INTERNATIONAL MONETARY FUND

IMF Country Report No. 14/89

REPUBLIC OF ARMENIA

March 2014

REQUEST FOR ARRANGEMENT UNDER THE EXTENDED FUND FACILITY; STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF ARMENIA

In the context of the request for an arrangement under the Extended Fund Facility, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 7, 2014, following discussions that ended on December 19, 2013, with the officials of Armenia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on February 20, 2014

- An **Informational Annex** prepared by the IMF.

- A **Press Release** including a statement by the Chair of the Executive Board.

- A **Statement by the Executive Director** for Armenia.

The following documents have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Armenia*
Memorandum of Economic and Financial Policies by the authorities of Armenia*
Technical Memorandum of Understanding*

*Also included in Staff Report

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

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

February 20, 2014

REQUEST FOR ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

KEY ISSUES

Context and recent developments. Performance under the 2010–13 program, which was supported by arrangements under the Extended Fund Facility and Extended Credit Facility, was sound, with growth restored, large fiscal and external imbalances reduced, and buffers rebuilt. However, challenges remain, particularly in further reducing vulnerabilities and strengthening medium-term growth dynamics. Growth and inflation have remained volatile—in 2013, growth slowed significantly and inflation rose well above the CBA's target range. The external current account deficit and dollarization continue to be high, keeping the economy vulnerable to shocks. Poverty and unemployment also remain high, and the transition to an alternative to the pre-crisis, construction-led growth model—involving a more open, competitive, and globally- and regionally-integrated economy—has been slow.

Program objectives. In light of these challenges, the Armenian authorities have requested a new 38-month arrangement under the Extended Fund Facility, with access equivalent to SDR 82.21 million (89.4 percent of quota). Key objectives of the new program are to consolidate stability and buffers against possible external shocks and to support growth through further reforms in the transition towards a dynamic emerging market economy.

Program policies. Fiscal policy will support the growth recovery in 2014 by providing a modest stimulus, before moving to a gradual consolidation stance in 2015–17. This will place public debt on a declining path during the program period. Revenue measures will support the consolidation and also create room for addressing social and investment needs. Monetary and exchange rate policies will be guided by the authorities' framework of inflation targeting and exchange rate flexibility, with program policies focusing on continued improvements in monetary operations, communications, and modeling. Financial sector policies will target implementation of remaining recommendations of the 2012 FSAP Update, which aim to promote resilience to shocks and greater financial deepening. Structural reforms will support medium-term growth by targeting improvements in the business climate, strengthening institutions, improving connectivity and competition, creating a stronger environment for private and foreign direct investment, and tackling key risks, especially in the energy sector.

Staff views. Staff supports the authorities' request for an Fund-supported program. The LOI/MEFP provides a strong set of policies to pursue the objectives of the program. While the program is not without risks, staff assesses Armenia's repayment capacity to be robust, with the fiscal consolidation and growth-supporting reforms embedded in the program reinforcing this assessment. If the program's policies are implemented, and barring any major shocks, the program should be able to achieve exit from Fund support, with Armenia sustaining market access at the end of the program period.

Approved By:
Juha Kähkönen (MCD) and Ranil Salgado (SPR)

Discussions were held in Yerevan during September 5–18 and December 9–19, 2013, with Prime Minister Sargsyan, Central Bank of Armenia (CBA) Chairman Javadyan, Finance Minister Sargsyan, Economy Minister Avanesyan, Minister-Chief of Staff Gabrielyan, Energy Minister Movsisyan, other senior officials, and representatives of the private sector, civil society, and diplomatic community. The team comprised M. Horton (head), K. Katayama, and P. Rodriguez (all MCD), Z. Arvai (SPR), and T. Komatsuzaki (FAD). T. Daban (Resident Representative), M. Aleksanyan, A. Ghazaryan, V. Janvelyan, and A. Manookian, (IMF office) assisted. M. Hadzi-Vaskov (OED) participated in the September mission.

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INTRODUCTION

1. **A three-year Fund-supported program expired in July 2013, with sound performance.** Program objectives were to restore fiscal and external sustainability, preserve financial stability, restore growth, and reduce poverty. These were largely met, and six reviews were completed with few delays or missed targets. Key achievements were reestablishing growth after a 14 percent contraction in 2009 and attaining major reductions in the fiscal and external current account deficits.

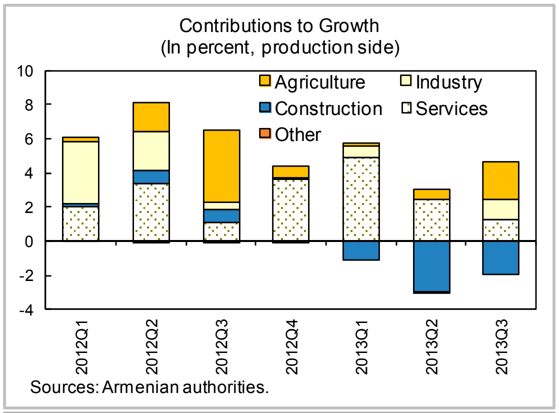
2. **Important challenges remain, however, in terms of stabilization, reducing vulnerabilities, and enhancing medium-term growth.** Inflation and growth remain volatile, and the external current account deficit and dollarization are high, making the economy vulnerable to shocks. Poverty and unemployment remain high, and further efforts are needed to strengthen growth and to make it more inclusive and sustainable. Structural reforms will be essential to continue Armenia's post-crisis transformation from a growth model that involved capital accumulation in construction and saw the establishment of strong positions by well-connected business interests to a more open, integrated, competitive, and diversified emerging market economy.

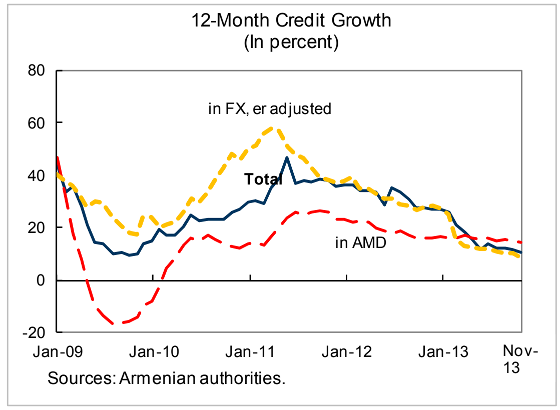
3. **In light of these challenges, the authorities have requested a new 38-month arrangement under the Extended Fund Facility.** Key objectives are to consolidate stability and buffers against possible shocks and to support growth through further reforms in the transition towards a dynamic emerging market economy. In particular, the program seeks to: (i) safeguard sound public finances; (ii) continue monetary and financial sector policies that strengthen resilience and buffers; and (iii) promote greater competition, competitiveness, and global and regional integration, and thereby, higher investment, exports, and growth. With key policy decisions taken in late-2013, including a debut Eurobond, a decision to join the Eurasian Customs Union (ECU), and a new five-year gas supply arrangement, the authorities are keen to continue close cooperation with the Fund in support of a strong macroeconomic policy framework and structural reform agenda and with other partners, including the EU, the World Bank, regional development institutions (AsDB, EADB, EBRD), and bilaterals. The authorities envisage the new arrangement under the Extended Fund Facility to be an "exit" from Fund program support (provided that balance of payments difficulties are resolved, as expected).

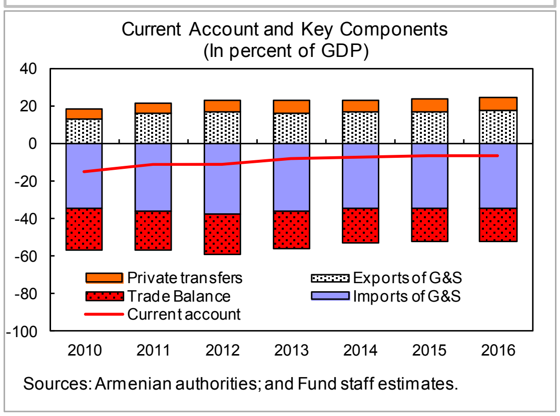
RECENT ECONOMIC DEVELOPMENTS

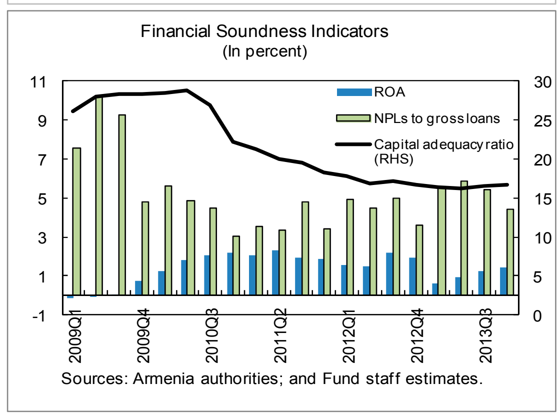
4. **Growth slowed in 2013, while the current account deficit narrowed and credit conditions weakened.** After growing by 7.1 percent in 2012, the economy grew by just 3.2 percent in 2013, with construction continuing to decline. A deceleration of domestic demand due to domestic energy price hikes and a tight fiscal position—reflecting delays in budget execution—was an important contributing factor. In spite of the slowdown in key trading partners (e.g., Russia, Georgia), exports and remittances held up well. This development, along with flat imports,

supported a significant reduction of the external current account deficit of over 2½ percent of GDP to 8½ percent of GDP, the first single-digit deficit since 2007. The slowing of growth and domestic demand was accompanied by a rapid deceleration of credit growth. The ratio of nonperforming loans picked up in the second half of the year, before declining in December. The banking system remains well capitalized, although profitability, which strengthened significantly from 2009 to 2012, weakened last year.

