November 2009
IMF Country Report No. 09/316

Republic of Armenia: Second Review Under the Stand-By Arrangement, Request for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Rephasing of Purchases—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director and Advisor for the Republic of Armenia.

In the context of the second review under the Stand-By Arrangement, request for waiver of nonobservance of performance criterion, modification of performance criteria, and rephasing of purchases for the Republic of Armenia, the following documents have been released and are included in this package:

- The staff report for the Second Review Under the Stand-By Arrangement, Request for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Rephasing of Purchases, prepared by a staff team of the IMF, following discussions that ended on September 16, 2009, with the officials of the Republic of Armenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 14, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Press Release summarizing the views of the Executive Board as expressed during its October 30, 2009, discussion of the staff report.

- A statement by the Executive Director and Advisor for the Republic of Armenia.

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

Letter of Intent sent to the IMF by the authorities of the Republic of Armenia*
Technical Memorandum of Understanding*
Statistical Annex/Appendix*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

Second Review Under the Stand-By Arrangement, Request for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Rephasing of Purchases

Prepared by the Middle East and Central Asia Department
(In Consultation with Other Departments)

Approved by Ratna Sahay (MCD) and Ranil Salgado (SPR)

October 14, 2009

- **Stand-By Arrangement:** A 28-month Stand-By Arrangement (SBA) in the amount of SDR 368 million (400 percent of quota) was approved by the Executive Board on March 6, 2009 (Country Report No. 09/140). Given the rapidly worsening economic situation, an augmentation in the amount of SDR 165.6 million (180 percent of quota) was approved on June 22 at the time of the first review (Country Report No. 09/214). Given that this review combines what were the second and third reviews under the original schedule, the authorities are requesting that SDR 37.2 million become available upon completion of this combined review.
- **Mission:** A staff team visited Yerevan during September 2–17, 2009. The team comprised M. Lewis (head), A. Bibolov, A. Bordon, C. Sdralevich (all MCD), A. ElGanainy (FAD), E. Gemayel (SPR), and D. Saeju (MCM). Mr. Friedman (OED) joined the discussions. The mission was assisted by N. Oomes (Resident Representative), A. Manookian, and A. Stepanyan (both from the Resident Representative office). The mission met with the prime minister, the ministers of finance and economy, the Governor of the Central Bank of Armenia, and representatives of the donor community and the private sector.
- **Program status:** The program remains broadly on track. The authorities met all quantitative performance criteria for end-June and end-September, with the exception of the end-September fiscal balance. All structural benchmarks for end-June and end-September were also implemented. The authorities request a waiver of nonobservance for the end-September fiscal balance performance criterion given the minor and temporary nature of the deviation. Staff supports this request, as well as the authorities' request for completing this review.
- **SDR allocation:** The authorities intend to use the proceeds of the recent SDR allocation to further bolster their international reserves.
- **Publication:** The Armenian authorities have consented to the publication of the staff report and the attached Letter of Intent.

Contents Page

EXECUTIVE SUMMARY

The effects from the global crisis continue to weigh heavily on the Armenian economy, but the authorities have adapted their policies rapidly and appropriately. Starting in late 2008, following the drop in metals prices and the downturn in Russia, economic and financial conditions in Armenia worsened rapidly. The large depreciation in March 2009 helped to improve competitiveness without threatening financial stability. The subsequent monetary and fiscal easing helped mitigate the impact of the crisis on output and the poor, while preserving macroeconomic stability. The authorities have largely adhered to the program targets and have continued to implement their structural reform program.

Real GDP is now expected to contract by over 15 percent in 2009, with inflation remaining low. Relative to the previous projection of a 10 percent real GDP contraction, this mostly reflects a collapse in the construction sector, which had in recent years grown rapidly to become close to 30 percent of GDP, and is now adjusting to the end of the remittance-fueled boom. Nonetheless, output appears to have stabilized. Inflation remains low, but could increase as a result of higher international prices and the exchange rate pass-through.

The authorities have considerably eased fiscal policy in 2009, and plan to gradually reduce the fiscal deficit starting in 2010. Despite the large drop in tax revenues, external financing from the Fund and other donors have allowed the authorities to largely implement planned budget expenditures, while increasing spending on priority infrastructure projects. As a result, the fiscal deficit is expected to widen to 7.5 percent of GDP this year. The 2010 budget envisages a gradual consolidation, with the deficit falling to just below 6 percent of GDP.

Despite a significant easing in monetary policy, credit growth has continued to decline. Given the weak transmission mechanism, high dollarization, and higher credit risk, monetary easing is translating into a build-up in liquidity in the banking system rather than higher credit growth. The Central Bank of Armenia (CBA) is now trying to mop up some of the excess liquidity, and is considering a more neutral stance in the months ahead.

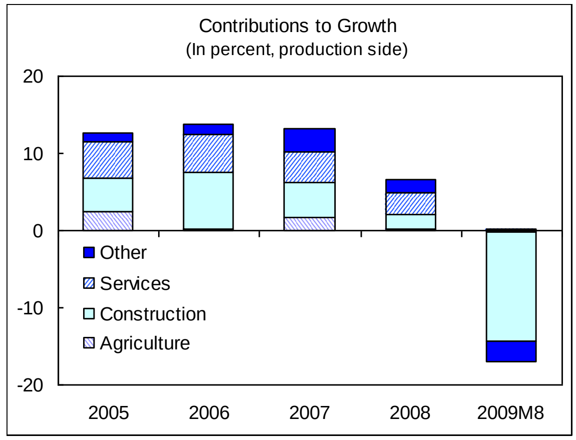
The exchange rate has recently seen more flexibility. Following the return to a floating regime in March, the exchange rate initially remained broadly stable. However, more recently, the CBA has more strictly adhered to its new intervention strategy that allows the exchange rate to be largely market determined.

The banking sector remains sound, despite a worsening of its loan portfolio. Capital and liquidity ratios continue to be high and the leverage ratio low, providing a strong buffer to the economic crisis, as reflected by the latest stress tests. However, the downturn could further lead to a deterioration in asset quality. In this setting, lending activity has recently abated, reflecting a combination of supply and demand factors.

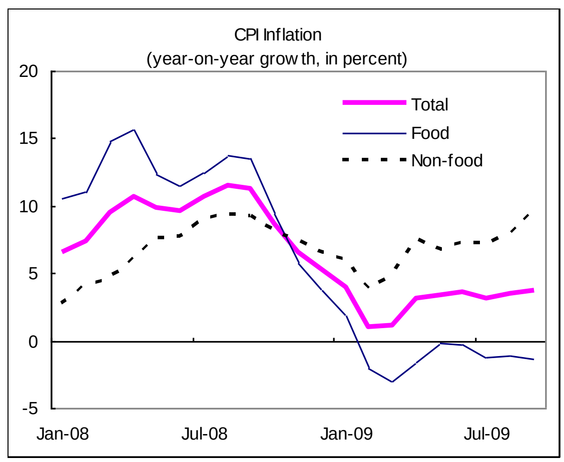
I. Background

1. **The effects from the global crisis continue to weigh heavily on the Armenian economy.** Starting in late 2008, following the drop in metals prices and the downturn in Russia, economic and financial conditions in Armenia worsened rapidly. In response, the authorities successfully implemented a swift package of reforms, including the return to a floating exchange rate regime, and stepped up measures to maintain financial stability.

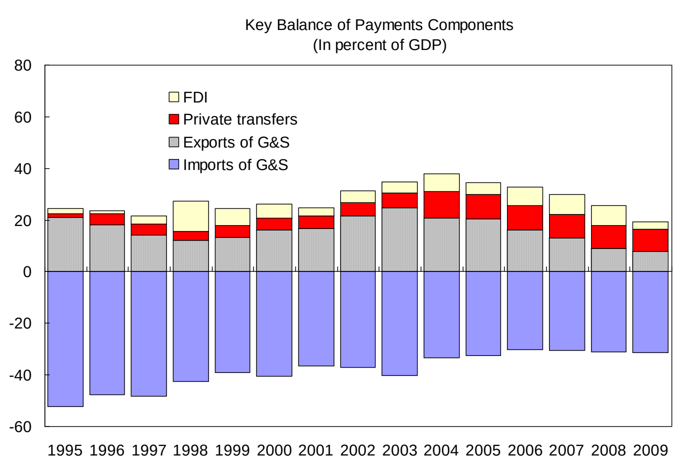
2. **The second-round effects of the crisis have led to a dramatic fall in output, with the unwinding of the remittance-fueled construction boom that had driven growth in recent years** (Box 1). As a result, real GDP fell by 18½ percent through the first eight months of 2009, with about ¾ of this decline due to a plunge in construction output. Other sectors, such as agriculture and services, have been much less affected by the crisis.



3. **Output appears to have stabilized in the last few months, while inflation has remained low.** Preliminary data suggest that the fall in construction output and real estate prices is coming to an end. Rising metals prices, together with a weaker dram, are helping the mining sector to recover. Government support to these and other sectors is also contributing to the recovery (Box 2). Despite the March depreciation, annual inflation has remained at about 3½ percent, given weak domestic demand and low import prices.

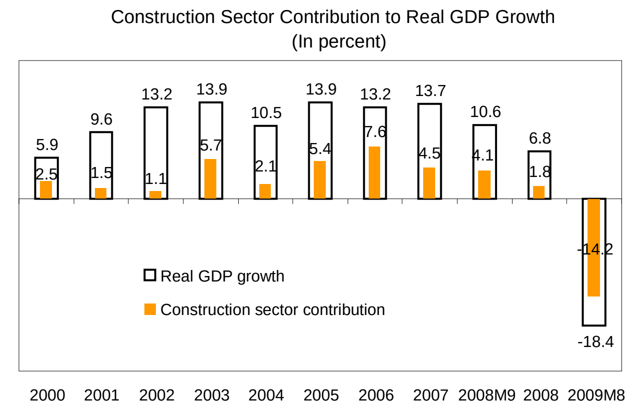


4. **The external position has also stabilized, partly with the help of Fund resources.** The sharp drop in exports, remittances, and foreign direct investment (mostly from Russia, see below) is being offset by a contraction in imports and a substantial increase in external assistance. In that context, Fund financing has been flexibly used to allow a larger fiscal deficit and strengthen the external position.

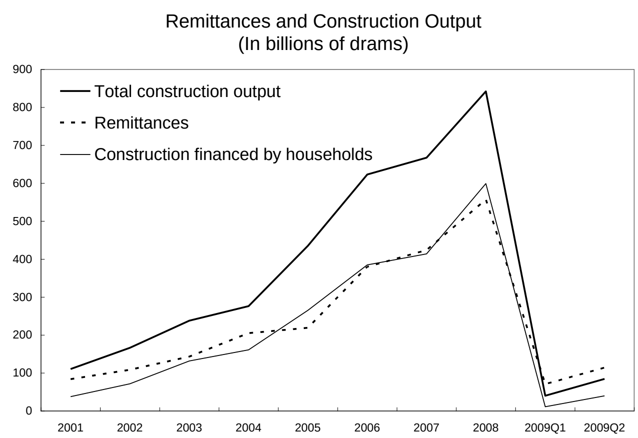


Box 1. Armenia: Collapse in Construction and Remittances

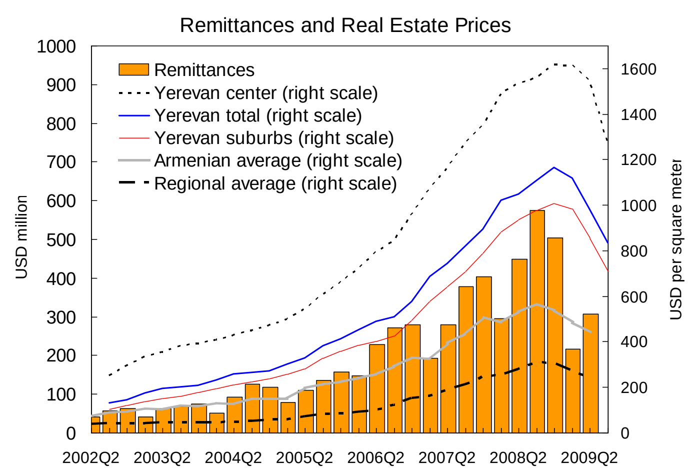
The construction sector has been the main contributor to GDP growth in Armenia since 2005, reaching 27 percent of GDP in 2008. In the first eight months of 2009, the economy contracted by more than 18 percent, of which 14.2 percent was due to construction, in particular residential construction. During the first half of 2009, real estate transactions and prices fell by 34 percent and 16 percent year-on-year, respectively. Remittances, which quintupled in dollar terms between 2003 and 2008 (reaching almost 18 percent of GDP in 2008) collapsed by about 30 percent during the first seven months of 2009.



Construction output and real estate prices are highly correlated with remittances. Official data suggest that Armenian households financed about 70 percent of total construction output during 2008, of which only 3 percent used mortgage loans. Since remittances are a significant source of income for many Armenian households, this suggests that the fall in remittances, rather than in mortgage credit, has been responsible for the drop in construction.



Remittances in Armenia also include an investment component. Remittances are estimated largely based on banking system data on "noncommercial" private transfers, which also reflect flows from Armenian nonresidents—including the Armenian Diaspora—that do not strictly fall in the categories of workers' remittances, employee compensation, and migrants' transfers. These flows are often ultimately destined to finance residential construction.



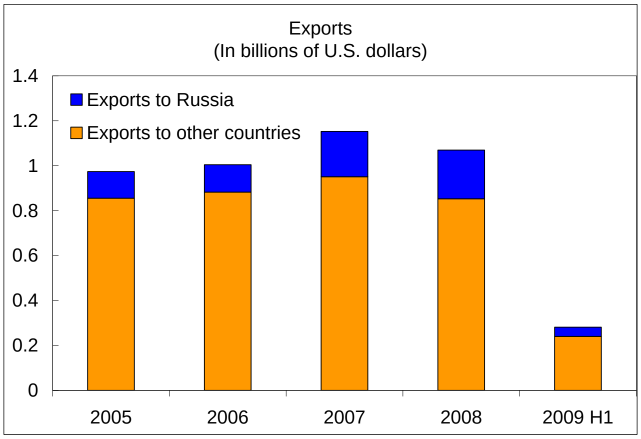
Box 2. Armenia: Summary of Anti-crisis Measures Taken by the Armenian Authorities

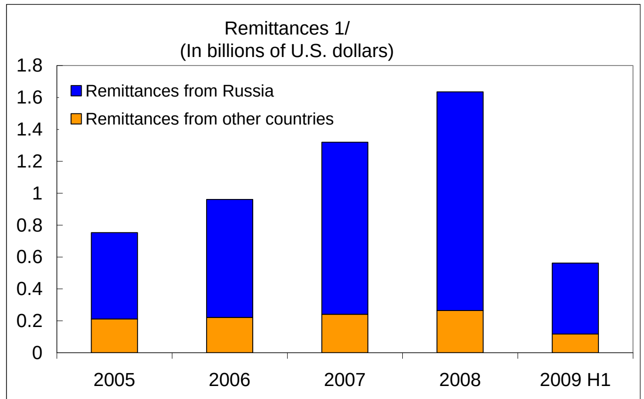
Since the onset of the global downturn, the Armenian authorities have swiftly implemented a range of measures to help contain the impact of the crisis. Financial support from external partners has played an important role, with Armenia receiving nearly $300 million in budget support for 2009 (from the IMF, World Bank, and ADB), $50 million from the World Bank for on-lending to SMEs, $500 million from Russia, and project support from a number of other donors. Key ongoing or planned measures include:

- ✓ Providing about $37 million to the private sector in the form of direct credit, government guarantees, and equity investments.
- ✓ Providing about $10 million in government guarantees to construction companies with at least a 50 percent complete rate in residential construction projects.
- ✓ Funding a Pan-Armenian bank to help finance large national investment projects.
- ✓ Offering on-lending programs using about half of the $500 million Russia loan (see table below) and $50 million from the World Bank.
- ✓ Establishing a National Mortgage Foundation with mixed public-private capital, initially funded by AMD 5 billion from the CBA, for on-lending to the mortgage market.
- ✓ Creating instruments to help young families purchase apartments, by means of (i) 10–15 year non-interest mortgage loans for up to 30 percent of the required down payment, and (ii) interest rates subsidies for mortgage loans.
- ✓ Offering a subordinated loan facility to banks to support regulatory capital ratios and to encourage bank mergers.
- ✓ Doubling the coverage for bank deposit insurance.

Projects Financed by the $500 mln Loan from Russia

	Millions of U.S. dollars	Percent of GDP
Earthquake zone reconstruction project	130	1.5
On-lending through the banking system	181	2.1
Mortgage market	32	0.4
Small and medium enterprises (SMEs)	67	0.8
Other sectors	81	0.9
On-lending through SME development center	12	0.1
Direct loans to systemically important companies	62	0.7
Other	115	1.3
Total	500	5.8





1/ Defined as non-commercial private transfers through the banking system.

5. **The fiscal position remains weak.** During the first eight months, tax revenues fell by more than 18 percent year-on-year, driven by a collapse in VAT collection, as imports declined sharply. Expenditures, especially foreign-financed capital investment, increased significantly during the first half of the year relative to 2008, but remained below budgeted levels.

6. **The banking sector is sound, despite a worsening of the quality of the loan portfolio.** Capital and liquidity ratios continue to be high and the leverage ratio low, providing a strong buffer to the economic crisis, as reflected by the latest stress tests. However, the downturn could further lead to a deterioration in asset quality. In this setting, lending activity has been weak, reflecting a combination of supply and demand factors.

II. Policy Discussions

A. Macroeconomic Outlook

7. **Real GDP growth is expected to contract by more than 15 percent in 2009, but growth should return to positive territory in 2010** (Table 1). This scenario assumes that output begins to recover toward the end of this year, with no further worsening in the Russian economy. Medium-term growth would be expected to recover only gradually under current policies, underpinned by the successful implementation of the authorities' structural reform agenda (Table 9 and LOI ¶21). Growth prospects would be revised considerably upward if the Turkish-Armenian land border were to be reopened (Box 3). Inflation could pick up toward the end of this year, but is likely to remain within the inflation target band of 4±1.5 percent.

8. **The external outlook remains in line with projections at the time of the first review** (Table 2). Imports will likely not fall sufficiently to offset the fall in exports, while remittances are expected to drop by about 30 percent compared to 2008. The current account

deficit is thus projected to rise to about 13½ percent of GDP and to remain at a similar level in 2010, before gradually falling to about 8½ percent of GDP by 2013. Sizable external financing from IFIs and bilateral donors (IMF, World Bank, ADB, Russia, and EU) is expected to remain in place this year, and gradually decline over the medium term. Gross international reserves should remain at a comfortable level with an import cover of about 6 months of imports. The program is fully financed in 2009–10, with the remaining financing needs in 2010 expected to come from the European Union.

Box 3. Armenia: Economic Impact of a Possible Reopening of the Turkish-Armenian Land Border

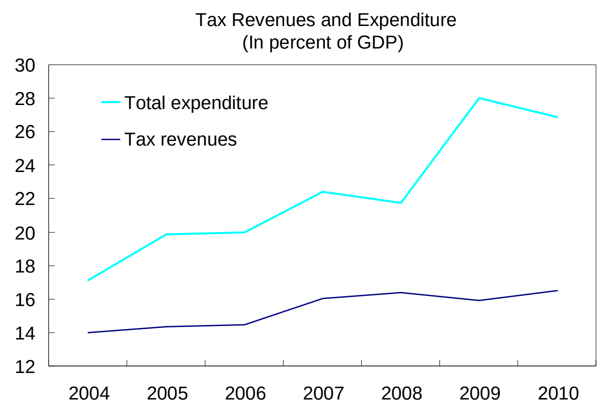
There has been progress on talks to reopen the land border between Armenia and Turkey, which has been closed since 1993. A protocol has been signed by the foreign ministers of the two countries, and will also need to be ratified by the Armenian and Turkish parliaments before the borders could be opened, a step that is still far from certain.

The reopening of the Turkish-Armenian land border is expected to have a positive impact on the Armenian economy in the medium term, with the direct impact initially through trade. Were the border to reopen, both countries would gradually establish greater trading ties. The result would be an increase in trade in the goods and services of each country's comparative advantage. One immediate impact would be a decline in transportation costs to and from Turkey as well as other destinations by as much as 10 to 20 percent, leading to a drop in import prices that could improve the standards of living of the Armenian population. In addition, the Turkish economy would provide an enormous potential market for Armenian goods and services. However, while Armenian consumers and exporters are likely to benefit, some Armenian firms producing for the local market could in the short term feel stiff competitive pressures.

