia's external debt is not sensitive to interest shocks, but public debt is sensitive to exchange rate shocks. Dollarization in the financial system also makes it vulnerable to exchange rate shocks.	Diversify trade channels, continue the de-dollarization efforts, maintain exchange rate flexibility, and strengthen banking supervision and provisions to respond in the event of higher NPLs in dollar.
Structural Risks				
Deepening geo-economic fragmentation and geopolitical tensions.	Broadening of conflicts and reduced international cooperation accelerate deglobalization, resulting in a reconfiguration of trade, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial system, and lower potential growth.	High	The war in Ukraine and regional tensions would have adverse political and economic implications, including higher uncertainty and lower trade and investment.	Strengthen and diversify trade channels/markets. Enhance diplomacy. Prepare and implement contingency plans. Strengthen social safety nets. Undertake structural reforms to build resilience of the domestic economy.
Cyberthreats	Cyberattacks on critical physical or digital infrastructure (including digital currency platforms) trigger financial instability or widespread disruptions in socio-economic activities.	Medium	Highly uncertain assessment of systemic risks and potential economic costs due to insufficient information and evolving risks.	Strengthening international and regional cooperation and developing government and business contingency and continuation plans.
Natural disasters related to climate change.	More frequent natural disasters deal severe damage to infrastructure (especially in smaller vulnerable economies) and amplify supply chain disruptions and inflationary	Medium	Higher frequency and severity of natural disasters would cause severe economic damages and disrupt economic activities.	Undertake a comprehensive climate risk assessment of Armenia and develop national adaptation and mitigation policies to strengthen the resilience against climate change risks.

Risk Assessment Matrix				
Risk	**Description**	**Likelihood**	**Possible Impact**	**Policy Advice**
	pressures, causing water and food shortages and reducing medium-term growth.			
Domestic Risks				
Financial sector risks	Risks could increase due to the rapid increase in house prices and mortgage lending, the war in Ukraine, and sanctions on financial institutions and other businesses.	Medium	An NPL rise could undermine financial stability and increase government contingent liabilities. Sanctions could cause reputational damage to the economy and increase transaction costs.	Enforce prudential and provisioning rules that are consistent with international standards and strengthen further the regulatory and supervisory framework and the effective implementation of AML/CFT measures to support the establishment of new CBRs. Implement macroprudential measures. Closely monitor the financial sector.
Geopolitical tensions and regional conflict:	Risks from tensions at the border and possibly renewed military conflict and the spillovers of the war in Ukraine, will slow down growth in the Armenian economy.	High	Armenia may face greater uncertainty, lower trade, investment, and remittances, exchange rate pressures, and food supply disruptions (e.g., due to ban on food items by Russia).	Enhance diplomacy, prepare, and implement contingency plans, strengthen social safety nets, diversify trade markets/channels, enhance monitoring of the financial sector, maintain flexibility of the exchange rate as a shock absorber. CBA interventions in the FX market in case to address disorderly market conditions.
High inflation	Higher aggregate demand, including due to the inflow of international visitors and money transfers, supply constraints, and surge in global and domestic food and energy prices could lead to prolonged periods of high inflation.	High	Persistent inflation above CBA's target and an extended period of monetary policy tightening may cause loss of access to finance, dampen economic activity, cause social discontent, and increase fiscal pressures. High food prices—including due to border disruptions—raise food security concerns.	Analyze drivers of inflation, anchor inflation expectations, deliver clear communication on monetary policy priorities, and proactively respond with adequate monetary policy adjustments, whenever required. Build external and fiscal buffers to provide targeted support to the most vulnerable, if needed.

Annex IV. Illustrative Adverse Scenario

1. Armenia is vulnerable to external shocks that could worsen the reserve position, posing risks to external sustainability. Under the baseline scenario, Armenia's reserve position is expected to remain adequate throughout the forecast horizon (Annex II) and the country does not face a financing gap. Nevertheless, an external shock could widen the current account deficit and curtail capital inflows to the economy, creating a potential balance of payments need.

2. Adverse scenario. It simulates a growth contraction for 2023 in the US, the Euro Area, and Russia, with negative impact on Armenia's trade balance, remittances, and capital inflows. Staff assumes some permanent scarring effects of the shock on the output level, in line with past crisis episodes, although growth rates are expected to recover by 2024–25. The scenario also assumes that supply chain disruptions due to the war in Ukraine and unresolved border disruptions along Armenia's trading routes with Russia would result in a significant increase in food prices. Shocks to gas prices are expected to remain moderate due to Armenia's long-term contracts with Russia. Key assumptions and dynamics are described in greater detail below:

- **Exports.** In an adverse scenario, exports of goods contract by 20 percent in 2023 due to weaker demand from key trading partners (corresponding to 1.6 standard deviations of the historical change in goods exports). Following a decline in tourism receipts, service exports are also expected to decline by approximately 176 million US dollars relative to the baseline (equivalent to 1.6 standard deviations of the historical change in service credits).

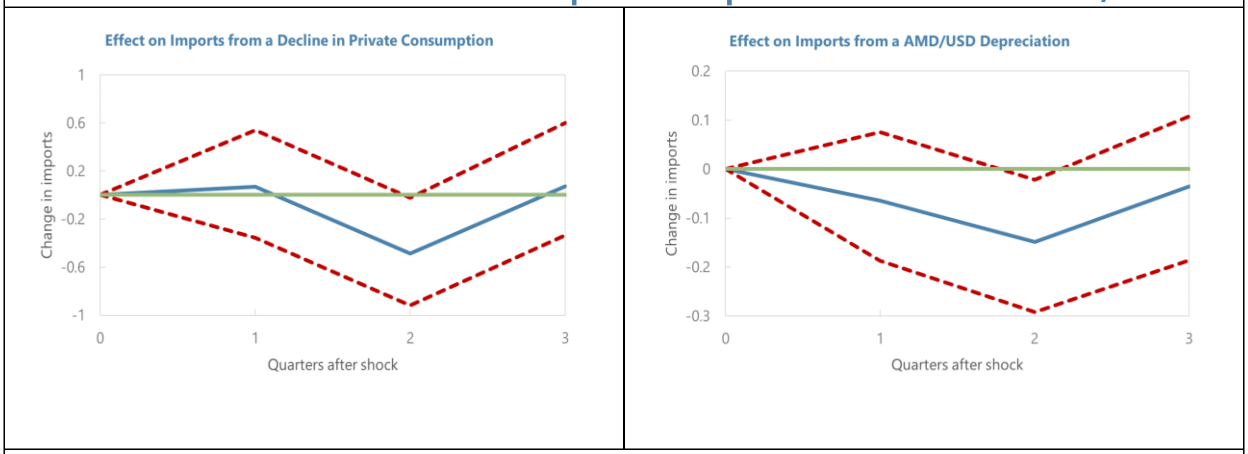
- **Food prices.** A 20 percent increase in imported food prices (1.6 standard deviations of the historical nonfuel commodity price change) would lead to a deterioration of Armenia's terms-of-trade (by 3 percent) and a 2.0 percent increase in the 2023 imports relative to baseline.

- **Remittances.** Remittances are projected to decline by 37 percent in 2023—about 1.6 standard deviations of the historical change in net transfers, which is comparable to the contraction in remittances observed after the 2008–09 and 2014 crises.

- **Capital flows.** A decline in capital inflows stemming from an abrupt reversal in global risk appetite, leads to a partial withdrawal of the capital inflows observed so far in 2022. Under the baseline scenario, net capital inflows are projected to reach a cumulative amount of US$ 2.5 billion in 2022–23. Under the adverse scenario, net inflows are projected to remain at around US$ 1.5 billion during the same period. The difference is equivalent to 1.6 standard deviations decline in other capital flows (US$ 720 million), plus the further withdrawal of US$ 300 million, roughly equivalent to half of the inflows in foreign deposits observed during the first two quarters of 2022.

3. Effects. Lower external demand and a decline in remittances would lead to a contraction in real growth and consumption, limiting imports. A higher current account deficit and capital outflows would put downward pressures on the dram and induce depreciation of 25 percent to absorb the shock.[1] The exchange rate adjustment would lead to further import compression, both directly (through higher import prices) and indirectly, as a result of its pass-through and higher consumer prices. Staff's estimates show that a one standard deviation decline in consumption is associated on average with a 0.5 standard deviation contraction in imports two quarters after the shock, while an exchange rate depreciation tends to be followed by a 0.15 standard deviation decline in imports over the same period (Text Chart). Based on these estimates, staff projects a US$ 1.2 billion decline in 2023–24 imports relative to the baseline. The magnitude of the adjustment is broadly consistent with previous crisis episodes. Exports would increase somewhat after the initial phase of the shock.

Armenia: Estimated Decline in Imports in Response to Individual Shocks 1/



Sources: National authorities and staff calculations.

1/ The figure shows impulse response functions from vector autoregressive (VAR) models for standardized changes in imports, against standardized declines in consumption (left-hand side) and AMD/USD exchange rate (right-hand side), including seasonal dummies. VAR models are estimated using quarterly data for Armenia over the period 2001/Q1 - 2022-Q1.

Armenia: Impact of a Plausible External Shock

	2022	2023		2024		2025	
	Baseline	Baseline	Adverse Scenario	Baseline	Adverse Scenario	Baseline	Adverse Scenario
National income and prices:							
Real GDP (percent change)	11.0	4.5	1.7	4.5	4.5	4.5	4.5
CPI (period average; percent change)	8.8	7.5	8.1	5.1	5.1	4.5	4.5
Overall balance on a cash basis	-2.5	-3.0	-3.8	-2.5	-3.0	-2.0	-2.0
Central Government's PPG debt (in percent)	51.3	50.0	58.8	48.7	51.5	47.8	49.5
Current account balance (in percent of GDP)	-5.6	-5.5	-7.7	-5.4	-5.2	-5.4	-5.2
Gross international reserves (in millions of U.S. dollars)	3,746	3,547	2,706	3,491	2,711	3,377	2,791

Sources: National authorities and Fund staff estimates and projections.

[1] The size of the depreciation under the adverse scenario is equivalent to the implied devaluation necessary to align the current account deficit to the estimated norm for 2021 (see Annex II).

4. Policy responses. Under the adverse scenario, the central bank would need to increase the policy rate to halt inflationary pressures that stem from the dram depreciation, dampening growth. Limited exchange rate intervention may be needed to avoid disorderly market conditions; however, it is assumed that in the shock scenario the authorities would let the dram depreciate by about 25 percent and act as a shock-absorber. Fiscal policy would initially allow automatic stabilizers to operate and be geared toward targeted support to the most vulnerable while maintaining long-term fiscal sustainability. The adverse scenario incorporates a moderate fiscal deficit widening relative to the baseline in 2023–24, equivalent to 0.8 percent of GDP additional deficit in 2023 and 0.5 percent in 2024. The overall deficit would revert to its baseline level by 2025. A larger deficit, the dram depreciation, and lower GDP level would raise public debt by close to 9 percentage points relative to baseline in 2023.

5. Implications. In the adverse scenario, reserves would decline below 95 percent of the ARA metric in 2023. Access at 100 percent of quota (SDR 128.8 million) under a Fund-supported program would help maintain reserves above 95 percent of ARA metric. Additional financing of about $250 million is expected to be provided by development partners to ensure that the reserves remain above 100 percent of ARA in 2023 and over the program horizon.

Armenia: Potential Impact of Adverse Shocks
(In millions of US dollars, unless otherwise indicated)

	Baseline				Shock			
	2022	**2023**	**2024**	**2025**	**2022**	**2023**	**2024**	**2025**
Current account	-1,036	-1,142	-1,201	-1,288	-1,036	-1,262	-1,141	-1,095
Exports G&S	7,786	8,525	9,034	9,533	7,786	7,425	9,040	8,463
Imports G&S	-9,244	-10,080	-10,660	-11,252	-9,244	-8,941	-10,606	-9,989
Incomes and transfers (net)	422	413	425	431	422	255	425	431
Capital & financial account	1,465	1,036	1,317	1,309	1,465	16	1,317	1,309
Overall balance	429	-106	116	21	429	-1,246	177	214
Financing								
Change in reserves (increase -)	-517	200	56	114	-945	1,152	-5	-79
Net use of Fund credit (repurchase)	88	-93	-172	-134	88	-93	-172	-134
Gross international reserves	3746	3547	3491	3377	3746	2407	2412	2491
As % of ARA metric	**151**	**136**	**128**	**120**	**151**	**95**	**89**	**91**
Under the proposed IMF-supported program:								
Proposed IMF financing in adverse scenario					24	49	49	50
Assumed financing from development partners 1/						250		
Gross international reserves					3771	2706	2711	2791
As % of ARA metric					**152**	**106**	**100**	**101**

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

1/ Estimated financing necessary to keep reserves above 100 percent of ARA metric during the program period.

