IMF Country Report No. 23/416

REPUBLIC OF ARMENIA

2023 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR MODIFICATIONS OF PERFORMANCE CRITERIA AND MONETARY POLICY CONSULTATION CLAUSE—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR

December 2023

In the context of the Staff Report for the 2023 Article IV Consultation and Second Review Under the Stand-By Arrangement and Request for Modifications of Performance Criteria and Monetary Policy Consultation Clause, 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 11, 2023 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 11, 2023, following discussions that ended on September 25, 2023 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 November 17, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Armenia.

The document listed below has been or will be separately released.

Selected Issues Paper

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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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes the 2023 Article IV Consultation and Completes the Second Review Under the Stand-By Arrangement with Armenia

FOR IMMEDIATE RELEASE

- *The Executive Board of the International Monetary Fund (IMF) concluded the 2023 Article IV Consultation and completed the second review under the Stand-By Arrangement (SBA) with Armenia. The Armenian authorities continue to treat the SBA as precautionary.*
- *Real GDP is projected to grow by 7 percent in 2023 before moderating to 5 percent in 2024. Inflation has subsided rapidly and is projected to revert to the central bank's target of 4 percent by mid-2024.*
- *Key policy priorities include preserving macroeconomic stability, building fiscal buffers to support priority infrastructure and social spending, managing fiscal risk, enhancing the monetary policy, macroprudential, and supervisory frameworks, and strengthening economic resilience by advancing structural reforms in the labor and product markets, access to finance, and governance.*

Washington, DC – **December 11, 2023:** The Executive Board of the International Monetary Fund (IMF) completed the second review under the Stand-By Arrangement with Armenia. This provides the country with access to about US$24.4 million (SDR 18.4 million), bringing the total access to about US$73.3 million (SDR 55.2 million). The Armenian authorities continue to treat the SBA as precautionary.

Armenia's strong growth momentum continued through 2023. Supported by robust private consumption and investment, the economy is projected to grow by 7 percent in 2023 before moderating to 5 percent in 2024. Over the medium-term, growth is projected to reach its potential of around 4.5 percent, while steadfast implementation of structural reforms under the program could increase potential growth further. Inflation is projected to revert to the central bank's target of 4 percent by mid-2024 and stabilize around it. The current account is projected to reach 3 percent of GDP in 2023 and 2024 due to robust consumption and investment demand. Foreign direct investment and capital inflows have moderated. Fiscal overperformance has persisted, with the overall fiscal balance remaining in surplus through September 2023, owing to higher than anticipated revenue collection and spending under-execution, notwithstanding the authorities' prompt fiscal support to address the urgent needs of Nagorno-Karabakh's refugees.

The Executive Board today also concluded the 2023 Article IV consultation[1] with Armenia. The associated press release will be issued separately.

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

Following the Executive Board's discussion today, Mr. Bo Li, Deputy Managing Director and Acting Chair, made the following statement:

"Armenia's economy has managed to overcome recent external shocks and faces a favorable outlook, with strong growth in the context of moderate inflation. The program performance remains broadly satisfactory. However, an uncertain domestic and external environment warrant continued policy prudence and unwavering reform effort.

"The policy focus of the 2024 budget on preserving macroeconomic stability and providing humanitarian and development support to NK refugees is welcome. In the medium term, a gradual fiscal deficit reduction, anchored on Armenia's fiscal rules, will ensure that public debt remains moderate. Progress on structural fiscal reforms including tax expenditure rationalization and SOE ownership policy will help contain fiscal risks and mobilize revenues to support priority expenditures on health, social protection, and capital projects.

"The monetary policy stance is appropriate and has helped ease inflation. The CBA should remain proactive in case strong demand conditions pose risks to the inflation outlook. The CBA's plan to transition to a risk-based approach to price stability should ensure that the credibility of the inflation targeting framework is preserved. The flexible exchange rate has served Armenia well in absorbing external shocks, while building reserve buffers.

"In the face of rising financial sector risks, particularly in the housing sector, the CBA should advance its prudential regulation and supervisory reforms. Efforts should focus on preserving capital buffers, enhancing supervisory powers and capacities, and strengthening crisis management.

"Advancing structural reforms will support sustainable and inclusive growth. The authorities' efforts to raise labor force participation and reduce structural unemployment, ease access to finance, diversify exports, and strengthen governance will enhance economic resilience and uplift potential growth."

Table 1. Armenia: Selected Economic and Financial Indicators, 2020–25

	2020	2021	2022	2023	2024	2025
	Act.	Act.	Prel.		Proj	
National income and prices:						
Real GDP (percent change)	-7.2	5.7	12.6	7.0	5.0	4.5
Final consumption expenditure, Contrib. to Growth	-10.5	4.0	6.6	7.5	2.2	2.6
Gross fixed capital formation, Contrib. to Growth	-0.2	1.1	1.7	2.2	2.9	2.0
Changes in inventories, Contrib. to Growth	0.1	0.7	-0.9	-1.0	0.0	0.0
Net exports of goods and services, Contrib. to Growth	3.4	-0.2	5.2	-1.6	-0.1	-0.1
Gross domestic product (in billions of drams)	6,182	6,983	8,501	9,424	10,325	11,211
Gross domestic product (in millions of U.S. dollars)	12,642	13,861	19,514	23,787	24,745	26,569
Gross domestic product per capita (in U.S. dollars)	4,269	4,679	6,587	8,029	8,352	8,967
CPI (period average; percent change)	1.2	7.2	8.6	2.7	3.9	4.0
CPI (end of period; percent change)	3.7	7.7	8.3	2.5	4.0	4.0
GDP deflator (percent change)	1.8	6.9	8.1	3.6	4.3	3.9
Unemployment rate (in percent)	18.2	15.5	13.0	13.5	14.0	14.0
Investment and saving (in percent of GDP)						
Investment	19.7	20.7	21.7	23.3	24.0	23.8
National savings	15.7	17.2	22.5	20.2	20.9	20.2
Money and credit (end of period)						
Reserve money (percent change)	18.3	17.1	5.0	1.3	4.0	6.0
Broad money (percent change)	9.0	13.1	16.1	15.9	10.3	7.2
Private sector credit growth (percent change)	14.3	-3.9	4.5	13.2	7.5	5.9
Central government operations (in percent of GDP)						
Revenue and grants	25.2	24.1	24.3	25.2	25.1	25.2
Of which: tax revenue	22.0	22.1	21.9	22.9	23.1	23.3
Expenditure	30.6	28.7	26.4	28.2	29.7	29.0
Overall balance on a cash basis	-5.4	-4.6	-2.1	-2.9	-4.6	-3.8
Public and publicly-guaranteed (PPG) debt (in percent of GDP)	67.4	63.4	49.2	50.3	50.1	50.8
Central Government's PPG debt (in percent)	63.5	60.3	46.7	47.5	47.5	48.4
Share of foreign currency Central Government PPG debt (in percent)	75.6	71.2	62.1	58.2	55.8	51.7
External sector						
Exports of goods and services (in millions of U.S. dollars)	3,818	5,012	10,038	12,313	12,269	12,913
Imports of goods and services (in millions of U.S. dollars)	-5,082	-6,120	-10,186	-13,043	-13,192	-13,990
Exports of goods and services (percent change)	-34.1	31.3	100.3	22.7	-0.4	5.2
Imports of goods and services (percent change)	-33.2	20.4	66.5	28.0	1.1	6.0
Current account balance (in percent of GDP)	-4.0	-3.5	0.8	-3.1	-3.1	-3.6
FDI (net, in millions of U.S. dollars)	86	342	948	437	461	530
Gross international reserves (in millions of U.S. dollars)	2,616	3,230	4,112	4,004	3,903	4,006
Import cover 1/	5.1	3.8	3.8	3.6	3.3	3.2
End-of-period exchange rate (dram per U.S. dollar)	523	480	394	…	…	…
Average exchange rate (dram per U.S. dollar)	489	504	436	…	…	…

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.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

November 17, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR MODIFICATIONS OF PERFORMANCE CRITERIA AND MONETARY POLICY CONSULTATION CLAUSE

EXECUTIVE SUMMARY

Context. Armenia's growth accelerated in 2022 and remained strong in 2023, boosted by an inflow of foreign exchange, migrants, and businesses, mainly from Russia. Inflation, which peaked in the wake of the war in Ukraine, has quickly subsided. However, the regional security situation worsened significantly in September 2023, after Azerbaijan's government took full control of Nagorno-Karabakh, which triggered the exodus of about 100,000 ethnic Armenians into Armenia. The government has responded with prompt policy measures to support their immediate needs.

Program implementation is broadly on track. All quantitative performance criteria (QPCs) and indicative targets (ITs) for end-June were met. Low inflation breached the lower MPCC band. Progress on structural benchmarks (SB) continues, although with some delays. The authorities remain committed to advancing institutional and structural reforms.

Article IV discussions. Discussions focused on policies to strengthen medium- and long-term resilience and potential growth, including: (i) advancing the authorities' structural reform plans; (ii) rebuilding fiscal buffers, including to strengthen investment and social spending; and (iii) bolstering the central bank's monetary policy and supervisory frameworks.

SBA. Staff supports the authorities' request for completion of the second review, consultation under the MPCC, and modifications of QPC and MPCC. Upon completion of this review, a disbursement of SDR18.4 million will be made available to Armenia. The authorities continue to treat the SBA as precautionary.

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

Discussions were held during September 13-25, 2023, in Yerevan. The team comprised I. Petrova (head), M. Al Taj, M. Atamanchuk, G. Lisi, N. Reyes (MCD), U. Rawat (Resident Representative), A. Carvalho (MCM), M. Coelho (FAD), L. O'Sullivan (SPR), J. Garrido and A. French (LEG). M. Aleksanyan, V. Janvelyan and L. Karapetyan (IMF Office) supported the mission, H. Fuje (MCD) supported at headquarters. M. Scholer (OED) participated in meetings with the authorities. B. Laumann and M. Gaetskaya (MCD) assisted with document preparation. The mission met with Deputy Prime Ministers Grigoryan and Khachatryan, Governor of the Central Bank of Armenia Galstyan, Minister of Finance Hovhannisyan, Minister of Economy Kerobyan, Chairman of the State Revenue Committee Badasyan, and other senior government officials.

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BACKGROUND

1. **Armenia's economy has continued to grow strongly.** Boosted by an influx of foreign exchange, migrants, and businesses (Figure 1), real GDP grew by 12.6 percent in 2022—an unprecedented rate in the last 15 years – and above 10 percent in 2023H1. Inflation, which flared up post-COVID and peaked at the start of the war in Ukraine, has quickly subsided.

2. **Despite this strong performance, Armenia's long-standing economic challenges remain pressing.** Structural unemployment is still high, and informality is pervasive. Fiscal space is needed to raise human and physical capital, including for an overhaul of the health system, better labor market programs, and new infrastructure. Financial markets remain relatively shallow, limiting policy effectiveness, and institutional frameworks and capacity need to continue strengthening.

3. **Regional security concerns have added to these challenges.** Tensions with Azerbaijan have remained high, including border skirmishes that have led to loss of life on both sides. Following a military offensive in September 2023, Azerbaijan's government took full control of Nagorno-Karabakh (NK), which resulted in the dissolution of NK's administration and an exodus of its residents to Armenia. Peace negotiations between Armenia and Azerbaijan have progressed very slowly.

4. **Armenia's political environment has also become more complex.** The security situation has weighed on the government's approval, but in the absence of a clear alternative, the opposition has failed to challenge Prime Minister Pashinyan's cabinet. While the PM's Civil Contract party lost majority in Yerevan's city council at the recent municipal elections, a Civil Contract nominee was ultimately appointed as Yerevan's new mayor.

5. **Armenia's three-year Stand-By-Arrangement (SBA) is broadly on track and supports the authorities' macro-stabilization and reform efforts.** The SBA, approved by the IMF Executive Board in December 2022, has helped secure policy continuity and strengthen macroeconomic, financial, and fiscal stability. The first review was completed in mid-June, and the authorities' policies are broadly aligned with program objectives. The Armenian authorities continue treating the SBA as precautionary.

Box 1. Armenia: Refugee Crisis

Following the recent escalation in the region, nearly all NK residents have sought refuge in Armenia. The Government has registered 101848 NK refugees in government-run registration centers. The refugees are currently located in different regions across Armenia, with the highest numbers residing in Yerevan (38 percent), Syunik (16 percent), Kotayk (8 percent) and Ararat (7 percent). Anticipating further movement of the refugees and planning for their support is exceptionally challenging.

The government has responded with prompt policy measures to address urgent needs. The initial support package (Box 1, Table 1) includes cash transfers to address essential needs and temporary accommodation allowances. A government-led and UN-supported coordination framework has also been setup to assess humanitarian needs.[1]

Box 1. Armenia: Refugee Crisis (Concluded)

Box 1. Table 1. Armenia: Government Support Programs Effective in October 2023*

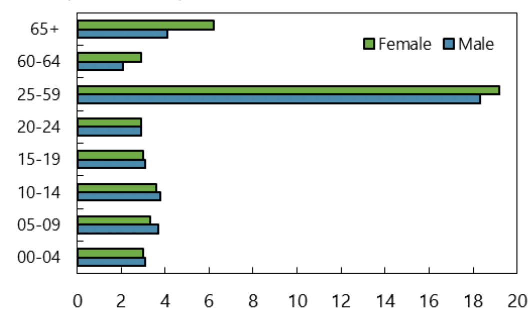
	From October 1	Duration	Number of refugees	Cost in Bill. AMD (3 months)		Cost as percent of GDP (3 months)	
				2023	2024	2023	2024
Housing	Per person AMD 40,000	At least 6 months	101848	12.2	12.2	0.1	0.1
Utility	Per person AMD 10,000	At least 6 months	101848	3.1	3.1	0.0	0.0
One-off support	Per person AMD 100,000	Additional 50,000 AMD per person per month for Nov and Dec	101848	20.4		0.2	
TOTAL				35.6	15.3	0.4	0.1

* Maximum amount of support, subject to eligibility.

According to a preliminary rapid needs assessment, USD 97 million (0.4 percent of GDP) is needed to meet the most urgent humanitarian needs. This includes immediate support for protection, health, basic needs, education, and resilience. Bilateral donors have pledged around USD 50 million (0.2 percent of GDP) in grant support, but the modalities of disbursement are not yet clear.

A comprehensive assessment is required for budgeting medium to long-term needs of the displaced population. Longer-term integration of refugees would entail creating sustainable housing opportunities, access to education, healthcare, and provision of social services. Around 63 percent of the refugees are of working age (15–64), and their integration into the workforce would require expansion of employment programs and opportunities, enhancing access to finance, and skill development and training.

Age and Gender Breakdown
(In thousands)



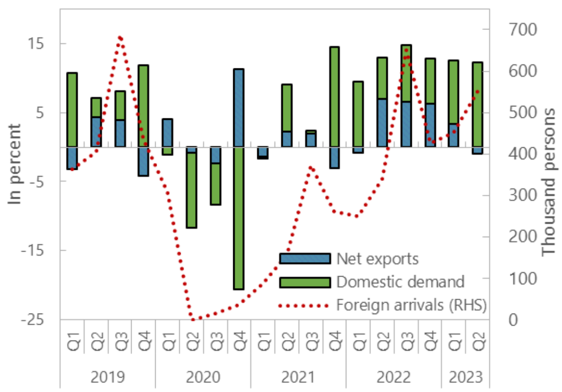
Source: National Authorities, migration and citizenship service RA.

[1] The Deputy Prime Minister's office is coordinating the framework, with support by the Ministry of Internal Affairs, Ministry of Territorial Administration, Ministry of Health, Ministry of Education, Science, Culture and Sports, and Ministry of Labor and Social Affairs; as well as various UN agencies, national and international NGOs, and community-based organizations.

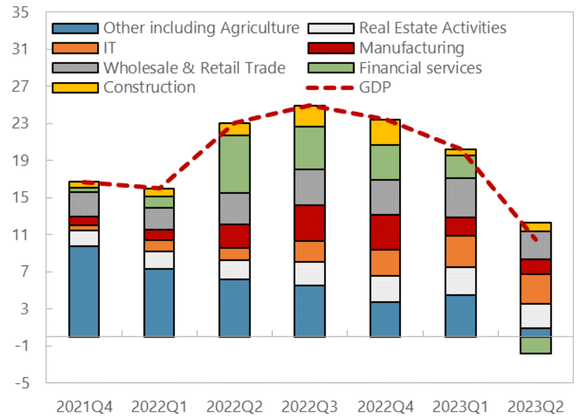
RECENT ECONOMIC DEVELOPMENTS

6. **The economy continues to expand rapidly.** Real GDP grew by 10.5 percent in 2023H1, driven by robust private consumption and investments. Strong domestic demand also resulted in negative contribution of net exports (Figure 2). Real estate, IT, and trade-related sectors continued to support growth through August 2023, while growth in industrial output eased, and financial services contracted.

Contributions to Real GDP Growth and Foreign Arrivals



GDP Growth Contribution by Sector
(Current prices, percent, Y-o-Y)



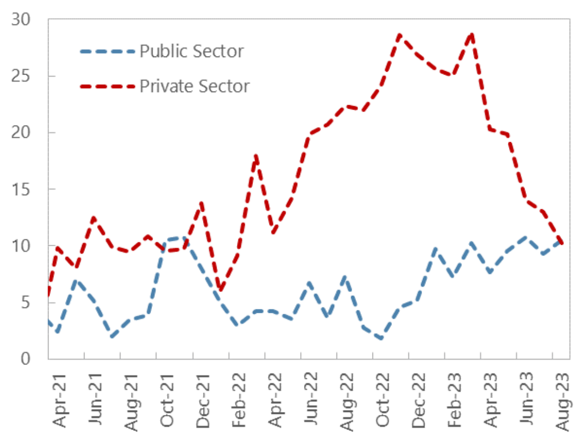
Sources: Haver (Armstats), National Authorities, and IMF staff calculations.

7. The labor market conditions are improving. Strengthening of future employment expectations,[1] and an inflow of foreign workers have resulted in an uptick of both labor force and labor force participation, which recovered to their pre-pandemic levels in 2023Q2. The output growth momentum has also driven employment to a record high and the unemployment rate to a new low of 11.7 percent. This has put pressure on nominal wages, which rose by 18.0 percent y-o-y in January–August. High wages of foreign nationals who have joined the Armenian labor market since 2022, including in the IT sector, and an increase in public wages have also contributed to the strong nominal wage rise.

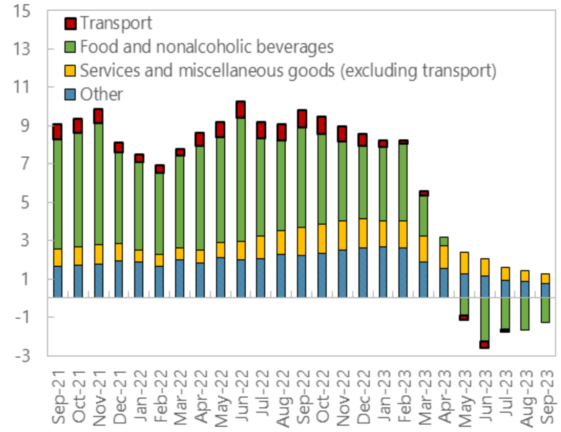
8. Notwithstanding wage pressures, inflation has moderated significantly. It dropped to -0.2 percent year-on-year in August, before turning positive in September (0.1 percent), reflecting dram appreciation relative to 2022, falling food and fuel prices, and lower price of imported goods, as well as tight monetary policy. Core inflation—partly reflecting an energy price impact—also declined rapidly to -0.1 percent in September, and service price inflation moderated but remains persistently higher (3.2 percent). Since June, the CBA has reduced the policy rate by 125 basis points to 9.5 percent (Figure 5).

[1] A new Consumer Confidence Index is published by the American University of Armenia, based on a telephone survey of 2,000 participants (The AUA Consumer Confidence Index). The index includes an indicator of employment expectations.

Nominal Wages Growth
(In percent y-o-y)



Contribution to Inflation
(In percent, y-o-y)



Sources: Haver (Armstats) and IMF staff calculations.

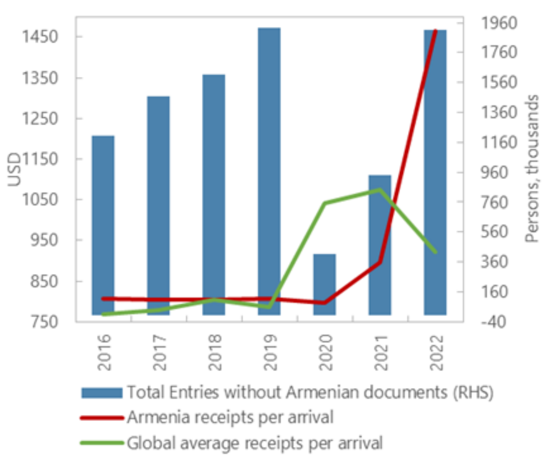
9. **Fiscal overperformance has persisted through September 2023.** The overall fiscal balance recorded a surplus of 0.7 percent of GDP, meeting comfortably the end-September target. Higher than anticipated revenues (0.5 percent of GDP) were driven by a robust increase in income taxes and social security contributions due to strong labor market developments and wage growth, record tax collections on 2022 banking sector profits, and VAT buoyed by strong domestic consumption. Current expenditures were underexecuted (0.7 percent of GDP) despite implementation of planned increases in civil servants' wages and pensions (0.2 percent of GDP each). Capital expenditures were significantly lower than projected by 1.6 percent of GDP. The authorities completed a US$187.6 million (0.8 percent of GDP) buyback of a US$500 million outstanding Eurobond due in 2025 and overexecuted their end-September 2023 domestic borrowing plan by AMD 42 billion (0.4 percent of GDP).

10. **The current account improvement was short lived**. A surge in tourism and foreign arrivals driven by the end of the pandemic and the impact of the war in Ukraine was accompanied by significantly longer visitor stays and higher expenditures than observed prior to 2022. This supported an unprecedented services trade surplus of 8.8 percent of GDP in 2022 (Figure 3, Table 2). Trade in precious metals, machinery, and equipment—largely due to reexports to Russia—helped narrow the trade deficit in goods to 9.5 percent of GDP in 2022. Robust trade and remittances resulted in a current account surplus of 0.8 percent of GDP in 2022. Taking into account substantial temporary effects, Armenia's 2022 external position was broadly in line with the level implied by fundamentals and desirable policies (Annex I). In 2023, the tourism strength has continued, but pent-up consumption demand has raised imports and widened the merchandise trade deficit. The external shock has thus started tapering, with an ongoing normalization of the current account through 2023Q2.

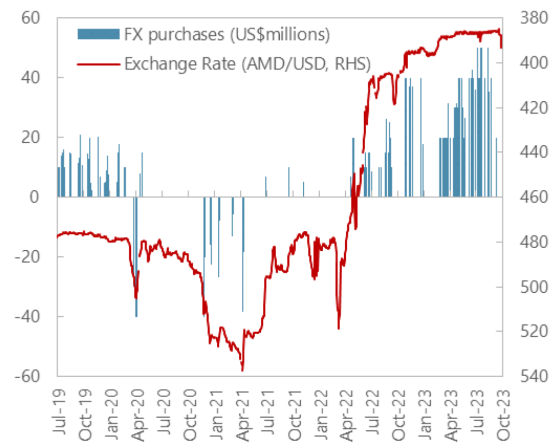
11. **The appreciation of the dram has allowed further accumulation of foreign exchange buffers**. Large FDI and other investment inflows reflecting primarily capital flows from Russia (mainly in the mining, energy, and telecommunication sectors), contributed to a 22 percent appreciation of

the dram against the US dollar during March 2022–September 2023. In early October, due in part to refugees' higher demand for foreign exchange, the dram weakened temporarily by about 10 percent against the dollar before settling at about 5 percent below its mid-September value. While FDI and capital inflows decelerated in 2023, international reserves reached $4.0 billion (135 percent of the ARA metric) in August 2023.

Total Entries and Receipts per Arrival



FX Intervention and Exchange Rate



Sources: Haver (Armstat), UNWTO, CBA, and IMF staff calculations.

Notes: LHS chart: entries at the Armenian border checkpoint. RHS chart: recent FX interventions correspond to dollar purchases to build international reserves.

12. The financial system is performing well. Banks have Pillar 1 capital well above the requirement of 11 percent, comfortable liquidity levels, and relatively low non-performing loans (NPLs) (Figure 6, Table 5). The record returns banks earned in 2022 have eased but remain significant, supported by FX gains and benefiting from higher interest income in 2023. Adjusting for the exchange rate, growth of 9.5 percent in mortgages and 26.6 percent in construction lending increased banks' loan portfolio by 13.6 percent in September (year to date). Deposit growth in September 2023 decelerated to 5 percent (year to date), as non-resident deposits declined by 10 percent.

PROGRAM IMPLEMENTATION

13. The program remains broadly on track.

- *All end-June quantitative performance criteria (QPC) and indicative targets (IT) were met with comfortable margins* (Attachment I, Table 1). Preliminary data indicate that the end-September indicative targets for NIR, program fiscal balance, budget domestic lending, external public debt arrears, new government guaranteed debt, and social spending were met.

- *The end-June headline inflation rate of –0.5 percent breached the lower-outer band of the Monetary Policy Consultation Clause.* This triggers a consultation with the Executive Board

(Attachment III). Lower inflation was mainly due to base effects and external factors, including falling food and transportation prices, and dram appreciation.

- *Considerable progress is made on the implementation of structural benchmarks (SB), albeit with some delays* (Attachment I, Table 2a). The authorities prepared a study on the bottlenecks for the execution of foreign-funded capital projects and an action plan (with delay) for strengthening public investment management (PIM), published an assessment of tax expenditures, and provided a roadmap for introducing Pillar 2 bank capital add-ons (June 2023 SBs). They have also finalized with delay a concept note for subnational government borrowing (September 2023 SB). The authorities have significantly advanced the preparation of a draft bank resolution, but further consultations are needed with resolution experts and domestic stakeholders (November 2023 SB, proposed to be rescheduled to June 2024). A draft concept note for the review of the bankruptcy law has also advanced but needs more time for finalization and cabinet discussions (September 2023 SB, proposed to be rescheduled to January 2024). The completion of the new employment strategy was delayed due to lack of critical details (employment rates by age and gender) in the 2022 labor market statistics that are needed to inform policies in the current rapidly changing population environment (June 2023 SB, proposed to be rescheduled for June 2024).

OUTLOOK AND RISKS

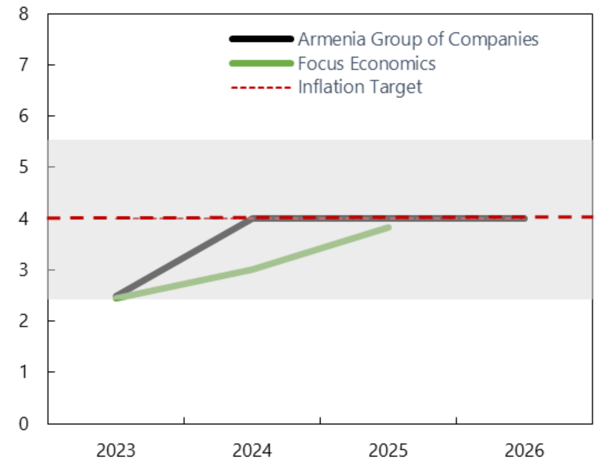
14. Growth is projected to be above potential in 2023–24. As base effects strengthen toward the end of the year, growth is expected to decelerate from its current very high rate. Nonetheless, staff projects real GDP growth to reach 7 percent in 2023 and 5 percent in 2024, driven by continued expansion in the construction and trade sectors. With the caveat of considerable uncertainty in estimates reflecting the unprecedented factors that have affected Armenia's economy in recent years, the 2023 output gap is expected to be positive at around 2 percent in 2023 due to strong domestic demand and to contract rapidly in 2024.

15. Medium-term growth is expected to moderate but remain robust. A combination of factors, including the dissipating impact of labor and capital inflows and tight monetary policy, will steer growth toward its estimated potential rate of about 4.5 percent in the medium term. However, there is significant uncertainty in the medium-term projections. The recent inflow of working-age migrants—some 4–9.4 percent of the total labor force—could increase potential GDP growth by up to 0.5 percentage points. Steadfast implementation of structural reforms under the program could add another 0.5 percentage points to potential growth in the medium term.[2]

[2] Armenia – Selected Issues (2023). *Armenia's Potential Growth: Long-Run Dynamics, Recent Developments, and Impact of Reforms.*

16. Inflation is projected to revert to the CBA's target of 4 percent by mid-2024 and stabilize around it. Moderate food and commodity prices and rapidly subsiding inflation in trading partners are expected to continue putting downward pressure on headline inflation in the near term. On the other side, the positive output gap, driven by robust domestic demand, could exert upward inflationary pressures, including through further increases in service prices. On balance, with proactive monetary policy, inflation expectations are expected to remain anchored, and the inflation rate is projected to stabilize at around 4 percent.

Inflation: Market Expectations
(Percent)



Source: Focus Economics.
Note: Focus Economics includes the forecast from Renaissance Capital, Fitch Solutions, Fitch Ratings, EIU, ING and Moody's Analytics.

17. The current account is projected to move back into a deficit. The strong performance in the balance of services is expected to be offset by a widening merchandise trade deficit (now projected to increase from 9½ to 12½ percent of GDP in 2023) and declining remittances. As a result, the current account deficit is projected at around 3 percent of GDP in 2023 and 2024 before it converges towards its norm in the medium term.[3] FDI and capital inflows are projected to decline sharply from their 2022 levels. Reserves are projected to remain around US$4 billion by end-2024 (132 percent of the ARA metric).

18. Downside risks to the outlook are significant, and uncertainty remains high. Elevated risks stem from a challenging domestic and external environment (Annex II). Uncertainty surrounding further regional tensions, potential political instability, tight global financial conditions, a slowdown in major trading partners—including Russia—a recurrence of high global food and energy prices, fast easing of the monetary policy stance, and loose fiscal policy could trigger capital outflows, put depreciation pressures on the dram, and cause reemergence of inflationary pressures. While the risk of secondary sanctions on isolated companies and individuals remains nonnegligible, it is mitigated by the authorities' strong commitment to compliance with international sanctions. Upside risks stem from higher export receipts and continued capital and migrant inflows to Armenia, as well as from implementation of key structural reforms that could positively affect potential growth.

19. In the event of a downside shock, Armenia may need to access Fund resources. An illustrative negative scenario, trigered by a combination of shocks, including a decline in trading

[3] Exports to Russia (much of which consisted of re-exports) contribute significantly to the improvement in the current account in 2022 (see Annex I) as a positive spillover from the war in Ukraine. Based on trends in the first half of 2023, and as a result of ongoing spillover effects, overall merchandise export growth is expected to continue in 2023 but to a lesser extent, while in 2024 and the medium term, trade growth is projected to revert to its historical trend. The projections are subject to significant uncertainty, given the unknown duration and medium-term impact of the war and sanctions.

partners' growth and rising commodity prices could exacerbate the current account deficit, undermine growth, and cause a reversal in gross capital flows, putting significant pressure on reserves (Annex III). The authorities' commitment to prudent policies in such an event remains strong. Nonetheless, while the exchange rate will remain the key shock absorber, Armenia may need access to financial support from the Fund and other multilateral creditors. Public and external debt are projected to remain sustainable under plausible shocks while the economy adjusts (Annex I and Annex IV).

Armenia: Impact of a Plausible External Shock

	2024		2025		2026	
	Baseline	Adverse Scenario	Baseline	Adverse Scenario	Baseline	Adverse Scenario
National Income and Prices						
Real GDP (percent change)	5.0	1.5	4.5	2.5	4.5	4.5
CPI (Period average; percent change)	3.9	5.0	4.0	6.0	4.0	4.0
Overall Balance on a cash basis (in percent of GDP)	-4.6	-6.2	-3.8	-4.5	-3.5	-3.5
Central Government PPG Debt (in percent)	47.5	60.4	48.4	57.7	48.9	52.8
Current Account Balance (in percent of GDP)	-3.1	-5.0	-3.6	-4.6	-4.1	-4.1
Gross international Reserves (in millions of U.S. dollars)	3903	2719	4006	2536	4264	2952

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

Authorities' Views

20. The authorities broadly concurred with staff's near-term growth and inflation projections. They agreed that while robust domestic demand driven by inflows of migrant and capital has propped up growth in 2023, the momentum will ease in 2024. Nonetheless, they consider that Armenia's long-term growth potential would be higher than 4.5 percent in view of the recent inflow of labor with higher productivity, which is also expected to have some domestic spillover effects. The authorities concurred that a reversal of the current account is already materializing and considered a quick return to its norm to be a likely outcome. The authorities agreed with staff's assessment of the risks to the outlook. They noted that geopolitical developments pose a key risk but emphasized that existing fiscal, external, and banking sector buffers would help in addressing potential shocks. They also reiterated their commitment to prudent policies to reduce the risk of destabilizing macroeconomic imbalances.

POLICY DISCUSSIONS

Discussions on near-term policies focused on assessing progress with commitments under the program and ensuring: (i) the 2024 budget supports macro-stability objectives while accommodating urgent social assistance needs; (ii) an appropriate monetary policy path in view of the uncertain inflation outlook; and (iii) an effective control of financial stability risks. Discussions under the 2023 Article IV consultation focused on strengthening medium- and long-term resilience of the economy, including through: (i) advancing structural reforms to sustain a high potential growth; (ii) building fiscal buffers *to create room for raising investment and social spending; and (iii) strengthening the central bank's credibility by bolstering the monetary policy and supervisory frameworks.*

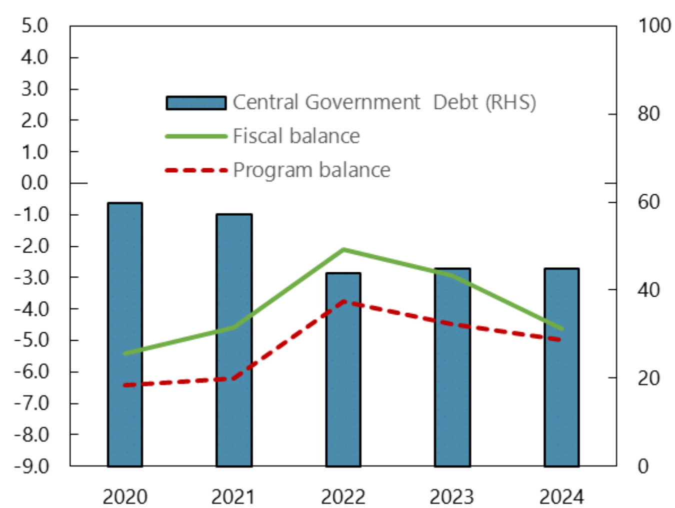
A. Fiscal Policies to Support Macro-Stability and Long-Term Prosperity

21. Staff projects the 2023 fiscal deficit to reach 2.9 percent of GDP, in line with program objectives. Revenues are expected to surpass the 2023 budget targets as VAT, CIT, and PIT have remained buoyant over the year. Current expenditures are expected to be higher than the budgeted amounts due to social assistance to refugees to cover accommodation, utilities, and essential relief items (Box 1), and interest payments on higher domestic borrowing to prefund future financing needs. The overall capital expenditure target is expected to be met, with the authorities propping up infrastructure investment with domestic financing. Gross debt is expected to remain below 50 percent of GDP.

