

Republic of Armenia: Second Reviews Under the Extended Fund Facility and Extended Credit Facility, and Request for Modification of Performance Criteria—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Armenia.

In the context of the second reviews under the Extended Fund Facility and Extended Credit Facility, and request for modification of performance criteria, the following documents have been released and are included in this package:

- The staff report for the Second Reviews Under the Extended Fund Facility and Extended Credit Facility, and Request for Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on April 12, 2011, with the officials of Armenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 14, 2011. 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.
- An informational annex of June 14, 2011.
- A Press Release summarizing the views of the Executive Board as expressed during its June 29, 2011 discussion of the staff report that completed the request and/or review.
- A statement by the Executive Director for the Republic of Armenia.

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

Poverty Reduction Strategy Paper--Progress Report

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

**Second Reviews Under the Extended Fund Facility and Extended Credit Facility,
and Request for Modification of Performance Criteria**

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

Approved by Ratna Sahay (MCD) and Thomas Dorsey (SPR)

June 14, 2011

- **Background.** Growth was below expectations in 2010, as agricultural output declined sharply and weaknesses in construction continued. Inflation has emerged as a concern, and the authorities have responded by raising interest rates and tightening liquidity, while providing targeted support to farmers and the poor. Fiscal adjustment is proceeding as planned, but revenue collections have not improved.
- **Program.** Continuous and periodic performance criteria for end-December 2010 were met, and indicative targets and structural benchmarks for end-March 2011 were implemented. The authorities are requesting SDR 36.2 million to become available upon completion of this review.
- **Discussions.** The team comprised M. Horton (head), V. Bacalu, A. Bordon, A. Mineshima, (all MCD), R. Romeu (FAD), J. Thornton (SPR), and K. Fujita (MCM). Discussions were held in Yerevan, led by Ms. Bacalu, during March 31–April 12, 2011. G. Tolosa (Resident Representative) and A. Manookian and A. Ghazaryan (IMF office) assisted. The mission met Prime Minister Sargsyan, Minister of Finance Gabrielyan, Minister of Economy Davtyan, Central Bank Chairman Javadyan, and other senior officials and representatives of the corporate sector, civil society, and the donor community. G. Sargsyan (OED) joined the discussions.
- **Publication.** The authorities have consented to publication of the staff report and Letter of Intent.

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EXECUTIVE SUMMARY

The recovery has been sluggish and uneven, and inflation is a concern. Growth was 2.1 percent in 2010, with continuing weakness in construction and a sharp drop in agriculture. Booming mining exports and recovering remittances helped narrow the current account deficit, but it remains high at 14 percent of GDP. A drop in foreign direct investment (FDI) was offset by bank inflows, as credit has surged. Driven by food prices, inflation rose through March, reaching 11½ percent.

Program performance has been strong, with all targets met, but challenges have not subsided. Fiscal adjustment is proceeding, but tax administration measures have not delivered higher collections. This could threaten consolidation going forward, particularly with elections in 2012–13, and undermine growth and poverty reduction prospects. Foreign exchange reserves targets were met comfortably, but were supported by inflows that may prove temporary. To support its commitment to a flexible exchange rate, the Central Bank of Armenia (CBA) agreed to an increase of the program targets on net international reserves (NIR).

The authorities have responded appropriately to the surge of inflation. The CBA raised its policy rate three times during February–April and stepped up liquidity management. The authorities have also provided seeds and subsidized loans to farmers and a targeted gas subsidy within the budget envelope. Inflation is projected to return to the target range of 4 ± 1.5 percent in early 2012.

The financial system has been resilient to shocks due to high capitalization and liquidity. The authorities recognize risks from high dollarization and raised provisioning requirements on foreign currency loans. Risks are rising, however, as foreign currency lending is increasing sharply, including to unhedged borrowers. Further measures are underway to strengthen contingency planning and risk management.

Efforts to step up structural reforms will continue. There is a need to deliver on reforms that enhance competition, diminish monopolistic behavior, and reduce the costs of trade and doing business. An overall improvement in the investment climate is preferable to tax breaks or free zones, given risks of leakage and lower fiscal revenues.

I. ECONOMIC CONTEXT

A. Background and Program Implementation

1. **Having emerged from the global crisis, Armenia faces several challenges.** These include sizable external imbalances, low fiscal revenues, higher public debt, a surge of supply-driven inflation, high dollarization, and increased poverty.
2. **The political landscape remains broadly unchanged.** Elections for parliament and the presidency are scheduled in 2012 and 2013. The last presidential elections, in 2008, were followed by demonstrations that turned violent. Protests resumed in February, but the authorities and the opposition have pursued dialogue and confidence-building measures in recent weeks. Risks remain from Nagorny Karabakh.
3. **Program performance has been strong.** All continuous and periodic performance criteria for end-December 2010 were met, and indicative targets and structural benchmarks for end-March 2011 were implemented.

B. Recent Developments

4. **The recovery has been sluggish and uneven, and inflation has picked up.** The economy grew by 2.1 percent in 2010, with slow growth in construction and a sharp drop in agriculture. Mining, industry, trade, and transport were growth drivers. With domestic constraints and high global prices, food price inflation surged to 17 percent in March, bringing overall inflation to 11½ percent.¹ Nonfood inflation reached nearly 7 percent. Data for April and May indicate a moderation of pressures.
5. **The external current account deficit declined slightly in 2010, and capital inflows resumed.** Exports increased by almost 50 percent, buoyed by high metals prices, and remittances picked up with the recovery in Russia. However, imports also grew strongly. Private capital inflows resumed, as banks accessed external deposits and credit lines to support domestic lending, largely in foreign currency. Foreign investment declined, as large projects were completed.
6. **Appreciation pressures eased in 2011, but the dram remains overvalued.**² Supported by private inflows, the end-2010 reserves target was exceeded by a large margin.
7. **Fiscal consolidation has continued, despite low revenue collections.** Tax revenues remained at 16.4 percent of GDP. Profits taxes were lower, and VAT and customs duties

¹ Food comprises 48.5 percent of the consumer basket.

² See Appendix II of Country Report 10/350.

declined in the second half of 2010. Still, the deficit declined by nearly 3 percentage points of GDP, as the authorities restrained spending, particularly domestically-financed investment. The government met its social spending targets, and an increase in family benefits and lump-sum aid is planned for 2011. These benefits have helped ensure that poverty has not risen further with the crisis (Appendix I).

8. **Targeted measures have been taken in response to the food and energy price shocks.** The government introduced a gas subsidy targeted to the poor, and to assist the hard-hit agriculture sector, an interest rate subsidy, distribution of seeds, and infrastructure improvements. The budgetary cost of these measures is well contained and has been financed by savings in other areas.

9. **Concerned with possible second-round effects, the CBA tightened monetary policy.** Beginning in February 2011, the CBA raised its policy rate by 125 basis points in three steps to 8.5 percent. The CBA has moved to mop up excess dram liquidity and bring interest rates more in line with its policy stance. It worked with the government to issue additional treasury bills for liquidity management. The CBA also stepped up public communications to explain the exogenous and temporary nature of the shock.

10. **While credit has grown at a brisk pace, the banking sector remains sound.** Foreign currency lending grew by 40 percent in 2010, and total credit by 27 percent (Box 1). Credit demand has remained strong across sectors and firm size in 2011. The rapid growth of foreign currency lending has increased vulnerabilities, although capital adequacy was over 22 percent at end-2010, with no banks below 12 percent. The ratio of nonperforming loans has declined to around 4 percent from a peak of 10 percent in mid-2009.

11. **The authorities adopted an action plan in January to improve the business environment.** This aims to improve Armenia's "Doing Business" rankings including in trade, starting new businesses, permits and registration, contract enforcement, investor protection, and closure and liquidation.

C. Short and Medium-Term Outlook and Risks

12. **Growth is projected to accelerate in 2011, and inflation should moderate.** Growth is projected at 4.6 percent, helped by a recovery in agriculture. Construction, an important pre-crisis growth driver, is likely to remain sluggish. Inflation pressures appear to be moderating, as food inflation declined in April. This is likely to continue as the harvest season begins. Inflation should return to the target range of 4 ± 1.5 percent in early 2012. Growth is likely to remain around 4–4½ percent during 2012–13. Key risks include continuing weaknesses in agriculture and even stronger global food and fuel price pressures.

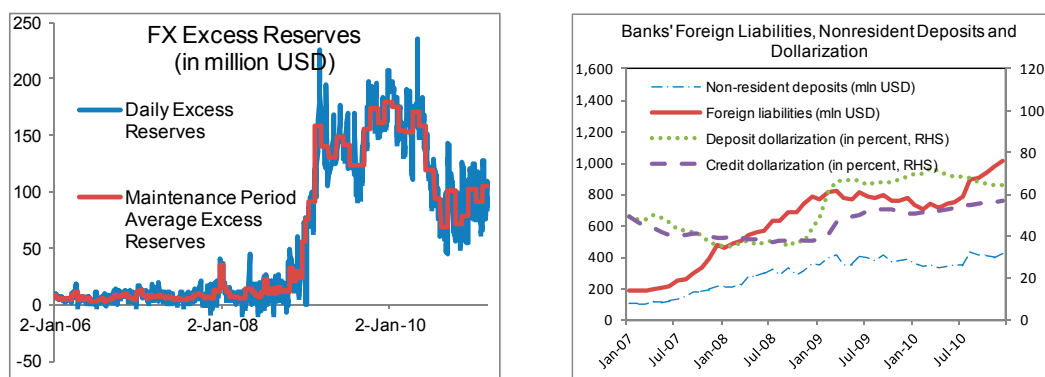
13. **The external current account deficit is projected to decline from 14 to 11½ percent of GDP.** High prices will boost food and fuel imports, but mining exports and remittances are expected to increase further. Private inflows are likely to moderate, but FDI

should begin to rebound from low levels in 2010. Official inflows are likely to be higher reflecting additional and delayed disbursements. Small external financing gaps projected for

Box 1. Armenia: Foreign Currency Lending

Foreign currency (FX) lending has risen fast. Financing sources have been mainly in FX, and deposits remain highly dollarized. As the outlook has improved and the currency denomination of required reserves has changed, banks have drawn down excess FX reserves for lending. The extended period of relative stability of the dram-dollar exchange rate since last summer may also have provided further incentives for borrowing in FX.

Factors that have supported FX lending are expected to diminish, while deposit dollarization is declining. Excess reserves have been reduced, and CBA measures have contributed to an initial dedollarization of deposits. Greater exchange rate flexibility would reduce incentives to borrow in FX.



Sources: Armenian authorities; and Fund staff estimates.

2012–13 could widen if further food and fuel price pressures emerge, or expected remittance and FDI flows do not materialize. Spillovers from renewed financial uncertainty in Southern Europe or sustained difficulties in the Middle East appear unlikely, in the absence of adverse domestic or regional developments.

14. **The medium-term external outlook remains challenging.** Barring a sharp increase in FDI, the current account will need to decline substantially as crisis support unwinds and given limited potential for private borrowing. High export prices and strong remittance flows may cushion the adjustment, but further structural reform and a return of the real exchange rate to its equilibrium level would be important to help limit risks.

15. **Further fiscal consolidation is needed to support external adjustment, but this may be increasingly challenging given the election cycle.** The 1-percentage point adjustment in 2011 reflects a further decline in capital spending, albeit to levels within pre-crisis norms. Tax revenues are cautiously projected to remain flat. The deficit is projected to decline to 2.4 percent of GDP in 2013 and stabilize at 2 percent of GDP thereafter, so that

debt declines in percent of GDP. However, this stance may be challenging with elections in 2012–13.

II. POLICY DISCUSSIONS

16. **Key objectives for 2011 are to support the recovery and alleviate poverty, while bringing down inflation.** This requires: (i) continuing fiscal adjustment (maintaining priority investment spending and well-targeted social assistance); (ii) prudent monetary policy; (iii) exchange rate flexibility; and (iv) further structural reforms.

A. Fiscal Policy

17. **Fiscal consolidation remains a top priority, with a focus on revenue measures.**

- **The 2011 budget is in line with the deficit-reduction target.** Staff observed that revenue weaknesses experienced in 2010 may persist, and the authorities pledged to manage expenditures cautiously to achieve the deficit targets.
- **Staff and the authorities agreed on the importance of deeper tax reforms, but implementation needs to be firmed up.** Staff noted that spending has borne the burden of adjustment and stressed the need to make a decisive breakthrough on revenue reforms to enhance collections and equity (Box 2). The authorities agreed in principle on a number of reforms, including base broadening of the VAT and income taxes. However, they noted that near-term implementation is subject to capacity constraints, while politically-sensitive measures require consensus building. The authorities agreed that the erosion of excise taxes

Box 2. Armenia: Tax Reforms

Critical tax collection gains remain elusive. Actions have been taken to develop audit manuals, cash register surveillance, improved large taxpayer auditing, and risk management in VAT refunds, and to pass legislation bringing several forms of presumptive taxation into the regular tax regime. However, the broad tax reform effort has so far fallen short of expectations, in terms of higher revenues. This reflects the need for continuing improvements in revenue administration, including coordination between the Finance Ministry (MoF) and the State Revenue Committee (SRC), and underlying tax policy weaknesses.

Important work remains ahead. In addition to new program benchmarks for 2011, the authorities should diversify revenue sources and raise collections from visible and less mobile bases (natural resources, property, consumption). Better taxing visible wealth (property, land) would also help address informality. Equity concerns should be addressed, including capital gains, interest income, and dividends, exemptions for agriculture and military pay, deductions for mortgage interest and tuition, and corporate tax incentives. A new fiscal regime for mining in line with best practices is also critical. As a key step, the authorities are strengthening information sharing between the MoF and SRC.

should be addressed and committed to other tax measures, including a reform strategy paper drawing on recent TA recommendations. Staff urged that the window for enacting far-reaching reforms before the election cycle be used.

- **While debt sustainability remains on firm footing, staff cautioned that fiscal slippage would increase vulnerability.** Staff projections show public debt rising further in 2011 before declining to below 40 percent of GDP by 2014. However, relaxing the deficit path by just $\frac{1}{2}$ –1 percentage point of GDP would reverse this reduction. Prospects would be further undermined by a change in the concessionality of Armenia’s borrowing. Higher revenues would significantly ease the burden of consolidation and provide space for additional social and capital outlays.

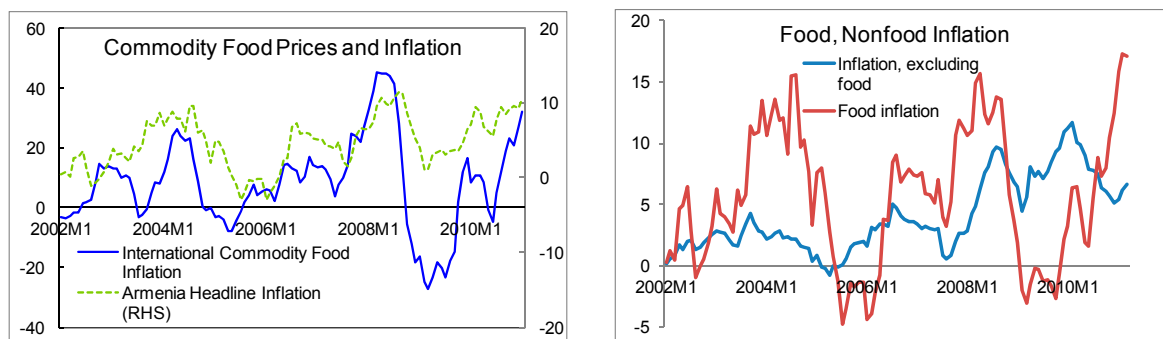
B. Monetary Policy and Banking Sector

18. Monetary policy remains geared to bringing inflation to low single digits and developing the financial system.

- **The CBA will maintain a tight monetary stance until inflation pressures subside.** The central bank expects to continue raising the policy rate if needed and to increase reserve requirements on foreign liabilities. Staff noted that future actions should be forceful, if inflationary pressures do not ease (Box 3).

Box 3. Armenia: Inflation Spillovers

Shocks to global food prices have a strong impact on nonfood inflation in Armenia. Staff estimates of the passthrough from food to nonfood inflation suggest that three months after a 1 percent food price shock, nonfood prices rise by 0.3 percent. This pattern was evident in early 2011, as nonfood inflation picked up in the wake of the global rise of food prices.