Annex V. Public Debt Sustainability Analysis

Due to a strong recovery in GDP growth and exchange rate appreciation in 2022, Armenia's public debt remains sustainable and projected to decline sharply as a share of GDP in 2022. Staff's recommended measures would further put debt on a gradual declining path, but the high share of foreign currency debt remains a source of vulnerability. Alternative scenarios and stress tests suggest that shocks to growth and the exchange rate would have the largest impact on debt dynamics and government financing needs.

1. **Public debt declined to 63.4 percent of GDP in 2021.** This was primarily due to favorable contributions from interest rate-growth differential by -5.1 percentage points and exchange rate appreciation by 3.8 percentage points. The 2021 fiscal deficit was 4.6 percent of GDP, which the government financed with a 10-year Eurobond worth $750 million at a favorable 3.9 percent interest rate. Gross financing needs narrowed to 10.3 percent of GDP in 2021.

2. **Public debt is projected to decline further to 55.3 percent and central government debt to 51.3 percent in 2022 and remain on a declining path over the medium term in line with the fiscal rules.** This reflects staff's baseline projections, which assume a lower fiscal deficit, strong GDP growth, and exchange rate appreciation. In the medium-term, a decline in policy lending to Nagorno-Karabakh as a share of GDP will also reduce the debt-to-GDP ratio. After using the fiscal rule's escape clause during 2020–21, the authorities had committed to bring central government debt below 60 percent of GDP and put it on a gradual declining path in line with the fiscal rule. This objective is projected to be achieved in 2022, well in advance of the 5-year timeline stipulated in the fiscal rules.

3. **Gross financing needs are also projected to decline over the medium term to about 7.0 percent of GDP by 2027**. A $500-million Eurobond maturity implies a one-off rise in GFN in 2025, but it is planned to be rolled-over to meet the financing need. The remaining external gross financing (on average around $600 million per annum) is projected to be met from official multilateral/bilateral sources and the share of external financing is projected to decline over the projection horizon, with increase in borrowing through domestic T-bills and bond issuances, which are mostly in longer maturities. No IMF financing is assumed in the baseline, as the authorities intend to treat the SBA as precautionary.

4. **Baseline projections are subject to significant uncertainty.** Historically, Armenia's growth, primary balance, and inflation have been volatile. The war in Ukraine and border tensions with Azerbaijan, the potential slowdown in advanced economies, and tightening of global financial conditions amplify the uncertainty surrounding the baseline projections. Assuming a symmetric distribution of shocks, a fan chart for the public debt-to-GDP ratio—corresponding to the range between the 10th and 90th percentiles—suggests that government debt is likely to be between 49 and 62 percent in 2022 and between 35 and 63 percent in 2027. An asymmetric fan chart, which rules out real exchange rate appreciation, suggests that debt could range between 40 and 67 percent of GDP at the end of the projection horizon.

5. **The heat map flags residency and currency composition of the debt structure as key vulnerabilities.** While the debt is currently sustainable, a surge in public debt levels, especially if downside risks materialize, could pose sustainability risks. FX-denominated debt and debt held by non-residents remain important risk factors for debt sustainability. A major depreciation of the exchange rate beyond the baseline would worsen the debt outlook as indicated by the relevant stress test (see Figure AV.4), although debt would remain on a declining path over the medium term. Overall, risks associated with public external debt are modest, despite considering higher interest rates under the baseline scenario in the wake of global financial tightening. External public debt stood at about US$6.6 billion at end-2021 (48 percent of GDP), of which a large share is owed to multilateral and bilateral official creditors (74 percent). The outstanding Eurobonds at end-2021 were US$1.75 billion (US$0.5 billion each maturing in 2025 and 2029 and US$0.75 billion maturing in 2031). Owing to the high share of debt to multilateral official creditors, the average interest rate of the external public debt is relatively low at 3 percent.

6. **Scenarios assuming key variables at their historical averages underscore the need for consolidation.** The paths of public debt and gross financing needs deviate significantly from the baseline under the historical scenario. Such a scenario would raise the government debt to around 63 percent of GDP and the gross financing need near 12.5 percent of GDP in 2027. This implies that without active policy measures aimed at reducing the fiscal deficit, debt sustainability would be jeopardized.

7. **Stress tests suggest that shocks to growth and the exchange rate have the largest impact on debt indicators.** A combined macro-fiscal shock, whereby real GDP contracts by 4.5 percent in 2023–24 in each year relative to baseline together with a worsening primary balance, can cause public debt to increase to 70 percent of GDP, and public gross financing needs to surge to 11.7 percent of GDP in 2027. The government aims to implement quality tax policy and administrative measures to improve revenues as a share of GDP and reprioritize spending by reducing current expenditures and increasing the share of capital expenditures. These measures will strengthen fiscal sustainability and help mitigate the risks, which could come from macroeconomic shocks. In isolation, shocks to growth, followed by shocks to the real exchange rate, have the most sizable adverse impact on the public debt path, relative to the baseline.

Figure AV.1. Armenia: Public Sector Debt Sustainability Analysis - Baseline Scenario

(in percent of GDP unless otherwise indicated)

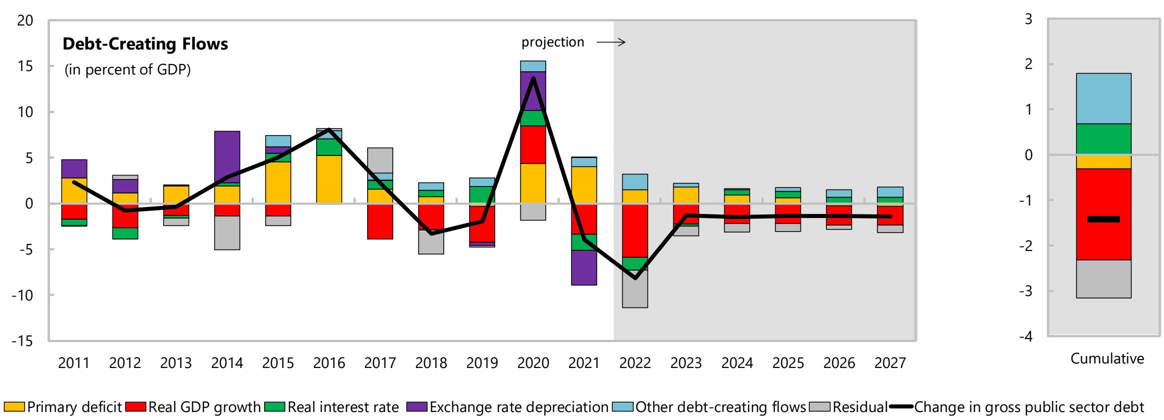
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2011-2019 [3/]	2020	2021	2022	2023	2024	2025	2026	2027
Nominal gross public debt	49.1	67.4	63.4	55.3	53.9	52.4	51.1	49.7	48.3
Public gross financing needs	7.4	11.5	10.3	8.7	9.7	9.3	10.8	7.7	7.0
Net public debt 2/		61.4	57.8	50.8	49.8	48.7	47.6	46.9	45.7
Real GDP growth (in percent)	4.7	-7.2	5.7	11.0	4.5	4.5	4.5	4.5	4.5
Inflation (GDP deflator, in percent)	2.5	1.8	6.9	7.0	6.0	4.5	4.0	3.8	3.7
Nominal GDP growth (in percent)	7.4	-5.5	13.0	18.8	10.8	9.1	8.7	8.5	8.4
Effective interest rate (in percent) [5/]	3.5	4.7	4.3	5.1	5.7	5.8	5.7	5.4	5.4

As of October 19, 2022		
Sovereign Spreads		
Spread (bp) 4/		486
CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	Ba3	Ba3
S&Ps	B+	B+
Fitch	B+	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2011-2019	2020	2021	2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance [10/]
Change in gross public sector debt	1.6	13.7	-3.9	-8.2	-1.3	-1.5	-1.3	-1.4	-1.4	-15.1	
Identified debt-creating flows	2.1	15.6	-4.0	-7.4	0.3	-0.2	0.0	-0.5	-0.3	-8.1	
Primary deficit	2.2	4.4	4.0	1.5	1.8	0.9	0.6	-0.2	-0.3	4.2	0.0
Primary (noninterest) revenue and grants	22.0	25.2	24.1	24.6	24.7	25.0	25.3	25.5	25.9	151.0	
Primary (noninterest) expenditure	24.1	29.6	28.1	26.0	26.5	25.9	25.9	25.3	25.6	155.2	
Automatic debt dynamics [6/]	-0.6	10.0	-9.0	-10.6	-1.9	-1.2	-1.0	-1.1	-1.1	-16.9	
Interest rate/growth differential [7/]	-1.6	5.8	-5.1	-7.3	-2.5	-1.6	-1.4	-1.4	-1.4	-15.7	
Of which: real interest rate	0.5	1.7	-1.7	-1.4	-0.3	0.6	0.7	0.7	0.7	0.9	
Of which: real GDP growth	-2.1	4.1	-3.4	-5.9	-2.2	-2.2	-2.2	-2.1	-2.1	-16.7	
Exchange rate depreciation [8/]	1.1	4.2	-3.8	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.5	1.2	1.0	1.7	0.4	0.1	0.4	0.8	1.1	4.6	
Domestic net lend./drawdown of gov. dep. (negative)	0.0	0.0	-0.6	-0.2	-1.1	-1.3	-0.9	-0.4	0.0	-4.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
External net lending	0.5	1.2	1.6	2.0	1.6	1.4	1.3	1.2	1.1	8.6	
Residual, including asset changes [9/]	-0.5	-1.9	0.0	-4.1	-1.0	-0.9	-0.9	-0.5	-0.8	-8.3	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Net public debt is defined as gross debt minus financial assets corresponding to debt instruments.

3/ Based on available data.

4/ Bond Spread over U.S. Bonds.

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

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

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

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

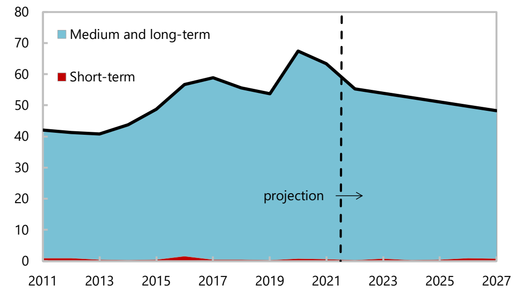
9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

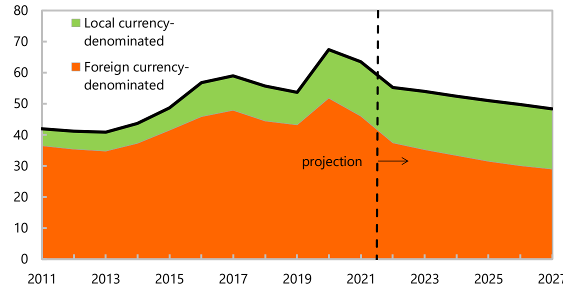
Figure AV.2. Armenia: Public Debt Sustainability Analysis - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)

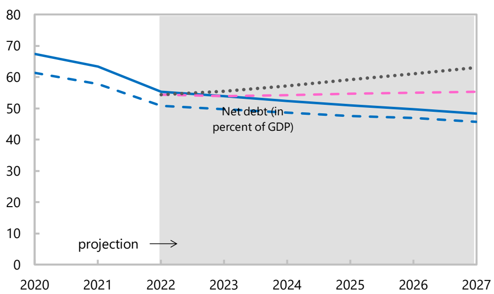


By Currency
(in percent of GDP)