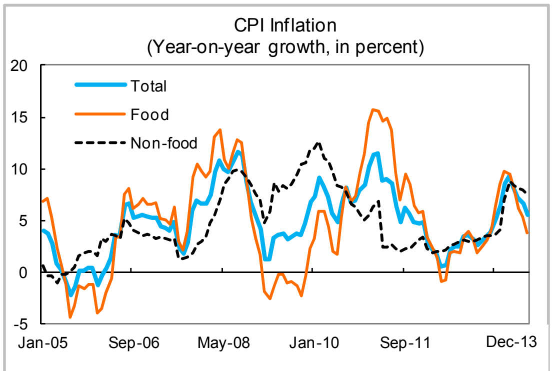




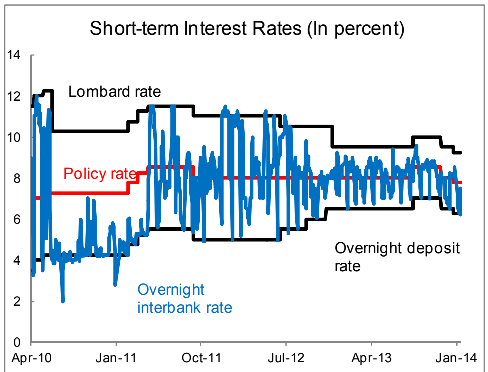




5. Inflation has been above the CBA's 4±1.5 percent target range since August, but is declining rapidly. Year-on-year inflation rose to 9.3 percent following sizeable increases in gas and electricity prices in July, the first since 2010. The CBA increased its policy rate by ½ percentage point to 8½ percent in August, the first change in nearly two years, then reversed the move in November, with inflation declining rapidly and activity weaker than expected. A further ¼-point cut took place in December, and inflation reached 5.6 percent (yoy) at year-end.

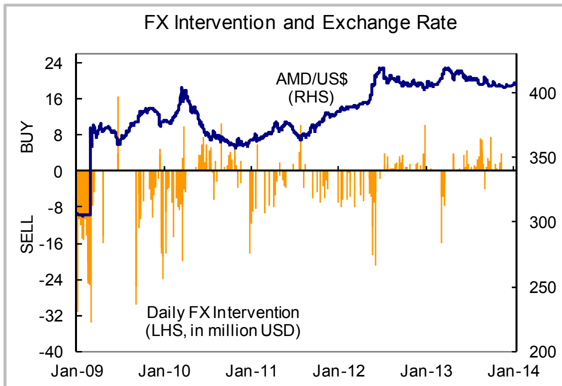


Sources: Armenian authorities.



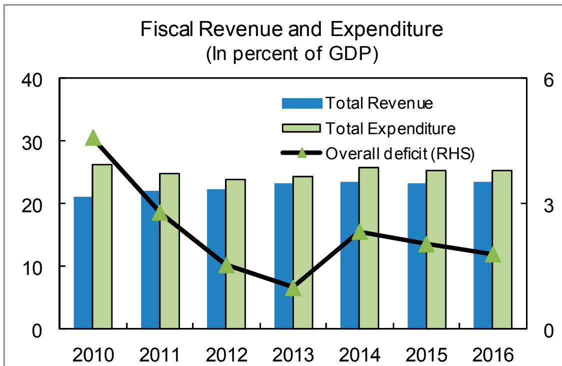
Sources: Armenian authorities; and Fund staff estimates.

6. The dram has been under appreciation pressures since the second quarter of 2013, and reserves have increased. After strong seasonal pressures in a thin foreign exchange market led to CBA sales of $44 million last March, the stronger current account position has contributed to upward pressures in the foreign exchange (FX) market. The dram appreciated by around 3 percent in nominal terms through end-2013, and the CBA accumulated over $100 million to help strengthen reserves. Reserves also increased with the debut Eurobond and strong short-term bank inflows at year-end.



Source: Armenian authorities.

7. Capital underspending again contributed to fiscal overperformance. The first phase of the complex, multi-donor North-South highway continued to advance more slowly than anticipated, although implementation improved late in the year. Underspending occurred on other large foreign-financed projects (e.g., border crossing modernization). Despite slower growth, revenues were in line with budget targets, although this partly reflected stepped-up pressures on compliant taxpayers. The underlying deficit is projected to have closed the year at 1 percent of GDP—well below the budgeted 2.6 percent—although preliminary data suggest that the figure could be even lower. A one-off, gas-related transfer brought the headline deficit from 1 percent to 2½ percent of GDP.



Sources: Armenia authorities; and Fund staff estimates.
Note: 2013 deficit excludes a one-off transfer to ArmRusGasprom

8. The authorities took major financial and trade decisions in 2013. A debut 7-year, $700 million Eurobond was issued in September (6.25 percent yield, bullet repayment). The authorities repaid the rest of a 2009 crisis loan from Russia ($450 million) and are using the rest for budget financing, net lending, and reserves. Also in September, President Sargsyan announced that Armenia would join the ECU and not conclude a free trade agreement with the EU. In December, a road map to ECU membership was agreed (see Annex I). The ECU agreement helped pave the way for a new five-year gas arrangement with Russia and Gazprom, reached in December (Box 1).

9. The new mandatory funded pension system was launched in January 2014, but the roll-out is facing legal challenges. Preparations were concluded in late 2013 with the licensing of two top-tier European firms to manage pension funds, and the new system was rolled-out on January 1. However, in late January, the Constitutional Court accepted a case presented by opposition parties questioning the constitutionality of the new system. A decision by the court is expected in late March. In the meantime, the court has suspended some of the provisions of the new system.

OUTLOOK AND RISKS

10. Growth is expected to strengthen in 2014 and beyond, while inflation should return to the CBA's target range. Following the slowdown in 2013, a pick-up is expected in 2014 with more supportive fiscal and monetary policies and improvements in external conditions. With growth-enhancing reforms, staff expects growth to stabilize at around 5 percent in the medium term, while the authorities consider that growth could be somewhat higher. The main inflation impact of last July's energy tariff increases was absorbed in 2013, and the rapid deceleration of inflation—supported by monetary policy actions, the strength of the dram, and the tight fiscal position—suggests that there have been limited second-round effects. Inflation is expected to reach 4 percent by end-2014, notwithstanding the gradual pick-up of activity. While the new gas agreement is likely to provide price stability, inflation is likely to remain volatile, given the large food component in the CPI basket (48 percent) and strong links between food and international commodity prices. The authorities view their strategy of regional integration and their planned increase in public investment as key elements supporting growth, both in 2014 and in the medium-term.

Box 1. Gas Price Agreement

In December 2013, the authorities reached a set of agreements with Russia and Gazprom, involving:

- A new base price of $189/1000 m3 from January 2014, incorporating a 30 percent discount via waiver of an export duty charged by Russia (in connection with accession to the ECU). The new price also reflects a discount from prices that Gazprom had been charging ArmRusGaz (ARG), the local distributor. The sales price will be adjusted by changes in a domestic gas price in Russia (in rubles) and by U.S. CPI inflation. The discount is expected to save Armenia 1½ percent of GDP per year.

- Sale of remaining state shares (20 percent) in ARG to Gazprom for $155 million (1½ percent of GDP). State holdings in ARG started at 45 percent in 1997, with Gazprom owning 45 percent and another Russian firm, Itera, owning 10 percent. A 2008 debt-equity swap involving gas subsidies and an unfinished power plant and acquisition of Itera's shares led Gazprom's stake to rise to 80 percent.

- Transfer of the sales proceeds to Gazprom to cover losses arising from differences between the gas price at the border and ARG's domestic gas tariffs during 2011–13.

- A 30-year immunity clause on changes to laws, regulations, decrees, and corporate income tax rates that could negatively affect the company's finances.

Discussion. Prior to domestic gas and electricity tariff increases in July 2013, rates were last adjusted in 2010, based on a border price of $180/1000 m3. Negotiations on a new border price began in 2011 and continued through 2013, with the Armenian authorities insisting that the price remain at $180. However, the price charged by Gazprom to ARG increased in mid-2011 to $210 and reached $270 in April 2013, leading to the build-up of ARG liabilities. These losses reached over $300 million, with the amount above $155 million being written off.

Some commentators have suggested that the buildup of liabilities and the debt-equity swap were not transparent and were politically driven, given parliamentary and presidential elections in 2012–13. According to the authorities, no requests were made by ARG for domestic gas tariff adjustments, in light of the ongoing negotiations. The liabilities were made public with issuance by ARG of its end-year financial statements, which by law must be issued by June 30 of the following year. More frequent financials were submitted to the Public Services Regulatory Commission, and some indicators were published.

The new border price of $189 and increased domestic tariffs appear to have reestablished ARG's profitability on domestic gas operations. The agreements provide significant savings, important to the medium-term balance of payments. Greater transparency would have been desirable, along with more timely tariff action to mitigate the build-up of debt and the eventual debt-equity swap. Going forward, close attention and timely energy sector policy decisions will be needed, as the Armenian economy will face a significant adjustment if the gas price discount is not extended.