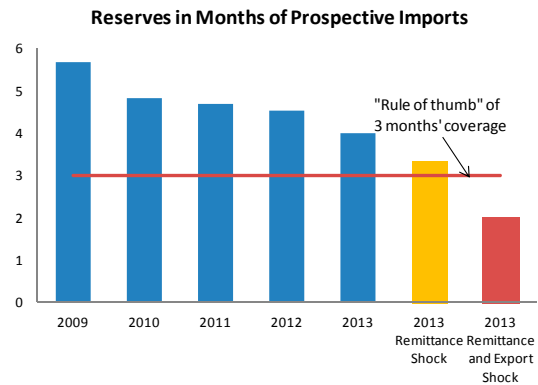
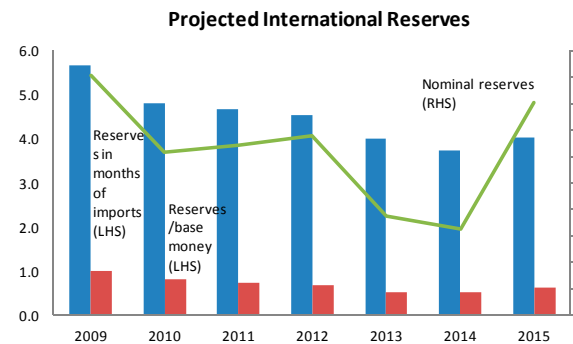
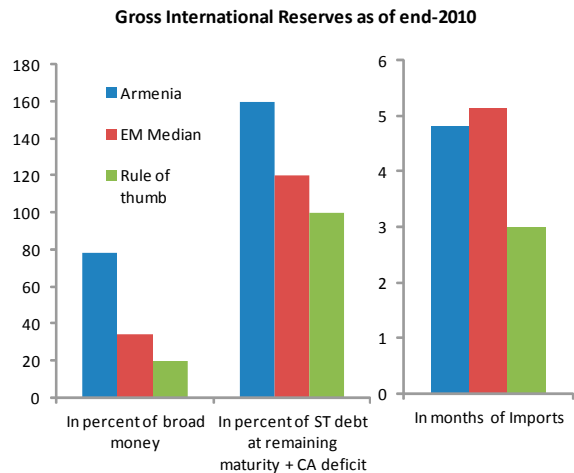
Sources: Armenian authorities; and Fund staff estimates

- **Staff urged the CBA to bring liquidity conditions in line with the announced policy stance and thereby strengthen the interest rate channel.** The CBA agreed with staff recommendations to publish its liquidity forecasts to inform market participants.
- **The CBA is committed to exchange rate flexibility, but expressed concern on possible inflationary impacts given high passthrough.** Staff stressed the role that flexibility plays in providing signals.
- **Staff and the CBA agreed on the need to safeguard reserves in light of possible shocks and medium-term debt service payments (Box 4).** NIR targets for June and December were increased. Intervention may be necessary in light of the thin market, aiming to smooth volatility and rebuild reserves.

Box 4. Armenia: Reserve Adequacy

By most standard measures, Armenia’s gross reserves are at comfortable levels. However, they are expected to decline over the medium term with the unwinding of external crisis support. High dollarization also constitutes a risk, along with concentration of exports in mining and remittances on Russia.

A negative shock to remittances equivalent to that of 2009 could reduce reserves to three months of imports in 2013. A combined shock to both remittances and exports of 2009 magnitudes could imply a fall to just two months. Given Armenia’s vulnerabilities, the current level of reserves appears not unreasonable high.



Sources: Armenian authorities; and Fund staff estimates.

- **The authorities pledged to remain vigilant against banking sector risks associated with dollarization.** The CBA raised capital and provisioning requirements on foreign currency loans in September and January, respectively. The CBA pledged to take further steps as needed.
- **The CBA is continuing efforts to strengthen crisis preparedness and banking system resilience.** The central bank is improving its stress testing to better capture real-financial linkages and will take further crisis preparedness and contingency planning actions, including a review of commercial bank contingency plans, formulation of an internal crisis management framework, and a crisis simulation involving commercial banks. The upcoming FSAP Update and a review of the legal regime for bank resolution will help further shape stability policy.

C. Medium-Term Adjustment and Structural Reforms

19. Accelerating structural reforms is vital for addressing imbalances, sustainable growth, and poverty reduction.

- **Staff and the authorities agreed on the need for further reforms to boost competitiveness.** The authorities highlighted measures to promote exports and to reduce the

Box 5. Armenia: Structural Issues in Agriculture

Weather contributed to the 2010 collapse, but underlying weaknesses also played a role:

- **Limited access to financing.** Loan terms (collateral, maturities, interest rates) do not match farmers' capacity, leading to reliance on cash and volatile remittances.
- **Fragmentation.** 97 percent of output is produced by household farms, averaging 1.1 hectares of arable land, a tenth of the EU average.
- **Outdated equipment.** 95 percent of farm equipment is considered obsolete.
- **Limited arable and irrigated land.** Just 47 percent of land is arable and one-third of arable land is unused. Just two-thirds of irrigable land is irrigated.
- **High dependence on imported fertilizer, feeds, and fuel.**
- **Limited transport capacity.** With borders with Turkey and Azerbaijan closed, limited road and rail access to Georgia and Iran is a constraint.
- **Low food safety standards.** Standards are below international levels, constraining exports.

To tackle these, the government has launched an agricultural strategy for 2010–20, which aims to: expand use of arable land and improve yields by consolidating lands, modernizing technology, and upgrading infrastructure; and enhance the quality and capacity of food processing and marketing. The strategy also targets a new agriculture insurance system and new finance instruments.

costs of trade, registering businesses, and obtaining construction permits. Progress has also been made in addressing obstacles to a free trade area (FTA) with the EU (product and sanitary standards, trade and investment regulations, competition rules). Staff welcomed these efforts, and stressed that an overall improvement in the investment climate was preferable to tax breaks or free zones, given risks of leakage and lower revenues. In agriculture, measures are being taken to address immediate concerns (e.g., distributing seeds), but significant structural weaknesses warrant comprehensive reforms (Box 5).

- **The authorities also agreed that creating more competitive domestic markets is essential.** Staff expressed concern with possible distortions under a new law that would limit price increases of some staples. The authorities noted that the law was intended to deter aggressive pricing by firms with market power and agreed that distortions should be avoided. Amendments to the competition law enhancing the monitoring and enforcement power of the competition committee are a welcome step.

III. PROGRAM ISSUES

31. **An Annual Progress Report on the Sustainable Development Plan** has been prepared ahead of the new medium-term strategy expected to be completed later this year (Box 6).

Box 6. Armenia: Annual Progress Report of the Sustainable Development Program

The Annual Progress Report (APR) of the Sustainable Development Program (SDP) for 2008–13 provides a comprehensive evaluation of outturns and performance relative to SDP benchmarks. As the APR sets out, with the impact of the global financial crisis on Armenia, many SDP goals became unattainable, and progress fell short in most sectors, including health, education, water and sanitation, and transport. Some areas fared better, including pensions and environmental protection. The APR notes that many targets will need to be revised in light of outturns and diminished fiscal space.

While the APR does not provide revised forecasts, its analysis is in line with the macroeconomic policy framework underlying Fund- and Bank-supported programs. The report asserts that the economic landscape has changed significantly, with key pre-crisis growth drivers—construction and consumption fueled by remittances and other inflows—unlikely to recover quickly or fully, public debt sharply higher, and new risks emerging, most notably from food price inflation. The APR calls for a “new model” that emphasizes greater productivity and competitiveness to drive diversification and export growth, supported by further reforms to public administration and institutions.

Given implementation shortfalls and the imperative to reduce the fiscal deficit, the APR could have provided updated targets more comprehensively across sectors, as well as more specific guidance on how spending programs should be re-prioritized over the remaining SDP period. For example, ambitious targets for increased coverage and size of a range of social and pension benefits set under the SDP in 2008 may now be unrealistic, and infrastructure spending priorities may need to be adjusted significantly in light of sharply lower fiscal space compared with 2008 estimates. A World Bank Public Expenditure Review, now nearing completion and focusing on health, education, transport, and the wage bill, will provide important inputs to the forthcoming full new medium-term strategy.

32. **Program design and monitoring will remain broadly unchanged.** The authorities are requesting modification of end-June performance criteria (PCs) for NIR and net domestic assets and for the program fiscal balance, in line with a revised definition that incorporates project loans. Structural benchmarks focus on tax policy and revenue administration, social policy, and monetary operations.

IV. STAFF APPRAISAL

33. **Policies have broadly delivered on program objectives.** The recovery should pick up and broaden in 2011. Progress has been made toward reestablishing fiscal sustainability. The policy response to the pickup of inflation has been timely, and banking sector indicators continue to improve. The resumption of private inflows and credit has also been positive.

34. **The economy is set to grow faster, but additional efforts are needed to strengthen medium-term growth potential, ensure job creation, and reduce poverty.** Recent measures taken to reduce supply-side constraints—particularly for the EU FTA and in the agriculture sector—are welcome. Risks remain, however, and these efforts should be accompanied by comprehensive reforms to improve the business environment and agriculture. Promoting greater domestic competition would help improve external competitiveness.

35. **Continuing consolidation will help maintain stability and reduce vulnerability.** The adjustment has been excessively weighted to spending cuts, as tax reform progress has been disappointing. A decisive breakthrough in tax policy and revenue administration is needed, particularly given that elections in 2012–13 may make reforms more difficult. This would provide space for additional, well-targeted capital and social spending, and mitigate risks.

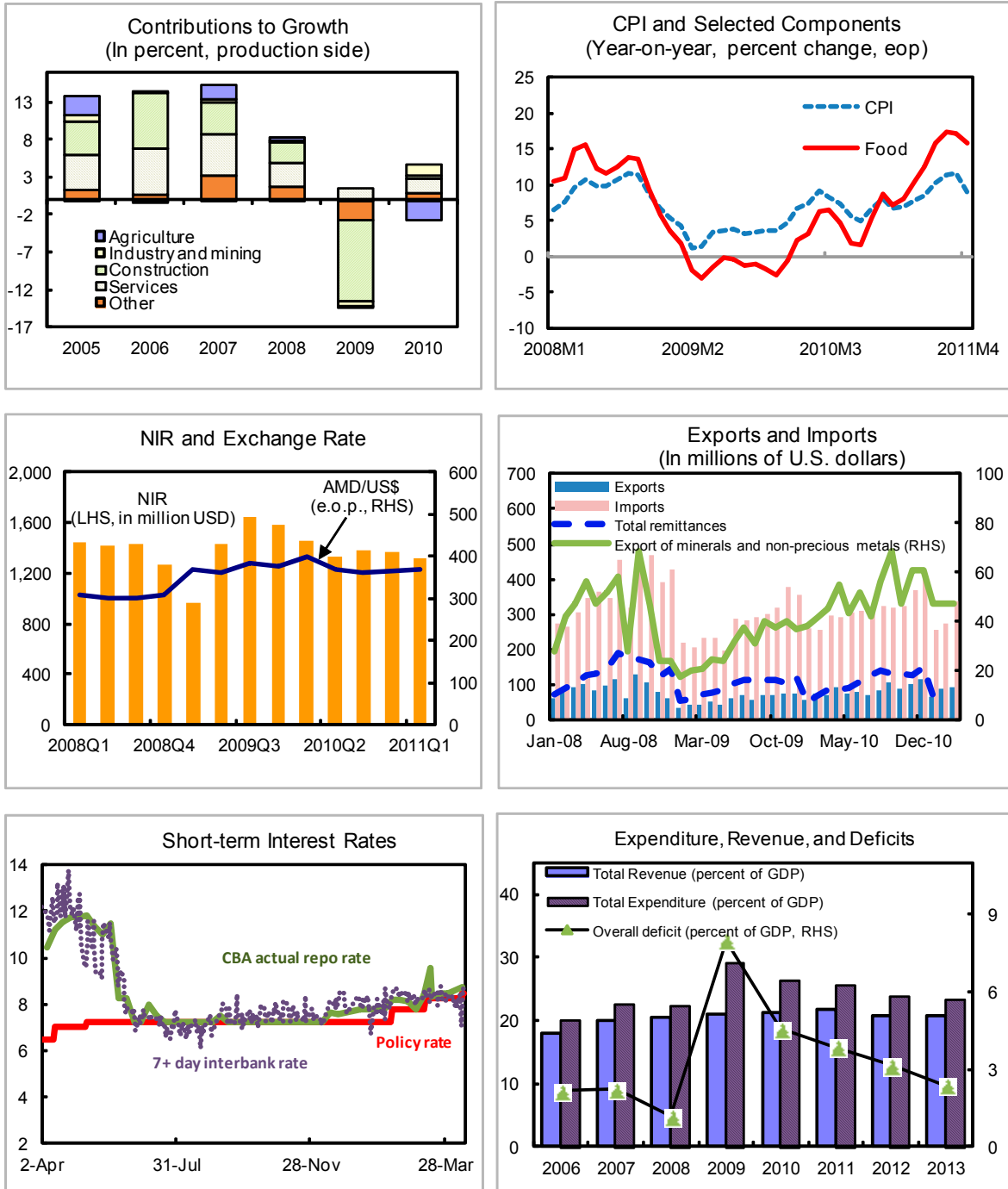
36. **Continued implementation of sound policies should help ensure a smooth and orderly external adjustment.** External pressures may reemerge, for example, from possible further strong global food and fuel price pressures or a fall in remittances. Together with sustained reforms, greater exchange rate flexibility will be essential to provide appropriate price signals and reduce incentives for an excessive build-up of foreign exchange exposure. Concerns with passthrough to inflation are understandable, but are best addressed by monetary policy actions to anchor expectations.

37. **The CBA's response to inflation has been appropriate, but active liquidity management is needed.** Liquidity management efforts to keep market rates in line with the declared policy stance will strengthen the traction of monetary policy. Once again, risks to inflation remain from possible further global price pressures. The CBA should stand vigilant, and future monetary policy actions should be forceful, if inflation does not moderate.

38. **While the banking sector remains sound, the CBA should continue its efforts to improve its resilience.** Dollar lending is increasing bank vulnerabilities. The CBA is right to remain vigilant and step up monitoring and crisis preparedness.

39. **All continuous and periodic quantitative PCs and indicative targets for end-December 2010 as well as all indicative targets for end-March 2011 were observed.** Structural benchmarks were met on time. Staff recommends completion of the Second Review, approval of the request for modification of end-June 2011 PCs, and establishment of new PCs for end-December 2011.

Figure 1. Armenia: Selected Macroeconomic Indicators



Sources: Armenian authorities; and Fund staff estimates.

Table 1. Armenia: Selected Economic and Financial Indicators, 2006–13

	2006	2007	2008	2009	2010	2011		2012	2013
	Act.	Act.	Act.	Act.	Prel.	Country Report No. 10/350	Proj.	Proj.	Proj.
National income and prices									
Real GDP (percent change)	13.2	13.7	6.9	-14.2	2.1	4.6	4.6	4.3	4.2
Gross domestic product (in billions of drams)	2,656	3,149	3,568	3,103	3,462	3,771	3,837	4,202	4,567
Gross domestic product (in millions of U.S. dollars)	6,384	9,206	11,662	8,541	9,265	8,858	10,037	9,945	10,440
Gross domestic product per capita (in U.S. dollars)	1,982	2,853	3,606	2,615	2,808	2,658	3,012	2,955	3,071
CPI (period average; percent change)	3.0	4.6	9.0	3.5	7.3	5.5	9.4	5.1	4.0
CPI (end of period; percent change)	5.4	6.7	5.3	6.7	8.5	4.6	6.7	4.0	4.0
GDP deflator (percent change)	4.6	4.2	5.9	1.3	9.2	3.9	6.0	5.0	4.3
Poverty rate (in percent)	26.5	25.0	23.5	27.6	34.1	...	...	...	...
Investment and saving (in percent of GDP)									
Investment	33.6	38.2	43.8	33.9	33.6	34.3	33.2	33.5	33.8
National savings	31.7	31.8	32.0	17.9	19.6	21.7	21.7	23.1	24.5
Money and credit (end of period)									
Reserve money (percent change)	41.1	50.9	5.3	13.8	-0.8	10.4	10.9	...	...
Broad money (percent change)	32.9	42.3	2.4	16.4	10.6	13.5	14.0	...	...
Velocity of broad money (end of period)	5.5	4.6	5.0	3.8	3.8	3.6	3.7	...	...
Commercial banks' 3-month lending rate (in percent)	17.1	18.6	17.9	19.1	17.7	...	...	...	...
Central government operations (in percent of GDP)									
Revenue and grants	18.0	20.1	20.5	21.1	21.2	22.7	21.7	20.6	20.7
<i>Of which: tax revenue</i>	14.5	16.0	16.8	16.3	16.4	17.2	16.4	16.5	16.6
Expenditure 1/	20.0	22.4	22.2	28.9	26.2	26.6	25.6	23.8	23.1
Overall balance on a cash basis	-2.2	-2.2	-1.2	-8.0	-4.6	-3.9	-3.9	-3.2	-2.4
Government and government-guaranteed debt (in percent of GDP)	18.7	16.1	16.2	40.6	39.9	48.9	45.2	43.8	41.3
Share of foreign currency debt (in percent)	88.1	86.7	83.7	88.9	87.7	89.1	88.5	87.3	85.6
External sector									
Exports of goods and services (in millions of U.S. dollars)	1,510	1,777	1,757	1,336	1,863	1,720	2,207	2,412	2,606
Imports of goods and services (in millions of U.S. dollars)	-2,536	-3,589	-4,748	-3,683	-4,246	-4,129	-4,631	-4,791	-5,002
Exports of goods and services (percent change)	6.7	17.6	-1.1	-24.0	39.5	13.7	18.5	9.3	8.0
Imports of goods and services (percent change)	19.4	41.5	32.3	-22.4	15.3	6.2	9.1	3.5	4.4
Current account balance (in percent of GDP)	-1.8	-6.4	-11.8	-16.0	-14.0	-12.6	-11.5	-10.3	-9.3
FDI (net, in millions of U.S. dollars)	450	701	940	725	569	799	641	679	713
External debt (in percent of GDP) 2/	18.9	15.7	13.5	34.7	36.0	41.8	36.9	37.6	34.7
Debt service ratio (in percent of exports of goods and services)	3.9	2.9	7.8	5.4	4.9	7.6	4.8	10.5	15.8
Gross international reserves (in millions of U.S. dollars) 3/	1,072	1,659	1,407	2,004	1,859	1,790	1,872	1,903	1,761
Import cover 4/	3.6	4.2	4.6	5.7	4.8	4.9	4.7	4.6	4.1
Nominal effective exchange rate (percent change) 5/	9.9	14.1	6.3	-8.4	-2.7	...	...	...	...
Real effective exchange rate (percent change) 5/	8.7	14.1	8.6	-7.5	1.5	...	...	...	...
End-of-period exchange rate (dram per U.S. dollar)	364	304	307	378	363	...	...	...	...
Average exchange rate (dram per U.S. dollar)	416	342	306	363	374	...	...	...	...
Memorandum item:									
Population (in millions)	3.2	3.2	3.2	3.2	3.2	...	...	...	...