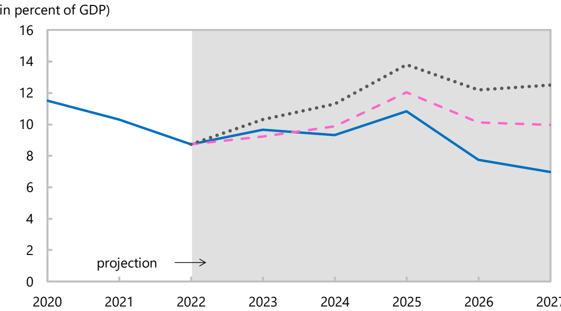


Alternative Scenarios

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



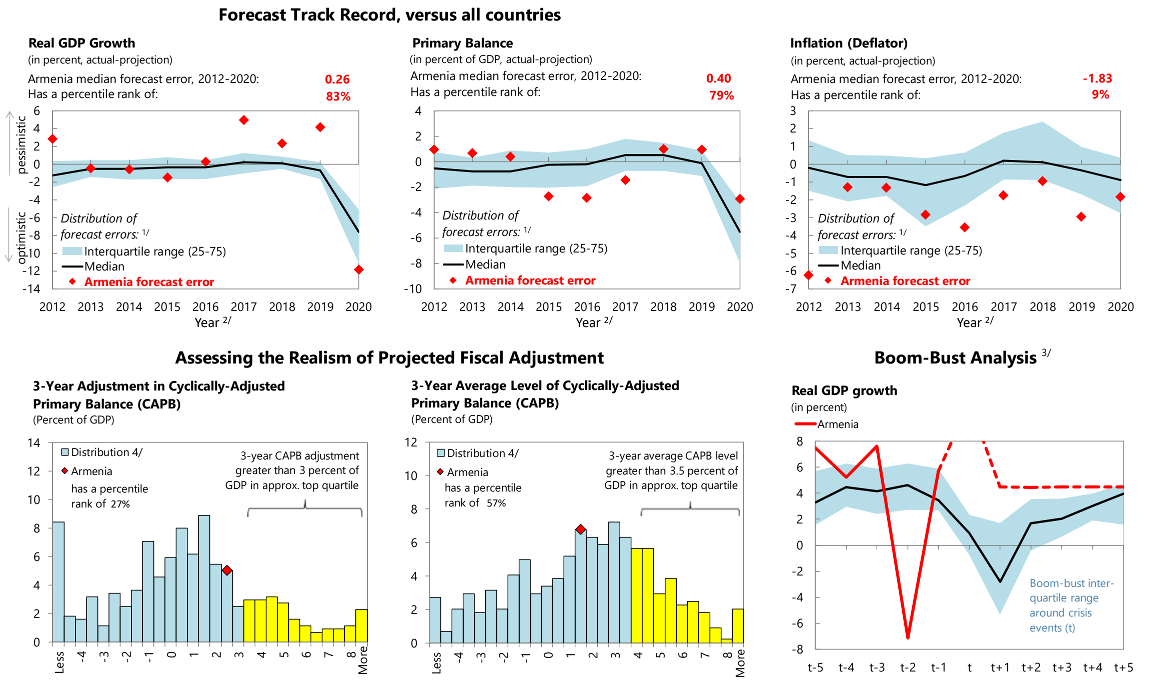
Underlying Assumptions
(in percent)

Baseline Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	11.0	4.5	4.5	4.5	4.5	4.5
Inflation	7.0	6.0	4.5	4.0	3.8	3.7
Primary Balance	-1.5	-1.8	-0.9	-0.6	0.2	0.3
Effective interest rate	5.1	5.7	5.8	5.7	5.4	5.4
Constant Primary Balance Scenario						
Real GDP growth	11.0	4.5	4.5	4.5	4.5	4.5
Inflation	7.0	6.0	4.5	4.0	3.8	3.7
Primary Balance	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	5.1	5.7	5.8	5.8	5.5	5.6

Historical Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	11.0	3.7	3.7	3.7	3.7	3.7
Inflation	7.0	6.0	4.5	4.0	3.8	3.7
Primary Balance	-1.5	-2.5	-2.5	-2.5	-2.5	-2.5
Effective interest rate	5.1	5.7	6.0	6.0	5.8	5.9

Source: IMF staff.

Figure AV.3. Armenia: Public Debt Sustainability Analysis - Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

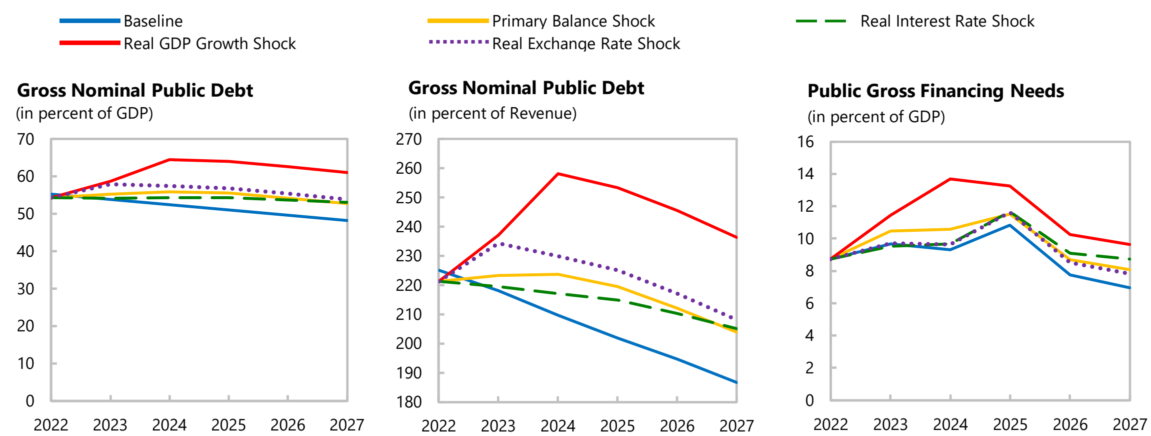
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Armenia has had a positive output gap for 3 consecutive years, 2019-2021 and a cumulative increase in private sector credit of 7 percent of GDP, 2018-2021. For Armenia, t corresponds to 2022; for the distribution, t corresponds to the first year of the crisis.

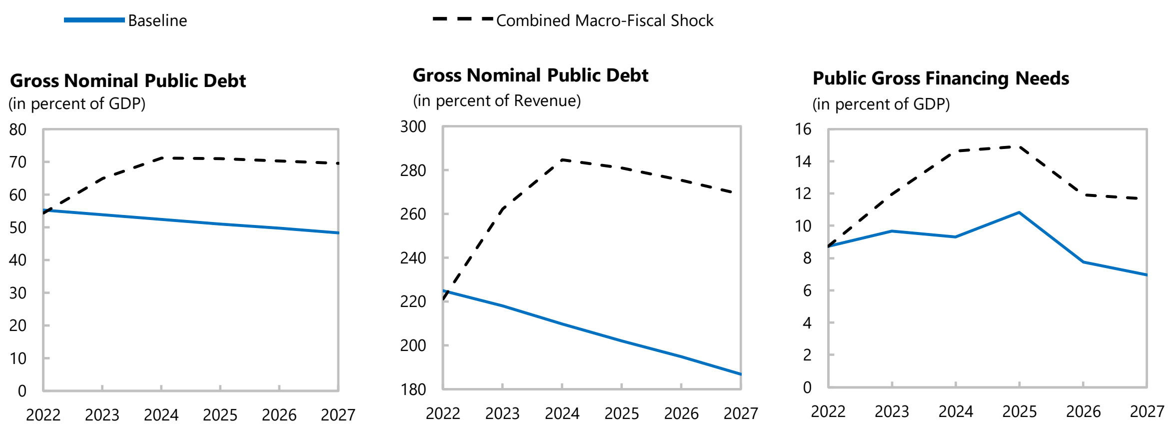
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure AV.4. Armenia: Public Debt Sustainability Analysis - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2022	2023	2024	2025	2026	2027
Primary Balance Shock						
Real GDP growth	11.0	4.5	4.5	4.5	4.5	4.5
Inflation	7.0	6.0	4.5	4.0	3.8	3.7
Primary balance	-1.5	-2.7	-1.9	-0.6	0.2	0.3
Effective interest rate	5.1	5.7	5.9	5.9	5.6	5.6
Real Interest Rate Shock						
Real GDP growth	11.0	4.5	4.5	4.5	4.5	4.5
Inflation	7.0	6.0	4.5	4.0	3.8	3.7
Primary balance	-1.5	-1.8	-0.9	-0.6	0.2	0.3
Effective interest rate	5.1	5.7	6.4	6.7	6.9	7.2
Combined Shock						
Real GDP growth	11.0	0.0	0.0	4.5	4.5	4.5
Inflation	7.0	4.9	3.3	4.0	3.8	3.7
Primary balance	-1.5	-3.2	-3.9	-0.6	0.2	0.3
Effective interest rate	5.1	6.1	6.2	6.7	7.0	7.2

	2022	2023	2024	2025	2026	2027
Real GDP Growth Shock						
Real GDP growth	11.0	0.0	0.0	4.5	4.5	4.5
Inflation	7.0	4.9	3.3	4.0	3.8	3.7
Primary balance	-1.5	-3.2	-3.9	-0.6	0.2	0.3
Effective interest rate	5.1	5.7	6.0	6.1	5.8	5.7
Real Exchange Rate Shock						
Real GDP growth	11.0	4.5	4.5	4.5	4.5	4.5
Inflation	7.0	10.2	4.5	4.0	3.8	3.7
Primary balance	-1.5	-1.8	-0.9	-0.6	0.2	0.3
Effective interest rate	5.1	6.1	5.6	5.6	5.3	5.3

Source: IMF staff.

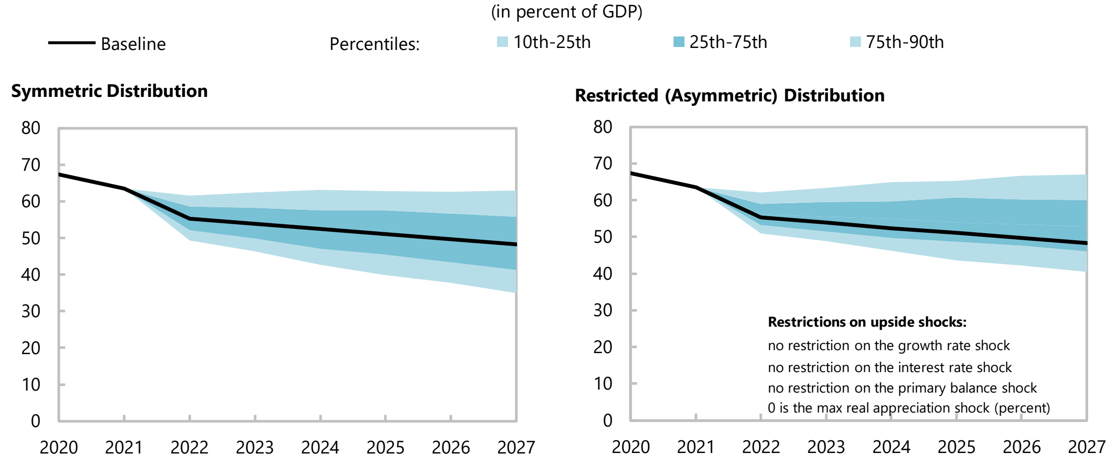
Figure AV.5. Armenia: Public Debt Sustainability Analysis Risk Assessment

Heat Map

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

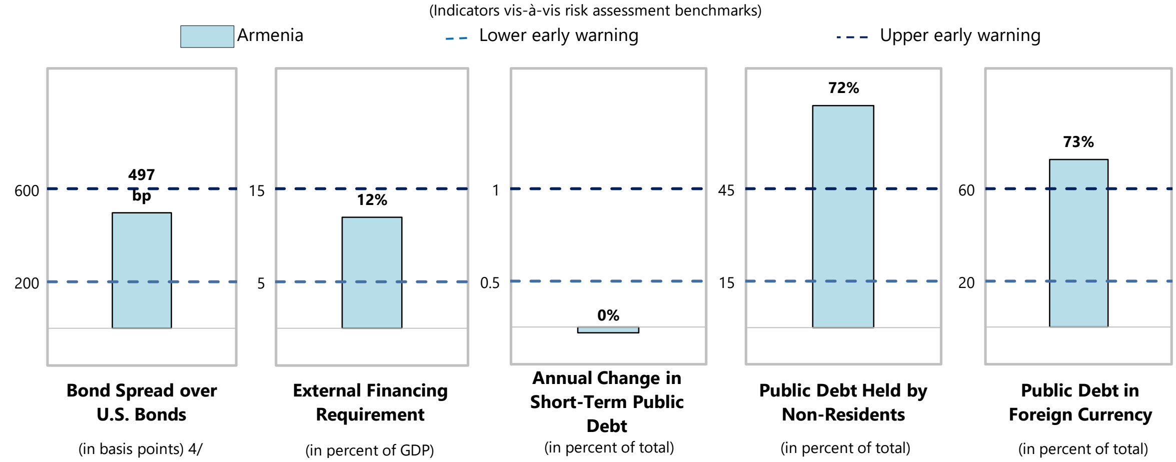
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

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

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

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

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

4/ An average over the last 3 months, 21-Jul-22 through 19-Oct-22.