11. **The external current account is expected to improve by a further 2 percent of GDP during 2014–17.** This reflects the impact of lower gas prices and structural reforms under the new program that will lower costs and support export growth. Exports are also expected to be supported by infrastructure improvements and continued gains in Russian and ECU markets

12. **Risks are slanted to the downside**. The Eurobond and the gas agreement helped mitigate two sources of risk, government financing and energy costs. However, downside risks remain, particularly if exports and remittances—which held up well in 2013 in spite of the slowdown in Russia—falter in the context of a deeper or protracted Russian slowdown (see the Risk Assessment

Matrix in Annex II). One concern is that remittances could fade after the Sochi Winter Olympics are concluded. Greater global financial volatility and a possible reemergence of financial stress in the euro area are also potential risks, but the lack of strong financial sector linkages, as well as healthy reserves, the remaining Eurobond funding, and continuing official support are mitigating factors. Risks would heighten, however, if Russia is strongly affected by greater global financial volatility or euro-area stress. The election cycle was concluded in 2012–13, suggesting lower political risks, but major geopolitical risks persist, especially concerning Nagorno-Karabakh, as well as relations of Iran and the West and Russia and Georgia. On the upside, the resolution of geopolitical tensions and the conclusion of a number of large FDI projects—both in the pipeline (e.g., sale of a large hydroelectric power station, mining sector investments) and prospective (e.g., new investments in the context of ECU accession)—could provide a substantial boost. The authorities broadly concurred with staff's risk assessment, although they consider that ECU accession and further penetration of traditional markets could provide a strong boost to exports and investment and help mitigate risks.

PROGRAM POLICIES

The program focuses on macroeconomic stabilization, reduction of vulnerabilities, and structural reforms needed for the continuing transition to a dynamic emerging market economy. The program supports a pickup of growth through higher growth-enhancing spending in 2014, while also sustaining policy space, contributing to the continuing external adjustment, and further establishing buffers. Structural measures target a further strengthening of fiscal and monetary policy institutions, enhanced financial sector resilience, higher private and foreign investment and export-led growth through greater regional integration, enhanced domestic competition, governance and business climate reforms, and measures to address risks and challenges in energy and transport.[1] *The program measures draw lessons from and build on the previous Fund-supported program and the 2012 EPA.*

A. Fiscal Policy

13. With substantial adjustment having taken place under the 2010–13 program, fiscal policies will aim at consolidating past gains, while addressing social and investment needs. Staff and the authorities agreed that the key objectives under the new program should be to place public debt on a declining path during the program, to increase revenues in an equity-enhancing and growth-friendly way, to continue to improve the composition of spending, including by providing better remuneration for the core civil service and strengthening implementation of major investment projects, and to improve fiscal institutions, particularly related to identifying and mitigating fiscal risks.

[1] See Annex III for a taxonomy linking objectives, policy areas, and key measures.

14. For 2014, the program will support the growth pickup by targeting a deficit of 2.3 percent of GDP, over 1 percentage point higher than the (underlying) 2013 outturn. This is premised on improved implementation of foreign-financed infrastructure investment projects and higher outlays for road maintenance, school rehabilitation, pension and wages, which were compressed following the crisis.[2] The pick-up of capital spending will support growth, and the reversal of the erosion of pensions and wages will help address worsening social indicators among the elderly and difficulties attracting and retaining qualified staff. Higher pay will come with structural changes to introduce a more consistent wage policy in the public sector, including clearer job descriptions and more standardized salaries, and eventually, greater flexibility in hiring and retention. Wages of hospitals and schools will continue to be managed autonomously, on the basis of payment by the state for specific services and outcomes. Additional support to the economy will come from net lending of some of the Eurobond proceeds (0.3 percent of GDP) to SMEs and exporters. Although staff does not generally support on-lending, the authorities stressed that these operations are closely monitored by the Finance Ministry and CBA and will take place on commercial terms via institutions that have a strong track record in managing lending, including via commercial banks, with the banks taking full credit risk.

15. In 2014, revenue efforts will focus on tax and customs administration improvements, while deferring tax policy measures to 2015. The authorities expressed concern that a strong focus on tax revenue gains this year would have negative implications for the business environment, following two years of strong revenue gains, the significant slowdown of activity in the second half of 2013, and the substantial increase of electricity and gas tariffs in July. Staff agreed, noting that while the authorities have achieved a significant increase in the tax to GDP ratio in recent years, which supported the sizable adjustment under the previous program, the quality of the revenue effort was not always optimal—for example, efforts were often targeted to compliant taxpayers rather than closing tax gaps. This contributed to pressures for prepayments and a buildup of tax credits. Staff and the authorities therefore considered that efforts in 2014 should focus on revenue administration gains in areas of low compliance (Box 2).

16. After the modest impulse in 2014, the program will target consolidation to begin to reduce public debt and rebuild buffers, with a focus on higher revenues. The deficit will be cut to 2 percent of GDP in 2015 and to 1.8 percent of GDP thereafter. Revenue measures will provide room for addressing social and investment needs. In 2015, revenue efforts will aim to keep the overall revenue ratio constant, while supporting a reduction of outstanding tax credits by 0.3 percent of GDP. The authorities' objective is that this reduction in tax credits will support private activity by easing working capital constraints for taxpayers and facilitating hiring, purchases, and investment. During 2016–17, the program targets revenue gains of 0.3 percent of GDP per year and

[2] Delays in implementing large foreign-financed projects were a key factor for underspending in recent years. The complicated nature of some projects was contributing factor, including multiple donors and requirements, multi-phased financing, complex land acquisition requirements, and contractors and consultants new to the region.

an increase in capital spending.[3] Higher capital outlays, particularly in road transport—both the important North-South Highway and regional and local roads—are intended to support better connectivity and stronger growth, while public sector energy-efficiency investments (schools, clinics) will help mitigate energy-related risks and free up spending for health and education improvements.[4]

17. Revenue measures under the program will include both revenue administration and tax policy actions. For revenue administration, the program will target implementation of a modern tax compliance program, enhancing the coverage and capacity of the large taxpayer unit of the State Revenue Committee (SRC), improving custom administration by modernizing legislation and procedures, and facilitating greater transparency and enhanced dialog with taxpayers. Efforts will also be made to improve coverage and compliance of high-wealth individuals. In tax policy, measures will focus on addressing tax gaps, including through new instruments (e.g., new excises, notably on liquefied natural gas), higher rates for specific taxes and excises, and elimination of exemptions, notably for specific types of income, fuels, and sectors (agriculture). The authorities expressed concern with the incidence and efficiency of new tax policy measures and will analyze poverty impacts and administrative costs of new measures in 2014, with a view to mitigating these as the measures are designed and rolled out. Revenue efforts under the program will be supported by structural benchmarks, and where needed, further Fund TA.

18. The program will continue to emphasize poverty reduction and full implementation of well-targeted social spending. Poverty remains high, despite progress reflected in the latest data (for 2012) and recent increases in the minimum wage and pensions. The program will retain an indicative target (IT) on social spending with a wider base aimed to increase impacts. The authorities continue to place strong emphasis on targeting, efficiency, and quality of social spending, and highlighted their efforts in recent years to streamline and unify the full range of social services to an integrated, one-stop approach, supported by enhanced social work and case management. With an eye on getting the unemployed more quickly into jobs, unemployment benefits were redistributed in the 2014 budget to other spending, including work skills training, rides to job interviews, and enhanced job matching and placement.

19. The strategy of debt stabilization and reduction will be complemented by institutional actions. The new program will support the creation of risk management units at the Finance Ministry and the SRC to strengthen the monitoring and control of risks related to revenue performance, public utilities, and PPPs. The program retains an IT on the average concessionality of new public external debt and introduces a limit for guarantees. These aim to contain borrowing costs, support Armenia's continuing graduation from low-income country status, and help avoid that the debt reduction strategy is derailed by explicit or implicit liabilities (Appendix I). The

[3] Given past delays, the new program includes an adjustor to allow for catching up on major infrastructure projects as experience is gained and execution is accelerated.

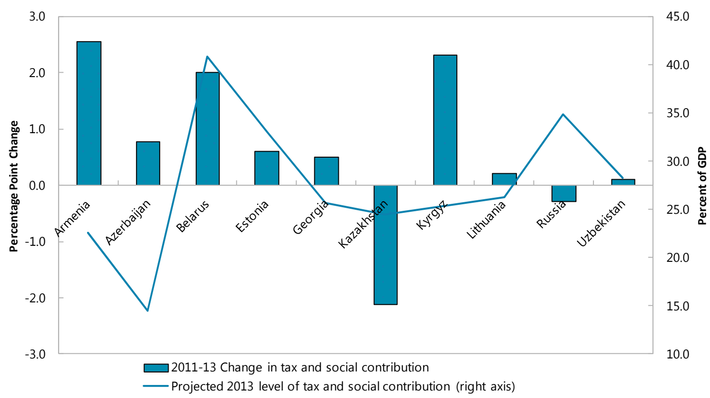
[4] An important issue is to ensure that investments in road transport in Armenia are met by corresponding improvements in Georgia.

authorities will continue to consult closely with the Fund and World Bank staff on major projects, such as modernization of the Nairit synthetic rubber factory. The program includes a new performance criterion (PC) strictly limiting the absorption of liabilities or other bailouts of local companies.

Box 2. Tax Revenues

In recent years, Armenia has made progress in revenue mobilization, a long-standing issue. The tax-to-GDP ratio increased by 2.5 percentage points in 2011–13, although the level of collections still lags Armenia's comparators. The increase was partly achieved by tax policy actions such as elimination of income tax exemptions for the military and law enforcement personnel and introduction of a new royalty regime in mining. Revenue administration gains were also made, including through a strengthening of information systems and improved taxpayer services. However, a strong focus on meeting nominal revenue targets also meant that pressures on compliant taxpayers intensified, especially with the slowing of growth in 2013. One symptom has been the further accumulation of tax credits, by about 0.6 percent of GDP over the past two years, reflecting cumbersome refund and offsetting procedures for VAT credits and administrative pressures. A further concern expressed by businesses is that the playing field is not even, with large, well-connected taxpayers getting a lighter burden.