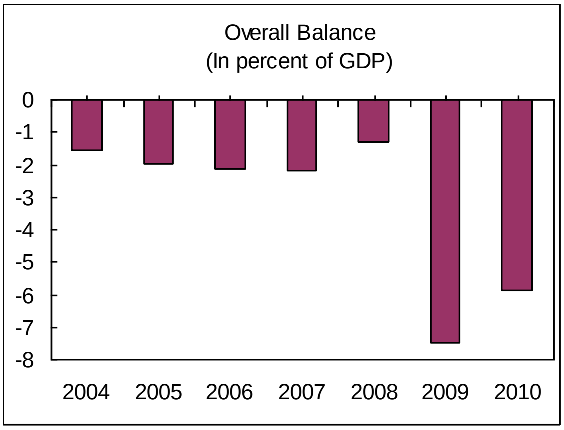
Tourism, FDI, and remittances to Armenia would also likely benefit as a result of the reopening of the land border. Tourism will likely increase in both countries as visitors can move more easily across the border. The reopening of the border could provide a more attractive environment for investment and regional integration, serving to attract FDI to Armenia. Finally, domestic labor markets would potentially be open to both countries over time, thereby increasing and diversifying the sources of remittances to Armenia.

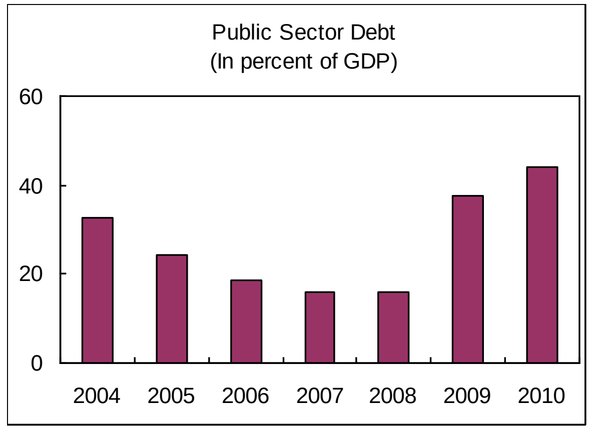
B. Fiscal Policy

9. **Fiscal policy will continue to support the economy in the period ahead, thanks in part to external borrowing.** The deficit is projected to widen to 7.5 percent in 2009, up from 6.5 percent of GDP at the time of the first review (Tables 5 and 6), reflecting a further decline in tax revenue and a lower projection for grants. Both domestic and external financing



constraints, in addition to concerns about debt dynamics, preclude a wider deficit this year, even though nominal spending would rise relative to 2008 levels. As a result, fiscal stimulus—proxied by the increase in primary spending—is projected to amount to nearly 6 percent of GDP for the year.[1] The deficit will be financed mainly through external resources, but a small increase in domestic financing may be envisaged as well, subject to favorable domestic market conditions (LOI, ¶9).





10. **Expenditure plans in 2009 focus on (i) undertaking wide-ranging anti-crisis measures, (ii) increasing foreign-financed capital spending, and (iii) protecting social spending.** The government's anti-crisis plan includes the measures summarized in Box 2. New capital spending, financed in part by the Russian loan, would mostly be directed to new housing projects in the earthquake zone. To protect the poor, the program aims at increasing social allowances, including pensions, by 18 percent in nominal terms in 2009.

11. **Public debt remains manageable, but its rapid accumulation calls for undertaking fiscal consolidation as soon as the recovery takes hold in 2010.** While Armenia's initial low level of public debt, about 16 percent of GDP in 2008, provided scope for fiscal expansion, the public debt ratio has more than doubled in 2009 (Table 7, Figure 2). Therefore, staff and the authorities agreed that an effort to start reducing the fiscal deficit beginning in 2010 would be desirable, while aiming to secure a higher share of concessional resources from donors.

12. **Accordingly, the authorities plan to tighten the 2010 budget by about 1½ percent of GDP.** As growth is projected to remain well below potential, this fiscal stance—which

---

[1] In addition, domestic net lending will increase by 2.4 percent of GDP this year.

reflects debt sustainability considerations but also financing constraints—amounts to a withdrawal of fiscal stimulus,[2] and might be relaxed should more concessional financing become available in the course of the year. The adjustment will rely on revenue increases of about ½ percent of GDP—due to tax administration reforms and some recovery of highly taxed sectors (e.g., mining) [3]—and expenditure restraint of about 1 percent of GDP, particularly capital spending. Capital spending could be topped up in 2010, only to the extent that additional grants or concessional financing are identified. The deficit will continue to be financed by external resources, albeit less than in 2009, and the rest through domestic resources. Fiscal adjustment will continue beyond 2010 through revenue-enhancing measures and reductions in non-priority expenditure, as the authorities progress with their structural reform agenda.

13. **In the fiscal structural area, the authorities have made progress in addressing two long-standing problems in tax administration.** In particular, they reduced the large amount of outstanding tax credits in line with program objectives (indicative target), and shortened delays in VAT refund processing to exporters (continuous structural benchmark, and structural benchmark for end-September; LOI ¶18, and LOI Table 2).

14. **To strengthen the medium-term fiscal outlook, the authorities are committed to further reforms in the public finance area** (LOI ¶18 and ¶19, and LOI Table 2):

- (i) Introduce e-filing of tax returns by December 2009 for large taxpayers, following the recent successful pilot project;
- (ii) Implement risk-based audits in VAT refund processing in 2010 (Box 4; structural benchmark for end-March 2010);
- (iii) Submit legislation to parliament to abolish the presumptive taxation regime for tobacco and fuel products effective January 2011 (structural benchmark for end-December 2009); and
- (iv) Work closely with the World Bank to develop a strategy to further strengthen the targeting of social safety nets (structural benchmark for end-December 2009), which will help to protect the poor, while enhancing the efficiency of social spending.

---

[2] See Appendix II of the Middle East and Central Asia Regional Economic Outlook for an overview of the fiscal stance in Armenia and the region.

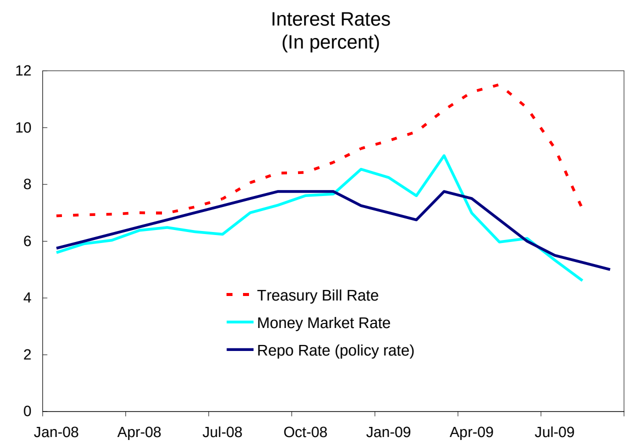
[3] The revenue projection for 2010 also includes an additional 0.2 percent of GDP in revenue from taxation of donor-funded projects; this is neutral on the fiscal balance, as the government provides equal counterpart spending to donor-funded projects subject to taxation.

Box 4. Armenia: Structural Conditionality, 2009–10	
Structural Measure	**Rationale for Macro-Criticality**
<u>Tax Administration</u>	
1. Meet the statutory 90-day processing deadline for all VAT refund claims filed in 2009 (structural benchmark, continuous in 2009).	***Boost the integrity of the tax system and enhance revenue performance by increasing compliance and reducing incentives for tax evasion.***
2. Submit legislation to parliament to (a) **strengthen penalties for false VAT refund claims** effective January 2010, and (b) **pay interest on all legitimate VAT refund claims** filed after December 2009 and not refunded within 90 days, with interest to be paid out of VAT revenues (structural benchmark for end-September 2009).	***Enhance the efficiency of tax administration and improve revenue performance while ensuring the integrity of the VAT system by reducing incentives for fraud and corruption.***
3. As a necessary condition for implementing a fully functional risk-management approach in VAT refund processing, **submit legislation to parliament that allows only high-risk VAT refunds to be subject to review** (structural benchmark for end-March 2010).	***Enhance the efficiency of tax administration by introducing best practice in modern tax administration, while ensuring the integrity of the VAT system.***
<u>Tax and Social Policy</u>	
4. In close collaboration with the World Bank, **develop a strategy to further strengthen the targeting of social safety nets** (structural benchmark for end- December 2009).	***Improve the targeting and efficiency of social safety nets so as to provide additional assistance to the poor while minimizing costs.***
5. Submit legislation to parliament to bring petroleum and tobacco products within the regular tax regimes (excise tax, customs duties, profit tax, and VAT), effective January 2011 (structural benchmark for end- December 2009).	***Establish a sustainable and effective revenue base by increasing revenue collection from petroleum and tobacco products, while enhancing tax efficiency and equity.***
<u>Financial Sector</u>	
6. Submit to parliament an amendment to Article 11 of the "Law on the Central Bank of the Republic of Armenia" to allow a gradual recapitalization of the CBA with marketable interest bearing securities (structural benchmark for end-September 2009).	***Promote central bank financing modalities that increase transparency and support monetary policy implementation.***

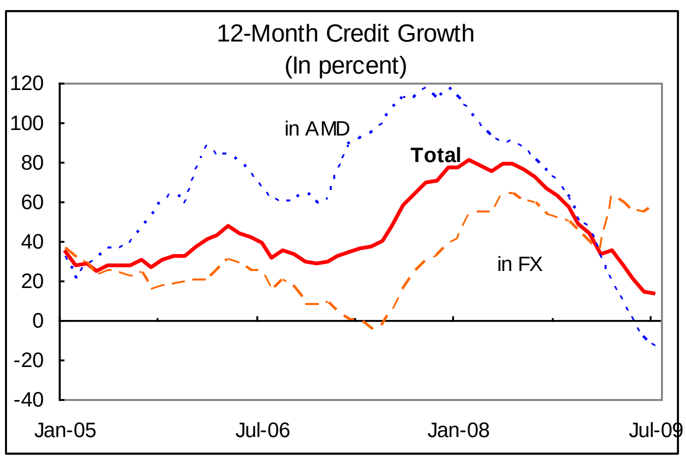
15. **The authorities are committed to strengthening their medium-term debt management strategy.** To meet this objective, they will adopt by March 2010 a ministerial order to develop a time-bound action plan to strengthen public debt management with the aim of developing a comprehensive medium-term debt strategy (LOI ¶20). The authorities will also seek further technical assistance from their international partners. The debt management strategy should be underpinned by a sound medium-term expenditure framework.

C. Monetary Policy

16. **Given low inflation and weak credit growth, the CBA has continued to ease its monetary stance, consistent with its inflation targeting framework** (Table 3). Since early April, the CBA has gradually lowered its policy rate by 275 basis points to 5 percent in September. It also injected dram liquidity through various channels in an effort to boost credit growth, including by conducting outright purchases of government securities, and increasing the maturity of its repo operations to 90 days (structural benchmark, end-June 2009). As a result, interbank and T-bill rates have fallen and banks reported comfortable levels of dram liquidity.

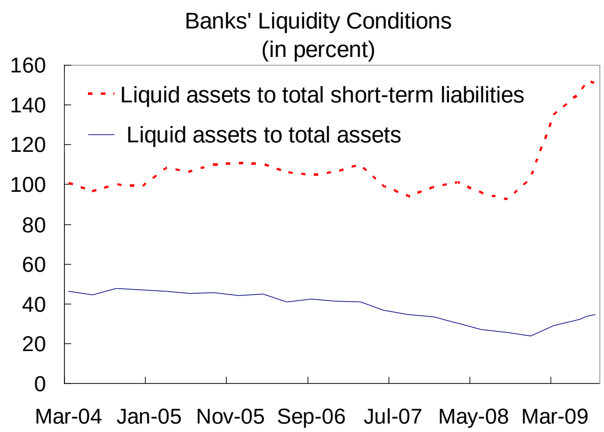


17. **Despite the easing, credit growth has continued to decline, leading the government and the CBA to take additional measures.** Bank lending rates, which have remained at around 18 percent, have not been responsive to the drop in both repo and interbank rates, implying that the monetary transmission remains weak. In response, the government and the CBA have arranged to onlend at competitive rates to SMEs and other targeted sectors



through the CBA and commercial banks, using resources from Russia and other donors.[4] Use of the lending facilities has been slow, however, as banks have tightened their lending standards in the face of economic uncertainty as well as reported weak demand for credit.

18. **The CBA is concerned that the weak transmission mechanism and increased government spending are creating excess liquidity in the banking system.** The CBA has drained some of this excess liquidity to keep short-term interbank rates from falling below the policy rate and prevent potential capital flight or speculative exchange rate pressure that could jeopardize the inflation target (LOI, ¶9). The issuance of recapitalization bonds (structural benchmark for end-September 2009, LOI, ¶14) should further enhance the CBA's liquidity management capacity.[5] Part of the challenge for monetary policy is a deposit dollarization ratio that currently hovers above 65 percent. Going forward, once macroeconomic condition stabilizes, it is expected that dollarization will gradually decrease, allowing the authorities to gain greater control of monetary policy.



19. **Under its inflation targeting framework, the CBA is committed to adjusting its monetary policy stance should inflationary pressures emerge.** Inflation so far remains comfortably within the target band of 4±1.5 percent, and in the view of staff, inflation pressures are limited. However, the CBA believes that there are upside inflation risks toward the end of the year, owing to rising international prices, the ongoing expansionary policies, downward rigidities in domestic prices, and speculative exchange rate pressures stemming from excess liquidity. The CBA has signaled the end to the easing cycle in its latest monetary policy committee statement and intends to shift to a neutral stance and promptly react to inflationary signals, if necessary, by tightening monetary conditions (LOI, ¶9).

---

[4] Quasi-fiscal risks from these operations appear limited. Under the successful framework pioneered by KfW, banks have to show that the borrower meets strict minimum standards set by the CBA before funds are released to the bank, and banks assume all credit risk. Applying a ratio of loss loans to the total loan portfolio of 10 percent—well above the actual ratio of 2½ percent—defaults on these externally refinanced loans would be limited to around 0.1 percent of GDP.

[5] The government has agreed to gradually issue marketable interest-bearing government bonds to compensate for the CBA's accumulated losses, which amounted to approximately AMD 85.7 billion as of end-2008.

D. Exchange Rate Policy

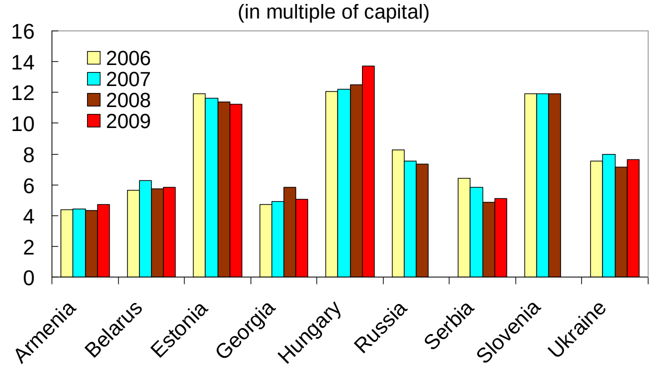
20. **Following the return to a floating regime in March, the exchange rate initially remained broadly stable** (Figure 1). This stability reflected in part improved confidence and relatively balanced daily flows in the foreign exchange market. Exertion of moral suasion on market participants and close scrutiny of banks' activity may have also played a role. The authorities noted that the thin market and lumpy transactions of key actors require close oversight of market conditions.

21. **The exchange rate has recently seen more flexibility, as the CBA has more strictly adhered to its intervention strategy that allows the exchange rate to be largely market-determined** (structural benchmark for end-June 2009)**.** The strategy, designed with the help of Fund technical assistance, is designed to limit the use of interventions to rebuilding reserves and to smoothing excessive volatility without targeting a particular exchange rate level or band. The CBA's interventions (including both purchases and sales) have so far been in line with this strategy. Recent estimates suggest that the exchange rate is broadly in line with fundamentals.

E. Financial Sector Policies

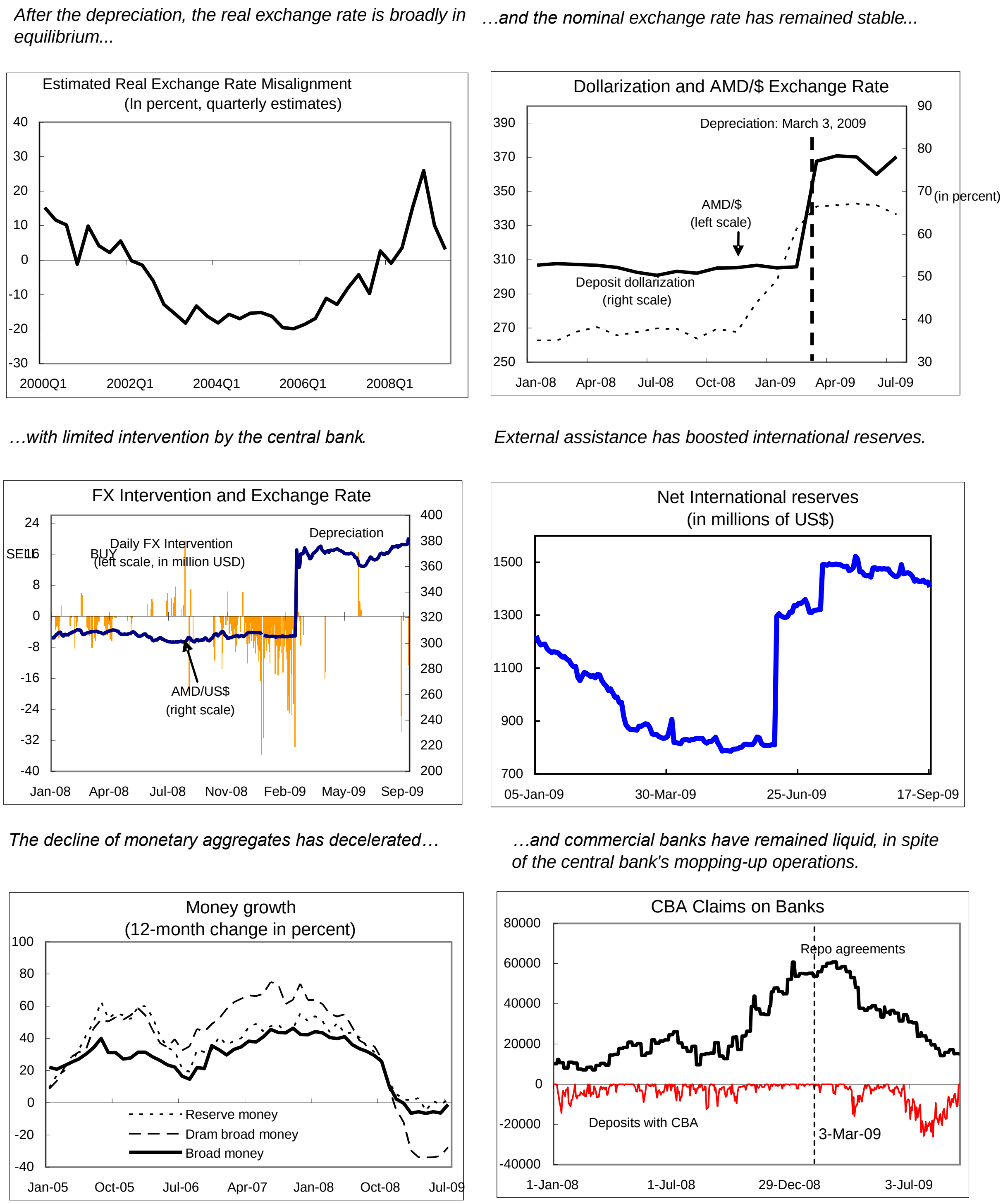
22. **Despite a marked increase in nonperforming loans (NPLs), the banking system remains highly capitalized with ample liquidity and appears reasonably well-placed to withstand stress** (Table 4). The system-wide capital adequacy ratio (CAR) in July was 29 percent, well above the 12 percent regulatory requirement. Banks are now relatively more exposed to higher credit risk, owing to the economic downturn and to exposure to unhedged borrowers. Nonetheless, the latest stress tests through end-July show that, under all scenarios except for extreme credit shocks, the CAR would decline by no more than 2 percentage points for the system as a whole and would stay above the regulatory norm in all banks. The low leverage ratio in the Armenian banking sector represents a source of resilience, a factor less present in comparator countries.