Armenia. Decomposition of Public Debt and Debt Service by Creditor, 2021 /1

	Debt Stock (end of period, residency principle) 2021			Debt Stock (end of period, instrument principle) 2021			Debt Service 7/ 2021	2022	2023	2021	2022	2023
	(In mln. US$)	(Percent total debt)	(Percent GDP)	(In mln.US$)	(Percent total debt)	(Percent GDP)	(In US$)			(Percent GDP)		
Total	9225.69	100	63.4	9225.69	100	63.4						
External (including guarantees)	6648.40	72.1	45.7	6696.71	72.6	46.0	373.2	406.9	492.7	2.6	2.2	2.4
Multilateral creditors /2	3770.89	40.9	25.9	3770.89	40.9	25.9	215.3	227.9	305.0	1.5	1.2	1.5
IMF	439.00	4.8	3.0	439.00	4.8	3.0						
World Bank	1760.62	19.1	12.1	1760.62	19.1	12.1						
ADB/AfDB/IADB	778.67	8.4	5.4	778.67	8.4	5.4						
Other Multilaterals	792.61	8.6	5.4	792.61	8.6	5.4						
o/w: list largest two creditors			0.0									
EDB	324.09	3.5	2.2	324.09	3.5	2.2						
EIB	154.80	1.7	1.1	154.80	1.7	1.1						
list of additional large creditors												
Bilateral Creditors	1151.17	12.5	7.9	1151.17	12.5	7.9	86.3	94.2	102.9	0.6	0.5	0.5
Paris Club	1125.81	12.2	7.7	1125.81	12.2	7.7	83.5	100.2	100.5	0.6	0.5	0.5
o/w: list largest two creditors	773.97	8.4	5.3	773.97	8.4	5.3						
Germany/KFW	417.44	4.5	2.9	417.44	4.5	2.9						
RF	356.53	3.9	2.5	356.53	3.9	2.5						
list of additional large creditors												
Non-Paris Club	25.36	0.3	0.2	25.36	0.3	0.2	2.8	2.8	2.7	0.0	0.0	0.0
o/w: list largest two creditors	25.36	0.3	0.2	25.36	0.3	0.2						
Export-Import Bank of China	21.97	0.2	0.2	21.97	0.2	0.2						
Abu-Dhabi Fund for Development	3.39	0.0	0.0	3.39	0.0	0.0						
list of additional large creditors	-											
Bonds /3	1701.68	18.4	11.7	1750.00	19.0	12.0	69.0	82.5	82.5	0.5	0.4	0.4
Commercial creditors	24.65	0.3	0.2	24.65	0.3	0.2	2.6	2.4	2.3	0.0	0.0	0.0
o/w: list largest two creditors		0.0	0.0		0.0	0.0						
Erste Bank/Austria	16.26	0.2	0.1	16.26	0.2	0.1						
Raiffeisen Bank/Austria	6.19	0.1	0.0	6.19	0.1	0.0						
list of additional large creditors												
Other international creditors	-			-			-	-	-			
o/w: list largest two creditors												
list of additional large creditors												
Domestic (including guarantees) /4	2577.3	27.9	17.7	2529.0	27.4	17.4	531.7	476.4	385.5	3.7	2.6	1.9
Held by residents, total	2566.1	27.8	17.6	2405.4	26.1	16.5	N/A	N/A	N/A			
Held by non-residents, total				112.4	1.2	0.8	N/A	N/A	N/A			
T-Bills	101.1	1.1	0.7	101.1	1.1	0.7	121.8	101.1	0.0	0.8	0.5	0.0
Bonds	2416.7	26.2	16.6	2416.7	26.2	16.6	409.9	375.3	385.5	2.8	2.0	1.9
Loans												
Domestic guarantees	11.2	0.1	0.1	11.2	0.1	0.1						
Memo items:												
Collateralized debt /5												
o/w: Related												
o/w: Unrelated												
Contingent liabilities												
o/w: Public guarantees	19.06	0.0	0.1	19.06	0.2	0.1		3.9	7.3		0.0	0.0
o/w: Other explicit contingent liabilities /6												

1/ As reported by Country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as the DSA.

2/ Multilateral creditors" are simply institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policies (e.g. Lending Into Arrears)

3/ Based on residency principle, all Treasury Bonds and Eurobonds acquired by non-residents are included in the line "Bonds" as part of external debt.

4/ Based on residency principle, all Treasury Bonds and Eurobonds acquired by residents are included in domestic debt.

5/ Debt is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. Collateralization entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. Collateral is "unrelated" when it has no relationship to a project financed by the loan. An example would be borrowing to finance the budget deficit, collateralized by oil revenue receipts. See the joint IMF-World Bank note for the G20 "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers" for a discussion of issues raised by collateral.

6/ Includes other-one off guarantees not included in publicly guaranteed debt (e.g. credit lines) and other explicit contingent liabilities not elsewhere classified (e.g. potential legal claims, payments resulting from PPP arrangements).

7/ Debt service profile is represented based on debt instrument principle, because data by residency principle is not available.

Annex VI. Reforming the Insolvency Regime[1]

Armenia is in the process of reforming its 2006 Bankruptcy Law. Since the transition to a market economy, the Armenian insolvency regime has not been effective in achieving its function of preserving business value and protecting creditor rights. A full revision offers the opportunity of bringing bankruptcy law closer to best international practices so that it can fulfil its core role in finance, business, and society.

1. The existing bankruptcy law: issues and reform priorities. Armenia has a comprehensive bankruptcy law that regulates the liquidation and reorganization of companies and the bankruptcy of natural persons. Since the current law entered into force, there has been considerable debate in Armenia about the lack of effectiveness of insolvency proceedings. The regime has been analyzed by various institutions, such as the EBRD, the Good Governance Fund (UK) and the ADB, and all studies have revealed numerous issues in the practical operation of the system. When embarking on reforms of the insolvency regime, the authorities should focus on the following priorities:

- **Efficiency of the insolvency process.** Armenia is one of the few countries that has specialized insolvency courts. To maximize the potential of specialization, it would be necessary to streamline the insolvency process by making full use of new technologies and by clarifying the regulation of appeals.

- **The restructuring toolbox.** Armenia lacks restructuring practice. The introduction of out-of-court and hybrid restructuring mechanisms could usefully complement reforms in the insolvency regime.

- **Creditor rights in insolvency**. One of the major shortcomings of the insolvency regime is the lack of creditor control. The rights of creditors should be strengthened, particularly by expanding the rights to receive information and the rights to participate in critical decisions.

- **Reorganization and control of collateral**. The most problematic area of the current regime is the relationship between reorganization proceedings and secured credit. The system is biased towards providing the control of collateral to the insolvency representative. Secured creditors can request the court to release the collateral, but there are no clear grounds for a judicial decision and the end result is that the rights of secured creditors are often ignored.

- **Insolvency administrators**. Aside from allegations of lack of integrity, insolvency administrators in Armenia do not appear to have the necessary qualifications. It would be crucial to regulate access and requirements for the profession, establish a remuneration regime with proper incentives, and establish a supervisory and sanctioning regime, preferably administered by a specialized institution.

[1] Prepared by Jose Garrido (IMF, Legal Department).

- **Personal bankruptcy**. There is a widespread perception that there is frequent abuse and fraud in the operation of the personal insolvency regime. The law should introduce mechanisms to control fraudulent and deliberate bankruptcy, and to ensure that debtors make accurate disclosure of their assets and liabilities.

2. Other issues. There are many other issues that require attention, such as the regulation of post-petition finance in reorganizations, or the system for the appointment of insolvency administrators. A full reform is an opportunity to consider additional matters, too, such as the insolvency of enterprise groups, the insolvency of micro and small enterprises, and rules for cross-border insolvency.

Annex VII. Armenia's Agricultural Sector: Recent Trends and Policy Priorities

1. **Armenia's agricultural sector has experienced weak growth and declining productivity in recent years**. Between 2016 and 2021, agricultural value added contracted by approximately 24 percent in real terms, while the sector's share in GDP dropped from 17 to around 10 percent. Agriculture negatively contributed to GDP growth in each year from 2016 to 2020, with a contraction in both production volumes and value added per cultivated land, suggesting a sustained decline in sectoral productivity. These trends largely contrast with the expansion of agriculture observed in other CCA economies during the same period, pointing to significant underperformance in the sector.

2. **Fragmented land ownership and limited investments contribute to low agricultural productivity**. According to census data, smallholders constitute about 95 percent of all Armenia's farms and contribute to over 90 percent of gross agricultural product.[1] Small-scale farms are often engaged in semi-subsistence activities with low levels of investment and limited adoption of advanced technologies. This constrains sectoral growth and diversification. Developing land markets and introducing a modern land registration system, as envisaged in the 2021–26 Government Program, would contribute to farm enlargement, thus supporting investment and productivity within the sector.

3. **Water management is as an important challenge**. Armenia's agriculture is heavily dependent on irrigation, with more than 80 percent of crop output coming from irrigated lands. Water is distributed through local Water User Associations (WUA) and remains largely subsidized by the government, which covers the difference (50 percent on average) between the cost of water delivery and the WUA's irrigation fees. Much of the infrastructure is in poor condition and relies on high-cost procedures, including pumping from rivers.[2] This exacerbates the sector's vulnerability to dry weather and to increasing temperatures (see below).

4. **Agricultural employment is characterized by high levels of informality**. Agriculture absorbs about one fifth of Armenia's employed population and over 65 percent of its estimated informal workforce. The number of informal workers in agriculture has declined between 2015 and 2020 but remains higher than in the formal agricultural sector. The share of informal agricultural workers in total informal employment has remained stable in recent years. Agriculture also accounts for the largest percentage of informal employment among women (75 percent of the total) and the rural population (88 percent). Informal female workers tend to be engaged in seasonal work with reduced access to social protection, increasing their vulnerability.

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[1] Food and Agriculture Organization "Armenia at a Glance," *https://www.fao.org/armenia/fao-in-armenia/armenia-at-a-glance/ru/*.

[2] World Bank (2018) "Sustainable, Inclusive Agriculture Sector Growth in Armenia: Lessons from Recent Experience of Growth and Contraction."

5. Armenia's agricultural sector benefits from significant tax advantages. Income tax exemptions for agricultural production and lower effective taxation under the presumptive SME regimes have partly aimed to incentivize formal activity in the sector. Despite this preferential tax treatment, the share of informal agricultural activity remained high and stable in recent years. Available agricultural census statistics suggest over half of all agricultural production in Armenia has no legal registration with the state, including for tax purposes. In addition, given estimates of over 90 percent of agricultural production coming from smallholder farmers, the bulk of registered taxpayers with SRC fall under the highly preferential turnover tax or microenterprise regimes. Even VAT-registered large agrobusinesses are fully exempt from corporate income tax. Budgeted 2023 tax expenditures associated with the agricultural sector amount to as much as 1.1 percent of GDP. A future review of indirect tax expenditures would help verify this amount and present a balanced set of rationalization options.

6. Climate change vulnerabilities add to risks to the sector. In recent decades, Armenia has experienced increasing temperatures and dry weather, and the agricultural sector is especially vulnerable to weather shocks and extreme events including droughts, floods, and hailstorms. Cumulative losses to agriculture arising from environmental shocks have been estimated at AMD 110 billion (US$ 0.2 billion, or 11.8 percent of 2020 agricultural GDP) for the period 2015–20. Existing projections also show that Armenia will remain exposed to high temperatures, declining precipitations, lower water flows in some rivers, and a fall in the level of lake Sevan in the coming decades, raising the need to limit environmental risks to protect investments and support growth within the sector.[3]

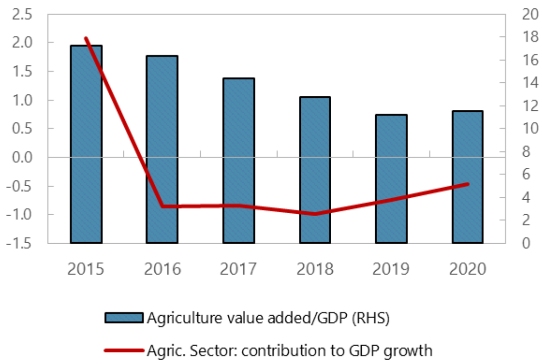
7. Climate change adaptation measures, including expansion of the existing agricultural insurance scheme, are key to contain losses arising from weather events. Recognizing the risks from climate change, the government has adopted a comprehensive adaptation plan (decree N 749-L). In this context, the development of an agricultural insurance mechanism represents a strategic priority. In 2018, the authorities introduced a pilot insurance scheme with donors' support, giving farmers in selected regions the possibility of insuring different crops (including peach, apricot, grapes) to two types of environmental hazards (hail and frost). The insurance mechanism has been subsequently extended to cover additional risks (e.g., wildfires) and regions. Under the scheme, the government subsidizes up to 60 percent of the insurance premium, while the Agricultural Insurance National Agency—a specialized institution with board members from insurers, the central bank, and the Ministry of Economy—is in charge of developing insurance products. Further extensions of this risk-sharing mechanism, together with careful analysis to ensure the scheme's overall sustainability, would help to contain farmers' costs, protect investments, and support productivity levels within the agricultural sector.

[3] International Monetary Fund, 2022, "Armenia: Technical Assistance Report-Quantifying Fiscal Risks from Climate Change". IMF Country Report No. 2022/329, October 2022.

Figure AVII.1. Armenia: Agricultural Sector Profile

Armenia's agricultural sector has experienced low growth…

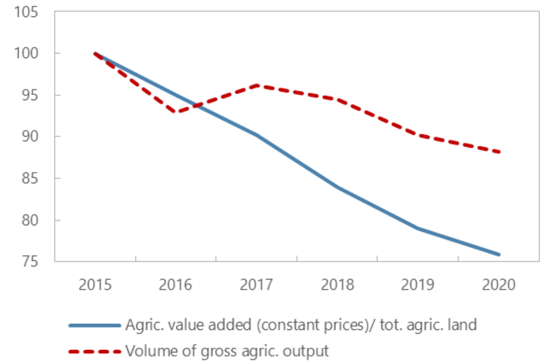
Agriculture sector Growth and Contribution to GDP



Source: World Development Indicators and staff calculations.