Figure: Changes and Levels in Tax and Social Contribution



Sources: Staff estimates

The program places emphasis on ensuring that recent revenue increases are sustainable, equitable, and business friendly. In tax policy, emphasis will be placed on well-planned efforts to address long-standing policy gaps. These include new tax instruments (e.g., new excises, including on liquefied natural gas), increases of some tax rates (e.g., specific excise tax rates on alcoholic beverages, fuels, and tobacco), and reducing or eliminating exemptions (e.g., for specific sectors like agriculture, products, or forms of income—dividends, capital gains). In revenue administration, the SRC's business process will continue to be recalibrated toward better and more systematic risk and compliance management. Finally, the authorities will step up efforts to engage taxpayers at the strategic level on ways to make the tax system more efficient and buoyant.

B. Monetary and Exchange Rate Policies

20. The program envisages a transition to inflation-targeting conditionality. The reserve money IT will be replaced by conditionality on inflation to place more emphasis on inflation outcomes. The program will retain a PC on CBA net domestic assets, but with a margin to lessen potential inconsistencies with the inflation-targeting framework.[5] Staff and the authorities envisage that over the course of the program, and following a durable reduction of inflation to the target band, inflation-consultation clause conditionality will be introduced and the NDA PC will be dropped. In the meantime and with Fund TA support, the CBA will further strengthen its inflation-targeting regime, particularly in modeling and communications.

21. Exchange rate policies will help maintain buffers and support external adjustment. Targets on net international reserves aim to maintain strong buffers, somewhat above standard benchmarks, in light of Armenia's high dollarization and vulnerability to shocks (Annex IV). The CBA will continue to allow the dram to move according to its fundamentals, limiting intervention in the FX market. This should support the narrowing of the current account deficit and a gradual correction of estimated exchange rate overvaluation (Annex IV).

C. Financial Sector Policy

22. The program will target continued implementation of recommendations of the 2012 FSAP Update, to promote resilience to shocks. While the CBA expressed confidence in the regulatory and supervisory framework, it will work to achieve closer alignment with Basel III, particularly regarding capital requirements and identification of domestic systematically-important financial institutions (SIFIs). Regulatory and legislative measures will aim to improve supervision (e.g., large exposures) and crisis management infrastructure (e.g., rules related to the Deposit Guarantee Fund). Given high dollarization, the program will seek to strengthen the CBA's monitoring capacity of bank FX exposures, along with banks' own capacity to deal with these exposures. The program will initially build on measures taken previously (e.g., new templates to assess currency mismatches, minimum FX liquidity ratios). The authorities did not see a case for further prudential measures to target dedollarization, as their use is already significant and complex (currency denomination of reserve requirements, reserve requirement levels, liquidity ratios, loan capitalization ratios, etc.). Staff agreed, and accordingly, the program will first target work to assess the impact of the current array of measures in this area.

23. The program will also seek greater financial sector deepening. Program measures target improved credit markets (e.g., legal, regulatory, and institutional changes to simplify registration and execution of collateral), as well as developing the secondary securities market including through improved access of foreign participants to local capital markets. Staff and the authorities will work

[5] NDA ceilings under the previous program coexisted well with the inflation targeting framework, with few tensions (e.g., in late 2012, inflation was subdued, but NDA was close to the ceiling). The cushion will minimize such cases, while the program transitions to full inflation-targeting conditionality.

on assessing remaining obstacles to developing the FX derivatives market and FX hedging instruments.

D. Structural Reforms

24. Further structural reforms are needed to complete Armenia's post-crisis transformation from a construction-led growth model to a more open, integrated, and competitive emerging market economy. These reforms are broadly in line with the authorities' Armenia Development Strategy 2013–25 (Box 3) and would help diversify the economy and make growth less volatile and more inclusive and sustainable. Structural benchmarks under the new program target regulatory streamlining, consolidation of inspection agencies (from 18 to 9, thereby significantly easing the compliance burden and reducing opportunities for corruption), and bankruptcy procedures, improved institutional arrangements and capacity of the Competition Committee, and better connectivity and significantly lower costs through far-reaching civil aviation reforms. In addition, while the recently-signed gas agreement offers stable and low prices for the next five years, the program aims to identify energy policy options and efficiency gains to reduce vulnerabilities, cope with shocks, and prepare the economy for possible future price adjustments. These measures are macro-critical, in that they aim to further improve the business climate, strengthen institutions, improve connectivity and competition, create a stronger environment for FDI, and tackle key risks, especially in the energy sector.

Box 3. Armenian Development Strategy 2013–25

The authorities' new Armenian Development Strategy (ADS) is intended to guide policies for the next decade, with the "prime goal" of creating high-productivity jobs through reforms in:

- The business and investment climate, with actions targeted to areas where Armenia ranks low in World Bank Doing Business rankings (e.g., revenue administration, contract enforcement).*
- Financial deepening and competition, with reforms targeting lower credit costs and spreads.
- Specific sectors: (i) industry and export promotion; (ii) tourism, IT, and agriculture; and (iii) SME creation and support.
- Labor market reforms, particularly to further improve flexibility.
- Infrastructure, notably in drinking water, irrigation, transport, and electricity.
- Human capital development, with emphasis on healthcare and education.
- Social protection through the new pension system and expansion of existing, integrated assistance programs (e.g., the Family Benefits Program).
- Modernization of public administration and governance, including improving efficiency and transparency of decision-making, and civil society participation.

Staff finds the ADS to be coherent and comprehensive, but also optimistic in terms of productivity gains, growth, revenue gains, and fiscal space. Achieving the goals of the ADS will require decisive implementation of structural reforms, including under the new program.

* "As pointed out in an independent evaluation of the Doing Business survey (see www.worldbank.org/ieg/doingbusiness), care should be exercised when interpreting these indicators given subjective interpretation, limited coverage of business constraints, and a small number of informants, which tend to overstate the indicators' coverage and explanatory power."

25. The program will also support Armenia's increased regional and global integration. This is especially important as exports remain relatively small and dominated by mining. The authorities stressed that joining the Eurasian Customs Union (ECU) will secure lower prices for raw materials and improved access to the larger regional market, particularly important for Armenia's non-mining exports, especially processed agricultural products and light industrial goods.[6] That said, they agreed that efforts to ensure that the final ECU arrangements are consistent with Armenia's WTO obligations will be important, as ECU external tariffs are generally significantly higher than Armenia's present tariff levels. The authorities are negotiating exemptions from higher ECU external tariffs, which will be important to avoid higher costs for domestic consumption, production, and exports through sharp increases in the prices of imported inputs, food, and machinery or through costs associated with a substantial reorientation of trade. Staff also observed that uncertainty and a drawn-out process may dampen FDI interest, which has been restrained in recent years. The authorities will also continue efforts to improve ties with the broader regional and global economy, particularly with the EU via harmonization of standards, accreditation, technical control and certification, and market supervision practices. To focus limited public resources, the authorities will also clarify their export development and promotion strategy and rationalize a range of agencies in this area.

E. Program Modalities

26. To cover external financing gaps projected at $225 million during 2014–17, the authorities have requested Fund support equivalent to SDR 82.21 million (about $125 million, 89.4 percent of quota). The program would maintain reserves at 4.9 months of imports, somewhat above the standard benchmarks, but in line with recent levels and important to bolster confidence in light of Armenia's moderate growth prospects, continuing balance of payments weaknesses, high dollarization, and vulnerability to shocks (Annex IV). Financing needs are higher in the first two years of the program, declining with lower debt payments and a smaller current account deficit later. The authorities have requested further macro financial assistance from the EU, and the proposed Fund financing would cover the residual gap after support from the EU is taken into account.[7] While balance of payments gaps are expected to close after the program horizon, the authorities need to be mindful of sizable repayments in 2020, in connection with the maturity of the recently-issued Eurobond. A well-designed debt-management strategy will be important to address these obligations.

[6] ECU membership could lead to new financing for infrastructure and industrial projects, including the Metsamor nuclear power plant, national rail and road networks, and Nairit, as well as to FDI in agro-processing, information technology, financial, light industry, and services. Some investors may see Armenia's relatively favorable business environment (among ECU countries) as a positive platform for operations in the ECU as a whole.

[7] If EU financing is delayed until 2015, imports and the external current account deficit are likely to lower, and the authorities may temporarily draw down fiscal and foreign exchange reserves as a bridge.

27. A relatively low access, extended arrangement is the most appropriate instrument for Armenia. This reflects the expected extended period for payoff from still-complex, growth-and export-enhancing reforms. The program would cover a 38-month period and be monitored via semi-annual reviews, with June and December test dates. Quantitative performance criteria for June and December 2014 are shown in Table 1 of the attached Letter of Intent and Memorandum of Economic Policies (LOI/MEFP). Structural benchmarks through December 2014 are shown in Table 2 of the LOI/MEFP. Finally, purchases are proposed to be made in seven (nearly) equal tranches, as indicated in Table 10.

28. Armenia's repayment capacity remains robust. Public and external debt are expected to remain sustainable and decline at the end of the program period, constituting an important buffer in case program performance is weaker than anticipated. The composition of public external debt—largely owed to multilateral organizations with long maturities—provides another buffer. Finally, notwithstanding new purchases under the program, Fund exposure will decline over the program period, in light of sizable repayments of previous support. A new safeguards assessment is expected in the first half of 2014.