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

1/ Including the gas subsidy in 2006–08.

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 holdings.

5/ A positive sign denotes appreciation.

Table 2. Armenia: Balance of Payments, 2008–16
(In millions of U.S. dollars, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
	Act.	Act.	Prel.			Proj.			
Current account	-1,382	-1,367	-1,300	-1,150	-1,028	-969	-894	-917	-958
Trade balance	-2,664	-2,081	-2,142	-2,259	-2,275	-2,305	-2,331	-2,419	-2,531
Exports, fob	1,112	749	1,113	1,352	1,455	1,572	1,714	1,835	1,959
Imports, fob	-3,776	-2,830	-3,255	-3,611	-3,730	-3,877	-4,045	-4,254	-4,490
Services (net)	-327	-266	-241	-166	-104	-91	-54	-57	-47
Credits	645	587	749	854	957	1,033	1,116	1,183	1,254
Debits	-972	-853	-990	-1,020	-1,061	-1,125	-1,170	-1,240	-1,301
Income (net)	471	167	159	193	232	240	250	260	270
Transfers (net)	1,138	814	924	1,081	1,118	1,187	1,240	1,299	1,350
Private	1,062	733	844	975	1,063	1,132	1,194	1,260	1,317
Official	75	81	80	106	56	55	46	39	34
Capital and financial account	1,134	1,560	975	1,077	1,099	1,006	1,016	1,168	1,181
Capital transfers (net)	149	89	114	120	126	132	145	152	160
Foreign direct investment (net)	940	725	569	641	679	713	749	786	826
Portfolio investment (net)	8	-4	9	10	11	12	13	15	16
Public sector (net)	145	1,024	168	243	205	67	24	127	88
Disbursements	160	907	193	272	276	258	226	234	214
Amortization	-15	-21	-25	-29	-72	-191	-202	-108	-126
CBA	0	138	0	0	0	0	0	0	0
Other capital (net)	-108	-273	115	63	78	82	85	88	92
Errors and omissions	14	-39	20	0	0	0	0	0	0
Overall balance	-234	155	-304	-73	71	37	122	251	223
Financing	234	-155	304	-36	-186	-134	-122	-251	-223
Gross international reserves (increase: -) 1/	252	-597	145	-13	-31	142	29	-224	-184
Use of Fund credit, net	-20	442	160	-22	-155	-276	-150	-27	-39
Purchases/disbursements	7	466	181	...	...	...	...	...	...
Repurchases/repayments	-27	-23	-22	-22	-155	-276	-150	-27	-39
Exceptional financing 2/	2	0	0	0	0	0	0	0	0
Financing gap	0	0	0	109	115	97	0	0	0
Identified financing									
IMF ECF/EFF	0	0	0	109	101	83	...	...	...
Other	0	0	0	0	14	15	...	...	...
Memorandum items:									
Financing gap (EBS/10/209)	0	0	54	119	115	97	0	0	0
Current account (in percent of GDP)	-11.8	-16.0	-14.0	-11.5	-10.3	-9.3	-8.1	-7.9	-7.8
Trade balance (in percent of GDP)	-22.8	-24.4	-23.1	-22.5	-22.9	-22.1	-21.2	-20.8	-20.6
Gross international reserves (end of period)	1,407	2,004	1,859	1,872	1,903	1,761	1,732	1,956	2,139
In months of next year's imports	4.6	5.7	4.8	4.7	4.6	4.1	3.8	4.1	4.2
Net international reserves (program definition)	1,057	1,019	885	819	832	770	757	855	936
Merchandise export growth, percent change	-7.1	-32.7	48.7	21.5	7.6	8.0	9.1	7.0	6.8
Merchandise import growth, percent change	35.0	-25.0	15.0	10.9	3.3	3.9	4.3	5.2	5.6
Nominal external debt 3/	1,577	2,967	3,336	3,700	3,736	3,628	3,617	3,697	3,728
Nominal external debt stock (in percent of GDP) 3/	13.5	34.7	36.0	36.9	37.6	34.7	32.9	31.8	30.3
External debt-to-exports ratio (in percent) 3/	89.8	222.2	179.1	167.7	154.9	139.2	127.8	122.5	116.0
External debt service in percent of exports 3/	7.8	5.4	4.9	4.8	10.5	15.8	9.8	5.8	16.5

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

1/ Gross international reserves include the SDR holdings.

2/ Debt relief from the United Kingdom.

3/ Based on government and government-guaranteed debt.

Table 3. Armenia: Monetary Accounts, 2007–11
(In billions of drams, unless otherwise indicated)

	2007		2008		2009		2010				2011			
	Dec. Act.	Dec. Act.	Dec. Act.	Dec. Act.	Dec. Act.	Dec. Act.	Mar. Act.	Jun. Act.	Sep. Act.	Dec. Prel.	Mar. Prel.	Jun. Prog. 1/	Sep. Prog. 1/	Dec. Prog. 1/
Central Bank of Armenia														
Net foreign assets	445.9	377.5	515.4	503.3	415.0	419.5	421.5	407.5	416.2	398.6	411.3			
Net international reserves	456.2	390.0	595.8	585.6	487.6	496.9	498.3	488.4	497.8	481.0	502.1			
Medium and long-term	-10.3	-12.4	-80.5	-82.3	-72.6	-77.5	-76.9	-80.9	-81.6	-82.4	-90.7			
Net domestic assets	-18.8	72.2	-3.7	-38.3	19.6	18.9	86.1	98.9	105.9	139.4	151.7			
Claims on general government (net)	-89.8	-96.5	-152.5	-154.5	-145.6	-150.8	-95.6	-92.1	-79.0	-68.2	-45.6			
<i>Of which: central government (net)</i>	-51.4	-84.4	-138.8	-132.3	-119.6	-124.8	-76.7	-67.1	-54.0	-43.2	-20.6			
Claims on banks	24.6	80.6	66.2	59.5	55.4	59.0	57.4	67.2	68.9	81.7	59.0			
KfW	14.4	19.9	39.1	43.5	49.8	58.2	61.5	62.2	62.9	63.7	72.0			
Monetary instruments (net) excluding CBA bills	10.2	60.7	27.1	16.0	5.5	0.8	-4.1	5.0	6.0	18.0	-13.0			
CBA bills 2/	-49.0	-1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
Other items (net)	95.3	89.5	82.6	56.7	109.8	110.6	124.3	123.8	115.9	125.9	138.3			
Reserve money	427.1	449.7	511.7	465.0	434.5	438.4	507.6	506.3	522.0	538.0	563.0			
Currency issue	350.3	344.5	320.7	276.4	295.6	304.0	348.2	312.4	334.8	356.3	390.2			
Deposits	76.8	105.2	191.0	188.6	139.0	134.4	159.4	193.9	187.3	181.6	172.8			
Deposits in drams	38.4	39.3	42.3	31.2	41.8	55.0	61.4	104.6	105.6	108.1	110.4			
Deposits in foreign currency	38.5	65.9	148.7	157.4	97.2	79.4	98.0	89.3	81.7	73.5	62.4			
Banking system														
Net foreign assets	369.6	229.2	379.1	380.9	285.2	249.4	191.5	149.9	136.2	123.6	100.3			
Net domestic assets	321.8	479.0	444.9	444.0	510.3	568.6	719.7	780.1	814.4	866.2	938.4			
Claims on government (net)	-54.0	-37.3	-125.3	-145.1	-142.5	-131.7	-50.9	-51.1	-40.7	-20.1	14.3			
<i>Of which: claims on central government (net)</i>	-15.6	-25.3	-111.6	-122.8	-116.5	-105.8	-32.0	-26.2	-15.7	4.9	39.2			
Claims on rest of the economy	429.8	638.6	728.3	771.8	785.7	839.1	922.9	998.3	1022.2	1053.4	1091.2			
Other items (net)	-54.0	-122.3	-158.0	-182.7	-132.9	-138.8	-152.2	-167.1	-167.1	-167.1	-167.1			
Broad money	691.3	708.2	824.0	824.9	795.5	818.1	911.2	930.0	950.6	989.9	1038.8			
Currency in circulation	326.0	316.1	282.7	247.5	265.2	272.1	304.5	278.5	306.8	328.3	362.2			
Deposits	365.3	392.2	541.3	577.4	530.3	545.9	606.7	651.5	643.9	661.5	676.6			
Domestic currency	235.0	219.5	170.7	157.4	165.9	186.5	216.7	227.5	232.3	241.9	251.8			
Foreign currency	130.3	172.6	370.6	420.0	364.4	359.4	389.9	424.0	411.6	419.6	424.8			
Memorandum items:														
Exchange rate (in drams per U.S. dollar, end of period)	304.2	306.7	377.9	400.5	367.5	361.3	363.4	369.7	...	...	...
NIR, program definition, at program exchange rates (in millions of U.S. dollars)	1,350	1,057	1,019	895	912	933	885	833	795	769	819			
12-month change in reserve money (in percent)	50.9	5.3	13.8	18.7	6.5	-5.0	-0.8	8.9	20.1	22.7	10.9			
12-month change in broad money (in percent)	42.3	2.4	16.4	28.6	19.2	8.3	10.6	12.7	19.5	21.0	14.0			
12-month change in private sector credit (in percent)	78.0	48.6	14.0	17.0	24.6	23.0	26.7	29.4	30.1	25.5	18.2			
Velocity of broad money (end of period)	4.6	5.0	3.8	3.8	4.1	4.1	3.8	3.8	3.8	3.8	3.7			
Money multiplier	1.6	1.6	1.6	1.8	1.8	1.9	1.8	1.8	1.8	1.8	1.8			
Dollarization in bank deposits 3/	35.7	44.0	68.5	72.7	68.7	65.8	64.3	65.1	63.9	63.4	62.8			
Dollarization in broad money 4/	18.9	24.4	45.0	50.9	45.8	43.9	42.8	45.6	43.3	42.4	40.9			
Currency in circulation in percent of deposits	89.2	80.6	52.2	42.9	50.0	49.8	50.2	42.7	47.6	49.6	53.5			
Stock of foreign currency deposits (in millions of U.S. dollars) 1/	428.4	562.8	980.8	1,091.0	946.5	933.6	1,012.9	1,101.4	1,069.0	1,090.0	1,103.4			
Banking system financing of the central government (cumulative) 5/	-24.7	-9.6	-86.4	-11.2	-4.9	5.9	79.6	5.8	16.3	36.9	71.2			

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).

5/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.

Table 4. Armenia: Financial Soundness Indicators for the Banking Sector, 2007–11
(In percent, unless otherwise indicated)

	2007	2008	2009				2010				2011
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.
Capital adequacy											
Total regulatory capital to risk-weighted assets	30.1	27.5	26.1	28.0	28.3	28.3	28.6	28.9	26.9	22.2	21.3
Tier I regulatory capital to risk-weighted assets	29.0	...	...	...	...	...	...	...	...	...	...
Capital (net worth) to assets	22.5	23.0	21.2	22.3	21.0	21.0	20.6	22.1	21.6	20.4	20.2
Asset composition											
Sectoral distribution of loans (in billions of drams)											
Industry (excluding energy sector)	49.1	66.2	78.0	76.0	89.6	115.3	121.2	127.7	136.7	156.7	164.9
Energy sector	7.2	19.7	17.3	18.6	26.7	31.7	32.0	24.3	37.0	47.2	56.3
Agriculture	22.4	36.5	44.6	45.9	45.2	44.2	48.1	48.7	50.0	52.4	57.3
Construction	22.0	39.5	43.3	44.0	48.9	54.1	57.5	58.8	65.3	74.8	78.8
Transport and communication	5.8	10.2	10.3	9.8	14.7	15.4	17.8	22.2	26.0	25.7	30.2
Trade/commerce	86.8	132.0	140.4	131.0	143.6	145.5	161.0	164.7	174.1	184.8	200.1
Sectoral distribution of loans to total loans (percent of total)											
Industry (excluding energy sector)	11.9	10.7	12.2	12.5	13.7	16.5	16.2	16.9	17.0	17.7	17.1
Energy sector	1.7	3.2	2.7	3.1	4.1	4.5	4.3	3.2	4.6	5.3	5.9
Agriculture	5.4	5.9	7.0	7.6	6.9	6.3	6.4	6.4	6.2	5.9	6.0
Construction	5.3	6.4	6.8	7.3	7.5	7.7	7.7	7.8	8.1	8.4	8.2
Transport and communication	1.4	1.7	1.6	1.6	2.2	2.2	2.4	2.9	3.2	2.9	3.1
Trade/commerce	21.1	21.4	22.0	21.6	22.0	20.8	21.6	21.8	21.6	20.9	20.8
Foreign exchange loans to total loans	40.7	38.7	48.7	51.5	54.3	54.0	54.3	55.4	56.4	58.0	59.6
Asset quality											
Nonperforming loans (in billions of drams)											
Watch (up to 90 days past due)	5.8	21.8	36.6	38.8	27.0	14.9	23.2	18.3	18.9	11.3	20.7
Substandard (91-180 days past due)	1.3	3.4	11.4	19.3	23.2	10.1	16.0	13.8	13.8	11.3	8.5
Doubtful (181-270 days past due)	3.1	2.7	2.1	6.5	14.3	11.3	4.7	6.4	5.2	6.1	6.5
Loss (>270 days past due)	...	10.2	12.7	14.3	20.9	26.2	32.3	32.0	34.0	34.6	36.4
Nonperforming loans to gross loans	2.4	4.4	7.6	10.2	9.3	4.8	5.6	4.8	4.5	3.1	3.5
Provisions to nonperforming loans	66.6	38.2	26.9	26.6	33.1	46.7	36.2	41.4	41.9	56.7	51.0
Spread between highest and lowest rates of interbank borrowing in AMD	0.5	3.0	4.5	5.0	7.0	2.5	3.0	2.8	4.3	4.0	4.0
Spread between highest and lowest rates of interbank borrowing in foreign currency	0.0	1.0	8.0	11.3	5.8	3.0	4.0	7.6	2.8	5.0	2.0
Earnings and profitability											
ROA (profits to period average assets)	2.9	3.1	-0.1	-0.1	0.0	0.7	1.3	1.8	2.0	2.2	2.0
ROE (profits to period average equity)	14.9	13.6	-0.7	-0.3	0.1	3.4	6.1	8.5	9.5	10.2	10.0
Interest margin to gross income	47.9	45.9	47.1	44.4	42.2	42.2	43.5	44.1	44.3	43.8	43.6
Interest income to gross income	68.6	72.7	86.2	83.0	79.5	78.3	79.0	78.9	78.2	77.0	78.9
Noninterest expenses to gross income	44.5	42.0	45.3	44.1	41.5	40.7	39.4	39.6	38.9	39.2	36.9
Liquidity											
Liquid assets to total assets	33.7	23.8	29.1	32.0	35.2	34.2	33.9	30.1	30.1	29.5	28.9
Liquid assets to total short-term liabilities	98.2	103.1	135.4	145.3	146.2	142.1	140.4	128.8	129.3	131.5	137.2
Customer deposits to total (non-interbank) loans	106.2	81.4	92.1	96.3	100.7	96.4	96.5	86.8	86.5	87.2	87.1
Foreign exchange liabilities to total liabilities	48.3	55.1	69.4	70.9	68.9	67.6	70.3	67.4	66.2	64.9	65.3
Sensitivity to market risk											
Gross open positions in foreign exchange to capital	8.8	11.5	13.8	8.4	7.1	3.4	3.1	3.8	3.6	2.9	3.0

Source: Central Bank of Armenia.