… and declining productivity trends…

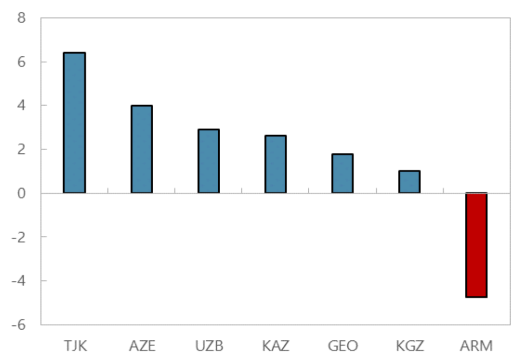
Agriculture Productivity
(Index, 2015= 100)



Source: World Development Indicators, ARMSTAT, and staff calculations.

… leading to underperformance compared to regional peers.

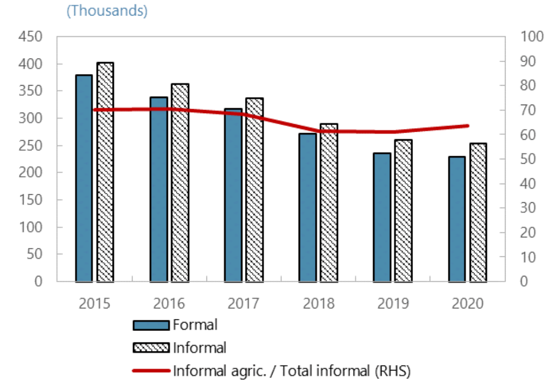
Agriculture value added
(Annual % growth, average 2016-21)



Source: World Development Indicators and staff calculations.

Informality remains high in agriculture…

Agriculture sector employment
(Thousands)



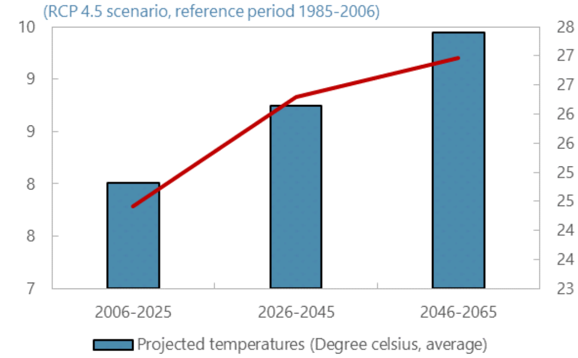
Source: ARMSTAT

… while climate change represents a key risk to the sector.

Temperature and weather patterns, 2000-2020
(5-year rolling average)

Source: World Bank Climate Change Knowledge Portal and IMF staff calculations.

Temperature projections, 2026-65
(RCP 4.5 scenario, reference period 1985-2006)



Source: World Bank Climate Knowledge Portal and staff calculation.

Stand-By Arrangement

Attached hereto is a letter from the Prime Minister, the Minister of Finance, and the Governor of the Central Bank of Armenia, dated November 15, 2022 ("Letter"), with its annexed Memorandum of Economic and Financial Policies ("MEFP") and Technical Memorandum of Understanding ("TMU"), requesting a Stand-By Arrangement ("Arrangement") from the International Monetary Fund ("Fund") and setting forth:

a) the objectives and policies that the authorities intend to pursue for the period of this Arrangement;

b) the policies and measures that the authorities intend to pursue during the first twelve months of this Arrangement; and

c) understandings of Armenia with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities will pursue for the remaining period of this Arrangement.

To support these objectives and policies, the Fund grants this Arrangement in accordance with the following provisions:

1. For a period of thirty-six months from the date of the approval of this Arrangement, Armenia will have the right to make purchases from the Fund in an amount equivalent to SDR 128.8 million, subject to paragraphs 2, 3, 4, and 5 of this Arrangement, without further review by the Fund.

2. (a) Purchases under this Arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 18.4 million until June 9, 2023, the equivalent of SDR 36.8 million until December 11, 2023, the equivalent of SDR 55.2 million until June 10, 2024, the equivalent of SDR 73.6 million until December 11, 2024, the equivalent of SDR 92 million until June 9, 2025, and the equivalent of SDR 110.4 million until November 21, 2025.

   (b) None of the limits in (a) above shall apply to a purchase under this Arrangement that would not increase the Fund's holdings of Armenia's currency subject to repurchase beyond 25 percent of quota.

3. Armenia will not make purchases under this Arrangement that would increase the Fund's holdings of Armenia's currency subject to repurchase beyond 25 percent of quota:

   (a) subject to paragraph 2 of Decision No. 14407-(09/105), during any period in which the data at the end of the preceding period indicate that:

      i. the floor on the net official international reserves; or

      ii. the floor on the program fiscal balance; or

iii. the ceiling on domestic budgetary lending,

as specified in Table 1 of the MEFP and as further specified in the TMU, is not observed; or

(b) if at any time during the period of this Arrangement:

i. the ceiling on the stock of external public debt arrears, as specified in Table 1 of the MEFP and as further specified in the TMU, is not observed; or

ii. Armenia imposes or intensifies restrictions on the making of payments and transfers for current international transactions; or

iii. Armenia introduces or modifies multiple currency practices; or

iv. Armenia concludes bilateral payments agreements that are inconsistent with Article VIII; or

v. Armenia imposes or intensifies import restrictions for balance of payments reasons; or

(c) if Armenia has not consulted with the Fund as provided for in paragraph 5 of the TMU and Table 1 of the MEFP; or

(d) after June 8, 2023, December 10, 2023, June 9, 2024, December 10, 2024, June 8, 2025, and November 20, 2025, until the respective reviews contemplated in paragraph 21 of the MEFP are completed.

When Armenia is prevented from purchasing under this Arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Armenia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Armenia will not make purchases under this Arrangement during any period in which Armenia (i) has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action; (ii) is failing to meet a repayment obligation to the PRG Trust established by Decision No. 8759-(87/176) ESAF, or a repayment expectation to that Trust pursuant to the provisions of Appendix I to the PRG Trust Instrument; or (iii) is failing to meet a repayment obligation to the Resilience and Sustainability Trust (RST) established by Decision No. 17231-(22/37), or a repayment expectation to that Trust pursuant to the provisions of Appendix II to the RST Instrument.

5. Armenia's right to engage in the transactions covered by this Arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the

Managing Director, formally to suppress or to limit the eligibility of Armenia. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this Arrangement will be resumed only after consultation has taken place between the Fund and Armenia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this Arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless, at the request of Armenia, the Fund agrees to provide SDRs at the time of the purchase.

7. Armenia shall pay a charge for this Arrangement in accordance with the decisions of the Fund.

8. (a) Armenia shall repurchase the amount of its currency that results from a purchase under this Arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Armenia's balance of payments and reserve position improves.

   (b) Any reductions in Armenia's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

9. During the period of this Arrangement, Armenia shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Armenia or of representatives of Armenia to the Fund. Armenia shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Armenia in achieving the objectives and policies set forth in the Letter and the attached MEFP and TMU.

10. In accordance with paragraph 4 of the Letter, Armenia will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government of Armenia or whenever the Managing Director of the Fund requests consultation because any of the criteria in paragraph 3 of this Arrangement have not been observed or because the Managing Director considers that consultation on the program is desirable. In addition, after the period of this Arrangement and while Armenia has outstanding purchases in the upper credit tranches, the Government of Armenia will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director of the Fund, concerning Armenia's balance of payment policies.

Appendix I. Letter of Intent

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

Yerevan, November 15, 2022

Dear Ms. Georgieva:

1. **Supported by sound macroeconomic policies, Armenia's economic performance has strengthened.** Following a sharp economic contraction in 2020 associated with the Covid-19 pandemic and the war in the Nagorno-Karabakh conflict zone, economic growth rebounded in 2021 and excelled in the first half of 2022, in part owing to a large inflow of external income, capital, and labor. Guided by sound macroeconomic policies, we are on course to achieve double-digit growth in 2022 and raise the per-capita GDP of Armenians to above US$6200. Public debt as a percentage of GDP is expected to fall by 9 percentage points of GDP this year after a temporary spike in 2020. Fiscal policy continues to be anchored by the rules-based fiscal framework. The Central Bank of Armenia has proactively raised the policy rate to 10.5 percent in November to steer inflation toward its medium-term target. Our international reserves have also risen, with the currency appreciating in the past few months. The banking system is in good health, thanks to prudent risk management and strong supervision. Important structural reforms have taken place in the areas of tax policy and revenue administration, public financial management, the inflation targeting framework, the financial sector, and governance.

2. **Despite this success, important challenges remain.** The geopolitical and regional situation is tense; inflation, unemployment, and poverty remain high; informality is large; and further efforts are needed to shift private activity from consumption to investment and pursue an export-led growth strategy. To tackle these challenges, we have pledged to carry out extensive structural reforms in our 2021–26 Government program. Our key priorities include developing the infrastructure and human capital to raise the productive capacity of the economy; improving transparency, governance, and access to finance to enhance the business environment; and strengthening healthcare, social protection, and labor force participation to ensure inclusion and reduce income inequality. We are also committed to preserve Armenia's macroeconomic, fiscal, and financial stability.

3. **The enclosed Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU) provide comprehensive details of our reform agenda and program.** In support of these efforts, the government of Armenia requests a 36-month Stand-By Arrangement in the cumulative amount of SDR 128.8 million (100 percent of quota). While we believe that our envisaged package of policies will increase resilience, a new IMF-supported program will provide insurance against external shocks. We intend to treat the Stand-By Arrangement as precautionary.

4. **We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program.** We will maintain a close policy dialogue with the IMF to ensure the achievement of our economic objectives under the program, and will take any further measures that may become appropriate for this purpose. In addition, we will consult with the IMF in advance of any revisions to the policies contained in our MEFP, in accordance with the IMF's policies on such consultations; and will provide IMF staff with the data and information necessary for the purpose of monitoring the program.

5. **We authorize the IMF to publish this Letter of Intent and its attachment (MEFP and TMU), as well as the accompanying staff report.** These documents will also be posted on the official websites of the Armenian government after the approval by the IMF Board.

Yours sincerely,

/s/
Nikol Pashinyan
Prime Minister

/s/
Tigran Khachatryan
Minister of Finance

/s/
Martin Galstyan
Governor, Central Bank of Armenia

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

1. This memorandum reports on recent economic developments, outlook and risks, and outlines the policy agenda of the government and the Central Bank of Armenia (CBA). The government's program for 2021–26 aims at improving productivity and building export-led, investment-driven, knowledge-based growth. To this end, we aim to: (1) preserve macro, fiscal, and financial stability; (2) continue creating an environment that supports higher and more inclusive growth; and (3) invest in Armenia's future economic prosperity by developing its physical and digital infrastructure and human capital, and address pressing climate mitigation and adaptation challenges. Our policy agenda will be supported by our request for a 36-month Stand-by Arrangement.

RECENT DEVELOPMENTS

2. Economic performance and policy implementation have been sound.

- *Growth momentum has accelerated but inflation remains high*. Real GDP surged by 11 percent in the first half of 2022, driven by strong private consumption, and led by the services, manufacturing, and construction sectors. While headline inflation declined to 9.1 percent year-on-year, core inflation continued to grow to 10.2 percent in August amid buoyant external and domestic demand.

- *The current account deficit* (4 percent of GDP in the first half of 2022) was largely financed by FDI. Rapid service export growth, driven by a significant increase in the number of international visitors, and robust remittance and other foreign exchange inflows resulted in a dram appreciation of 19 percent in January–August 2022. The CBA allowed the exchange rate to act as a shock absorber in response to a large external demand shock, while intervening in the foreign exchange market only to prevent disorderly market conditions. The CBA's foreign exchange purchases contributed to gross international reserves climbing to US$ 3.6 billion (4½ months of imports) at end-August 2022.

- *We have tightened monetary policy proactively since end-2020*, raising the policy rate to 10.5 percent in November. Tightening monetary policy and dram appreciation are expected to curb overheating and reduce inflationary expectations.

- *Fiscal performance has been strong.* In the first three quarters of 2022, we achieved a fiscal surplus of 0.6 percent of expected annual GDP against a budgeted deficit of 2.5 percent of GDP. Higher than budgeted tax revenue of 0.9 percent of GDP contributed to the overperformance, buoyed by strong economic activity and rising global commodity and domestic consumption prices. Current expenditures were contained, with the winding down of COVID-19 related support. Progress on capital expenditures, especially foreign financed projects, remained slow. Public debt declined sharply at end-June 2022 due to the strong fiscal and GDP growth performance and a significant appreciation of the dram.

- *The financial system is in good health*. Financial soundness indicators of the banking sector continue to improve. Nonetheless, we are closely monitoring the risks associated with quickly rising mortgage lending.