Near-Term Policies

22. The 2024 budget will focus on ensuring macroeconomic stability and humanitarian and development support to NK refugees. The authorities' 2024 budget targets an overall deficit of 4.6 percent of GDP **(budget adoption is a prior action)**. The higher deficit, relative to 2023, will include about 1.5 percent of GDP in additional social assistance (1 percent of GDP) and investment spending (0.5 percent of GDP) to support refugees, including medical care, housing, education, and social protection. These measures are planned to be financed by redirecting about 1.5 percent of GDP loan (off-budget spending included in the program fiscal balance) that Armenia used to extend to the NK administration annually.[4] Beyond urgent social spending needs, the budget will support priority expenditures on roads, schools, and water management projects, as well as pensions, social assistance, and national security. These will be partially supported through reforms of the turnover tax regime. Excluding refugee support, the fiscal stance remains broadly neutral, which is appropriate in the context of a narrowing output gap and very low inflation, and will help keep the economy from overheating.

Fiscal Balances and Central Government Debt
(As percent of GDP)



Sources: National Authorities and IMF staff calculations.
Note: The program fiscal balance treats off-budget fiscal transactions as part of government spending.

[4] See Attachment II, *Technical Memorandum of Understanding,* for the definition of program fiscal balance, and IMF Country Report No. 22/366.

Medium-Term Policies

23. Over the medium term, a gradual fiscal consolidation will help sustain fiscal buffers. The authorities' recently approved 2024–26 Medium-Term Expenditure Framework (MTEF) assumes an annual increase in both current and capital expenditures (0.5 percentage point of GDP) financed by annual tax revenue increases of 0.8 percent of GDP. However, the fiscal impact of the recent refugee inflow—once a full assessment becomes available—would necessitate a substantial revision of medium-term fiscal plans at the next MTEF cycle in early 2024 to reflect higher permanent spending on public services and infrastructure. With the caveat that the medium-term fiscal path is very uncertain, keeping public debt moderate and guarding fiscal stability against exchange rate and growth risks would require a deficit reduction of about 1 percentage point of GDP by 2026.[5]

24. The medium-term fiscal path needs to accommodate critical development spending. Staff encouraged the authorities to prioritize medium-term spending on healthcare, social protection, and high-quality capital investment and support it with concrete tax policy measures (see below).

- ***Health***. The health care system is severely underfunded, with extraordinarily high out-of-pocket expenses for households. The authorities plan full implementation of the Universal Health Coverage (UHC) reform by 2027, but lack of consensus about the benefit package and financing modalities will likely cause delays and allow only gradual reform budgeting as the Ministry of Health delivers measured outcomes under the World Bank's Program-for-Results.

- ***Social protection.*** The authorities aim to strengthen the social protection system by improving targeting and coverage of the Social Safety Net through '*hybrid means testing*' based on incomes and assets with eligibility threshold linked to the minimum food basket.[6],[7] Fiscal resources should also be dedicated to costing the upcoming employment strategy, which aims to enhance youth and female employment participation. A potential introduction of a new unemployment insurance scheme in the medium term will help improve automatic stabilizers but needs careful calibration to ensure effective financing. The authorities' plan to eventually align the average pension with the minimum consumer basket by 2026 will incur additional backloaded fiscal costs, partially compensated by incentives for higher retirement age.

- ***Investment.*** The government aims to raise capital spending to about 6.5 percent of GDP through high-quality public investment projects to boost Armenia's medium-term growth potential. This is an ambitious increase, and staff noted the need to continue strengthening the

[5] Some of this deficit reduction will result from the expiration of temporary refugee assistance, as refugees are integrated in the labor market and the social safety net.

[6] Armenia - Selected Issues (2023). *Strengthening Armenia's Social Safety Net*. The government plans to move from proxy-based vulnerability score approach to hybrid-means test for the family benefit program wherein the benefits will be calculated based on the difference between the eligibility threshold and the total family income. Income, assets, and expenditures such as utility bills will be verified through administrative databases and informal incomes will be imputed.

[7] An increase in social spending would go beyond what is already covered under the indicative target on social assistance spending.

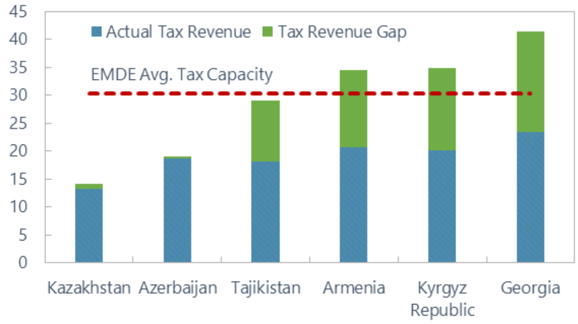
public investment framework at all stages of the investment cycle (planning, allocation, and implementation) as public capital investment continues to be systematically under-executed. Initial steps are being taken to address procedural bottlenecks in the PIM process and improve the quality of infrastructure projects. The PIM Investment Committee approved a first batch of project feasibility studies, marking a milestone towards the full project cycle implementation through the PIM framework. Following their recent PIM action plan, the authorities have committed to improve the regulatory clarity of the PIM process by amending the Budget System Law and PIM decree to clarify the definition of public investment projects (***June 2024 SB***).

25. Steadfast progress with structural fiscal reforms is needed to maintain a sustainable medium-term fiscal path and support more resilient and inclusive growth.

- ***Mobilizing revenue through tax policy reforms.*** There is significant scope to improve tax revenue yields by streamlining tax expenditures, recently estimated at more than 5½ percent of GDP. Reforms in the turnover and micro-enterprise tax systems (primarily through a lower VAT threshold, as well as higher effective tax rates in the turnover regime) would encourage integration of microenterprises in the standard tax regimes and company size growth. Tax revenues from the fast-growing financial sector could increase by: (i) eliminating VAT exemptions on fee-based financial transactions and insurance services; (ii) taxing capital gains and reducing reinvested dividend tax credits; and (iii) introducing a Financial Activities Tax. Further reforms could include adjustments to excise taxes (tobacco and alcohol) already approved in June and discontinuation of CIT and PIT incentives to the IT sector. To this end, the authorities have committed to submitting to parliament in 2023–24 new tax policy reforms yielding at least 0.75 percent of GDP in additional revenue cumulatively by 2026 (***December 2024 SB***).

- ***Strengthening revenue administration capacity.*** A comprehensive revenue administration capacity assessment (e.g., the Tax Administration Diagnostic Assessment Tool) should inform further revenue administration reforms to ensure sustained collection rates as the tax base expands. In 2024, the authorities anticipate that improved desk reviews, collection enforcement, and more efficient customs administration may yield as much as ½ percent of GDP in new revenues. The 2024 rollout of the universal PIT declaration, whose first stage will cover public officials and corporate shareholders, will be supported at its final deployment by empowering the SRC to conduct tax audits of natural persons (***SB proposed to be rescheduled for June 2024***).

Tax Capacity
(As percent of GDP)



Source: IMF Departmental Paper (2022). Revenue Mobilization for a Resilient and Inclusive Recovery in the Middle East and Central Asia.
Note: Taxes exclude hydrocarbon-related taxes and are expressed as percent of nonhydrocarbon GDP for hydrocarbon-exporting countries. Tax capacity is the sum of actual tax revenue and tax revenue gap.

Tax Expenditure
(As percent of GDP)

Tax	Estimated Tax Expenditures	Potential Reform Yield
VAT	4.42	3.27
Profit tax	0.14	0.07
PIT tax	0.83	0.41
Excise tax	0.12	0.12
Total	**5.51**	**3.87**

Source: IMF Technical Report (2023). Armenia – Review of Tax Expenditures (July 2023).

- ***Managing fiscal risks.*** To curb fiscal risks and promote competition, the authorities have started implementing the recently adopted decree clarifying ANIF's mandate, reporting, transparency, and viability requirements through the revision of its charter. They are also drafting a concept note for a broader state ownership policy to clarify the role of SOEs and their contribution to national development priorities or critical public sector services. The authorities have completed a concept note for an upcoming local government fiscal framework reform, which is a key pre-requisite to ensure prudent and flexible fiscal decentralization and local government borrowing. Furthermore, methodological improvements in the Fiscal Risk Statement have resulted in higher estimates of the contingent liabilities associated with existing PPP contracts, standing at nearly 7 percent of GDP as of end-2022. While the PPP law and decree limiting the stock of new PPP contingent liabilities provide good safeguards to minimize fiscal risks pertaining to future PPP contracts, a more effective cap of total PPP-related contingent liabilities may require further legislative revisions, as well as full integration with PIM and budget processes. Finally, audits of COVID-19 spending completed by the State Audit Chamber have found a number of irregularities, including ineffective control and reporting, and misappropriation of COVID-19 budget resources, and the Anti-Corruption Committee has followed up by initiating criminal cases.[8]

- ***Modernizing fiscal reporting.*** The authorities are on track to develop the terms of reference for the implementation of a Government Financial Management Information System (GFMIS) module with basic employee data, which will be pivotal to improve the quality of central government wage bill data. Eventual GFMIS implementation design should take into account findings from the functional review of the Ministry of Finance and upcoming Public Expenditure and Financial Accountability Assessment. Closer alignment of fiscal statistics collection and

[8] In view of the small amount of COVID-related on-lending by the CBA (0.5 percent of GDP), and that the CBA is already subject to an audit by an internationally reputable firm, no ex-post audit of on-lending activities is currently considered given its high potential cost and low effectiveness, given the time lag.

reporting in line with GFSM 2014 is ongoing, including through a revision of the comprehensiveness and structure of public sector debt under the Public Debt Law.

Authorities' Views

26. The authorities broadly agreed with the need for medium-term fiscal structural reforms and see challenges to the fiscal outlook in light of recent shocks. They concur on the need to focus medium-term fiscal policies on growth- and resilience-enhancing reforms. They are cautiously optimistic about the scope to mobilize revenues through tax policy reforms and expect larger yields from strengthening the revenue administration. Nonetheless, they agree that clear medium-term spending prioritization and tax policy planning are critical to accommodate development needs. The authorities agree on the importance of broad-based public reforms to improve the efficiency of government administration, the progressivity of the overall tax-transfer system, and the effectiveness of the social safety net. They are also keenly interested in reining in potential fiscal risks and strengthening the overall fiscal framework. While they concur that a gradual medium-term fiscal deficit reduction is needed to maintain a moderate debt level, the recent refugee inflow has created near-term fiscal pressures and poses medium-term challenges, the full fiscal impact of which is yet to be fully assessed and may hinder their ability to rebuild fiscal buffers quickly.

B. Enhancing Monetary Policy Credibility

27. The monetary policy stance is appropriate, and the CBA should continue to carefully evaluate inflation dynamics, taking a gradual approach toward policy rate normalization. The CBA's proactive and timely actions since end-2020 have helped tackle inflationary pressures and bring inflation down. Monetary policy tightening has had a significant effect, especially by limiting the pass-through from external price shocks to domestic inflation.[9] After raising the refinancing rate to 10.75 percent, the CBA kept it on hold for several months, before lowering it in June–October to 9.5 percent. The real policy rate of about 6 percent remains notably above the neutral real rate of close to 4 percent.[10] This provides some space for a gradual reduction of policy rates, while remaining mindful that strong demand conditions and a positive output gap, as well as exchange rate pressures could create pressures for inflation to return to higher levels in the coming months. The rapid dram depreciation triggered by FX demand in the wake of the recent refugee inflow necessitated limited sell-side intervention by the CBA to counter disorderly market conditions in a period of heightened uncertainty and geopolitical turbulence. The CBA remains committed to allowing exchange rate flexibility to act as the main shock absorber, with interventions limited to addressing disorderly market conditions and opportunistically building reserves to maintain a strong NIR position.

[9] Prudent monetary policy has an important role in anchoring expectations, limiting second-round effects of foreign price pressures to expectations and broad-based increases in domestic prices (Blanco, Ottonello, and Ranosova 2022; Reis 2022). See Lisi, G., M. Atamanchuk, A. Hajdenberg, D. Kadissi, and N. Rao. 2023. "Drivers of Inflation in the Caucasus and Central Asia." IMF Working Paper, International Monetary Fund, Washington, DC (forthcoming).

[10] Staff calculations; IMF, April 2023. "Regional Economic Outlook, Middle East and Central Asia." Chapter 2.

28. The inflation targeting framework has served Armenia well and further strengthening would support its effectiveness.[11] Despite the CBA's success in managing inflation and inflation expectations, the inflation dynamics remain complex, especially in periods of frequent and large shocks. In this regard, efforts should continue to improve the analysis and assessment of risks, the transmission of policy decisions, and their effective communication to markets. Building on the newly established over-the-counter commercial trading platform for the overnight repo market, the authorities should continue promoting capital market development and digitalization. The CBA also plans to transition to a risk-based approach to monetary policy that guides policy rate decisions through a set of policy scenarios—rather than a baseline— and market expectations. While introducing policy scenarios could help sensitize the CBA Board and markets to the importance of assessing and mitigating economic risks, the risk-based approach could challenge CBA's policy communication. The CBA's baseline projections remain critical to providing effective guidance to markets, preserving monetary policy credibility, and serving as a benchmark for the overall macroeconomic policy consistency in Armenia. In this context, the CBA's commitment to publish a comprehensive review of its monetary policy framework and adopt an enhanced monetary policy communication strategy are critical to preserving credibility in the inflation targeting framework.

Authorities' Views

29. The authorities underscored their commitment to exercising monetary policy prudence and further enhancing the monetary policy framework. While acknowledging the presence of both demand and supply factors of inflation dynamics, the CBA has tended to reflect demand-side pressures in monetary policy decisions, taking a generally cautious approach. The authorities emphasized that risks associated with high inflation have notably diminished, but sticky prices remain elevated, suggesting potential renewal of inflationary pressures. They are set to implement the new risk-based approach to price stability in early 2024, expecting Board members to take on an elevated role in the policy decision-making process and launching a series of initiatives to further enhance CBA's communication, transparency, and staff capacity. The authorities also reiterated their commitment to further advancing financial markets and the digitalization agenda.

C. Preserving Financial Stability

Near-Term Risks

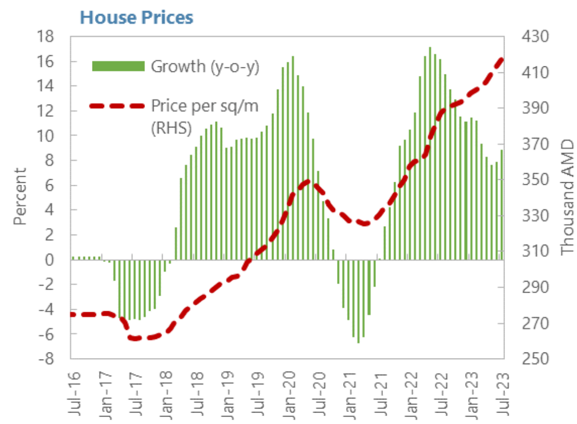
30. House prices pose a significant risk for the banking system. Banks' mortgage portfolios have more than tripled in the last four years, and the share of loans to the construction sector in banks' portfolios has almost doubled. There are signs of overheating in the housing market, with prices exceeding their fundamental values by as much as 25 percent (Box 2). The CBA has started assessing credit risk under adverse circumstances by constructing a macro-financial stress test taking into account heightened stress on property developers' financial positions, substantial declines in household income, and sharp reductions in house prices. The stress test needs to reflect a severe macroeconomic scenario, with clear transmission channels to borrowers' debt service capacity.

[11] Armenia-Selected Issues (2023). *Enhancing Armenia's Monetary Policy Framework*.

Results of the stress test should be used to calibrate macroprudential measures and tighten further the loan-to-value ratio or introduce a debt-service-to-income limit. To reduce bank risks associated with the construction industry, the Government has submitted draft amendments to the Civil Code to limit the use of funds in escrow accounts by property developers. Reducing the generosity of the existing mortgage interest tax credit would further curtail mortgage borrowing incentives and reduce banks' mortgage-related risks.

Box 2. Armenia: House Prices Dynamics in Armenia

Housing prices in Armenia have experienced a rapid increase, with year-on-year growth averaging 9 percent in the last five years. This has raised concerns about house price sustainability, drivers, and alignment with underlying fundamentals, including household income, demographic factors, financial market conditions, and housing supply.



Source: National authorities.
Note: Houses prices in Armenia proxied by the average price per sq/m of multiapartments buildings in Yerevan.

House price overvaluation is estimated to range between 8 percent and 25 percent, based on the borrowing capacity approach (Andrle and Plasil, 2019) and depending on the assumptions used to estimate household disposable income. The approach derives the maximum size of a mortgage loan that a household can safely borrow, given its income level, market interest rates, and a sustainable household income share allocated to mortgage payments. The lower end of the overvaluation range results when the measure of household disposable income includes wage growth instead of income per capita, and remittances.

Mortgage lending has been an important driver of house prices in Armenia. A linear regression model helps gain insights into the driving forces behind the house price dynamics. The model incorporates several explanatory variables to capture demand and supply factors, including those specific to recent developments in Armenia (Annex VII):

- ***Mortgage lending***. Rapid growth in mortgage lending, catalyzed by the mortgage interest tax credit program since 2018, significantly explains house price dynamics.[1]
- ***Migration and capital inflows***. Variables reflecting recent economic developments, such as foreign arrivals and net monetary transfers, exhibit a positive correlation with housing prices since the onset of the war in Ukraine. However, their significance diminishes when considered alongside other explanatory variables. The evolution of these variables and their impact should be closely monitored considering the current limitations of available quarterly data.
- ***Housing supply***. The expansion of construction projects proxied by growth in value added of the construction sector is significant in offsetting the increase in house prices.
- Finally, the COVID-19 pandemic was associated with a 12 percent decrease in housing prices.

[1] Quarterly data of mortgage cashback during 2018–21 shows a five-fold increase in that period. World Bank's PIT simulation report, June 2023.

31. Other risks in the banking sector have also increased and require closer monitoring and further supervisory measures. Banks have been keeping a significant portion of nonresident deposit inflows in liquid assets, with a liquidity coverage ratio (LCR) of 283 percent as of June 2023.

The CBA performs a quarterly stress test simulating the outflow of all new banks' deposits. While 40 percent of banks' liquid assets is in cash and deposits, about the same share is in government bonds but not marked to market, which can potentially impair profitability if sold before maturity.[12] In addition, the rapid growth of banks' balance sheets since end-2021, with four banks growing at a pace close or above 50 percent, poses additional risks in the current environment of uncertain inflation, interest, and exchange rates. In this context, with the aim of assessing interest rate risk in the banking book (IRRBB), the CBA has committed to conducting an IRRBB impact study in the banking system, using the Basel Framework methodologies (***December 2024 SB***), which will inform the introduction of new regulatory requirements on IRRBB measurement and management.

Medium-Term Reforms

32. With risks in the financial sector mounting, strengthening the CBA's supervisory framework has become a priority. Reform efforts focus on clarifying capital buffers, enhancing supervisory powers, and strengthening crisis management.

- ***Preserving Pillar 1 capital buffers***. Current Pillar 1 capital buffers are in line with the Basel III framework. The systemically important buffer of 1.5 percent is in effect since January 2023, the countercyclical capital buffer (CCyB) increased to 1.5 percent of risk-weighted assets in August 2023, and the capital conservation buffer will reach 2.5 percent in 2024. Future plans to adjust Pillar 1 capital buffers need to take full consideration of the systemic risks in the banking system. In particular, the existing risk weights applicable to FX loans are well aligned with the Basel III Framework,[13] and the introduction of minimum Pillar 2 capital add-ons applicable to all banks should not lead to erosion of related Pillar 1 capital requirements.

- ***Introducing Pillar 2 capital add-ons.*** A pilot review of banks' internal capital adequacy assessment processes (ICAAP) has provided inputs to upgrade CBA's ICAAP guidelines, which will better specify minimum requirements, including stress test parameters for banks. All banks are currently included in a micro prudential stress test exercise that will help advance the supervisory review and evaluation process (SREP), including through supervisory judgment and qualitative assessments. For the SREP to be effective, the supervisory framework needs to have well-established decision-making processes. Supervisory manuals for assessing risks in SREP are being developed and are expected to be approved by end-2023.

- ***Enhancing supervisory powers and resources.*** An effective SREP also requires that supervisors have powers for early intervention and enforcement of supervisory recommendations. The CBA can impose supervisory measures on banks only when there is a breach of minimum regulatory ratios. Empowering the CBA with an early intervention framework would require amendments to

[12] This does not affect the LCR calculation, which requires all liquid assets to be marked to market for computing the ratio.

[13] Basel III framework for credit risk, paragraph 20.92, available at: [CRE20 - Standardised approach: individual exposures (bis.org)](). It requires a 1.5 multiplier to the risk weight applicable to exposures with currency mismatch, such as unhedged retail and residential real estate exposures to individuals.

the CBA Law. Supervisory capacity, including human resources, technology, and data collection and processing also need to be significantly upgraded, requiring greater CBA budget resources.

- ***Developing a bank resolution framework.*** The CBA has made significant progress in drafting a Bank Resolution Law that incorporates Financial Stability Board's Key Attributes for effective resolution. An alignment of the new resolution framework with other legal acts is critical to ensure its effective future implementation. Operationalization of decision-making in resolution would also benefit from future changes in the CBA's governance framework, and, while these are pending, it should mirror current supervisory decision-making procedures and arrangements. Decisions regarding resolution funding need to be better specified, with the roles of the Ministry of Finance and the CBA well defined and delineated, the mandates of the deposit insurance fund and the resolution fund clearly described, and the fiscal and governance implications of establishing a resolution fund better understood. Enhanced supervisory processes for review of banks' recovery plans, cross-border supervisory cooperation and correspondent banks' governance are also necessary. Given the complexity of the remaining challenges, the authorities have committed to continue intensive consultations with relevant experts and stakeholders before submitting the draft law resolution framework to parliament (***SB proposed to be rescheduled for June 2024***).

33. The authorities are committed to sustainable finance objectives. In October 2023, the CBA issued a National Sustainable Finance Roadmap, a high-level framework outlining the long-term strategic direction to enhance the ability of the financial market to deliver on the country's climate and sustainable development goals. The document outlines the integration of sustainability considerations into financial sector decision-making and the development of sustainable finance products. A critical element of the roadmap is adopting a robust supervisory framework that considers climate-related and environmental, social and governance (ESG) risks, guides financial market participants in assessing these risks, and requires adequate disclosure. The CBA has begun assessing climate-related risks in the financial sector and, as of June 2022, calculates that approximately 29 percent of the banking sector loan book is allocated to climate vulnerable sectors, with an additional 19 percent allocated to mortgages where underlying assets are exposed to physical risks.

Authorities' Views

34. While underscoring the soundness of the financial sector, the CBA recognized the emergence of vulnerabilities and underscored its commitment to addressing them. The CBA noted the high capital and liquidity levels that have benefited from recent record profitability. The CBA saw the real estate market as a pocket of vulnerability but considered that peak activity has been reached, since mortgage growth rate is decreasing. The authorities pointed out that the CCyB increase helps buffer risks, and that NPLs are stable. The CBA reiterated its commitment to advancing its prudential regulation and supervisory agenda and recognized the need for additional resources and capacity development. The authorities also underscored the importance of consolidating the views of all key stakeholders in developing the bank resolution law to ensure its future effectiveness.

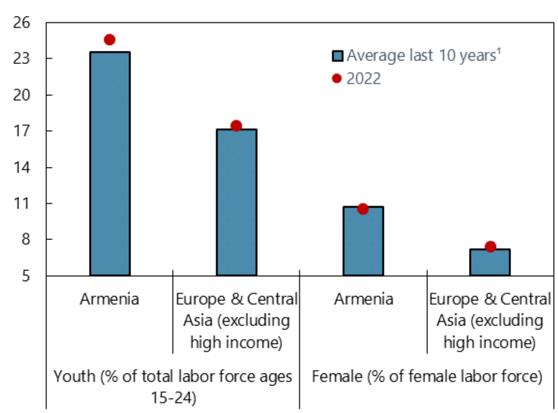
D. Boosting Potential Growth

35. The current favorable economic environment provides an opportunity to press ahead with structural reforms to address long standing challenges and raise Armenia's long-run economic prospects. The recent inflow of migrants may have increased medium-term potential growth by as much as 0.5 percentage points, on average, due to increases in labor force and productivity levels. Nevertheless, Armenia's long-standing challenges—including a long-term decline in the labor force, infrastructure bottlenecks, and weak access to finance—continue inhibiting its long-term growth potential. Reforms to reduce structural unemployment, boost investment, and foster export diversification, in line with the 2021–26 Government program, could add on average 0.5 percent to long-run growth. However, full implementation will be needed.

36. The authorities remain committed to an ambitious structural reform agenda:

- ***Labor market***. Work is advancing on a new employment strategy that identifies measures to increase labor force participation and reduce unemployment among vulnerable groups (***SB proposed to be rescheduled for June 2024***). With support from development partners, the authorities are piloting selected active labor market programs (e.g., work practice and vocational training). Nevertheless, severe lags in the release of labor market statistics, including employment rates by age and gender, continue to pose a challenge for the targeting and costing of envisaged measures, delaying the approval of the final document. Modernizing labor data systems, including the collection, processing, and dissemination of labor survey data remains a priority to support implementation of the reform.

Unemployment
(In percent)



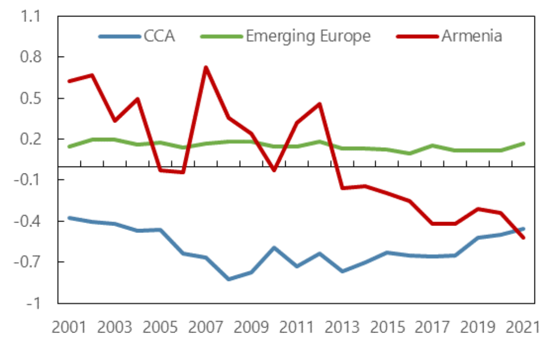
Source: World Bank, Gender Data Portal. Modeled ILO estimate.

1/ Average 2013–22.

- ***Access to finance.*** Strengthening the efficiency of insolvency and debt enforcement proceedings is a priority for improving access to finance and the business environment in Armenia. The draft concept note for insolvency reform (***SB proposed to be rescheduled for January 2024***) needs to focus on the specific challenges of the Armenian legal system, while also incorporating important developments in comparative insolvency practice. The concept note should prioritize the streamlining of judicial procedures, improving the position of creditors, and increasing the restructuring options for Armenian companies. Strengthening the regulation of insolvency administrators, taking full advantage of the specialization of the judiciary, and tackling fraudulent conduct in personal and business bankruptcy would contribute to the effectiveness of the legal reforms. In the meantime, the authorities have submitted a set of amendments to Parliament that enable the use of IT systems in insolvency proceedings and address specific instances of abuse in personal bankruptcy.

- ***Export diversification***. Armenia's increasingly concentrated export structure, with low export complexity and limited destination markets, creates a vulnerability and exposes the economy to increasing risks of a shock to commodity markets and economic activity in Russia. The authorities have progressed in developing an export strategy that identifies measures to remove export bottlenecks and improve the capacity to export high value-added products.

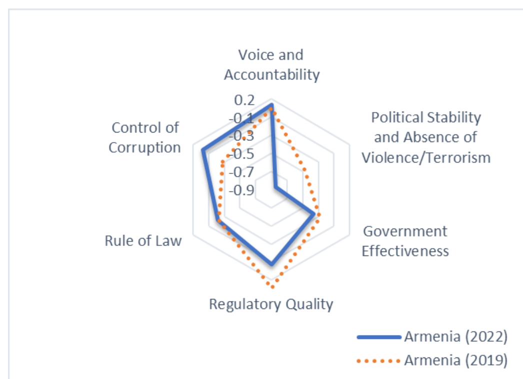
Economic Complexity Index (ECI)
(The higher, the more diversified and complex the export basket)



Sources: Akepanidtaworn, K., Karapetyan, L., Reyes, N., & Ustyugova, Y. (2022). Raising Armenia's Export Potential.

- ***Governance***. Significant reforms have been launched over the last years to address corruption; however, the implementation gap is large and new institutions are lacking professional capacity (text chart and Annex V). Armenia has introduced new institutions to enhance the specialization of anti-corruption frameworks including an anti-corruption investigative agency, new structures at the Prosecutor's office, and an anti-corruption court. The Judicial and Legal Strategy for 2022–26 aims at enhancing legal justice efficiency in addressing the case backlog[14] and improving the specialization and integrity checks of judges. However, efforts are needed to fully integrate the new institutions into the preventive and enforcement anti-corruption frameworks. The effectiveness of the asset declaration system in detecting illicit enrichment hinges on exchange of information with other state registry and public procurement databases, registering all SOE and public procurement officers, and allowing public access. Efforts should also focus on: (i) implementing the Freedom of Information law and whistleblowing legislation; (ii) raising the professional capacity of anti-corruption bodies in prosecuting complex corruption cases, particularly those that involve foreign jurisdictions; and (iii) developing a strategy for mutual legal assistance and international cooperation for both criminal cases of corruption and recovery of foreign assets abroad.

Worldwide Governance Indicators
(The higher the better)



Sources: World Bank, Worldwide Governance Indicators.

[14] The case load has been traditionally high in Armenia, with a steady increase of 43 percent between 2017 and end-2021 (mainly driven by contractual/money obligations), which greatly affects clearance rates and timeliness of justice.

- **AML/CFT.** Further measures should be taken to enhance the AML/CFT framework and to effectively mitigate ML/TF risks. Continued supervisory efforts are needed to address the main ML/TF risks, including tax evasion and corruption (Annex V), and to address emerging risks in relation to non-resident cross border financial flows (both in the financial and the real estate sector), and digitalization. While legislative amendments require all legal entities to file a declaration on the beneficial owner, and an electronic platform for beneficial owners has been launched, further legislative reforms should align the beneficial ownership framework with the recently updated FATF international standards. Swift measures are needed to ensure the effectiveness of the AML/CFT framework ahead of the upcoming comprehensive assessment planned in 2025.[15]

- ***Public administration.*** Advancing the public administration reform will improve public service, quality, and delivery. The newly revised public administration reform strategy approved in August 2023 aims at establishing an evidence-based and result-oriented framework for policy formulation, including by improving the system for strategic planning and regulatory impact assessment. Improvements in competitiveness and quality of public services are also envisaged, including through a move toward merit-based and professional public service and use of digitalization and technology-based solutions in service delivery.

- ***Climate Adaptation***. Further policy measures are needed to strengthen climate resilience. Accelerating the implementation of Armenia's National Adaptation Plan (2021–25) is key to reduce and manage climate-related risks. The agriculture sector, identified as a priority in the NAP, is vulnerable to extreme weather events including droughts, floods, and hailstorms. The recent expansion of the agricultural insurance scheme to cover more risks, regions, and crops would help partially mitigate these risks. Further investment, including in improved seeds, water management, early warning systems, and disease and pest prevention, is required to improve the sector's resilience.

Authorities' Views

37. The authorities agreed that efforts need to focus on implementing structural reforms to raise potential growth and strengthen the resilience of the economy. They underscored the importance of an effective, robust, and dynamic employment strategy to address both long-standing challenges and frequent shocks to the economy. They acknowledged the limitations posed by lags in the release of labor statistics for the implementation of effective and evidence-based employment policies. The authorities emphasized their commitments to an insolvency reform that addresses drawbacks in the existing framework and is tailored to Armenia's legal system and practices, as well as the need for a broad public consultation on its legislative design. The authorities noted their efforts to strengthen the fight against corruption, including though greater transparency and focus on areas of weakness, such as procurement, SOEs, and the business sector. They also acknowledged that tangible implementation efforts need to shore up the significant recent

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[15] Armenia's comprehensive AML/CFT mutual evaluation by MONEYVAL was completed in 2015, with further progress on technical compliance reported in the 2018 follow-up report to MONEYVAL. *https://www.coe.int/en/web/moneyval/jurisdictions/armenia*.

legislative and institutional changes, including by strengthening professional capacity, data analytics, and international mutual legal assistance.

PROGRAM MODALITIES

38. Staff proposes to update program targets. The end-December QPC on net international reserves is proposed to be revised upward to lock in accumulated foreign exchange buffers (Attachment I, Table 1). The projection for net international reserves for end-June 2024 has also been revised upward and is proposed as a QPC, along with other end-June 2024 QPCs. To reflect the substantial inflation rate reduction and staff's baseline inflation projections, the MPCC for December 2023 is proposed to be reset, with symmetric inner and outer bands of the MPCC adjusted accordingly.

39. Staff also proposes revisions to the structural conditionality. The September 2023 SB for a concept note on amendments to the insolvency legislation has not been met and is proposed to be rescheduled for January 2024 to allow for the completion of public consultations and cabinet discussions (Attachment I, Table 2b). The June 2023 SB for the adoption of an employment strategy has not been met and is proposed to be (i) modified to require modernization of labor market data processes to facilitate evidence-based policymaking; and (ii) rescheduled for June 2024 to allow the collection of necessary survey data and inter-ministerial discussions. The November 2023 SB for an enhanced bank resolution framework is proposed to be rescheduled for June 2024 to allow completion of consultation with experts and domestic stakeholders. The authorities have also made progress in improving SRC's access to third-party information; however, further work is needed to empower SRC to conduct comprehensive tax audit for natural persons to align these powers with the full introduction of the universal PIT declaration, and the December 2023 SB is proposed to be rescheduled for June 2024. New proposed structural benchmarks seek to ensure progress in revenue mobilization, implementation of the PIM process, and the introduction of Pillar 2 bank capital add-ons.