29. Risks to program are significant, but manageable. Armenia continues to find itself in a complex geopolitical situation, with closed borders and a tense standoff with Azerbaijan. Downside risks include adverse geopolitical events and external shocks, including a weakening of inflows in the context of a protracted slowdown in Russia. ECU accession has reconfirmed energy supplies and provides an opportunity to expand exports to traditional markets, while continued cooperation with the EU offers prospects for diversification. An important risk, however, is that the final ECU arrangements come through a drawn out process and involve significantly higher tariffs. Further, the program could encounter difficulties in meeting its objectives, if the authorities fail to decisively implement key measures, especially further revenue mobilization or improvements in domestic competition and the business environment. This could reflect, for example, continuing pressures from well-connected businessmen ("oligarchs"). Greater transparency, improved public communications, and a wider policy dialogue offer prospects to overcome resistance. The authorities' long track record of sound and prudent macroeconomic policies is expected to continue, providing assurances about a sound implementation of the program.

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30. Despite sound performance under the 2010–13 Fund-supported program, challenges to the Armenian economy remain, in terms of macroeconomic stabilization, reduction of vulnerabilities, and medium-term growth dynamics. Inflation and growth remain highly volatile, as the growth slowdown and inflation increase in 2013 have illustrated. The external current account deficit and dollarization remain high, keeping the economy vulnerable to shocks. Poverty and unemployment also remain high, and the transition towards an alternative to the pre-crisis construction-led growth model has been slow.

31. The authorities' new Fund-supported program rightly addresses these challenges and paves the way for exit from Fund support. The program aims to support a rebound of growth, further progress in poverty reduction, inflation stabilization, and a reduction in outstanding fiscal and external vulnerabilities. The program also puts in place structural reforms to promote robust and sustainable medium-term growth and address key risks. Barring major shocks, Armenia's balance of payments gaps should close by the end of the program period and the country should be able to sustain access to international financial markets, paving the way for an exit from Fund program support, provided that balance of payments difficulties are resolved, as expected.

32. Fiscal policy will appropriately preserve stabilization gains, while providing further space for key spending needs. A positive impulse in 2014, including from stepped-up capital spending and commercial lending operations, should support a pickup of growth. Thereafter, adjustment over the rest of the program should put debt on a declining path. Further revenue gains are needed to support the adjustment and provide room for addressing social and investment needs, and the program's measures aim to achieve these gains without hampering activity or worsening the business environment or equity. The pause in 2014 is appropriate, but renewed efforts will be needed from 2015 on, so that low revenues do not contribute to poor public services- and weak output growth. This strategy will be rightly complemented by efforts to strengthen execution of key major infrastructure projects and measures to better manage fiscal risks—including guarantees—while limiting nonconcessional debt.

33. Although Armenia has graduated from Fund concessional support and low-income country status, further efforts are needed to reduce poverty. The authorities' efforts to streamline and better target social assistance spending have been impressive. Once the new system is fully operational, efforts should be made to expand coverage, where feasible. Pensions and wage increases—both the minimum wage and civil service remuneration—are reasonable after years of compression, but should not undermine the prudent fiscal framework or competitiveness.

34. Monetary and exchange rate policies should continue to support a sustained low rate of inflation—within the CBA's target range—as well as external adjustment. Monetary policy will continue to be guided by the authorities' inflation targeting framework, with program conditionality placing more emphasis on inflation outcomes. The CBA has shown a strong commitment to strengthening its inflation-targeting framework, particularly in terms of modeling work, and will benefit from further efforts to enhance communications, with support from Fund TA. NIR targets aimed at maintaining robust buffers, together with flexibility of the dram, should support further reduction of the external current account deficit to its sustainable level. Dollarization in the financial sector should continue to be closely monitored, with a view to adopting measures if conditions warrant.

35. Financial sector policies rightly aim to promote further resilience to shocks and financial sector deepening. The CBA has focused efforts on implementation of recommendations of the 2012 FSAP Update and will continue to strengthen its regulatory and supervisory framework to achieve close alignment with Basel III. Regulatory and legislative improvements to strengthen supervision, enhance the crisis management infrastructure, and strengthen the CBA's monitoring capacity of bank FX exposures are welcome. Measures to accelerate financial deepening, improve credit markets and facilitate foreign investor access to local capital markets are also important.

36. The authorities' strategy of regional and global integration and business-climate reforms should move forward decisively to enhance medium-term growth prospects. Determined implementation of the ADS and reforms to improve the business climate, enhance domestic competition, and improve connectivity with the rest of the world will be critical. After several years of negotiations of a free trade agreement with the EU, joining the ECU came as a surprise to many. At the same time, the decision promises to provide Armenia with greater access to the larger regional market, along with cheaper inputs and possible financing for critical projects like extending the operating life of Metsamor nuclear power station and building a replacement unit. However, ECU membership will also pose a challenge for some sectors, given prospects for higher ECU common tariffs and efforts will also need to be made to ensure consistency with Armenia's WTO obligations. The authorities are encouraged to continue to pursue integration with EU structures to provide diversification of markets, products, and investors. An important objective is to strengthen the environment for private and foreign investment, as export-oriented greenfield investment will be critical for the transition to a dynamic emerging market economy. The new gas-supply arrangement will bring significant savings over the medium term (as well as the write-off of past liabilities), but greater energy efficiency and diversification of energy sources will, nonetheless, be essential to ease prospects for a painful adjustment down the road. It is also vital that the operations of large companies are sufficiently transparent to limit fiscal risks, as with the liabilities of ArmRusGaz that built up during 2011–13. The new PC aims to strictly limit bailouts in the future.

37. Risks to the program are manageable, and Armenia's repayment capacity is robust. Key risks include geopolitical events, a protracted slowdown in Russia, and stress from global financial volatility or a worsening of conditions in Europe. A failure to decisively improve the business environment is an important implementation risk. Parliamentary and presidential elections in 2012–13 have set the stage for progress, along with major decisions on market financing, regional integration, and energy supplies taken in late 2013. Boldness in moving forward will be needed, supported by greater transparency, improved communications, and a wider policy dialogue. The authorities' long track record of sound macroeconomic policies is expected to continue, and also support a break-though on the structural front. To the extent that there is fiscal underperformance in the future, the authorities are urged to respond with measures on the revenue side, in order to protect capital and social spending and sustain growth. Armenia's repayment capacity is expected to remain robust, with the fiscal consolidation and growth-supporting reforms embedded in the program reinforcing this assessment. Other factors that support this assessment are strong reserves, the long-term profile of public external debt, and prospects for continued external adjustment and a pick-up of FDI from low levels in recent years.

38. Staff supports the authorities' request for a 38-month Fund-supported program with access equivalent to SDR 82.21 million (89.4 percent of quota). The LOI/MEFP provides a strong set of policies to pursue the objectives of the program. Semi-annual reviews are expected to work well, as was the case under the previous Fund-supported program.

Table 1. Armenia: Selected Economic and Financial Indicators, 2009–16

	2009	2010	2011	2012	2013		2014	2015	2016
	Act.	Act.	Act.	Prel.	EBS/13/75	Proj.	Proj.	Proj.	Proj.
National income and prices									
Real GDP (percent change)	-14.1	2.2	4.7	7.1	5.1	3.2	4.3	4.5	4.7
Gross domestic product (in billions of drams)	3,142	3,460	3,778	3,998	4,351	4,290	4,714	5,123	5,578
Gross domestic product (in millions of U.S. dollars)	8,648	9,260	10,142	9,950	10,365	10,547	11,216	11,609	12,039
Gross domestic product per capita (in U.S. dollars)	2,661	2,838	3,097	3,033	3,153	3,208	3,405	3,517	3,640
CPI (period average; percent change)	3.5	7.3	7.7	2.5	4.0	5.8	5.0	4.0	4.0
CPI (end of period; percent change)	6.7	8.5	4.7	3.2	4.0	5.6	4.0	4.0	4.0
GDP deflator (percent change)	2.6	7.8	4.3	-1.2	4.0	4.0	5.4	4.0	4.0
Poverty rate (in percent)	34.1	35.8	35.0	…	…	…	…	…	…
Investment and saving (in percent of GDP)									
Investment	33.8	29.4	27.0	22.8	24.5	23.9	24.4	24.9	25.5
National savings	18.0	14.6	16.1	11.6	14.4	15.5	17.3	18.1	18.9
Money and credit (end of period)									
Reserve money (percent change)	13.8	-0.8	32.3	1.9	10.3	29.9	9.0	…	…
Broad money (percent change)	16.4	10.6	23.6	19.6	15.9	15.2	11.3	…	…
Velocity of broad money (end of period)	3.8	3.8	3.4	3.0	2.8	2.8	…	…	…
Commercial banks' 3-month lending rate (in percent)	19.1	17.7	20.7	18.5	…	18.3	…	…	…
Central government operations (in percent of GDP)									
Revenue and grants	20.9	21.2	22.1	22.3	23.2	23.3	23.5	23.3	23.6
Of which: tax revenue 1/	16.1	16.4	16.7	18.1	21.7	22.5	22.7	22.7	23.0
Expenditure 2/	28.6	26.2	25.0	23.9	25.5	25.8	25.9	25.4	25.4
Overall balance on a cash basis	-7.9	-4.6	-2.8	-1.5	-2.3	-2.5	-2.3	-2.0	-1.8
Public and publicly-guaranteed debt (in percent of GDP)	40.2	39.7	42.0	44.0	43.5	45.4	45.2	46.0	46.2
Share of foreign currency debt (in percent)	88.9	87.4	86.8	86.9	86.4	84.8	84.4	84.4	84.9
External sector									
Exports of goods and services (in millions of U.S. dollars)	1,336	1,937	2,407	2,440	2,699	2,583	2,757	2,932	3,123
Imports of goods and services (in millions of U.S. dollars)	-3,683	-4,212	-4,797	-4,907	-5,135	-5,022	-5,155	-5,365	-5,596
Exports of goods and services (percent change)	-24.0	45.0	24.3	1.4	8.3	5.8	6.8	6.3	6.5
Imports of goods and services (percent change)	-22.4	14.4	13.9	2.3	4.9	2.3	2.6	4.1	4.3
Current account balance (in percent of GDP)	-15.8	-14.8	-10.9	-11.2	-10.0	-8.4	-7.2	-6.8	-6.6
FDI (net, in millions of U.S. dollars) 3/	725	562	447	474	440	549	413	432	472
External debt (in percent of GDP)	56.4	66.4	71.5	76.2	76.0	79.3	77.0	77.7	78.1
o.w. public debt (in percent of GDP) 4/	35.7	34.7	36.4	38.2	37.6	38.5	38.1	38.8	39.2
Debt service ratio (in percent of exports of goods and services) 4/	5.4	4.7	4.2	9.8	15.6	34.1	10.4	6.3	6.7
Gross international reserves (in millions of U.S. dollars)	2,004	1,866	1,869	1,799	1,467	2,253	2,193	2,278	2,376
Import cover 5/	5.7	4.7	4.6	4.3	3.3	5.2	4.9	4.9	4.9
Nominal effective exchange rate (percent change) 6/	-8.4	-2.6	-2.8	-7.3	…	…	…	…	…
Real effective exchange rate (percent change) 6/	-7.5	1.3	0.0	-6.1	…	…	…	…	…
End-of-period exchange rate (dram per U.S. dollar)	378	363	385.8	403.6	…	405.6	…	…	…
Average exchange rate (dram per U.S. dollar)	363	374	372.5	401.8	…	406.8	…	…	…
Memorandum item:									
Population (in millions)	3.2	3.3	3.3	3.3	…	…	…	…	…