Table 5. Armenia: Central Government Operations, 2008–13
(In billions of drams)

	2008	2009	2010				2011				2012	2013			
	Act.	Act.	Q1		Q2	Q3	Q4	Country Report No. 10/350		Q1	Q2	Q3	Q4	Proj.	Proj.
			Prel.	Prel.	Prel.	Prel.	Prel.	Proj.	No.	Prel.	Proj.	Proj.	Proj.		
Total revenue and grants	730.8	655.6	734.3	157.9	197.8	195.0	183.5	832.5	855.2	179.5	229.1	222.4	201.5	867.7	946.4
Total revenue	715.6	634.4	706.1	153.2	192.2	187.1	173.6	774.2	791.9	170.6	212.2	207.1	184.3	847.9	926.1
Tax revenues	597.9	505.9	568.9	120.8	154.7	150.6	142.9	627.8	650.2	136.1	173.9	169.7	148.1	691.7	756.3
VAT	296.3	239.2	278.1	57.5	75.1	76.5	69.1	307.3	300.9	64.1	86.8	87.4	69.0	340.7	374.9
Profits, simplified and presumptive	113.3	104.9	99.7	23.9	30.3	21.8	23.7	108.7	123.3	31.8	32.5	24.4	20.1	119.1	129.4
Personal income tax	53.7	60.2	73.9	16.2	18.3	20.1	19.4	82.0	77.4	17.6	20.2	22.3	21.8	89.8	97.5
Customs duties	37.3	25.1	29.4	6.7	8.5	7.6	6.6	32.6	44.6	6.6	9.4	8.4	8.1	35.6	38.7
Other	97.3	76.5	87.8	16.5	22.5	24.6	24.1	97.3	104.1	16.0	24.9	27.3	29.1	106.5	115.8
Social contributions	104.1	102.9	105.3	26.2	28.5	29.5	21.1	123.4	120.4	29.9	31.4	32.7	29.4	135.2	146.9
Other revenue	13.6	25.6	31.8	6.2	9.0	7.0	9.5	23.0	21.3	4.7	6.9	4.7	6.7	21.0	22.8
Grants	15.1	21.2	28.2	4.7	5.6	7.9	10.0	58.3	63.2	8.9	16.8	15.3	17.3	19.8	20.4
Total expenditure	793.4	897.1	906.6	189.2	225.8	221.2	270.5	980.9	1003.0	184.7	262.8	260.0	273.3	1000.1	1055.0
Expense	652.0	712.0	727.9	152.1	183.6	182.5	209.7	818.8	803.4	161.0	222.1	203.8	231.9	832.1	881.4
Wages	73.0	83.5	82.5	17.5	20.8	20.1	24.0	91.0	89.5	16.9	21.7	21.7	30.7	93.9	94.9
Pensions	4.1	4.6	4.5	0.8	1.1	1.1	1.4	5.4	4.8	0.8	1.3	1.3	1.9	4.9	5.2
Subsidies	38.4	18.4	17.4	3.6	4.5	4.4	4.9	19.0	24.1	3.9	5.0	4.8	5.3	23.4	24.2
Interest	10.4	16.2	30.2	6.1	8.6	7.2	8.3	42.6	50.3	7.5	12.4	8.6	14.1	44.5	46.1
Social allowances and pensions	206.2	239.9	241.7	58.2	62.3	59.6	61.6	268.2	267.6	62.6	68.0	65.8	71.8	293.7	319.2
Of which: pensions	153.5	176.0	176.8	43.7	44.2	44.3	44.6	196.9	196.5	46.6	49.2	49.2	51.9	196.7	215.4
Goods and services	133.1	150.7	155.6	28.4	39.9	39.0	48.2	168.2	165.4	28.9	57.2	42.4	39.6	174.0	189.3
Grants	52.9	62.0	66.6	14.2	17.4	18.2	16.8	69.6	57.6	14.4	18.1	17.9	19.1	56.6	57.7
Other expenditure	133.9	136.6	129.5	23.3	29.0	32.8	44.4	154.9	144.2	26.0	38.2	41.3	49.4	141.1	144.9
Transactions in nonfinancial assets	141.5	185.1	178.7	37.0	42.2	38.7	60.8	162.0	199.6	23.8	40.7	56.2	41.4	168.1	173.5
Acquisition of nonfinancial assets	162.6	195.7	179.2	37.1	42.7	38.8	60.6	162.1	199.6	23.8	40.7	56.2	41.4	168.1	173.5
Of which: projects related to the Russian loan	...	26.5	23.0	8.8	9.7	3.5	1.0	30.0	30.0	8.8	7.5	7.5	6.2	10.6	0.0
Disposals of nonfinancial assets	21.1	10.6	0.5	0.1	0.5	0.1	-0.2	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-62.7	-241.5	-172.3	-31.3	-27.9	-26.2	-86.9	-148.3	-147.8	-5.2	-33.7	-37.6	-71.8	-132.4	-108.5
Statistical discrepancy	21.0	-6.2	13.8	13.0	0.5	8.0	-7.7	0.0	0.0	-2.3	0.8	0.8	0.8	0.0	0.0
Overall balance (below-the-line)	-41.7	-247.7	-158.5	-18.3	-27.4	-18.2	-94.6	-148.3	-147.8	-7.6	-32.9	-36.8	-71.0	-132.4	-108.5
Financing	41.7	247.7	158.5	18.3	27.4	18.2	94.6	148.3	147.8	7.6	32.9	36.8	71.0	132.4	108.5
Domestic financing	23.7	-108.5	95.9	7.6	6.4	5.7	76.2	68.6	63.5	6.2	8.1	21.4	32.9	78.8	122.7
Banking system 1/	-9.6	-40.0	95.0	-6.9	14.5	10.8	74.6	78.0	54.5	7.3	12.2	22.3	36.1	77.5	121.3
CBA	-33.0	-54.4	62.1	6.5	12.6	-5.2	48.1	56.1	25.5	9.5	13.1	10.8	22.6	50.0	89.2
Of which: deposits related to the Russian loan	0.0	-76.6	20.8	0.9	16.1	4.0	-0.1	44.5	27.1	12.5	11.1	11.1	9.8	10.6	0.0
Commercial Banks	23.4	14.4	32.9	-13.4	1.9	16.0	26.4	21.9	29.0	-2.2	-1.0	11.5	13.5	27.5	32.0
Nonbanks	33.4	-68.5	0.9	14.5	-8.1	-5.1	1.7	-9.4	9.0	-1.2	-4.1	-1.0	-3.2	1.3	1.4
Privatization proceeds	31.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills	3.5	8.7	5.5	6.8	-1.9	-0.2	0.8	5.0	6.0	-0.3	-0.5	2.6	3.1	5.5	6.0
Promissory note/other	-1.2	-3.2	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-0.5	-74.0	-2.6	7.6	-6.2	-4.9	0.9	-14.4	3.0	-0.9	-3.6	-3.6	-6.3	-4.2	-4.6
Of which: financed with the Russian loan	...	-78.8	2.2	7.9	-6.4	-0.5	1.1	-14.5	2.9	-3.6	-3.6	-3.6	-3.6	0.0	0.0
External financing	17.9	356.2	62.5	10.7	21.0	12.5	18.4	79.8	84.3	1.4	24.8	15.5	38.1	53.6	-14.1
Gross inflow 2/	48.8	395.6	105.3	22.8	31.2	24.1	27.3	125.6	131.2	11.0	36.3	27.8	50.5	118.5	96.2
Of which: Russian project loan	...	185.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Amortization due	-4.9	-6.3	-9.7	-3.4	-1.2	-3.1	-2.0	-10.7	-11.9	-3.3	-1.9	-3.3	-2.2	-30.1	-75.9
Net lending	-26.0	-33.1	-33.1	-8.7	-9.0	-8.6	-6.9	-35.1	-35.1	-6.3	-9.5	-9.1	-10.2	-34.7	-34.4
Memorandum items:															
Nominal GDP (in billion of drams)	3,568	3,103	3,462	3,462	3,462	3,462	3,462	3,837	3,771	3,837	3,837	3,837	3,837	4,202	4,567
Program balance 3/	-68.2	-354.8	-123.8	3.5	-25.9	-17.8	-83.6	-186.9	-112.3	-3.8	-46.1	-49.5	-87.5	-52.9	-51.3
Overall balance excl. spending financed with the Russian loan	...	-215.0	-149.3	-22.4	-18.2	-22.7	-85.9	-118.3	-117.8	3.6	-26.2	-30.1	-65.6	-121.8	-108.5
Budget support loans	...	290.9	35.0	0.0	14.5	10.2	10.3	65.7	63.6	0.0	24.4	9.7	31.6	0.0	0.0
T-bill issuance	25.3	45.4	30.2	0.6	-3.0	17.8	14.7	30.0	30.0	3.6	-2.5	13.2	15.7	30.0	35.0

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

1/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.

2/ Includes IMF budget support.

3/ The program balance is measured as below-the-line overall balance minus net lending. From 2010 to 2011Q1, it is measured as in 2009 less project financing.

Table 6. Armenia: Central Government Operations, 2008–13
(In percent of GDP, unless otherwise specified)

	2008	2009	2010				2011				2012	2013			
	Act.	Act.	Q1	Q2	Q3	Q4	Country Report No. 10/350		Q1	Q2	Q3	Q4	Proj.	Proj.	
			Prel.	Prel.	Prel.	Prel.	Prel.	Proj.	Proj.	Proj.	Proj.				
Total revenue and grants	20.5	21.1	21.2	4.6	5.7	5.6	5.3	21.7	22.7	4.7	6.0	5.8	5.3	20.6	20.7
Total revenue	20.1	20.4	20.4	4.4	5.6	5.4	5.0	20.2	21.0	4.4	5.5	5.4	4.8	20.2	20.3
Tax revenues	16.8	16.3	16.4	3.5	4.5	4.3	4.1	16.4	17.2	3.5	4.5	4.4	3.9	16.5	16.6
VAT	8.3	7.7	8.0	1.7	2.2	2.2	2.0	8.0	8.0	1.7	2.3	2.3	1.8	8.1	8.2
Profits, simplified and presumptive	3.2	3.4	2.9	0.7	0.9	0.6	0.7	2.8	3.3	0.8	0.8	0.6	0.5	2.8	2.8
Personal income tax	1.5	1.9	2.1	0.5	0.5	0.6	0.6	2.1	2.1	0.5	0.5	0.6	0.6	2.1	2.1
Customs duties	1.0	0.8	0.8	0.2	0.2	0.2	0.2	0.8	1.2	0.2	0.2	0.2	0.2	0.8	0.8
Other	2.7	2.5	2.5	0.5	0.6	0.7	0.7	2.5	2.8	0.4	0.6	0.7	0.8	2.5	2.5
Social contributions	2.9	3.3	3.0	0.8	0.8	0.9	0.6	3.2	3.2	0.8	0.8	0.9	0.8	3.2	3.2
Other revenue	0.4	0.8	0.9	0.2	0.3	0.2	0.3	0.6	0.6	0.1	0.2	0.1	0.2	0.5	0.5
Grants	0.4	0.7	0.8	0.1	0.2	0.2	0.3	1.5	1.7	0.2	0.4	0.4	0.4	0.5	0.4
Total expenditure	22.2	28.9	26.2	5.5	6.5	6.4	7.8	25.6	26.6	4.8	6.8	6.8	7.1	23.8	23.1
Expense	18.3	22.9	21.0	4.4	5.3	5.3	6.1	21.3	21.3	4.2	5.8	5.3	6.0	19.8	19.3
Wages	2.0	2.7	2.4	0.5	0.6	0.6	0.7	2.4	2.4	0.4	0.6	0.6	0.8	2.2	2.1
Pensions	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.1
Subsidies	1.1	0.6	0.5	0.1	0.1	0.1	0.1	0.5	0.6	0.1	0.1	0.1	0.1	0.6	0.5
Interest	0.3	0.5	0.9	0.2	0.2	0.2	0.2	1.1	1.3	0.2	0.3	0.2	0.4	1.1	1.0
Social allowances and pensions	5.8	7.7	7.0	1.7	1.8	1.7	1.8	7.0	7.1	1.6	1.8	1.7	1.9	7.0	7.0
Of which: pensions	4.3	5.7	5.1	1.3	1.3	1.3	1.3	5.1	5.2	1.2	1.3	1.3	1.4	4.7	4.7
Goods and services	3.7	4.9	4.5	0.8	1.2	1.1	1.4	4.4	4.4	0.8	1.5	1.1	1.0	4.1	4.1
Grants	1.5	2.0	1.9	0.4	0.5	0.5	0.5	1.8	1.5	0.4	0.5	0.5	0.5	1.3	1.3
Other expenditure	3.8	4.4	3.7	0.7	0.8	0.9	1.3	4.0	3.8	0.7	1.0	1.1	1.3	3.4	3.2
Transactions in nonfinancial assets	4.0	6.0	5.2	1.1	1.2	1.1	1.8	4.2	5.3	0.6	1.1	1.5	1.1	4.0	3.8
Acquisition of nonfinancial assets	4.6	6.3	5.2	1.1	1.2	1.1	1.8	4.2	5.3	0.6	1.1	1.5	1.1	4.0	3.8
Of which: projects related to the Russian loan	...	0.9	0.7	0.3	0.3	0.1	0.0	0.8	0.8	0.2	0.2	0.2	0.2	0.3	0.0
Disposals of nonfinancial assets	0.6	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-1.8	-7.8	-5.0	-0.9	-0.8	-0.8	-2.5	-3.9	-3.9	-0.1	-0.9	-1.0	-1.9	-3.2	-2.4
Statistical discrepancy	0.6	-0.2	0.4	0.4	0.0	0.2	-0.2	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-1.2	-8.0	-4.6	-0.5	-0.8	-0.5	-2.7	-3.9	-3.9	-0.2	-0.9	-1.0	-1.9	-3.2	-2.4
Financing	1.2	8.0	4.6	0.5	0.8	0.5	2.7	3.9	3.9	0.2	0.9	1.0	1.9	3.2	2.4
Domestic financing	0.7	-3.5	2.8	0.2	0.2	0.2	2.2	1.8	1.7	0.2	0.2	0.6	0.9	1.9	2.7
Banking system 1/	-0.3	-1.3	2.7	-0.2	0.4	0.3	2.2	2.0	1.4	0.2	0.3	0.6	0.9	1.8	2.7
CBA	-0.9	-1.8	1.8	0.2	0.4	-0.1	1.4	1.5	0.7	0.2	0.3	0.3	0.6	1.2	2.0
Of which: deposits related to the Russian loan	...	-2.5	0.6	0.0	0.5	0.1	0.0	1.2	0.7	0.3	0.3	0.3	0.3	0.3	...
Commercial Banks	0.7	0.5	1.0	-0.4	0.1	0.5	0.8	0.6	0.8	-0.1	0.0	0.3	0.4	0.7	0.7
Nonbanks	0.9	-2.2	0.0	0.4	-0.2	-0.1	0.0	-0.2	0.2	0.0	-0.1	0.0	-0.1	0.0	0.0
Privatization proceeds	0.9	0.0	0.0	0.0	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	0.3	0.2	0.2	-0.1	0.0	0.0	0.1	0.2	0.0	0.0	0.1	0.1	0.1	0.1
Promissory note/other	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	0.0	-2.4	-0.1	0.2	-0.2	-0.1	0.0	-0.4	0.1	0.0	-0.1	-0.1	-0.2	-0.1	-0.1
Of which: financed with the Russian loan	...	-2.5	0.1	0.2	-0.2	0.0	0.0	-0.4	0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0
External financing	0.5	11.5	1.8	0.3	0.6	0.4	0.5	2.1	2.2	0.0	0.6	0.4	1.0	1.3	-0.3
Gross inflow 2/	1.4	12.8	3.0	0.7	0.9	0.7	0.8	3.3	3.5	0.3	0.9	0.7	1.3	2.8	2.1
Of which: Russian project loan	...	6.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization due	-0.1	-0.2	-0.3	-0.1	0.0	-0.1	-0.1	-0.3	-0.3	-0.1	0.0	-0.1	-0.1	-0.7	-1.7
Net lending	-0.7	-1.1	-1.0	-0.3	-0.3	-0.2	-0.2	-0.9	-0.9	-0.2	-0.2	-0.2	-0.3	-0.8	-0.8
Memorandum items:															
Nominal GDP (in billion of drams)	3,568	3,103	3,462	3,462	3,462	3,462	3,462	3,837	3,771	3,837	3,837	3,837	3,837	4,202	4,567
Program balance 3/	-1.9	-11.4	-3.6	0.1	-0.7	-0.5	-2.4	-4.9	-3.0	-0.1	-1.2	-1.3	-2.3	-1.3	-1.2
Overall balance excl. spending financed with the Russian loan	...	-6.9	-4.3	-0.6	-0.5	-0.7	-2.5	-3.1	-3.1	0.1	-0.7	-0.8	-1.7	-2.9	-2.6
Budget support loans	...	9.4	1.0	0.0	0.4	0.3	0.3	1.7	1.7	0.0	0.6	0.3	0.8	0.0	0.0
T-bill issuance	0.7	1.5	0.9	0.0	-0.1	0.5	0.4	0.8	0.8	0.1	-0.1	0.3	0.4	0.7	0.8

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

1/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.

2/ Includes IMF budget support.

3/ The program balance is measured as below-the-line overall balance minus net lending. From 2010 to 2011Q1, it is measured as in 2009 less project financing.