40. The program is fully financed, and Armenia's capacity to repay remains adequate. There are firm commitments of financing in place for the next 12 months of the arrangement , and there are good prospects that there will be adequate financing for the remainder of the program. Armenia's capacity to repay the Fund is supported by moderate public debt, a firm downward trajectory of external debt over the medium term, and the authorities' long track-record of sound macroeconomic management. IMF payment obligation ratios are projected to reach 7.6 percent of gross reserves and 2.3 percent of exports in 2024. This is close to the median value of the upper middle income countries comparison group, while Fund obligations in percent of GDP and gross reserves are above the 75th percentile of all SBA programs since 2010.

41. An update safeguards assessment has been completed. Findings indicate that the CBA maintains strong internal controls over its central banking operations, and its external and internal audit arrangements and financial reporting practices are largely aligned with international standards. However, the authorities should strengthen further the oversight roles of the Board and the Audit Committee and complete work on legal amendments to the central bank act, as recommended in

2019. Fund TA has been requested to that end. Furthermore, the CBA should define a clear strategy to implement its plan to exit non-core activities, assess, and effectively mitigate the risks of channeling development lending. Finally, the CBA also requested TA to support the development of enterprise risk management and initiated steps to implement the remaining recommendations.

STAFF APPRAISAL

42. Armenia has managed to navigate effectively multiple challenges in recent years and preserve economic and financial stability. The economic outlook remains positive, with growth remaining strong, although gradually decelerating toward its potential, as the impact of labor and capital inflows dissipates. Risks, however, remain elevated including from further regional tensions, potential political instability, tight global financial conditions, and rising global food and energy prices. Continued implementation of prudent policies and acceleration of reforms will be critical to further strengthen resilience and secure inclusive and sustainable growth in the period ahead.

43. The agreed 2024 budget deficit appropriately accommodates immediate refugee support, while ensuring macroeconomic stability. Overall fiscal prudence and a cyclically neutral fiscal stance (excluding the refugee support) will help close the positive output gap and contain the risk of resurgence of inflationary pressures in the economy. Efforts should continue to improve revenue mobilization through tax policy as well as revenue administration measures to support planned expenditures and keep debt at a moderate level.

44. Medium-term fiscal sustainability hinges upon mitigating potential fiscal risks, improving the robustness of fiscal policy, and creating fiscal space for priority spending. A gradual fiscal deficit reduction and completion of the ongoing public financial management reforms are needed to reduce risks to the debt path associated with potential macroeconomic and contingent liability shocks. The authorities' plans to increase investment and social spending—including refugee support and integration—should be prioritized and aligned with revenue mobilization efforts and fiscal structural reforms ensuring an increasingly effective public sector.

45. Prudent monetary policy has helped strengthen CBA's credibility but efforts to improve the monetary policy framework can further enhance policy effectiveness. The CBA has timely and proactively managed inflation in the face of multiple shocks to the economy. But the narrow room to further lower policy rates could be quickly exhausted should strong demand conditions and exchange rate pressures deanchor inflation expectations. Enhancements to the monetary framework should focus on transparency, communication, governance, and capital market development. The flexible exchange rate should continue to serve as a key shock absorber, with foreign exchange interventions limited to addressing disorderly market conditions and opportunistically building reserves to maintain a strong NIR position.

46. Strengthening the CBA's prudential and supervisory framework will help stem rising financial sector risks. The ongoing macro-financial stress test should inform the need for strengthening the macroprudential toolkit. Medium-term reform efforts should focus on preserving capital buffers, enhancing supervisory powers, and strengthening crisis management, including through the adoption and implementation of the new bank resolution law. Supervisory capacity, including human resources, technology, and data collection and processing also need to be significantly upgraded, requiring greater CBA budget resources.

47. Implementation of structural reforms is critical to support the authorities' goal for higher, knowledge-based, export oriented, and resilient long-term growth. Reliable labor market data should underpin evidence-based policies under the new employment strategy to help raise labor force participation and lower structural unemployment in the country. Access to finance hinges on greater corporate transparency and improvements in the insolvency framework. Efforts are also needed to improve Armenia's export complexity and export market diversification. Finally, governance reforms, including to improve the effectiveness and operationalization of the anti-corruption and anti-money laundering frameworks, and the overall public administration have significant impact on Armenia's business environment and attractiveness for domestic and foreign investment.

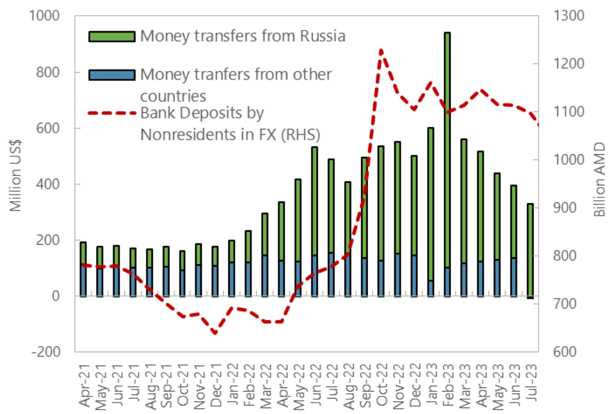
48. Staff supports the authorities' request for completion of the second review and consultation under the MPCC, given their strong performance and program ownership. Staff supports the authorities' request for modifications of QPC and MPCC. Upon completion of the review, an additional $24.5 million (SDR 18.4 million) would be made available to Armenia. The authorities intend to continue treating the arrangement as precautionary.

49. The next Article IV Consultation will be held on the 24-month cycle, in accordance with Decision No. 14747-(10/96).

Figure 1. Armenia: Spillovers from the War in Ukraine

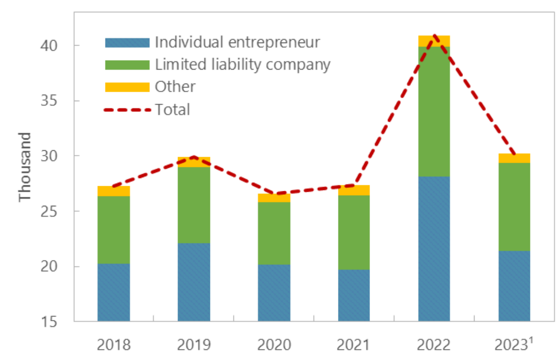
Since the start of the war in Ukraine, money transfers, non-resident deposits…

Money Transfers and Deposits by Nonresidents



….and the number of newly registered companies in Armenia has increased.

New Registered Entities by Legal Type

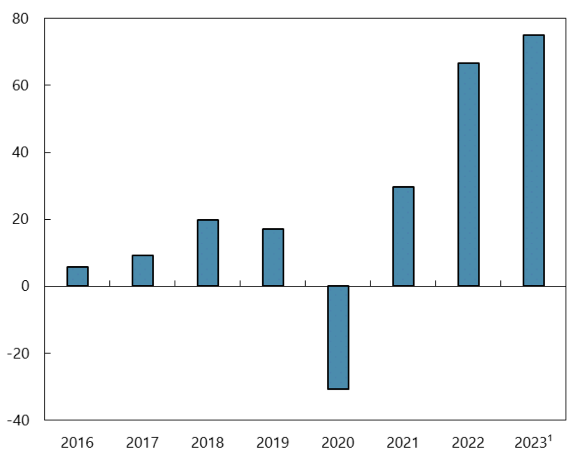


Note: [1]Data as of September 2023.

The number of new foreign residents has more than doubled.

New Foreign Residents

(Thousands of people)

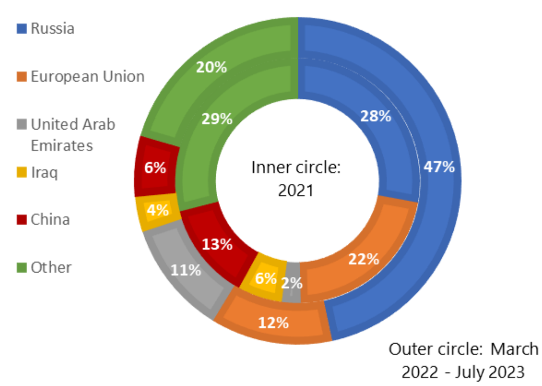


Note: [1]2023 data up to July

Armenia's exports have risen, but so has its exposure to Russia.

Top 5 Export Destinations

(As percent of total)

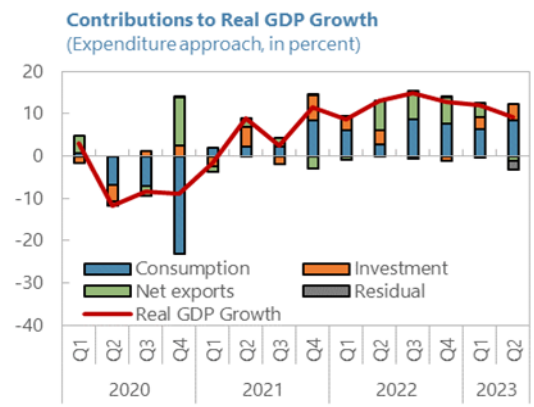


Sources: Haver (CBA), Armenia Electronic Register, Comtrade, National Authorities and IMF staff calculations.

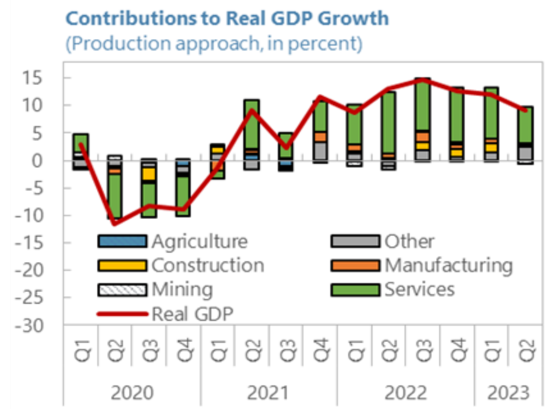
Note: New foreign residents are measured as the difference between entries and departures of people with non-Armenian documents through border checkpoints.

Figure 2. Armenia: Real Sector Developments

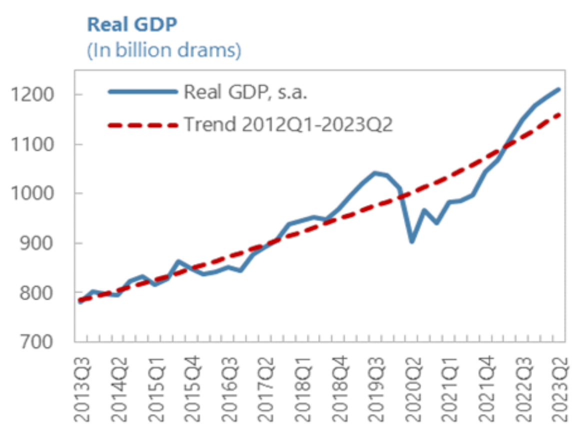
Real GDP growth has been driven by strong consumption and net exports…



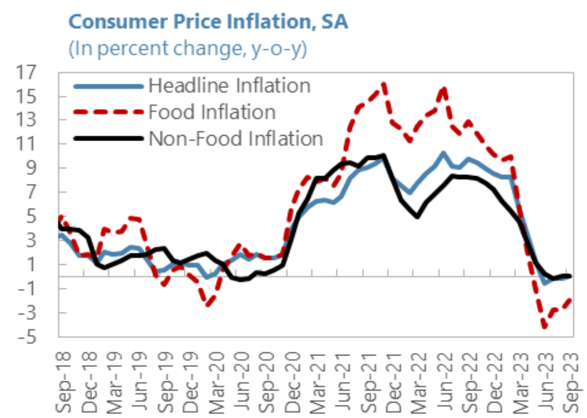
…and boosted by performance in the services sector….



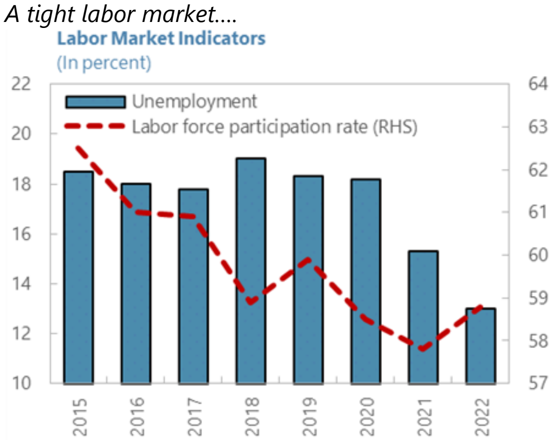
…supporting a recovery in output beyond its pre-COVID trend.



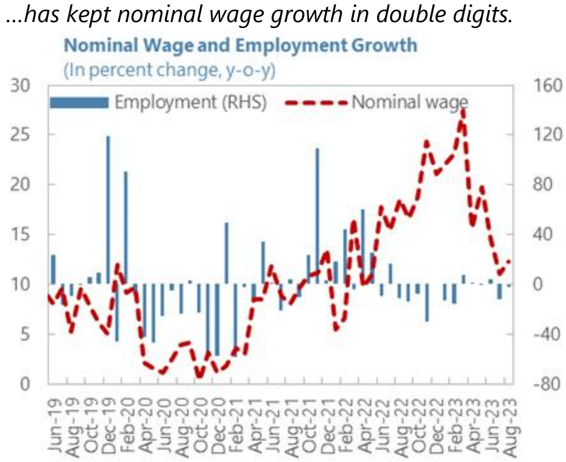
Base effects and lower food prices have eased inflation…



A tight labor market….



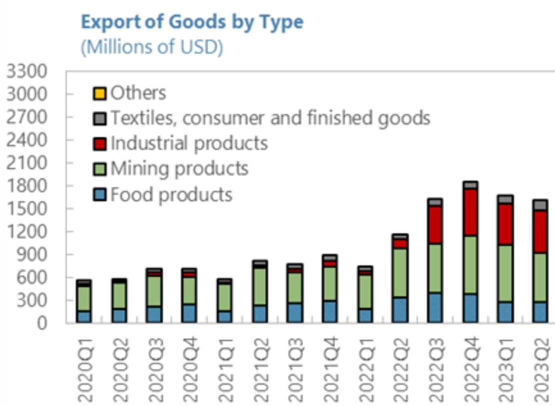
…has kept nominal wage growth in double digits.



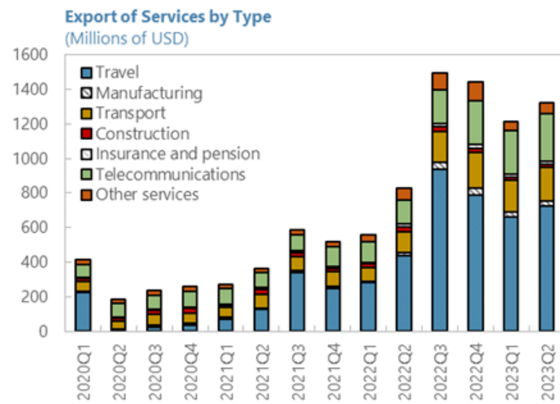
Sources: National authorities, Haver, IMF World Economic Outlook, IMF International Financial Statistics, and IMF staff calculations.

Figure 3. Armenia: External Developments

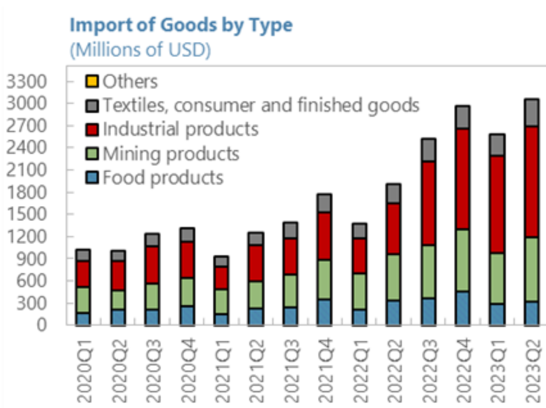
Armenia's exports are dependent on commodities…



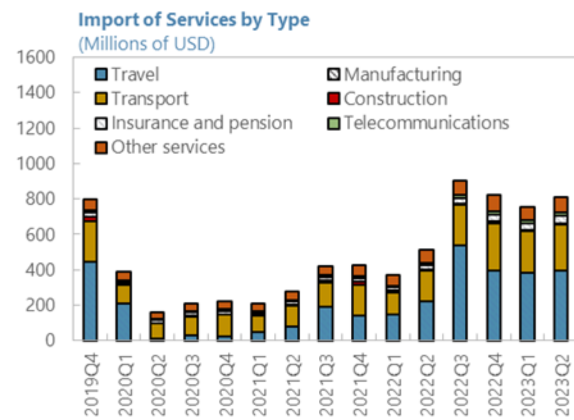
…and tourism, both of which picked up strongly in 2022.



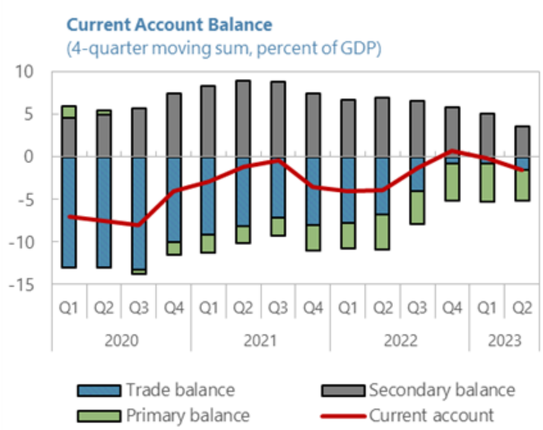
Re-exports to Russia and domestic demand boosted merchandise imports …



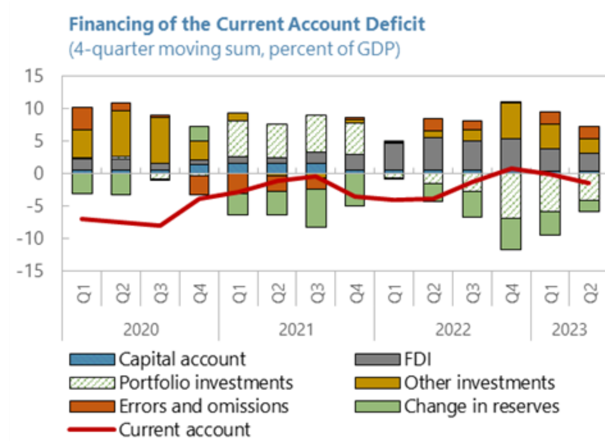
…and imports of services.



The current account strengthened in 2022…



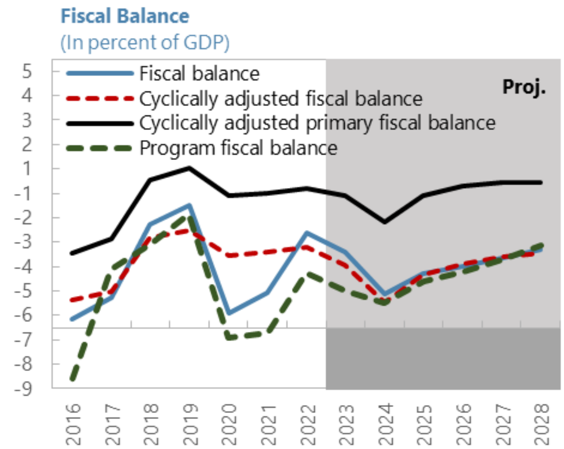
…resulting in a significant increase in reserves.



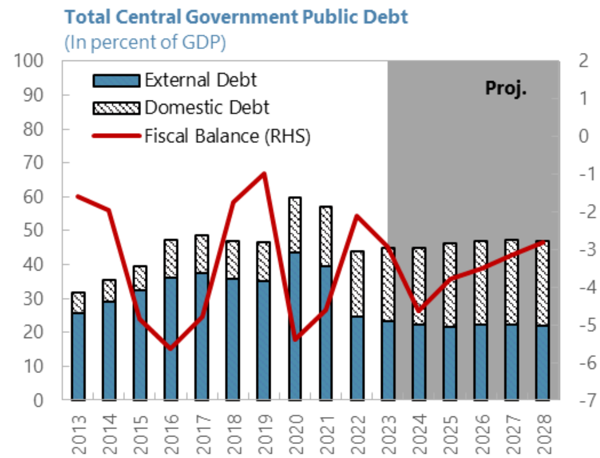
Sources: National authorities, IMF Information Notice Systems Database, and IMF staff calculations.

Figure 4. Armenia: Fiscal Developments

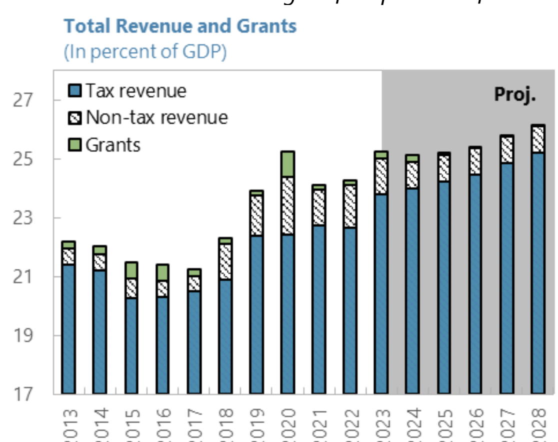
A gradual fiscal consolidation…



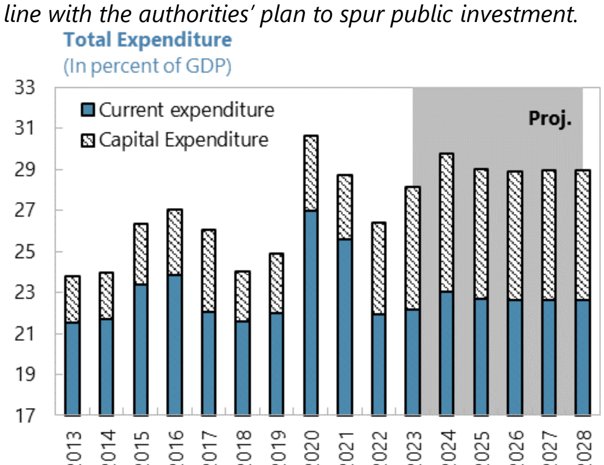
…will keep debt below 50 percent of GDP.



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



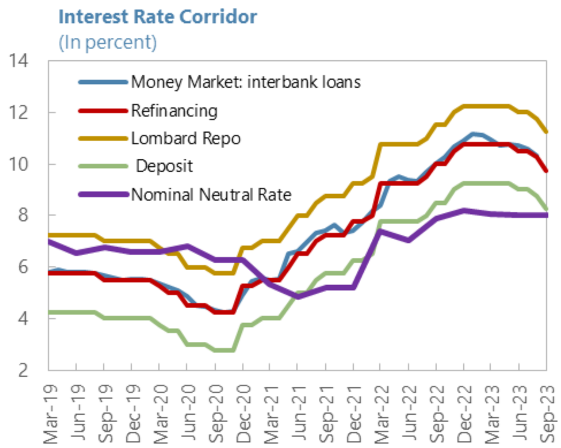
Capital expenditures are projected to gradually grow in line with the authorities' plan to spur public investment.



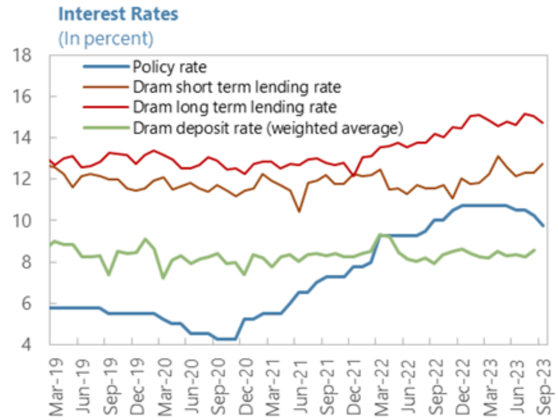
Sources: National authorities and IMF staff calculations.

Figure 5. Armenia: Monetary Developments

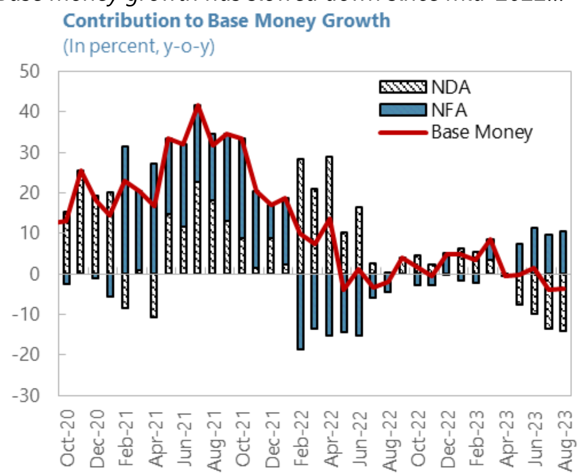
Despite CBA's recent policy easing, the policy rate is above neutral…



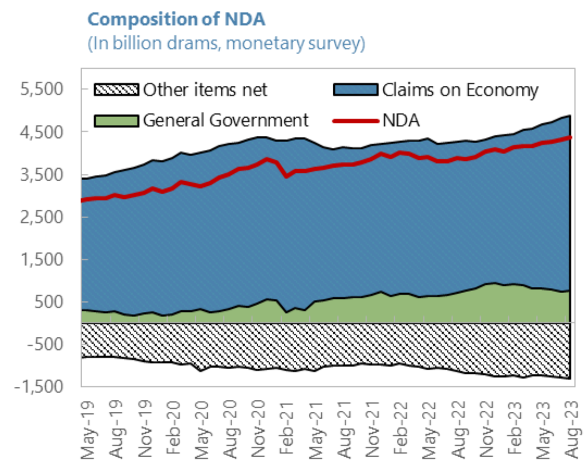
…and long-term lending rates have remained stable.



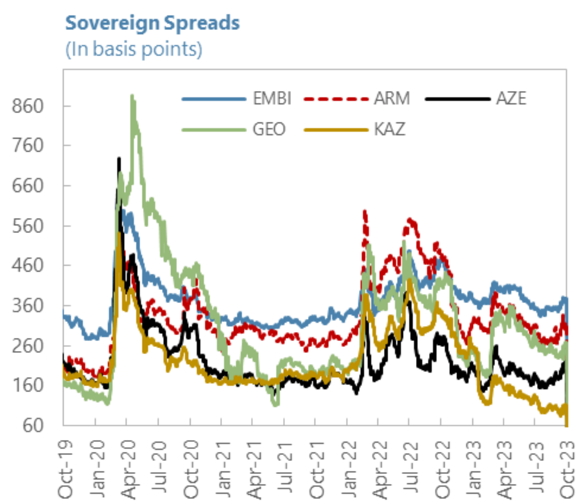
Base money growth has slowed down since mid-2022…



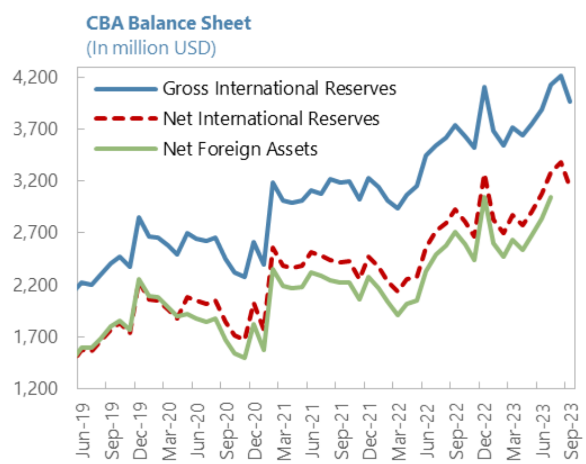
…reflecting slower growth in claims on the economy.



Sovereign spreads have eased…



…while reserve buffers have strengthened.

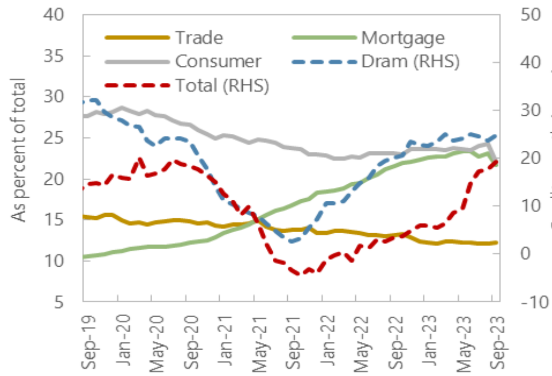


Sources: Central Bank of Armenia and IMF staff calculations.

Figure 6. Armenia: Financial Developments

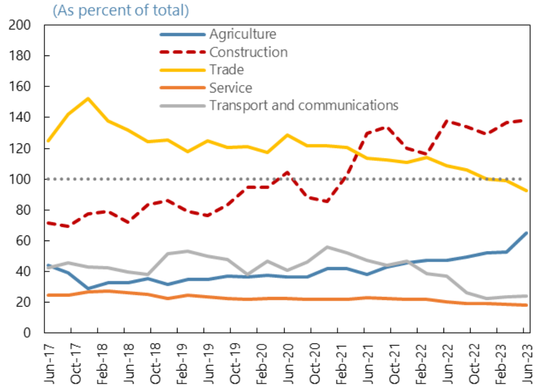
The pick-up in credit growth has been driven by an increase in dram mortgage loans…

Sectoral Distribution of Loans



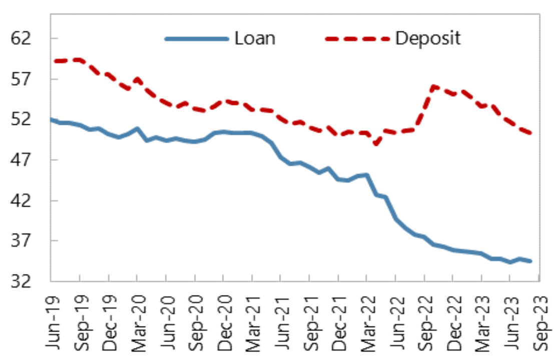
…and credit to the construction sector has continued to outpace its value added in the economy.

Credit by Sector as Ratio of GVA by Sector
(As percent of total)



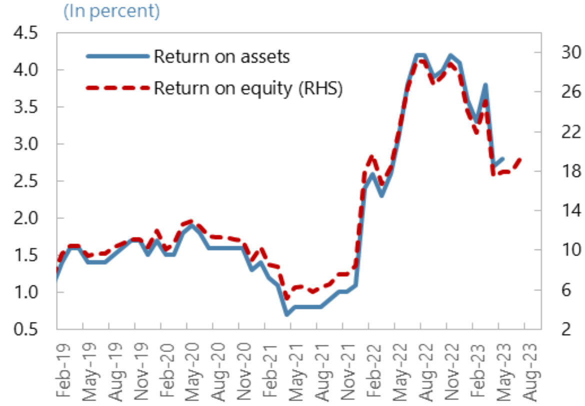
Deposit dollarization increased due to an increase in FX non-resident deposits but did not affect loan dollarization..

Loan and Deposit Dollarization
(In percent, residents and non residents)



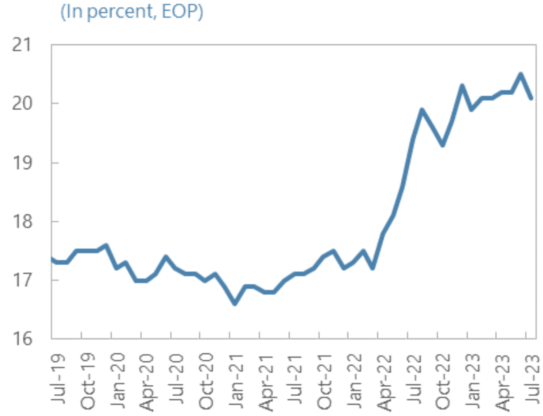
Banks' profitability rose due to foreign exchange gains and lower provisioning but has started normalizing.

Profitability
(In percent)



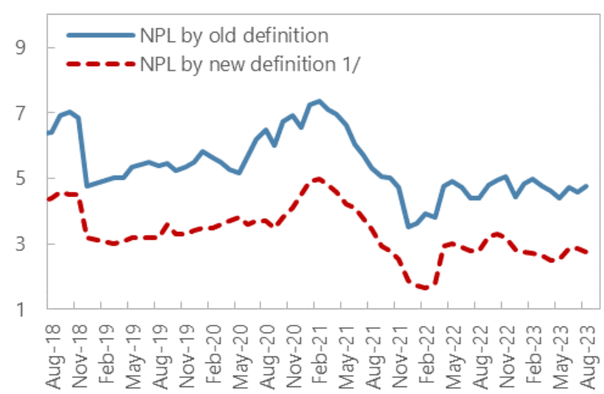
Banks' capital buffers are solid.

Regulatory Capital to Risk-Weighted Assets
(In percent, EOP)



NPLs—excluding watch loans—remain low.