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

1/ From 2013, tax revenue includes social contribution.

2/ In 2013 includes 1.5 percent of GDP related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom, and the transfer (expenditure) of the same amount from the government to ArmRusGazprom to liquidate liabilities. Excluding this transaction, the deficit would amount to 1 percent of GDP.

3/ In 2013, a credit for $155 million is registered in FDI to reflect the acquisition by Gazprom of 20 percent of the shares of ArmRusGazprom, while an offseting debit is registered in other capital (net) to reflect the corresponding reduction in liabilities of the latter with the former.

4/ Based on public and publicly-guaranteed debt.

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

6/ A positive sign denotes appreciation.

Table 2. Armenia: Balance of Payments, 2009–17
(In millions of U.S. dollars, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016	2017
	Act.	Act.	Act.	Prel.			Proj.		
Current account	-1,367	-1,373	-1,108	-1,115	-891	-802	-790	-789	-824
Trade balance	-2,081	-2,033	-2,078	-2,119	-2,106	-2,060	-2,080	-2,116	-2,164
Exports, fob	749	1,175	1,580	1,619	1,712	1,830	1,944	2,086	2,237
Imports, fob 1/	-2,830	-3,208	-3,658	-3,738	-3,817	-3,890	-4,024	-4,202	-4,402
Services (net)	-266	-242	-312	-348	-334	-337	-353	-357	-386
Credits	587	762	827	821	871	927	987	1,037	1,078
Debits	-853	-1,004	-1,139	-1,169	-1,204	-1,265	-1,340	-1,394	-1,464
Income (net)	167	339	559	629	759	790	814	834	849
Transfers (net)	814	563	723	723	789	805	829	851	877
Private	733	477	563	629	708	743	781	820	861
Official	81	86	160	94	81	62	48	31	16
Capital and financial account	1,560	1,058	1,050	969	1,528	799	824	889	968
Capital transfers (net)	89	108	96	105	74	73	72	71	71
Foreign direct investment (net) 2/	725	562	447	474	549	413	432	472	496
Portfolio investment (net)	-4	11	-10	1	-1	-52	-60	-60	-60
Public sector borrowing (net)	886	194	152	225	432	212	224	236	281
Disbursements	907	219	180	255	964	251	280	305	365
Amortization	-21	-25	-28	-30	-532	-39	-56	-69	-84
Other capital (net) 2/	-136	184	365	164	474	153	155	170	180
Errors and omissions	-39	18	-29	165	0	0	0	0	0
Overall balance	155	-298	-88	-18	637	-3	33	101	144
Financing	-155	298	88	18	-637	-90	-110	-137	-162
Gross international reserves (increase: -)	-597	138	-4	70	-454	60	-85	-98	-104
Use of Fund credit, net	442	160	92	-52	-183	-150	-25	-39	-57
Purchases/disbursements	466	181	114	103	83	…	…	…	…
Repurchases/repayments	-23	-22	-23	-155	-266	-150	-25	-39	-57
Financing gap	0	0	0	0	0	93	77	36	18
Proposed IMF EFF	0	0	0	0	0	36	36	36	18
Other 3/	0	0	0	0	0	57	41	0	0
Memorandum items:									
Current account (in percent of GDP)	-15.8	-14.8	-10.9	-11.2	-8.4	-7.2	-6.8	-6.6	-6.5
Trade balance (in percent of GDP)	-24.1	-21.9	-20.5	-21.3	-20.0	-18.4	-17.9	-17.6	-16.9
Gross international reserves (end of period)	2,004	1,866	1,869	1,799	2,253	2,193	2,278	2,376	2,480
In months of next year's imports	5.7	4.7	4.6	4.3	5.2	4.9	4.9	4.9	4.8
Merchandise export growth, percent change	-32.7	57.0	34.4	2.5	5.7	6.9	6.2	7.3	7.2
Merchandise import growth, percent change	-25.0	13.4	14.0	2.2	2.1	1.9	3.4	4.4	4.8
Nongas merchandise imports growth, percent change		11.2	7.3	0.6	0.6	7.6	3.3	4.4	4.8
Nominal external debt	4,878	6,145	7,252	7,586	8,362	8,640	9,021	9,400	9,765
o.w. public external debt	2,967	3,299	3,568	3,738	4,040	4,166	4,392	4,601	4,787
Nominal external debt stock (in percent of GDP)	56.4	66.4	71.5	76.2	79.3	77.0	77.7	78.1	76.5
External public debt-to-exports ratio (in percent)	222.1	170.3	148.2	153.2	156.5	151.1	149.8	147.3	144.4
External public debt service (in percent of exports)	5.4	4.7	4.2	9.8	33.8	10.3	6.2	6.6	7.1

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

1/ From 2014 on, imports of gas are calculated at the (lower) price of $189 per thousand cubic meter. In addition to reducing projected gas imports in 2014, this change also implies lower FDI (lower intercompany lending between parent and subsidiary)

2/ In 2013, a credit for $155 million is registered in FDI to reflect the acquisition by Gazprom of 20 percent of the shares of ArmRusGazprom, while an offseting debit is registered in other capital (net) to reflect the corresponding reduction in liabilities of the latter with the former.

3/ Prospective EU financing. The authorities have requested new Macro Financial Assistance from the EU.

Table 3. Armenia: Monetary Accounts, 2009–14
(In billions of drams, unless otherwise indicated)