Banking System Leverage Ratios
(in multiple of capital)



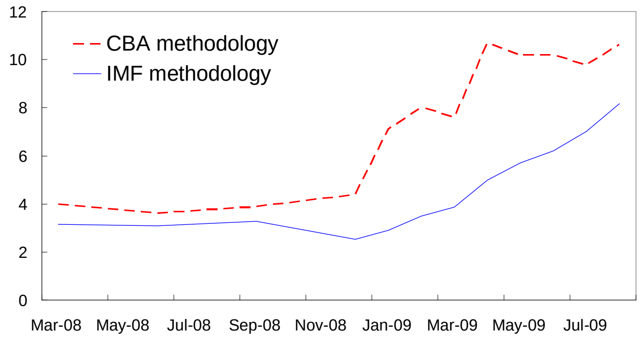
Source: GFSR. In the GFSR, leverage is depicted by the ratio of capital to total assets. Here, the leverage ratio is defined as total assets divided by capital.

Figure 1. Armenia: Recent Exchange Rate and Monetary Sector Developments



Sources: Armenia authorities; and Fund staff estimates.

Nonperforming Loans in Percent of Total Loans 1/



1/ CBA methodology includes loans that are 1 to 90 days past due, and excludes loans that are 270 days past due and are written off.

23. **The possibility of a further deterioration in the quality of banks' loan portfolios cannot yet be ruled out.** Headline NPLs, as measured by the CBA, have largely stabilized. However, the CBA definition of NPL includes loans in the "watch" category, which are not considered NPLs according to the IMF's methodology. Using the IMF definition, NPLs are still rising, as more loans continue to migrate to the loss category. The increased loan-loss provisioning could add strains to the banking sector's profitability, which has turned negative since the beginning of this year, mainly due to foreign exchange losses associated with the March depreciation.

24. **The CBA is making good progress in safeguarding financial stability, in particular, through further strengthening the financial safety net, contingency planning, and crisis preparedness** (LOI ¶12 and ¶13). The Deposit Guarantee Fund (DGF) is being strengthened considerably, and the bank supervision and regulation framework continues to improve. The CBA is considering additional prudential measures that would (i) restrict banks' reliance on a single source of funding to ensure funding stability, and (ii) reinstate limits on banks' net open foreign exchange positions to reduce the potential for destabilizing speculation. The mission and the CBA agreed that the CBA should consult closely with affected parties and thoroughly review the potential impact of these measures to ensure that they are appropriately specified and will not have unintended consequences. The CBA plans to set up a new financial stability department next year, intensifying the focus on macro-prudential risks and macro-financial linkages. An IMF technical assistance mission in late October will work with the CBA on further improving contingency planning.

III. Risks and Capacity to Repay

25. **Risks to the program have lessened somewhat, but are in line with those identified at the time of the first review:**

- There is uncertainty to the economic growth projections. While the recent signs of a stabilization of output are encouraging, it is not certain that the downturn has run its course. Opening of the Turkish land border would boost medium-term growth prospects considerably.

- Balance-of-payments inflows remain volatile and uncertain, although at this stage the risks appear evenly balanced.

- Fiscal risks remain, most notably whether ongoing tax administration reforms will lead to sustained improvements in revenue.

- The financial sector appears robust, but continued economic weakness could lead to a continued increase in non performing loans.

26. **Armenia's debt dynamics are still in line with the assessment made at the time of the first review.** The external debt stock would increase from 13 percent of GDP at end-2008 to 40 percent in 2011, before declining gradually to 29 percent of GDP by 2014, reflecting the repurchase obligations to the IMF mainly during 2012–14 (Tables 8 and 11). While debt levels are manageable under a strong policy scenario, the outlook is, as noted, subject to risks. The standard bound tests show that the combined shocks lead to an increase in the debt-to-GDP ratio by several percentage points (Figure 3). The effect of a real exchange rate shock is particularly pronounced, reflecting the rising weight of external debt in total public debt.

27. **Armenia's capacity to repay the Fund broadly remains good.** External vulnerabilities remain significant due to the global credit crunch, higher projected current account deficits, and rising external debt over the medium term. The rise in repurchase obligations to the Fund during the period 2012–14 is significant but temporary, reflecting the relatively short maturity profile of IMF lending and the relatively large share of IMF obligations in total obligations. Nonetheless, indicators of IMF credit still suggest a good capacity to repay the Fund. Given that the June 2009 purchases from the Fund were disbursed to the budget, the CBA and ministry of finance have worked closely to clarify debt service obligations and appropriate accounting treatment.

IV. PROGRAM MODALITIES

28. **The attached LOI describes the authorities' progress in implementing their economic program, and sets out conditionality through March 2010:**

- The authorities request a waiver of nonobservance for the end-September fiscal balance performance criterion, since, on the basis of the available information, there is clear evidence that the performance criterion has not been met, even though the deviation was minor (about 0.4 percent of GDP), and in line with the upward revision of the end-year deficit target agreed with staff.

- The authorities, following discussion with staff, request a modification of the quantitative performance criteria for end-December 2009 to reflect the revised macroeconomic framework. Given that this review combines what were the second and third reviews under the original schedule, the authorities also request that the amounts scheduled to be available following the second and third reviews become available upon completion of this review.

- The LOI sets quantitative performance criteria for end-March 2010, indicative targets for the remainder of 2010, and new structural benchmarks.

- Given the expected deterioration in the debt outlook, the authorities would like to request the addition of an indicative target on contracting or guaranteeing new nonconcessional public debt. The targets under the proposed nonconcessional debt limit largely reflect the contraction of additional loans from the World Bank and the ADB for which framework agreements were already approved, mostly for infrastructure projects.

V. Staff Appraisal

29. **The sharp economic downturn induced by the global crisis appears to have run its course, although sizable risks remain.** The dramatic fall in output this year signals the end of the long remittance-fueled construction boom. Even as output is now expected to gradually recover in the period ahead, and financial stability has been maintained, growth is unlikely to return to the double digit rates of several years ago. Moreover, downside risks remain, most notably a continued weakness in the external outlook. The challenge ahead will be to balance adjustment to the deteriorated outlook, while not reversing policy stimulus too quickly as a very gradual recovery takes hold.

30. **In this context, the authorities' policies have adapted rapidly and appropriately, and program performance has been strong.** The large depreciation in March 2009 helped to improve competitiveness without threatening financial stability. The subsequent monetary and fiscal easing helped mitigate the impact of the crisis on output and the poor, while preserving macroeconomic stability. The authorities have largely adhered to the program targets and continued to implement their structural reform program.

31. **The relaxation of fiscal policy has appropriately provided support to the economy, mindful of financing constraints and debt sustainability concerns.** While the authorities have largely accommodated the fall in revenues in 2009 without significantly cutting expenditures, they appropriately intend to reduce the 2010 deficit through expenditure restraint to put public finances on a sustainable path, although the program allows for higher spending if additional donor financing becomes available. The reintroduction of a medium-term expenditure framework would be a key element of a sound debt strategy.

32. **Efforts to address the chronic revenue weaknesses, notably through strengthening of tax administration, will be crucial to ensuring a fair and equitable tax burden and a sustainable fiscal position**. Staff welcome the authorities' commitment to advance the fiscal structural reform agenda, including through continued improvement in VAT refund processing, introduction of e-filing of tax returns by end-2009 for large taxpayers, and further strengthening the large taxpayer inspectorate. It will likewise be

important to move forward on tax policy reforms, notably the elimination of the presumptive taxation regime for tobacco and fuel products by 2011.

33. **An accommodative monetary policy stance remains appropriate.** In light of the severe output contraction, the authorities should defer tightening the monetary policy stance until clear signs of incipient inflation emerge. At the same time, given the weak transmission mechanism and economic uncertainty, lower interest rates are not leading to an increase in credit, but rather to a build-up in liquidity in the banking system. Mopping up some of this liquidity can be useful to avoid speculative pressures on the exchange rate. Potential inflationary pressures appear distant, although, with the stabilization of output, the authorities will have to be mindful of incipient inflation and adjust policy as needed.

34. **Greater flexibility in the exchange rate serves Armenia well.** Since the renewed float of the dram in March, CBA interventions intended to smooth volatility have at times unfortunately conveyed the impression that the CBA was targeting a particular level or band of the exchange rate. The CBA should continue to adhere to its intervention guidelines and avoid moral suasion that could hinder the exchange rate adjustment. In this context, staff welcomes the recent greater flexibility of the exchange rate. Staff also supports the CBA's plans to reinstate limits on net open foreign exchange positions, which should be developed in close consultation with market participants. Finally, staff endorses the authorities' intention to use their share of the recent SDR allocation to bolster the CBA's international reserves.

35. **Staff welcomes the CBA's continued strengthening of banking supervision, the regulatory framework, and contingency planning.** The financial sector is sound, but continued vigilance is needed. Nonperforming loans could further pick up in the period ahead, eroding the capital buffer. Leverage ratios in the system are low, mitigating potential risks, but the CBA, with the help of Fund technical assistance, should continue to closely monitor financial sector stability and make further progress on crisis preparedness.

36. **Risks to the program are broadly balanced.** On the upside, the output contraction could be less than envisaged should the decline in the construction sector soften, or if the spillovers to the rest of the economy are weaker. A faster improvement in the global outlook, notably in Russia, would have important positive ramifications for Armenia. Likewise, opening the Turkish land border would present considerable potential for exports and investment, with lower transport costs improving the competitiveness of Armenian firms and the purchasing power of the Armenian population. On the downside, a weaker global outlook would pose a risk. In addition, Armenia's debt position is sustainable, but the rapid accumulation of debt would pose an important risk if the fiscal position does not improve or growth does not rebound. Armenia's external partners are encouraged to increase the share of concessional resources in their overall lending envelopes.

37. **Staff supports the authorities' request for completion of the second review under the SBA.** Staff also supports the authorities' request for a waiver of nonobservance for the end-September fiscal balance performance criterion, modification of the end-December performance criteria, setting performance criteria for end-March 2010, a rephasing of purchases, and setting a new indicative target on contracting or guaranteeing new nonconcessional public debt. Finally, staff welcomes the authorities' renewed commitment to exchange rate flexibility, their commitment to fiscal adjustment, and their willingness to deepen structural reforms.

Table 1. Armenia: Selected Economic and Financial Indicators, 2006–10

	2006 Act.	2007 Act.	2008 Prel.	2009 Country Report No. 09/214	2009 Proj.	2010 Proj.
National income and prices						
Real GDP (percent change)	13.2	13.7	6.8	-9.5	-15.6	1.2
Gross domestic product (in billions of drams)	2,656	3,149	3,646	3,350	3,116	3,215
Gross domestic product (in millions of U.S. dollars)	6,384	9,206	11,917	9,333	8,683	8,200
Gross domestic product per capita (in U.S. dollars)	1,982	2,853	3,685	2,857	2,658	2,485
CPI (period average; percent change)	2.9	4.4	9.0	3.0	3.2	3.7
CPI (end of period; percent change)	5.2	6.6	5.2	3.5	5.2	3.0
GDP deflator (percent change)	4.6	4.2	8.4	1.5	1.3	1.9
Unemployment rate (in percent)	7.5	7.0	6.3	…	…	…
Poverty rate (in percent)	26.5	25.0	...	...	...	...
Investment and saving (in percent of GDP)						
Investment	33.6	38.2	42.8	35.8	36.0	35.2
National savings	31.7	31.8	31.2	22.7	22.2	21.4
Money and credit (end of period)						
Reserve money (percent change)	41.1	50.9	5.3	10.7	11.2	15.4
Broad money (percent change)	32.9	42.3	2.4	10.4	13.0	12.5
Commercial banks' 3-month lending rate (in percent)	17.1	18.6	17.9	...	...	...
Central government operations (in percent of GDP)						
Revenue and grants	18.0	20.1	20.0	20.4	20.5	21.0
Of which : tax revenue	14.5	16.0	16.4	15.6	15.9	16.5
Expenditure 1/	20.0	22.4	21.8	26.9	28.0	26.8
Overall balance on a cash basis	-2.1	-2.2	-1.3	-6.5	-7.5	-5.8
Overall balance (excl. projects related to the Russian loan)	…	…	…	-5.8	-6.7	-5.2
Government and government-guaranteed debt	18.7	16.1	15.9	37.8	37.4	44.5
Share of foreign currency debt (in percent)	88.1	86.7	83.7	90.0	89.2	89.1
External sector						
Exports of goods and services (in millions of U.S. dollars)	1,510	1,777	1,711	1,273	1,272	1,431
Imports of goods and services (in millions of U.S. dollars)	-2,536	-3,589	-4,692	-3,516	-3,588	-3,744
Exports of goods and services (percent change)	6.7	17.6	-3.7	-26.2	-25.6	12.4
Imports of goods and services (percent change)	19.4	41.5	30.7	-24.8	-23.5	4.4
Current account balance (in percent of GDP)	-1.8	-6.4	-11.5	-13.0	-13.7	-13.8
FDI (net, in millions of U.S. dollars)	450	701	929	440	263	305
External debt (in percent of GDP) /2	18.9	15.7	13.2	31.7	31.1	38.9
Debt service ratio (in percent of exports of goods and services)	3.9	2.9	3.1	5.8	6.5	7.7
Gross international reserves (in millions of U.S. dollars) 3/	1,072	1,659	1,407	1,604	1,910	1,861
Import cover 4/	3.6	4.2	4.7	5.1	6.1	5.6
Nominal effective exchange rate (percent change) 5/	10.1	14.9	9.0	…	…	…
Real effective exchange rate (percent change) 5/	9.1	15.2	11.6	…	…	…
End-of-period exchange rate (dram per dollar)	364	304	307	…	…	…
Average exchange rate (dram per dollar)	416	342	306	…	…	…
Memorandum item:						
Population (in millions)	3.221	3.227	3.234	…	…	…

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

1/ Including the gas subsidy in 2006–2008.

2/ Based on government and government-guaranteed debt.

3/ Excluding the special privatization account (SPA), but including the Russian project loan.

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

5/ A positive sign denotes appreciation.

Table 2. Armenia: Balance of Payments, 2007–14
(in millions of U.S. dollars, unless otherwise indicated)

	2007	2008	2009	2010	2011	2012	2013	2014
	Act.	Prel.	Projections					
Current account	-589	-1,372	-1,193	-1,128	-1,034	-948	-841	-815
Trade balance	-1,600	-2,654	-2,040	-2,108	-2,234	-2,368	-2,509	-2,658
Exports, fob	1,197	1,066	686	727	786	848	916	990
Imports, fob	-2,797	-3,720	-2,727	-2,836	-3,020	-3,216	-3,425	-3,648
Services (net)	-213	-327	-275	-205	-177	-211	-232	-242
Credits	580	645	586	703	823	889	978	1,075
Debits	-793	-972	-861	-909	-1,000	-1,099	-1,209	-1,317
Income (net)	279	471	327	354	415	482	577	629
Transfers (net)	945	1,138	795	832	962	1,148	1,323	1,456
Private	850	1,062	733	794	937	1,124	1,270	1,397
Official	94	75	62	38	25	24	53	59
Capital and financial account	1,191	1,124	1,240	658	896	995	1,206	1,198
Capital transfers (net)	143	149	104	50	79	46	106	112
Foreign direct investment (net)	701	929	263	305	382	477	631	675
Portfolio investment (net)	-9	8	9	10	11	12	13	14
Public sector (net)	133	145	923	340	355	360	366	377
Disbursements	149	160	805	361	379	387	394	406
Amortization	-17	-15	-19	-21	-24	-26	-28	-29
CBA	0	0	137	0	0	0	0	0
Other capital (net)	224	-107	-59	-47	70	100	89	20
Errors and omissions	-2	15	0	0	0	0	0	0
Overall balance	600	-233	47	-470	-138	47	365	383
Financing	-600	233	-105	30	72	-47	-365	-383
Gross international reserves (increase: -) 1/	-587	252	-503	49	92	103	-152	-304
Use of Fund credit, net	-14	-19	397	-21	-22	-152	-215	-81
Purchases/disbursements	10	7	410	...	...	...	...	...
Repurchases/repayments	-24	-26	-13	-21	-22	-152	-215	-81
Exceptional financing 2/	1	0	2	2	2	2	2	2
Financing gap	0	0	58	440	66	0	0	0
Identified financing								
IMF SBA	0	0	58	291	56	0	0	0
Other	0	0	0	149	10	0	0	0
Memorandum items:								
Financing gap (Country Report No. 09/214)	0	0	218	440	66	0	0	0
Current account (in percent of GDP)	-6.4	-11.5	-13.7	-13.8	-12.2	-10.5	-8.6	-7.6
Trade balance (in percent of GDP)	-17.4	-22.3	-23.5	-25.7	-26.3	-26.2	-25.6	-24.7
Gross international reserves (end of period)	1,659	1,407	1,910	1,861	1,769	1,666	1,818	2,122
In months of next year's imports	4.2	4.7	6.1	5.6	4.9	4.3	4.4	4.8
Net international reserves (program definition)	1,350	1,057	1,037	988	939	884	965	1,126
Merchandise export growth, percent change	16.7	-10.9	-35.6	6.0	8.0	8.0	8.0	8.0
Merchandise import growth, percent change	45.6	33.0	-26.7	4.0	6.5	6.5	6.5	6.5
Nominal external debt 3/	1,449	1,577	2,701	3,191	3,394	3,329	3,209	3,092
Nominal external debt stock (in percent of GDP) 3/	15.7	13.2	31.1	38.9	39.9	36.8	32.8	28.7
External debt-to-exports ratio (in percent) 3/	81.6	92.2	212.3	223.0	211.0	191.6	169.5	149.7
External debt service in percent of exports 3/	2.9	3.1	6.5	7.7	7.3	14.5	20.9	17.7

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

1/ Gross international reserves include the SDR allocation.
2/ Debt relief from the United Kingdom through 2015 (in respect of IDA credits).
3/ Based on government and government-guaranteed debt.

Table 3. Armenia: Monetary Accounts, 2006–10

(in billions of drams, unless otherwise indicated)

	2006	2007	2008	2009				2010			
	Dec.	Dec.	Dec.	Mar.	June	Sep.	Dec.	Mar.	June	Sep.	Dec.
	Act.	Act.	Act.	Prel.	Prel.	Prog. 1/	Prog. 1/	Prog. 1/	Prog. 1/	Prog. 1/	Prog. 1/
Central Bank of Armenia											
Net foreign assets	321.8	445.9	377.5	340.5	488.4	557.3	513.4	474.7	452.7	463.7	494.5
Net international reserves	329.9	456.2	390.0	356.4	514.4	636.0	592.1	553.4	531.4	542.5	573.3
Medium and long-term	-8.0	-10.3	-12.4	-15.9	-26.0	-78.7	-78.7	-78.7	-78.7	-78.7	-78.7
Net domestic assets	-38.8	-18.8	72.2	51.2	-80.5	-99.1	-13.2	29.3	71.1	77.3	82.6
Claims on general government (net)	-57.7	-89.8	-96.5	-60.3	-202.1	-203.0	-106.1	-62.9	-21.7	-33.5	-37.8
Of which : central government (net)	-16.2	-51.5	-79.6	-42.1	-188.2	-189.2	-92.3	-49.0	-7.8	-19.7	-23.9
Claims on banks	7.9	24.6	80.6	75.2	50.0	43.3	41.2	41.2	41.2	58.2	68.2
KfW	11.9	14.4	19.9	20.1	23.9	28.3	38.2	38.2	38.2	46.2	56.2
Monetary instruments (net) excluding CBA bills	-4.0	10.2	60.7	55.1	26.1	15.0	3.0	3.0	3.0	12.0	12.0
CBA bills 2/	-39.0	-49.0	-1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other items (net)	50.0	95.3	89.5	36.4	71.6	60.6	51.6	51.0	51.6	52.6	52.1
Reserve money	283.0	427.1	449.7	391.7	407.9	458.2	500.2	504.0	523.9	541.0	577.1
Currency issue	226.8	350.3	344.5	234.1	258.9	295.7	313.5	305.4	320.8	340.4	377.5
Deposits	56.2	76.8	105.2	157.7	149.0	162.5	186.7	198.6	203.1	200.6	199.7
Deposits in drams	32.0	38.4	39.3	38.6	25.4	32.0	36.0	36.0	37.0	36.0	35.5
Deposits in foreign currency	24.1	38.5	65.9	119.0	123.6	130.5	150.7	162.6	166.1	164.6	164.2
Banking system											
Net foreign assets	332.5	369.6	229.2	124.2	354.9	407.9	357.5	316.2	290.8	298.6	316.0
Net domestic assets	153.2	321.8	479.0	517.2	312.2	366.4	442.8	479.1	526.5	545.4	584.4
Claims on government (net)	-31.8	-54.0	-37.3	-10.6	-167.1	-147.5	-50.6	4.2	53.0	53.6	56.5
Of which : claims on central government (net)	9.7	-15.7	-20.5	7.6	-153.2	-133.7	-36.7	18.1	66.8	67.5	70.3
Claims on rest of the economy	241.5	429.8	638.6	659.5	630.5	674.7	693.6	694.3	710.7	730.9	764.6
Other items (net)	-56.4	-54.0	-122.3	-131.7	-151.2	-160.7	-200.3	-219.4	-237.2	-239.2	-236.8
Broad money	485.7	691.3	708.2	641.4	667.2	774.3	800.3	795.4	817.3	844.0	900.3
Currency in circulation	211.5	326.0	316.1	212.3	236.3	262.7	279.5	271.4	286.3	304.9	337.0
Deposits	274.3	365.3	392.2	429.1	430.8	511.6	520.8	523.9	531.0	539.1	563.4
Domestic currency	130.9	235.0	219.5	143.7	143.2	177.8	185.4	187.5	190.6	195.1	204.5
Foreign currency	143.4	130.3	172.6	285.5	287.6	333.8	335.4	336.5	340.4	344.0	358.8
Memorandum items:											
Exchange rate (in drams per U.S. dollar, end of period)	363.5	304.2	306.7	367.8	360.1	384.3	...	...	...	...	...
12-month change in reserve money (in percent)	41.1	50.9	5.3	2.9	-1.2	4.5	11.2	28.7	28.4	18.1	15.4
12-month change in broad money (in percent)	32.9	42.3	2.4	-5.5	-6.3	2.8	13.0	24.0	22.5	9.0	12.5
12-month change in private sector credit (in percent)	28.2	78.0	48.6	35.8	14.5	9.1	8.6	5.3	12.7	8.3	10.2
Velocity of broad money (end of period)	5.5	4.6	5.1	5.6	5.2	4.2	3.9	3.9	3.9	3.8	3.6
Money multiplier	1.7	1.6	1.6	1.6	1.6	1.7	1.6	1.6	1.6	1.6	1.6
Dollarization in bank deposits 3/	52.3	35.7	44.0	66.5	66.8	65.2	64.4	64.2	64.1	63.8	63.7
Dollarization in broad money 4/	29.5	18.9	24.4	44.5	43.1	43.1	41.9	42.3	41.7	40.8	39.9
Currency in circulation in percent of deposits	77.1	89.2	80.6	49.5	54.9	51.3	53.7	51.8	53.9	56.6	59.8
Stock of foreign currency deposits (in millions of USD)	394.5	428.4	567.4	741.5	746.9	866.9	871.1	874.0	884.2	893.4	932.0
Banking system financing of the central government (cumulative)	-19.4	-25.5	-4.7	28.1	-132.7	-113.2	-16.2	54.8	103.5	104.2	107.1

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

1/ At the program exchange rate.