Nonperforming Loans to Total Gross Loans
(In percent, EOP)



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, 2020–28

	2020	2021	2022	2023	2024	2025	2026	2027	2028
	Act.	Act.	Prel.			Proj.			
National income and prices:									
Real GDP (percent change)	-7.2	5.7	12.6	7.0	5.0	4.5	4.5	4.5	4.5
Final consumption expenditure, Contrib. to Growth	-10.5	4.0	6.6	7.5	2.2	2.6	2.3	2.9	2.6
Gross fixed capital formation, Contrib. to Growth	-0.2	1.1	1.7	2.2	2.9	2.0	2.4	2.0	2.3
Changes in inventories, Contrib. to Growth	0.1	0.7	-0.9	-1.0	0.0	0.0	0.0	0.0	0.0
Net exports of goods and services, Contrib. to Growth	3.4	-0.2	5.2	-1.6	-0.1	-0.1	-0.2	-0.3	-0.4
Gross domestic product (in billions of drams)	6,182	6,983	8,501	9,424	10,325	11,211	12,172	13,216	14,349
Gross domestic product (in millions of U.S. dollars)	12,642	13,861	19,514	23,787	24,745	26,569	28,444	30,507	32,751
Gross domestic product per capita (in U.S. dollars)	4,269	4,679	6,587	8,029	8,352	8,967	9,599	10,294	11,050
CPI (period average; percent change)	1.2	7.2	8.6	2.7	3.9	4.0	4.0	4.0	4.0
CPI (end of period; percent change)	3.7	7.7	8.3	2.5	4.0	4.0	4.0	4.0	4.0
GDP deflator (percent change)	1.8	6.9	8.1	3.6	4.3	3.9	3.9	3.9	3.9
Unemployment rate (in percent)	18.2	15.5	13.0	13.5	14.0	14.0	14.0	14.0	14.0
Investment and saving (in percent of GDP)									
Investment	19.7	20.7	21.7	23.3	24.0	23.8	23.9	24.0	24.0
National savings	15.7	17.2	22.5	20.2	20.9	20.2	19.9	19.5	19.0
Money and credit (end of period)									
Reserve money (percent change)	18.3	17.1	5.0	1.3	4.0	6.0	6.7	6.0	6.6
Broad money (percent change)	9.0	13.1	16.1	15.9	10.3	7.2	8.6	8.6	7.0
Private sector credit growth (percent change)	14.3	-3.9	4.5	13.2	7.5	5.9	5.0	4.8	5.5
Central government operations (in percent of GDP)									
Revenue and grants	25.2	24.1	24.3	25.2	25.1	25.2	25.4	25.8	26.2
Of which: tax revenue	22.0	22.1	21.9	22.9	23.1	23.3	23.5	23.9	24.3
Expenditure	30.6	28.7	26.4	28.2	29.7	29.0	28.9	29.0	29.0
Overall balance on a cash basis	-5.4	-4.6	-2.1	-2.9	-4.6	-3.8	-3.5	-3.2	-2.8
Public and publicly-guaranteed (PPG) debt (in percent of GDP)	67.4	63.4	49.2	50.3	50.1	50.8	50.7	50.4	50.1
Central Government's PPG debt (in percent)	63.5	60.3	46.7	47.5	47.5	48.4	48.9	48.9	48.5
Share of foreign currency Central Government PPG debt (in percent)	75.6	71.2	62.1	58.2	55.8	51.7	51.2	51.3	51.2
External sector									
Exports of goods and services (in millions of U.S. dollars)	3,818	5,012	10,038	12,313	12,269	12,913	13,683	14,571	15,497
Imports of goods and services (in millions of U.S. dollars)	-5,082	-6,120	-10,186	-13,043	-13,192	-13,990	-14,941	-16,044	-17,229
Exports of goods and services (percent change)	-34.1	31.3	100.3	22.7	-0.4	5.2	6.0	6.5	6.4
Imports of goods and services (percent change)	-33.2	20.4	66.5	28.0	1.1	6.0	6.8	7.4	7.4
Current account balance (in percent of GDP)	-4.0	-3.5	0.8	-3.1	-3.1	-3.6	-4.1	-4.5	-5.0
FDI (net, in millions of U.S. dollars)	86	342	948	437	461	530	551	568	596
Gross international reserves (in millions of U.S. dollars)	2,616	3,230	4,112	4,004	3,903	4,006	4,264	4,453	4,552
Import cover 1/	5.1	3.8	3.8	3.6	3.3	3.2	3.2	3.1	3.0
End-of-period exchange rate (dram per U.S. dollar)	523	480	394	…	…	…	…	…	…
Average exchange rate (dram per U.S. dollar)	489	504	436	…	…	…	…	…	…

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, 2020–28
(In millions of U.S. dollars, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028
	Act.			Proj.					
Current account	-505	-483	151	-727	-778	-964	-1,156	-1,379	-1,643
Trade balance	-1,382	-1,505	-1,859	-2,996	-2,882	-2,980	-3,136	-3,341	-3,581
Exports	2,719	3,277	5,718	6,604	6,846	7,261	7,730	8,295	8,876
Imports	-4,101	-4,781	-7,577	-9,600	-9,728	-10,241	-10,866	-11,636	-12,457
Services (net)	118	397	1,711	2,267	1,959	1,904	1,878	1,868	1,850
Credits	1,099	1,735	4,320	5,710	5,424	5,653	5,953	6,275	6,621
Debits	-981	-1,338	-2,609	-3,443	-3,465	-3,749	-4,075	-4,408	-4,771
Income (net)	-196	-406	-849	-759	-672	-662	-649	-635	-619
Transfers (net)	955	1,031	1,148	762	816	774	751	729	707
Private	786	955	1,219	829	788	764	741	719	697
Official	169	77	-71	-67	29	10	10	10	10
Capital and financial account	372	937	621	697	850	1,201	1,476	1,570	1,742
Capital transfers (net)	179	63	76	36	39	21	11	11	11
Foreign direct investment (net)	86	342	948	437	461	530	551	568	596
Portfolio investment (net)	-44	6	-1,356	-126	-80	-80	-80	-80	-80
Public sector borrowing (net)	-223	666	481	95	448	294	459	291	297
Disbursements	90	912	741	562	741	918	865	612	602
Amortization	-312	-246	-260	-467	-293	-624	-406	-321	-305
Other capital (net)	373	-140	471	255	-19	436	534	780	918
Errors and omissions	-365	51	21	0	0	0	0	0	0
Overall balance	-499	505	793	-30	71	237	319	191	99
Financing	499	-505	-793	30	-71	-237	-319	-191	-99
Gross international reserves (increase: -)	234	-614	-882	108	101	-103	-258	-189	-99
Use of Fund credit, net	264	-66	89	-78	-172	-135	-61	-2	0
Of which: IMF (SBA) budget support	334	0	72	0	0	0	0	0	0
SDR allocation	0	175	0	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)	-4.0	-3.5	0.8	-3.1	-3.1	-3.6	-4.1	-4.5	-5.0
Trade balance (in percent of GDP)	-10.9	-10.9	-9.5	-12.6	-11.6	-11.2	-11.0	-11.0	-10.9
Gross international reserves (end of period)	2,616	3,230	4,112	4,004	3,903	4,006	4,264	4,453	4,552
In months of next year's imports	5.1	3.8	3.8	3.6	3.3	3.2	3.2	3.1	3.0
In percent of IMF's Reserve Adequacy Metric (ARA)	122	143	154	135	131	131	134	137	137
Goods export growth, percent change	-19.1	20.5	74.5	15.5	3.7	6.1	6.5	7.3	7.0
Goods import growth, percent change	-19.3	16.6	58.5	26.7	1.3	5.3	6.1	7.1	7.1
Nominal external debt	12,659	13,609	14,358	14,661	15,430	16,044	16,846	17,488	18,181
o.w. public external debt	6,059	6,757	7,232	7,150	7,431	7,565	7,926	8,189	8,486
Nominal external debt stock (in percent of GDP)	100.1	98.2	73.6	61.6	62.4	60.4	59.2	57.3	55.5
External public debt-to-exports ratio (in percent)	158.7	134.8	72.0	58.1	60.6	58.6	57.9	56.2	54.8
External public debt service (in percent of exports)	14.7	9.2	4.7	6.6	5.1	7.3	4.5	3.1	2.6

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

Table 3a. Armenia: Central Government Operations, 2020–28

(In billions of Armenian drams)

	2020	2021	2022	2023	2024	2025	2026	2027	2028
		Act.				Proj.			
Total revenue and grants	1,560.7	1,683.8	2,063.1	2,377.8	2,593.1	2,825.0	3,093.3	3,410.6	3,754.0
Total revenue	1,507.5	1,671.5	2,048.1	2,356.9	2,569.0	2,816.1	3,084.4	3,401.8	3,745.1
Tax revenues 1/	1,360.5	1,543.9	1,861.5	2,159.0	2,383.2	2,614.3	2,865.3	3,163.9	3,486.9
VAT	471.6	556.0	679.6	782.2	857.0	941.7	1,022.5	1,123.3	1,234.0
Profits, simplified and presumptive	148.8	158.6	222.8	301.6	320.1	347.5	377.3	422.9	473.5
Personal income tax	411.5	426.3	474.8	519.2	572.0	621.1	674.3	732.2	789.2
Customs duties	68.3	84.8	56.7	75.4	103.3	123.3	158.2	185.0	215.2
Other	260.3	318.2	427.6	480.6	530.8	580.7	632.9	700.4	774.9
Social contributions	24.7	43.0	64.5	84.8	92.9	100.9	109.5	118.9	129.1
Other revenue	122.2	84.6	122.2	113.1	92.9	100.9	109.5	118.9	129.1
Grants	53.2	12.4	15.0	20.9	24.1	8.9	8.9	8.9	8.9
Total expenditure	1,894.6	2,004.3	2,242.6	2,652.8	3,071.3	3,250.3	3,520.1	3,827.1	4,156.9
Expenses	1,668.5	1,788.0	1,862.2	2,091.3	2,376.0	2,542.9	2,751.1	2,991.3	3,248.5
Wages	380.8	394.8	419.6	446.7	489.5	537.1	584.3	634.4	688.8
Payments to individual pension accts.	59.9	58.7	54.3	49.0	46.5	44.8	36.5	26.4	28.7
Subsidies	1.7	12.4	19.8	18.8	21.7	22.4	18.3	26.4	28.7
Interest	164.6	180.8	198.3	262.1	336.6	361.0	391.5	401.0	414.5
Social allowances and pensions	499.9	564.3	559.3	608.9	741.6	788.2	846.0	938.3	1,018.8
Pensions/social security benefits	297.1	317.9	356.6	372.4	424.2	483.8	517.3	568.3	617.0
Social assistance benefits	202.9	246.4	202.7	236.5	317.4	304.5	328.6	370.0	401.8
Goods and services	114.1	131.6	136.0	160.2	180.7	207.4	249.5	290.7	322.9
Grants	185.5	202.9	237.6	240.3	256.6	269.1	273.9	297.4	322.9
Other expenditure 2/	261.9	242.5	237.4	305.1	302.9	312.8	351.2	376.7	423.3
Transactions in nonfinancial assets	226.2	216.3	380.4	561.5	695.3	707.5	769.0	835.8	908.3
Acquisition of nonfinancial assets	227.7	218.4	389.3	571.5	710.3	717.5	779.0	845.8	918.3
Disposals of nonfinancial assets	1.5	2.1	8.9	10.0	15.0	10.0	10.0	10.0	10.0
Overall balance (above-the-line)	-334.0	-320.5	-179.5	-275.0	-478.2	-425.4	-426.8	-416.5	-402.9
Statistical discrepancy	18.7	0.0	16.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-315.3	-320.5	-163.5	-275.0	-478.2	-425.4	-426.8	-416.5	-402.9
Financing	315.3	320.5	163.5	275.0	478.2	425.4	426.8	416.5	402.9
Domestic financing	342.3	101.2	272.1	411.0	345.7	353.9	248.9	300.7	274.0
Banking system	306.7	183.5	85.2	264.9	249.5	228.0	158.7	191.9	151.6
CBA	59.2	-133.6	21.3	33.0	65.0	-12.0	-14.0	10.0	10.0
Commercial Banks	247.5	317.2	64.0	231.9	184.5	240.0	172.7	181.9	141.6
Nonbanks	35.7	-82.3	186.9	146.1	96.2	125.9	90.2	108.8	122.4
T-Bills/other	55.2	-61.0	169.4	154.6	123.0	160.0	115.1	121.3	94.4
Promissory note/other	0.0	-12.7	-11.9	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-19.6	-8.6	29.4	-8.5	-26.8	-34.1	-25.0	-12.5	28.0
External financing	-27.0	219.3	-108.6	-136.1	132.5	71.4	177.9	115.9	128.9
Gross disbursement	207.2	466.5	166.6	222.5	309.1	387.5	370.1	265.3	263.9
of which : IMF budget support	162.5	0.0	31.4	0.0	0.0	0.0	0.0	0.0	0.0
Amortization due	-152.4	-115.6	-99.6	-227.3	-168.4	-316.1	-192.1	-149.4	-135.0
Net lending	-81.8	-131.7	-175.6	-131.2	-8.2	0.0	0.0	0.0	0.0
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)	6,181.9	6,983.0	8,501.4	9,423.7	10,325.2	11,210.7	12,172.1	13,215.9	14,349.2
Program balance 3/	-398.0	-432.5	-320.7	-422.4	-513.2	-459.5	-451.8	-429.0	-374.8
Primary balance 4/	-270.8	-279.9	-127.4	-152.6	-176.6	-98.5	-60.3	-28.0	39.7

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 3b. Armenia: Central Government Operations, 2020–28

(In percent of GDP, unless otherwise specified)

	2020	2021	2022	2023	2024	2025	2026	2027	2028
		Act.				Proj.			
Total revenue and grants	25.2	24.1	24.3	25.2	25.1	25.2	25.4	25.8	26.2
Total revenue	24.4	23.9	24.1	25.0	24.9	25.1	25.3	25.7	26.1
Tax revenues 1/	22.0	22.1	21.9	22.9	23.1	23.3	23.5	23.9	24.3
VAT	7.6	8.0	8.0	8.3	8.3	8.4	8.4	8.5	8.6
Profits, simplified and presumptive	2.4	2.3	2.6	3.2	3.1	3.1	3.1	3.2	3.3
Personal income tax	6.7	6.1	5.6	5.5	5.5	5.5	5.5	5.5	5.5
Customs duties	1.1	1.2	0.7	0.8	1.0	1.1	1.3	1.4	1.5
Other	4.2	4.6	5.0	5.1	5.1	5.2	5.2	5.3	5.4
Social contributions	0.4	0.6	0.8	0.9	0.9	0.9	0.9	0.9	0.9
Other revenue	2.0	1.2	1.4	1.2	0.9	0.9	0.9	0.9	0.9
Grants	0.9	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Total expenditure	30.6	28.7	26.4	28.2	29.7	29.0	28.9	29.0	29.0
Expense	27.0	25.6	21.9	22.2	23.0	22.7	22.6	22.6	22.6
Wages	6.2	5.7	4.9	4.7	4.7	4.8	4.8	4.8	4.8
Payments to individual pension accts.	1.0	0.8	0.6	0.5	0.5	0.4	0.3	0.2	0.2
Subsidies	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Interest	2.7	2.6	2.3	2.8	3.3	3.2	3.2	3.0	2.9
Social allowances and pensions	8.1	8.1	6.6	6.5	7.2	7.0	7.0	7.1	7.1
Pensions/social security benefits	4.8	4.6	4.2	4.0	4.1	4.3	4.3	4.3	4.3
Social assistance benefits	3.3	3.5	2.4	2.5	3.1	2.7	2.7	2.8	2.8
Goods and services	1.8	1.9	1.6	1.7	1.8	1.9	2.1	2.2	2.3
Grants	3.0	2.9	2.8	2.5	2.5	2.4	2.3	2.3	2.3
Other expenditure 2/	4.2	3.5	2.8	3.2	2.9	2.8	2.9	2.9	3.0
Transactions in nonfinancial assets	3.7	3.1	4.5	6.0	6.7	6.3	6.3	6.3	6.3
Acquisition of nonfinancial assets	3.7	3.1	4.6	6.1	6.9	6.4	6.4	6.4	6.4
Disposals of nonfinancial assets	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Overall balance (above-the-line)	-5.4	-4.6	-2.1	-2.9	-4.6	-3.8	-3.5	-3.2	-2.8
Statistical discrepancy	0.3	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-5.1	-4.6	-1.9	-2.9	-4.6	-3.8	-3.5	-3.2	-2.8
Financing	5.1	4.6	1.9	2.9	4.6	3.8	3.5	3.2	2.8
Domestic financing	5.5	1.4	3.2	4.4	3.3	3.2	2.0	2.3	1.9
Banking system	5.0	2.6	1.0	2.8	2.4	2.0	1.3	1.5	1.1
CBA	1.0	-1.9	0.3	0.4	0.6	-0.1	-0.1	0.1	0.1
Commercial Banks	4.0	4.5	0.8	2.5	1.8	2.1	1.4	1.4	1.0
Nonbanks	0.6	-1.2	2.2	1.6	0.9	1.1	0.7	0.8	0.9
T-Bills/other	0.9	-0.9	2.0	1.6	1.2	1.4	0.9	0.9	0.7
Promissory note/other	0.0	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-0.3	-0.1	0.3	-0.1	-0.3	-0.3	-0.2	-0.1	0.2
External financing	-0.4	3.1	-1.3	-1.4	1.3	0.6	1.5	0.9	0.9
Gross disbursement	3.4	6.7	2.0	2.4	3.0	3.5	3.0	2.0	1.8
Amortization due	-2.5	-1.7	-1.2	-2.4	-1.6	-2.8	-1.6	-1.1	-0.9
Net lending	-1.3	-1.9	-2.1	-1.4	-0.1	0.0	0.0	0.0	0.0
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)	6,182	6,983	8,501	9,424	10,325	11,211	12,172	13,216	14,349
Program balance 3/	-6.4	-6.2	-3.8	-4.5	-5.0	-4.1	-3.7	-3.2	-2.6
Primary balance 4/	-4.4	-4.0	-1.5	-1.6	-1.7	-0.9	-0.5	-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, 2021–24
(In billions of drams, unless otherwise indicated)

	2021	2022	2023				2024			
	Act.	Act.	Mar.	Jun.	Sep.	Dec.	Mar	Jun	Sep	Dec
			Act.	Act.	Prelim.	Proj.	Proj.			
Central Bank of Armenia										
Net foreign assets	1186.6	1287.5	1114.0	1187.3	1262.9	1254.2	1200.4	1174.9	1199.9	1270.5
Net international reserves 1/	694.2	685.7	684.1	835.5	912.5	843.8	840.0	789.5	789.5	830.1
Other	492.3	601.8	429.9	351.8	350.4	410.4	360.4	385.4	410.4	440.4
Net domestic assets	644.2	634.5	631.3	530.4	475.5	693.8	711.7	729.6	737.4	755.3
Claims on general government (net)	-393.8	-372.6	-486.6	-577.1	-560.6	-343.9	-327.7	-311.4	-295.2	-278.9
Of which : central government (net)	-323.6	-308.2	-408.9	-498.4	-491.9	-275.2	-259.0	-242.7	-226.5	-210.2
central government deposits	403.5	381.5	495.5	586.4	570.1	284.7	268.5	252.2	236.0	219.7
Claims on banks	696.4	528.3	611.9	607.4	580.2	581.9	583.5	585.1	596.7	598.3
Other items (net)	341.6	478.9	506.0	500.1	455.9	455.9	455.9	455.9	435.9	435.9
Reserve money	1,830.7	1,922.1	1,745.3	1,717.7	1,738.4	1,948.0	1,912.0	1,904.4	1,937.3	2,025.8
Currency issue	747.2	803.1	745.4	808.4	850.1	893.2	861.3	861.9	909.1	893.4
Banks' reserves	1,043.9	1,088.5	967.9	872.1	868.3	1,014.8	1,020.7	1,012.5	998.2	1,102.3
In drams	408.8	360.7	407.4	396.4	397.5	484.1	540.0	506.8	467.5	541.6
In foreign currency	635.1	727.8	560.5	475.7	470.8	530.8	480.8	505.8	530.8	560.8
Other accounts	39.7	30.5	32.0	37.2	20.0	40.0	30.0	30.0	30.0	30.0
Banking system										
Net foreign assets	-178.0	333.5	322.9	353.7	399.4	310.7	286.9	216.4	196.4	217.0
Net domestic assets	3,980.6	4,081.5	4,174.9	4,279.1	4,472.8	4,808.1	4,816.3	5,005.3	5,311.2	5,430.9
Claims on government (net)	744.0	937.4	890.7	798.7	884.9	1,198.0	1,260.4	1,322.7	1,385.1	1,447.5
Of which : claims on central government (net)	814.2	1,001.8	968.4	877.4	953.6	1,266.7	1,329.1	1,391.4	1,453.8	1,516.2
Claims on rest of the economy	4,208.7	4,397.6	4,559.2	4,742.3	4,971.0	4,978.1	4,923.9	5,050.5	5,294.1	5,351.4
Other items (net)	-972.1	-1,253.5	-1,275.0	-1,261.8	-1,383.0	-1,368.0	-1,368.0	-1,368.0	-1,368.0	-1,368.0
Broad money	3,802.6	4,415.0	4,497.8	4,632.9	4,872.3	5,118.8	5,103.1	5,221.7	5,507.6	5,647.9
Currency in circulation	636.1	675.7	630.9	692.3	729.7	766.6	734.3	731.3	771.4	751.0
Deposits	3,166.5	3,739.3	3,866.9	3,940.6	4,142.6	4,352.2	4,368.9	4,490.4	4,736.2	4,896.9
Domestic currency	1,826.7	2,118.0	2,188.9	2,319.5	2,424.8	2,587.8	2,577.5	2,672.0	2,890.8	3,024.4
Foreign currency	1,339.8	1,621.2	1,678.0	1,621.1	1,717.8	1,764.3	1,791.4	1,818.4	1,845.4	1,872.5
Memorandum items:										
Exchange rate (drams per U.S. dollar, end of period)	480.1	393.6	392.6	386.3	401.1	...	...	...	...	...
12-month change in reserve money (in percent)	17.1	5.0	8.6	1.5	-2.3	1.3	9.6	10.9	11.4	4.0
12-month change in broad money (in percent)	13.1	16.1	18.2	21.5	20.3	15.9	13.5	12.7	13.0	10.3
12-month change in dram broad money (in percent)	12.8	13.4	16.8	21.0	22.9	20.1	17.4	13.0	16.1	12.6
12-month change in private sector credit (in percent)	-3.9	4.5	5.1	12.4	16.0	13.2	8.0	6.5	6.5	7.5
Velocity of broad money (end of period)	1.8	1.9	2.0	2.0	1.9	1.8	1.9	1.9	1.8	1.8
Money multiplier	2.1	2.3	2.6	2.7	2.8	2.6	2.7	2.7	2.8	2.8
Private sector credit (in percent of GDP)	60.3	51.7	48.4	50.3	52.7	52.8	47.7	48.9	51.3	51.8
Dollarization in bank deposits 2/	42.3	43.4	43.4	41.1	41.5	40.5	41.0	40.5	39.0	38.2
Dollarization in broad money 3/	35.2	36.7	37.3	35.0	35.3	34.5	35.1	34.8	33.5	33.2
Currency in circulation in percent of deposits	20.1	18.1	16.3	17.6	17.6	17.6	16.8	16.3	16.3	15.3
NIR (U.S. dollars, program exchange rate)	1,452.7	1,703.0	1,718.6	2,125.7	2,286.8	2,080.1	2,070.6	1,946.3	1,946.3	2,046.3
NIR (U.S. dollars, actual exchange rate)	1,445.9	1,742.3	1,742.5	2,162.7	2,275.2	2,080.1	2,070.6	1,946.3	1,946.3	2,046.3

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, 2021–23

(In percent, unless otherwise indicated)

	2021				2022				2023		
	Mar	Jun	Sep	Dec	Mar	June	Sep	Dec	Mar	Jun	Aug
Capital adequacy											
Total regulatory capital to risk-weighted assets	17.0	17.0	17.2	17.2	17.2	18.6	19.6	20.3	20.1	20.6	20.2
Capital (net worth) to assets	13.3	13.0	12.8	13.0	14.8	15.2	14.9	14.9	15.4	15.4	15.8
Asset composition											
Sectoral distribution of loans (in billions of drams)											
Industry (excluding energy sector)	435.2	418.2	389.3	390.2	415.7	375.7	371.1	372.2	367.0	339.2	336.0
Energy sector	195.9	127.5	136.5	120.8	132.8	122.1	122.7	127.5	135.4	135.5	146.9
Agriculture	200.6	190.6	196.3	222.3	230.4	227.5	221.3	238.2	247.6	259.2	255.0
Construction	275.0	304.2	325.1	315.2	333.7	328.4	340.2	349.6	370.3	400.4	433.5
Transport and communication	139.8	129.6	121.8	126.9	116.7	101.4	87.3	88.6	92.8	105.1	104.3
Trade/commerce	532.8	501.3	481.0	482.4	504.9	472.1	477.5	469.7	486.9	501.1	515.2
Consumer credits	915.6	871.2	833.2	824.8	834.4	824.6	837.6	895.5	928.6	962.6	1027.2
Mortgage loans	517.2	551.5	587.3	654.7	698.0	721.9	780.4	849.4	897.7	959.0	980.5
Sectoral distribution of loans to total loans (percent of total)											
Industry (excluding energy sector)	11.0	11.2	10.5	10.3	10.6	9.9	9.4	8.9	8.6	7.6	7.2
Energy sector	4.9	3.4	3.7	3.2	3.4	3.2	3.1	3.1	3.2	3.0	3.1
Agriculture	5.1	5.1	5.3	5.9	5.9	6.0	5.6	5.7	5.8	5.8	5.5
Construction	6.9	8.1	8.8	8.3	8.5	8.6	8.6	8.4	8.7	9.0	9.3
Transport and communication	3.5	3.5	3.3	3.3	3.0	2.7	2.2	2.1	2.2	2.4	2.2
Trade/commerce	13.4	13.4	13.0	12.7	12.9	12.4	12.1	11.3	11.4	11.2	11.0
Mortgage loans	13.0	14.8	15.8	17.3	17.8	18.9	19.8	20.4	21.0	21.5	21.0
Consumer credits	23.1	23.3	22.4	21.8	21.3	21.6	21.3	21.5	21.8	21.6	22.0
Foreign exchange loans to total loans	51.5	48.4	47.3	45.5	46.0	40.5	38.1	36.6	38.6	51.1	46.0
Asset quality											
Nonperforming loans (in billions of drams)	290.0	236.8	113.6	74.1	72.6	113.9	129.0	117.4	114.3	128.5	130.5
Watch (up to 90 days past due)	95.2	75.4	82.6	64.8	82.5	72.7	63.0	67.0	91.7	84.9	95.0
Substandard (91-180 days past due)	121.5	90.4	66.7	46.4	39.9	37.3	41.3	36.7	38.6	51.1	46.0
Doubtful (181-270 days past due)	73.3	71.0	46.9	27.7	32.8	76.5	87.8	80.7	75.7	77.4	84.6
Loss (>270 days past due, in billions of drams)	357.8	394.0	428.8	440.6	455.2	434.9	460.0	489.7	487.3	480.7	477.7
Nonperforming loans to gross loans	7.1	6.1	2.9	1.9	1.8	2.9	3.2	2.8	2.7	2.9	2.8
Provisions to nonperforming loans	45.2	49.4	84.1	99.7	91.2	76.5	74.5	80.3	82.6	87.6	94.4
Spread between highest and lowest rates of interbank borrowing	0.9	1.8	0.3	1.6	6.5	1.2	1.5	1.0	0.4	0.3	1.2
Spread between highest and lowest rates of interbank borrowing	0.4	0.3	0.0	0.6	1.8	1.3	0.5	2.5	1.3	1.0	1.8
Earnings and profitability											
ROA (profits to period average assets)	1.12	0.84	0.9	1.1	2.3	3.7	3.9	4.1	3.8	2.7	3.1
ROE (profits to period average equity)	8.3	6.3	6.6	8.7	16.7	26.3	26.8	27.9	25.1	17.9	20.1
Interest margin to gross income	35.2	34.5	33.5	32.3	26.2	24.2	24.0	25.0	35.1	36.2	36.4
Interest income to gross income	76.7	76.5	76.3	75.5	65.0	58.2	55.9	55.4	68.7	69.2	69.0
Noninterest expenses to gross income	26.7	28.7	28.6	29.3	26.9	25.3	23.9	26.1	30.0	29.9	29.4
Liquidity											
Liquid assets to total assets	28.1	30.8	31.7	32.0	31.1	32.6	34.8	37.0	38.2	35.5	34.9
Liquid assets to total short-term liabilities	117.6	122.1	120.1	122.7	117.5	111.8	108.9	102.4	104.6	98.6	100.5
Customer deposits to total (non-interbank) loans	108.7	115.3	117.3	119.7	114.3	118.2	125.8	135.9	130.4	125.1	124.7
Foreign exchange liabilities to total liabilities	52.1	49.8	48.4	47.4	47.7	46.8	48.7	50.3	48.5	47.5	47.9
Sensitivity to market risk											
Gross open positions in foreign exchange to capital	4.2	3.6	5.5	5.9	12.4	9.3	6.8	3.3	2.0	2.5	1.8
Net open position in FX to capital	-2.1	-0.1	1.5	4.6	11.1	7.2	5.0	1.9	0.4	0.7	-0.1

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: Schedule of Reviews and Available Purchases Under the Stand-By 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-December 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, 2023–30

	2023	2024	2025	2026	2027	2028	2029	2030
				Projections				
Fund obligations based on existing credit								
(in millions of SDRs)								
Principal	58.3	128.6	99.9	45.1	14.2	0.0	0.0	0.0
Charges and interest	6.6	20.6	13.6	9.9	7.8	7.5	7.4	7.4
Fund obligations based on existing and prospective credit 1/								
In millions of SDRs	65.2	153.4	118.6	61.4	60.2	62.3	41.5	21.7
In millions of US$	91.3	215.9	167.0	86.4	84.8	87.7	58.4	30.5
In percent of Gross International Reserves	2.3	7.6	6.1	2.7	2.4	2.2	1.4	0.7
In percent of exports of goods and services	0.7	2.3	1.5	0.7	0.6	0.6	0.3	0.2
In percent of external public debt service	11.2	34.1	17.5	13.8	16.7	18.2	6.2	8.1
In percent of GDP	0.4	0.9	0.7	0.3	0.3	0.3	0.2	0.1
In percent of quota	50.6	119.1	92.1	47.7	46.8	48.3	32.2	16.8
Outstanding Fund credit based on existing drawings								
In millions of SDRs	287.7	159.1	59.3	14.2	0.0	0.0	0.0	0.0
In billions of US$	0.4	0.2	0.1	0.0	0.0	0.0	0.0	0.0
In percent of Gross International Reserves	10.1	5.7	2.1	0.5	0.0	0.0	0.0	0.0
In percent of exports of goods and services	3.3	1.8	0.6	0.1	0.0	0.0	0.0	0.0
In percent of external public debt service	49.3	35.4	8.8	3.2	0.0	0.0	0.0	0.0
In percent of GDP	1.7	0.9	0.3	0.1	0.0	0.0	0.0	0.0
In percent of quota	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	342.9	251.1	188.1	143.0	96.6	46.0	13.8	0.0
In billions of US$	0.5	0.4	0.3	0.2	0.1	0.1	0.0	0.0
In percent of Gross International Reserves	12.0	12.5	9.7	6.2	3.9	1.6	0.5	0.0
In percent of exports of goods and services	3.9	3.7	2.4	1.6	1.0	0.4	0.1	0.0
In percent of external public debt service	58.7	55.9	27.8	32.1	26.7	13.5	2.1	0.0
In percent of GDP	2.0	1.5	1.1	0.8	0.5	0.2	0.1	0.0
In percent of quota	266.2	195.0	146.0	111.0	75.0	35.7	10.7	0.0
Net use of Fund credit (millions of SDRs) existing and prospective 1/	-65.2	-114.9	-80.1	-22.1	-60.2	-62.3	-41.5	-21.7
Disbursements	0.0	38.5	38.5	39.3	0.0	0.0	0.0	0.0
Repayments and Repurchases	65.2	153.4	118.6	61.4	60.2	62.3	41.5	21.7
Memorandum items (adverse scenario)								
Nominal GDP (in millions of US$)	23,787	24,072	25,059	26,838	28,798	32,751	35,176	38,312
Exports of goods and services (in millions of US$)	12,313	9,452	11,194	12,986	13,934	15,847	17,020	18,537
Gross international reserves (in millions of US$)	4,004	2838	2735	3230	3,466	3,942	4,234	4,612

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.

Table 8. Armenia: External Financing Requirements and Sources, 2022–25
(In millions of U.S. dollars, unless otherwise indicated)

	2022	2023	2024	2025
Gross Financing Needs	**1,033**	**1,184**	**1,141**	**1,816**
Current Account Deficit excluding budget support grants	-151	727	778	964
Change in NFA	882	-108	-101	103
External debt amortization (excluding IMF)	260	467	292	624
Repayment to the Fund (amortization)	42	98	171.8	125
Financing Sources	**1033**	**1184**	**1141**	**1816**
FDI	948	437	461	530
Loan disbursements (public sector)	498	562	741	918
- Program	206	250	330	330
- Project	292	312	411	588
External Grants	49	53	58	21
- Program	31	17	19	0
- Project	18	36	39	21
Other Capital Flows	-483	132	-119	346
Errors and Omissions	21	0	0	0
Financing Gap	0	0	0	0

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

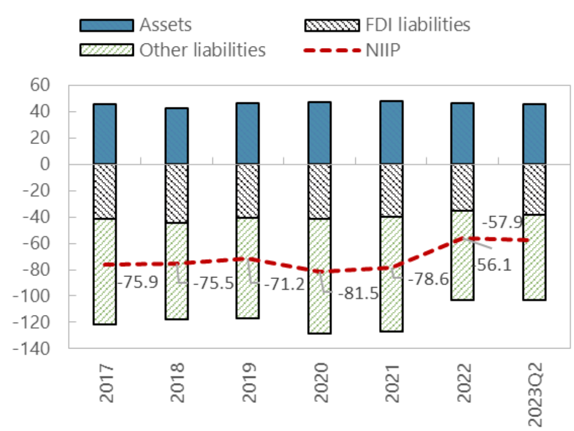
Annex I. External Sector Assessment

Overall Assessment and Policy Responses: *The external position of Armenia in 2022 was broadly in line with the level implied by fundamentals and desirable policies. Continued prudent fiscal policy, exchange rate flexibility, and structural reforms to boost competitiveness would bolster buffers and support the economy's resilience against risks, including exogenous shocks related to the war in Ukraine. The current account is expected to converge to the norm of 4.9 percent of GDP over the medium term.*

Foreign Assets and Liabilities: Position and Trajectory

1. Background. The net international investment position (NIIP) improved to around -56.1 percent of GDP at the end of 2022, from -78.6 percent in December 2021, reflecting both the surplus on the current account in 2022 and a sharp increase in nominal GDP in US dollar terms (as a result of the growth surge and the sharp appreciation of the dram against the dollar). Under staff's baseline projections, the NIIP is expected to improve further to around 44 percent of GDP in 2023, notwithstanding a widening of the current account balance, and stabilize below -45 percent of GDP in the medium-term.

Net International Investment Position (NIIP)
(In percent of GDP)



Sources: National Authorities and IMF staff calculations.