	2009	2010	2011	2012	2013				2014			
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
	Act.	Act.	Act.	Act.	Act.	Act.	Prel.	Proj.	Proj. 1/	Proj. 1/	Proj. 1/	Proj. 1/
Central Bank of Armenia												
Net foreign assets	515.4	423.8	465.0	467.2	436.3	418.1	704.9	651.4	485.9	486.5	502.6	628.6
Net international reserves	595.8	500.6	521.2	538.7	509.1	490.7	816.9	764.3	603.8	605.6	624.1	751.3
Other	-80.5	-76.9	-56.3	-71.5	-72.8	-72.6	-112.0	-112.9	-117.9	-119.1	-121.5	-122.7
Net domestic assets	-3.7	83.8	206.3	216.6	208.7	241.1	17.7	236.7	241.0	267.6	282.7	339.2
Claims on general government (net)	-152.5	-95.6	-66.7	-93.3	-104.5	-101.1	-406.1	-194.9	-163.2	-158.0	-163.8	-152.4
Of which: central government (net)	-138.8	-76.7	-54.2	-80.5	-82.3	-80.8	-357.7	-146.4	-114.8	-109.6	-115.4	-104.0
Claims on banks	66.2	57.4	137.0	152.9	153.0	158.5	201.2	174.0	189.0	200.2	212.7	223.8
KfW & IBRD	39.1	61.5	90.7	106.4	107.5	102.4	96.6	95.9	100.8	102.1	104.5	105.7
Monetary instruments (net) excluding CBA bills	27.1	-4.1	46.3	46.6	45.5	56.1	104.6	78.2	88.2	98.2	108.2	118.2
CBA bills 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
Other items (net)	82.6	122.0	136.0	157.0	160.2	183.8	222.6	257.5	215.2	225.4	233.9	267.7
Reserve money	511.7	507.6	671.3	683.8	645.0	659.2	722.6	888.1	726.9	754.1	785.3	967.7
Currency issue	320.7	348.2	398.8	440.1	395.6	404.2	408.1	446.8	419.0	427.9	432.0	472.2
Deposits	191.0	159.4	272.5	243.7	249.4	255.0	314.5	441.2	307.9	326.2	353.3	495.5
Deposits in drams	42.3	61.4	169.9	157.7	165.0	150.4	186.0	202.4	186.1	188.7	197.9	226.7
Deposits in foreign currency	148.7	98.0	102.6	86.0	84.4	104.6	128.5	238.8	121.8	137.5	155.4	268.8
Banking system												
Net foreign assets	379.1	193.8	31.9	-124.2	-137.0	-166.5	158.2	-58.8	-124.9	-153.2	-167.7	-163.0
Net domestic assets	444.9	717.4	1,094.7	1,471.2	1,499.7	1,553.5	1,303.9	1,610.9	1,655.9	1,718.5	1,778.1	1,890.8
Claims on government (net)	-125.3	-50.9	-1.8	17.0	5.0	13.2	-278.2	-67.0	-31.7	-22.9	-25.1	-10.1
Of which: claims on central government (net)	-111.6	-32.0	10.7	29.8	27.2	33.5	-229.8	-18.6	16.7	25.5	23.3	38.3
Claims on rest of the economy	728.3	922.9	1,251.2	1,587.9	1,619.8	1,654.0	1,690.3	1,777.9	1,782.6	1,831.3	1,888.3	1,980.9
Other items (net)	-158.0	-154.5	-154.7	-133.7	-125.1	-113.6	-108.3	-100.0	-95.0	-90.0	-85.0	-80.0
Broad money	824.0	911.2	1,126.6	1,347.0	1,362.7	1,387.1	1,462.1	1,552.1	1,531.0	1,565.2	1,610.4	1,727.8
Currency in circulation	282.7	304.5	349.6	384.3	344.4	352.3	355.8	384.9	361.6	369.9	373.6	404.1
Deposits	541.3	606.7	777.0	962.7	1,018.3	1,034.8	1,106.2	1,167.2	1,169.4	1,195.3	1,236.8	1,323.7
Domestic currency	170.7	216.7	306.5	355.9	372.7	384.4	410.5	470.2	432.3	438.3	459.8	526.6
Foreign currency	370.6	389.9	470.5	606.8	645.6	650.3	695.7	697.0	737.0	757.0	777.0	797.0
Memorandum items:												
Exchange rate (in drams per U.S. dollar, end of period)	377.9	363.4	385.8	403.6	418.6	409.9	405.3	405.6	…	…	…	…
NIR, program definition, at program exchange rates (in millions of U.S. dollars)	1,019	892	794	830	767	712	1,446	1,068	1,004	1,002	1,020	1,078
12-month change in reserve money (in percent)	13.8	-0.8	32.3	1.9	16.5	17.0	19.7	29.9	12.7	14.4	8.7	9.0
12-month change in broad money (in percent)	16.4	10.6	23.6	19.6	20.4	15.7	15.1	15.2	12.3	12.8	10.1	11.3
12-month change in private sector credit (in percent)	14.0	26.7	35.6	26.9	20.9	11.8	12.1	12.0	10.1	10.7	11.7	11.4
Velocity of broad money (end of period)	3.8	3.8	3.4	3.0	3.0	2.9	2.8	2.8	2.9	2.9	2.8	2.7
Money multiplier	1.6	1.8	1.7	2.0	2.1	2.1	2.0	1.7	2.1	2.1	2.1	1.8
Dollarization in bank deposits 3/	68.5	64.3	60.6	63.0	63.4	62.8	62.9	59.7	63.0	63.3	62.8	60.2
Dollarization in broad money 4/	45.0	42.8	41.8	45.0	47.4	46.9	47.6	44.9	48.1	48.4	48.3	46.1
Currency in circulation in percent of deposits	52.2	50.2	45.0	39.9	33.8	34.0	32.2	33.0	30.9	30.9	30.2	30.5
Stock of foreign currency deposits (in millions of U.S. dollars) 1/	980.8	1,012.9	1,222.2	1,576.1	1,677.0	1,689.2	1,696.9	1,700.1	1,797.7	1,846.5	1,895.2	1,944.0
Banking system financing of the central government (cumulative) 5/	-86.4	79.6	42.7	19.1	-2.7	3.7	-259.6	-48.4	35.2	44.1	41.8	56.9
Banks' deposits at CBA to deposits in banking system (in percent)	35.3	26.3	35.1	25.3	24.5	24.6	28.4	37.8	26.3	27.3	28.6	37.4

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

1/ At the program exchange rate. Program exchange rate changes to 410 dram per U.S. dollar from September 2013.
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 exp lained by government lending to the economy through commercial banks.

Table 4. Armenia: Financial Soundness Indicators for the Banking Sector, 2009–13
(In percent, unless otherwise indicated)

	2009	2010	2011	2012				2013			
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Capital adequacy											
Total regulatory capital to risk-weighted assets	28.3	22.2	18.3	17.8	16.8	17.2	16.8	16.4	16.3	16.5	16.7
Capital (net worth) to assets	21.0	20.4	17.2	17.8	16.5	16.3	15.9	15.5	15.4	15.6	15.3
Asset composition											
Sectoral distribution of loans (in billions of drams)											
Industry (excluding energy sector)	115.3	156.7	178.6	205.5	231.8	242.8	250.3	196.4	204.8	210.2	222.7
Energy sector	31.7	47.2	77.5	79.5	62.6	66.2	74.9	78.3	86.3	91.2	95.4
Agriculture	44.2	52.4	80.7	87.9	102.6	97.6	101.4	109.3	116.7	110.2	118.2
Construction	54.1	74.8	96.0	97.6	108.6	103.3	100.1	103.9	103.4	103.2	109.4
Transport and communication	15.4	25.7	50.9	52.2	42.2	50.5	48.3	50.0	50.8	49.1	54.0
Trade/commerce	145.5	184.8	275.7	298.0	327.3	321.9	321.0	341.6	334.5	341.9	352.3
Sectoral distribution of loans to total loans (percent of total)											
Industry (excluding energy sector)	16.5	17.7	14.0	15.2	14.3	15.6	15.5	11.6	11.7	11.8	12.2
Energy sector	4.5	5.3	6.1	5.9	3.9	4.2	4.6	4.6	5.0	5.1	5.2
Agriculture	6.3	5.9	6.3	6.5	6.3	6.3	6.3	6.5	6.7	6.2	6.5
Construction	7.7	8.4	7.5	7.2	6.7	6.6	6.2	6.1	5.9	5.8	6.0
Transport and communication	2.2	2.9	4.0	3.8	2.6	3.2	3.0	3.0	2.9	2.8	3.0
Trade/commerce	20.8	20.9	21.6	22.0	20.3	20.6	19.9	20.2	19.2	19.3	19.3
Foreign exchange loans to total loans	54.0	58.0	61.2	62.7	64.6	64.4	64.7	66.0	65.0	64.6	63.8
Asset quality											
Nonperforming loans (in billions of drams)	36.3	28.6	43.7	66.4	66.1	78.2	58.4	91.9	101.1	94.7	79.7
Watch (up to 90 days past due)	14.9	11.3	18.8	43.1	32.0	44.1	26.5	61.4	63.3	46.4	41.4
Substandard (91-180 days past due)	10.1	11.3	15.6	12.2	23.1	18.5	19.0	14.4	22.7	35.0	19.5
Doubtful (181-270 days past due)	11.3	6.1	9.3	11.1	11.0	15.6	12.8	16.1	15.2	13.4	18.8
Loss (>270 days past due)	26.2	34.6	45.2	65.8	75.5	74.4	77.4	87.8	95.0	102.5	108.0
Nonperforming loans to gross loans	4.8	3.1	3.4	4.9	4.1	5.0	3.6	5.5	5.9	5.4	4.5
Provisions to nonperforming loans	46.7	56.7	55.4	43.2	47.9	44.3	55.1	40.7	39.1	41.7	49.5
Spread between highest and lowest rates of interbank borrowing in AMD	2.5	4.0	1.5	3.0	3.0	3.5	1.0	0.8	1.3	1.0	2.2
Spread between highest and lowest rates of interbank borrowing in foreign currency	3.0	5.0	5.3	2.5	5.0	9.5	9.5	2.0	8.8	2.0	6.3
Earnings and profitability											
ROA (profits to period average assets)	0.7	2.2	1.9	1.5	1.5	2.2	1.9	0.6	1.0	1.2	1.4
ROE (profits to period average equity)	3.4	10.2	9.8	8.7	8.6	12.9	11.5	4.0	6.1	8.0	9.2
Interest margin to gross income	42.2	43.8	42.0	45.5	43.1	42.0	40.6	36.5	37.9	37.7	37.1
Interest income to gross income	78.3	77.0	78.3	82.7	81.6	80.9	80.0	80.5	80.5	80.2	79.1
Noninterest expenses to gross income	40.7	39.2	36.4	33.5	34.1	33.3	34.2	32.6	33.2	32.6	33.0
Liquidity											
Liquid assets to total assets	34.2	29.5	27.9	26.6	24.4	25.3	25.6	26.1	26.1	26.3	29.1
Liquid assets to total short-term liabilities	142.1	131.5	120.8	126.4	118.1	127.6	126.1	136.1	127.1	136.9	142.3
Customer deposits to total (non-interbank) loans	96.4	87.2	91.5	85.5	85.0	89.2	92.6	96.1	98.4	99.3	105.6
Foreign exchange liabilities to total liabilities	67.6	64.9	63.3	63.4	65.6	65.9	64.9	66.4	66.0	64.7	64.1
Sensitivity to market risk											
Gross open positions in foreign exchange to capital	3.4	2.9	3.0	3.1	2.9	2.5	3.8	3.0	2.8	2.7	3.7
Net open position in FX to capital	1.9	-0.2	-0.9	-0.9	-0.2	1.2	1.6	1.3	0.5	0.8	0.1

Source: Central Bank of Armenia.