Table 7. Armenia: Medium-Term Macroeconomic Framework, 2008–16
(In percent of GDP, unless otherwise specified)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
	Act.	Act.	Prel.			Projections			
National income and prices									
Real GDP (percent change)	6.9	-14.2	2.1	4.6	4.3	4.2	4.0	4.0	4.0
Gross domestic product (in millions of U.S. dollars)	11,662	8,541	9,265	10,037	9,945	10,440	10,984	11,629	12,319
Gross national income per capita (in U.S. dollars)	3,752	2,666	2,856	3,070	3,024	3,142	3,272	3,429	3,595
CPI inflation, end of period (percent change)	5.3	6.7	8.5	6.7	4.0	4.0	4.0	4.0	4.0
Investment and saving									
Investment	43.8	33.9	33.6	33.2	33.5	33.8	34.0	34.4	34.9
Private	39.8	28.0	28.5	29.0	29.5	30.0	30.5	31.0	31.5
Public	4.0	6.0	5.2	4.2	4.0	3.8	3.5	3.4	3.4
National savings	32.0	17.9	19.6	21.7	23.1	24.5	25.8	26.5	27.1
Private	29.8	19.7	19.4	21.4	22.3	23.1	24.3	25.1	25.7
Public	2.2	-1.8	0.2	0.4	0.8	1.4	1.5	1.4	1.4
Central government operations									
Revenue and grants	20.5	21.1	21.2	21.7	20.6	20.7	20.8	20.7	20.7
<i>Of which:</i> tax revenue	16.8	16.3	16.4	16.4	16.5	16.6	16.7	16.8	16.9
grants	0.4	0.7	0.8	1.5	0.5	0.4	0.4	0.4	0.4
Expenditure	22.2	28.9	26.2	25.6	23.8	23.1	22.8	22.7	22.7
Current expenditure	18.3	22.9	21.0	21.3	19.8	19.3	19.3	19.3	19.3
Capital expenditure	4.0	6.0	5.2	4.2	4.0	3.8	3.5	3.4	3.4
Overall balance on a cash basis	-1.2	-8.0	-4.6	-3.9	-3.2	-2.4	-2.0	-1.9	-1.9
Domestic financing	0.7	-3.5	2.8	1.8	1.9	2.7	2.3	2.1	1.9
External financing	0.5	11.5	1.8	2.1	1.3	-0.3	-0.3	-0.2	-0.1
Government and government-guaranteed debt	16.2	40.6	39.9	45.2	43.8	41.3	39.5	38.6	37.2
External sector									
Exports of goods and services	15.1	15.6	20.1	22.0	24.3	25.0	25.8	26.0	26.1
Imports of goods and services	40.7	43.1	45.8	46.1	48.2	47.9	47.5	47.2	47.0
Current account (in percent of GDP)	-11.8	-16.0	-14.0	-11.5	-10.3	-9.3	-8.1	-7.9	-7.8
Current account (in millions of U.S. dollars)	-1,382	-1,367	-1,300	-1,150	-1,028	-969	-894	-917	-958
Capital and financial account (in millions of U.S. dollars)	1,134	1,560	975	1,077	1,099	1,006	1,016	1,168	1,181
<i>Of which:</i> direct foreign investment	940	725	569	641	679	713	749	786	826
public sector disbursements	160	907	193	272	276	258	226	234	214
Change in gross international reserves (in millions of U.S. dollars) ^{1/}	252	-597	145	-13	-31	142	29	-224	-184
Arrears and debt relief (in millions of U.S. dollars)	2	0	0	0	0	0	0	0	0
Financing gap (in millions of U.S. dollars)	0	0	0	109	115	97	0	0	0
<i>Of which:</i> IMF	0	0	0	109	101	83	0	0	0
Other	0	0	0	0	14	15	0	0	0
Gross international reserves in months of imports	4.6	5.7	4.8	4.7	4.6	4.1	3.8	4.1	4.2

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

^{1/} A negative figure indicates an increase.

Table 8. Armenia: Fund Disbursements and Timing of Reviews under a Three-year EFF/ECF Blend

Date of Availability	Conditions	Amount (millions of SDRs)			Percent of Quota		
		ECF	EFF	Total	ECF	EFF	Total
June 28, 2010	Board approval of the arrangement	18.70	17.50	36.20	20.33	19.02	39.35
December 1, 2010	Observance of end-June 2010 performance criteria and completion of first review	18.70	17.50	36.20	20.33	19.02	39.35
March 30, 2011	Observance of end-December 2010 performance criteria and completion of second review	18.70	17.50	36.20	20.33	19.02	39.35
September 30, 2011	Observance of end-June 2011 performance criteria and completion of third review	18.70	17.50	36.20	20.33	19.02	39.35
March 30, 2012	Observance of end-December 2011 performance criteria and completion of fourth review	16.00	17.50	33.50	17.39	19.02	36.41
September 30, 2012	Observance of end-June 2012 performance criteria and completion of fifth review	16.00	17.50	33.50	17.39	19.02	36.41
March 30, 2013	Observance of end-December 2012 performance criteria and completion of sixth review	26.60	28.40	55.00	28.91	30.87	59.78
	Total	133.40	133.40	266.80	145.00	145.00	290.00

Source: Fund staff estimates and projections.

Table 9. Armenia: Indicators of Capacity to Repay the Fund, 2011–19 1/

	2011	2012	2013	2014	2015	2016	2017	2018	2019
	Projections								
Fund obligations based on existing credit									
(in millions of SDRs)									
Principal	14.4	101.0	180.2	98.1	16.4	16.5	15.2	13.9	13.3
Charges and interest	7.6	6.4	4.5	2.0	1.1	0.9	0.8	0.7	0.6
Fund obligations based on existing and prospective credit									
(in millions of SDRs)									
Principal	14.4	101.0	180.2	98.1	17.9	25.7	38.3	46.9	48.9
Charges and interest	8.3	10.3	8.2	3.8	2.8	2.6	2.4	2.0	1.6
Total obligations based on existing and prospective credit									
In millions of SDRs	22.7	111.3	188.5	101.9	20.7	28.3	40.7	48.8	50.5
In millions of U.S. dollars	35.0	170.8	288.8	156.0	31.7	43.3	62.3	74.7	77.2
In percent of gross international reserves	1.9	9.0	16.4	9.0	1.6	2.0	3.0	3.9	4.5
In percent of exports of goods and services	1.6	7.1	11.1	5.5	1.1	1.3	1.8	2.1	2.0
In percent of debt service 2/	33.4	67.6	70.1	56.0	18.0	25.1	34.7	40.8	41.9
In percent of GDP	0.3	1.7	2.8	1.4	0.3	0.4	0.5	0.5	0.5
In percent of quota	24.7	121.0	204.8	110.7	22.5	30.8	44.2	53.1	54.9
Outstanding Fund credit 2/									
In millions of SDRs	539.0	505.0	379.7	281.7	263.8	238.1	199.7	152.9	104.0
In billions of U.S. dollars	0.8	0.8	0.6	0.4	0.4	0.4	0.3	0.2	0.2
In percent of gross international reserves	44.3	40.7	33.1	24.9	20.6	17.0	14.9	12.1	9.4
In percent of exports of goods and services	37.6	32.1	22.3	15.2	13.4	11.3	8.9	6.5	4.1
In percent of debt service 2/	790.6	306.6	141.2	154.7	229.0	211.0	170.1	127.8	86.3
In percent of GDP	8.3	7.8	5.6	3.9	3.5	3.0	2.3	1.7	1.1
In percent of quota	585.8	548.9	412.8	306.2	286.7	258.8	217.1	166.2	113.0
Net use of Fund credit (in millions of SDRs)									
Disbursements	72.4	67.0	55.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	14.4	101.0	180.2	98.1	17.9	25.7	38.3	46.9	48.9
Memorandum items:									
Nominal GDP (in millions of U.S. dollars)	10,037.4	9,945.2	10,440.5	10,983.7	11,628.6	12,318.6	13,049.5	13,823.8	14,644.0
Exports of goods and services (in millions of U.S. dollars)	2,206.7	2,412.2	2,605.5	2,830.5	3,017.7	3,213.0	3,417.2	3,621.5	3,838.5
Gross international reserves (in millions of U.S. dollars)	1,872.3	1,902.8	1,760.6	1,731.9	1,955.6	2,139.4	2,046.8	1,932.2	1,697.7
Debt service (in millions of U.S. dollars) 2/	105.0	252.8	412.2	278.7	176.2	172.6	179.6	182.9	184.3
Quota (in millions of SDRs)	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0

Source: Fund staff estimates and projections.

1/ Indicators cover both GRA and ECF credit.

2/ Total debt service includes IMF obligations.

Table 10. Armenia: Structural Benchmarks for Future Implementation Under the EFF/ECF

Item	Measure	Desired Outcome
<u>Tax administration</u>		
1	Implement a fully functional risk-based management approach in VAT refund processing. (end-June 2011)	Reduce corruption and increase tax compliance
2	Set up a taxpayer registry. (end-December 2011, new)	
<u>Tax policy</u>		
3	Increase the tax rate structure for up-market luxury vehicles and SUVs for 2012 and adjust the specific tax on cars annually for inflation. (end-December 2011, new)	Enhance revenue collection
4	Introduce legislative changes that provide for annual automatic indexation of excises for inflation. (end-August 2011, new)	
5	Approve a Tax Strategy paper. (end-December 2011, new)	
<u>Social policy</u>		
6	Submit amendments to existing laws to parliament to enable the full functioning of an integrated system for the provision of social protection services. (end-December 2011)	Reduce poverty
<u>Monetary sector</u>		
7	Approve terms and conditions for deposit auction to enable the CBA to absorb liquidity with greater flexibility. (end-September 2011, new)	Strengthen the monetary transmission mechanism
8	Publish the CBA's liquidity forecast that provides projected amount of dram liquidity before CBA's actions with indication of separate components such as currency outside the CBA, net foreign assets, government transactions excluding treasury bill issuances, and treasury bill issuances for liquidity management purposes (end-December 2011, new).	

Appendix I. The Crisis and Armenia's Children

Poverty in Armenia increased with the crisis, rising from 23.5 percent in 2008 to 34.5 percent in 2009. The rate for children is higher, 38.1 percent, with 4.5 percent below the extreme poverty line (3.6 percent for the population as a whole). Child poverty links short-term macroeconomic fluctuations with long-term performance: with malnutrition, limited health service, and school absence, poor children will not likely develop their full physical and intellectual capacity, weakening Armenia's long-term potential.

With the increased share of poor families, social protection coverage decreased. Only one poor family in four received family benefits, and just 58 percent of extremely poor families were reached. However, without family benefits, the poverty rate would have been 4 percentage points higher, and 31 percent of children who are not poor would have been so classified without family benefit income.

Armenia: Child Poverty Rates With and Without Family Benefit Income

Threshold	Child poverty rate	
	With benefits	Without benefits
Extreme poverty line	3.2	8.2
Total poverty line	26	30.2

Source: UNICEF Armenia. Child weights used.

Armenia: Child Poverty Rates With and Without Family Benefit Income
(Recipient Households)

	Lifted above extreme poverty line (with family benefit)	Lifted above total poverty line (with family benefit)
Below extreme poverty line (without family benefit)	22.6	
Below total poverty line (without family benefit)		31.3

Source: UNICEF Armenia. Child weights used.

Program commitments to maintain family benefit spending likely prevented a further deterioration. To reach the more than 12,000 extremely poor families not currently receiving family benefits, UNICEF Armenia estimates that an additional 0.1 percent of GDP would be needed (excluding additional administrative costs).

ATTACHMENT I. ARMENIA: LETTER OF INTENT

The Acting Managing Director
International Monetary Fund
Washington, D.C. 20431

Yerevan, May 30, 2011

Dear Acting Managing Director:

1. **Armenia continues its path of recovery and stabilization in spite of the emergence of fresh challenges.** Most sectors of the economy grew in 2010, with public finances improving considerably. The financial sector is expanding rapidly and continues to be well capitalized. However, agriculture sector developments locally and internationally have hampered economic growth and fueled inflation. In this context, our longer-term challenges regarding structural rigidities and social protection and development have become all the more critical.
2. **Performance under our program supported by arrangements under the Extended Fund and Extended Credit facilities (EFF/ECF) has been very strong.** The program is on track with all continuous and periodic quantitative performance criteria and indicative targets for end-December 2010 as well as all indicative targets for end-March 2011 observed. The structural benchmarks were also met.
3. **This Letter of Intent (LOI) describes policies we intend to implement for the remainder of 2011.** Our near-term macroeconomic policies will continue to be geared towards containing macroeconomic pressures while avoiding major disruptions to the still fragile recovery. We remain committed to our reform program aimed at economic growth and poverty reduction, fiscal and debt sustainability, and developing a sound financial system.

I. RECENT DEVELOPMENTS AND OUTLOOK

4. **The economic recovery has been relatively weak and uneven across sectors, with headline inflation reaching exceptional levels.** In 2010, mining, industry, trade, and transportation grew strongly, supported by a recovery of external and domestic demand and increased financial intermediation. In contrast, agricultural production dropped sharply due to unfavorable weather conditions and underlying structural weaknesses in the sector. This resulted in weaker-than-expected overall GDP growth. Consumer prices increased to 11.5 percent in March, mainly driven by a surge in food prices, attributable both to domestic supply constraints and high global food prices, with some initial signs of second-round effects also observed. The fiscal deficit has narrowed considerably, due to expenditure restraint in spite of higher prices. Both trade and remittance inflows have rebounded, but the current account deficit remains high. Banks

remain well capitalized and liquid, and credit to the economy is booming, notably in foreign currency.

5. **The economy is set to recover at a faster pace in 2011, with the pickup driven mostly by a recovery in agricultural production.** High oil prices will likely increase remittances from Russia. We expect agricultural production to recover strongly at around 9–10 percent, on the back of improved weather conditions and measures taken by the government to support the agricultural sector. However, growth in other sectors is expected to remain moderate, particularly in construction, a key pre-crisis growth driver, with overall GDP projected to grow by around 4.6 percent.

6. **The medium-term outlook will continue to be challenging, as external demand and remittances are likely to recover only gradually, while FDI and private investment remain weak.** GDP growth is expected to be around 4–4½ percent over 2012–13. Barring further shocks, inflation is expected to revert to the CBA’s target band of $4 \pm 1\frac{1}{2}$ percent during the first half of 2012. Public debt is also expected to fall to around 41 percent of GDP by 2013 under the medium-term expenditure framework. On the basis of structural reforms, fiscal consolidation, and inflation reduction, the current account deficit is expected to be reduced considerably.

II. THE PROGRAM FOR 2011

A. Fiscal Policy and Debt Sustainability

7. **We continue to focus on reducing the deficit to help ease inflationary pressures, address external imbalances, and ensure fiscal and debt sustainability.** In 2010, we were able to reduce our deficit by nearly 3 percentage points of GDP to just under 5 percent. Building on this success, we will further reduce the deficit to 3.9 percent of GDP in 2011, and we expect a deficit of 3.2 percent of GDP in 2012. We will continue down this consolidation path and project to reach a deficit target of 2.4 percent of GDP by the end of our program. Our goal of improving the revenue-to-GDP ratio by 0.4 percentage points per annum remains, as does our commitment to save at least half of tax revenue overperformance relative to EFF/ECF projections. As in the past, we will continue to prioritize fiscal consolidation, adjusting spending as needed, informed by the ongoing Public Expenditure Review.

8. **We will implement a further set of measures to increase our low tax-to-GDP ratio.** The centerpiece is to phase in an increase in excise taxes over four years from 2012. Since 2002, excise tax yields have been substantially eroded—by 2 percentage points of GDP—by the effects of inflation on unadjusted tax rates. At the same time, we will introduce legislative changes to automatically update specific tax rates in response to annual inflation beginning in 2012 (Structural benchmark, August 2011). Further, to strengthen collections from property taxes, we will work to align cadastre values with recent property sales. This will involve, among other actions, providing cadastral

passports for older buildings and ensuring consistent recording of all property sales with the State Committee of the Real Property Cadastre. We will adjust the specific tax on cars annually for inflation, and further revise upwards the rates on luxury and sport utility vehicles for 2012 (Structural benchmark, December 2011). More broadly, we are at the beginning stages of developing a detailed strategy paper on a broader tax reform plan (Structural benchmark, December 2011). The strategy will build on recent technical assistance received from the Fund.

B. Monetary and Exchange Rate Policy

9. **We will continue to take decisive action to contain inflation.** In light of the food price shocks and some signs of second-round effects, we have responded vigorously by raising our policy rate by 125 bps, increasing reserve requirements on foreign liabilities, and stepping up communication to explain the exogenous and expected temporary nature of the shock. With agriculture set to rebound, international food price inflation decelerating, and inflation expectations broadly anchored, we believe that inflation will start to decline, gradually returning to within the target band in the next 7–10 months. However, if inflationary pressures persist, we stand ready to increase the policy rate further with supporting steps to tighten liquidity conditions.

10. **We remain committed to a floating exchange rate.** Our interventions in the foreign exchange market will continue to aim at smoothing large exchange rate movements, while not resisting fundamental trends. We also aim to continue guarding international reserves as a buffer against exogenous shocks. We intend to lock in strong performance on international reserves by increasing our program targets for the remainder of 2011, in comparison with targets set at the time of the First Review. We will communicate clearly and act accordingly to ensure that market participants recognize the two-way risks in the foreign exchange market.