2/ Following the agreement between the CBA and the Ministry of Finance, the issue of new CBA bills was terminated in 2008.

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

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

Table 4. Armenia: Financial Soundness Indicators for the Banking Sector, 2004–09

(In percent, unless otherwise indicated)

	2004	2005	2006	2007				2008				2009		
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Jul.
Capital adequacy														
Total regulatory capital to risk-weighted assets	32.3	33.7	34.9	35.3	32.7	31.4	30.1	27.0	26.0	27.2	27.5	26.1	28.0	28.9
Tier I regulatory capital to risk-weighted assets	30.2	31.7	32.7	33.4	31.4	30.2	29.0	26.1	...	...	...	...	...	
Capital (net worth) to assets	17.8	21.5	22.9	23.2	23.9	22.3	22.5	22.7	22.1	22.5	23.0	21.2	22.3	21.7
Asset composition														
Sectoral distribution of loans (billions of drams)														
Industry (excluding energy sector)	29.0	30.4	34.3	39.4	43.0	47.8	49.1	57.4	59.9	65.7	66.2	78.0	76.0	85.8
Energy sector	6.6	8.7	5.0	5.4	6.4	10.1	7.2	7.4	8.3	18.5	19.7	17.3	18.6	22.4
Agriculture	8.6	11.3	14.2	16.4	18.1	19.0	22.4	24.1	30.3	31.7	36.5	44.6	45.9	47.5
Construction	5.3	7.9	11.5	13.1	14.8	17.4	22.0	25.6	31.7	37.4	39.5	43.3	44.0	47.3
Transport and communication	1.2	3.7	3.9	4.2	4.5	4.4	5.8	7.1	10.6	9.8	10.2	10.3	9.8	11.7
Trade/commerce	31.1	42.2	49.6	55.4	60.3	75.5	86.8	97.6	109.6	126.0	132.0	140.4	131.0	134.2
Sectoral distribution of loans to total loans (percent of total)														
Industry (excluding energy sector)	22.2	17.0	16.2	15.4	14.8	13.5	11.9	12.4	11.3	11.1	10.7	12.2	12.5	13.7
Energy sector	5.0	4.8	2.3	2.1	2.2	2.9	1.7	1.6	1.6	3.1	3.2	2.7	3.1	3.6
Agriculture	6.6	6.3	6.7	6.4	6.2	5.4	5.4	5.2	5.7	5.3	5.9	7.0	7.6	7.6
Construction	4.0	4.4	5.5	5.1	5.1	4.9	5.3	5.5	6.0	6.3	6.4	6.8	7.3	7.5
Transport and communication	0.9	2.0	1.9	1.6	1.5	1.2	1.4	1.5	2.0	1.6	1.7	1.6	1.6	1.9
Trade/commerce	23.8	23.5	23.4	21.7	20.7	21.4	21.1	21.1	20.8	21.2	21.4	22.0	21.6	21.4
Foreign exchange loans to total loans	70.4	63.7	52.8	46.3	42.5	42.3	40.7	39.0	37.5	38.2	38.7	48.7	51.5	53.8
Asset quality														
Nonperforming loans (billions of drams)	3.1	3.8	6.0	7.3	8.6	10.6	10.3	18.7	19.2	23.3	27.9	50.2	64.6	65.5
Watch (up to 90 days past due)	1.5	2.9	3.6	5.4	5.5	7.0	5.8	13.3	11.9	13.3	21.8	36.6	38.8	34.4
Substandard (91-180 days past due)	0.4	0.5	1.0	1.1	2.1	2.2	1.3	2.0	4.8	2.8	3.4	11.4	19.3	21.0
Doubtful (181-270 days past due)	1.1	0.5	1.4	0.9	0.9	1.4	3.1	3.3	2.6	7.2	2.7	2.1	6.5	10.2
Loss (>270 days past due)	…	…	…	11.3	11.1	10.7	10.1	9.7	9.4	10.0	10.2	12.7	14.3	16.8
Nonperforming loans to gross loans	2.1	1.9	2.5	2.8	2.8	2.9	2.4	4.0	3.6	3.9	4.4	7.6	10.2	9.8
Provisions to nonperforming loans	77.0	70.7	64.3	54.7	54.4	53.8	66.6	43.9	46.4	50.1	38.2	26.9	26.6	29.3
Spread between highest and lowest rates of interbank borrowing in AMD	2.0	3.7	3.0	1.4	1.3	1.3	0.5	5.0	7.0	8.0	3.0	4.5	5.0	2.5
Spread between highest and lowest rates of interbank borrowing in foreign currency	1.0	1.0	2.3	0.0	…	0.0	0.0	0.0	0.0	0.0	1.0	8.0	11.3	7.8
Earnings and profitability														
ROA (profits to period average assets)	3.2	3.1	3.6	3.5	3.6	3.8	3.4	3.0	2.8	2.9	3.1	-0.1	-0.1	-0.1
ROE (profits to period average equity)	18.4	15.5	15.9	15.2	15.6	16.7	15.0	13.0	12.4	13.1	13.6	-0.7	-0.3	-0.7
Interest margin to gross income	44.2	41.1	47.1	48.6	49.1	48.6	47.9	48.8	48.2	47.7	45.9	47.1	44.4	43.6
Interest income to gross income	63.7	59.8	66.3	69.9	69.6	69.0	68.6	74.4	74.0	73.4	72.7	86.2	83.0	81.6
Noninterest expenses to gross income	46.5	49.7	45.1	45.5	44.3	43.2	44.5	42.1	43.5	41.0	42.0	45.3	44.1	43.4
Liquidity														
Liquid assets to total assets	47.1	44.2	41.2	41.0	36.7	34.7	33.7	30.5	27.1	25.5	23.8	29.1	32.0	33.9
Liquid assets to total short-term liabilities	98.7	110.5	106.1	109.9	98.6	93.7	98.2	101.0	95.6	92.4	103.1	135.4	145.3	152.1
Customer deposits to total (non-interbank) loans	177.3	140.5	130.8	119.3	118.3	105.9	106.2	96.4	91.4	87.5	81.4	92.1	96.3	100.0
Foreign exchange liabilities to total liabilities	73.3	66.8	56.0	52.4	51.0	48.7	48.3	48.7	50.0	50.2	55.1	69.4	70.9	69.9
Sensitivity to market risk														
Gross open positions in foreign exchange to capital	7.4	4.9	4.4	4.3	4.8	5.5	8.8	6.9	4.8	4.1	11.5	13.8	8.4	4.6

Source: Central Bank of Armenia.

Table 5. Armenia: Central Government Operations, 2007–10

(In billions of drams)

	2007	2008	2009	2009	2009				2010	2010			
	Jan.-Dec.	Jan.-Dec.	Jan.-Dec.		Q1	Q2	Q3	Q4	Jan.-Dec.	Q1	Q2	Q3	Q4
	Act.	Prel.	Proj.	Country Report No. 09/214	Prel.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	632.5	730.8	639.2	682.4	133.8	153.6	168.7	183.1	674.3	141.0	162.5	178.1	192.8
Total revenue	609.1	715.6	623.1	638.9	129.8	151.5	162.3	179.4	659.3	137.3	160.5	172.1	189.4
Tax revenues	504.3	597.9	495.7	522.5	102.4	121.4	133.4	138.4	530.7	109.7	130.0	142.8	148.2
VAT	248.0	296.3	238.4	251.7	47.1	49.1	68.3	73.9	255.2	50.4	52.6	73.1	79.1
Profits, simplified and presumptive	103.4	113.3	90.9	95.9	21.5	35.1	16.7	17.6	97.3	23.0	37.6	17.9	18.8
Personal income tax	46.8	53.7	51.0	51.0	12.0	14.8	12.0	12.3	54.6	12.8	15.9	12.8	13.1
Customs duties	24.0	37.3	26.5	26.5	6.3	5.5	7.3	7.4	28.4	6.7	5.9	7.8	7.9
Other	82.1	97.3	88.9	97.3	15.6	16.9	29.2	27.2	95.2	16.7	18.1	31.3	29.1
Social contributions	85.1	104.1	103.1	101.6	21.5	26.3	25.0	30.3	105.2	22.0	26.9	25.5	30.9
Other revenue	19.6	13.6	24.3	14.8	5.9	3.8	3.9	10.7	23.4	5.7	3.6	3.8	10.3
Grants	23.5	15.1	16.1	43.5	4.0	2.1	6.4	3.6	15.0	3.7	2.0	6.0	3.4
Total expenditure	706.1	793.4	872.6	899.5	160.2	210.6	242.7	259.1	862.2	203.9	218.8	213.7	225.9
Expense	541.6	652.0	711.8	732.9	143.2	173.6	185.7	209.2	737.7	145.7	188.9	191.0	212.3
Wages	61.3	73.0	88.9	88.9	15.3	18.9	24.6	30.1	91.8	15.8	19.5	25.4	31.1
Pensions	21.1	4.1	4.9	4.9	0.8	1.1	1.3	1.7	4.9	0.8	1.0	1.3	1.7
Subsidies	58.9	38.4	19.7	20.5	3.7	4.8	6.5	4.7	26.8	5.0	6.6	8.8	6.4
Interest	10.0	10.4	19.2	23.3	3.5	2.4	7.5	5.9	38.4	7.1	4.7	14.9	11.7
Social allowances and pensions	183.7	206.2	243.3	243.1	55.7	61.4	61.1	65.2	240.9	55.1	60.7	60.5	64.6
Of which: social insurance	85.8	153.5	178.8	178.8	43.2	44.2	45.7	45.6	178.0	43.0	44.0	45.5	45.4
Goods and services	206.7	133.1	148.8	165.7	28.6	38.6	35.4	46.2	157.3	30.2	40.8	37.5	48.8
Grants	...	52.9	65.3	66.2	13.1	12.5	18.9	20.8	51.9	10.4	9.9	15.0	16.5
Other expenditure	...	133.9	121.5	120.2	22.4	34.1	30.5	34.6	125.7	21.1	45.6	27.6	31.4
Transactions in non-financial assets	164.5	141.5	160.8	166.6	17.0	37.0	57.0	49.9	124.5	58.3	29.9	22.7	13.6
Acquisition of non-financial assets	183.3	162.6	175.1	179.9	18.8	41.2	61.5	53.6	124.5	58.3	29.9	22.7	13.6
Of which: projects related to the Russian loan	… ..	…	24.0	24.0	0.0	0.0	17.0	7.0	22.1	22.1	0.0	0.0	0.0
Disposals of non-financial assets	18.9	21.1	14.2	13.3	1.8	4.2	4.5	3.8	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-73.5	-62.7	-233.4	-217.0	-26.4	-57.0	-74.0	-76.1	-187.9	-62.9	-56.3	-35.6	-33.1
Statistical discrepancy	4.1	16.1	0.0	0.0	0.2	12.5	-6.3	-6.3	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-69.4	-46.6	-233.4	-217.0	-26.2	-44.5	-80.3	-82.4	-187.9	-62.9	-56.3	-35.6	-33.1
Financing	69.4	46.6	233.4	217.0	26.2	44.5	80.3	82.4	187.9	62.9	56.3	35.6	33.1
Domestic financing	30.6	28.6	-85.7	-113.8	23.9	-151.9	-13.7	56.0	88.0	36.3	50.0	1.6	0.2
Banking system	-6.4	-4.7	-16.2	-79.3	28.1	-160.9	19.5	97.0	107.1	54.8	48.8	0.6	2.9
CBA 1/	-16.2	-28.1	-12.6	-111.3	37.5	-146.2	-1.0	96.9	68.3	43.2	41.2	-11.8	-4.2
Of which: deposits related to the Russian loan	0.0	0.0	-87.1	-135	0.0	-184.4	52.4	44.9	46.6	44.7	2.0	0.0	0.0
Commercial Banks	9.9	23.4	-3.6	32.0	-9.4	-14.7	20.5	0.1	38.7	11.6	7.6	12.5	7.1
Nonbanks	37.0	33.4	-69.5	-34.6	-4.3	9.0	-33.2	-41.0	-19.0	-18.5	1.3	0.9	-2.7
Privatization proceeds	44.2	31.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills	-2.8	3.5	8.2	3.0	-1.3	7.2	2.5	-0.2	3.0	0.8	0.8	0.8	0.8
Promissory note/other	-1.0	-1.2	-2.0	-0.1	0.0	-0.7	0.0	-1.3	-2.0	0.0	-0.7	0.0	-1.3
Net lending	-3.4	-0.5	-75.7	-37.5	-3.0	2.5	-35.7	-39.5	-20.0	-19.2	1.2	0.2	-2.2
Of which: financed with the Russian loan	… ..	…	-71.9	-33.8	0.0	0.0	-35.4	-36.6	-22.6	-22.6	0.0	0.0	0.0
External financing	38.8	17.9	319.1	330.9	2.4	196.4	94.0	26.4	99.9	26.6	6.3	34.0	32.9
Gross inflow 1/	64.5	48.8	359.1	370.8	12.2	205.9	106.6	34.4	141.5	36.0	17.3	45.8	42.4
Of which: Russian project loan	… ..	…	185.1	192.5	0.0	185.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization due	-6.0	-4.9	-6.6	-6.6	-2.6	-0.5	-2.9	-0.6	-9.9	-2.5	-2.5	-2.5	-2.5
Net lending	-19.7	-26.0	-33.3	-33.3	-7.2	-9.0	-9.7	-7.4	-31.7	-6.9	-8.6	-9.3	-7.0
Memorandum items:													
Nominal GDP (billion of drams)	3,149	3,646	3,116	3,350	3,116	3,116	3,116	3,116	3,215	3,215	3,215	3,215	3,215
Program balance 2/	-92.5	-73.0	-342.4	-287.8	-36.4	-51.0	-125.7	-129.3	-239.7	-89.0	-63.7	-44.7	-42.3
Overall balance excl. spending financed with the Russian loan	...	...	-209.4	-193.0	-26.4	-57.0	-57.0	-69.1	-165.9	-40.9	-56.3	-35.6	-33.1
T-bill issuance	7.8	25.3	32.0	...	-6.9	15.6	25.0	-1.7	30.0	7.5	7.5	7.5	7.5

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

1/ Includes IMF budget support

2/ The program balance reflects net lending activities and is measured as below-the-line overall balance minus net lending.

Table 6. Armenia: Central Government Operations, 2007–10

(in percent of GDP, unless otherwise specified)

	2007	2008	2009		2009				2010	2010			
	Jan.-Dec.	Jan.-Dec.	Jan.-Dec.		Q1	Q2	Q3	Q4	Jan.-Dec.	Q1	Q2	Q3	Q4
	Act.	Prel.	IMF Proj.	Country Report No. 09/214	Prel.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	20.1	20.0	20.5	20.4	4.3	4.9	5.4	5.9	21.0	4.4	5.1	5.5	6.0
Total revenue	19.3	19.6	20.0	19.1	4.2	4.9	5.2	5.8	20.5	4.3	5.0	5.4	5.9
Tax revenues	16.0	16.4	15.9	15.6	3.3	3.9	4.3	4.4	16.5	3.4	4.0	4.4	4.6
VAT	7.9	8.1	7.7	7.5	1.5	1.6	2.2	2.4	7.9	1.6	1.6	2.3	2.5
Profits, simplified and presumptive	3.3	3.1	2.9	2.9	0.7	1.1	0.5	0.6	3.0	0.7	1.2	0.6	0.6
Personal income tax	1.5	1.5	1.6	1.5	0.4	0.5	0.4	0.4	1.7	0.4	0.5	0.4	0.4
Customs duties	0.8	1.0	0.9	0.8	0.2	0.2	0.2	0.2	0.9	0.2	0.2	0.2	0.2
Other	2.6	2.7	2.9	2.9	0.5	0.5	0.9	0.9	3.0	0.5	0.6	1.0	0.9
Social contributions	2.7	2.9	3.3	3.0	0.7	0.8	0.8	1.0	3.3	0.7	0.8	0.8	1.0
Other revenue	0.6	0.4	0.8	0.4	0.2	0.1	0.1	0.3	0.7	0.2	0.1	0.1	0.3
Grants	0.7	0.4	0.5	1.3	0.1	0.1	0.2	0.1	0.5	0.1	0.1	0.2	0.1
Total expenditure	22.4	21.8	28.0	26.9	5.1	6.8	7.8	8.3	26.8	6.3	6.8	6.6	7.0
Expense	17.2	17.9	22.8	21.9	4.6	5.6	6.0	6.7	22.9	4.5	5.9	5.9	6.6
Wages	1.9	2.0	2.9	2.7	0.5	0.6	0.8	1.0	2.9	0.5	0.6	0.8	1.0
Pensions	0.7	0.1	0.2	0.1	0.0	0.0	0.0	0.1	0.2	0.0	0.0	0.0	0.1
Subsidies	1.9	1.1	0.6	0.6	0.1	0.2	0.2	0.2	0.8	0.2	0.2	0.3	0.2
Interest	0.3	0.3	0.6	0.7	0.1	0.1	0.2	0.2	1.2	0.2	0.1	0.5	0.4
Social allowances and pensions	5.8	5.7	7.8	7.3	1.8	2.0	2.0	2.1	7.5	1.7	1.9	1.9	2.0
Of which : social insurance	2.7	4.2	5.7	5.3	1.4	1.4	1.5	1.5	5.5	1.3	1.4	1.4	1.4
Goods and services	6.6	3.7	4.8	4.9	0.9	1.2	1.1	1.5	4.9	0.9	1.3	1.2	1.5
Grants	...	1.5	2.1	2.0	0.4	0.4	0.6	0.7	1.6	0.3	0.3	0.5	0.5
Other expenditure	...	3.7	3.9	3.6	0.7	1.1	1.0	1.1	3.9	0.7	1.4	0.9	1.0
Transactions in non-financial assets	5.2	3.9	5.2	5.0	0.5	1.2	1.8	1.6	3.9	1.8	0.9	0.7	0.4
Acquisition of non-financial assets	5.8	4.5	5.6	5.4	0.6	1.3	2.0	1.7	3.9	1.8	0.9	0.7	0.4
Of which : projects related to the Russian loan	…	…	0.8	0.7	0.0	0.0	0.5	0.2	0.7	0.7	0.0	0.0	0.0
Disposals of non-financial assets	0.6	0.6	0.5	0.4	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-2.3	-1.7	-7.5	-6.5	-0.8	-1.8	-2.4	-2.4	-5.8	-2.0	-1.8	-1.1	-1.0
Statistical discrepancy	0.1	0.4	0.0	0.0	0.0	0.4	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-2.2	-1.3	-7.5	-6.5	-0.8	-1.4	-2.6	-2.6	-5.8	-2.0	-1.8	-1.1	-1.0
Financing	2.2	1.3	7.5	6.5	0.8	1.4	2.6	2.6	5.8	2.0	1.8	1.1	1.0
Domestic financing	1.0	0.8	-2.8	-3.4	0.8	-4.9	-0.4	1.8	2.7	1.1	1.6	0.0	0.0
Banking system	-0.2	-0.1	-0.5	-2.4	0.9	-5.2	0.6	3.1	3.3	1.7	1.5	0.0	0.1
CBA 1/	-0.5	-0.8	-0.4	-3.3	1.2	-4.7	0.0	3.1	2.1	1.3	1.3	-0.4	-0.1
Of which : deposits related to the Russian loan	…	…	-2.8	-4.0	0.0	-5.9	1.7	1.4	1.5	1.4	0.1	0.0	0.0
Commercial Banks	0.3	0.6	-0.1	1.0	-0.3	-0.5	0.7	0.0	1.2	0.4	0.2	0.4	0.2
Nonbanks	1.2	0.9	-2.2	-1.0	-0.1	0.3	-1.1	-1.3	-0.6	-0.6	0.0	0.0	-0.1
Privatization proceeds	1.4	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills	-0.1	0.1	0.3	0.1	0.0	0.2	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Promissory note/other	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0
Net lending	-0.1	0.0	-2.4	-1.1	-0.1	0.1	-1.1	-1.3	-0.6	-0.6	0.0	0.0	-0.1
Of which : financed with the Russian loan	…	…	-2.3	-1.0	0.0	0.0	-1.1	-1.2	-0.7	-0.7	0.0	0.0	0.0
External financing	1.2	0.5	10.2	9.9	0.1	6.3	3.0	0.8	3.1	0.8	0.2	1.1	1.0
Gross inflow 1/	2.0	1.3	11.5	11.1	0.4	6.6	3.4	1.1	4.4	1.1	0.5	1.4	1.3
Of which : Russian project loan	…	…	5.9	5.7	0.0	5.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization due	-0.2	-0.1	-0.2	-0.2	-0.1	0.0	-0.1	0.0	-0.3	-0.1	-0.1	-0.1	-0.1
Net lending	-0.6	-0.7	-1.1	-1.0	-0.2	-0.3	-0.3	-0.2	-1.0	-0.2	-0.3	-0.3	-0.2
Memorandum items:													
Nominal GDP (billion of drams)	3,149	3,646	3,116	3,350	3,116	3,116	3,116	3,116	3,215	3,215	3,215	3,215	3,215
Program balance 3/	-2.9	-2.0	-11.0	-8.6	-1.2	-1.6	-4.0	-4.1	-7.5	-2.8	-2.0	-1.4	-1.3
Overall balance excl. spending financed with the Russian loan	…	…	-6.7	-5.8	-0.8	-1.8	-1.8	-2.2	-5.2	-1.3	-1.8	-1.1	-1.0
T-bill issuance	0.2	0.7	1.0	…	-0.2	0.5	0.8	-0.1	0.9	0.2	0.2	0.2	0.2