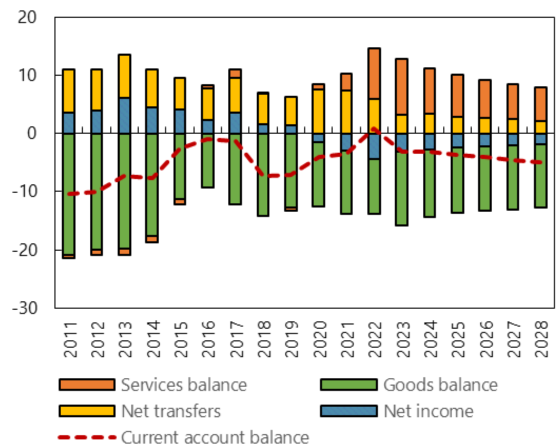
2. Assessment. The negative IIP does not pose immediate risks to external sustainability. Prior to the sudden improvement in 2022, the NIIP was broadly stable over the previous five years (Text Chart) and consistent with the economy's need for investment-related imports. In terms of composition, the share of foreign direct investments (FDI) over total liabilities remains stable at about 40 percent of GDP while the declining share of debt flows as a source of external financing in 2022 has reduced the vulnerability in the IIP composition.

2022 (Percent GDP)	NIIP: -57.5	Gross Assets: 47.9	Debt Assets: 22.9	Gross Liab.: 105.4	Debt Liab.: 78.2

Current Account

3. Background. In 2022, the current account balance (CAB) moved into surplus (0.8 percent of GDP, from a deficit of 3.5 percent in 2021). This reflects a rebound in external demand; robust service exports following the recovery in tourism linked to migratory flows driven by the war in Ukraine; and strong remittances inflows. In 2023, the current account is expected to turn into a deficit of 3.1 percent of GDP on account of increased imports (amid strong private consumption) and relative strength of the dram against the US dollar (which has stimulated imports). The CA deficit is expected to reach 3.1 percent of GDP in 2024, as tourism exports and remittances continue to moderate, before converging to its long-run norm of near 5 percent of GDP (see next paragraph) in the medium-term.

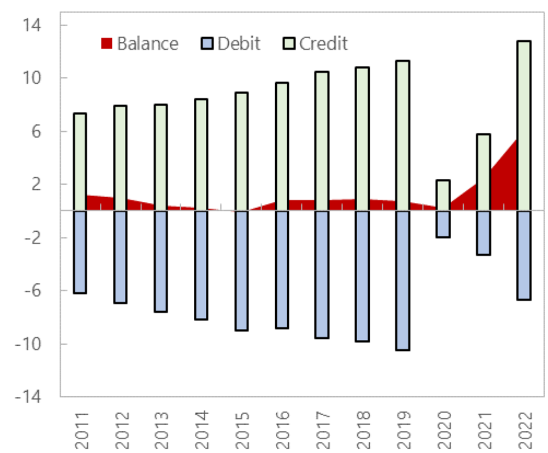
Current Account
(In percent of GDP)



Sources: National authorities and IMF staff calculations.

4. There are a number of idiosyncratic factors influencing the 2022 current account outcome in Armenia, including a very sharp increase in re-exports to Russia, and a record number of nonresidents and foreign exchange inflows that entered Armenia after the start of Russia's war in Ukraine. Tourist arrivals from Russia nearly doubled to 800 thousand, reaching almost half of total arrivals, and spending per tourist increased substantially in 2022.

Current Account: Tourism Related Services
(As percent of GDP)



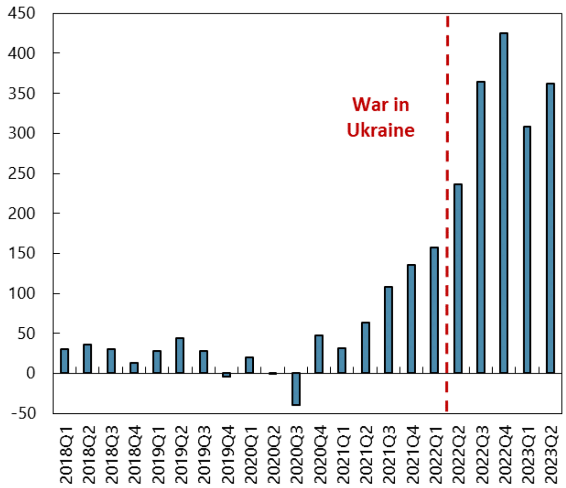
Source: National Authorities.

5. For the purpose of assessing the current account in 2022, specific account thus needs to be taken of the following factors.

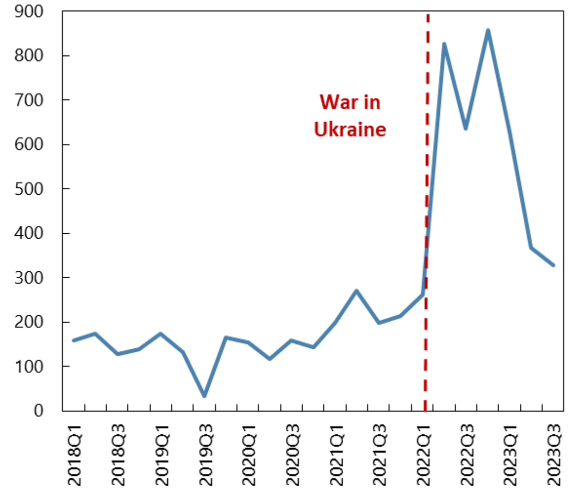
- **Merchandise trade with Russia.** Assessing the bilateral trade data for 2022, the net impact of the improvement in the merchandise trade balance with Russia on the current account is calculated at about 4 percent of GDP in 2022. Russia accounts for two thirds of the nearly 80 percent increase in exports and a quarter of the 64 percent increase in imports. As this is a temporary shock which is expected to moderate in the medium term, the assessment of the current account (CA) gap needs to take the increase in net exports relative to the historical pattern explicitly into account. To address this factor, an adjustment of 3 percent of GDP is made by way of a statistical adjustment.

Figure AI.1. Armenia: Current Account Impact from the War in Ukraine

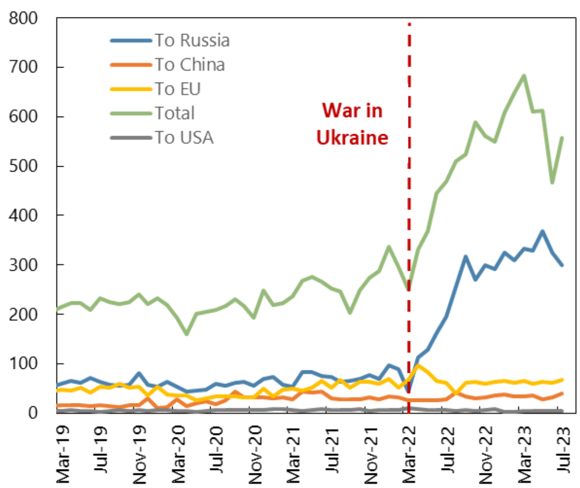
BOP: Balance on Tourism Related Services in Travel and Passenger Transport
(Million USD, seasonally adjusted)



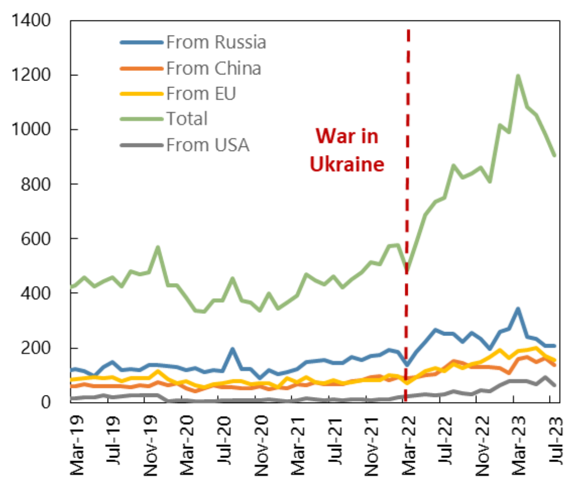
Money Transfers of Individuals: Net Inflow
(Million USD, seasonally adjusted)



Export of Goods
(Million USD, seasonally adjusted)



Import of Goods
(Million USD, seasonally adjusted)



Sources: Haver (Armstat and CBA) and IMF staff calculations.

- **Exports of services**: the services balance also improved to almost 9 percent of GDP in 2022 (from -0.6 percent of GDP in 2019), largely reflecting the inflow of tourists and migrants following the outbreak of the war in Ukraine. Tourism exports were more than 5 percent of GDP higher than initially projected. The tourism shock is considered also temporary in nature and this is captured in the model via adjusters adapted for this purpose. The net impact is to reduce the CA gap by 1.6 percent of GDP relative to the norm calculated by the model.

- **Emigrants' remittances** increased by more than 1 percent of GDP compared to initial projections contributing, along with the merchandise trade and tourism shocks, to the dram appreciation against the US dollar in 2022. This increase in remittances is considered temporary in nature as well and is captured in the model via adjusters with a net impact of 0.86 percent of GDP on the calculated CA gap.

6. Assessment. The EBA-Lite current account model estimates a cyclically adjusted current account norm of -4.9 percent of GDP for 2022, against an adjusted CA deficit of 4.1 percent of GDP; this implies a positive gap of about 0.8 percent of GDP and a small REER undervaluation of 3.7 percent. The assessment includes adjustments to the current account to reflect risks arising from natural disasters and conflicts and additional adjustors for tourism exports and remittances, which surged in 2022. 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) models are consistent with this assessment.

Armenia: EBA-lite Model Results, 2022

	CA model 1/	**REER model** 1/
	(in percent of GDP)	
CA-Actual	**0.8**	
Cyclical contributions (from model) (-)	-0.5	
Adjustors (-) 2/	2.5	
Additional temporary/statistical factors (-) 3/	3.0	
Natural disasters and conflicts (-)	-0.1	
Adjusted CA	**-4.1**	
CA Norm (from model) 4/	**-4.9**	
Adjustments to the norm (-)	0.0	
Adjusted CA Norm	**-4.9**	
CA Gap	**0.8**	**0.1**
o/w Relative policy gap	3.7	
Elasticity	-0.2	
REER Gap (in percent)	**-3.7**	**-0.3**

1/ Based on the EBA-lite 3.0 methodology

2/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism and remittances (6-6.5 percent of GDP). 75 percent of the shock to tourism is assumed temporary.

3/ The surge in exports to Russia is estimated to generate a 4 percent of GDP shock, of which 75 percent is assumed temporary.

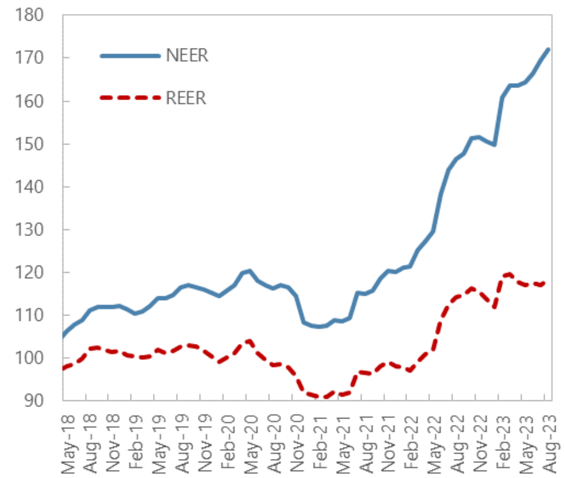
4/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

7. Background. The REER appreciated on average by 14 percent in 2022 relative to 2021, reflecting a moderate increase in inflation differentials with respect to trading partners (approximately 3.6 percent) and nominal appreciation. Between January and September 2023, the REER further appreciated by about 5.5 percent, mainly because of continued nominal appreciation of the Armenian dram against the US dollar since the beginning of the war in Ukraine. The dram appreciated by over 20 percent against the US dollar in 2022 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.

Real and Nominal Effective Exchange Rates

(Index, 2010 = 100; increase means appreciation)



Source: IMF (INS).

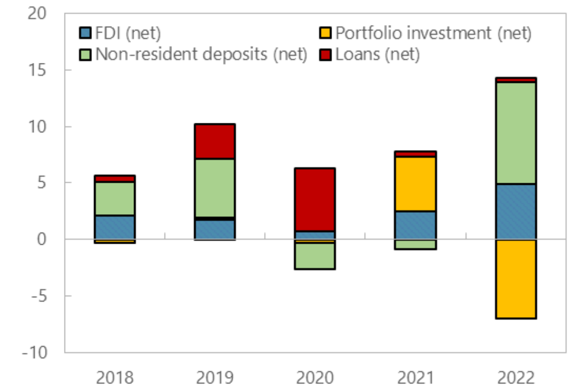
8. Assessment. The EBA-Lite CA model (see above) estimates a REER gap of around 3.7 percent for 2022 based on an elasticity of the REER to the current account of -0.21 percent. This is somewhat larger than the undervaluation of about 0.3 percent for 2022 produced by the REER model for the same year (Text Table), reflecting the sharp improvement in the current account resulting from the large shock to tourism exports.

Capital and Financial Accounts

9. Background. In 2022, there was a very sharp increase in net inflows of nonresident deposits (9.0 percent of GDP) in contrast to the net outflows in 2021 (0.9 percent of GDP), but these inflows were offset by portfolio investment outflows (7.0 percent of GDP) reflecting substantial net acquisitions of financial assets. The contribution of FDI to capital inflows has increased significantly in recent years reflecting the impact of the war in Ukraine. A net FDI inflow of 4.9 percent of GDP was recorded in 2022 following a net inflow of 2.5 percent of GDP in 2021, both well above the historical average of about 1.5 percent of GDP.

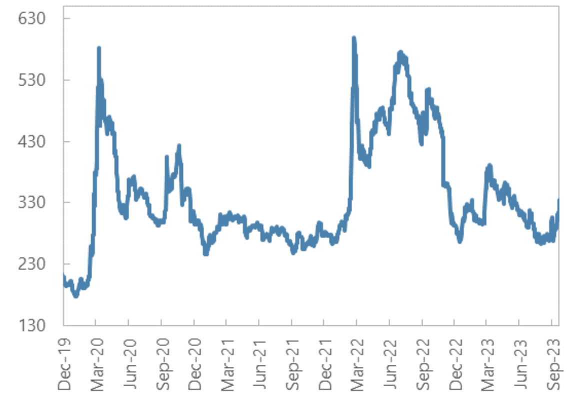
10. Assessment. Spreads on Armenia's Eurobond increased by more than 200 basis points after the start of the war in Ukraine—reflecting worsening sovereign risk perceptions and tightening of global financial conditions—before declining again to pre-war levels towards end-2022 and into 2023. Given elevated 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 maintaining 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: Haver (Armstat) and IMF staff calculations.

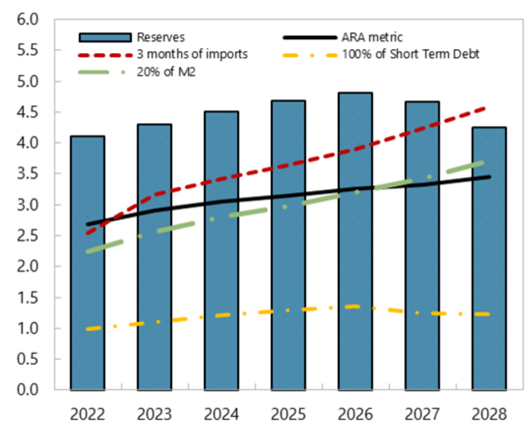
Sovereign Spread
(In basis points)



Source: Bloomberg.

FX Intervention and Reserves Level

Reserve Adequacy Indicators
(US$ billion)



Sources: National authorities and IMF staff calculations.

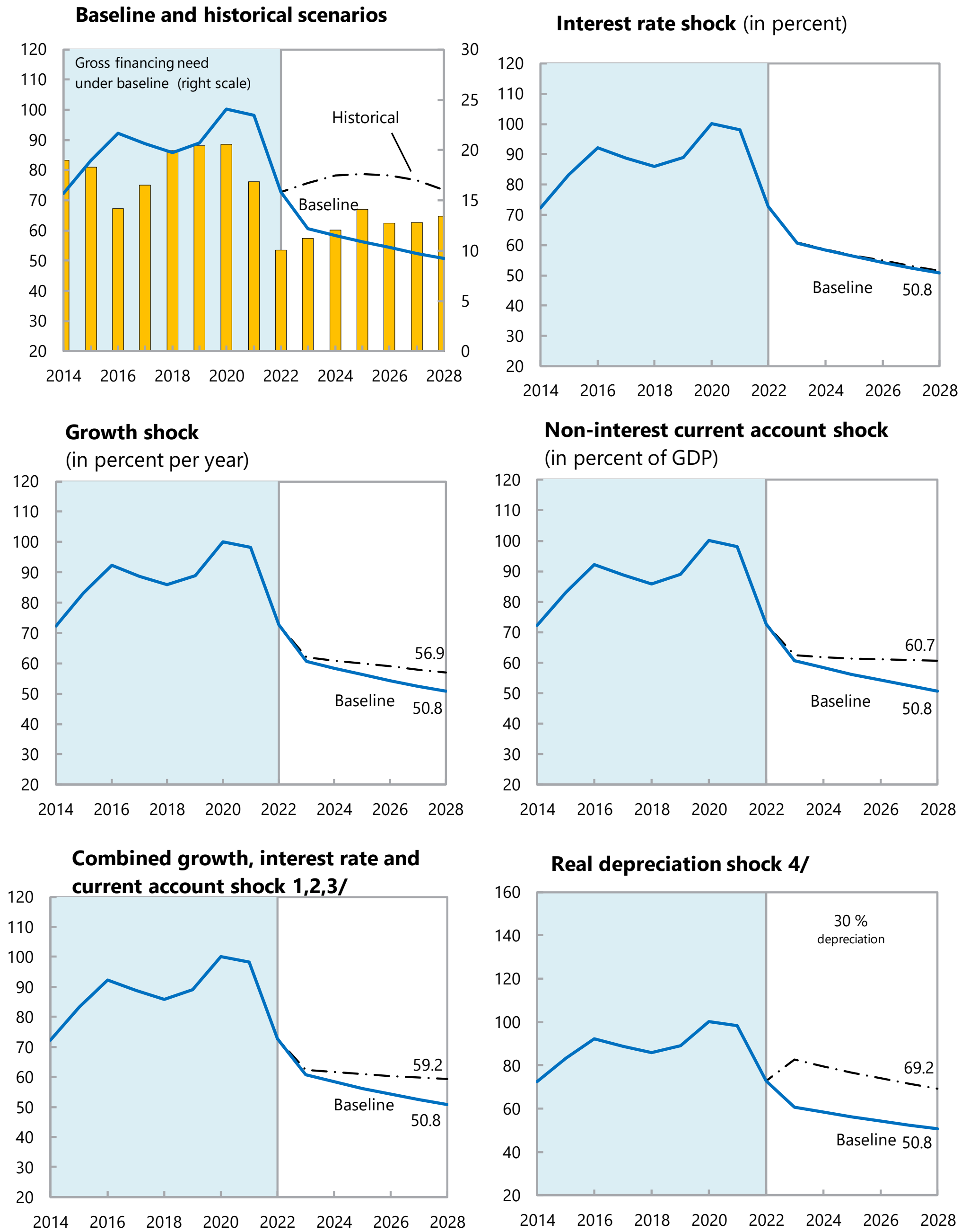
11. Background and assessment. Gross international reserves increased from US$ 3.3 billion at end-2021 to approximately US$ 4.1 billion at the end-2022, roughly equivalent to 3.8 months of prospective imports. In 2022, the reserve position was supported by the current account going into surplus and a surge in FDI inflows. In 2022, the authorities carried out US dollar purchases to build external buffers, for a total of approximately US$ 0.7 billion. Further dollar purchases of US$ 0.4 billion have been carried out to end-June 2023. Based on the IMF's reserve adequacy (ARA) metric, Armenia's gross international reserves are estimated to be adequate at over 150 percent of the ARA metric at end-2022, remaining above 130 percent of the projected 2023 ARA metric at end-2023, and above 130 percent throughout the forecast horizon.

External Debt Sustainability

12. Armenia's external debt-to-GDP ratio has improved in 2022 and is expected to decline further under staff's baseline scenario. The debt-to-GDP ratio declined to 72.7 percent at end-2022, from 98.2 percent at end-2021: the substantial decline can be attributed to the large dram appreciation against the US dollar (see above). The declining trend is projected to continue 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 rising above 80 percent of GDP 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 AI.2. 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 2023.

Figure AI.3. Armenia: External Debt Sustainability Framework, 2018–28

(In percent of GDP, unless otherwise indicated)

	2018	2019	2020	2021	2022			2023	2024	2025	2026	2027	2028	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	85.9	89.0	100.1	98.2	72.7			**60.7**	**58.4**	**56.2**	**54.3**	**52.5**	**50.8**	**-3.3**
2 Change in external debt	-2.9	3.1	11.1	-2.0	-25.5			-12.0	-2.3	-2.2	-1.9	-1.9	-1.7	
3 Identified external debt-creating flows (4+8+9)	-1.2	-2.2	10.5	-7.8	-27.1			-15.0	-4.8	-3.0	-2.1	-1.2	-0.1	
4 Current account deficit, excluding interest payments	3.6	3.4	-0.4	-0.5	-3.8			-1.4	-0.2	0.6	1.4	2.2	3.2	
5 Deficit in balance of goods and services	14.1	13.3	10.0	8.0	0.8			2.8	3.4	4.0	4.5	5.2	6.0	
6 Exports	39.5	42.5	30.2	36.2	51.4			48.0	46.7	45.7	45.2	44.8	44.5	
7 Imports	53.6	55.8	40.2	44.1	52.2			50.8	50.2	49.7	49.7	50.1	50.5	
8 Net non-debt creating capital inflows (negative)	-1.8	-1.9	-0.3	-2.5	2.1			-1.3	-1.5	-1.7	-1.7	-1.6	-1.6	
9 Automatic debt dynamics 1/	-3.0	-3.6	11.2	-4.9	-25.4			-12.4	-3.1	-1.9	-1.8	-1.8	-1.7	
10 Contribution from nominal interest rate	3.6	3.7	4.4	4.0	3.0			2.5	2.3	2.2	2.0	1.9	1.8	
11 Contribution from real GDP growth	-4.3	-6.0	6.9	-5.2	-8.8			-4.1	-2.8	-2.4	-2.4	-2.3	-2.2	
12 Contribution from price and exchange rate changes 2/	-2.3	-1.3	0.0	-3.6	-19.6			-10.8	-2.6	-1.7	-1.4	-1.4	-1.4	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-1.7	5.3	0.6	5.9	1.6			3.0	2.5	0.8	0.2	-0.7	-1.6	
External debt-to-exports ratio (in percent)	217.1	209.2	331.5	271.5	141.3			126.4	124.9	123.0	120.1	117.0	114.1	
Gross external financing need (in billions of US dollars) 4/	2.5	2.8	2.6	2.3	2.0			2.7	3.2	4.1	4.0	4.3	4.8	
in percent of GDP	20.0	20.4	20.6	16.9	10.1	10-Year	10-Year	11.2	12.0	14.1	12.7	12.8	13.4	
Scenario with key variables at their historical averages 5/								**75.7**	**78.2**	**78.7**	**78.2**	**76.5**	**73.4**	**-2.4**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	5.2	7.6	-7.2	5.7	12.6	3.7	4.5	7.0	5.0	4.5	4.5	4.5	4.5	
GDP deflator in US dollars (change in percent)	2.7	1.6	0.0	3.8	25.0	-0.3	4.4	17.5	4.5	3.0	2.6	2.6	2.6	
Nominal external interest rate (in percent)	4.4	4.7	4.6	4.3	4.3	4.3	0.5	4.2	4.1	4.1	3.8	3.8	3.8	
Growth of exports (US dollar terms, in percent)	11.7	17.6	-34.1	31.3	100.3	7.8	17.9	17.4	6.8	5.2	6.1	6.3	6.5	
Growth of imports (US dollar terms, in percent)	18.1	13.8	-33.2	20.4	66.5	3.9	18.4	22.5	8.3	6.7	7.2	7.9	8.1	
Current account balance, excluding interest payments	-3.6	-3.4	0.4	0.5	3.8	-1.7	3.6	1.4	0.2	-0.6	-1.4	-2.2	-3.2	
Net non-debt creating capital inflows	1.8	1.9	0.3	2.5	-2.1	3.1	2.4	1.3	1.5	1.7	1.7	1.6	1.6	

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 II. Risk Assessment Matrix[1]

Risk	Description	Likelihood	Possible Impact	Policy Advice
Conjunctural Risks				
Intensification of regional conflict(s).	Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, FDI and financial flows, and payment systems, and lead to refugee flows.	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 pressures on correspondent banking relations (CBR).	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 volatility.	A succession of supply disruptions (e.g., due to conflicts, uncertainty, and export restrictions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, contagion effects, and social and economic instability.	Medium	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.
Abrupt global slowdown or recession	Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation causing sudden stops in EMDEs. • **U.S.:** Amid tight labor markets and/or commodity price shocks, inflation	Medium	A slowdown in trading partners will affect economic activity and result in an abrupt bout of risk aversion for Armenia.	Strengthen and diversify trade channels/markets. Enhance diplomacy. Allow the exchange rate to operate as a shock absorber, intervene in the fx market to address disorderly market conditions.

[1] Risk assessment matrix shows events that could materially alter the baseline path.

Risk	Description	Likelihood	Possible Impact	Policy Advice
	remains elevated, prompting the Fed to keep rates higher for longer and resulting in more abrupt financial, housing and commercial real estate market correction, and "hard landing". • **Europe:** Intensifying fallout from the war in Ukraine, recurrent energy crisis and supply disruptions, and monetary tightening exacerbate economic downturns, and housing and commercial real estate market corrections. • **China:** Sharper-than-expected slowdown in the property sector, unexpected fiscal tightening due to local government financing stress and decline in investment, and/or rising geopolitical tensions disrupt economic activity.			
Monetary policy miscalibration.	Amid high economic uncertainty and financial sector fragility, major central banks pause monetary policy tightening or pivot to loosen policy stance prematurely, de-anchoring inflation expectations, triggering a wage-price spiral and spillovers to financial markets.	Medium	Domestic inflation may accelerate.	Stand ready to tighten monetary policy as needed along with coordinated monetary-fiscal policy mix to contain inflation.
Systemic financial instability.	Sharp swings in real interest rates and risk premia, and asset repricing amid economic slowdowns and policy shifts trigger insolvencies in countries with weak banks or non-bank financial institutions, causing market dislocations and adverse cross-border spillovers.	Medium	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.	Continue the de-dollarization efforts and strengthen banking supervision and provisions to respond in the event of higher NPLs in dollar.
Sovereign debt distress	Domino effects of higher global interest rates, a growth slowdown in AEs, and/or	Medium	Armenia's debt is particularly vulnerable to growth and	Fiscal policy should be prudent. Build fiscal buffers by raising revenues and prioritizing

Risk	Description	Likelihood	Possible Impact	Policy Advice
	disorderly debt events in some EMDEs spillover to other highly indebted countries, resulting in capital outflows, an increase in risk premia, and loss of market access.		exchange rate risks. Higher global interest rates for long, coupled with potential reversal of large capital and migrant inflows due to the war in Ukraine, could result in depreciation of exchange rate and lower growth.	spending to guard against risks. Develop domestic financial markets to diversify sources of borrowing and reducing reliance on external debt.
Social discontent.	Supply shocks, high inflation, real wage drops, and spillovers from crises in other countries worsen inequality, trigger social unrest, and give rise to financing pressures and damaging populist policies with possible spillovers to other EMDEs. This exacerbates imbalances, slows growth, and triggers market repricing.	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.
		Structural Risks		
Deepening geo-economic fragmentation.	Broader and deeper conflict(s) and weakened international cooperation result in a more rapid reconfiguration of trade and FDI, supply disruptions, protectionism, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, 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 and to diversify Armenia's trade basket and trading partners.
Cyberthreats	Cyberattacks on physical or digital infrastructure (including digital currency and crypto assets ecosystems) or misuse of AI technologies trigger financial and economic instability.	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.
Extreme climate events.	Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower	Medium	Higher frequency and severity of natural disasters would cause severe economic	Undertake a comprehensive climate risk assessment of Armenia and develop national adaptation policies to strengthen

Risk	Description	Likelihood	Possible Impact	Policy Advice
	growth, and financial instability.		damages and disrupt economic activities.	the resilience against climate change risks.
Domestic Risks				
Financial sector risks	Risks could increase due to the rapid increase in house prices and mortgage lending, 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 with Azerbaijan 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, higher fiscal spending need due to refugee inflow, 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, raise revenues and prioritize expenditures, 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.
Resurgence of inflationary pressures	Higher aggregate demand, including due to the inflow of international visitors and money transfers, influx of refugees, supply constraints, resurge in global and domestic food and energy prices and monetary and fiscal policy miscalibrations could lead to resurge in inflationary pressures.	Medium	Resurgence in inflationary pressures could lead to another cycle of monetary policy tightening that may constrain access to finance, dampen economic activity, 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 III. Illustrative Adverse Scenario

1. Armenia's susceptibility to adverse shocks remains a concern, with potential repercussions for its economy and foreign reserves. While the baseline outlook predicts satisfactory reserve levels (table AII.2.), the occurrence of an adverse shock could amplify risks by unsettling the current account, disrupting capital inflows, eroding existing buffers, and inducing balance of payments pressures.

2. Adverse scenario. The staff simulates a contraction in real growth for major global economies including Russia, the Euro Area, the United States, and China, anticipated to commence in 2024Q1 and deepen later in the year. The scenario also envisages a simultaneous economic downturn driven by the reversal of various spillovers from War in Ukraine. A notable decrease in exports and imports to Russia is projected, bringing trade flows back to historical trends. Monetary transfers and gross capital inflows are also foreseen to decline— including due to jitters about a potential regional conflict—accompanied by a reduction in credit services attributed to a decrease in foreign visitors. In this complex landscape, it is projected that the economy may exhibit scarring effects throughout 2024 and 2025; however, a rebound in growth rates is envisaged for the year 2026.[1]

- **Current account**. In an adverse scenario, goods exports contract by approximately 40 percent relative to the baseline (1.6 historical standard deviations in exports). This decline is mainly led by Russia's exports as the trading partner contributing to roughly 60 percent of the total growth in 2022. Goods imports also decrease by 20 percent, possibly reflecting re-export dynamics and some import compression from lower growth and dram depreciation (see below). Staff also assumes a contraction in service exports (1.6 percent historical standard deviations in service credit) and a 40 percent decline in remittances, equivalent to 1.6 standard deviations of the historical change in net transfers.

- **Financial account.** While under the baseline scenario, net capital inflows are projected to reach about USD0.8 billion in 2024, in the shock scenario, net inflows are expected to decline by approximately USD0.7 billion relative to this amount in the same year. The difference is equivalent to half of the increase in net deposit liability observed in 2022, relative to its historical average, and corresponds to 2 historical standard deviations in other capital flows.

3. Effects. The weaker current and financial account position would put downward pressure on the exchange rate, leading to a 30 percent nominal depreciation relative to the baseline in 2024. At the same time, growth and private consumption would decline due to weaker external demand and remittances. The current account would initially widen in response to a significant decrease in exports, while inflation would increase, given the pass-through from nominal depreciation. After the initial shock, lower private consumption and the weaker exchange rate would lead to a progressive

[1] See also International Monetary Fund, "Republic of Armenia: Request for a Stand-By Arrangement" IMF Country Report 22/366, December 2022.

adjustment to the trade balance, in line with past crisis episodes, allowing the current account to revert to the baseline projection gradually.

Table AIII.1. Armenia: Impact of a Plausible External Shock

	2024		2025		2026	
	Baseline	Adverse Scenario	Baseline	Adverse Scenario	Baseline	Adverse Scenario
National Income and Prices						
Real GDP (percent change)	5.0	1.5	4.5	2.5	4.5	4.5
CPI (Period average; percent change)	3.9	5.0	4.0	6.0	4.0	4.0
Overall Balance on a cash basis (in percent of GDP)	-4.6	-6.2	-3.8	-4.5	-3.5	-3.5
Central Government PPG Debt (in percent)	47.5	60.4	48.4	57.7	48.9	52.8
Current Account Balance (in percent of GDP)	-3.1	-5.0	-3.6	-4.6	-4.1	-4.1
Gross international Reserves (in millions of U.S. dollars)	3903	2719	4006	2536	4264	2952

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

4. Policies. The adverse scenario assumes that monetary tightening will control inflationary pressures from nominal depreciation. The central bank should remain ready to implement targeted interventions to avoid disorderly conditions in FX markets. The CBA should let the exchange rate depreciate to serve as a shock absorber in line with its inflation-targeting regime. The fiscal deficit would cumulatively increase by about 2.3 percent of GDP in 2024–25 as the authorities let automatic stabilizers operate before reverting to its baseline projection in 2026. A larger budget deficit and the large dram depreciation imply a temporary increase in government debt in 2024 by approximately 13 percent relative to the baseline. Government debt would subsequently decline, consistent with a gradual appreciation of the currency and fiscal consolidation.

5. Implications. In a shock scenario, nominal gross international reserves would decline to approximately 101 percent of the ARA metric in 2024, creating a potential balance of payment need. Access to Fund resources at 100 percent of quota (SDR 128.8 million) and additional financing from development partners of USD 130 million during 2024–26 would ensure that reserves remain at or close to 100 percent of the ARA metric throughout the program.

6. In the event of a significant downturn in the macroeconomic environment, the program modalities can be modified following a request from the authorities and subsequent Board approval.