- *Structural reforms have progressed*. Reforms under the previous SBA helped improve governance, support the business environment, and provided targeted health and social spending, while preserving fiscal sustainability. We expect the new arrangement to support the completion of our reform agenda in line with the objectives outlined in the 2021–26 Government program and its detailed action plan.

OUTLOOK FOR 2023 AND THE MEDIUM TERM

3. We envisage the following macroeconomic scenario and risks under the IMF-supported program:

- **Real GDP growth** is expected at double digits in 2022, supported by robust household consumption and external demand. Considering the tightening monetary policy stance and anticipated slowdown in global growth and external demand, we project that GDP growth will decelerate in 2023 before it converges to its potential over the medium term.

- **Inflation** is expected to be at around 10 percent by end-2022. With the dissipating impact of imported food prices and the effects of the ongoing monetary policy tightening, inflation is projected to moderate significantly by the second half of 2023, and converge to the CBA's 4 percent target within the program horizon.

- **The current account deficit** is projected to widen in in the second half of 2022 driven by robust demand and —with the dissipation of the external shock—to gradually converge to its long-term sustainable level of about 5 percent of GDP in the medium term with both exports and imports expanding moderately.

- **Risks.** Renewed regional tensions are a major source of risk. In addition, tighter global financial conditions could limit capital inflows and adversely affect remittances and trade. Logistical bottlenecks and higher food prices could have a higher than anticipated effect on inflation, with negative repercussions on consumption. On the upside, strong growth dynamics in 2022 could carry into next year, with further overheating of the economy and rising inflation. New transportation links, long-term integration of international visitors in the labor market, increased export, and full implementation of the government's 2021–26 agenda could result in higher growth over the medium term.

POLICIES

4. **While significant progress has been achieved under the 2019–2022 Stand-By-Arrangement, challenges remain.** A successor program would help provide policy continuity; maintain macroeconomic stability amid rising geopolitical and regional uncertainty and greater global financial market volatility; restore fiscal buffers through growth-friendly and inclusive fiscal policies; address financial sector risks, enhance financial supervision, and further develop capital markets. On the structural front, the program would support our efforts to strengthen fiscal risk management; further improve governance and transparency; facilitate investment-driven, knowledge-based, and export-led growth; pursue the government's digitalization agenda; and build resilience against climate change. The program would also provide assurances to other partners and private investors.

FISCAL POLICY

5. **We remain committed to fiscal sustainability and full compliance with the rules-based fiscal framework**.

- ***Fiscal policy stance in 2023***. While we witness a strong fiscal outturn in 2022, we remain mindful of significant risks posed by the uncertain global and regional economic environment. Accordingly, as **a prior action**, we will adopt a 2023 budget with an overall deficit of around 3 percent of GDP. This fiscal position will allow an increase in much needed capital spending, supported by an improving PIM process for infrastructure development. We also aim to contain current expenditures, in line with the fiscal rules, and keep the debt to GDP ratio on a declining path. Any revenue over-performance will be allocated to improve fiscal buffers and institutional resilience.

- ***Fiscal path in 2024–25***. With the economy expected to grow at a healthy rate over the medium term, we will narrow the deficit in line with the cyclical position of the economy and the rules-based fiscal framework and to reduce debt toward 50 percent of GDP. At the same time, we will follow a policy of a gradual increase in pension, social assistance, health, education, and infrastructure spending within the targeted deficit path.

6. **We will adopt a set of fiscal reforms to underpin the targeted fiscal path**. To create space for growth-friendly and inclusive expenditure and support our structural agenda, we will: (i) adopt a series of revenue-enhancing policies that aim to increase tax revenues (including social security contributions) to 25 percent of GDP over the medium term; (ii) conduct expenditure reviews and prioritization, and (iii) complete reforms that ensure higher-quality public investment.

REVENUE-ENHANCING GROWTH-FRIENDLY POLICIES

7. **We are moving toward a more transparent, equitable, and efficient tax system that generates higher revenues and is environmentally friendly.** To strengthen revenue buoyancy,

we will reduce the tax policy gap—including by rationalizing tax expenditures and broadening the tax base—and improve revenue administration. Future reforms will be grounded in rigorous analysis and include:

- ***CIT and PIT reforms.*** We will implement the already approved reform of the mining fiscal regime from January 1, 2023. We have adopted legislation to gradually repeal the inefficient and regressive mortgage interest tax credit associated with new developments in Yerevan. We also intend to move towards a pre-filled universal PIT declaration and introduce taxation of individual capital gains, supported by adequate tax administration measures and tools**.**

- ***Tax expenditures***. Supported by IMF Technical Assistance, we will undertake a detailed assessment of tax expenditures, including indirect taxes, to identify potential opportunities for rationalization of inefficient and regressive ones (**June 2023 SB**). We plan to maintain a simple and unitary-rate VAT regime.

- ***SME and microenterprise taxation***. We plan to harmonize the tax burden across firms of different sizes to incentivize their growth and employment creation. We will achieve this by simplifying the compliance requirements, rather than providing preferential tax treatment, for small enterprises. In particular, the turnover threshold for payment of VAT and CIT, which is very high relative to peers, allows many SMEs to pay only a turnover tax with much lower tax burden. Furthermore, we have identified loopholes in microenterprise taxation, which allows full tax exemption of some individuals with high incomes. We envisage comprehensive reforms of both regimes to ensure a fairer tax burden relative to taxpayers in general regimes.

- ***Excise tax reforms.*** We will enhance the excise tax system by (i) revising specific excises on alcohol, tobacco, and other goods with negative health externalities; (ii) increasing the current stamp duty on gambling activities; and (iii) assessing the scope to harmonize environmental taxes into a unified carbon price (or a proxy price) to bring about climate-conscious behavioral changes, generate socio-economic benefits, and raise additional revenues.

8. To support the effectiveness of our tax policies, we will continue to strengthen the revenue administration. We plan to enhance SRC's capacity to credibly monitor taxpayers and their sources of income and thus reduce compliance risks and costs. We will introduce a universal income tax declaration system with pre-filled information, which is an effective tool to ease taxpayer's filing costs. Implementing the reform would require that the SRC have (i) authority to audit natural persons and expand the use of indirect audit methods (**March 2023 SB**); and (ii) systematic access to third-party data that is informative of taxpayers' incomes, expenses, and wealth. We will amend the legislation to grant the SRC the power to obtain bank account information of legal entities on request to verify information provided by taxpayers (**March 2023 SB**). Furthermore, we will develop a concept note and a roadmap specifying the reforms that are needed to ensure SRC's access to bank information for individuals while balancing tax enforcement needs and taxpayer/bank account holder confidentiality considerations. Lastly, we will develop a detailed implementation plan to assign transfer pricing audit responsibilities within the SRC, with access to data and increased resources and capacity.

Efficiency-improving expenditure policies

9. **We intend to strengthen the efficiency and effectiveness of government spending to support the government's strategic priorities.**

- ***Wages.*** A series of medium-term reforms will ensure greater clarity in public sector remuneration and workforce planning. We will establish a system to regularly collect and analyze information on the general government wage bill and better integrate compensation and employment policies into the budgetary process.

- ***Health.*** We are working with the World Bank on ways to introduce a comprehensive health coverage system in Armenia. This is a potentially costly initiative that should be analyzed, gradually phased in, accompanied by reforms, and fit in the overall resource envelope. We expect to finalize a concept note for this reform by end of 2022. We will reflect the estimated costs in the next MTEF.

- ***Pensions.*** The Government's 2021–26 program envisages that the average pension (basic and labor) reach the level of the minimum consumption basket and the minimum pension reach the level of the food security basket. This will potentially require increases in pension benefits at a fiscal cost of 0.8–1.3 percent of GDP. To ensure sufficient fiscal space, we plan to phase in the increases gradually—with an initial focus on minimum pensions— and incentivize later retirement. We also intend to encourage the self-employed and farmers to voluntarily participate in Pillar II of the pension system.

- **Social Safety Nets.** We plan to improve the coverage of the Family Living Standards Enhancement Benefits and their targeting by developing beneficiaries' registration, vulnerability assessment based on Hybrid Means Testing, and incentives for labor market participation of working-age beneficiaries. We intend to make the childcare benefits for children under the age of two universal (with appropriate work incentives) as of 1 January 2023. Furthermore, we intend to review the effectiveness and efficiency of support to Nagorno Karabakh (NK) with the NK's authorities.

10. We are committed to strengthening our public financial management, including through robust fiscal risk, transparency, and governance frameworks.

- ***Central government budget processes***. We have embarked on reformulating the MoF's structure and functions to further enhance its institutional, personnel, and analytical capacities. We plan to improve the expenditure classification methodology, monitoring, and reporting of budget execution. We are working to improve the costing of new fiscal policy initiatives and align better annual budgets and the medium-term expenditure framework. To improve our program-based budgeting processes and enhance spending efficiency, we plan to conduct regular program monitoring and evaluations, including through a council that coordinates budget execution activities.

- ***Quality public investment.*** To support the country's significant infrastructure needs, we will ensure that the public investment management (PIM) process is fully operational. We will develop an action plan to strengthen the PIM institutional framework and processes, by identifying and addressing the bottlenecks to ensure an effective cycle of planning, budgeting, implementing, and monitoring of large capital projects (**June 2023 SB**). Furthermore, we will improve the transparency of public-private partnership (PPP) projects by publishing the contracts, analyzing their fiscal risks, and disclosing their lifetime fiscal implications in the 2023 budget.

- ***Fiscal risk management.*** The MoF's newly reorganized fiscal risk department will conduct comprehensive monitoring, assessment, and management of fiscal risks, including contingent liabilities arising from the financial sector in close coordination with the CBA. We will start with mainstreaming and improving the quality and coverage of fiscal risks in the budget documentation. To contain SOE-related fiscal risks, by early-2023 and with IMF Technical Assistance support, we will develop a concept note specifying the mandate, reporting, transparency, and viability requirements of public sector units. Based on these guidelines, we will adopt a government decree enacting these requirements for strategic SOEs such as the Armenian National Interest Fund (ANIF) (**March 2023 SB**). Finally, to facilitate fiscal decentralization, we intend to prepare a concept note for a future monitoring, approval and control framework related to local governments and local government borrowing (**September 2023 SB**).

- ***Debt and cash management.*** As the gatekeeper of public resources, the MOF will seek to strengthen its cash planning and management functions. Furthermore, we will improve the exchange of information between the CBA and the MOF in relation to deficit financing plans and for the purpose of domestic and foreign exchange liquidity management. This will include preparing the necessary data through an enhanced cash forecasting and debt flow templates to facilitate the CBA's liquidity management.

- ***Government financial statistics.*** With progress on the classification of public and quasi-public entities, we plan to publish a public sector balance sheet. We intend to improve cooperation across data-producing institutions (Armstat, MOF, CBA) and the use of available sources and standards to enhance fiscal data compilation and harmonization. In this regard we will consider the necessity and possibility of clarifying the statistical treatment of lending to NK in fiscal accounts in line with the *Government Finance Statistics Manual 2014* aiming to accordingly reflect it in future budget documentation.

MONETARY AND EXCHANGE RATE POLICIES

11. Monetary policy will continue to be implemented within an inflation targeting framework. We will continue monitoring the inflation outlook to determine whether further changes to the policy rate are needed to steer inflation toward the target. To enhance the effectiveness of the monetary policy transmission mechanism amid large (global) supply shocks and high dollarization, we will seek to foster domestic financial market development and deepen financial inclusion. We aim to further enhance our communications toolkit and improve data collection and surveys, especially related to inflation expectations.

12. Our exchange rate policy will continue to support the inflation targeting framework, with strong commitment to exchange rate flexibility. The exchange rate will continue to play a shock-absorbing role on both sides. The CBA's foreign exchange interventions will be only limited to mitigating disorderly market conditions, while maintaining healthy reserve buffers.

FINANCIAL SECTOR STABILITY AND DEVELOPMENT

13. We have improved our supervisory toolkit and will further deepen our approach to risk-based supervision. We have implemented Basel III capital and liquidity standards, enhanced risk-based supervision, and introduced macroprudential measures in the form of LTV limits on new mortgages of 90 percent for AMD loans and 70 percent for FX loans. Furthermore, we will introduce Pillar 2 capital buffers, and improve our capacity to perform supervisory review of banks (SREP) and assess their business models. In particular:

- ***Pillar 2 capital buffers***. To incentivize banks to improve their governance, risk management capacity, and resilience, we will develop a formal roadmap for the introduction of Pillar 2 capital buffers (**June 2023 SB**). We will also: (a) update the regulatory requirements for banks on Internal Capital Adequacy Assessment Process (ICAAP) in line with Basel standards, (b) develop the internal tools, methodologies and processes for assessing and challenging the adequacy of the banks' own estimates of Pillar 2 capital add-ons, (c) develop a governance structure for the review and approval of Pillar 2 capital requirements and other supervisory measures for the individual banks, and (d) enhance the capacity to assess and rate banks' material risks and quality of risk management, including those related to Money Laundering and Terrorist Financing.