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

1/ Includes IMF budget support

2/ The program balance reflects net lending activities and is measured as below-the-line overall balance minus net lending.

Table 7. Armenia: Public Sector Debt Sustainability Framework, 2004-2014
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	32.4	24.4	18.7	16.1	15.9	**37.4**	**44.1**	**46.6**	**43.3**	**41.1**	**37.4**	**-2.7**
Of which : foreign-currency denominated	30.1	22.1	16.5	14.0	13.3	33.4	39.3	40.5	36.3	32.8	28.1	
Change in public sector debt	-8.5	-8.0	-5.7	-2.6	-0.3	21.6	6.7	2.4	-3.3	-2.2	-3.7	
Identified debt-creating flows (4+7+12)	-9.6	-5.2	-6.8	-3.4	-1.4	10.2	4.7	1.9	0.8	-0.2	-1.2	
Primary deficit	0.6	1.6	1.7	2.0	1.4	6.9	4.6	3.7	3.5	2.5	1.5	
Revenue and grants	15.4	17.8	18.0	20.1	20.0	20.5	21.0	21.1	21.6	22.0	22.4	
Primary (noninterest) expenditure	16.0	19.4	19.7	22.1	21.5	27.4	25.6	24.9	25.1	24.5	23.9	
Automatic debt dynamics 2/	-10.2	-6.3	-7.1	-4.9	-3.2	3.3	0.1	-1.8	-2.7	-2.7	-2.7	
Contribution from interest rate/growth differential 3/	-5.6	-4.4	-3.5	-2.6	-1.9	3.3	0.1	-1.8	-2.7	-2.7	-2.7	
Of which : contribution from real interest rate	-1.9	-0.6	-0.7	-0.4	-1.0	0.4	0.5	-0.6	-1.2	-1.1	-1.0	
Of which : contribution from real GDP growth	-3.6	-3.8	-2.7	-2.2	-0.9	2.9	-0.4	-1.2	-1.5	-1.6	-1.7	
Contribution from exchange rate depreciation 4/	-4.6	-1.9	-3.6	-2.3	-1.3	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	-0.6	-1.4	-0.5	0.3	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	-0.6	-1.9	-1.4	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or 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 (specify, e.g. bank recapitalization)	0.0	0.0	0.5	0.9	1.2	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	1.0	-2.7	1.1	0.8	1.2	11.4	1.9	0.5	-4.1	-2.0	-2.5	
Public sector debt-to-revenue ratio 1/	210.4	137.0	104.2	80.3	79.1	182.4	210.3	220.3	200.7	187.0	167.2	
Gross financing need 6/	4.2	3.4	3.3	3.4	2.4	9.3	7.9	7.1	6.6	5.9	5.2	
in billions of U.S. dollars	0.2	0.2	0.2	0.3	0.3	0.8	0.6	0.6	0.6	0.6	0.6	
Scenario with key variables at their historical averages 7/						**37.4**	**36.5**	**34.3**	**28.7**	**25.4**	**22.3**	**-2.5**
Scenario with no policy change (constant primary balance) in 2009-2014						**37.4**	**46.4**	**52.0**	**51.8**	**53.4**	**54.2**	**-4.0**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	10.5	13.9	13.2	13.7	6.8	-15.6	1.2	3.0	3.5	4.0	4.5	
Average nominal interest rate on public debt (in percent) 8/	1.5	1.7	1.6	2.0	2.0	3.4	3.4	3.0	1.4	1.5	1.6	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-4.8	-1.6	-3.0	-2.2	-6.4	2.1	1.5	-1.3	-2.7	-2.5	-2.4	
Nominal appreciation (increase in US dollar value of local currency, in percent)	16.5	7.9	23.8	19.5	11.8	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	6.3	3.2	4.6	4.2	8.4	1.3	1.9	4.2	4.0	4.0	4.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.6	38.0	14.7	27.9	3.7	7.6	-5.3	-0.1	4.4	1.5	1.9	
Primary deficit	0.6	1.6	1.7	2.0	1.4	6.9	4.6	3.7	3.5	2.5	1.5	

Source: Fund staff estimates and projections.

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

Table 8. Armenia: External Debt Sustainability Framework, 2004-2014
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	33.3	22.4	18.9	15.7	13.2	**31.1**	**38.9**	**39.9**	**36.8**	**32.8**	**28.7**	**-8.4**
Change in external debt	-5.8	-10.9	-3.5	-3.1	-2.5	17.9	7.8	1.0	-3.1	-4.1	-4.0	
Identified external debt-creating flows (4+8+9)	-10.0	-12.7	-10.4	-7.0	0.1	13.6	9.6	6.5	3.9	0.8	0.0	
Current account deficit, excluding interest payments	4.3	0.8	1.7	6.3	11.4	13.4	13.2	11.6	9.9	8.0	7.1	
Deficit in balance of goods and services	14.9	14.4	16.1	19.7	25.0	26.7	28.2	28.3	28.5	28.0	26.9	
Exports	27.7	28.9	23.7	19.3	14.4	14.7	17.4	18.9	19.2	19.3	19.2	
Imports	42.6	43.3	39.7	39.0	39.4	41.3	45.7	47.3	47.7	47.3	46.1	
Net nondebt creating capital inflows (negative)	-6.1	-4.7	-7.0	-7.6	-7.8	-3.0	-3.7	-4.5	-5.3	-6.4	-6.3	
Automatic debt dynamics 1/	-8.2	-8.8	-5.1	-5.7	-3.5	3.1	0.2	-0.6	-0.8	-0.8	-0.9	
Contribution from nominal interest rate	0.3	0.2	0.2	0.1	0.1	0.3	0.5	0.6	0.6	0.5	0.5	
Contribution from real GDP growth	-3.2	-3.4	-2.3	-1.8	-0.8	2.8	-0.4	-1.1	-1.3	-1.4	-1.3	
Contribution from price and exchange rate changes 2/	-5.2	-5.6	-2.9	-4.0	-2.8	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	4.1	1.8	6.9	3.9	-2.6	4.3	-1.8	-5.5	-7.0	-4.8	-4.0	
External debt-to-exports ratio (in percent)	120.1	77.6	79.8	81.6	92.2	212.3	223.0	211.0	191.6	169.5	149.7	
Gross external financing need (in billions of US dollars) 4/	0.2	0.1	0.2	0.6	1.4	1.2	1.2	1.1	1.1	1.2	1.1	
in percent of GDP	7.0	2.1	2.6	6.8	11.9	14.4	14.5	13.0	12.7	12.1	10.5	
Scenario with key variables at their historical averages 5/						**31.1**	**24.6**	**18.8**	**14.0**	**11.6**	**10.3**	**-7.4**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	10.5	13.9	13.2	13.7	6.8	-15.6	1.2	3.0	3.5	4.0	4.5	
GDP deflator in U.S. dollars (change in percent)	15.3	20.3	15.1	26.8	21.2	-13.7	-6.7	0.7	2.7	4.2	5.2	
Nominal external interest rate (in percent)	0.9	1.0	0.9	0.9	0.8	1.7	1.7	1.5	1.5	1.6	1.6	
Growth of exports (U.S. dollar terms, in percent)	9.0	43.8	6.7	17.6	-3.7	-25.6	12.4	12.4	8.0	9.0	9.0	
Growth of imports (U.S. dollar terms, in percent)	7.7	40.3	19.4	41.5	30.7	-23.5	4.4	7.3	7.4	7.4	7.1	
Current account balance, excluding interest payments	-4.3	-0.8	-1.7	-6.3	-11.4	-13.4	-13.2	-11.6	-9.9	-8.0	-7.1	
Net nondebt creating capital inflows	6.1	4.7	7.0	7.6	7.8	3.0	3.7	4.5	5.3	6.4	6.3	

Source: Fund staff estimates and projections.

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,
ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) 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 nondebt inflows in percent of GDP.

Table 9. Armenia: Medium-Term Macroeconomic Framework, 2007–14

	2007	2008	2009	2010	2011	2012	2013	2014
	Act.	Prel.	Projections					
	(In percent of GDP, unless otherwise specified)							
National income and prices								
Real GDP (percent change)	13.7	6.8	-15.6	1.2	3.0	3.5	4.0	4.5
Gross domestic product (in millions of U.S. dollars)	9,206	11,917	8,683	8,200	8,505	9,044	9,798	10,771
Gross national income per capita (in U.S. dollars)	2,940	3,830	2,758	2,593	2,677	2,830	3,052	3,321
CPI inflation, end-of-period (percent change)	6.6	5.2	5.2	3.0	4.0	4.0	4.0	4.0
Investment and saving								
Investment	38.2	42.8	36.0	35.2	35.7	36.3	36.9	37.4
Private	32.9	38.9	30.8	31.3	31.8	32.3	32.8	33.3
Public	5.2	3.9	5.2	3.9	3.9	4.0	4.1	4.1
National savings	31.8	31.2	22.2	21.4	23.5	25.8	28.3	29.8
Private	28.9	29.1	24.5	23.4	24.5	25.9	27.3	27.8
Public	2.9	2.2	-2.3	-2.0	-1.0	-0.1	1.0	2.0
Central government operations								
Revenue and grants	20.1	20.0	20.5	21.0	21.1	21.6	22.0	22.4
Of which: tax revenue	16.0	16.4	15.9	16.5	16.9	17.3	17.7	18.1
grants 1/	0.7	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Expenditure	22.4	21.8	28.0	26.8	26.0	25.6	25.0	24.4
Current expenditure	17.2	17.9	22.8	22.9	22.1	21.6	20.9	20.3
Capital expenditure	5.2	3.9	5.2	3.9	3.9	4.0	4.1	4.1
Overall balance (including grants)	-2.2	-1.3	-7.5	-5.8	-4.9	-4.1	-3.1	-2.1
Domestic financing	1.0	0.8	-2.8	2.7	2.8	2.2	2.7	1.8
External financing	1.2	0.5	10.2	3.1	2.1	1.9	0.3	0.3
Underlying balance 2/	-2.8	-1.6	-7.8	-5.7	-4.7	-4.0	-3.2	-2.1
Government and government-guaranteed debt	16.1	15.9	37.4	44.5	46.6	43.6	41.1	37.6
External sector								
Exports of goods and services	19.3	14.4	14.7	17.4	18.9	19.2	19.3	19.2
Imports of goods and services	39.0	39.4	41.3	45.7	47.3	47.7	47.3	46.1
Current account (in percent of GDP)	-6.4	-11.5	-13.7	-13.8	-12.2	-10.5	-8.6	-7.6
Current account (in millions of U.S. dollars)	-589	-1,372	-1,193	-1,128	-1,034	-948	-841	-815
Capital and financial account (in millions of U.S. dollars)	1,191	1,124	1,240	658	896	995	1,206	1,198
Of which: direct foreign investment	701	929	263	305	382	477	631	675
public sector disbursements	149	160	805	361	379	387	394	406
Change in gross international reserves (in millions of U.S. dollars) 3/	-587	252	-503	49	92	103	-152	-304
Arrears and debt relief (in millions of U.S. dollars)	1	0	2	2	2	2	2	2
Financing/gap (in millions of U.S. dollars)	0	0	58	440	66	0	0	0
Of which: IMF	0	0	58	291	56	0	0	0
Other	0	0	0	149	10	0	0	0
Gross international reserves in months of imports	4.2	4.7	6.1	5.6	4.9	4.3	4.4	4.8

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

1/ For 2007–09, the figures include projections for disbursements under the U.S. Millennium Challenge Account.

2/ Underlying balance is defined as overall balance before grants and excluding external interest payments.

3/ A negative figure indicates an increase.

Table 10. Armenia: Fund Disbursements and Timing of Reviews Under the Twenty Eight -Month Stand-By Arrangement, 2009-11

(SDR millions)

Date of Availability	Conditions	SBA	Augmentation	Total
6 March, 2009	Board approval of the Stand -By arrangement	161.552		161.552
22 June, 2009	Observance of end -March 2009 performance criteria and completion of first review	36.800		36.800
	Board approval of the SBA augmentation		65.868	65.868
23 October, 2009*	Observance of end -September 2009 performance criteria and completion of second review	37.720		37.720
15 February, 2010	Observance of end -December 2009 performance criteria and completion of third review	23.552	24.933	48.485
15 May, 2010	Observance of end -March 2010 performance criteria and completion of fourth review	23.552	24.933	48.485
15 August, 2010	Observance of end -June 2010 performance criteria and completion of fifth review	23.552	24.933	48.485
15 November, 2010	Observance of end -September 2010 performance criteria and completion of sixth review	23.552	24.933	48.485
15 February, 2011	Observance of end -December 2010 performance criteria and completion of seventh review	18.860		18.860
15 May, 2011	Observance of end -March 2011 performance criteria and completion of eighth review	18.860		18.860

Source: Fund staff estimates and projections.
* This review is the combination of the second and third reviews under the original program.

Table 11. Armenia: Indicators of Capacity to Repay the Fund, 2008–15 1/

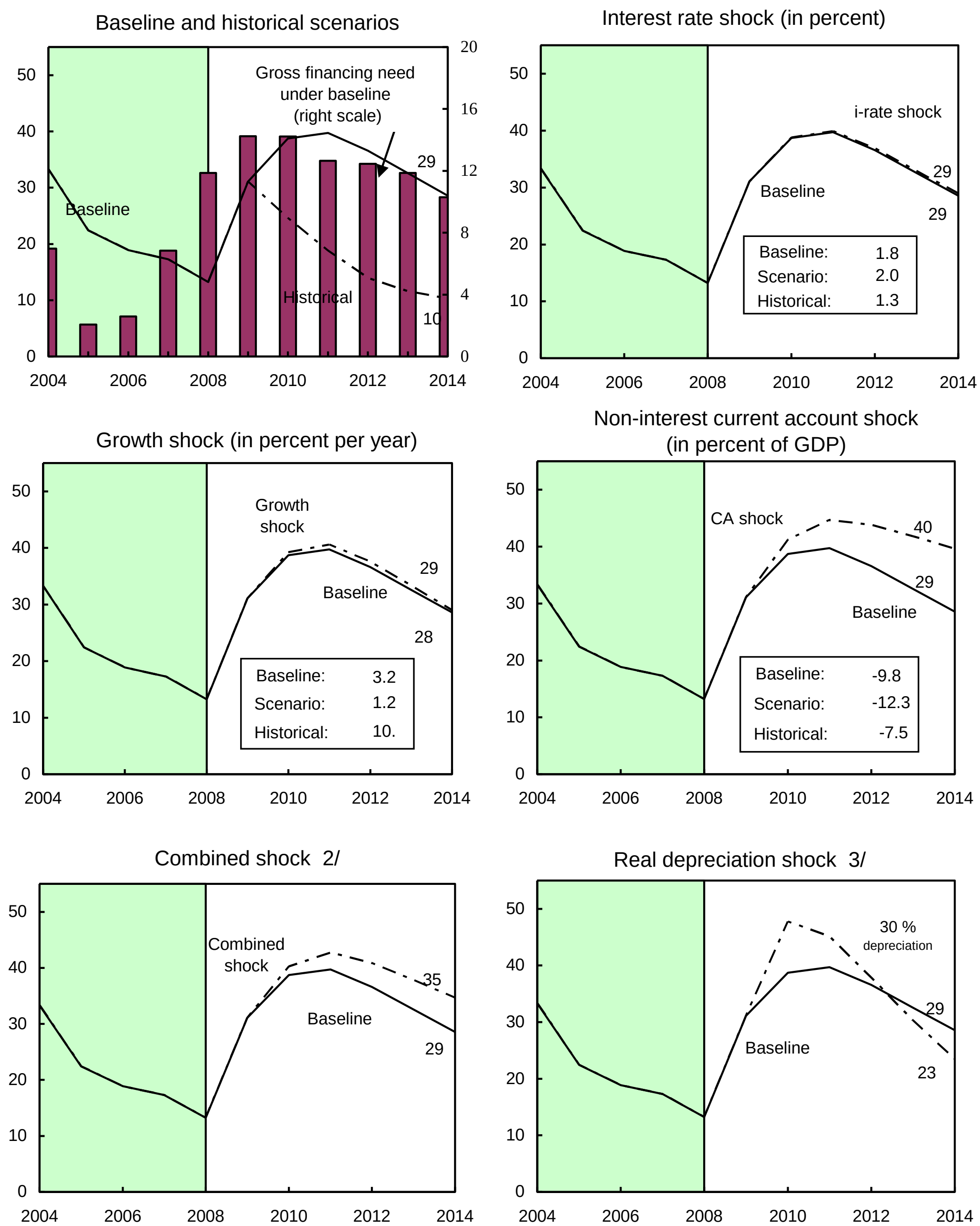
	2008	2009	2010	2011	2012	2013	2014	2015
	Prelim.	Projections						
Fund obligations based on existing credit (in millions of SDRs)								
Principal	17.1	8.1	14.1	14.4	101.0	143.2	53.5	4.5
Charges and interest	0.5	1.1	3.7	3.6	3.4	2.0	0.4	0.1
Fund obligations based on existing and prospective credit (in millions of SDRs)								
Principal	17.1	8.1	14.1	14.4	101.0	198.4	181.1	84.0
Charges and interest	0.5	1.2	5.9	7.0	6.8	5.2	2.6	0.7
Total obligations based on existing and prospective credit								
In millions of SDRs	17.6	9.3	20.1	21.4	107.8	203.6	183.7	84.7
In millions of US$	26.4	14.5	30.1	32.1	161.8	306.2	276.6	127.6
In percent of Gross International Reserves	1.9	0.8	1.6	1.8	9.7	16.8	13.0	6.0
In percent of exports of goods and services	1.5	1.1	2.1	2.0	9.3	16.2	13.4	5.7
In percent of debt service 2/	49.9	17.6	27.4	27.4	64.2	77.3	75.5	45.9
In percent of GDP	0.2	0.2	0.4	0.4	1.8	3.1	2.6	1.1
In percent of quota	19.1	10.1	21.8	23.3	117.1	221.3	199.7	92.1
Outstanding Fund credit 2/								
In millions of SDRs	87.5	374.3	554.1	577.3	476.3	277.9	96.8	12.8
In billions of US$	0.13	0.58	0.83	0.87	0.72	0.42	0.15	0.02
In percent of Gross International Reserves	9.4	30.4	44.7	48.9	42.9	23.0	6.9	0.9
In percent of exports of goods and services	7.7	45.6	58.1	53.8	41.2	22.1	7.1	0.9
In percent of debt service 2/	248.3	707.1	757.0	739.5	283.6	105.5	39.8	6.9
In percent of GDP	1.1	6.7	10.1	10.2	7.9	4.3	1.4	0.2
In percent of quota	95.1	406.8	602.2	627.5	517.8	302.1	105.2	13.9
Net use of Fund credit (millions of SDRs)	-12.5	293.9	179.8	23.3	-101.0	-198.4	-181.1	-84.0
Disbursements	4.6	301.9	193.9	37.7	0.0	0.0	0.0	0.0
Repayments and Repurchases	17.1	8.1	14.1	14.4	101.0	198.4	181.1	84.0
Memorandum items:								
Nominal GDP (in millions of US$)	11,916.6	8,682.6	8,199.7	8,505.4	9,044.1	9,798.5	10,771.4	11,725.9
Exports of goods and services (in millions of US$)	1,710.9	1,272.3	1,430.7	1,608.4	1,737.1	1,893.9	2,064.9	2,240.9
Gross international reserves (in millions of US$)	1,406.8	1,910.0	1,861.0	1,769.3	1,666.4	1,818.1	2,122.4	2,140.5
Debt service (in millions of US$) 2/	53.0	82.1	109.8	117.1	252.1	396.3	366.3	277.8
Quota (millions of SDRs)	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0

Sources: Fund staff estimates and projections.