Table AIII.2. Armenia: Potential Impact of Adverse Shocks

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

	Baseline			Shock		
	2024	**2025**	**2026**	**2024**	**2025**	**2026**
Current account	-778	-964	-1,156	-1,262	-1,250	-1,198
Exports G&S	12,269	12,913	13,683	9,452	11,194	12,986
Imports G&S	-13,192	-13,990	-14,941	-10,730	-12,447	-14,188
Incomes and transfers (net)	145	112	102	16	3	4
Capital & financial account	850	1,201	1,476	150	1,201	1,676
Overall balance	71	237	319	-1,112	-49	477
Financing						
Change in reserves (increase -)	101	-103	-258	1,285	183	-416
Net use of Fund credit (repurchase)	-172	-135	-61	-172	-135	-61
Gross international reserves	3903	4006	4264	2719	2536	2952
As % of ARA metric	**131**	**131**	**134**	**101**	**88**	**91**
Under the proposed IMF-supported program:						
Proposed IMF financing in adverse scenario				49	49	50
Assumed financing from development partners 1/				70	30	30
Gross international reserves				2838	2735	3230
As % of ARA metric				**106**	**95**	**100**

Source: IMF Staff calculations

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

Annex IV. Sovereign Risk and Public Debt Sustainability Assessment

Table AIV.1. Armenia: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Moderate	The overall risk of sovereign stress is "moderate", reflecting moderate level of vulnerability in medium-term, and manageable risks in the long term.
Medium term	Moderate	Moderate	Medium-term risk is assessed "moderate" in line with the mechanical signal. The debt stabilizes at a comfortable terminal level of below 50 percent of GDP in the medium-term and the Gross Financing Needs (GFN) are low and stable. However, there is considerable uncertainty around the baseline as the debt is vulnerable to growth and exchange rate risks.
Fanchart	Moderate	…	
GFN	Moderate	…	
Stress test	Cont. Liabty., Nat. Disast.	…	
Long term	…	n.a.	Long-term risks to debt may arise from large amortization payments and climate adaptation needs. The historical 10-year average scenario underscores the importance of adhering to the fiscal consolidation targets under the SBA. Over the long-run, debt amortization (both in levels and in % of GDP) will be higher than in the past (reflecting past elevated borrowing) limiting the fiscal space for deviations from the planned fiscal consolidation.
Sustainability assessment 2/	…	Sustainable	The projected debt path is expected to stabilize and GFNs will remain at manageable levels, conditional on the fiscal consolidation recommended under the baseline. The overall debt is assessed as sustainable.
Debt stabilization in the baseline			Yes

DSA summary assessment

Commentary: The overall risk of sovereign stress is "moderate" and the debt is "sustainable" in Armenia. After using the fiscal rules' escape clause in 2020-21 as the debt surpassed the 60 percent of GDP threshold during the twin shocks of COVID-19 and the 2020 war, the central government debt declined by 13.7 percentage points of GDP to 46.7 percent of GDP in 2022. The debt-to-GDP ratio is expected to surge to 48.9 percent of GDP by 2027 before declining to 48.5 percent by 2028. Gross Financing Needs (GFN) are projected to remain at manageable levels of 10.0 percent of GDP on average in the medium-term. The uncertainty around the baseline is considerable in medium-term, as debt is highly vulnerable to growth and exchange rate shocks. Fiscal consolidation to build buffers and developing the domestic debt market to diversity funding sources will help guard against risks. In the long-term, large amortization payments and climate adaptation needs may add to the risks to debt profile; however, such risks are expected to be manageable.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure AIV.1. Armenia: Debt Coverage and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					No	
2. Subsectors included in the chosen coverage in (1) above:						

Sector		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	No	Not applicable
CPS / NFPS / GG: expected	4	State governments	No	Data limitations
CPS / NFPS / GG: expected	5	Local governments	No	Data limitations
CPS / NFPS	6	Public nonfinancial corporations	No	Cont. Liab. test activated
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	Data limitations

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

	Basis of recording		Valuation of debt stock		
4. Accounting principles:	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on intra-government debt holdings

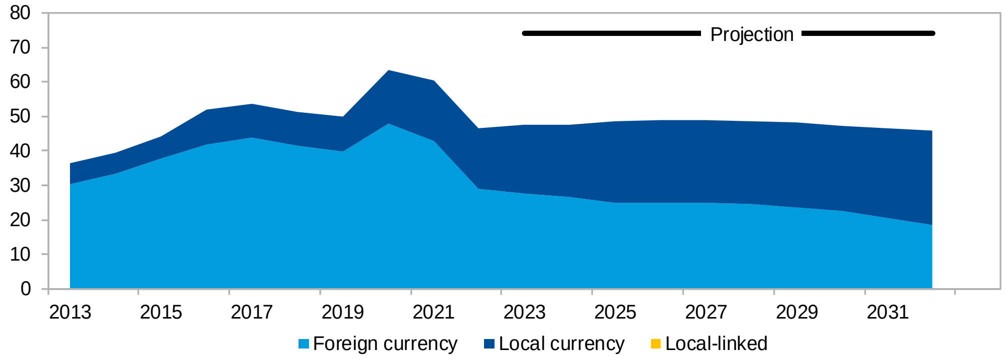
Sector		Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS / NFPS / GG: expected / CG	1	Budget. central govt									0
CPS / NFPS / GG: expected / CG	2	Extra-budget. funds									0
CPS / NFPS / GG: expected / CG	3	Social security funds									0
CPS / NFPS / GG: expected	4	State govt.									0
CPS / NFPS / GG: expected	5	Local govt.									0
CPS / NFPS	6	Nonfin pub. corp.									0
CPS	7	Central bank									0
CPS	8	Oth. pub. fin. corp									0
		Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The debt coverage is central government. Social Security Funds in Armenia are private entities therefore not included in the central government debt coverage. Data on state and local government debt is not available to staff and not published by the authorities as part of the GG debt. However, authorities have initiated legislative changes to broaden the definition of General Government debt to include debt of state and local governments, public sector non-financial organizations and public sector financial organizations and intend to collect and publish the broader general government debt data in future.

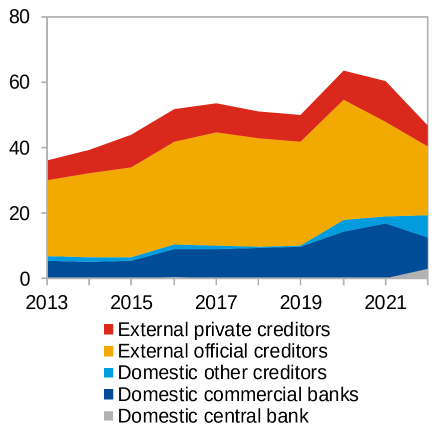
Figure AIV.2. Armenia: Public Debt Structure Indicators

Debt by currency (Percent of GDP)



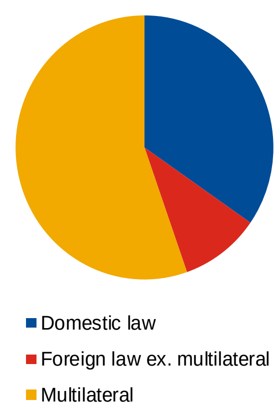
Note: The perimeter shown is central government.

Public debt by holder (percent of GDP)



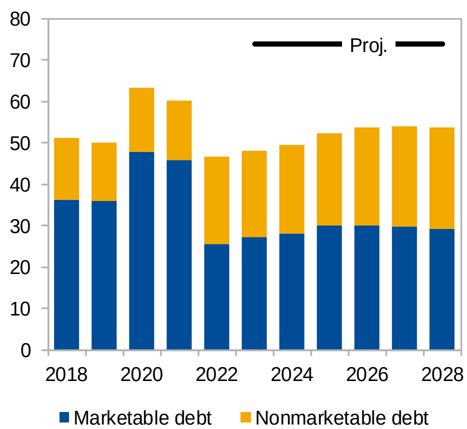
Note: The perimeter shown is general government.

Public debt by governing law, 2022 (percent)



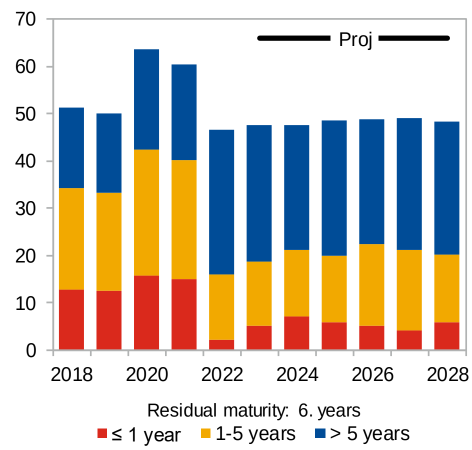
Note: The perimeter shown is general government.

Debt by instruments (percent of GDP)



Note: The perimeter shown is general government.

Public debt by maturity (percent of GDP)



Note: The perimeter shown is general government.

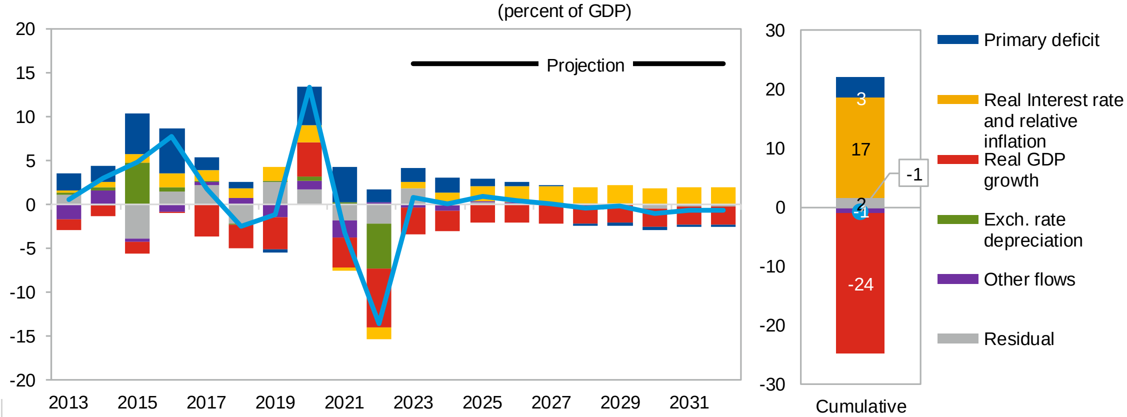
Commentary: The share of foreign currency debt is projected to decline from 62 percent of GDP in 2022 to 51 percent of GDP by 2028 in line with the authorities' objective to reduce reliance on foreign currency debt. The recent US$ 187.6 million (0.8 percent of GDP) buyback of a US$ 500 million outstanding Eurobond due in 2025 through higher domestic market borrowing also supported the objective of reducing foreign currency debt.

Table AIV.2. Armenia: Baseline Scenario
(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public debt	46.7	47.5	47.5	48.4	48.9	48.9	48.5	48.3	47.3	46.6	45.9
Change in public debt	-13.6	0.8	0.0	0.9	0.4	0.0	-0.5	-0.2	-1.0	-0.7	-0.7
Contribution of identified flows	-11.5	-1.0	0.1	0.6	0.3	-0.1	-0.6	-0.3	-0.5	-0.4	-0.4
Primary deficit	1.5	1.6	1.7	0.9	0.5	0.2	-0.3	-0.3	-0.3	-0.3	-0.3
Noninterest revenues	24.3	25.2	25.1	25.2	25.4	25.8	26.2	26.2	26.2	26.2	26.2
Noninterest expenditures	25.8	26.9	26.8	26.1	25.9	26.0	25.9	25.9	25.9	25.9	25.9
Automatic debt dynamics	-13.2	-2.3	-0.9	-0.4	-0.3	-0.2	-0.2	0.0	-0.2	-0.1	-0.1
Real interest rate and relative inflation	-1.3	0.8	1.3	1.7	1.7	1.9	1.9	2.1	1.9	1.9	1.9
Real interest rate	-1.7	0.8	0.8	1.2	1.3	1.4	1.4	1.5	1.4	1.5	1.6
Relative inflation	0.4	-0.1	0.5	0.5	0.5	0.5	0.5	0.6	0.4	0.4	0.4
Real growth rate	-6.7	-3.1	-2.3	-2.0	-2.1	-2.1	-2.1	-2.1	-2.1	-2.0	-2.0
Real exchange rate	-5.1	…	…	…	…	…	…	…	…	…	…
Other identified flows	0.3	-0.4	-0.6	0.1	0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.3	-0.4	-0.6	0.1	0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Contribution of residual	-2.1	1.8	-0.1	0.3	0.2	0.2	0.1	0.1	-0.5	-0.3	-0.3
Gross financing needs	7.6	8.4	9.9	11.7	10.8	10.4	9.3	11.6	10.1	12.8	11.4
of which: debt service	6.1	6.8	8.2	10.8	10.3	10.2	9.6	11.9	10.4	13.1	11.7
Local currency	4.0	3.9	5.9	7.6	8.3	8.5	7.7	8.4	8.0	8.8	8.9
Foreign currency	2.0	2.9	2.3	3.2	2.0	1.7	1.9	3.5	2.5	4.3	2.9
Memo:											
Real GDP growth (percent)	12.6	7.0	5.0	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
Inflation (GDP deflator; percent)	8.1	3.6	4.3	3.9	3.9	3.9	3.9	3.9	3.9	3.9	4.0
Nominal GDP growth (percent)	21.7	10.8	9.6	8.6	8.6	8.6	8.6	8.6	8.6	8.6	8.6
Effective interest rate (percent)	4.7	5.6	6.2	6.7	6.8	7.0	7.1	7.2	7.2	7.4	7.6

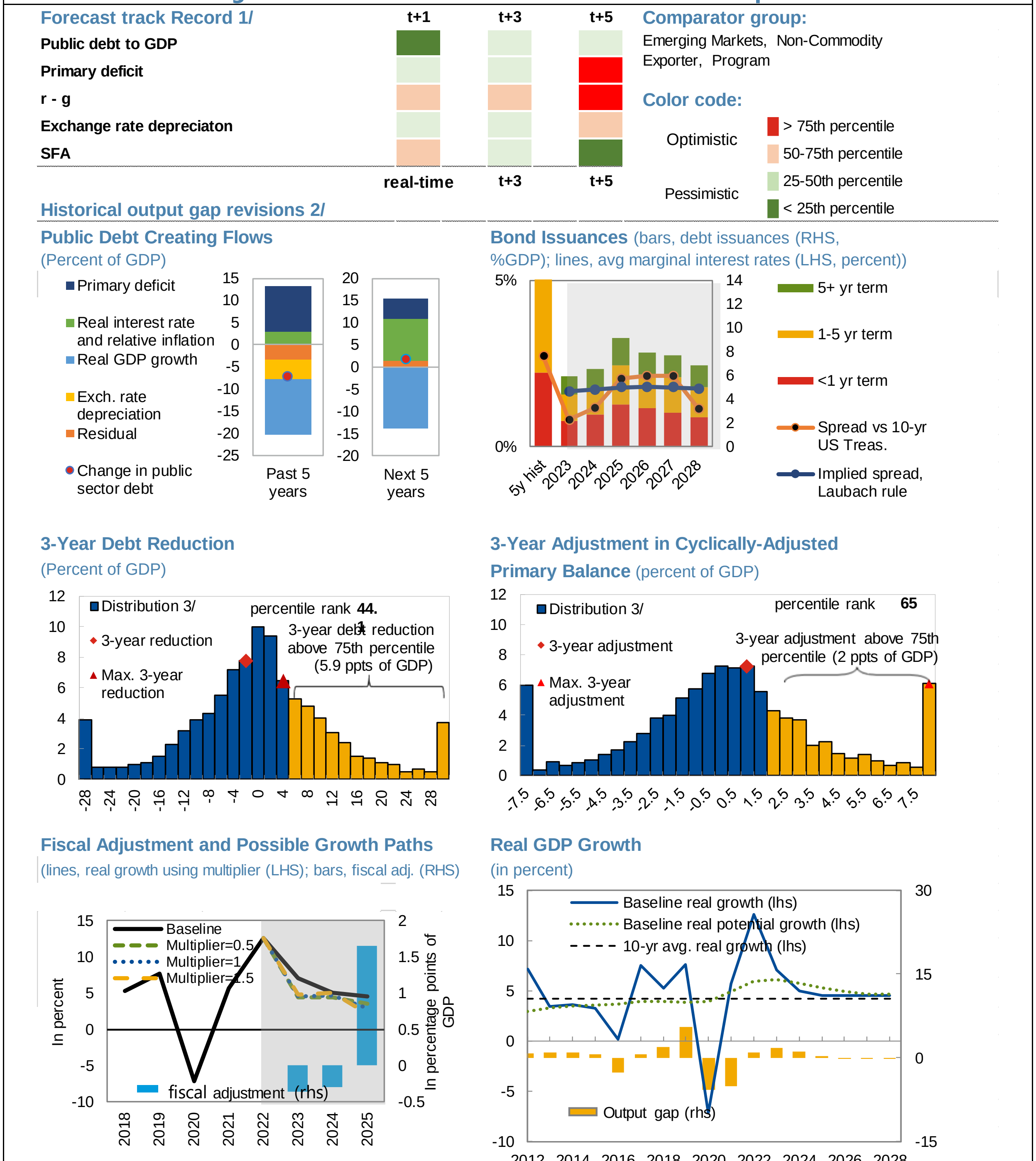
Contribution to change in public debt

(percent of GDP)



Staff commentary: Government debt is expected to remain at comfortable levels of below 50 percent of GDP over the medium-term. The debt surges from 46.7 percent of GDP in 2022 to 48.9 percent of GDP in 2027 but comes down to 48.5 percent of GDP in 2028. GDP growth is projected to be the key contributor in declining debt to GDP ratio in the medium-term. Gross Financing Needs on average remain at comfortable level of 10.0 percent of GDP.

Figure AIV.3. Armenia: Realism of Baseline Assumptions



Commentary: Realism analysis does not point to major concerns: past forecast errors do not reveal any systematic biases and the projected fiscal adjustment and debt reduction are well within norms.

Figure AIV.4. Armenia: Medium-term Risk Analysis

Debt fanchart and GFN financeability indexes

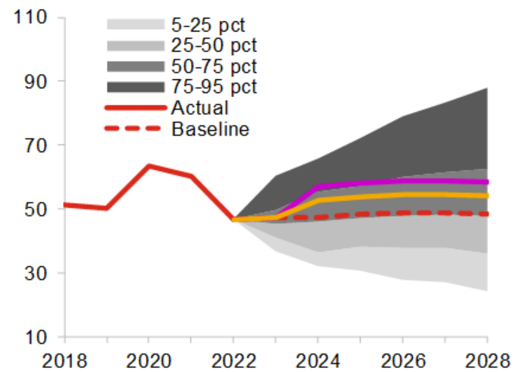
(percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	63.6	0.9	…
	Probability of debt not stabilizing (pct)	44.7	0.4	…
	Terminal debt level x institutions index	29.3	0.6	…
	Debt fanchart index	**…**	**1.9**	**Moderate**
GFN finance-ability module	Average GFN in baseline	10.1	3.4	…
	Bank claims on government (pct bank assets)	14.2	4.6	…
	Chg. in claims on govt. in stress (pct bank assets)	6.6	2.2	…
	GFN financeability index	**…**	**10.3**	**Moderate**

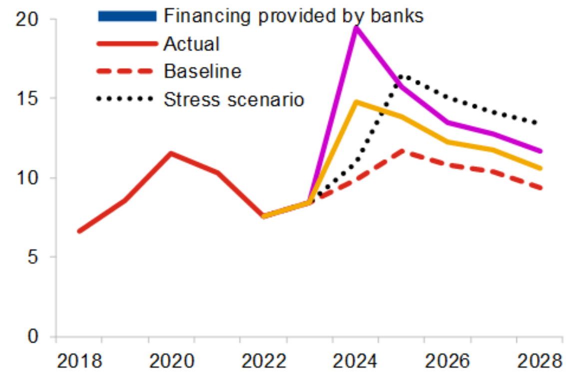
Adv. Econ., Non-Com. Exp, Program: 0 25 50 75 100

Legend: Interquartile range Armenia

Final fanchart (pct of GDP)



Gross Financing Needs (pct of GDP)

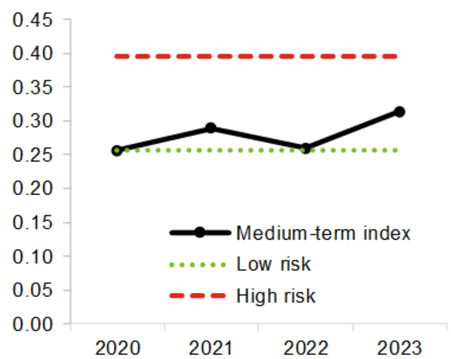


Triggered stress tests (stress tests not activated in gray)

Banking crisis Commodity prices Exchange rate Contingent liab. Natural disaster

Medium-term index

(index number)



Medium-term risk analysis

	Low risk threshold	High risk threhsold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.4
GFN finaceability index	7.6	17.9	0.5	0.2
Medium-term index (MTI)	0.3	0.4	…	0.3, Moderate

Prob. of missed crisis, 2023-2028 (if stress not predicted): 18.2 pct.

Prob. of false alarm, 2023-2028 (if stress predicted): 26.1 pct.

Commentary: Medium-term risk is assessed as moderate in line with the mechanical signal. Both Debt Fan Chart Index and GFN Index show moderate risk. The debt is stabilizing at a comfortable terminal level below 50 percent of GDP in the medium-term. Gross Financing Needs (GFN) are low and stable on average around 10 percent of GDP in the medium term. However, a broad fan chart width – reflecting uncertainty around the baseline – is contributing to a relatively high Debt Fan chart index score. This is because Armenian debt has historically been volatile due to significant vulnerability to growth and exchange rate risks. A customized contingent liabilities (CL) stress test of about 10 percent of GDP has been built-in to account for CL from PPPs as reported in the budget fiscal risk report and potential outstanding bank loans to NK. Further, a natural disaster stress test is also triggered. These shocks could raise GFN by more than 10 percentage points of GDP in the medium term, if materialized. Fiscal consolidation to build buffers and developing the domestic debt market would help guard against growth and exchange rate risks to debt in the medium-term.

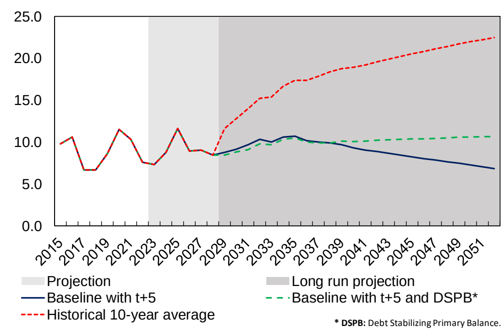
Figure AIV.5. Armenia: Long-term Risk Analysis

Large Amortization Trigger

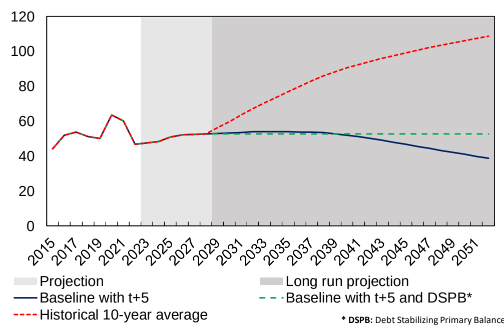
Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

Alternative Baseline Long-term Projections

GFN-to-GDP ratio



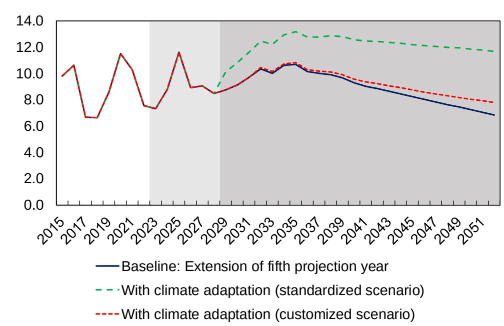
Total public debt-to-GDP ratio



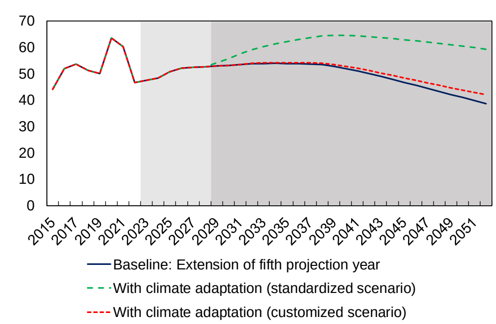
Commentary: Amortization payments are projected to increase including due to Eurobond maturities of $500 million in 2029 and $750 million in 2031 and a large share of long-term debt in both domestic and external borrowings. The historical 10-year average scenario underscores the importance of adhering to the fiscal consolidations targets under the SBA. Over the long-run, debt amortization (both in levels and in % of GDP) will be higher than in the past (reflecting past elevated borrowing) limiting the fiscal space for deviations from the planned fiscal consolidation. However, overall, considering a large share of concessional, multilateral loans in external debt and borrowing from domestic banks as well as non-bank sources, the risks are expected to remain manageable.

Climate Change: Adaptation

GFN-to-GDP ratio



Total public debt-to-GDP ratio



Commentary: In the Baseline scenario (extension of fifth year projection year) climate adaptation costs would slightly increase the debt and GFN levels in the medium-term before declining below 2022 levels in the long-term. The standardized climate adaption module adds a cost of 1.0 percentage points of GDP increase in primary balance per year over the long term, which would raise the peak levels of GFN to 13.2 percent of GDP by 2035 and Debt to 65 percent of GDP by 2040. A more plausible/moderate customized test based on the "unmitigated climate adaptation scenario" of the IMF TA report on "Quantifying fiscal risks from climate change" assumes a 0.4 percentage points of GDP increase in primary balance over the long-term and shows that the debt and GFN levels may surge in the medium-term but then gradually come down to the norm in the long run. Nevertheless, this is a moderate scenario and in case of extreme weather conditions, fiscal costs even higher than those reflected in the standard scenario may materialize, requiring greater public sector resources for climate adaptation.

Table AIV.3. Armenia. Decomposition of Public Debt and Debt Service by Creditor, 2022 /1

	Debt Stock (end of period, residency principle) 2022			Debt Stock (end of period, instrument principle) 2022			Debt Service 7/ 2022	2023	2024	2022	2023	2024
	(In mln. US$)	(Percent total debt)	(Percent GDP)	(In mln.US$)	(Percent total debt)	(Percent GDP)	(In US$)			(Percent GDP)		
Total	10086.35	100	46.7	10086.35	100	46.7		include external guarantees				
External (including guarantees)	5894.07	58.4	27.3	6261.32	62.1	29.0	392.53	479.66	565.51	1.8	2.6	2.7
Multilateral creditors /2	3495.87	34.7	16.2	3495.87	34.7	16.2	213.67	290.63	379.02	1.0	1.6	1.8
IMF	376.74	3.7	1.7	376.74	3.7	1.7						
World Bank	1620.52	16.1	7.5	1620.52	16.1	7.5						
ADB/AfDB/IADB	845.45	8.4	3.9	845.45	8.4	3.9						
Other Multilaterals	653.16	6.5	3.0	653.16	6.5	3.0						
o/w: list largest two creditors												
EDB	331.39	3.3	1.5	331.39	3.3	1.5						
EIB	131.05	1.3	0.6	131.05	1.3	0.6						
list of additional large creditors												
Bilateral Creditors	994.25	9.9	4.6	994.25	9.9	4.6	94.18	104.98	102.46	0.4	0.6	0.5
Paris Club	972.87	9.6	4.5	972.87	9.6	4.5	91.45	102.42	99.95	0.4	0.6	0.5
o/w: list largest two creditors	555.16	5.5	2.6	555.16	5.5	2.6						
Germany/KFW	235.70	2.3	1.1	235.70	2.3	1.1						
RF	319.46	3.2	1.5	319.46	3.2	1.5						
list of additional large creditors												
Non-Paris Club	21.37	0.2	0.1	21.37	0.2	0.1	2.73	2.56	2.51	0.0	0.0	0.0
o/w: list largest two creditors	21.37	0.2	0.1	21.37	0.2	0.1						
Export-Import Bank of China	18.60	0.2	0.1	18.60	0.2	0.1						
Abu-Dhabi Fund for Development	2.77	0.0	0.0	2.77	0.0	0.0						
list of additional large creditors	-											
Bonds /3	1382.74	13.7	6.4	1750.00	17.4	8.1	82.50	82.50	82.50	0.4	0.4	0.4
Commercial creditors	13.74	0.1	0.1	13.74	0.1	0.1	2.18	1.55	1.53	0.0	0.0	0.0
o/w: list largest two creditors		0.0	0.0		0.0	0.0						
Erste Bank/Austria	7.23	0.1	0.0	7.23	0.1	0.0						
Raiffeisen Bank/Austria	4.94	0.0	0.0	4.94	0.0	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	4192.3	41.6	19.4	3825.0	37.9	17.7	695.41	851.10	634.79	3.2	4.6	3.1
Held by residents, total	4192.3	41.6	19.4	3690.0	36.6	17.1	N/A	N/A	N/A			
Held by non-residents, total				111.8	1.1	0.5	N/A	N/A	N/A			
T-Bills	262.0	2.6	1.2	262.0	2.6	1.2	151.26	291.02	0.00	0.7	1.6	0.0
Bonds	3539.8	35.1	16.4	3539.8	35.1	16.4	544.15	560.09	634.79	2.5	3.0	3.1
Loans												
Domestic guarantees	23.3	0.2	0.1	23.29	0.2	0.1	-	10.7	2.5		0.1	0.0
Memo items:												
Collateralized debt /5	0	0	0.0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
o/w: Related												
o/w: Unrelated												
Contingent liabilities												
o/w: Public guarantees	30.76	0.0	0.1	30.76	0.3	0.1	-	11.08	3.19		0.1	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 the line "Domestic" as part of external 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 V. Governance

Introduction

1. Armenia's perception and enforcement of corruption have improved in recent years. Armenia's score on the corruption perception index (CPI) improved notably between 2018 and 2021 from 35 to 49 before decreasing slightly to 46 in 2022 (100 being the best score). Significant legislative and institutional reforms have been launched. High-level corruption cases involving senior ex-officials are now in the courts. Prosecutors have submitted claims to courts requesting to confiscate amounts equivalent to 1.8 percent of GDP although only a small amount has been transferred to the state.

2. Nonetheless, the country remains confronted with high risks of illicit enrichment, especially in specific vulnerable sectors, as recent reforms are yet to become fully effective. Public procurement has long been a key risk for corruption due to limited transparency and insufficient oversight on bidders. The mining sector and state-owned enterprises (SOEs) are also high-risk due to conflict of interest related to politically exposed persons (PEPs). Illicit income obtained offshore also remains difficult to detect. New institutions in charge of corruption prevention and anti-corruption enforcement are yet to build capacity and become fully operational.

Prevention of Corruption

3. The Corruption Prevention Commission (CPC) has a wide legal mandate but lacks resources and tools to improve its effectiveness. Since February 2023, asset declarations are publicly accessible.[1] The compliance rate for filing asset declarations is steadily improving,[2] and sanctions have been initiated for failure to file.[3] The CPC has been given responsibility for expanded analysis and verification powers—including ability to check bank information. However, the CPC lacks sufficient staffing (7 staff verifying 25,000 declarations), adequate software (verification is manual), and automated and direct access to databases from other administrations. The publication format hinders access by foreign civil society organizations, investigative journalists, financial institutions, or law enforcement agencies. Limited sharing of analytical information by the CPC to the Prosecutor General Office, including due to data confidentiality issues (e.g., bank information), results in very few referrals to the Anti-Corruption Commission (ACC).[4]

4. Armenia's Whistleblowing and Freedom of Information (FOI) laws—in existence for a long time—lack a central agency responsible for overseeing their implementation. The

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[1] http://cpcarmenia.am/hy/declarations-registry/.

[2] In 2021 annual declaration were 11,700 and in 2022 annual declaration were 12,500.

[3] 30 proceedings were initiated in 2021, in six of which administrative fines (of AMD 200,000) were imposed. In 2022, 97 proceedings were initiated, in two of which administrative fines (of AMD 200,000) were imposed. In 2023, 19 proceedings were initiated, 16 of which were terminated because the declarations were filed, and three of the proceedings are currently underway.

[4] In 2022, 7 cases were referred to the Prosecutor General's office based on information received by the CPC.

Whistleblowing Protection law provides reporting procedures and an e-platform[5] for anonymous reports but fails to protect whistleblowers, resulting in very few cases of internal reporting.[6] In the case of the FOI law, the onus for sharing information as per the criteria is the responsibility of each agency[7] and should they not comply, the only recourse is to take the agency to court.

5. **The State Audit Chamber (SAC) is a new institution whose capacity and operational independence need strengthening in line with INTOSAI standards.** SAC's legal framework should safeguard its operational independence, including recruitment and dismissal of staff. A risk-based approach to audit should ensure that SAC's limited audit capacity focuses on government agencies' highest vulnerabilities, and a follow-up mechanism should assess the impact of its recommendations. SAC's staff capacity also needs to be enhanced.

6. **Supervisory authorities should ensure that regulated entities are implementing preventive measures related to politically exposed persons.** Armenia's 2015 MONEYVAL Mutual Evaluation Report (MER) found that Armenia lacked legislative measures related to domestic politically exposed persons (PEPs) holding prominent public functions. These measures are crucial for enabling the financial and other AML/CFT regulated sectors to apply risk-based measures in relation to such domestic PEPs. In 2021, Armenia introduced amendments to expand the definition of politically exposed persons and should further ensure their effective implementation by regulated sectors.

7. **Armenia is taking significant measures to improve transparency of beneficial ownership**. The types of legal entities required to provide beneficial ownership information in a centralized registry has been widened, and efforts are ongoing to increase the number of entities recording beneficial ownership information in the register. Further efforts should ensure that the beneficial ownership framework is in line with the recently updated FATF international standards.[8].

Anti-Corruption Enforcement

8. **New anti-corruption law enforcement agencies have been established but have limited resources and need better prioritization.** The Anti-Corruption investigative agency (ACC) was set up in 2021 as the sole anti-corruption investigative body for corruption crimes and will receive all referral corruption cases as of January 2024. The ACC staff comprises investigators and criminal intelligence officers with extended powers (e.g. wiretapping capabilities). The number of pending corruption cases (600+) is growing and need to be prioritized. The Prosecution Service has set up

[5] azdararir.am – Unified Electronic Platform for Whistleblowing.

[6] 75 cases of internal whistleblowing reports recorded.

[7] As per Article 2 (b), the law applies to the activity of the state and local self-government bodies, state offices, organizations financed from the state budget, as well as private organizations of public importance and their state officials.

[8] A good source for guidance for countries on how to effectively implement such requirements is the IMF's Guide to Beneficial Ownership Transparency "Unmasking Control", which is available at https://www.elibrary.imf.org/display/book/9798400208041/9798400208041.xml.

specialist departments (*the Department on Confiscation of Illicit Property* and the D*epartment of Supervision over Legality of Pre-trial Proceedings*) to separate prosecution of corruption crime and civil forfeiture, with 11 prosecutors handling on average 80–90 cases.