11. **We will continue to strengthen the status of the CBA policy rate as the market reference rate.** Recognizing that persistent excess liquidity weakens the impact of policy rate changes on the economy, we will step up liquidity management in dram markets so that market rates will move in line with the policy rate. To this end, we have conducted reverse repo operations and if conditions warrant, will restart the issuance of central bank bills. In addition, we will develop a deposit auction to enable the CBA to absorb liquidity with greater flexibility (Structural benchmark, September 2011). We will also improve our communications on liquidity management by publishing liquidity forecasts with the indication and T-bill issuance for liquidity management (Structural benchmark, December 2011). To enhance further the interest rate channel, we are also pursuing initiatives to develop the market for dram instruments such as supporting the efforts by NASDAQ OMX Armenia to develop term interbank markets.

12. **We remain determined to reduce dollarization, given that it weakens the monetary transmission mechanism.** We have continued to raise the proportion of dram

denominated reserve requirements for foreign liabilities to increase the spread between dram and foreign currency deposits. The increase in reserve requirements on foreign liabilities is intended to make dram deposits more attractive. While this has reduced deposit dollarization, foreign currency loans continue to grow rapidly in the context of abundant foreign currency liquidity. We acknowledge that successful dedollarization will ultimately hinge on our commitment to a flexible exchange rate policy and economic and price stability. We will remain vigilant to ensure that near-term dedollarization measures do not disrupt financial intermediation

C. Financial Sector Stability and Development

13. **We are committed to preserving the stability of the banking system and deepening financial intermediation.** Despite rapid credit growth, mostly in foreign currency, we remain confident of the soundness of the Armenian banking system, as banks remain liquid and well-capitalized. Nonetheless, recognizing that the high level of dollarization poses significant risks to financial stability, we raised capital and provisioning requirements on foreign currency loans in September 2010 and January 2011, respectively. We will continue monitoring FX-induced credit risk and foreign currency liquidity risk of banks and take further steps to limit vulnerability as needed.

14. **We continue efforts to enhance the resilience of the banking system.** In line with the Fund's technical assistance recommendations, we will enhance our supervisory framework with a more forward-looking assessment of potential risks. To this end we are improving our stress testing methodology, with a view to capturing linkages between the real and financial sectors. We have established a permanent internal financial stability committee which meets quarterly to assess developments and the outlook for the financial sector. The forthcoming FSAP Update will help shape financial stability policy to increase the resilience of the banking sector.

15. **We will strengthen our crisis preparedness and contingency planning.** We have issued a regulation requiring banks to set up contingency plans for liquidity and solvency support. The banks have already submitted plans, and the supervision arm of the CBA will review their coverage and adequacy. We are also drafting a crisis management framework that will identify the roles and responsibilities of each party in the CBA and the steps that will be taken in the event of a crisis. The framework is expected to be completed by September and approved by management by the end of the year. We have also developed scenarios for a crisis simulation exercise and will carry out drills before the end of the year.

III. STRUCTURAL REFORMS

A. Fiscal Reforms

16. **We have reduced the costs of tax compliance.** We have made tax reporting and payment less frequent, and reduced the number of forms needed. We have extended the e-filing system to over 4,000 taxpayers, and are expecting to operate electronic processing of tax returns and automated invoice processing by end-2011. We have improved the quality of taxpayer services, and are studying the introduction of a tax mediator/reconciler to improve the fairness of the tax system.

17. **We have made progress in the area of tax administration.** We finalized manuals in tourism, real estate, and transport using cash register machines for tax audits for usage starting January 2011. We increased the number of large taxpayers (LTPs) covered by the large taxpayer office by about 100 through December 2010 with a view to ensuring that LTPs' contribution in terms of total domestic revenues is continuously increasing compared to the previous year and in line with international best practices. We adopted a government decree establishing a mechanism for implementing a fully functional risk management approach in VAT refund processing. This will be fully operational by June 2011 (Structural benchmark, June 2011).

18. **Notwithstanding this progress, we will enhance our tax administration reforms efforts.** We will develop a Three-Year Strategic Plan for Tax Administration (2012–15) to map out our transition towards a more efficient and fairer tax system. As a first step towards achieving this broader reform effort, we will establish a taxpayer registry. The registry should help us to begin to make progress with the large stock of outstanding VAT credits. Establishing the registry is expected to take a number of steps, including: compiling existing taxpayer information; cross-checking this with supplementary data source and eliminating duplicates; identifying non-filers; and making contact with taxpayers. Completion of these steps would constitute establishment of the registry (Structural benchmark, December 2011). We are working to enhance information sharing between the Ministry of Finance and the State Revenue Committee to strengthen our assessment of revenue developments and our capacity for tax policy and revenue administration. Work in this area will commence with formation of a joint revenue analysis and forecasting committee to undertake an inventory of tax data now available and production of a new tax database for analysis of trends and policy initiatives.

B. Other Structural Reforms

19. **We have stepped up our efforts to improve the business environment.** We established a “one-stop shop” and an electronic business registration system, which have significantly reduced the cost and time for business registration. From January, we have also reduced substantially the number of licenses required for various business activities. Notably, the time and cost for obtaining construction permits have decreased

significantly. Furthermore, measures such as easing the requirement of certificates of origin for exports and reducing the time required for custom formulation for imports have reduced the cost of trading across borders. In addition, we are working with the European Union to undertake customs reform aimed at improving compliance and governance, while speeding clearance. We passed amendments to the Law on Competition to enhance the power of the Competition Commission, through strengthened inspections, improved methodologies, and increased penalties for monopolistic behaviors. In the area of anti-money laundering and combating the financing of terrorism (AML/CFT), we will submit to parliament later this year a package of bills to amend relevant laws and address shortcomings.

20. **We are developing an export promotion strategy.** We are in the process of creating an export-oriented free-economic zone for the agricultural sector and high-tech industry. We will take steps to strictly limit leakage and loss of fiscal revenues from any free zones. We will also take measures to address the obstacles identified by the European Commission in February 2009 to prepare for a Deep and Comprehensive Free Trade Area with the EU (e.g., product and sanitary standards, non EU-aligned trade and investment regulations, and competition rules). A negotiation team has been established with the Ministry of Economy as coordinator, aiming to start negotiations with the EU as soon as possible.

21. **We continue to work to shield the most vulnerable from the effects of the crisis and food price shock.** Notwithstanding the difficult fiscal situation, we met our social expenditure targets, and we will further increase the social spending on the Family Benefit Program and lump-sum financial aid by 16 percent in 2011 (indicative target). In addition, we introduced a targeted gas price subsidy for the poor covered by savings in other areas and an interest rate subsidy for the agricultural sector paid for by a contingency item in the budget.¹ Moreover, in order to further improve the registration process, coverage, and provisioning of social assistance, we adopted in January a decree on introducing an integrated system for the provision of social protection services, followed by a time-bound action plan in March. We will submit the amendments to Parliament in October (structural benchmark, December 2011).

22. **We are finalizing an Annual Progress Report on our Sustainable Development Plan,** and work has started on an updated strategy paper which will set out our vision for our nation's economic growth and social development over the long term.

¹ During April 1, 2011—March 31, 2012, the natural gas tariff for targeted vulnerable people is reduced to AMD100/cubic meter, from AMD132/cubic meter, up to a usage of 300 cubic meters in total during this period (the regular tariff of AMD132/cubic meter is charged to the use of natural gas exceeding 300 cubic meters).

IV. CONCLUSION

23. **Given our strong program implementation, we request the completion of the second review of the EFF/ECF program and the associated disbursement of SDR 36.2 million.** We also request modification of the end-June performance criteria for net international reserves and net domestic assets, as well as for the program fiscal balance in accordance with a revised definition. In addition, we request the establishment of performance criteria for end-December 2011. We will maintain a close policy dialogue with the Fund and stand ready to take additional measures, as appropriate, to ensure the achievement of the government social and economic objectives under the EFF/ECF program. We will continue to consult with the Fund on the adoption of measures, and in advance of revisions of the policies contained in the LOI, in accordance with the Fund's policies on such consultation. We will also provide the Fund with information it requests for monitoring progress during program implementation. The program's quantitative performance criteria and indicative targets, as per attached Technical Memorandum of Understanding and structural benchmarks are set out in Tables 1 and 2. The third review is expected to be completed on or after September 30, 2011. The fourth review is expected to be completed on or after March 30, 2012.
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/

Vache Gabrielyan
Minister of Finance
Republic of Armenia

/s/

Artur Javadyan
Chairman of the Central Bank
Republic of Armenia

Table 1. Armenia: Quantitative Targets for 2010-11 1/
(In billions of drams, at program exchange rates, unless otherwise specified)

	2010						2011								
	Mar. 2/	Jun.	Sep.	Dec.			Mar. 3/	Jun.	Sep. 3/	Dec.					
	Act.	Act.	Act.	Country Report No. 10/350	Adj. Prog.	Prel.	Country Report No. 10/350	Adj. Prog.	Prel.	Country Report No. 10/350	Prog.	Country Report No. 10/350	Prog.	Country Report No. 10/350	Prog.
Performance Criteria															
Net official international reserves (floor, in millions of U.S. dollars)	895	912	933	808	763	885	831	748	833	780	795	801	769	747	819
Net domestic assets of the CBA (ceiling)	-28	-16	-10	125	116	56	99	98	85	121	109	138	143	190	155
Program fiscal balance (floor) 4/	3	-22	-40	-140	-140	-124	-34	-34	-4	-58	-50	-90	-99	-112	-187
External public debt arrears (continuous criterion)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Indicative Targets															
Reserve money (ceiling)	465	435	438	540	545	508	515	520	506	530	522	555	538	596	563
Average concessionality of newly disbursed debt (floor, in percent) 5/				30	30	32								30	30
Social spending of the government (floor) 6/	7	15	23	31	31	31	9	9	9	18	18	27	27	36	36

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU.

2/ The net official international reserves balance excludes the total IMF disbursement received by Armenia on March 31.

3/ Indicative target.

4/ Below-the-line overall balance excluding net lending and project financing until March 2011. Below-the-line overall balance excluding net lending from June 2011.

5/ Assessed on a calendar year basis.

6/ Defined as 100 percent of the budgeted amount of the family benefit program and lump-sum financial aid.

Table 2. Armenia: Structural Benchmarks Under the EFF/ECF Arrangement

Item	Measure	Proposed Time Frame (End of Period)	Outcome
<u>Tax administration</u>			
1	Issue a government decree stipulating that clarifications and interpretations of laws, regulations, and procedures on taxes, duties, and mandatory fees should be approved by the Ministry of Finance. These clarifications and interpretations will become normative acts to be published and applied consistently across all taxpayers effective September 1, 2010.	July 2010	Met
2	Set up a Tax Appeals Council under the Government to deal with legal and procedural disputes of taxpayers.	September 2010	Met with delay
3	Develop manuals in tourism, real estate, transport, and sectors using cash register machines for tax audits for usage starting January 2011.	December 2010	Met
4	Simplify the reporting system by reducing the frequency of reporting to tax authorities and considerably streamline tax forms for VAT, profits tax, and personal income tax.	December 2010	Met
5	Adopt a government decree establishing a mechanism for implementing a fully functional risk management approach in VAT refund processing.	December 2010	Met
6	Implement a fully functional risk-based management approach in VAT refund processing.	June 2011	
7	Set up a taxpayer registry.	December 2011	
<u>Tax policy</u>			
8	Increase the tax rate structure for up-market luxury vehicles and SUVs for 2012 and adjust the specific tax on cars annually for inflation.	December 2011	
9	Introduce legislative changes that provide for annual automatic indexation of excises for inflation.	August 2011	
10	Approve a Tax Strategy paper.	December 2011	
<u>Social policy</u>			
11	Submit amendments to existing laws to parliament to enable the full functioning of an integrated system for the provision of social protection services.	December 2011	
<u>Fiscal and debt sustainability</u>			
12	Approve a medium-term expenditure framework (2011–13), including a medium-term debt management strategy.	August 2010	Met
<u>Monetary sector</u>			
13	Approve terms and conditions for deposit auction to enable the CBA to absorb liquidity with greater flexibility.	September 2011	
14	Publish the CBA's liquidity forecast that provides projected amount of dram liquidity before CBA's actions with indication of separate components such as currency outside the CBA, net foreign assets, government transactions excluding treasury bill issuances, and treasury bill issuances for liquidity management purposes.	December 2011	
<u>Financial sector</u>			
15	Issue prudential regulations to specifically address currency-induced credit risk, including increased loan-loss provisioning requirements and higher risk weights in capital requirements for foreign currency loans.	June 2010	Met
16	Formalize the Committee for Financial Stability in an MOU to set the modalities for main policy makers to coordinate their policies and responses in case of an imminent critical situation in the banking sector.	September 2010	Met
17	Issue prudential regulation requiring banks to prepare their contingency plans for liquidity and solvency support.	December 2010	Met

ATTACHMENT II. ARMENIA: UPDATED TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum sets out the understandings between the Armenian authorities and the IMF staff regarding the definition of performance criteria and indicative targets, their adjusters, and data reporting requirements for the three-year EFF/ECF Arrangement as per the Letter of Intent dated May 20, 2011 (LOI).
2. For program monitoring purposes, all foreign currency-related assets, liabilities, and flows in the monetary accounts will be evaluated at program exchange rates. The program exchange rate of the Armenian dram to the U.S. dollar is set at 385 dram per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

I. Quantitative Targets

3. The program sets performance criteria and indicative targets for defined test dates (see Table 1 in the May 20, 2011 LOI). The program sets the following performance criteria:
 - Floor on the net official international reserves (NIR) of the Central Bank of Armenia (CBA);
 - Ceiling on the net domestic assets (NDA) of the CBA;
 - Ceiling on external public debt arrears (continuous); and
 - Floor on the program fiscal balance;

The program sets the following indicative targets:

- Ceiling on reserve money;
- Floor on average concessionality of new debt; and
- Floor on social spending of the government.

4. **The net official international reserves** (stock) of the Central Bank of Armenia (CBA) will be calculated as the difference between total gross official international reserves (excluding commercial bank required and excess reserves at CBA in FX) and gross official reserve liabilities.
 - Gross official international reserves are defined as the CBA's holdings of monetary gold (excluding amounts pledged as collateral), holdings of Special Drawing Rights (SDRs), including the August 28, 2009 General Allocation and the September 9, 2009 Special Allocation, the country's reserve position at the IMF, and holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments). Gross reserves held in the form of

securities and other financial instruments are marked to market. Excluded from gross reserves are the balance on the government's Special Privatization Account (SPA), capital subscriptions in foreign financial institutions and illiquid foreign assets, any assets that are pledged, collateralized, or otherwise encumbered, claims on residents, claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options), precious metals other than gold, assets in nonconvertible currencies, and illiquid assets.

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

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

5. **Reserve money** is defined as the sum of currency issued, required and excess reserves, and current and time deposit accounts of certain resident agents. Liquidity absorbing transactions under reverse repurchase agreements, foreign currency swaps, and securities issued by the CBA are excluded from the reserve money definition. The ceiling will be considered as met if the outcome is within AMD 5 billion of the indicative target sets in Table 1 attached to the Letter of Intent dated May XX, 2011.

6. **Net domestic assets** are defined as reserve money minus NIR, minus commercial bank required and excess reserves at CBA in FX, plus medium and long-term foreign liabilities (i.e. liabilities with a maturity of one year or more) of the CBA, minus the balance of outstanding Fund purchases credited to the government account at the CBA. NDA is composed of net CBA credit to the general government; outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money and other items net.

7. **External public debt arrears** are defined as 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.¹ The ceiling on external payment arrears is set at zero.

¹ 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 (as defined in paragraph 12).

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

- **Net banking system credit to the central government** equals the change during the period of net credit to the central government.
- **Net nonbank financing** equals the sum of: (1) the change during the period of outstanding treasury bills and bonds to nonbanks (including accrued interest for treasury bills and excluding accrued interest for treasury bonds);² (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 drams, less amortization paid by the central government to private resident nonbank agents.
- **Net external financing** equals total debt-increasing disbursements from non-residents to the central government (including Fund net purchases credited directly to the government accounts at the CBA) less total amortization from the central government to non-residents. All foreign currency-denominated transactions are recorded in drams using the prevailing exchange rate at the time of the transaction.

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

10. Some project implementation units maintain accounts at the CBA. Grants received by these units are recorded in the fiscal accounts as external grants on the revenue side and as foreign-financed capital expenditure on the expenditure side. In addition, any loans to finance investments that are intermediated through the banking system are recorded in the financial accounts as a financing item below the line and are thus excluded from net lending. Under previous Technical Memoranda of Understanding, these activities were excluded from the calculation of the program fiscal balance. This treatment reflected lags in receiving information from project implementation units and on project loans intermediated through the banking system. With the shift to semi-annual program reviews with the EFF/ECF arrangement and consolidation of the accounts of these units in the Treasury, there is no

² 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.

longer a need for such exclusion, and these activities are now fully accounted for in the program fiscal balance.