1/ Indicators cover both GRA and PRGF credit.

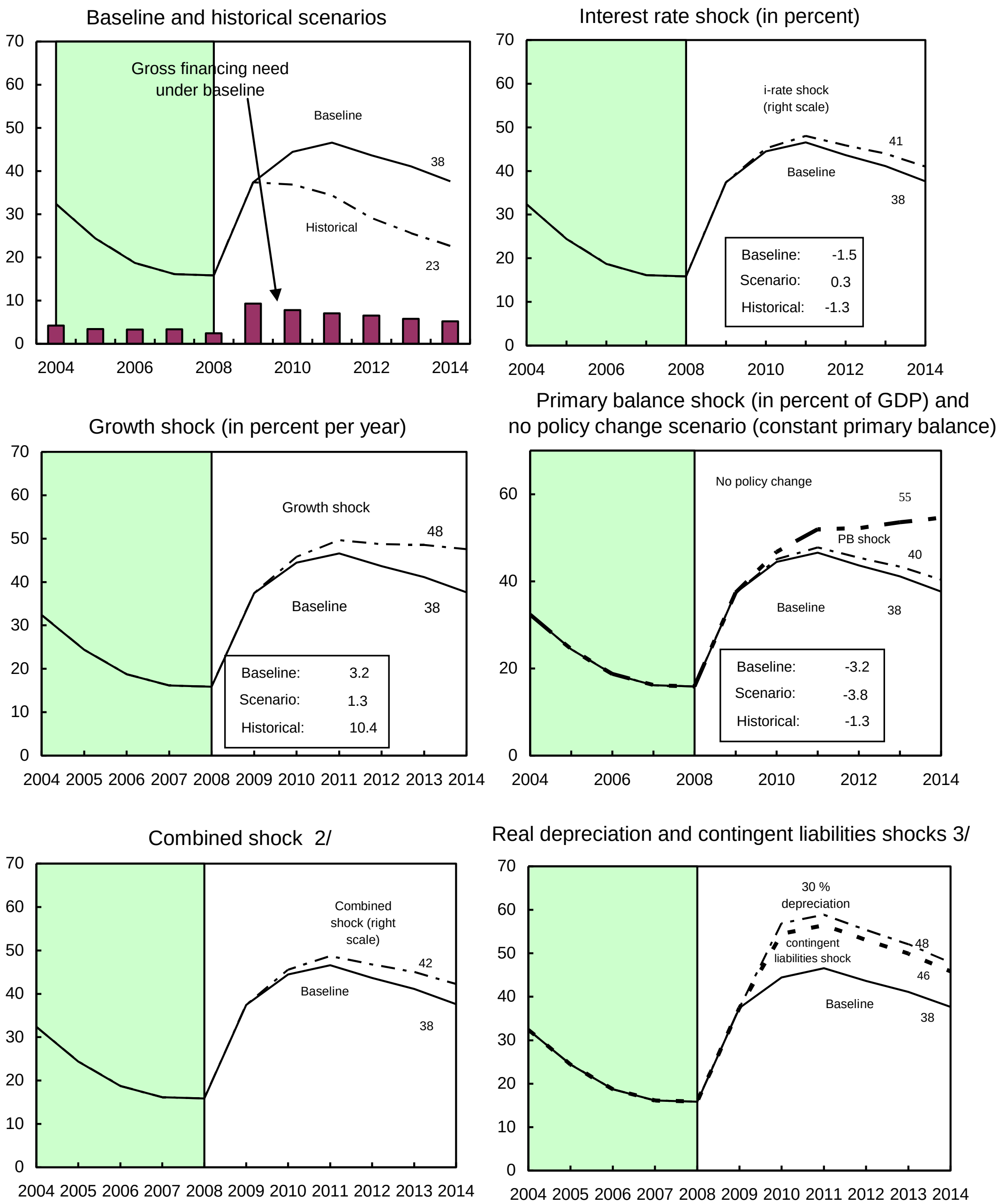
2/ Total debt service includes IMF repurchases and repayments.

Figure 2. Armenia: External Debt Sustainability: Bound Tests 1/
(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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2009.

Figure 3. Armenia: Public Debt Sustainability: Bound Tests 1/
(Public 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

ATTACHMENT I. ARMENIA: LETTER OF INTENT

October 14, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

1. 2009 has been an extremely challenging year for Armenia. The sharp deterioration in the external outlook beginning in late 2008 led to a substantial weakening of the balance of payments, with pressures on the exchange rate and growing concerns about the financial system. While the return to the floating exchange rate in March 2009 has served the economy well by restoring confidence and reducing concerns about financial stability, the economic decline has deepened. Both the balance of payments and the public finances have likewise weakened further.

2. We have responded forcefully to the crisis, implementing macroeconomic policies and structural reforms aimed at mitigating its impact and setting the stage for a rebound. Timely support from the IMF has been an important element of our strategy, first with the approval of the Stand-By Arrangement in March of this year, followed by an augmentation of resources at the time of the First Review.

3. Program performance has been very strong (Tables 1 and 2). All quantitative performance criteria for end June were met, and all performance criteria for end-September for which data are available have also been met. Given that the final data are not yet available for the program fiscal balance at end-September, we are requesting a waiver of nonobservance for this performance criterion, which we expect to have missed by a small margin. In addition, all structural benchmarks for end-June and end-September were implemented.

4. This letter of intent outlines the policies we intend to pursue in the remainder of 2009 and in 2010 to achieve our program objectives, namely to help adjust to the worsened outlook, maintain confidence, and protect the poor. These policies supplement those outlined in the memoranda of economic and financial policies dated March 2, 2009 and June 5, 2009.

5. We welcome the Executive Board's decision to back the US$250 billion general SDR allocation. We intend to use our share of the allocation to bolster the CBA's international reserves.

I. Recent Developments and Outlook for 2009-10

6. The contraction in economic activity in Armenia has deepened. Growth has fallen by more than 18 percent in the first seven months of 2009 driven by the collapse in the construction sector as remittances from abroad, notably Russia, slowed down. We anticipate some improvement in the economy by the end of 2009 with a pick up of activity in industry, as the mining sector benefits from the weaker exchange rate and rising metal prices, and the construction sector stabilizes. Nonetheless, real GDP is now projected to fall by around 15 percent in 2009. Inflation remains contained on the background of weak domestic demand, but could increase moderately in the coming months as international commodity prices strengthen. Falling exports on account of feeble external demand and significantly lower remittances have widened the current account deficit, despite the significant decline in imports.

7. We expect the economy to gradually recover during the next year, supported by a rebound in services, agriculture, and industry, particularly mining. However, prospects for recovery in Armenia will depend crucially on improvements in external conditions, and in particular on a turnaround in the Russian economy.

II. Monetary, Exchange Rate, and Financial Policies

8. Our monetary policy continues to be underpinned by an inflation targeting framework. However, in the context of falling output and weak price pressures, the CBA's stance has so far continued to focus on easing credit conditions. Credit to the private sector has been declining since end-March, as borrowers wait for the economic uncertainty to clear and banks continue to keep tight lending criteria in light of the heightened credit risk. With price pressures still contained, the CBA can focus on overcoming the credit crunch consistent with the inflation target. In light of this, it has gradually lowered its policy rate to 5 percent in September, down from its peak of 7.75 percent in the aftermath of the return to the floating exchange rate regime. We expect credit to start rising again toward the end of the year as a result of the loose monetary conditions and of our various programs to support bank lending to the private sector. These include the CBA's foreign-financed on-lending window to finance SMEs through commercial banks and the mortgage refinancing facility offered by the newly-created mortgage operator.

9. We stand ready to adjust the monetary stance in line with inflation developments in the coming months. Besides the possible increase in international commodity prices, the abundant dram liquidity resulting from our expansionary policies could weaken the exchange rate and further add to price pressures. To preempt excessive liquidity buildup, the CBA has suspended the outright purchases of government securities, and is relying more on the available monetary operations instruments, including foreign exchange swaps. Without

undermining its overarching objective to stimulate economic activity, and market conditions permitting, the Ministry of Finance will increase its net T-bill issuance in coordination with the CBA. This will help absorb some of the excess liquidity, while allowing the government to refinance its debt at attractive interest rates. Proceeds from the issuance would be placed at the central bank at market interest rates.

10. We remain committed to the floating exchange rate regime and strive to promote increased exchange rate flexibility. In this context, the CBA will adhere to its internal guideline on foreign exchange intervention strategy introduced in June 2009. The strategy is designed to allow the exchange rate to move freely, with interventions limited to smoothing excessive exchange rate volatility and rebuilding reserves. The CBA will take particular care to avoid giving the market any perception, verbally or otherwise, of targeting a particular exchange rate level or band. In addition, to enhance transparency, the CBA will refrain from conducting foreign exchange intervention with counterparties other than foreign exchange market operators and government entities.

11. We continue to closely monitor the health of the financial sector and are ready to promptly take necessary actions to preserve financial stability. The latest stress tests show that the banking system remains sound with high capital and liquidity ratios, and is now less exposed to exchange rate risk. While non-performing loans have increased due to the economic crisis, banks are taking appropriate action by provisioning fully and by working with borrowers to restructure troubled but viable loans.

12. We will reduce banking sector vulnerabilities by imposing additional prudential measures, as appropriate. We intend to restrict banks' reliance on a single source of funding, and reinstate limits on net open foreign exchange positions to ensure proper exchange rate risk management. We are in close consultation with market participants to ensure proper design of these measures and maximize their effectiveness.

13. We have made good progress on strengthening financial safety net and crisis preparedness. The government has approved the changes proposed by the Deposit Guarantee Fund (DGF) to enhance its effectiveness (structural benchmark, end-June 2009) and submitted the relevant law amendments to parliament in September. The changes include doubling the coverage on both domestic and foreign currency deposits, reviewing the appropriate level of coverage every 5 years, and increasing the financial resources of the DGF with government back-up funding. The proposed doubling of coverage would bring the coverage level to approximately 2.5 times per capita GDP. To further enhance our crisis management capability, we will participate in a regional crisis simulation exercise as part of the crisis preparedness programs organized by the Toronto Centre, which will provide an opportunity to test the effectiveness of our existing policy tools and coordination and decision-making mechanism framework. We also expect to receive Fund technical assistance in this area starting in October.

14. The draft legislation on the recapitalization of the CBA with marketable interest-bearing securities was submitted to parliament (structural benchmark for end-September

2009). The MOF will gradually issue government bonds to recapitalize the CBA, and bond issuance would follow a clear schedule to enhance the credibility of this operation and support the financial strength and independence of the central bank. The issuance of these securities would also help the development of the local debt market.

III. Fiscal Policy

15. A counter-cyclical fiscal policy remains appropriate for Armenia to minimize the impact of the global downturn on our economy. The government is implementing an expansionary strategy based on an increase in nominal spending compared to last year, despite the collapse in tax revenues under the impact of the crisis. This fiscal impulse goes beyond the effect of automatic stabilizers, as we are increasing capital expenditures and lending to SMEs and key enterprises compared to last year, while ringfencing social expenditures. In line with this stance, we will allow the fiscal deficit to rise up to 7.5 percent of GDP. Financing relies heavily on generous external financing from bilateral and multilateral partners, including the Fund.

16. However, we remain committed to a sustainable medium-term fiscal position. Because of the large external borrowing secured in 2009, the public-debt-to-GDP ratio is projected to more than double this year and to continue to rise in the coming years. While the public debt remains manageable, its rapid accumulation calls for undertaking strong fiscal consolidation as soon as possible. In addition, we intend to work with our development partners to obtain more favorable terms for new borrowing.

17. We will accordingly tighten fiscal policy starting next year. The 2010 budget that we will submit to parliament envisages a fiscal tightening of about 1½ percent of GDP as the economy is expected to rebound under the effect of this year’s expansionary policies. The fiscal adjustment will hinge on increasing tax collection in line with the economic recovery and on containing expenditures, mainly capital spending, compared to this year’s levels. We plan to finance the fiscal deficit from external sources—albeit to a lesser degree than in 2009—and a moderate increase in domestic debt. Should the economic crisis persist longer than anticipated, we stand ready to loosen our fiscal stance, provided that adequate domestic or external financing is available.

IV. Fiscal Structural Reforms

18. We remain committed to our tax administration reform program based on a self-assessment model to enhance the business environment and ensure a sustainable revenue base. To this end, we have submitted to parliament draft legislation to strengthen penalties for false VAT refund claims and to pay interest on all late legitimate VAT refund claims (structural benchmark for end September 2009), and we have further decreased the stock of tax credits (indicative target). We have made progress in implementing reforms in other areas, including the introduction of e-filing of tax returns by December 2009 for large taxpayers, and over 2010-2011 for all other taxpayers; the improvement of analytical capacity of the tax services; and development of a plan for further strengthening the large

taxpayer inspectorate. In the remainder of 2009 and in 2010, we will continue to focus on addressing the systemic problems underlying tax credits, and ensuring the functionality of the risk-based audit system. We will also proceed with implementing a fully functional risk-based approach to VAT refund processing, a necessary condition for which is a change in legislation so to allow only high-risk VAT refunds to be subject to review (structural benchmark for end-March 2010). Finally, we will consider strengthening penalty regimes for all taxes by introducing graduated penalty rates, based upon the severity of the offence. Fund TA is helping us in all these efforts.

19. In the tax policy area, we are committed to abolishing presumptive taxation for fuel and tobacco products. To this effect, legislation will be submitted to parliament to bring all tobacco and petroleum products within the regular tax regimes (excise tax, customs duties, profit tax, and VAT), effective January 2011 (structural benchmark for end December 2009). To improve the effectiveness of social spending, the government is working with the World Bank to further strengthen the targeting of social safety nets (structural benchmark for end December 2009).

20. We also intend to strengthen our debt monitoring and planning capacity, notably regarding data on receipts and projections of foreign grants and loans. To this end, we will approve by end-March 2010 a time-bound action plan to strengthen our public debt management with the aim of developing a comprehensive medium-term debt strategy, preconditions for which are (a) the implementation of a public debt management information system; (b) the restructuring of the Public Debt Management Department (PDMD) of the Ministry of Finance along functional lines; and (c) the consolidation of public debt management within the PDMD. Timely delivery of technical assistance will be crucial to the successful implementation of this reform.

V. Other Structural Reforms

21. We believe that deepening structural reforms will boost the productive capacity of the economy, help support the economic recovery, and promote long-term economic growth. These reforms include substantial investments in transportation infrastructure, information technology, and telecommunications, and a continued push to strengthen education services. Likewise, we are committed to maintaining an open trade regime. We are carrying out a number of initiatives to improve Armenia’s business environment, with a focus on improving the capacity of regulatory bodies and the ease of doing business. We also intend to continue our anti-corruption efforts, notably by enforcing the constitutional provisions restricting public officials from engaging in commercial activities.

VI. Conclusion

22. We request the completion of the Second Review under the Stand-By Arrangement in light of the strong performance under the program and our continued commitment to strong policies. In addition, we request a waiver of nonobservance for the end-September performance criterion on the program fiscal balance, a target which we expect to have missed

by a small margin. Since this review combines what were the second and third reviews under the original schedule, we request that the amounts previously scheduled to be available following the second and third reviews become available upon completion of this review, and we intend to purchase the SDR37.72 million that will be available to us upon completion of this review. We will maintain the usual close policy dialogue with the Fund and stand ready to take additional measures, as appropriate, to ensure the achievement of the government's social and economic objectives under the Stand-By Arrangement. We will continue to consult with the Fund on the adoption of measures, and in advance of revisions to the policies contained in the LOI, in accordance with the Fund's policies on such consultation. We will also provide the Fund with the information it requests for monitoring progress during program implementation.

23. The program will continue to be monitored via quarterly performance criteria, indicative targets, and structural benchmarks. We request the modification of the performance criteria for end December 2009, the establishment of performance criteria for end March 2010, and indicative targets for the remainder of 2010 as specified in the attached Table 1. Given the expected deterioration in our debt outlook, we also request that the program include an indicative target on contracting or guaranteeing new nonconcessional debt by the public sector, which would help inform our policy decisions. We expect to complete the third review of the program on or after February 15, 2010, and the fourth review on or after May 14, 2010. The attached Technical Memorandum of Understanding updates definitions for the adjusters related to external financing to the public sector Structural benchmarks under the program are described in Table 2.

24. We authorize the IMF to publish this Letter of Intent and its attachments as well as the accompanying staff report.

Very truly yours,

/s/
Tigran Sargsyan
Prime Minister
Republic of Armenia

/s/
Tigran Davtyan
Minister of Finance
Republic of Armenia

/s/
Artur Javadyan
Chairman of the Central Bank
Republic of Armenia

Table 1. Armenia: Quantitative Targets, 2009-10 1/
(in billions of drams, at program exchange rates, unless otherwise specified)

	2008	2009											2010 2/			
	Dec.	Mar.			Jun.			Sep.			Dec.		Mar.	Jun.	Sep.	Dec.
		Country Report No. 09/140	Adj. Prog.	Prel.	Country Report No. 09/214	Adj. Prog.	Prel.	Country Report No. 09/214	Adj. Prog.	Prel.	Country Report No. 09/214	Prog.	Prog.	Prog.	Prog.	Prog.
Performance Criteria																
Net official international reserves (floor, in millions of dollars)	1,056.6	455.9		654.1	1,008.3	990.7	1,089.7	923.3	899.8	1,150.7	839.8	976.8	897.8	802.3	792.5	834.1
Net domestic assets of the CBA (ceiling)	75.3	148.9	143.6	32.3	-117.8	-27.5	-115.9	-60.0	-50.7	-97.3	24.5	-11.4	31.2	73.0	79.1	84.4
Net banking system credit to the government (ceiling)	-37.3	-23.6		**-10.6**	-217.6	-120.9	-167.1	-163.7	-124.7	-147.5	-118.6	-50.6	4.2	53.0	53.6	56.5
Program fiscal balance (floor) 3/	-73.0	-31.9	-29.9	**-36.4**	-123.4		-87.4	-212.3		-210.1	-287.8	-342.4	-89.0	-152.7	-197.4	-239.7
External arrears (continuous criterion)	0	0		0	0		0	0		0	0	0	0	0	0	0
Indicative Targets																
Stock of tax credits (ceiling) 4/	154.4	154.4		147.0	147.0		134.9	145.0		134.9	145.0	134.9	…	…	…	…
Contracting or guaranteeing of new non-concessional debt (ceiling, in millions of dollars) 5/												0	195.0	225.0	300.0	325.0

1/ All items as defined in the TMU. The figures in bold indicate when a target has not been met.
2/ Indicative targets for June, September, and December.
3/ Below-the-line overall balance excluding net lending.
4/ Indicative target up to end-December 2009.
5/ For 2009, cumulative beginning the second half and therefore excludes the Russian loan contracted in June 2009.