- ***Additional capital buffers***. We will maintain higher risk weights (150 – 200 percent) and higher loan loss provision for FX loans (20 percent higher) to mitigate FX risks until the introduction of Pillar 2 capital buffers. We will continue to restrict the payment of dividends and other discretionary distributions, such as bonuses and share repurchase for banks that are unable to maintain the Capital Conservation Buffer and/or the buffer for systemically important banks at the CBA targeted levels.

- ***Large exposure and related party limits***. The few banks whose exposures exceed the single external and internal borrower limits of 20 and 5 percent, respectively, have gradually decreased them according to schedules agreed with the CBA. We continue to monitor these exposures closely and will strengthen our enforcement practices to ensure that banks operate within the prescribed limits.

- ***Recovery and resolution planning*:** We will submit to parliament a draft law for an enhanced bank resolution framework that is in line with the Financial Stability Board's Key Attributes for Effective Resolution Regimes for Financial Institutions (**November 2023 SB**). Furthermore, we will improve our capacity to assess banks' recovery plans, to develop resolution plans for systemically important banks, and to effectively resolve weak banks.

14. We will continue implementing the Government's 2020 capital market development action plan. Among other measures, we aim to remove impediments to capital market development in Armenia, including by improving tax transparency and certainty of securities taxation. Furthermore, we will facilitate the introduction of an over-the-counter commercial trading platform for the overnight repo market (**March 2023 SB**). Finally, we will assess our payment systems and market infrastructure against IOSCO's *Principles for Financial Market Infrastructures* and address any potential gaps.

15. We will monitor and mitigate risks from the rapidly rising real estate prices. We have developed draft legislation to restrict mortgage lending in foreign currency. Furthermore, we will consider: (i) setting well-calibrated countercyclical capital buffers; and (ii) introducing, as necessary, new macroprudential tools for banks. In particular, we will develop supervisory guidelines for banks to comprehensively assess all income sources of borrowers and collect all relevant information needed to introduce new borrower-based tools.

STRUCTURAL REFORMS

16. The Government's Program for 2021–26 emphasizes structural reforms to promote investment and inclusive growth. We intend to pursue a knowledge-based, export-oriented, investment-driven growth model, aimed at fostering productivity, reducing poverty, and enhancing social protection. Achieving these objectives requires developing stronger trade links, building infrastructure to support connectivity, and green energy generation; improving transportation, land, and water management, fostering access to finance and labor force participation; completing governance reforms, and reducing informality. Our ambitious digitalization efforts will spearhead public administration reforms, improve public service quality and delivery.

17. We plan to achieve the above objectives with the following reforms:

- ***Infrastructure development, trade diversification, and investment***. We also plan to develop our transport logistics and reduce non-tariff trade barriers. We will conduct a study, with support by IMF TA, to identify bottlenecks in the execution of foreign-funded projects (**June 2023 SB**). To expand our export destination markets, we will develop (i) a strategy to evaluate the capacity to export specific (high value-added) products in third countries, and (ii) a roadmap to raise awareness of exporters with respect to selected target markets. We will also accelerate the digitization of cross-border documents for customs declarations and streamline the requirements for cross-border trade.

- ***Access to finance, especially for SMEs***. We aim at increasing credit availability to firms by strengthening the insolvency regime and enhancing corporate transparency. We will approve a concept note on the review of the bankruptcy legislation (**September 2023 SB**), including to strengthen creditors' rights. We will also complete the review and approve the new Corporate Governance Code. In support of SMEs, we will develop programs for research and innovation. Moreover, we will review the consumer protection rules to regulate the relationship between construction developers and their clients.

- ***Human capital and labor market policies.*** We are improving the education infrastructure and curriculum, and will seek to address skill mismatches, low level of labor force participation—especially among women—and high structural unemployment. We will reform the existing tertiary vocational education (TVET) system by implementing the action plan underpinning the education strategy and will (i) consolidate the TVET sector, (ii) align initial and tertiary VET systems, and (iii) integrate study pathways for students to progress towards tertiary VET. We will approve a costed employment strategy, including to bolster active labor market policies (**June 2023 SB**). Furthermore, to foster female labor force participation and develop human capital, we will introduce measures to expand access to early childhood development programs and services.

- ***Agriculture policies***. Fragmented land ownership and small-scale farming in a context of limited and shrinking arable land constrains the development of a dynamic and export-oriented agricultural sector. We plan to address these concerns by introducing a modern land registration system and developing land rental and sales markets. We will also seek to align the agricultural sector statistics with international best practice, reduce informality, and broaden the taxable base of the agricultural sector. We aim to enhance the agricultural sector's resilience to climate change, by expanding the existing agricultural insurance scheme to cover more risks, regions, and crops (**September 2023 SB**). Alongside, we aim to improve the infrastructure and strengthen the management of water resources.

- ***Governance***. We will expand our anti-corruption efforts and enhance the business ***climate to facilitate foreign investment. We plan to further reinforce the resources,*** capacity, and independence of the judiciary. Furthermore, we will strengthen the legal framework for domestic politically exposed persons, by introducing regulations on receiving gifts and strengthening legislative protection of whistle-blowers. We will also continue to improve the effectiveness of our AML/CFT framework by reviewing the existing legislation and, if necessary, bringing it into compliance with relevant international standards. Furthermore, we will fully implement the recently amended legal framework for beneficial ownership. Finally, we reiterate our commitment to finalize and publish the results of an ex-post audit of the COVID-19 on-lending business support scheme.

18. Advancing the public administration reform. We have launched an ambitious public administration reform aiming to: (i) develop a data-driven, result-oriented, and accountable strategic planning system; (ii) ensure citizen-centric and technology-based state and community service delivery; (iii) move toward a merit-based and professional public service; and (iv) build institutions to ensure the best value for money. These reforms are largely frontloaded with the first implementation phase focusing on institution building. We also intend to complete a functional review of the nonfinancial public sector and create a fiscal council over time. To support a merit-based public service we will introduce an annual process for adjusting basic salaries guided by resource availability and periodic comprehensive pay reviews establishing greater consistency in remuneration across the government and between the public and private sectors.

19. We will pursue Armenia's digital transformation agenda. We will work on a simultaneous digital transformation of society, the economy, the government, and formation of a common platform for national digital services. We will prepare a roadmap for the introduction of national digital ID and interoperability of services across different providers. This will require: (i) a review of existing or introduction of new data- and consumer-protection laws, and development of cyber security capacity; (ii) creating the necessary infrastructure and standards; (iii) a clear communication strategy to ensure that users are provided with adequate and consistent information on the digital ID including on functions, scope, risks, and safeguards. We will create and resource an innovation center or sandbox to promote fintech development and facilitate the development of regulatory framework for new firms and business models. Finally, to reduce informality, we have passed legislation requiring the use of electronic payments for high-value transactions.

20. We plan to design a comprehensive strategy to fight climate change. Armenia's average temperature has been on the rise, the average annual precipitation has declined over time, and the variability of climate conditions has also increased. Cognizant of these effects, we have adopted a series of climate change mitigation and adaptation targets in our 2021–26 government program and codified them in legislation (decree N 610-L). We will study options to introduce carbon pricing (or proxy pricing) and will consider recycling the revenues through targeted transfers to offset most of the increase in fossil fuel and electricity prices. We will also consider designing sectoral instruments, such as feebates in the transport, power, industry, building, forestry, extractive, and agricultural sectors. We will engage in public investment for transitioning to a cleaner energy system and develop a more coherent regulatory framework. Finally, we will accelerate adaptation to climate change as outlined in our sectoral adaptation strategy documents. The success of these efforts will also depend on the adequacy of international financial, technological, and capacity-building support.

PROGRAM MONITORING AND SAFEGUARDS

21. The program will be monitored through quantitative performance criteria, indicative targets, a monetary policy consultation clause, and structural benchmarks. Semiannual program reviews will be based on end-June and end-December test dates. The first review is expected to be completed on or after June 9, 2023 and will assess performance as of end-December 2022. The second review is expected to be completed on or after December 11, 2023 and will assess performance as of end-June 2023. All quantitative performance criteria and indicative targets are listed in Table 1, and structural benchmarks are set out in Table 2. The attached *Technical Memorandum of Understanding* defines the quantitative performance criteria and the monetary policy consultation clause as well as data provision requirements. During the IMF-supported program period, we will not introduce or intensify any exchange restrictions, introduce or modify multiple currency practice and will continue to comply with all obligations under Article VIII of the IMF's Articles of Agreements.

22. The CBA will continue to maintain a strong safeguards framework and internal controls environment in accordance with best practice and international standards. An update safeguards assessment will be completed by the time of the First Review. As required by the IMF's safeguards policy, we will continue the current best practice of engaging independent external audit firms to conduct the annual audit of the CBA's financial statements in accordance with international standards, thereby supporting public accountability and central bank independence.

23. We believe that the policies set forth in this MEFP are adequate for achieving the objectives of the program, and we stand ready to take additional measures as necessary. We will maintain a close policy dialogue with the Fund.

Table 1. Armenia: Quantitative Performance Criteria 1/

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

	2022	2023			
	Dec. 2/	Mar. 3/	Jun. 2/	Sep. 3/	Dec. 3/
	Prog.	Proj.	Prog.	Proj.	Proj.
Performance Criteria					
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,600	1,531	1,576	1,475	1,465
Program fiscal balance (flow, floor) 4/8/	-384	-124	-211	-315	-465
Budget domestic lending (cumulative flow, ceiling) 8/	5	10	10	10	10
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	0
MPCC 5/					
Inflation (upper-outer band, inflation consultation, percent)	12.5	11.5	10.5	9.5	8.5
Inflation (upper-inner band, percent)	11.5	10.5	9.5	8.5	7.5
Inflation (mid-point, percent)	10.0	9.0	8.0	7.0	6.0
inflation (lower-inner band, percent)	8.5	7.5	6.5	5.5	4.5
Inflation (lower-outer band, inflation consultation, percent)	7.5	6.5	5.5	4.5	3.5
Indicative Targets					
New government guaranteed external debt (stock, ceiling, in millions of USD) 6/	100	...	...	...	100
Social assistance spending of the government (flow, floor) 7/8/	65.0	20.0	40.1	60.1	80.2

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-outer/lower-outer band, a formal consultation with the Executive Board as part of program reviews would be triggered. If the end of period year-on-year headline inflation is outside the upper-inner/lower-inner band, an informal consultation with IMF staff as part of program reviews would be triggered.

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

7/ Defined as spending on the Family Living Standards Enhancement Benefits, childcare benefits for children less than two years of age, and Allowances for old age, disability, and loss of breadwinner.

8/ Cumulative limit.

Table 2. Armenia: Structural Benchmarks

Deadline	Macro Criticality	Responsible Agency	Measure
Fiscal Policy and Fiscal Structural Reforms			
Prior Action	Ensure macro-fiscal stability	MOF	Adopt 2023 budget with an overall deficit of around 3 percent of GDP.
June 2023	Mobilize tax revenue	MOF/SRC	Publish a detailed assessment of tax expenditures and an action plan for their rationalization.
March 2023	Improve tax compliance	MOF/SRC	Amend the Tax Code to empower the SRC with authority to audit natural persons and include broader indirect audit methods.
March 2023		DPM/CBA/MOF/ SRC	Amend the legislation to allow exchange of bank account information for legal entities on request to verify information provided by taxpayers between the banks and SRC, and to allow SRC access to bank account information for legal entities refusing to provide it upon a court order.
March 2023	Improve public financial management and reduce fiscal risks	DPM/MOE/MOF	Adopt a government decree clarifying the mandate, reporting, transparency, and viability requirements for ANIF and its subsidiaries, based on the concept note developed for public sector units.
June 2023		DPM/MOE/MOF	Develop an action plan to strengthen the PIM institutional framework and processes, by identifying and addressing the bottlenecks to ensure an effective cycle of planning, budgeting, implementing, and monitoring of large capital projects.
September 2023		MOF	Develop a concept note on monitoring, approval, and control framework related to local governments and local government borrowing.
Monetary Policy and Financial Sector Reforms			
March 2023	Capital market development	CBA	Facilitate the introduction of an over-the-counter commercial trading platform for the overnight repo market.
June 2023	Strengthen the regulatory and supervisory framework	CBA	Develop a formal roadmap for introduction of Pillar 2 capital buffers.
November 2023		CBA	Prepare and submit to parliament a draft law for an enhanced bank resolution framework that is in line with the Financial Stability Board's Key Attributes for Effective Resolution Regimes for Financial Institutions.
Structural Reforms			
June 2023	Infrastructure development	DPM/MOF/MTAI	Conduct a study to identify bottlenecks in the execution of foreign-funded projects.
September 2023	Improve the business environment	MOJ	Draft and submit the concept paper on the review of the legislation on bankruptcy.
September 2023		MOE	Expand the agricultural insurance scheme to cover more risks, regions, and crops.
June 2023	Enhance labor force participation and boost employment.	MLSA	Approve a costed employment strategy, including to bolster active labor market policies.