11. Foreign currency proceeds from selling enterprises are deposited into the Special Privatization Account (SPA). The SPA is held at the CBA and the proceeds are invested abroad together with the CBA's international reserves. These proceeds are included in the definition of the monetary accounts of the CBA as part of net foreign assets with a counter entry in other items net. Any 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. Domestic currency proceeds from selling enterprises to residents are deposited in a sub-account of the treasury single account and are also treated as a financing item and recorded below the line.

12. The program sets an annual indicative floor of 30 percent on average concessionality of new debt on a disbursement basis on debt with nonresidents with original maturities of one year or more contracted and guaranteed by the public sector.

- The monitoring of the average concessionality target is done on a disbursement-by-disbursement basis and consistent with the methodology used in the DSA to calculate the original average concessionality target. In particular, the discount rate and the exchange rates used in the DSA should be used for the monitoring. The concessionality of floating interest rates will be assessed based on the interest rates as of June 1 of the preceding year.
- The public sector comprises the general government, the central bank, and nonfinancial public enterprises (enterprises and agencies in which the government holds a controlling stake—typically owns more than 50 percent of the shares, but which are not consolidated in the budget).
- For program purposes, the guarantee of a debt arises from any explicit legal obligation of the public sector to service a debt in the event of nonpayment by the debtor (involving payments in cash or in kind), or from any implicit legal or contractual obligation of the public sector to finance partially or in full any shortfall incurred by the debtor.

13. The program sets a floor on **social spending of the government**. For the purposes of the program, social spending of the government is defined as 100 percent of the budgeted amount of the family benefit program and lump-sum financial aid.

II. Adjustors

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

- **Changes in reserve requirements:** The ceiling on the NDA of the CBA and the ceiling on reserve money will be adjusted downward (upward) by the amount of banks' reserves freed (seized) by any reduction (increase) of the reserve requirement ratio on both domestic currency and foreign currency liabilities relative to the baseline assumption as per the following formula: $\Delta\text{NDA} = \Delta rB$, where B denotes the level of liabilities subject to reserve requirements in the initial definition and Δr is the change in the reserve requirement ratio.
- **KfW 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.
- **Budget support grants to the public sector** are defined as grants received by the general government for direct budget support from external donors and not related to project financing.
- **Budget support loans to the public sector** are defined as disbursements of loans from bilateral and multilateral donors for budget support and Fund purchases credited directly to the government accounts at the CBA.
- **Project financing to the public sector** is defined as disbursements of loans from bilateral and multilateral donors for public sector projects.
- **The floor on NIR** will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants (excluding Fund disbursements to the government) compared to program amounts (Table 3). The floor on NIR will be adjusted downward for any external public debt amortization amounts in excess of program amounts.
- **The ceiling on NDA** will be adjusted downward by the amount of any excess of budget support loans or budget support grants compared to program amounts (Table 3).
- **The floor on the program fiscal balance on a cash basis** will be adjusted upward (downward) by the cumulative total amount of the budget support grants received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap

of \$25 million in either direction. The floor on the program fiscal balance on a cash basis will also be adjusted downward (upward) by the cumulative total amount of the project financing received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of \$50 million in either direction.

III. Data Reporting

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA	CBA balance sheet	Summary	Daily	The following working day
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within seven days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks by chart of accounts at actual official exchange rates	Monthly	Within 25 days of the end of each month
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Daily	The following working day
	Foreign exchange market	Official exchange rates (buying and selling); daily trade volume, and weighted average exchange rate of the interbank, intrabank and Nasdaq-OMX	Daily	Within 1 day
	Foreign exchange market	CBA foreign exchange operations, (exchange rate, volume, 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
	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 . For project implementation units, within 21 days of the end of each month (preliminary data) and within 45 days of the end of each month (final data)
	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions	Monthly	Within 7 days of the end of each month
	Domestic expenditure arrears	All unpaid claims outstanding at the end of the month which includes wages, social contributions (including for pensions), family allowances, and amortization and domestic interest payments	Monthly	Within 45 days of the end of each month for government arrears

	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month
	Treasury single account (TSA)	Detailed breakdown of central treasury account, including deposits at the central treasury, community budgets, off budget account, monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.	Monthly	Within 7 days of the end of each month
	Consolidated central 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,	Quarterly	Within 30 days of the end of each

		and irrigation sectors		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)
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax inspectorate	Monthly	Within 45days after the end of each month
	Import data	<ol style="list-style-type: none"> 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 in U.S. 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
SDR	593.00	1.5403

Table 2. Armenia: KFW and IBRD SME Loan Disbursements, 2010-11 1/
(In millions of U.S. dollars)

Mar-10	Jun-10	Sep-10	Dec-10		Mar-11		Jun-11		Sep-11		Dec-11	
Actual	Actual	Actual	Country Report No. 10/350	Prel.	Country Report No. 10/350	Prel.	Country Report No. 10/350	Prog.	Country Report No. 10/350	Prog.	Country Report No. 10/350	Prog.
0.0	0.0	5.0	29.9	5.0	2.0	0.0	4.0	2.0	6.0	4.0	8.0	25.8

1/ Cumulative from the end of the previous year.

Table 3. Armenia: External Disbursements to the Public Sector in 2010-11 1/
(In millions of U.S. dollars)

	Mar-10	Jun-10	Sep-10	Dec-10		Mar-11		Jun-11		Sep-11		Dec-11	
	Actual	Actual	Actual	Country Report No. 10/350	Prel.	Country Report No. 10/350	Prel.	Country Report No. 10/350	Prog.	Country Report No. 10/350	Prog.	Country Report No. 10/350	Prog.
Project financing	63	107	145	187	193	14	30	61	62	95	109	159	158
Budget support loan	0	38	67	116	96	56	0	85	66	131	91	160	175
Budget support grant	...	...	...	...	...	...	8	...	41	...	41	...	82
of which: EU program	...	...	0	0	0	25	0	25	20	50	20	50	50
Total	63	145	212	303	289	95	30	171	168	275	240	368	414

1/ Cumulative from the end of the previous year.

IV. Guidelines on the Indicative Benchmark with Respect to the Definition of External Debt

For program purposes, the definition of debt is set out in Executive Board Decision No. 12274, Point 9, as revised on August 31, 2009 (Decision No. 14416-(09/91)).

(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 Reviews Under the Extended Fund Facility and Extended Credit Facility,
and Request for Modification of Performance Criteria**

Informational Annex

Prepared by the Middle East and Central Asia Department

June 14, 2011

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ANNEX I. ARMENIA: RELATIONS WITH THE FUND
(As of May 31, 2011)

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	477.43	518.95
Reserve Tranche Position	0.00	0.00
III. SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	87.99	100.00
Holdings	12.55	14.27
IV. Outstanding Purchases and Loans:	SDR Million	Percent of Quota
Stand-by Arrangements	350.43	380.90
ECF Arrangements	90.25	98.10
Extended Arrangements	35.00	38.04

V. Latest Financial Arrangements:

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
Stand-By	03/6/2009	06/27/2010	533.60	350.43
ECF	06/28/2010	06/27/2013	133.40	37.40
EFF	06/28/2010	06/27/2013	133.40	35.00

VI. Projected Payments to Fund

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2011	2012	2013	2014	2015
Principal	9.11	101.00	180.22	98.08	16.43
Charges/interest	<u>4.26</u>	<u>8.20</u>	<u>4.78</u>	<u>1.99</u>	<u>1.06</u>
Total	13.37	109.20	185.00	100.07	17.49

VII. Safeguards Assessment

Under the Fund's safeguards assessment policy, an update safeguards assessment of the Central Bank of Armenia (CBA) was completed in November 2010 with respect to the current EFF/ECF arrangements. The update safeguards assessment found that the CBA

maintains a sound safeguards framework And made recommendations to further strengthen oversight arrangements.

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 2010 Article IV consultation with Armenia was concluded on December 1, 2010. 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 a 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.

XI. Resident Representatives

Mr. Guillermo Tolosa, since January 2010.

XII. Technical Assistance

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

Armenia: Technical Assistance from the Fund, 2002–11

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	Resident 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	MoF, SRC
Tax administration	Short-term	April 28 – May 22, 2009	MoF, SRC
Tax administration	Short-term	September 23 – October 6, 2009	MoF, SRC
Tax administration	Short-term	March 1–May 14, 2010	MoF, SRC
Tax administration	Short-term	August 30 – November 10, 2010	MoF, SRC
Tax administration	Short-term	September 2010	MoF, SRC
Tax administration	Short-term	November 2010	MoF, SRC
Tax policy	Short-term	February 2011	MoF
Tax administration	Short-term	February-March 2011	MoF, SRC
Tax administration	Short-term	May-June 2011	MoF, SRC
Tax policy	Short-term	June 2011	MoF
Legal Department			
Tax legislation	Resident advisor	September 1, 2004–December 31, 2005	
Legislation Development & FIU	Short-term	July 31–August 7, 2006	

Subject	Type of Mission	Timing	Counterpart
Unified Tax Code	Short-term	June 16—23, 2007	MFE
Unified Tax Code	Short-term	April 13—18, 2009	MoF, SRC
AML-CFT National Strategies and Coordination	Short-term	April 19-26, 2010	CBA
AML-CFT National Strategies and Coordination	Short-term	January-February 2011	CBA
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
Sovereign credit quality	Short-term	September 6—10, 2005	CBA
Sovereign credit risk		August 20, 2005—August 20, 2006	CBA
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	Short-term	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
Contingency planning, crisis preparedness	Short-term	March 28—April 14, 2010	CBA
Workshop on Inflation Targeting (with IMF Research Dept.)	Workshop	April 27—May 6, 2011	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

Subject	Type of Mission	Timing	Counterpart
Multitopic bundled mission: national accounts, balance of payments, monetary and financial statistics	Short-term	January 25—February 5, 2010	National Statistical Service, CBA
National accounts	Short-term	September 16-28, 2010	National Statistical Service

**ANNEX II. ARMENIA: WORLD BANK AND IMF
COLLABORATION—JMAP IMPLEMENTATION (As of end-September, 2010)**

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
<p>1. Bank work program in next 12 months</p> <p><i>Selected Ongoing and New Operations</i></p> <p>Public Sector Modernization Project II (US\$9m)</p> <p>DPO-2 (Triggers on revenue administration, safety nets, business environment, and mining code) (US\$25m)</p> <p>DPO-3 (Triggers on revenue administration, safety nets, business environment, and mining code) (US\$30m)</p> <p>E-Society & Innovation Project (US\$24m)</p> <p>North South Improvement Project 1 (US\$65m)</p> <p>Community Agricultural Resource Management and Competitiveness Project (US\$16.5m)</p> <p>Electricity Supply Reliability and Energy Efficiency Project (US\$46m)</p> <p>PFM/Tax project (US\$20m)</p> <p><i>Analytical Work</i></p> <p>Programmatic fiscal work (fiscal sustainability, revenue performance, and expenditure rationalization)</p> <p>Poverty monitoring and assessment</p> <p>Trade analytical and TA work (on FTA, and export diversification/expansion)</p> <p>Institutional and Governance Review</p> <p><i>Selected Technical Assistance</i></p> <p>Public Debt Management IDF</p> <p>Tax Audits and Macroprojections IDF</p>	<p>Ongoing</p> <p>Quarterly</p> <p>Quarterly</p> <p>Ongoing</p> <p>Ongoing</p> <p>Ongoing</p> <p>Ongoing</p> <p>Ongoing</p> <p>Quarterly missions, next mission in late June 2011</p> <p>Continuous</p> <p>Next mission in late June 2011</p> <p>Mid-2010</p> <p>Ongoing</p> <p>Starting in late 2010</p>	<p>Project implementation started in September 2010</p> <p>Approved by WB board on January 2011</p> <p>September-October 2011 targeted for board date</p> <p>August 2010</p> <p>Planned for FY12</p> <p>October 2011</p> <p>November 2012</p> <p>September-October 2011 targeted for board date</p> <p>Synthesis report to be delivered by end of June 2011.</p> <p>Annual series; 2010 report delivered in June</p> <p>September 2011</p> <p>2011</p> <p>June 2011</p> <p>2011</p>	
<p>2. IMF work program in next 12 months</p> <p>Second EFF/ECF Review</p> <p>Third EFF/ECF Review</p> <p><i>Analytical work on:</i></p> <p>Fiscal adjustment and debt reduction; regional linkages and spillovers.</p> <p><i>Technical Assistance/Training</i></p> <p>MCM (Improvements to the inflation targeting regime; debt management)</p> <p>LEG and MCM (Special Resolution Regime)</p> <p>FAD (Tax Administration—Various operational issues to improve revenue collection)</p> <p>FAD (Tax Policy—Follow up review, with focus on mining tax regime)</p> <p>FAD (Public Financial Management—Review of Medium-term budgeting and link of medium-term framework to annual budget)</p> <p>STA (follow up mission on BOP statistics and moving BOP compilation under the central bank)</p>	<p>April 2011</p> <p>September 2011</p> <p>H2 2011</p> <p>H2 2011</p> <p>June 2011</p> <p>June 2011</p> <p>H2 2011</p> <p>H2 2011</p> <p>H2 2011</p> <p>H2 2011</p> <p>H2 2011</p>	<p>June 2011</p> <p>November 2011</p> <p>H2 2011</p> <p>H2 2011</p> <p>September 2011</p> <p>September 2011</p> <p>June 2011</p> <p>H2 2011</p> <p>H2 2011</p>	
<p>3. Joint work program</p> <p>CDS Progress Report</p> <p>FSAP Update</p>	<p>Early 2011</p> <p>Mid-2011</p>	<p>May 2011</p> <p>Late 2011</p>	

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

(As of May 1, 2011)

1. The EBRD's current country strategy was approved in May 2009. Key priorities are: (i) the financial sector; (ii) the 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.

2. As of April 30, 2011, the EBRD had approved 99 projects in Armenia in the power, transport, agribusiness, municipal and infrastructure, manufacturing and services, property, telecommunications and financial sectors. Total commitments amounted to approximately EUR 397 million.

3. The EBRD committed EUR 53 million to Armenia in 2010 through 25 transactions, of which one was a sovereign loan to Yerevan Metro Company. The portfolio for 2010 comprised 16 projects in the financial institutions sector, 6 in agribusiness, 1 each in manufacturing and property, and the sovereign project with Yerevan Metro Company. Notably, two loans to financial institutions are in local currency, and two loans were syndicated. In the beginning of 2011 (January–April), the Bank committed an additional EUR 17 million through 8 transactions, six in the financial institutions sector, one in telecoms and one in natural resources

4. There are four 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. 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. Second, in November 1994, an 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 a concession agreement). The new management has prepared a master plan for development of the airport, which is expected to generate further traffic for the cargo terminal. In April 2007, the EBRD approved a EUR 7 million loan to the State Committee for Water Systems, owner of water and wastewater assets located in small municipalities outside of Yerevan. The proceeds of this loan are being used to improve wastewater treatment in five municipalities located near Lake Sevan. In March 2010, EBRD signed a EUR 5.0 million sovereign loan with Yerevan Metro Company. This project will provide emergency investments in the Yerevan Metro, including safety upgrades and energy efficiency. The investment is part of a larger plan to improve and reform public transport services in the capital of Armenia.

5. Most of the EBRD's projects in Armenia are in the private sector. In addition to a loan to Electric Networks of Armenia (see paragraph 9 below), the EBRD approved an additional loan to Zvartnots International Airport of EUR 29.6 million, which will be supplemented by investments from ADB and DEG. This project follows on from the successful completion in May 2007 of the first phase of the passenger terminal, for which the EBRD provided a EUR 14.8 million loan together with a loan from DEG (USD 10 million). The new project involves construction and purchase of equipment for second phase of the passenger terminal complex at Zvartnots and will facilitate completion of the terminal with all arrivals and departures relocated from the old airport building. The loan was a commercial facility with no sovereign support. Other private sector finance includes smaller loans to private companies and equity participation in of companies in various sectors.

6. In the banking sector, the first equity participation, in the Commercial Bank of Greece-Armenia (EUR 1.1 million), was approved in 1999. There are now four local banks where the EBRD participates in equity: Armeconombank, Byblos Bank Armenia, Ararat Bank and Procredit Bank. The EBRD also acquired an equity stake in an Armenian nonbank financial intermediary, Cascade Insurance and Reinsurance Company, an insurance subsidiary of Cascade Capital Holding.

7. The Armenia Multi-Bank Framework Facility II (AMBFF II), was established to provide loans and equity to commercial banks and leasing companies in Armenia. It was originally approved by the EBRD Board on March 8, 2006 in an amount of USD40 million. The facility was extended by another USD80 million on November 9, 2007. In late 2009, the EBRD approved a further USD100 million extension to AMBFF II, in order to support increased financial intermediation and the development of the financial sector in Armenia, in particular, to contribute to economic development by providing medium- to long-term funding to selected Armenian financial intermediaries. Another extension of this facility is being discussed at present. The facility will seek to develop new products for financial institutions, including provision of local currency loans, agricultural credit lines, and mortgage financing. Additional technical assistance will be provided to partner banks.