Table 2. Armenia: Proposed Structural Benchmarks for the Second, Third, and Fourth Reviews

Item	Measure	Proposed Time Frame (End of Period)	Outcome
	Tax administration		
1	Meet the statutory 90-day processing deadline for all VAT refund claims filed in 2009.	Continuous in 2009	Met
2	Submit legislation to parliament to (a) strengthen penalties for overstated VAT refund claims effective January 2010, and (b) pay interest on all legitimate VAT refund claims filed after December 2009 and not refunded within 90 days, with interest to be paid out of VAT revenues.	September 2009	Met
3	As a necessary condition for implementing a fully functional risk-based approach to VAT refund processing, submit legislation to parliament that allows only high-risk VAT refunds to be subject to review.	March 2010	
	Tax and social policy		
4	In close collaboration with the World Bank, develop a strategy to further strengthen the targeting of social safety nets.	December 2009	
5	Submit legislation to parliament to bring petroleum and tobacco products within the regular tax regimes (excise tax, customs duties, profit tax, and VAT), effective January 2011.	December 2009	
	Financial sector		
6	Approve a plan to increase the resources of the Deposit Guarantee Fund.	June 2009	Met
7	CBA to adopt a formal foreign exchange market intervention strategy consistent with IMF technical assistance.	June 2009	Met
8	Start offering repo operations with a maturity of at least three months.	June 2009	Met
9	Submit to parliament an amendment to Article 11 of the “Law on the Central Bank of the Republic of Armenia” to allow a gradual recapitalization of the CBA with marketable interest bearing securities.	September 2009	Met

ATTACHMENT II. ARMENIA: TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum sets out the definitions for quantitative performance criteria, indicative targets, benchmarks, adjusters, as well as the reporting modalities referred to in the Letter of Intent, under which Armenia's performance under the program supported by the Stand-by Arrangement (SBA) will be assessed.

I. QUANTITATIVE TARGETS

1. **The program targets a minimum level of net official international reserves (NIR) of the Central Bank of Armenia (CBA; performance criterion)**. The stock of such reserves will be calculated as the difference between total official gross international reserves (excluding reserve money denominated in foreign currencies) and official gross reserve liabilities. Total gross official international reserves are defined as the CBA's holdings of monetary gold (excluding amounts pledged as collateral or in swaps), holdings of Special Drawing Rights (SDRs), including the August 28, 2009 General allocation and the September 9, 2009 Special allocation, any reserve position in 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. Gross reserves are reported separate from the balance on the government's Special Privatization Account (SPA) and the Millennium Challenge Account (MCA) and exclude capital subscriptions in foreign financial institutions and illiquid foreign assets. Official reserve liabilities shall be defined as the total outstanding liabilities of the government and the CBA to the IMF and convertible currency liabilities of the CBA to nonresidents with an original maturity of up to and including one year. NIR is monitored in U.S. dollars, and, for program monitoring purposes, assets and liabilities in currencies other than the U.S. dollar shall be converted into dollar-equivalent values using the exchange rates as specified in Table 1.

2. **The program targets a maximum level of net domestic assets (NDA) of the CBA (performance criterion).** For program purposes, NDA is defined as reserve money minus NIR, minus reserve money denominated in foreign currencies, plus medium- and long-term liabilities (i.e. liabilities with a maturity of one year or more) of the CBA, plus the balance of outstanding Fund purchases credited to the government account at the CBA. To evaluate program targets, the dram-equivalent values of NIR, medium- and long-term liabilities, and reserve money in U.S. dollar are calculated at the program exchange rate of dram 385 per U.S. dollar. The dram-equivalent value of reserve money in euro is calculated at the program exchange rate specified in Table 1. NDA is composed of net CBA credit to the general

government; outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money (exclusive of accrued interest), and other items net. Reserve money is defined as the sum of currency issued, required and excess reserves, and current and time deposit accounts of certain resident agents.[1]

3. **The program targets a maximum level of net banking system credit to the government (performance criterion), defined as** the sum of net credit from the CBA and net credit from commercial banks to the central government.

- **The stock of net credit from the CBA to the government,** which includes the CBA's holdings of treasury bills and treasury bonds less all types of government deposits with the CBA (including the deposits in the Treasury Single Account, deposits of donor-financed project implementation units, the Lincy foundation, and balances of proceeds from the sale of humanitarian assistance). Treasury bonds are valued at the purchase price and excluding accrued interest, and treasury bills are valued at the purchase price plus the implicit accrued interest.

- **Net credit from commercial banks to the government** includes: (1) gross commercial bank credit to the central government less government deposits with commercial banks (including the counterpart funds of certain government on lending to the economy financed by the Lincy Foundation and the World Bank); and (2) bank holdings of treasury bonds (valued at the purchase price and excluding accrued interest) and treasury bills (valued at the purchase price plus the implicit accrued interest).

4. **The program imposes a zero ceiling on external payment arrears (continuous performance criterion)** defined as all unpaid debt-service obligations (i.e., payments of principal and interest) arising in respect of public sector loans contracted or guaranteed including unpaid penalties or interest charges associated with these obligations that are overdue beyond 30 days after the due date.[2]

5. **The program targets a minimum level of the program fiscal balance (performance criterion).** The fiscal balance is measured as the negative of the sum of net domestic banking system credit to the government, domestic nonbank net financing, and

---

[1] Liquidity absorbing transactions under reverse repurchase agreements, the CBA's deposit facility, foreign currency swaps, and securities issued by the CBA are excluded from the reserve money definition.

[2] The public sector is 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.

external net financing to the government. Should a general subsidy be introduced off-budget, the overall balance will be measured including the subsidy as part of government spending.

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

- **Nonbank net 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 or the treasury sub-account containing privatization proceeds in dram, less amortizations made by the central government to private resident nonbank agents.

- **External net 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 amortizations from the central government to non-residents. All foreign-currency denominated transactions are recorded in drams using the prevailing exchange rate at the time of the transaction.

6. The project implementation units, which carry out projects financed by the US-based Lincy Foundation, maintain accounts at the CBA. These grants are recorded in the fiscal accounts as external grants on the revenue side and as foreign-financed capital expenditure on the expenditure side. In addition, any loans extended by the U.S.-based Lincy foundation to finance investments and 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.

7. Foreign currency proceeds from selling enterprises are deposited into the Special Privatization Account (SPA). The account 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 budgeted withdrawal from the SPA will be accounted for as privatization proceeds used to finance the budget and will be recorded below the line. Any unanticipated withdrawal from the SPA will be recorded below the line as privatization receipts; these withdrawals, however, will be replenished during the same fiscal year.

---

[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.

Domestic currency proceeds from selling enterprises to residents are deposited in a sub-account of the treasury single account.

8. **The program targets a maximum level of stock of tax credits (indicative target)** defined as the sum of outstanding accumulated credit by the State Revenue Committee (SRC) of all types of tax revenues (VAT, profit tax, excises, income tax, presumptive payments, and others) resulting from advanced tax payments to be offset against future tax liabilities.

9. **The program sets a maximum on contracting or guaranteeing of new nonconcessional external debt by the public sector (indicative target).** The definition of debt, for the purposes of the program, is set out in Executive Board Decision No. 12274, Point 9, as revised on August 24, 2000. For program purposes, nonconcessional external loans are defined as loans from lenders other than the IMF with a grant element of less than 35 percent of the value of the loan. The grant element is to be calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The NPV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the Organization for Economic Cooperation Development (OECD). For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six month average CIRR will be used. To both the ten-year and six-month averages, the same margins for differing repayment periods as those used by the OECD would continue to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more). Loans provided by a private entity will not be considered concessional unless accompanied by a grant or grant element provided by a foreign official entity, such as both components constitute an integrated financing package with a combined grant element equal to at least 35 percent. Previously contracted nonconcessional external debt that has been rescheduled will be excluded from the definition of “new debt” for the purposes of this performance criterion.

II. Adjusters

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

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

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

- **External financing to the public sector**, defined as disbursements of loans from bilateral and multilateral agencies for budget, project support, and the $500 million Russian loan disbursed in 2009 (including Fund purchases credited directly to the government accounts at the CBA), with the exception of the KfW and World Bank disbursements mentioned above:

    - The floor on NIR will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of external financing in the form of budget support (excluding Fund disbursements to the government) compared to program amounts (Table 3).

    - The ceiling on NDA will be adjusted upward by the amount of any shortfall of external financing in the form of budget support compared to program amounts.

    - The ceiling on net banking sector credit to government will be adjusted upward by the cumulative amount of any shortfall of total external financing compared to programmed amounts (Table 3).

    - The floor on the program fiscal balance on a cash basis will be adjusted downward by the cumulative amount of any excess of total external financing compared to programmed amounts (Table 3).

- **Recapitalization of the CBA**: the ceiling on net credit of the banking system to the government will be adjusted upward by the full amount of the recapitalization of the CBA.

III. Data Reporting

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA[4]	CBA balance sheet	Summary	Daily	The following working day
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within seven days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks by chart of accounts at actual official exchange rates	Monthly	Within 25 days of the end of each month
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Daily	The following working day
	Foreign exchange market	Official exchange rates (buying and selling); daily trade volume, and weighted average exchange rate of the interbank, intrabank and Nasdaq-OMX	Daily	Within 1 day
	Foreign exchange market	CBA foreign exchange operations, (exchange rate, volume, counterpart)	Daily	Within 1 day
	Foreign exchange market	Exchange rate (buying and selling)	Daily	Within 1 day
	Interest rates	Refinance rate	At least monthly	Within 1 days of the CBA Board decision
	Interbank money market	Daily interbank repo volume and interest rate and number of trades	Daily	Within 1 day
	CBA operations	Repo (reverse repo) operations, open market operations, Lombard credits, deposit facility, and foreign exchange swaps (volumes, maturity, yields, exchange rates)	Daily	Within 1 day
	Bank liquidity	Reserves and excess reserves, by currency	Monthly	Within 15 days of the end of each reference period

[4] As defined in CBA resolution No. 201 (December 6, 1999).

	Interest rates and flows of the funds attracted and allocated by commercial banks	By currency and maturity	Weekly	Last working day of the week
	T-bill and coupon bond financing, CBA securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Weekly	Last working day of the week
	Banking data	Sectoral distribution of loans and deposits; dollarization of loans and deposits; loan maturities; interbank rate, by volume and maturity; T-bill rate, bond yield; deposit and lending rates, by maturity; monthly weighted average interest rate on government bonds	Monthly	Within 25 days of the end of each month
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Monthly	Within 30 days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Monthly	Within 30 days of the end of each month
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Transfers	Non-commercial transfers of individuals	Monthly	Within 30 of the end of each month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
Ministry of Finance (MOF)	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 (preliminary data) and within 45 days of the end of each month (final data)
	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions	Monthly	Within 7 days of the end of each month
	Expenditure arrears	Government	Monthly	Within 45 days of the end of each

				month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month
	Treasury single account (TSA)	Detailed breakdown of central treasury account, including deposits at the central treasury, community budgets, off budget account, monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.	Monthly	Within 7 days of the end of each month
	Consolidated central 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 operations, and inflow of grants to the central government; expenditure data will be provided according to both economic and functional classifications, consistent with the GFSM2001 methodology	Monthly	Within one month following the end of each quarter.
NSS	Balance of payments	Detailed export and import data	Monthly	Within 28 days of the end of each month
		Detailed export and import data	Quarterly	Within 45 days of the end of each quarter
		Detailed balance of payments data	quarterly	Within 60 days of the end of each quarter
	CPI	By category	Monthly	Within 5 days of the end of each month

State Revenue Committee	Tax arrears	By type of tax	Monthly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)
		For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	Tax credits	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	VAT refund claims in arrears	Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90 day statutory processing period. Number of refund applications processed per month.	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty free recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving non-duty free recorded imports 5. Value of recorded imports where customs value was assessed using transaction prices, breaking out raw diamond imports; 6. Value of non-duty free recorded imports where customs value was assessed using transaction prices; 7. Number of transactions involving recorded imports where customs value was assessed using transaction prices; 8. Number of transactions involving non duty free recorded imports where customs value was assessed using transaction prices	Quarterly	Within 30 days of the end of each quarter

Table 1. Armenia: (Program) Exchange Rates of the CBA
(As of December 31, 2008 for dollars per currency rates)

Country	Drams Per Currency	Dollars Per Currency
Australian dollar	266.57	0.6924
Canadian dollar	313.39	0.8140
Swiss franc	365.58	0.9496
Danish krone	73.26	0.1903
Euro	546.00	1.4182
Pound sterling	558.68	1.4511
Japanese yen	4.27	0.0111
Norwegian krone	55.20	0.1434
Russian ruble	13.13	0.0341
Swedish krone	18.21	0.0473
U.S. dollar	[...]	1.0000
SDR	593.00	1.5403

Table 2. Armenia: KfW and IBRD SME Loan Disbursements, 2009–10 1/
(in millions of USD)

March-09		June-09		September-09	December-09	March-10
Prog	Actual	Prog	Actual	Prog	Prog	Prog
2.39	5.48	2.39	31.90	33.63	35.63	2.00

1/ Cumulative from the end of the previous year.

Table 3. Armenia: External Financing to the Public Sector,
2009-10 (program) 1/
(in billions of drams)

	March-09		June-09		September-09	December-09	Mar-10
	Prog	Actual	Prog	Actual	Prog	Prog	Prog
Project financing	14.72	12.20	50.82	33.01	81.21	62.69	18.18
Budget Financing	3.09	-	78.93	-	97.34	111.28	17.63
Russia	-	-	192.50	185.09	192.50	192.50	-
Total	**17.81**	**12.20**	**322.25**	**218.09**	**371.05**	**366.47**	**35.81**

1/ Cumulative from the end of the previous year, at program exchange rates, excluding grants.

IV. Guidelines on the Indicative benchmark with Respect to Foreign Debt

Excerpt from Executive Board Decision No. 12274, as revised on August 24, 2000.

9. (a) For the purpose of this guideline, the term “debt” will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

   (i) loans, that is, advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

   (ii) suppliers’ credits, that is, contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

   (iii) leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

   (b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (for example, payment on delivery) will not give rise to debt.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

Second Review Under the Stand-By Arrangement,
Request for Waiver of Nonobservance of Performance Criterion,
Modification of Performance Criteria, and Rephasing of Purchases

Informational Annex

Prepared by the Middle East and Central Asia Department

October 14, 2009

Contents | Page

ANNEX I. ARMENIA: RELATIONS WITH THE FUND
(As of September 30, 2009)

I. **Membership Status:** Joined 05/28/1992; Article VIII

II. **General Resources Account:**	**SDR Million**	**Percent of Quota**
Quota	92.00	100.00
Fund holdings of currency	356.22	387.20

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Holdings	88.76	100.87

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
Stand-by Arrangements	264.22	287.20
PRGF arrangements	80.40	87.39

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	03/6/09	07/5/11	533.60	264.22
PRGF	11/17/2008	03/6/2009	9.20	1.31
PRGF	05/25/2005	05/24/2008	23.00	23.00

VI. **Projected Payments to Fund** [1/]
(SDR Million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2009	2010	2011	2012	2013
Principal	8.09	14.13	14.44	101.00	143.18
Charges/interest	1.05	3.67	3.60	3.37	1.95
Total	9.14	17.80	18.04	104.37	145.12

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. **Safeguards Assessment**

Under the Fund's Safeguards Assessments policy, an update safeguards assessment of the Central Bank of Armenia (CBA) with respect to the PRGF approved on November 18, 2008, later replaced with the SBA approved on March 6, 2009 (and amended on June 22, 2009) was completed on May 4, 2009. The assessment found that the CBA's safeguards framework has been strengthened since the 2005 assessment in a number of areas, but some vulnerabilities remain. The CBA's governance structure remains to be modernized to allow for more independent oversight, and the CBA could further strengthen its internal audit function. A longer-term appointment of the external auditors would also improve audit efficiency and effectiveness.

VIII. **Exchange Rate Arrangement**

(a) The de jure arrangement is "free floating." The de facto arrangement was reclassified to "floating" from a "stabilized arrangement" effective March 3, 2009. The official exchange rate is quoted daily as a weighted average of the buying and selling rates in the foreign exchange market.

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

IX. **Article IV Consultations**

The 2008 Article IV consultation with Armenia was concluded on November 17, 2008. Armenia is subject to a 24-month consultation cycle.

X. **FSAP Participation and ROSCs**

A joint World Bank-International Monetary Fund mission assessed Armenia's financial sector as part of the Financial Sector Assessment Program (FSAP) update during February 16–March 4, 2005. The Financial Sector Stability Assessment (FSSA) report was discussed by the Executive Board on May 25, 2005.

ROSC Modules

Standard	Timing	Publication Status	Document Number
Basel Core Principles for Effective Banking Supervision (BCP)	April 2001	Unpublished	…
Core Principles for Systemically Important Payments Systems (CPSS)	April 2001	Unpublished	…
Insurance Principles set by the International Association of Insurance Supervisors (IAIS)	2001	Unpublished	…
Principles set by the International Organization of Securities Commissions (IOSCO)	2001	Unpublished	…

Code of Good Practices in Monetary and Financial Policy Transparency (MFPT)	April 2001	Unpublished	…
Code of Good Practices on Fiscal Transparency	March 2001	Published	02/37
Data ROSC module	September 2000	Published	02/06
AML-CFT assessment by MONEYVAL	July 2004	Unpublished	…
Basel Core Principles for Effective Banking Supervision (BCP) update	May 2005	Unpublished	…
Corporate Governance	May 2005	Unpublished	...
Data ROSC module	April 2008	Published	09/50

XI. Resident Representatives

Ms. Nienke Oomes, since August 2006.

XII. Technical Assistance

The following table summarizes the Fund's technical assistance to Armenia since 2002.