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 November 15, 2022.

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 405.65 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 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 SDR allocations, 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 (excluding SDR allocations) 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 the upper and lower (outer bands) around the mid-point target specified in Table 1 in the LOI/MEFP. Consultation with IMF Board would be triggered for end December 2022 test date if inflation falls outside the outer bands. 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. In addition, a staff consultation clause whereby the CBA will consult with IMF staff on the outlook for inflation and the proposed policy response will be triggered if inflation falls outside the inner bands and within the outer bands (Table 1 in the LOI/MEFP) for the December 2022 test date.

Inflation Consultation Bands

	Dec-22	Jun-23
Upper outer band	12.5	10.5
Upper inner band	11.5	9.5
Center point	**10.0**	**8.0**
Lower Inner band	8.5	6.5
Lower outer band	7.5	5.5

Source: IMF Staff.

6. **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).[1] This PC excludes arrears on external financial obligations of

[1] The term debt will be understood as defined in Guidelines on Public Debt Conditionality in Fund Arrangements, IMF Policy Paper, 2020/061.

the government subject to rescheduling.[2] 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.

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

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

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

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

8. **Budgetary ER.** Foreign currency-denominated transactions take place at the prevailing market ER at the time of the transaction. The framework arrangement will not be modified (in substance) but may be clarified to the extent necessary to avoid noncompliance with the program continuous PC on non-introduction of new exchange restrictions and multiple-currency practices, or intensification/modification of existing ones

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 ¶7). This effectively treats net lending as an expenditure item when loans are made and as a revenue item when the loans are repaid

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

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

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 ¶7, 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. **Ceiling on government guaranteed external debt.** A 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.

15. The program sets a floor on **social assistance spending of the government**. For the purposes of the program, social assistance spending of the government comprises the Family Living

Standards Enhancement Benefits, childcare benefits for children less than two years of age, and allowances for old age, disability, and loss of breadwinner.

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

- **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 grants and loans, CBA project financing, EEU customs pool transfers and government project financing loans and grants including for onlending disbursed through the CBA, compared to program amounts as indicated in Table 2. 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 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 2), 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 2), 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

17. 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 25 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
	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 attracted and	By currency and maturity	Weekly	First working day of the next week

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	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)	Monthly	First working day of the next month
	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 35 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 95 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	T-bill and coupon bond financing	By holders, i.e., CBA, resident banks, resident nonbanks, and nonresidents	Monthly	Within 7 days of each month
	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the CBA, and state-owned companies (by company); any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears	Monthly	Within 21 days of the end of each month. For project implementation units, within 21 days of the end of each month (preliminary data) and within 45 days of the end of each month (final data)
Ministry of Finance	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, license fee for export of minerals, social contributions and army servicemen insurance fund contributions.	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, Special Privatization Account, off budget account, monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.	Monthly	Within 7 days of the end of each month
	Consolidated central government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Central and local governments, and Non-Commercial Enterprises that belong within the general	Quarterly	Within 60 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		government (NCEs)		
	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 month.
National Statistical tService	Trade Statistics	Detailed export and import data	Monthly	Within 28 days of the end of each month
	Balance of payments	Detailed BOP data	Quarterly	Within 45 days of the end of each quarter
	CPI	By category	Monthly	Within 21 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)
	Large taxpayers	Data on the number of taxpayers and amount of taxes collected from taxpayers included in the list for special control approved annually by the chairman of SRC	Monthly	Within 45 days after the end of each month
	Risk-based selection	Percentage of selected companies chosen on the basis of risk-based approach, and identified	Monthly	Within 45 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		additional revenue to be collected from risk-based audits		(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 September 30, 2022, in U.S. dollars per currency rates)

		USD 1/	AMD 2/
AMD	Armenian Dram	0.002	1.00
XDR	SDR	1.280	519.18
USD	U.S. Dollar	1.000	405.65
CHF	Swiss Franc	1.016	412.02
GBP	Pound Sterling	1.113	451.65
JPY	Japanese Yen	0.007	2.80
EUR	EURO	0.980	397.42
CNY	Chinese Yuan	0.141	57.03
AUD	Australian Dollar	0.644	261.12
CAD	Canadian Dollar	0.727	294.98
XAU	Gold (1 gram)	53.81	21828.03

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

2/ Staff calculations based on the USD cross rates specified in column 1/.

Table 2. Armenia: External Disbursements through the CBA in 2022–23 1/
(In millions of U.S. dollars)

	Dec-22 Prog.	Mar-23 Prog.	Jun-23 Prog.	Sep-23 Prog.	Dec-23 Prog.
Budget support grants	20	0			3
Budget support loans	267		150	150	150
Project support grants	65	2	10	12	39
CBA project loans	194	49	99	149	199
EEU transfers	-6				
Project financing loans	177	26	117	209	401

1/ Cumulative during the year.

Statement by Mr. Rashkovan and Mr. Scholer on Republic of Armenia
December 12, 2022

On behalf of the Armenian authorities, we would like to extend our deep gratitude to Mrs. Petrova, her team, and the Resident Representative Office headed by Mr. Raissi for the constructive engagement on the authorities' request for Fund support. This positive collaboration is fully in line with the Fund's strong support to Armenia in recent years, notably the 2019-22 SBA and numerous capacity development activities, including through the recently established CCAMTAC.

The authorities have requested a 36-month Stand-By Arrangement with access at 100% of quota, which they intend to use on a precautionary basis. This would provide insurance against external shocks and thus complement the authorities' structural reform agenda aimed at building an export-led, investment-driven, and knowledge-based economic growth model. The request builds on the positive experience and solid track record of the 2019-22 SBA, during which the authorities have strengthened fiscal, monetary, structural, and institutional resilience despite a very challenging external environment. Yet, challenges remain, and the authorities are determined to maintain this reform momentum, continue the close policy dialogue with the IMF and take any measures needed to achieve the program objectives.

Macroeconomic developments & outlook

Supported by sound macroeconomic policies, Armenia's economy has rebounded strongly in 2022 due to robust domestic consumption and a large inflow of external income, capital, and labor. Despite double-digit growth, inflation has increased less quickly (also in comparison to regional peers) thanks to the early and steadfast actions by the Central Bank of Armenia – though inflation remains above target. Meanwhile, Armenia's external position was broadly in line with the level implied by fundamentals, and unemployment has dropped markedly since the COVID-19 pandemic.

Though the economic outlook remains generally positive on the back of Armenia's macroeconomic stability, uncertainty is extremely high amid downside risks from the external environment. In addition to Armenia being particularly exposed to the repercussions of the war in Ukraine and the general deterioration of economic performance in its main trading partners (Russia, EU, USA), regional instability further deepens uncertainty. At the same time, continued implementation of the authorities' comprehensive reform agenda should durably raise potential growth to 7% over the medium-term.

Fiscal policy

Consistent with the strong economic recovery, the fiscal outturn has been much better than anticipated in both 2021 and 2022. Importantly, this performance is driven by both buoyant tax revenues (notably corporate income taxes, VAT, and mining sector taxation) and current expenditure restraint. At the same time, capital spending is projected to further increase by 1.6pp of GDP in line with the government's ambitions for infrastructure investment.

For 2023, the authorities plan a neutral fiscal stance to help ease inflation and reduce public debt levels, while further improving the quality of public finances. The government maintains its strong commitment to keeping public debt on a downward trajectory to ensure stability in the face of tightening global financial conditions and developed an ambitious reform agenda to simultaneously create fiscal space for growth-friendly expenditure. Importantly, the authorities aim to reach a tax-to-GDP ratio of 25% by 2026.

To that end, and as reflected in the MEFP, the authorities are progressing on several workstreams to raise domestic revenue mobilization and improve spending efficiency. On the revenue side, a major policy objective is to reduce the tax policy gap – including by rationalizing tax expenditures and broadening the tax base. Moreover, there is scope to further strengthen the revenue administration, notably by introducing a universal income tax declaration system. On the expenditure side, significant reforms are underway to bolster the efficiency and effectiveness of spending on public sector wages, the healthcare system, pensions, and social safety nets.

Building on IMF technical assistance, the authorities plan to further improve public financial management. This strategy rests on further upgrading the Ministry of Finance's administrative capacity to cost new fiscal policy initiatives, conduct regular program evaluations, and identify fiscal risks. Moreover, continued improvements to data production and sharing will facilitate better liquidity management and coordination between institutions. Finally, to support the economy's growth potential, the authorities will conduct a review to close the execution gap on foreign-funded infrastructure projects.

Monetary policy

While inflation has remained high in 2022 due to strong demand and high global commodity prices, decisive monetary policy action will ensure a return to the inflation target of 4% over the medium term. Early tightening since end-2020 was showing signs of success before the repercussions of the war in Ukraine once again raised inflationary pressures. The CBA is ready to pursue further tightening if economic data warrants such action and is committed to keeping inflation expectations anchored through clear communication. To that end, the authorities reiterate their attachment to the CBA's independence.

Moreover, the authorities maintain their strong commitment to exchange rate flexibility on both sides, also in support of inflation targeting. As in early 2022, the CBA's foreign exchange interventions will be strictly limited to avoiding disorderly market developments.

Financial sector policies

The banking sector has remained resilient throughout the COVID-19 pandemic and the repercussions of the war in Ukraine, thanks to prudent risk management and strong supervision. Already high capital levels are further bolstered by the authorities' requirement to maintain a capital conservation buffer of 1.5/2.5%. Meanwhile, the ratio of liquid assets to total short-term liabilities remains comfortably above 100%. NPLs are also very low at 2.8% of gross loans.

At the same time, the authorities are committed to further strengthening risk-based supervision. Following the implementation of Basel III standards and macroprudential measures, the authorities will introduce Pillar 2 capital buffers. To mitigate foreign exchange risks in the meantime, higher risk weights and loss provisions for foreign exchange loans will remain in place. Moreover, in line with the MEFP, the authorities will develop a draft law for an enhanced bank resolution framework. Finally, capital market development remains a key priority, with immediate action focused on introducing an over-the-counter commercial trading platform for the overnight repo market.

<u>Structural policies</u>

As noted above, the authorities' request for a precautionary SBA will underpin the development of an export-led, investment-driven, and knowledge-based growth model for Armenia. To that end, the authorities designed a set of complementary reforms to (i) improve the business environment; (ii) enhance labor market outcomes; (iii) foster the economy's digitalization, and (iv) address structural obstacles in the agriculture sector.

To enhance the business environment, the authorities will focus on improving access to finance for domestic firms and facilitating foreign investment. In this context, notable actions include (i) progress on the reform of the insolvency regime; (ii) further reinforcements of the resources, capacity, and independence of the judiciary; and (iii) continued improvements to the AML/CFT framework in compliance with international standards.

To improve labor market outcomes, the authorities concluded a comprehensive reform of the education sector. Together with immediate actions to expand access to early childcare, this will address skills mismatches and raise labor force participation. Looking ahead, the focus will be on the development and costing of an employment strategy based on active labor market policies.

Furthermore, the authorities are steadfastly pursuing their efforts toward a digital transformation of society, the economy, and the government. The development of a national digital ID will be the cornerstone on which further developments can be built, notably as regards e-government, also benefitting from a vibrant IT sector.

As shown in Annex VII, modernizing the agriculture sector can have numerous positive effects, including in terms of revenue mobilization and climate change mitigation. To harness these positive effects, the authorities will introduce a modern land registration system to address fragmented land ownership and informality. Moreover, they will enhance climate change resilience through expanding the agricultural insurance scheme and improving water management.

Finally, as noted in the MEFP, the authorities will design a comprehensive strategy to fight climate change, based on national mitigation and adaptation targets. In this context, due consideration will be given to the introduction of carbon pricing, while using revenues to protect the most vulnerable.

Program objectives and safeguards

The authorities welcome the close alignment of the program objectives with their reform agenda. While this will ensure a high degree of ownership, it will also lend the IMF's credibility to the authorities' agenda, thus increasing the program's catalytical role. Indeed, firm financing commitments from other donors are already in place for the first 12 months of the program and there are good prospects for financing for the full period given the authorities' strong track record. Meanwhile, reserve levels are at comfortable levels and are projected to remain above 110% of the ARA metric over the entire forecast horizon.

Staff's debt sustainability analysis projects a decline in both public debt and gross financing needs over the medium-term. Indeed, even under a very adverse scenario, government debt is not expected to exceed 70% in 2027 – compared to a level of 63.4% in 2021.

Finally, the authorities reiterate their strong commitment to adequate safeguards. The CBA will undergo a new safeguards assessment by the time of the first review and the ex-post audit of the COVID-19 on-lending business support scheme will be finalized.

Concluding remarks

While the authorities are convinced that their reform agenda will steer the country and economy to a successful and stable growth model in the medium-term, they believe that a precautionary Fund program can serve as a positive signal on the appropriateness of their reform agenda and be a useful insurance against external downside risks.