9. An anti-corruption court was set up in August 2022. It has specialist judges in civil confiscation and criminal adjudication of corruption crimes. As of August 31, 2023, the court has received 547 criminal corruption cases[9], of which 95 have been disposed of since inception of the court. The court has classified 25 percent of cases as very grave and scandalous and 45 percent as complex. Judges complete on average 20–30 of their 50 assigned cases. The pending 53 illicit asset confiscation cases are yet to go to trial stage keeping the new legislation untested.

10. The ACC and the PGO need better data access, analytical capacity, and international legal cooperation. Lack of access to government databases and interoperability challenges prevents effective detection of fraud and corruption. Lack of professional experience and effective mechanisms for international cooperation and asset recovery hampers anti-corruption efforts.

11. Gaps in the AML/CFT framework and its implementation also impact enforcement measures for laundering of proceeds of corruption. Armenia's mutual evaluation and subsequent 2018 progress report indicated that Armenia lacked criminal sanctions for legal entities. Law enforcement agencies' powers to obtain access to information for use in investigations and prosecutions were also found to be limited. Criminal liability of legal entities was introduced in the new Criminal Code in 2022 and was slated to be in force from January 2023.[10]

12. Improvements to the enforcement and cooperation framework for ML/TF can significantly support detecting and acting against the laundering of proceeds of corruption. In its 2015 MER, Armenia received moderate ratings on effectiveness of financial intelligence function and low ratings on ML investigations and prosecutions and on the consequent confiscation of proceeds. Weaknesses in financial investigations by law enforcement authorities hinder detecting and investigating ML cases. In recent years, law enforcement investigative efforts have increased; however, the number of money laundering convictions reported remain low. Furthermore, Armenia initiated a large number of non-conviction-based confiscation cases.[11] However, in 2021, the UNODC recommended that Armenia enhance domestic and international cooperation.[12]

[9] This figure includes transfers of jurisdictions from other courts where the case had not started trial so migrated to the Anti-Corruption Court.

[10] https://corpgov.am/wp-content/uploads/2023/02/Criminal-Liability-of-Legal-Entities-in-Armenia.pdf

[11] *See also,* US Department of State, Bureau of International Narcotics and Law Enforcement Affairs, *International Narcotics Control Strategy Report*, Volume II Money Laundering, March 2022, https://www.state.gov/2022-incsr-volume-ii-money-laundering-as-submitted-to-congress/

[12] https://www.unodc.org/documents/treaties/UNCAC/WorkingGroups/ImplementationReviewGroup/ExecutiveSummaries2/V2102056_E.pdf.

Recommendations

Prevention

- To enhance the CPC ability to detect illicit enrichment and conflict of interest, link the databases of state registry (beneficial ownership information), asset declaration and public procurement databases.

- Amend the Public Servant Act to ensure that Directors of SOEs and public procurement officers are required to routinely declare their assets and interests.

- Ensure that the asset declaration system is on a public platform that can be easily translated into English.

- Implement the FOI law by assigning responsibility to an entity (perhaps the CPC) to enforce the law in ensuring that state agencies comply with publication requirements.

- Enhance implementation of preventive measures in relation to politically exposed persons.

- Align the beneficial ownership framework with the recently updated FATF international standards.

Enforcement

- Anti-corruption bodies (CPC, ACC and PGO) should develop a strategy for Mutual Legal assistance and international cooperation for both criminal cases of corruption and recovery of foreign assets abroad.

- Enhance the effectiveness of the system for money laundering investigations and prosecutions, taking into account the main risks for money laundering, including corruption, and focus on mitigating money laundering risks by increasing the effectiveness of the confiscation regime.

Annex VI. Implementation of the 2021 Article IV Recommendations

1. The 2021 Article IV Consultation with Armenia took place together with the fourth and fifth reviews under the 2019–22 Stand-By Arrangement (SBA). It focused on: (i) balancing fiscal support with MT sustainability; (ii) managing inflation; and (iii) maintaining financial stability. Medium-term discussions considered three interconnected agendas: (i) boosting export-led growth; (ii) attracting greater FDI while strengthening financial development; and (iii) fostering inclusion and enhanced governance and anti-corruption.

Fiscal Policy

2. The 2021 Article IV Consultation recommended promoting revenue-based, growth-friendly fiscal consolidation and maintaining fiscal sustainability post twin shocks. The key medium-term challenge was to preserve fiscal sustainability and rebuild buffers to guard against future shocks, while creating space for public investment in physical and human capital to raise potential growth. After using the fiscal rule's escape clause during 2020–21, the authorities had committed to bringing the central government debt below 60 percent of GDP by 2026.

3. The authorities have made substantial progress on completing the Article IV recommendations. The fiscal deficit came down to 2.1 percent of GDP in 2022—a reduction by 2½ percentage points of GDP relative 2021, largely on the back of lower current expenditure (3.7 percentage points of GDP) and some revenue gains (0.2 percentage points), while capital expenditures witnessed a welcome surge (1.4 percentage points of GDP). Central government debt declined by around 14 percentage points of GDP to 46.7 percent of GDP due to strong growth, exchange rate appreciation and improvement in the primary balance. Despite a strong GDP growth of 12.6 percent in 2022 and efforts to curb use of cash transactions, tax revenues showed limited buoyancy, reflecting the still significant need for greater quality tax policy measures.

Monetary Policy and Financial Sector

4. The 2021 Article IV Consultation recommended continued strengthening of the inflation targeting (IT) framework, developing capital markets, expanding access to finance, and enhancing the supervisory toolkit. These recommendations have been mostly implemented. Monetary policy has been guided by the IT regime, while anchoring inflationary expectations. Communication between the CBA, banks, and the public has been enhanced, and the CBA is working on a new communication strategy. The newly established over-the-counter commercial trading platform for the overnight repo market is expected to foster participation of private investors in the economy, help develop money markets, and improve the monetary policy transmission. Exchange rate flexibility has been preserved. The CBA has largely intervened only to counter disorderly market conditions. Work to implement Pillar 2 bank capital add-ons is ongoing and the CBA has prepared a roadmap for its completion. The CBA introduced a loan-to-value (LTV) limit for mortgages and increased the capital conservation, systemic risk, and countercyclical capital buffers.

Structural Reforms

5. The structural reforms agenda for the 2021 Article IV Consultation focused on reforms toward rebalancing Armenia's economy toward investment and tradeables with the aim of fostering higher and more inclusive growth.

6. Implementation of structural reforms has advanced. The authorities are working on an employment strategy that aims to boost labor force participation among the vulnerable population. The authorities are developing an export strategy to identify measures to remove export bottlenecks and improve the capacity to export high value-added products. Work is progressing on a concept note for the review of the bankruptcy legislation to strengthen creditors' rights, expedite the recovery of collateral, and improve the overall efficiency of the insolvency process. The authorities have adopted a new anti-corruption strategy, established an economic crime division, and expanded the requirement to file beneficial ownership information to all legal entities. In cooperation with development partners, the authorities are also working to upgrade the e-procurement system.

Annex VII. House Prices Dynamics in Armenia

This annex provides details about the data and model used in the analysis of the drivers of housing prices in Armenia.

1. The linear regression model employed in this analysis integrates a set of explanatory variables of housing prices, mainly focusing on demand-side factors. Value added in the construction sector is used as a proxy indicator for housing supply to test the hypothesis that, while relatively inelastic in the short term, housing supply is significant in affecting housing prices over the long term.

2. The estimation uses quarterly data for 2012Q4–2023Q2, sourced from the Central Bank of Armenia, ARMSTAT, and the IMF International Financial Statistics (IFS) database. Housing price data is provided on a monthly frequency by ARMSTAT. All explanatory variables have been used in lagged first differences. (Table AVII.1)

3. The baseline model is regression 11, which retains variables that proved to be the most robust to different model specifications (Table AVII.2).

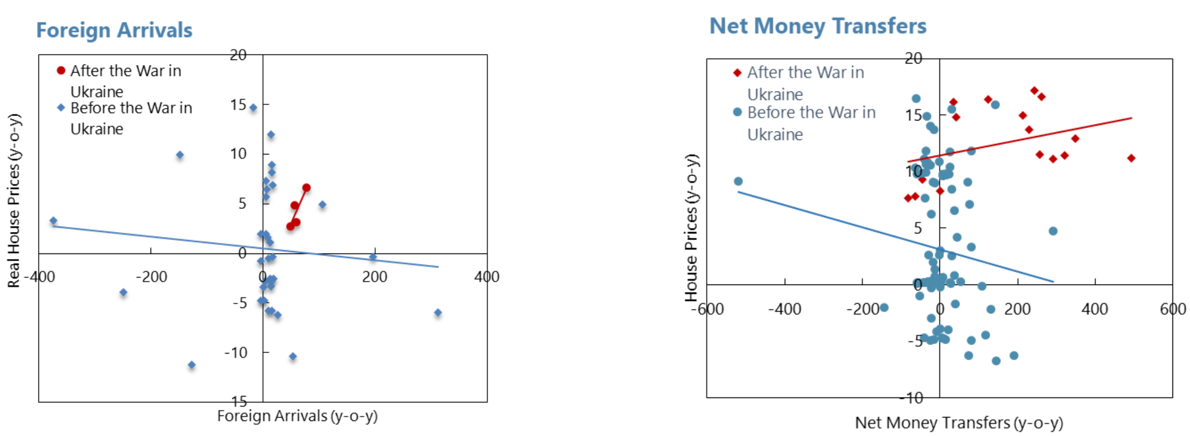
Table AVII.1. Armenia: House Prices Dynamics in Armenia

Dependent variable		
	hpi	Natural log of **Real** house price growth (4 periods). Hpi represents the log change in house prices adjusted for changes in the CPI between the current period and the fourth lagged period.
Independent variables		
General model specification		
1	Wage	Natural log of **Real** wage growth (4 period).
2	Credit to construction	Natural log of **Real** credit to construction, growth (4 periods)
3	Credit to mortgage	Natural log of **Real** credit to mortgage, growth (4 periods)
4	Interest rate	Lagged (2 periods) **Real** interest rate for mortgage lending to individuals.
5	GDP construction	Natural log of **Real** GDP construction growth (4 periods). As a proxy of stock data (supply).
Recent developments and policy variables		
6	Foreign arrivals	Natural log of foreign arrivals growth (4 periods)
7	Tourism	Natural log of BOP tourism credit growth (4 periods).
8	Monetary inflows	Natural log net money inflows growth (4 periods).
9	Nonresident deposits in FX	Natural log of nonresident FX deposit growth (4 periods)
10	Covid	Covid dummy= 1 if qdate >= q(2020q2) & qdate < q(2022q1)
11	War in Ukraine	War in Ukraine dummy if qdate > q(2021q4)
12	Tax reform (mortgage cash back)	Tax reform dummy if qdate > (2017Q4)

Table AVII.2. Armenia: Regression Results

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
	All	Basic before 2020	Basic all timeframe	Credit to construction	Foreign arrivals	Tourism	Monetary inflows	Nonresident deposits in FX	War in Ukraine	War in Ukrain and monetary inflows	Tax reform (mortgage cash back)
Wage	-0.0502	-0.159	-0.0665	-0.0805	-0.0384	-0.0887	-0.0770	-0.0986	-0.150	-0.130	-0.109
	(-0.22)	(-0.34)	(-0.32)	(-0.39)	(-0.17)	(-0.43)	(-0.38)	(-0.46)	(-0.71)	(-0.60)	(-0.57)
Credit to construction	-0.125			-0.0615							
	(-2.05)			(-0.97)							
Credit to mortgage	0.377**	0.556***	0.558***	0.600***	0.537***	0.542***	0.571***	0.546***	0.562***	0.569***	0.379***
	(3.70)	(5.21)	(7.90)	(7.24)	(7.42)	(7.54)	(8.13)	(7.42)	(8.06)	(8.06)	(4.12)
Interest rate	-0.0716	-0.0503	-0.211	-0.144	-0.344	-0.258	-0.122	-0.202	-0.0299	-0.0302	-0.113
	(-0.25)	(-0.19)	(-1.15)	(-0.73)	(-1.67)	(-1.39)	(-0.64)	(-1.09)	(-0.14)	(-0.14)	(-0.66)
GDP construction	-0.174*	-0.190*	-0.193***	-0.182***	-0.204***	-0.187***	-0.203***	-0.187***	-0.207***	-0.209***	-0.215***
	(-2.69)	(-2.61)	(-4.39)	(-4.01)	(-4.54)	(-4.25)	(-4.63)	(-4.13)	(-4.66)	(-4.68)	(-5.25)
Foreign arrivals	0.00645				-0.00817						
	(0.41)				(-1.38)						
Tourism	-0.0169					-0.00419					
	(-1.44)					(-1.14)					
Monetary inflows	0.0291						0.0162			0.0107	
	(1.39)						(1.41)			(0.81)	
Nonresident deposits in FX	-0.0278							0.0186			
	(-0.95)							(0.64)			
Covid	-0.138***		-0.112***	-0.108***	-0.114***	-0.113***	-0.120***	-0.108***	-0.110***	-0.116***	-0.121***
	(-5.58)		(-5.65)	(-5.31)	(-5.66)	(-5.72)	(-5.90)	(-5.13)	(-5.64)	(-5.55)	(-6.57)
War in Ukraine	-0.0342								0.0313	0.0210	
	(-1.06)								(1.42)	(0.82)	
Tax reform (mortgage cash back)	0.0722**										0.0506*
	(2.85)										(2.73)
_cons	-0.170	-0.0535	-0.0406	-0.0469*	-0.0262	-0.0327	-0.0491*	-0.0410	-0.0575*	-0.0576*	-0.0447*
	(-0.32)	(-1.74)	(-1.86)	(-2.06)	(-1.07)	(-1.44)	(-2.20)	(-1.86)	(-2.34)	(-2.33)	(-2.23)
N	38	25	39	39	38	39	39	39	39	39	39
Adj R-squared	0.7951	0.6449	0.7264	0.726	0.7275	0.7289	0.7344	0.7215	0.7346	0.7317	0.7712
rmse	0.0276	0.0315	0.0318	0.0318	0.0318	0.0316	0.0313	0.0321	0.0313	0.0315	0.0291
t statistics in parentheses	="* p<0.05	** p<0.01	*** p<0.001"								

Figure AVII.1. Armenia: War in Ukraine-Related Variables



Sources: National Authorities and Haver (CBA).

Appendix I. Letter of Intent

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

Yerevan, November 16, 2023

Dear Ms. Georgieva:

1. In the attached update to the Memorandum of Economic and Financial Policies (MEFP) from May 22, 2023, we describe our achievements and further policy steps and reforms needed to meet our IMF-supported program objectives.

2. Our economy has shown resilience to multiple shocks and continues to grow robustly, including on the back of strong policy efforts. Despite being hit by multiple shocks, our economy grew by 12.6 percent in 2022 and the growth momentum has continued in 2023. The decisive actions by the central bank helped contain inflation and inflation expectations. Fiscal and external positions have strengthened substantially, and the banking system remains well capitalized and liquid. We met all quantitative performance criteria (QPC) and indicative targets (IT) for end-June and made steady progress toward meeting the structural benchmarks. We will also conduct a consultation with the Executive Board of the IMF on the inflation outlook in line with the monetary policy consultation clause (MPCC).

3. The forced displacement of more than 100,000 people from Nagorno-Karabakh has required a prompt policy response. We have already launched urgent measures for refugee support. Ensuring their basic needs and smooth integration in the country is a priority for us. To this end, it is critical that we refocus our immediate reform efforts, policy, and spending priorities.

4. To better align the program with current developments and facilitate meeting program objectives, we request several modifications to the program. We request that (i) the end-December MPCC be lowered to reflect the recent significant decline in the inflation rate; (ii) the end-December QPC on net international reserves be revised upward; (iii) the September 2023 SB for a concept note on amendments to the insolvency legislation be reset to allow for the completion of public consultation; (iv) the June 2023 SB for the adoption of an employment strategy be reset to allow the completion of necessary survey data and inter-ministerial discussions; (v) the November 2023 SB for an enhanced bank resolution framework be reset to allow completion of consultation with experts and domestic stakeholders; (vi) the December 2023 SB to empower SRC with authority to audit natural persons be reset to better align reform with deployment of universal PIT declarations; (vii) QPCs be set for end-June 2024; and (viii) new structural benchmarks be set as outlined in the attached MEFP.

5. **Based on steps that we have already taken and commitments under the program, we request completion of the second review.** We continue to treat the arrangement as precautionary and will only consider making purchases if our balance of payments deteriorates materially.

6. **We will maintain a close policy dialogue with the Fund and stand ready to take additional measures, as appropriate, to ensure the achievement of our social and economic objectives under the IMF–supported program.** We will continue to consult with the Fund on the adoption of measures, and in advance of any revisions to the policies contained in the attached MEFP in accordance with the Fund's policies on such consultation. We will also provide the Fund with information it requests for monitoring program implementation. Reaffirming our commitment to transparency, we consent to the IMF's publication of this letter, along with the attached MEFP and the Technical Memorandum of Understanding (TMU), as well as the IMF staff report on the second review of the SBA, subject to Executive Board approval.

Yours sincerely,

/s/
Nikol Pashinyan
Prime Minister

/s/
Vahe Hovhannisyan
Minister of Finance

/s/
Martin Galstyan
Governor, Central Bank of Armenia

Attachment I. Memorandum of Economic and Financial Policies

1. This memorandum supplements our memorandum of May 22, 2023, provides information on recent developments, documents our achievements, and discusses further policy steps and reforms needed to meet our IMF-supported program objectives.

A. Recent Economic Developments and Outlook

2. Armenia's strong economic performance has continued in 2023. Real GDP grew by 10.5 percent in 2023H1 supported by expansion in the services, construction, and trade sectors. Unemployment rate—below 14 percent—is at its historic low and putting pressure on nominal wages. Despite this, inflation moved to negative territory in June 2023 (at -0.2 percent (y-o-y) in August), mainly due to base effects, exchange rate appreciation, falling food and transportation prices, as well as tight monetary policy. While core inflation also declined to 0.4 percent in August, service price inflation is stickier. After an unprecedented services trade surplus of 8.8 percent of GDP in 2022, tourism strength has continued in 2023. Amid continued capital inflows, international reserves increased by $100 million. The overall fiscal balance recorded a surplus of 1.3 percent of GDP in 2023H1 and central government debt declined to 43.3 percent of GDP. Banks have ample capital and liquidity buffers, and their profitability continues to remain high.

3. The influx of over 100,000 forcibly displaced people from Nagorno-Karabakh has resulted in a humanitarian crisis. We have responded proactively by providing cash support (100,000 AMD per person regardless of age) to address essential needs, financial aid to cover accommodation and utility expenses (40,000 AMD and 10,000 AMD respectively), core relief items (food, hygiene items, clothing, medication, etc.), and temporary shelters (hotels, guest houses, community buildings. Etc.). We have also conducted a rapid needs assessment in coordination with the UN to guide humanitarian support in close collaboration with donor partners and will undertake a comprehensive assessment of medium to long-term needs including those related to housing, education, and social protection. The large humanitarian and development spending needs are causing additional pressures on the state budget.

4. We expect that growth will decelerate this year but will remain buoyant in the medium term. We project growth to ease, as income and capital inflows moderate, and global and domestic financial tightening continues, but will remain robust, including due to strong export of services and public capital spending. In the medium term, fiscal and monetary policies are expected to steer growth to its long-term trend. Inflation is expected to revert to the CBA's target. The current account is projected to move back into a deficit in 2023 with the increase in imports and decline in income receipts. The risks to the outlook are significant, especially if geopolitical tensions escalate, risks related to political instability rise, projected growth in trading partners falters, or capital inflows reverse abruptly. However, growth could also surprise on the upside in the event of stronger export receipts and a renewed bout of income and capital inflows. Stronger implementation of structural reforms planned under the 2021–26 Government Program and an enabling investment environment could have a positive impact on medium-term growth. The large influx of highly productive migrants, if sustained, could also provide an upside to potential growth. Further, the integration of refugees in the labor force can also boost long-term potential.

B. Economic Policies for the Remainder of 2023 and Beyond

Fiscal Policy

5. We are committed to fiscal prudence and setting our 2024 budget targets in line with the SBA-supported program and the fiscal rules. In 2023, strong growth and revenue administration measures are likely to sustain the ongoing revenue overperformance of about 0.6 percent of GDP, and we will allocate it to humanitarian support to refugees from Nagorno-Karabakh, building fiscal buffers and strengthening institutional resilience. Furthermore, we expect that the humanitarian and development spending in support of the refugee population will remain manageable in 2024. To accommodate this support, as a **prior action**, we will adopt a 2024 budget with an overall deficit of 4.6 percent of GDP. Priority capital spending, focused on roads, schools, kindergartens, and water management, as well as on national security, will be supported by tax revenue enhancing measures.

6. In the medium term, we will continue preserving macro-fiscal stability and supporting Armenia's economic development. We will expand our expenditures by about ½ percent of GDP annually by 2026 to accommodate higher spending on infrastructure development, national security, and healthcare and social protection in line with the 2021–26 Government Program objectives, while also integrating the refugee population in these reform initiatives. This will be supported by an annual increase in tax revenues of about ¾ percentage points of GDP. A moderate medium-term fiscal deficit reduction of about 0.2 percent of GDP annually will keep debt below 50 percent of GDP and protect fiscal stability against exchange rate and growth risks.

7. We are making steadfast progress with fiscal structural reforms.

a. *Revenue mobilization*. Our ongoing tax gap analysis and a forthcoming Tax Administration Diagnostic Assessment Tool evaluation will help identify actions to improve compliance and further raise the tax-to-GDP ratio in the medium term. The implementation of the universal PIT declaration will take place in January 2024, and a tax code amendment to empower SRC to conduct risk-based comprehensive tax inspections of natural persons will support the long-term effectiveness of the reform **(June 2024 SB)**. Our continued revenue administration efforts will be bolstered by new base-broadening tax policy measures and already approved excise rate revisions. To help decrease the revenue gap relative to Armenia's tax potential, we have published a detailed assessment of tax expenditures and an action plan for their rationalization. In this context, during the course of 2023–24, we will submit to parliament tax policy reforms yielding at least 0.75 percent of GDP in additional revenue cumulatively by 2026(**December 2024 SB**). This will include additional measures submitted to the Parliament in 2023.

b. *Public Financial Management*. To raise the implementation rate and quality of government capital expenditures, we conducted a study to identify bottlenecks in the execution of foreign-funded projects and developed an action plan to strengthen the Public Investment Management (PIM) framework and processes. Implementing the plan will ensure an effective cycle of planning, budgeting, implementing, and monitoring of large capital projects. To this end, we will amend the Budget System Law and PIM decree to clarify the definition of public investment projects **(June 2024 SB)**. To contain fiscal risks, we have developed a concept note for a new framework for approval and control of local government borrowing, have started work on developing a concept note for a SOE policy, as well as assessing fiscal risks arising from state-owned enterprises. Further, we will also ensure that PPP-related contingent liabilities are effectively capped. We are in the process of finalizing the terms of reference for a tender on the new Government Financial Management Information System, the completion of which will be further informed by the findings of an ongoing Public Expenditure and Financial Accountability assessment and the upcoming functional review of the Ministry of Finance. Finally, we have drafted revisions to our public debt legislation to broaden the public debt coverage and improve fiscal reporting.

Monetary and Financial Sector Policies

8. The CBA will remain committed to its objective of price stability. Amid deflationary pressures and to guide inflation to the CBA's target of 4 percent, we have lowered the policy rate by 125 basis points to 9.5 percent since June 2023. Nonetheless, in view of the significant uncertainty to the inflation outlook, we will continue to monitor closely economic developments and stand ready to take necessary policy actions to ensure that inflation expectations remain anchored. The uncertain medium- and long-term economic environment requires that our inflation targeting framework be strengthened with a new communication strategy and a new approach sensitizing policy decision making to greater risks to the outlook. To this end, ahead of the adoption of the new approach, we will publish a comprehensive review of the CBA's monetary policy framework, decision making arrangements, capacities, and transparency requirements.

9. We are taking measures to mitigate the buildup of risks from rising house prices and fast-growing mortgage lending. The increased countercyclical capital buffer of 1.5 percent of risk-weighted assets became effective in August 2023, enhancing banking sector resilience to adverse shocks. We continue to monitor closely the housing market risks and stand ready to deploy additional macroprudential tools to address vulnerabilities. We have produced draft stress scenarios to assess the impact of house price and income shocks on property developers, households, and baking sector balance sheets. To reduce bank risks associated with the construction industry, the Government has submitted draft amendments to the Civil Code to limit the use of funds in escrow accounts by property developers.

10. We are advancing our efforts to further improve our supervisory toolkit and capacity. We have developed a formal roadmap for the introduction of Pillar 2 bank capital add-ons, which will be determined on the basis of assessments from the supervisory review and evaluation process of banks (SREP). To this end, we will submit to parliament an amendment to the Central Bank Law to give supervisors the power to impose early intervention measures in the context of SREP. Furthermore, to better assess the risks in the banking system against the backdrop of rapid growth in the banks' balance sheet and volatile interest rates, with IMF technical advice, we will conduct an impact study of the interest rate risk in the banking book (IRRBB), using the methodologies indicated in the Basel framework (**December 2024 SB**). We have also advanced the drafting of a law on bank resolution following Financial Stability Board's Key Attributes for effective resolution, which will be submitted to Parliament by June 2024 (**June 2024 SB**).

Structural Reforms

11. We remain committed to advancing structural reforms and strengthening the economy's resilience to future shocks.

a. *Labor market.* Our employment strategy—currently under preparation—aims to achieve growth of highly productive non-agricultural employment in communities that include regional cities, and to improve the employment prospects of non-learning and non-working youth, women aged 30–40, and capable to work persons of beneficiary families (**June 2024 SB**). We will pilot several active labor market programs (including work practice and vocational training) and introduce ex-post mechanisms to evaluate the impact of such schemes on employment rates for the targeted groups. To strengthen evidence-based employment policy and its implementation, the strategy will also plan for the modernization of labor market data processes, including data collection, processing, production and timely dissemination by the Statistical Committee (ARMSTAT). These improvements will facilitate thorough assessment of labor market conditions, enabling more effective policy decision-making.

b. *Access to finance*. The upgrading of our insolvency legislation will require extensive consultation with public and private stakeholders. To this end, we are working towards the adoption of a concept note for the drafting of amendments to the insolvency legislation, which will increase the protection of creditor rights, improve the efficiency of insolvency processes, upgrade the restructuring toolbox, and increase the capacity and accountability of insolvency administrators (**January 2024 SB**). We are also completing the revision of our corporate governance code, which will be approved by end-2023.

c. *Trade diversification*. We have advanced the preparation of our export strategy. We intend to encourage diversification in the country's export basket and markets, by addressing (i) bottlenecks to trade expansion and (ii) the capacity to export high value-added products in third countries.

d. *Governance*. We recognize the importance of good governance, transparency, and accountability for improving Armenia's business environment. We will take steps to ensure compliance with the Freedom of Information Law; strengthen our whistleblowing protection regime; advance the Corruption Prevention Commission's analytical capacity to detect conflict of interest and illicit enrichment; and bolster the enforcement and prevention capacity of Armenia's anti-corruption bodies.

C. Program Monitoring and Safeguards

12. The program will continue being monitored through quantitative performance criteria, indicative targets (Table 1), a monetary policy consultation clause, and structural benchmarks (Tables 2a and 2b). The third and fourth reviews are expected to be completed on or after June 10, 2024, and December 11, 2024, respectively.

13. The CBA will continue maintaining a strong safeguards framework and internal controls environment. The IMF safeguards assessment mission completed in June 2023 confirmed that the CBA maintains a strong safeguards framework and has well established safeguards in its external and internal audit arrangements, and sound financial reporting practices. The CBA will take the necessary steps to implement the safeguards recommendations, particularly in relation to governance modalities, including to support effective monetary policy; legal framework; and institution-wide risk management, including for development lending to banks and subsidiaries of the central bank.

Table 1. Armenia: Quantitative Performance Criteria and Indicative Targets 1/

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

	2022				2023										2024					
	Dec [2/]				Mar. [3/]		Jun. [2/]				Sep. [3/]		Dec. [2/]		Mar. [3/]		Jun. [2/]		Sept [3/]	Dec. [3/]
	Target	Adjusted Target	Act.	Status	Indic. Target	Act.	Target	Adjusted Target	Act.	Status	Indic. Target	Act.	Target	Rev. Target	Indic. Target	Rev. Target	Target	Rev. Target	Target	Target
Performance Criteria																				
Net official international reserves (stock, floor, in millions of U.S. dollars) [4/]	1,600	1,457	1,703	Met	1,531	1,721	1,654	1377	2,125	met	1,556	2,286	1,506	2,010	1,509	2,021	1,513	1,796	1,632	1,801
Program fiscal balance (flow, floor) [5/9/]	-384		-321	Met	-124	54	-211		77.0	met	-314	-102	-465	-465	-121	-121	-198	-198	-336	-519
Budget domestic lending (cumulative flow, ceiling) [9/]	5		0.3	Met	10	0	10		0.0	met	10	0.0	10	10	10	10	10	10	10	10
External public debt arrears (stock, ceiling, continuous criterion)	0		0	Met	0	...	0		0	met	0	0	0	0	0	0	0	0	0	0
MPCC [6/]																				
Inflation (upper-outer band, inflation consultation, percent)	12.5				11.5		8.0				7.5		7.0	5.0	6.5	6.5	6.5	6.5	6.5	6.5
Inflation (upper-inner band, percent)	11.5				10.5		7.0				6.5		6.0	4.0	5.5	5.5	5.5	5.5	5.5	5.5
Inflation (mid-point, percent)	10.0		8.3	Not Met	9.0	5.4	5.5		-0.5	Not met	5.0	0.1	4.5	2.5	4.0	4.0	4.0	4.0	4.0	4.0
inflation (lower-inner band, percent)	8.5				7.5		4.0				3.5		3.0	1.0	2.5	2.5	2.5	2.5	2.5	2.5
Inflation (lower-outer band, inflation consultation, percent)	7.5				6.5		3.0				2.5		2.0	0.0	1.5	1.5	1.5	1.5	1.5	1.5
Indicative Targets																				
New government guaranteed external debt (stock, ceiling, in millions of USD) [7/]	100		0	Met	100	0	100		0	met	100	0	100	100	100	100	100	100	100	100
Social assistance spending of the government (flow, floor) [8/9/]	65.0		75.9	Met	20.0	...	40.1		41.7	met	60.1	64.6	80.2	80.2	22.0	22.0	44.0	44.0	69.0	94.0

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/ September 2023 data are preliminary.

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

6/ 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.

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

8/ Excluding Eurobond. Calculated as the change in the stock.

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

8/ 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.

9/ Cumulative limit.

Table 2a. Armenia: Prior Actions and Structural Benchmarks under the SBA

Deadline	Status	Macro Criticality	Responsible Agency	Measure
Fiscal Policy and Fiscal Structural Reforms				
December 2022	Met (prior action)	Ensure macro-fiscal stability	MOF	Adopt 2023 budget with an overall deficit of around 3 percent of GDP.
March 2023	Met (prior action)	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.
March 2023	Met	Improve tax compliance	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.
June 2023	Met	Mobilize tax revenue	MOF/SRC	Publish a detailed assessment of tax expenditures and an action plan for their rationalization.
June 2023	Not met (Implemented with delay)	Improve public financial management and reduce fiscal risks	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	Not met (Implemented with delay)		MOF	Develop a concept note on monitoring, approval, and control framework related to local governments and local government borrowing.
December 2023	Proposed to be rescheduled to June 2024	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.
December 2023		Improve efficiency of civil service compensation	MOF	Publish the terms of reference to develop software design for the implementation of a module with basic employee data as part of the new public sector accounting system of the Government Financial Management Information System (GFMIS), with the aim to improve central government wage bill data quality.
March 2024		Improve public financial management	MOF	Complete a functional review of the Ministry of Finance, as a step towards an eventual review of all general government institutions.
			MOF	Adopt a Concept Note for a State Ownership Policy, defining the rationale for owning SOEs and the government's role in their oversight.
Monetary Policy and Financial Sector Reforms				
March 2023	Met	Capital market development	CBA	Facilitate the introduction of an over-the-counter commercial trading platform for the overnight repo market.
June 2023	Met	Strengthen the regulatory and supervisory framework	CBA	Develop a formal roadmap for introduction of Pillar 2 capital buffers.
November 2023	Proposed to be rescheduled to June 2024		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.

Table 2a. Armenia: Prior Actions and Structural Benchmarks under the SBA (Concluded)

December 2023		Mitigate real estate market risks	CBA	Conduct a thorough macro-financial stress testing exercise with an adverse scenario that implies a rise in balance sheet stress of property developers, significant deterioration of household income, and a sharp decline in house prices
March 2024		Enhance monetary policy transparency	CBA	Prepare and adopt an enhanced CBA communication strategy on monetary policy.
Structural Reforms				
June 2023	Met	Infrastructure development	DPM/MOF/MTAI	Conduct a study to identify bottlenecks in the execution of foreign-funded projects.
June 2023	Not met (Proposed to be rescheduled to June 2024)	Enhance labor force participation and boost employment.	MLSA	Approve a costed employment strategy, including to bolster active labor market policies.
September 2023	Not met (Proposed to be rescheduled to January 2024)	Improve the business environment	MOI	Draft and submit the concept paper on the review of the legislation on bankruptcy.
September 2023	Met ahead of schedule		MOE	Expand the agricultural insurance scheme to cover more risks, regions, and crops.
December 2023		Improve the business environment	MOE	Approve the newly revised corporate governance code.
March 2024		Support export-oriented growth	MOE	Complete and approve an export strategy that identifies and streamlines bottlenecks to export expansion.