8. The EBRD expanded its relationship with the partner banks in Armenia from four to twelve (two EBRD clients, Ameria Bank and Cascade Bank, merged in 2010). Nine banks were provided with new credit facilities under the AMBFF. One institution (Armeconombank) was provided with a mortgage facility, and the first leasing facility in Armenia was signed with ACBA Leasing in 2008 for EUR 5.9 million. A co-financing facility with six local banks was also extended, resulting in 14 sub-loans to Armenian corporates. By means of co-financing lines, the EBRD has entered new sectors, such as healthcare and telecoms, and has significantly expanded its portfolio of agribusiness loans. A trade facilitation program with the purpose of facilitating access of Armenian banks to trade financing was also made available to nine Armenian banks.

9. Supporting development of renewable energy is another core activity of the EBRD. To that end, the EBRD joined forces with the World Bank, USAID, and Cascade Credit (a financing arm of the Cafesdjian Foundation) to launch the Armenian Renewable Energy Programme (AREP). The EBRD's participation took the form of a loan to Cascade Credit. The EBRD also continued to finance renewable energy projects on its own through direct lending facility, with two projects signed. In addition to renewable energy, the EBRD returned to the mainstream segment of the energy sector, seeking to support post-privatization development with a loan to the privately-owned power distribution company. In April 2009, the EBRD signed a EUR 42 million loan with Electric Networks of Armenia to upgrade and modernize the obsolete low-voltage infrastructure and improve energy efficiency.

10. The EBRD launched turn around management (TAM) and business advisory service (BAS) programs in Armenia in 2003, originally funded by the EU-TACIS program, but now funded from the ETC Fund. The programs support micro, small, and medium-sized enterprises. Since 2003, BAS has completed 784 projects in the amount of EUR 2.979 million, as well as 39 market development activity (MDA) projects. TAM has delivered more than 20 projects.

11. Projects identified by the EBRD for future development are well diversified across sectors, and include several relatively large transactions. Additional business opportunities are offered in the infrastructure sector, including projects in the public sector (mainly municipal). The EBRD is exploring opportunities in transportation, water, sanitation and solid waste treatment. The Bank has launched a USD 25 million program to finance projects for industrial energy efficiency and renewable energy through local banks. In October 2010, the first USD 3.0 million, energy efficiency credit line was signed with Anelik Bank. Technical assistance has been put in place, financed by the Government of Austria.

12. As part of programs to reform the inspection regime and improve the business environment, the EBRD is assisting the government by supporting preparation of a corporate governance code, along with the Ministry of Economy, the CBA, the Stock Exchange and the International Financial Corporation. The EBRD is also providing assistance to the Public Services Regulatory Commission for telecommunications sector regulation. This assistance is being financed by the Government of Finland.

ANNEX IV. ARMENIA: RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ADB)
(As of May 1, 2011)

1. The ADB's economic report and the interim operational strategy for 2006–09 for Armenia were approved in 2006. The country operational business plan (COBP) for 2011–13 has been prepared and submitted to the government for endorsement. This COBP supports the government's Sustainable Development Program (SDP—the government's poverty reduction strategy program) and will help the authorities counter the economic vulnerability revealed by the crisis. The indicative focus areas under this COBP are (i) urban development; (ii) regional cooperation; and (iii) private sector development. In third quarter of 2011, the Bank is planning to prepare the first Country Partnership Strategy for the next 5 years.
2. As of May 1, 2011, the ADB had approved nine projects in the transport, municipal infrastructure, and general budget support sectors. Total commitments amounted to USD 441.9 million for sovereign and USD 40.0 non-sovereign loans. The only non-sovereign loan, amounting to USD 40 million was provided to Armenia International Airports (ArIA) for the Zvartnots Airport Expansion Project (Phase 2). The project will finance the construction of a new terminal building and purchase of equipment to supplement the existing concourse building.
3. The first ADB sovereign loan was a rural roads project (USD 30.6 million) for rehabilitation of 220 km of roads approved in November 2007. The second was a water supply and sanitation loan (USD 36 million) for repair and replacement of the water supply infrastructure in small towns and villages approved in December 2007. The third was a supplementary loan (USD 17.3 million) to the rural roads project approved in November 2008, to finance an increase in project cost from higher construction materials prices, domestic inflation, and appreciation of the dram. The fourth was a crisis recovery support program loan (USD 80 million) approved in July 2009, to protect budgetary social expenditures. The next two loans were tranches 1 (USD 60 million) and 2 (USD 170 million) of the North-South Road Corridor investment program approved in October 2009 and December 2010, respectively. Tranche 1 is providing for rehabilitation of 18.4 km of the four-lane Yerevan-Ashtarak highway and safety enhancement of a four-lane road between Yerevan and Ararat. Tranche 2 is providing for upgrading the Ashtarak-Talin road section from two-lane to four-lane first category road. The final loan was the first tranche (USD 48.6 million) of the Sustainable Urban Development investment program approved in April 2011. The project will provide for construction of two missing road links of the Yerevan inner bypass and strengthen institutional and management capacity of Yerevan Municipality and urban transport service providers.
4. Except for the North-South Road Corridor investment program Tranche 2 loan, all approved loans are from the ADB concessional window under the Asian Development Fund (ADF). The Tranche 2 loan is from the ADB's nonconcessional window under ordinary capital resources.

5. In addition to loan projects, the ADB is also involved in non-lending operations, mostly advisory and capacity development technical assistance. This is mostly research-oriented: Armenia's Transport Outlook, a transport sector masterplan for 2011–2020; and Institutional Modernization to Improve the Business Environment, to assist the government with introduction of an online business registry system. The advisory technical assistance may lead to loan projects.

6. To increase efficiency and long-term cooperation, the ADB has offered a new instrument: project funding under the Multi-Finance Facility (MFF). The MFF allows approval of long-term sector assistance to be disbursed in tranches. Under the MFF, the ADB has approved USD 500 million for the North-South Road Corridor investment program. The funds will be available for 7 years, and Armenia will request them in tranches. The first and second USD 60 million and USD 170 million tranches have already been approved. A USD 400 million MFF to help the government finance a share of the Sustainable Urban Development investment program will be available for a ten-year period from 2011 to 2020.

ANNEX V. ARMENIA: STATISTICAL ISSUES
(As of May 1, 2011)

Background

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

Real sector statistics

2. The National Statistics Service (NSS) compiles and disseminates annual and quarterly national accounts. The NSS also compiles and disseminates annually a full set of accounts (up to financial accounts) for the total economy and by institutional sectors. The NSS is developing a plan for implementing the *System of National Accounts 2008 (2008 SNA)*.

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

4. The NSS compiles discrete quarterly GDP estimates by production and by expenditure approaches at current and at constant prices. The production-side estimates at current prices are derived partially from cumulative source data (from business statistics surveys) and partially from discrete data sources. The NSS validates and reconciles data from different sources, but the underlying problems associated with de-cumulating the cumulative output data distort the quarterly pattern. The NSS compiles and disseminates two sets of quarterly GDP volume measures—one at the prices of corresponding quarter of the previous

year and the other at average prices of 2005. The first set does not constitute a time series since it does not allow a comparison of different periods. A multitopic IMF statistics technical assistance mission in January 2010 suggested that the NSS discontinue compiling these data. The compilation procedures for the second set (volume measures at average prices of 2005) need to be improved. The January 2010 mission also suggested that the NSS compile only one set of quarterly GDP estimates—quarterly GDP at previous-year average prices—and derive time series through chain-linking. These estimates would be conceptually consistent with the annual data. They would also allow comparisons between different periods, which is essential for analysis of business cycle.

5. The CPI covers 11 large population centers and Yerevan. 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 development of an approach to include household expenditure on owner-occupied dwellings in the CPI calculations.

Government finance statistics

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

7. The budget presentation and the classification of items under the economic and functional classification of expenditures need to be made more transparent; for instance, the data have been subject to frequent reclassification, and wages for military personnel are reported in the 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 nonfinancial assets. The reconciliation of central government with general government operations is done by the NSS in cooperation with the MoF.

8. Since 2008, government finance statistics meet the classification requirements of the *Government Finance Statistics Manual 2001 (GFSM 2001)* for central government. Plans for improvement of the MoF envisage further progress in 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

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

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

External sector statistics

11. In 2009, the Armenian authorities decided to transfer the responsibility for compiling the balance of payments, international investment position (IIP), and external debt statistics from the NSS to the CBA. Transfer is expected in 2011. The February 2010 mission agreed with the authorities on an action plan aimed at ensuring a smooth institutional transfer of responsibility, as well as consistency and continuity in the production of the external sector statistics. A follow up mission is scheduled for later in 2011.

12. 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. Remittance data obtained from surveys 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 improved 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.

13. 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: Common Indicators Required for Surveillance
(As of May 27, 2011)

	Date of latest observation	Date received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of publication ⁷
Exchange Rates	May 2011	5/27/2011	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	May 2011	5/27/2011	D	D	M
Reserve/Base Money	May 2011	5/27/2011	D	D	D
Broad Money	Apr 2011	5/25/2011	M	M	M
Central Bank Balance Sheet	Apr 2011	5/17/2011	D	M	M
Consolidated Balance Sheet of the Banking System	Apr 2011	5/25/2011	M	M	M
Interest Rates ²	May 2011	5/25/2011	W	W	M
Consumer Price Index	Apr 2011	5/3/2011	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ — General Government ⁴	Q4 2010	5/6/2011	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing ³ —Central Government	Apr 2011	5/24/2011	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	Apr 2011	5/24/2011	M	M	Q
External Current Account Balance	Q4 2010	4/4/2011	Q	Q	Q
Exports and Imports of Goods and Services	Apr 2011	5/20/2011	M	M	Q
GDP/GNP	Q4 2010	3/31/2011	Q	Q	Q
Gross External Debt	Q4 2010	4/1/2011	Q	Q	Q
International Investment Position ⁶	Q4 2010	5/25/2011	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, extrabudgetary 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).



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FOR IMMEDIATE RELEASE
June 29, 2011

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review Under EFF/ECF Arrangement for Armenia and Approves US\$57.8 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed its second review of Armenia's economic performance under a program supported by the Extended Fund Facility (EFF) and the Extended Credit Facility arrangement (ECF).¹

The decision enables the authorities to draw an additional SDR 36.2 million (about US\$57.8 million), bringing total disbursements under the arrangement to an amount equivalent to SDR 108.6 million (about US\$173.5 million).

The three-year SDR 266.8 million (about US\$426.2 million) EFF and ECF arrangement with Armenia was approved by the IMF's Executive Board on June 28, 2010 (see [Press Release No. 10/263](#)).

Following the Executive Board's discussion on Armenia, Ms. Nemat Shafik, Deputy Managing Director, stated:

“The Armenian authorities are to be commended for the continued implementation of sound policies under the Fund-supported program. These policies have helped underpin a steady recovery from the global financial crisis. Growth is expected to accelerate and broaden in 2011, but Armenia faces a number of outstanding challenges, including a surge of inflation, sizeable external and fiscal imbalances, high financial dollarization, and, in the wake of the crisis, increased public debt and poverty.

¹ The Extended Credit Facility (ECF) has replaced the Poverty Reduction and Growth Facility (PRGF) as the Fund's main tool for medium-term financial support to low-income countries by providing a higher level of access to financing, more concessional terms, enhanced flexibility in program design features, and more focused streamlined conditionality. Financing under the ECF carries a zero interest rate, with a grace period of 5½ years, and a final maturity of 10 years (<http://www.imf.org/external/np/exr/facts/ecf.htm>). The Fund reviews the level of interest rates for all concessional facilities every two years.

“Fiscal policies have been prudent, with the budget deficit reduced significantly in 2010, and further consolidation underway in 2011 and planned for the medium term. The strengthened fiscal position will help ensure fiscal and debt sustainability and reduce vulnerabilities. Decisive implementation of tax policy and revenue administration reforms will ease the burden of adjustment on spending and provide space for additional, well-targeted capital and social outlays. These, in turn, will help reverse the crisis-related increase in poverty.

“Monetary policy will continue to aim at mitigating wider inflationary pressures. The authorities’ policy response to the pickup of inflation has been timely and effective, and efforts to more actively manage liquidity have increased the responsiveness of market rates to the policy rate, improving the traction of monetary policy. The Central Bank of Armenia stands ready to take additional actions should inflationary pressures persist. Private inflows have resumed and banking indicators, already strong, continue to improve. The Central Bank of Armenia continues its efforts to improve the resilience of the banking sector.

“Sound macroeconomic policies and structural reforms will help ensure a smooth and orderly external adjustment. Broad-based reforms aimed at enhancing the business environment and domestic competition will promote external competitiveness, productivity, and exports, and greater flexibility of the dram will provide appropriate price signals and reduce exposure to foreign exchange risk.”

Statement by Age Bakker, Executive Director for Republic of Armenia
and Grigor Sargsyan, Advisor to Executive Director
June 29, 2011

Armenia continues to recover gradually from the deep global downturn and economic recession. The ECF/EFF blend arrangement approved by the Board in June 2010 has been instrumental for the authorities to restore growth, address the challenges of the surge of global inflation, set the basis for a smooth and orderly adjustment of the balance of payments, and strengthen the implementation of structural reforms. The authorities would like to thank Executive Directors, Management, and staff for their continued support and constructive dialogue.

The authorities concur with staff's appraisal on the necessity of further fiscal consolidation, reforms in tax administration, and external adjustment. Performance under the program has been strong, with many performance criteria met with a substantial margin. The authorities remain committed to advancing structural reforms to help underpin the nascent recovery by enhanced competitiveness, an improved business environment, and strong export growth. Macroeconomic policies will be geared to striking a balance between fostering growth and containing inflationary pressures, as well as preserving fiscal and debt sustainability.

Macroeconomic situation

During the past year, growth has been very uneven. While mining, industry, trade and transportation have performed strongly, overall output growth was dragged down by the agricultural sector, due to poor climatic conditions and structural weaknesses in the sector. The authorities are expecting a faster growth in 2011, supported by improved agricultural production, and staying above 4 percent for the next several years.

Inflationary pressures from shortages in domestic agricultural production were exacerbated by the increase in global food prices, pushing inflation to 11.5 percent in March 2011, a record-high level in the past 10 years. The monetary authorities, fearing that these pressures might spill over into second-round effect, acted by increasing interest rates by 125 bps. Recent data show that twelve-month inflation decreased to 9 percent in May.

With the post-crisis recovery underway, fiscal policy continues to be contractionary. After reaching 8 percent of GDP in 2009, the fiscal deficit was cut to 4.6 percent last year. The authorities plan further fiscal consolidation and intend to reach a target deficit of 2.4 percent of GDP by 2013. At the same time, the revenue-to-GDP remains relatively low. Based on recent technical assistance from the Fund, the Armenian authorities are planning a set of measures in tax policy and revenue administration that could add significantly—up to 4 percentage points of GDP—to overall revenue collections.

The financial system remains sound. However, while the banking sector is well capitalized and NPLs have decreased to 4 percent, the system on the whole remains highly dollarized, which impedes the effectiveness of monetary policy. The Central Bank of Armenia (CBA) has taken anti-dollarization measures, including requiring banks to maintain a higher portion of dram reserve requirements against foreign exchange deposits, as well as strengthening enforcement of foreign exchange regulations, which require the use of drams in certain transactions and for listing the prices of goods and services.

The authorities recognize the necessity of improving the business environment. A number of measures have been implemented during the past several months in this regard. With support from international partners, the business registry is now fully functional, allowing the registration of a new business on-line in just fifteen minutes. Also, the procedure for certifying exports has been streamlined. Seventy percent of exports need certification of origin, and recently-passed regulations have streamlined what were cumbersome and bureaucratic procedures for obtaining certification.

Future policies and measures

The CBA will continue its close monitoring of developments in consumer prices. Committed to inflation targeting, the CBA stands ready to increase interest rates further to curb inflation, especially if evidence reemerges of a pass through of food and fuel prices to core inflation. The authorities project inflation to moderate towards the end of the year and reach the target band of around 4 percent. The CBA is also aiming to increase the effectiveness of monetary policy by increasing the responsiveness of market interest rates to open market operations. Accordingly, several term-rate instruments are being developed for trading on the NASDAQ OMX Armenia exchange platform.

On the fiscal side, the authorities are planning to cut the deficit by another 0.7 percent of GDP in 2011. As in the past, the authorities are committed to saving at least half of any higher-than-expected revenues to create a buffer should risks materialize. This will also help maintain debt sustainability on a firm footing.

The authorities are committed to changing several laws and codes to support growth and increase fiscal revenue collection. Last week, Parliament began discussions on amendments to the mining code. The new code is aimed at improving taxation of the industry, while boosting investment in the sector. Non-ferrous metals, such as copper and molybdenum, as well as metal ore concentrates, are currently Armenia's largest export items.

Last week, the President of Armenia signed a new law on free economic zones. The aim of the law is to establish a favorable economic environment for export-oriented companies. The first two zones will be set up this year, one at the international airport in Yerevan, with operations including packaging of high-value fresh fruits and vegetables for export via air.

The second one will be a high-tech industrial facility. The authorities are strongly committed to preventing any leakages from the zones to the rest of the economy.