Armenia: Technical Assistance from the Fund, 2002–09

Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Tax policy and administration	Short-term	September 17–October 2, 2003	MFE, State Tax Service (STS), and Customs Committee
Tax policy	Short-term	April 22–May 6, 2004	MFE, STS, and Customs Committee
Tax administration	Short-term	July 13—27, 2004	MFE, STS, and Customs Committee
Public expenditure management advisor		November 7, 2003–November 6, 2004	
Tax administration	Short-term	October 5–18, 2006	MFE, STS
Public financial management reform	Short-term	November 27 – December 8, 2006	MFE
Tax administration	Short-term	October 31 – November 13, 2007	MFE, STS
Tax administration	Short-term	January 5 – 22, 2008	MFE, STS
Tax administration	Short-term	April 1-12, 2008	MFE, STS

Tax administration	Short-term	June 11-17, 2008	MFE, STS
Tax administration	Short-term	February 2-27, 2009	MFE, STS
Tax administration	Short-term	April 28 - May 22, 2009	MFE, STS
Tax administration	Short-term	September 23 – October 6, 2009	MoF, SRC
Legal Department			
Tax legislation		September 1, 2004–December 31, 2005	
Legislation Development & FIU	Short-term	July 31–August 7, 2006	
Unified Tax Code	Short-term	June 16—23, 2007	MFE
Monetary and Capital Markets Department			
Banking system issues	Short-term	April 15–19, 2002	CBA
Banking system, deposit insurance, foreign exchange market development, and CBA monetary operations.	Short-term	June 24–July 4, 2002	CBA
Unified financial supervision, mortgage financing markets and inflation targeting	Short-term	January 26–February 6, 2004	CBA
Financial sector assessment program update	Short-term	February 16–March 4, 2005	CBA
Recapitalization of the Central Bank of Armenia	Short-term	December 8–14, 2005	CBA
Monetary policy and markets		December 4, 2005–December 31, 2006	
Strengthening the implementation of monetary policy	Short-term	March 8–21, 2006	CBA
Monetary policy implementation and money market development	Short-term	October 5–17, 2006	CBA
AML/CFT preventive measures		April 1, 2006–April 30, 2007	
Inflation Targeting, Foreign Exchange Market Development and Responding to Dedollarization	Short-term	August 29—September 10, 2007	CBA
Exchange rate and collateral	Short-term	February 23—27, 2009	CBA
Contingency planning, crisis preparedness	Short-term	October 11—22, 2009	CBA
Statistics Department			
Data dissemination standards	Short-term	September 18–25, 2003	National Statistical

			Service
Balance of payments: remittances	Short-term	August 22–September 5, 2006	CBA
International Capital Market Department			
Sovereign credit quality	Short-term	September 6–10, 2005	CBA
Sovereign credit risk	Short-term	August 20, 2005–August 20, 2006	CBA

ARMENIA II. ARMENIA: WORLD BANK AND IMF COLLABORATION—JMAP IMPLEMENTATION

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
1. Bank work program in next 12 months	Economic policy report	Late 2009	January 2010
	DPO-2	Quarterly	Board discussion expected mid-2010
	Programmatic fiscal work	Late 2009 and early 2010	Draft report to government in mid-2010
	Poverty monitoring and assessment	Continuous	Mid-2010
	TA for DPO areas, including trade and statistics	Ongoing	Ongoing
	Public Debt Management	Ongoing	June 2011
2. IMF work program in next 12 months	Second SBA Review	September 2009	October 2009
	Third SBA Review	February 2010	March 2010
	Fourth SBA Review	May 2010	June 2010
	TA		
	- MCM (Contingency Planning, Crisis Preparedness) Assessment Mission	October 2009	January 2010
	- MCM (Contingency Planning, Crisis Preparedness) Expert Follow Up Mission	February 2010	February 2010
	- MCM (Contingency Planning, Crisis Preparedness) Expert Follow Up Mission	April 2010	April 2010
	- FAD (Tax Administration--Progress on reforms and priorites for implementation)	September 2009	November 2009
	- FAD (Tax administration--Various operational issues to improve revenue collection)	Early 2010 (resident advisor for one year)	Early 2011
	- STA (Monetary statistics—standardized report forms of other financial corporations)	February 2010	February 2010
3. Joint work program	TA on banking sector assessment	Late 2009	Mid-2010
	Fiscal sustainability analysis inputs, including debt sustainability analysis	Late 2009	Mid-2010
	JSAN for PRSP Update	Early 2010	Mid-2010

ANNEX III. ARMENIA: RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

(As of end-September 2009)

1. As of end September 2009, the EBRD approved 71 projects in the power, transport, agribusiness, municipal and infrastructure, general industries, property, telecommunications and financial sectors. Total commitments amounted to around EUR 341 million.

2. There are three sovereign projects. First, the EBRD approved a sovereign guaranteed loan of EUR 54.8 million for construction of the Hrazdan Unit 5 thermal power plant in March 1993, partly aimed at the eventual closure of Armenia's nuclear plant in Medzamor. The government was contemplating the privatization of Hrazdan Unit 5 as the completion of this plant was constrained by limited budgetary resources. The EBRD had funded technical assistance for the Hrazdan privatization prospectus and followed the privatization process. The Hrazdan Thermal Power Complex was transferred to the Russian Federation in the context of the debt-for-equity deal. Second, in November 1994, the agreement on a EUR 21.8 million loan to build an air cargo terminal in Zvartnots airport was signed under a guarantee by the Armenian government. The airport was transferred to private management in 2002 (according to concession agreement). The new management has prepared a master plan for the development of the airport, which is expected to generate further cargo traffic for the cargo terminal. Third, the EBRD approved a 7 million EUR loan to the State Committee for Water Systems, owner of the water and wastewater assets located in the small municipalities outside of Yerevan, in April 2007. The proceeds of this loan will be used to improve wastewater treatment in five municipalities located near Lake Sevan.

3. Most of the Bank's projects in Armenia are in the private sector. Amongst other corporate clients the EBRD has provided a loan to the Yerevan Brandy Company owned by Pernod Ricard of France (EUR 16.5 million). In 2007 the Bank provided a USD 20 million loan to the private concessionaire of Zvartnots International Airport, Armenia's principal gateway. The loan was a commercial facility with no sovereign support. Other private sector finance includes relatively smaller loans to private companies and equity participation in a number of companies in various sectors of the industry. In the banking sector, a first equity participation in the Commercial Bank of Greece-Armenia (EUR 1.1 million) was approved in late 1999 and a second equity participation in Armeconombank was approved in 2004. The Bank also acquired an equity stake in an Armenian non-bank financial intermediary, CIRCO, an insurance subsidiary of Cascade Capital Holding. A Multi-Bank Framework Facility of EUR 10 million, aimed at providing medium to long term funds to Armenian banks was activated in early 2000. In 2006 the Armenian Multi bank Framework Facility II in the amount of USD 40 million was approved, expanding the scope of eligible projects to equity and non-bank financial institutions financing. Subsequently, due to successful utilization of the facility, it was extended by another USD 80 million. The EBRD expanded its relationship with the partner banks in Armenia from four to ten. Six banks were provided with new credit facilities under the MBFF, including through historic (for Armenia) commercially-syndicated loans to ACBA Credit Agricole Bank and Armeconombank. The Bank acquired new equity stakes in three banks including those with foreign strategic co-investors (ProCredit and Byblos bank Armenia) and Ararat Bank. One institution (Armeconombank) was provided

with a mortgage facility, and the first leasing facility in Armenia was signed with ACBA Leasing. Co-financing facility with local banks was also extended through three MCFF facilities with eleven MCFF sub-loans. By means of MCFF the Bank has entered such new sectors as healthcare and telecom, in addition to significantly expanding its portfolio of agribusiness loans. A Trade Facilitation Program with the purpose to facilitate access of Armenian banks to trade financing was also made available to five Armenian banks.
In April 2009, the EBRD signed a EUR 42 mln loan agreement with Electric Networks of Armenia to upgrade and modernize the obsolete low-voltage infrastructure and improve energy efficiency. Again in 2009, the EBRD provided an additional EUR 3.1 million to ACBA Leasing, EUR 4.2 million to Elite Holding for the construction of a mixed-purpose building and EUR 0.2 million to a private TV station under MCFF with Armeconombank.

4. The EBRD has launched the Turn Around Management (TAM) and Business Advisory Service programs in Armenia in 2003, originally funded by the EU-Tacis program but now funded from the ETC Fund, to support micro, small, and medium-sized enterprises. Since 2003 BAS has completed 581 projects in the amount of € 2.2 million , while TAM delivered 17 projects.

5. Supporting development of renewable energy was another core activity of the Bank. To that end, the EBRD joined forces with the WB, USAID, and Cascade Credit (a financing arm of the Armenian-American Cafesdjian Foundation) to launch the Armenian Renewable Energy Programme (AREP). The Bank's participation took the form of a loan to Cascade Credit. The Bank also continued to finance renewable energy projects on its own through Direct Lending Facility, with two such projects signed. In addition to renewable energy, the Bank returned to the mainstream segment of the sector, seeking to support post-privatisation development of the sector with a loan to the Armenian privately-owned power distribution company.

6. Projects identified by the Bank for future development are well-diversified across sectors, and includes several relatively large transactions. Additional business opportunities are offered by the country's infrastructure sector, including projects in the public sector (municipal and sovereign). In this respect, the EBRD is considering financing the phase 2 in the development of Yerevan international airport and exploring opportunities in water, sanitation and solid waste treatment. The Bank is about to launch a USD 25 million program to finance projects for industrial energy efficiency and renewable energy through local banks.

7. The EBRD's current country strategy was approved in April 2009. The key priorities of the EBRD for the coming years are: (i) financial sector; (ii) enterprise sector, particularly SME and micro-enterprises financing through credit lines to Armenian banks or direct loans and equity investments, (iii) infrastructure investments in the development of alternative energy sources and municipal infrastructure projects and (iv) policy dialogue with the government, other multilateral and bilateral donors and other stakeholders.

ANNEX IV. ARMENIA: STATISTICAL ISSUES

1. Data provision has some shortcomings, but is broadly adequate for surveillance. Further improvements in real, fiscal, and external sector statistics would be desirable in order to facilitate enhanced design and monitoring of economic policies. The overall quality, timeliness, and coverage of macroeconomic statistics have improved significantly over the past few years. The Fund has substantially facilitated this process through technical assistance from the Statistics Department, the Fiscal Affairs Department, and the Monetary and Capital Markets Department. On November 7, 2003 Armenia subscribed to the Special Data Dissemination Standard (SDDS). The April 2008 data ROSC mission prepared a detailed evaluation of the quality of the macroeconomic statistics.

Real sector statistics

2. The National Statistics Service (NSS) has made significant changes to the national accounts methodology to bring it in line with best international practices although some shortcomings on data sources and methods remain. Progress has been made in developing estimates of monthly and (constant price) quarterly GDP that are now published. Basic data collection procedures have also partially improved. The national accounts statistics are compiled following the conceptual frameworks of the *1993 SNA* and *ESA 95.* The classification of value added by economic activity follows the *ESA 95* directions and data are published grouped accordingly to the A3, A6, A17 and A60 codes of the EU nomenclature of economic activities.

3. Annual and quarterly GDP estimates are compiled at current prices, at comparable previous year's prices, and at average annual prices of the base year (1998) for the series up to the year 2006. Since 2007, GDP at constant prices is computed at average annual 2005 prices. The February 2009 ROSC mission found that compilation techniques for the estimates of GDP by production at constant prices are sound, however there is still need for improvements in the corresponding estimates of GDP by expenditure, particularly regarding the volume measures of imports and exports. The mission also found that government expenditures and some transactions with the rest of the world are recorded on a cash basis rather than the required accrual method. Moreover, quarterly data are still collected on a cumulative basis, which are likely to undermine their accuracy. Additionally, statistical techniques need improvements regarding the estimates of the imputed rental services for owner-occupied dwellings, and consumption of fixed assets.

4. The CPI covers 11 large population centers and the capital city. Since January 2006 the CPI has been computed using 2005 weights. Concepts and definitions used in the compilation of the CPI are broadly in line with international standards; source data and compilation techniques are generally adequate. The NSS compiles a ten-day and a monthly CPI. The ten-day index and the monthly index are disseminated jointly. The February 2009

ROSC mission recommended the development of an approach to include household expenditure on owner-occupied dwellings in the CPI calculations.

Government finance statistics

5. The budget execution reporting system compiles 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. The Ministry of Finance (MoF) is undertaking a comprehensive reform of the treasury system, including the introduction of an internal auditing system in line ministries and their budgetary institutions. A single treasury account (TSA) was introduced in 1996, and all bank accounts held by budgetary institutions were closed, except for Project Implementation Units that are required by donors to operate with commercial banks' accounts. Starting in 2002, some budgetary institutions have been converted into "noncommercial organizations" (NCOs). These units have been taken out of the treasury system and have their own bank accounts but report data on cash flows and balances to the MoF since 2003. The February 2009 ROSC report recommended including NCOs in the government finance statistics data published on national websites. These exceptions notwithstanding, all government receipts and payments are processed through the TSA, although there are still shortcomings on the timeliness and quality of data on the operations of local governments. Classification of government transactions by function and economic category are generally in line with the *Manual on Government Finance Statistics 1986*, and monthly data on central government operations are disseminated one month after the reporting period.

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

7. Since 2008, government finance statistics meet the classification requirements of the *Government Finance Statistics Manual 2001* (*GFSM 2001*) for central government. The plans for improvement of the MoF envisage further significant progress within the next two years in implementing the *GFSM 2001* classification for local government in 2009 and in accrual recording for all units of general government in 2010.

Monetary and financial statistics

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

9. Responding to a STA request, the CBA has compiled and submitted a complete set of monetary data beginning from December 2001 using Standardized Report Forms (SRF). STA validated the resulting monetary aggregates and the data have been published since the December 2006 issue of *IFS Supplement* and are used to update IFS. An Integrated Monetary Database (IMD) has also been established by STA to share the SRF data with MCD.

External sector statistics

10. The coverage of external sector data has improved in recent years. Trade statistics are provided on a timely basis, and trade data by origin, destination, and commodity are generally available within a month. Price data for exports and imports are less readily available. Quarterly balance of payments statistics are generally available with a three-month lag. However, on remittances, which account for a significant part of the inflows, there are considerable discrepancies among available source data. Survey data are considerably lower than data obtained through the money transfer system. The NSS and CBA are working on establishing a compilation program that would enable proper measurement of remittances. 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.

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

Armenia: Table of Common Indicators Required for Surveillance

(As of October 6, 2009)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	Oct 2009	10/6/2009	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Sep 2009	10/6/2009	D	D	M
Reserve/Base Money	Sep 2009	10/6/2009	D	D	D
Broad Money	Aug 2009	9/25/2009	M	M	M
Central Bank Balance Sheet	Aug 2009	9/25/2009	D	M	M
Consolidated Balance Sheet of the Banking System	Aug 2009	9/25/2009	M	M	M
Interest Rates[2]	Sep 2009	9/25/2009	W	W	M
Consumer Price Index	Sep 2009	9/30/2009	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Q2 2009	9/24/2009	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Aug 2009	9/22/2009	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Aug 2008	9/22/2009	M	M	Q
External Current Account Balance	Q1 09	7/23/2009	Q	Q	Q
Exports and Imports of Goods and Services	July 09	8/20/2009	M	M	Q
GDP/GNP	Q2 09	9/30/2009	Q	Q	Q
Gross External Debt	Q1 09	7/23/2009	Q	Q	Q
International Investment Position[6]	Q1 09	7/23/2009	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).

Press Release No. 09/378
FOR IMMEDIATE RELEASE
November 2, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review Under Stand-By Arrangement with Armenia, Approves Request for Waiver of Nonobservance of Performance Criterion, Modification of Performance Criteria, and Rephasing of Purchases

The Executive Board of the International Monetary Fund (IMF) has completed the second review of Armenia's economic performance under a program supported by a Stand-By Arrangement (SBA) and approved a request for a waiver of nonobservance of end-September 2009 fiscal balance performance criterion, modification of the quantitative performance criteria for end-December 2009 to reflect the revised macroeconomic framework and rephasing of purchases to make the amounts scheduled to become available following the second and third review available upon completion of the second review.

These decisions enable the immediate release of SDR 37.72 million (about US$60 million), bringing the total disbursed to SDR 301.94 million (about US$479 million). The 28-month SBA was approved on March 6, 2009 (see Press Release No. 09/68), with access augmented on June 22, 2009 (see Press Release No. 09/228).

Following the Executive Board's discussion on Armenia, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, stated:

"The global crisis has continued to have a serious impact on the Armenian economy. While output appears to be stabilizing, the fall in remittances and the collapse in the construction sector have caused a more severe economic contraction and lower fiscal revenue than anticipated in the first review. The authorities have fully implemented their economic program, which calls for the continuation of fiscal and monetary easing and a flexible exchange rate.

"In light of continuing weak domestic demand, the authorities will maintain fiscal easing this year, with external resources taking up the revenue slack. Expenditure will focus on undertaking anti-crisis measures, increasing capital spending, and protecting social spending. The authorities are committed to starting fiscal consolidation in 2010, with a view to ensuring medium-term debt sustainability. The program allows for additional spending should more donor financing become available to smooth the withdrawal of fiscal stimulus.

"An accommodative monetary policy stance remains appropriate given low inflation. The move to a more flexible exchange rate has served Armenia well, helping the economy avoid significant overvaluation and increasing the effectiveness of monetary policy. However, given the remaining weaknesses in the monetary transmission mechanism, targeted measures now being implemented to stimulate credit are crucial.

"The short-term outlook remains challenging. As external conditions improve, growth is expected to resume gradually in 2010, although risks remain, including a slower recovery of the global economy. Continued reforms, particularly in the areas of tax policy and tax reform administration, the financial sector, and the business environment will be necessary to boost the medium-term growth potential of the economy," Mr. Kato said

Statement by Age Bakker, Executive Director,
and Grigor Sargsyan, Advisor for the Republic of Armenia
October 30, 2009

Since the conclusion of the first review, GDP growth projections for Armenia for 2009 have deteriorated substantially. However, the deterioration in economic activity mainly reflects the sharp contraction in the construction sector, while the contraction of other sectors in the economy has remained more limited. Looking ahead, the authorities expect to see the start of a slow recovery in the coming months, and GDP to grow by slightly above 1 percent in 2010, as projected by staff during the first review of the program.

Implementing the agreed policies in response to the sharp external shock has led to strong program performance. All quantitative PCs and indicative targets for end-June were met and all PCs and indicative targets for end-September for which data are available have been met. The authorities' and staff's calculations show that the end-September fiscal balance PC may have been missed by a very small margin, although the final data on the fiscal deficit will only be available in early November. Structural benchmarks for end-June and end-September were implemented.

Going forward, recovery in Armenia depends crucially on improvement in the external economic environment, as two of the fairly important sources of income for Armenia's economy – exports and remittances - are highly dependent on global recovery. Regarding domestic policies, we believe that the slight fiscal tightening planned for 2010, alongside accommodative monetary policy and a flexible exchange rate regime adopted as part of the program, will support economic recovery and ensure the achievement of the government's economic and social objectives under the SBA.

Fiscal Policy

In response to the sharp downturn, the government has implemented a counter-cyclical fiscal policy that has gone beyond automatic stabilizers. Despite the collapse in nominal terms of tax revenues, nominal spending has increased compared to last year. As a result, the authorities expect the fiscal deficit in 2009 to widen substantially up to 7½ percent of GDP, which is about 1 percentage point higher than projected during the first review.

In 2009, tax revenues are projected to be around 16 percent of GDP. As a share of GDP, this level is slightly higher than projected by staff in June, and reflects both the authorities' efforts to increase the tax revenues, and historically low tax proceeds from the construction sector (pulling down the denominator more than the numerator).

Going forward, the authorities recognize that the rapid accumulation of public debt over the last year requires a gradual unwinding of their expansionary fiscal stance as soon as the first signs of economic recovery become visible. Accordingly, the authorities' aim is to lower the deficit in 2010 to less than 6 percent of GDP, which hinges on increasing tax revenues (in nominal terms and as percentage of GDP) and on restraining capital expenditures. At the same time, the authorities will examine their debt management strategy to lengthen maturities in the period ahead.

Tax Administration Reforms

Tax administration reform is underway, yet a lot still has to be done. The Fund's TA has been very helpful in this regard, but further progress is needed, and thus efforts to increase the tax base and tax revenues must persist. In particular, the authorities intend to strengthen the use of risk-based audits in VAT refunds, which they aim to implement towards the end of March, 2010. Continued technical assistance in this area will be crucial.

The Armenian authorities expect that all large taxpayers will electronically file their returns by the end of this year. E-filing is motivated by allowing the taxpayers to file their returns electronically 10 days later than when filing returns by mail. VAT payers are expected to start paying taxes electronically at the beginning of next year, and other tax payers are expected to e-file their returns by 2011.

Monetary Policy, Exchange Rate, and the Financial Sector

Monetary policy continues to be underpinned by an inflation-targeting framework. As aggregate demand deteriorated and inflation and inflation expectations were low, this allowed monetary policy to focus on supporting real activity by easing credit conditions. The key policy interest rate has been lowered since March by 275 basis points reaching the low level of 5 percent. But, like in many other economies, the traditional monetary policy tools to bolster aggregate demand and economic activity did not function well. Banks have been reluctant to supply credit and private enterprises have been hesitant in increasing their demand for credit. Currency mismatches, due to the high level of dollarization, also played a role in hindering credit growth. In response, the authorities have introduced various programs to support bank lending to SMEs and provided government credit and guarantees to systemically important enterprises. The authorities expect bank credit to start rising, as the economy begins its recovery in the following months. The slowdown of credit to the private sector and of external financing of the fiscal deficit resulted in excess liquidity in the banking sector. This excess liquidity risks being channeled to the foreign exchange market and putting pressure on prices.

The authorities remain committed to their internal guidelines on foreign exchange intervention, limiting intervention to smoothing excessive exchange rate volatility and rebuilding reserves. The move to a flexible exchange rate regime as part of the program has served the economy well. Market perceptions that the CBA will defend an implicit exchange rate level or range have vanished as the dram has depreciated further since mid-September, with the exchange rate now stabilizing at about 385 AMD per USD, limiting inflation pressures driven by the pass-through from the exchange rate to imported goods and domestic goods and services.

The banking system remains sound with high capital and liquidity ratios. The latest stress tests show that banks are resilient to the recent rise in NPLs, yet the authorities closely monitor the banking sector and introduce new prudential measures, as needed, to maintain its stability. Thus, for example, the authorities intend to reinstate limits on net open foreign exchange positions and to restrict banks' reliance on single sources of funding. The proposed increase in the Deposit Guarantee Fund, which was submitted to the Parliament, is another step taken just recently to strengthen the banking sector.