Table 2b. Armenia: Proposed Modifications of Structural Program Conditionality

Deadline	Status	Macro Criticality	Responsible Agency	Measure
Fiscal Policy and Fiscal Structural Reforms				
Prior Action		Prevent overheating of the economy	MOF	Adopt a 2024 budget with an overall deficit of 4.6 percent of GDP.
June 2024	New proposed structural benchmark	Improve public financial management	DPM/MOE/MOF	Amend the Budget System Law and PIM decree to clarify the definition of public investment projects in both legal frameworks.
June 2024	Rescheduled to better align reform with deployment of universal PIT declaration	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.
December 2024	New proposed structural benchmark	Mobilize tax revenue and improve progressivity	MOF/SRC	Submit to parliament, during the course of 2023–24, tax policy reforms yielding at least 0.75 percent of GDP in additional revenue cumulatively by 2026.
Monetary Policy and Financial Sector Reforms				
June 2024	Rescheduled from November 2023 to complete consultation with experts and other stakeholders.	Strengthen the regulatory and supervisory framework	CBA/MOF	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.
December 2024	New proposed structural benchmark.		CBA	Conduct an impact study of the interest rate risk in the banking book (IRRBB), using the methodologies indicated in the Basel framework.
Structural Reforms				
June 2024	Unmet June 2023 SB. Rescheduled to complete cabinet discussions.	Enhance labor force participation and boost employment.	MLSA	Approve a costed employment strategy that details plans to bolster active labor market policies and modernize labor market statistics to inform the implementation of employment policies.
January 2024	Unmet September 2023 SB. Rescheduled to complete public consultations.	Improve the business environment and access to finance.	MOJ	Adoption and submission to Cabinet of the concept note for insolvency reform, aiming to increase the protection of creditor rights, improve the efficiency of insolvency processes, upgrade the restructuring toolbox, and increase the capacity of insolvency administrators.

Attachment II. Technical Memorandum of Understanding

1. This memorandum sets out understandings between the Armenian authorities and the IMF staff regarding the definition of performance criteria (PCs) and indicative targets (ITs), adjusters, and data reporting requirements for the Standby Arrangement as per the Letter of Intent and Memorandum of Economic and Financial Policies (LOI/MEFP) dated November 16, 2023.

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 2023 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 2023 test date.

Inflation Consultation Bands

	Dec-23	Jun-24
Upper outer band	5.0	6.5
Upper inner band	4.0	5.5
Center point	**2.5**	**4.0**
Lower Inner band	1.0	2.5
Lower outer band	0.0	1.5

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 the government subject to rescheduling.[2] This PC is to be monitored continuously by the authorities

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

[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).

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.

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.

[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.

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. Finally, the floor on the program fiscal balance will be adjusted downward by a cumulative maximum of AMD 350 billion to the extent that the Republic of Armenia assumes the debt of NK in a manner that ensures no further fiscal support.

- **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	CBA foreign exchange operations, (exchange rate, volume)	Daily	Within 1 day
	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 allocated by commercial banks	By currency and maturity	Weekly	First working day of the next week
	T-bill and coupon bond financing, CBA securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Monthly	First working day of the next month
	Banking data	loan maturities;	Monthly	Within 25 days of the end of

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
				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
	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)

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
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 government (NCEs)	Quarterly	Within 60 days of the end of each quarter
	Consolidated general government	Central and local governments, and NCEs that belong within the general government	Annual	Within 180 days of the end of each year
	Budget execution	All cash receipts, cash expenditures, including domestic and external debt-service payments, external and domestic borrowing and lending operations, and inflow of grants to the central government; expenditure data will be provided according to both economic and functional classifications, consistent with the GFSM2001	Monthly	Within one month following the end of each month.

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		methodology		
National Statistical Service	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 additional revenue to be collected from risk-based audits	Monthly	Within 45 days of the end of each quarter (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.

1/ USD cross rates.

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

Table 2. Armenia: External Disbursements through the CBA in 2023–24 1/

(In millions of U.S. dollars)

	Sep-23 Prog.	Dec-23 Prog.	Mar-24 Prog.	Jun-24 Prog.	Sep-24 Prog.	Dec-24 Prog.
Budget support grants	0	17	0	0	0	19
Budget support loans	104	250	0	0	0	330
Project support grants	21	36	11	11	21	39
Project financing loans	123	236	15	60	152	341
CBA project loans	46	76	10	30	50	70
EEU transfers	0	0	0	0	0	0
Privatization proceeds	0	0	0	0	0	0
Amortization	-386	-467	-57	-145	-204	-293

1/ Cumulative during the year.

Attachment III. Consultation with the IMF Executive Board on the Missed Inflation Target Under the MPCC

Consultation on Breach of MPCC Target in June 2023.

Central Bank of Armenia

November 16, 2023

In June 2023, 12-month CPI inflation declined to -0.5 percent, 3.5 percentage points below the lower bound of the inflation consultation band of 3.0 percent, agreed under the SBA. This letter explains: (1) the reasons why inflation has breached the lower limit of the inflation consultation band; and discusses: (2) the policy response and (3) the outlook of inflation.

1. Inflation deviation from the consultation band

Over the first half of 2023, inflation has been rapidly decelerating driven by both external and domestic factors, which we briefly discuss below:

Global economy and international prices

A substantial downward adjustment in international commodity prices, particularly in food and energy sectors, for the past year have significantly decreased inflation among our trading partners and in Armenia. The 12-month inflation in Armenia declined from 8.3 percent in December 2022 to -0.5 percent in June 2023, primarily due to lower prices of imported food and non-food products, with subsequent secondary effects impacting other components of the CPI basket. In particular, food price inflation—which accounts for more than 45 percent of Armenia's CPI basket—declined from 7.8 percent in December 2022 to -5.5 percent in June 2023.

Appreciation of the exchange rate

Since the beginning of last year, Armenia has experienced significant capital and financial inflows. At the same time, there has been a considerable surge in international visitors and tourists seeking Armenian goods and services. These factors have resulted in a considerable appreciation of the Armenian dram. As such, the appreciation helped contain the underlying inflationary pressures stemming from strong demand. Due to existing lags in pass-through and inherent uncertainty, most of the transmission was observed in the first half of 2023, further contributing to the deceleration of imported prices.

Constrained domestic demand

In 2022–23, economic growth significantly accelerated in Armenia, leading to a considerable increase in domestic income. However, domestic demand did not respond proportionally to the rise in income, and households and businesses accumulated substantial savings due to the uncertain economic outlook. While recent months have shown signs of a recovery in domestic consumption, the relatively restrained domestic demand kept inflationary pressures subdued in the first half of 2023.

To summarize, lower-than-projected global demand and commodity prices, the gradual pass-through of exchange rate appreciation and relatively contained domestic demand have all contributed to the deceleration of headline inflation below the lower bound of the monetary policy consultation band.

2. Policy response

Since December 2020, the CBA has tightened monetary policy, in response to inflationary pressures arising from the rapid global and domestic demand recovery in 2021 and the Russian–Ukrainian conflict in 2022. The CBA's proactive policy was able to effectively anchor inflation expectations and achieve a significant deceleration in inflationary pressures, which started to play out in early 2023.

In June 2023, the CBA began an easing cycle, cumulatively reducing the policy rate by 100 basis points by September 2023 in response to an easing of inflationary risks. However, despite the swift decline in headline inflation, inflationary pressures persisted due to underlying demand factors, which support wages and service prices.

The CBA remains committed to its policy strategy, aimed at controlling demand, stabilizing inflation expectations, and guiding inflation towards the CBA's 4 percent target in the medium-term horizon.

3. Inflation outlook

In September 2023, the 12-month inflation in Armenia stood at 0.1 percent. Growth of the imported core components of the CPI basket decelerated. However, inflation in non-regulated services and other goods with sticky prices remains relatively elevated, at around 6.6 percent in August. Under the CBA's current projection scenario, once the deflationary external pressures diminish, headline inflation is expected to gradually rise. Easing of monetary policy will also contribute to guiding inflation back to the target. We project that the 12-month inflation will remain below the target in the near future, before gradually increasing and stabilizing around the 4 percent target in the medium term.

In the view of remaining uncertainties related to the geopolitical situation, economic outlook and future inflationary developments, the CBA continues to closely monitor the global and domestic economic situation, and stands ready to respond accordingly in fulfilment of the price stability objective.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

November 17, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR MODIFICATIONS OF PERFORMANCE CRITERIA AND MONETARY POLICY CONSULTATION CLAUSE—INFORMATIONAL ANNEX

Prepared By

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

CONTENTS

FUND RELATIONS

(October 31, 2023)

Membership Status:

Joined 05/28/1992; Article VIII

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	128.80	100.00
Fund holdings of currency	448.04	347.86
Reserve Tranche Position	0.15	0.12

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	211.44	100.00
Holdings	38.88	18.39

Outstanding Purchases and Loans:	**SDR Million**	**Percent of Quota**
Stand-by Arrangements	283.06	219.76
Extended Arrangements	36.22	28.12

Latest Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-By	Dec 12, 2022	Dec 11, 2025	128.80	0.00
Stand-By	May 17, 2019	May 03, 2022	308.80	308.80
EFF	Mar 07, 2014	Jun 27, 2017	82.21	82.21

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

	Forthcoming				
	2023	2024	2025	2026	2027
Principal	31.62	128.55	99.85	45.10	14.17
Charges/Interest	6.89	22.05	14.99	11.18	9.08
Total	38.50	150.60	114.84	56.27	23.24

Safeguards Assessment

A Safeguards Assessment was conducted in mid-2023. The assessment found that the Central Bank of Armenia (CBA) maintains well-established operational controls and its external and internal audit arrangements and financial reporting practices are largely aligned with international standards. Despite some improvement, the authorities should further strengthen the oversight roles of the Board and the Audit Committee against their current focus on their regulatory role. Legal amendments continue to be needed, mainly to provide a clear delineation of responsibilities between the Board and executive levels and to strengthen the CBA's financial autonomy, including through stronger recapitalization provisions and budgetary autonomy.. Furthermore, the CBA should define a clear strategy to implement its Board-approved plan to exit non-core activities and to assess and effectively mitigate the risks of channeling development lending from IFIs to financial institutions. Finally, with the support of the requested TA, the CBA should develop a comprehensive approach to enterprise risk management. The authorities have requested IMF TA on CBA governance arrangements and legal framework.

Exchange Rate Arrangement

Exchange Rate
(AMD/USD)

Source: Haver (Financial Times).

The *de jure* arrangement is "free floating." The CBA intervenes in the foreign exchange market only to smooth excessive exchange rate volatility, defined as short-term, high-frequency exchange rate movements caused by speculative or trend-following elements rather than underlying macroeconomic fundamentals. The CBA intervenes anonymously mainly via auctions of foreign exchange, or openly in the interbank market, or through the stock exchange. There is no fundamental policy change and the CBA's commitment to maintaining a flexible exchange rate regime remains steadfast. The de facto exchange rate arrangement is classified as "stabilized." The de facto methodology for classification of exchange rate regimes is based on a backward-looking statistical approach that relies on past exchange rate movement and historical data. Therefore, this reclassification does not imply statements or views on future or intended policies nor does it imply a policy commitment on the part of the country authorities. Exchange rate has appreciated on account of large capital inflows in 2022-23 (text Figure). Every day, the CBA publishes official exchange rates. Effective March 1, 2022, the calculation methodology for the official exchange rates published by CBA was changed and the average exchange rate of the Armenian dram relative to US dollar is calculated as an arithmetic average of volume-weighted average of USD bought, AMD sold transactions and volume-weighted average of USD sold, AMD bought transactions.

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

Article IV Consultations

The previous Article IV consultation with Armenia was concluded on December 17, 2021.

FSAP Participation and ROSCs

A joint World Bank-IMF mission assessed Armenia's financial sector as part of a Financial Sector Assessment Program (FSAP) update during June 26–July 11, 2018. The Financial Sector Stability Assessment report was approved by the Executive Board in November 2018.

Resident Representative

Mr. Umang Rawat, since August 2023

Technical Assistance

The following table summarizes the Fund's technical assistance (TA) to Armenia since 2012.

Armenia: Technical Assistance from the Fund, 2012–23

Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Public financial management	Short-term	November 2012	MoF
Tax administration	Short-term	April 2013	MoF, SRC
Tax administration	Short-term	September 2013	MoF, SRC
Public finance management	Short-term	October 2013	MoF
Tax administration	Short-term	December 2013	MoF, SRC
Public finance management	Short-term	March 2014	MoF
Fiscal risk	Short-term	November 2014	MoF
Tax administration (LTI)	Short-term	April, 2015	MoF

Armenia: Technical Assistance from the Fund, 2012–23 (Continued)			
Customs administration	Short-term	May, 2015	MoF
Public financial management	Short-term	May-June-September 2015, February, May 2016	MoF
Tax Policy	Short-term	Nov-15	MoF
Fiscal risk management	Short-term	April-2015, June-July 2015	MoF
		May 2016, April-May 2017	
		May, 2018	
Public finance management	Short-term	Apr-15	MoF
Evaluate tax reform and revise draft legislation	Short-term	November, December 2015	MoF
Fiscal rules	Short-term	June-July, 2017	MoF
Tax administration	Short-term	March 2018, February, 2019	MoF, SRC
Fiscal Transparency Evaluation	Short-term	April, 2018	MoF
Public Investment Management Assessment (PIMA)	Short-term	June-July, 2018	MoF
Tax policy promoting trade sector and property taxation	Short-term	July, 2018	MoF
Public finance management (PFM)	Short-term	April, September 2018 February, 2019	MoF
PIMA follow-up and medium-term budgetary framework	Short-term	February, 2019	MoF
PFM First review of the rolling baseline State Budget Preparation	Short-term	November, 2019	MoF
Tax administration	Short-term	November, 2019	MoF
PFM Budget Preparation	Short-term	December, 2019	MoF
PFM Budget Preparation: enhancing the implementation of the new rolling baseline SBP	Short-term	January, 2020	MoF

Armenia: Technical Assistance from the Fund, 2012–23 (Continued)			
Tax administration	Short-term	March, 2020	MoF
PFM: Budget Preparation 2 of 2 [COVID-19-Virtual]	Short-term	April, 2020	MoF
Tax administration: Preparing a Compliance Strategy	Short-term	May, 2020	SRC
PFM: Budget Preparation	Short-term	June, 2020	MoF
Tax and Custom Administration CRM	Short-term	August, 2020	SRC/MoF
PFM: Budgeting and Public Asset Management	Short-term	October, 2020	MoF
PFM: PPP workshop	Short-term	November, 2020	MoF
Tax and Custom Administration CRM Implementation		February, 2021	SRC/MoF
PFM: Public investment management	Short-term	April, 2021	MoF
Tax Gap – 1st visit	Short-term	April, 2021	SRC
Tax Policy: Taxation of Financial Instruments	Short-term	April, 2021	MOF
Tax Policy	Short-term	May, 2021	MOF
Tax Administration	Short-term	May, 2021	SRC
Tax Administration	Short-term	June, 2021	SRC
PFM-Budget Preparation	Short-term	July, 2021	MOF
Tax Administration	Short-term	July, 2021 - August, 2021	SRC
Tax Administration	Short-term	August, 2021 - April, 2022	SRC
Tax Administration	Short-term	September, 2021 - March, 2022	SRC
PFM-Budget Preparation	Short-term	October, 2021 - April, 2022	MOF
PFM-Budget Preparation	Short-term	November, 2021 - February, 2022	MOF

Armenia: Technical Assistance from the Fund, 2012–23 (Continued)			
Public Sector Wage Bill	Short-term	November, 2021 - December, 2022	MOF
PFM - Fiscal Risk Management	Short-term	November, 2021 - January, 2022	MOF
Tax Policy	Short-term	January, 2022	MOF
Tax Administration	Short-term	January, 2022 - February, 2022	SRC
Public Sector Wage Bill	Short-term	February, 2022	MOF
Tax Administration	Short-term	March, 2022 - April, 2022	SRC
Tax Administration	Short-term	May, 2022	SRC
Tax Administration	Short-term	June, 2022	SRC
PFM - Fiscal Risk Management	Short-term	July, 2022	MOF
PFM - Budget Preparation	Short-term	July, 2022 - September, 2022	MOF
Tax Policy	Short-term	August, 2022 - October, 2022	MOF
Tax Administration	Short-term	August, 2022 - September, 2022	SRC
Tax Administration	Short-term	January, 2023 - April, 2023	SRC
PFM - Fiscal Risk Management	Short-term	January, 2023	MOF
Tax Administration	Short-term	February, 2023	SRC
Tax Policy	Short-term	March, 2023 - April, 2023	MOF
Tax Administration	Short-term	April, 2023	SRC
Public Investment Management	Short-term	April, 2023	MOF
Tax Policy	Short-term	May, 2023	MOF
PFM - Fiscal Risk Management	Short-term	May, 2023	MOF

Armenia: Technical Assistance from the Fund, 2012–23 (Continued)

Public Investment Management	Short-term	May, 2023	MOF
Tax Administration	Short-term	May, 2023	SRC
Tax Administration	Short-term	June, 2023 – July, 2023	SRC
Tax Administration	Short-term	On-going	SRC
PFM – Budget Preparation and GFMIS support	Short-term	On-going	MOF
PFM – Fiscal Risk Management	Short-term	On-going	
Legal Department			
AML/CFT	Short-term	Various	MoF
Monetary and Capital Markets Department			
FSAP update	Short-term	February 2012	CBA
Inflation targeting (with IMF Research Dept.)	Short-term	February-March 2012	CBA
Inflation targeting	Short-term	November 2012	CBA
Inflation targeting	Short-term	January 2013	CBA
Bank prudential framework	Short-term	April 2013	CBA
Monetary and foreign exchange policy	Short-term	June 2013	CBA
Central Bank communication	Short-term	April 2014	CBA
Inflation targeting	Short-term	April 2014 April, November 2015	CBA
TA needs assessment for the Central Bank	Short-term	August, 2016	CBA
Inflation targeting	Short-term	March, September 2016	CBA

Armenia: Technical Assistance from the Fund, 2012–23 (Continued)			
Financial Stability Assessment Program (FSAP)	Short-term	February, July, 2018	CBA, MoF
Inflation-indexed bonds and domestic bonds market development	Short-term	September, 2018	CBA, MoF
Capital Markets Development Program	Short-term	March, 2020	MoF/CBA
Monetary and Forex Operations and Market Developments	Short-term	April, 2021	CBA
Debt Management	Short-term	February, 2023	CBA, MOF
Statistics Department			
National accounts	Short-term	April 2012	SC
Monetary statistics	Short-term	April 2012	CBA
National accounts	Short-term	May 2012	SC
Monetary statistics	Short-term	October 2012	CBA
Construction Price Index	Short-term	September 2013	SC
Price Statistics: Diagnostic	Short-term	Oct-17	SC
Quarterly National Accounts	Short-term	January-February 2018	SC
Consumer Prices/Producer Price	Short-term	April, 2018	SC
Price Statistics	Short-term	November, 2018	SC
National Accounts Statistics	Short-term	March, 2019	SC
Consumer/Producer Price Index	Short-term	May, 2019	SC
Government Finance Statistics	Short-term	December, 2019	MoF/SC
Consumer Price Index / Residential Property Price Index	Short-term	January, 2020	SC
Government Finance Statistics	Short-term	January, 2021	MoF/SC

Armenia: Technical Assistance from the Fund, 2012–23 (Concluded)			
National Accounts	Short-term	June, 2021	SC
Government Finance Statistics	Short-term	September, 2021	MOF/SC
External Sector – BOP	Short-term	October, 2022	CBA
Government Finance Statistics	Short-term	October, 2022 - November, 2022	MOF/SC
National Accounts	Short-term	December, 2022	SC
Real Sector Prices	Short-term	July, 2023	SC
Government Finance Statistics	Short-term	On-going	MOF/SC
Institute for Capacity Development			
Developing a model-based framework for FPA	Short-term	January-February, April, July, October-November 2018, January-February 2019	MoF
Customized Training on Model-Based Monetary Policy Analysis and Forecasting	Short-term	July, 2019	MoF/CBA
Customized Training on DSGE models for Fiscal Policy Analysis	Short-term	November, 2019	MoF
Documentation for Fiscal Strategy Model	Short-term	April, 2020	MoF
Financial Programming and Policies	Short-term	November, 2020	MoF
Macroeconomic Frameworks	Short-term	July, 2023	MOF

RELATIONS WITH THE WORLD BANK GROUP AND OTHER IFIS

(As of November 2023)

Information about Armenia's relations with the World Bank Group and other international financial institutions can be obtained from the following webpages.

The World Bank Group	https://www.worldbank.org/en/country/armenia
European Bank for Reconstruction and Development	https://www.ebrd.com/armenia.html
Asian Development Bank	https://www.adb.org/countries/armenia/main

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General: 1. **Data provision by Armenia is broadly adequate for program monitoring and surveillance but has some shortcomings.** Program series, as defined in the Technical Memorandum of Understanding (TMU), are provided with the required timeliness. The program monetary variables, as specified in the TMU, are defined in a consistent manner. However, further improvements in real, fiscal, and external sector statistics would be desirable to facilitate enhanced design and monitoring of economic policies. Accordingly, CCAMTAC and STA TA activity has picked up, focusing on improving the accuracy of annual and quarterly GDP estimates and developing institutional sector accounts; implementing GFS 2014 through the newly established GFS working group at the Ministry of Finance and publishing a public sector balance sheet; supporting the development of a residential property price index (RPPI); and improving the coverage of cross-border activity of IT companies registered in Armenia and services sector exports, especially tourism.
National Accounts: 2. **The National Statistics Service (NSS) compiles and disseminates annual and quarterly national accounts.** The NSS also compiles and disseminates annually a full set of accounts (up to financial accounts) for the total economy and by institutional sectors. Recent TA has focused on improving financial sector accounts and balance sheets and updating the reference year of chain-linked volume estimates of GDP to 2013. As of 2015, the NSS has been preparing the national accounts under the methodology of the *System of National Accounts 2008 (2008 SNA).* GDP under this new methodology has been extended back to 2012, and there are plans to also cover earlier years. 3. **The accuracy of the annual estimates of the national accounts is undermined by the lack of exhaustive source data for informal activities and of appropriate price and volume indicators, particularly for construction activities.** Construction output volume measures are derived by deflating current values with a price index for output, which uses weights and base year prices from a survey in 1984. To improve volume measures of construction, the NSS has started compiling a new construction output price index based on more sound methodology. Until the new construction price index becomes available, the NSS should use other indicators for deriving construction aggregates at constant prices. The NSS should also implement new surveys to derive a proper benchmark for informal activities. 4. **The quality of source data and compilation procedures in national accounts needs to improve further.** The size of household survey data is too small to appropriately calculate household consumption expenditure and some of exports data are underreported, which leads to underestimation of net exports. On the expenditure approach, changes in inventories are mainly

derived as a residual and consequently volatile enough to cause for concern in economic analysis. In addition, the production approach has data collection issues, particularly in measuring agricultural outputs. Collecting the data in an inconsistent way has contributed to volatility in measured agricultural output.

Price Statistics:

5. The CPI covers 10 large population centers and Yerevan. The CPI weights are updated annually. Concepts and definitions used in the compilation of the CPI are broadly in line with international standards, and source data and compilation techniques are generally adequate.

Government Finance Statistics:

6. The budget execution reporting system compiles government finance data on a cash basis, supplemented with monthly reports on arrears and quarterly reports on receivables and payables. Daily revenue and cash expenditure data for the central government are available with a lag of one to two days and monthly data on central government operations are disseminated one month after the reference period. A treasury single account (TSA) was introduced in 1996, and all bank accounts held by budgetary institutions were closed, except for project implementation units (PIU) that are required by donors to operate with commercial bank accounts. However, these PIU accounts also are included in the TSA.

7. Since 2008, budget law has imposed a budget classification based on the Government Finance Statistics Manual 2001 (GFSM 2001). However, improvements are needed in the application of the economic and functional classification of expenditures to ensure accurate presentation of expenditures in particular with respect to ensuring that data on wages and salaries are comprehensive, as the wages for military personnel, teachers, and doctors are reported in the category of goods and services and other expense, rather than as a wage item. In addition, the extensive use of other expense categories by some budget data reporters requires addressing.

8. Since 2018, the balance of the single taxpayer accounts has been removed from government tax revenues, but this change has not been reflected in individual tax categories. Rather, there is a residual item reflecting the lump sum adjustment. As a result, the classifications of the tax components and total tax revenues are not fully consistent.

9. Government finance statistics are generally limited to the consolidated budget which includes both central and local budgetary units. However, significant numbers of additional units have been provisionally identified as meeting the definition of general government units, including state and local noncommercial organizations (NCOs), public foundations, and some public joint stock companies. National GFS publications cover only the consolidated budget while annual GFS data disseminated to the IMF's Statistics Department also includes state NCOs but not the other general government units.

10. The MoF is working on plans to reform the management and reporting of fiscal data. These reforms including the introduction of a new Government Financial Management Information System (GFMIS), the implementation of Armenian Public Sector Accounting Standards (based on the International Public Sector Accounting Standards) and establishment of a working group to oversee the implementation of improvements to the government finance statistics.

Monetary and Financial Statistics:

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

12. Financial Sector Surveillance. CBA regularly reports to the IMF 12 core financial indicators (FSIs) and 10 out of 12 additional FSIs for deposit takers and 4 for the other sectors, including household debt to GDP, on a quarterly basis in a timely manner, using the new report forms in line with the methodologies recommended by the 2019 *FSIs Guide*. CBA reports data on some key series of the Financial Access Survey (FAS), including mobile and internet banking, mobile money, and the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

External Sector Statistics:

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

14. Quarterly data on the international investment position are published by the CBA within one quarter after the reference period, and the annual data at end-March; and are also provided for publication in IFS.
II. Data Standards and Quality
15. Armenia subscribes to the IMF Special Data Dissemination Standard (SDDS) since November 2003. Armenia's latest SDDS Annual Observance Report is available on the Dissemination Standards Bulletin Board.

Armenia: Common Indicators Required for Surveillance
(As of November 6, 2023)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	October 2023	11/3/2023	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	September 2023	10/26/2023	D	D	M
Reserve/Base Money	September 2023	10/26/2023	D	D	D
Broad Money	September 2023	10/26/2023	M	M	M
Central Bank Balance Sheet	September 2023	10/26/2023	D	M	M
Consolidated Balance Sheet of the Banking System	September 2023	10/26/2023	M	M	M
Interest Rates[2]	September 2023	10/16/2023	M	M	M
Consumer Price Index	October 2023	11/3/2023	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]— General Government[4]	Q3 2023	10/15/2023	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Q3 2023	10/15/2023	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	September 2023	10/20/2023	M	M	Q
External Current Account Balance	Q2 2023	9/29/2023	Q	Q	Q
Exports and Imports of Services	Q2 2023	9/29/2023	Q	Q	Q
Exports and Imports of Goods	September 2023	25/10/2023	M	M	M
GDP	Q2 2023	08/21/2023	Q	Q	Q
Gross External Debt	Q2 2023	9/29/2023	Q	Q	Q
International Investment Position[6]	Q2 2023	9/29/2023	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA).

Statement by Vladyslav Rashkovan, Alternate Executive Director, and Michel Scholer, Advisor for the Republic of Armenia
December 11, 2023

On behalf of the Armenian authorities, we would like to express our appreciation for the diligent work and constructive approach of Mrs. Petrova, her team, and the Resident Representative Office headed by Mr. Rawat in preparing this second review under the Stand-By Arrangement (SBA). We are grateful for the Fund's steadfast support to Armenia throughout challenging times over the past years marked by the COVID-19 pandemic and geopolitical tensions in the region and beyond.

Despite this difficult external environment, the authorities have once again demonstrated strong program ownership by comfortably meeting all quantitative performance criteria and indicative targets, as well as making considerable progress on structural benchmarks. Only the end-June headline inflation rate breached the lower-outer band of the Monetary Policy Consultation Clause on account of base effects and external factors. **Against this background, the authorities request completion of the second review under the SBA and commit to maintaining a close policy dialogue with the Fund, while treating the arrangement as precautionary**. While noting that the exchange rate will remain the key shock absorber, the authorities are convinced that the SBA remains an important insurance against external shocks and positively complements their structural reform agenda aimed at building an export-led, investment-driven, and knowledge-based economic growth model.

Macroeconomic developments & outlook

The authorities share staff's assessment of strong economic growth in 2023 driven by expanding services, construction, and trade sectors, which benefitted from sound economic fundamentals and policies, as well as the influx of foreign exchange, migrants, and businesses. In the wake of this solid performance, the unemployment rate has fallen to a historic low of below 14 percent. Despite the resulting pressure on nominal wages, inflation has quickly subsided thanks to decisive actions by the Central Bank of Armenia (CBA). Notwithstanding a return to a current account deficit after a temporary improvement in 2022, Armenia's external position remains broadly in line with the level implied by fundamentals and desirable policies.

At the same time, the authorities are more sanguine about the medium-term outlook, as they believe that their comprehensive reform agenda and substantial investment program will have a more significant impact on growth potential than expected by staff. While the authorities thus maintain their objective of raising potential growth to 7 percent over the medium-term, they are cognizant of large uncertainty and significant downside risks, notably related to developments in the region and major trading partners. On inflation, the authorities share staff's expectation of a return to the 4 percent target.

Fiscal policy

Consistent with the strong economic performance, the fiscal outturn has been better than anticipated. Revenues, driven by strong growth of tax bases (consumption, imports, profit, and wage growth), have performed above expectations and are expected to surpass the 2023 budget targets. Despite higher-than-expected expenditures to accommodate the influx of over 100'000 people from Nagorno-Karabakh, the authorities will meet the program objective of a fiscal deficit below 3.0 percent. Meanwhile, gross debt is expected to remain below 50 percent of GDP and is assessed to be 'sustainable with high probability'.

Next year, the fiscal deficit is expected to widen temporarily to provide for the humanitarian and development support to refugees from Nagorno-Karabakh. The full fiscal impact of their influx can however only be assessed at a later stage, as their successful integration into the labor force could also boost growth and fiscal revenues. In line with the authorities' strong commitment to fiscal prudence, in the years to come the authorities will continue preserving macro-fiscal stability while supporting Armenia's economic development. With that in mind, the authorities will maintain priority capital spending to further bolster the country's resilience.

Meanwhile, the authorities continue the steadfast implementation of fiscal structural reforms. Continued efforts to strengthen revenue administration, together with new base-broadening tax policy measures, will bring the country closer to the government's objective of a 25 percent tax-to-GDP ratio by 2026. On top of the roll-out of the universal PIT declaration in early 2024, the authorities expect improved administration capacity to yield significant new revenues. In line with program objectives, the authorities are also committed to submitting additional tax policy reforms that would raise at least 0.75 percent of GDP in additional revenue.

On the expenditure side, the authorities aim to build on progress to improve the public investment framework and management of fiscal risks. To this end, the authorities are continuing the implementation of the action plan to ensure an effective cycle of planning, budgeting, implementing, and monitoring of large capital projects. Furthermore, concept notes have been, or are being, developed to contain fiscal risks stemming from local government borrowing and state-owned enterprises.

<u>Monetary & financial sector policies</u>

As outlined above, the CBA's decisive and proactive policy actions have effectively anchored inflation expectations and achieved a significant deceleration in inflationary pressures. This put the CBA into a position to begin an easing cycle in June 2023 with a cumulative reduction of the policy rate by 125 basis points. Yet, in the face of large uncertainty, the CBA will continue to closely monitor economic developments and stands ready to take necessary actions to ensure that inflation expectations remain anchored, and inflation returns to the 4 percent target over the medium-term.

Furthermore, the CBA remains committed to implementing its new risk-based approach to price stability in early 2024. To ensure its success, the change will be accompanied by several actions to further strengthen communication, transparency, and staff capacity.

The financial sector has remained sound over the past year, supported by high capital and liquidity levels. Nonperforming loans also remain very low at 2.8 percent of gross loans. As the authorities share staff's assessment of the real estate market as a pocket of vulnerability, they have taken measures to mitigate the buildup of risks, notably by increasing the countercyclical capital buffer and improving the CBA's stress-testing capacity. Relatedly, the government has submitted draft legislation to limit the use of funds in escrow accounts by property developers.

To further bolster the sector's medium-term resilience, the CBA is steadily progressing on measures to strengthen the CBA's supervisory toolkit and capacity. In line with staff advice, the authorities have developed a roadmap to introduce Pillar 2 bank capital add-ons and aim to give supervisors the power to impose early intervention measures. Moreover, the authorities have made substantial progress on aligning the bank resolution framework with the Financial Stability Board's Key Attributes for effective resolution and reiterated their commitment to finalize this work by June 2024.

Structural policies

The current government's key economic priority is to develop a knowledge-based, export-oriented, investment-driven, and private-sector-led growth model for the Armenian economy, aimed at reducing poverty and enhancing social protection.

Work is advancing on a new employment strategy, which is a central element of that ambition. Notwithstanding delays due to the lagged release of labor market statistics, which the authorities are committed to reducing, the authorities are piloting active labor market programs with ex-post mechanisms to assess their impact. Ultimately, the strategy seeks to increase labor force participation and reduce unemployment among vulnerable groups, notably women and the youth.

In order to improve the business environment, the authorities are working on several measures to facilitate access to finance and strengthen good governance. Adopting a concept note for amending the insolvency legislation to strengthen the protection of creditor rights, improve the efficiency of processes, and upgrade the restructuring toolbox is thus a priority. The authorities are also finalizing the revision of the corporate governance code before the end of the year. Following up on several significant reforms to strengthen good governance, the authorities will take further steps to fully integrate the new institutions into both the preventive and the enforcement anti-corruption frameworks.

In line with staff's advice, the authorities are committed to diversifying their export basket and markets. To that end, they have advanced work on a new export strategy that will address bottlenecks to trade expansion and increase the country's capacity to export high-value-added products.

Program performance & modalities

In keeping with their strong track record, the authorities have once again comfortably met all end-June quantitative performance criteria and indicative targets, while making significant progress on structural benchmarks. Only the end-June headline inflation rate breached the lower-outer band of the Monetary Policy Consultation Clause on account of base effects and external factors. Despite some slight delays – partly due to unforeseen external developments –, the authorities remain fully committed to the program objectives and parameters, which are closely aligned with their reform agenda thus ensuring a high degree of ownership. **Nevertheless, some amendments relative to the sequencing and timing of conditionality are warranted**. Thus, the structural benchmarks related to the insolvency legislation, employment strategy, and bank resolution framework are rescheduled for various reasons – though their objectives remain unchanged. In addition, given the substantial inflation reduction, the authorities share staff's proposal to reset the MPCC.

Moreover, the financial parameters of the program are sound. The large financial and human capital inflow and the resulting appreciation of the dram have allowed further accumulation of foreign exchange buffers, bringing international reserves to 135 percent of the ARA metric. In addition, the program is fully financed for the next 12 months, with good prospects for adequate financing for the remainder of the program. And Armenia's capacity to repay is strong, given moderate public debt and a downward trajectory of external debt.

Finally, in June 2023, a separate mission to Armenia confirmed that the CBA maintains a strong safeguards framework and sound financial reporting practices. The CBA is fully committed to further bolstering that framework in line with the Fund's recommendations.