Table 5. Armenia: Central Government Operations, 2009–16
(in billions of drams)

	2009	2010	2011	2012	2013		2014	2015	2016
	Act.	Act.	Act.	Prel.	EBS/13/75	Proj. 2/	Proj.	Proj.	Proj.
Total revenue and grants	655.6	734.3	834.5	892.6	1010.3	998.6	1108.1	1194.8	1317.5
Total revenue	634.4	706.1	776.6	875.7	992.3	989.3	1088.2	1181.9	1304.5
Tax revenues 1/	505.9	568.9	629.6	723.4	943.9	967.0	1069.9	1162.1	1282.9
VAT	239.2	278.1	301.5	340.4	371.9	376.0	413.1	449.0	494.5
Profits, simplified and presumptive	104.9	99.7	143.8	164.5	183.8	178.4	197.2	213.2	233.0
Personal income tax	60.2	73.9	81.2	91.7	241.2	262.6	287.1	312.5	345.8
Customs duties	25.1	29.4	34.7	41.3	45.1	44.3	51.8	56.3	61.4
Other	76.5	87.8	68.4	85.6	101.8	105.6	120.7	131.0	148.2
Social contributions	102.9	105.3	123.4	129.1	26.1	0.0	0.0	0.0	0.0
Other revenue	25.6	31.8	23.6	23.2	22.3	22.3	18.3	19.9	21.6
Grants	21.2	28.2	57.9	16.9	18.0	9.3	19.9	12.9	13.0
Budget support	10.3	5.4	28.4	10.5	6.4	0.0	7.0		
Project grants	9.0	22.8	29.5	6.4	11.6	9.3	12.9		
Total expenditure	897.1	906.6	943.1	956.3	1109.3	1105.5	1218.5	1299.3	1418.0
Expense 2/	712.0	727.9	788.7	852.4	929.9	965.4	1065.8	1135.4	1233.9
Wages	184.3	187.3	190.5	194.3	118.3	218.2	256.0	278.2	302.9
Social Contributions	4.6	4.5	4.7	4.8	0.0	0.0	0.0	0.0	0.0
Pension Co-payment	0.0	0.0	0.0	0.0	0.0	0.0	20.7	26.7	32.6
Subsidies	5.4	3.4	4.3	4.6	20.1	4.1	8.0	8.0	8.7
Interest	16.2	30.2	35.2	40.2	52.5	49.5	63.4	71.3	82.7
Social allowances and pensions	239.9	241.7	255.1	287.4	302.3	302.3	343.7	373.5	406.7
Pensions/social security benefits	176.0	176.8	186.6	197.5	197.6	197.6	236.3	256.8	279.6
Social assistance benefits	64.0	64.9	68.5	89.9	85.2	85.2	87.9	97.2	107.6
Employer social benefits	0.0	0.0	0.0	12.1	19.5	19.5	19.5	19.5	19.5
Goods and services	79.0	84.2	95.4	132.6	192.7	96.3	144.4	145.9	158.9
Grants	62.0	66.6	69.2	71.4	77.8	77.8	86.9	77.8	84.7
Other expenditure 3/	120.5	110.1	134.3	117.1	166.4	217.3	142.6	153.9	156.7
Transactions in nonfinancial assets	185.1	178.7	154.4	103.9	179.4	140.2	152.7	163.9	184.1
Acquisition of nonfinancial assets	195.7	179.2	157.7	106.6	179.4	140.2	152.7	163.9	184.1
Disposals of nonfinancial assets	10.6	0.5	3.3	2.7	0.0	0.0	0.0	0.0	0.0
			0.0						
Overall balance (above-the-line)	-241.5	-172.3	-108.7	-63.8	-99.0	-107.0	-110.4	-104.5	-100.5
Statistical discrepancy	-6.2	13.2	2.9	2.1	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-247.7	-159.1	-105.8	-61.6	-99.0	-107.0	-110.4	-104.5	-100.5
Financing	247.7	159.1	105.8	61.6	99.0	107.0	110.4	104.5	100.5
Domestic financing	-108.5	96.5	62.7	6.8	52.0	-55.2	69.5	32.1	43.5
Banking system 4/	-40.0	95.6	55.1	20.1	28.0	-48.4	56.9	18.0	27.5
CBA	-54.4	62.1	22.4	-26.3	2.1	-65.9	42.5	2.0	7.4
Commercial Banks	14.4	33.5	32.7	46.4	25.9	17.5	14.4	16.0	20.1
Nonbanks	-68.5	0.9	7.6	-13.2	23.9	-7.9	12.6	14.2	16.1
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills	8.7	5.5	4.3	-24.6	6.0	-11.9	3.6	3.9	4.9
Promissory note/other	-3.2	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-74.0	-2.6	3.4	11.4	17.9	4.0	9.0	10.2	11.2
External financing	356.2	62.5	43.0	54.8	47.1	162.1	26.9	57.7	57.0
Gross inflow 5/ 3/	395.6	105.3	88.9	118.4	157.3	455.5	105.5	123.6	132.0
Amortization due	-6.3	-9.7	-10.8	-27.9	-70.9	-254.0	-40.9	-24.9	-30.5
Net lending	-33.1	-33.1	-35.1	-35.6	-39.3	-39.3	-37.7	-41.0	-44.6
Other financing 6/	…	…	…	…	0.0	0.0	14.0	14.7	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	3,142	3,460	3,778	3,998	4,351	4,290	4,714	5,123	5,578
Program balance 7/	-354.8	-124.4	-137.5	-85.9	-120.4	-78.9	-139.1	…	…
Debt-creating fiscal balance 8/	-274.6	-205.4	-143.7	-99.4	-138.3	-82.9	-148.1	-145.5	-145.1
T-bill issuance	45.4	30.2	30.3	30.8	30.2	20.3	…	…	…

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

1/ From 2013, tax revenue includes social contribution.
2/ Composition of expense reclassified in November 2013 to account for wage bill more accurately.
3/ In 2013 includes AMD 63 billion related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom (gross inflow), and the transfer (other expenditure) of the same amount from the government to ArmRusGazprom to liquidate liabilities. Excluding this transaction, the deficit would amount to AMD 43.6 billion, or 1 percent of GDP.
4/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.
5/ Includes IMF budget support.
6/ Prospective EU financing. The authorities have requested new Macro Financial Assistance from the EU.
7/ The program balance is measured as below-the-line overall balance minus net lending, except from 2010 to 2011Q1, where project financing is also subtracted.
8/ Sum of overall balance (above-the-line) and external net lending. In 2013, it excludes the transfer associated to the acquisition of ArmRusGazprom by Gazprom, since it was financed with the sale of the government's shares in the company.

Table 6. Armenia: Central Government Operations, 2009–16
(In percent of GDP, unless otherwise specified)

	2009	2010	2011	2012	2013		2014	2015	2016
	Act.	Act.	Act.	Prel.	EBS/13/75	Proj. 2/	Proj.	Proj.	Proj.
Total revenue and grants	20.9	21.2	22.1	22.3	23.2	23.3	23.5	23.3	23.6
Total revenue	20.2	20.4	20.6	21.9	22.8	23.1	23.1	23.1	23.4
Tax revenues 1/	16.1	16.4	16.7	18.1	21.7	22.5	22.7	22.7	23.0
VAT	7.6	8.0	8.0	8.5	8.5	8.8	8.8	8.8	8.9
Profits, simplified and presumptive	3.3	2.9	3.8	4.1	4.2	4.2	4.2	4.2	4.2
Personal income tax	1.9	2.1	2.1	2.3	5.5	6.1	6.1	6.1	6.2
Customs duties	0.8	0.8	0.9	1.0	1.0	1.0	1.1	1.1	1.1
Other	2.4	2.5	1.8	2.1	2.3	2.5	2.6	2.6	2.7
Social contributions	3.3	3.0	3.3	3.2	0.6	0.0	0.0	0.0	0.0
Other revenue	0.8	0.9	0.6	0.6	0.5	0.5	0.4	0.4	0.4
Grants	0.7	0.8	1.5	0.4	0.4	0.2	0.4	0.3	0.2
Budget support	0.3	0.2	0.8	0.3	0.1	0.0	0.1		
Project grants	0.3	0.7	0.8	0.2	0.3	0.2	0.3		
Total expenditure	28.6	26.2	25.0	23.9	25.5	25.8	25.9	25.4	25.4
Expense 2/	22.7	21.0	20.9	21.3	21.4	22.5	22.6	22.2	22.1
Wages	5.9	5.4	5.0	4.9	2.7	5.1	5.4	5.4	5.4
Social Contributions	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Pension Co-payment	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.5	0.6
Subsidies	0.2	0.1	0.1	0.1	0.5	0.1	0.2	0.2	0.2
Interest	0.5	0.9	0.9	1.0	1.2	1.2	1.3	1.4	1.5
Social allowances and pensions	7.6	7.0	6.8	7.2	6.9	7.0	7.3	7.3	7.3
Pensions/social security benefits	5.6	5.1	4.9	4.9	4.5	4.6	5.0	5.0	5.0
Social assistance benefits	2.0	1.9	1.8	2.2	2.0	2.0	1.9	1.9	1.9
Employer social benefits	0.0	0.0	0.0	0.3	0.4	0.5	0.4	0.4	0.3
Goods and services	2.5	2.4	2.5	3.3	4.4	2.2	3.1	2.8	2.8
Grants	2.0	1.9	1.8	1.8	1.8	1.8	1.8	1.5	1.5
Other expenditure 3/	3.8	3.2	3.6	2.9	3.8	5.1	3.0	3.0	2.8
Transactions in nonfinancial assets	5.9	5.2	4.1	2.6	4.1	3.3	3.2	3.2	3.3
Acquisition of nonfinancial assets	6.2	5.2	4.2	2.7	4.1	3.3	3.2	3.2	3.3
Disposals of nonfinancial assets	0.3	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-7.7	-5.0	-2.9	-1.6	-2.3	-2.5	-2.3	-2.0	-1.8
Statistical discrepancy	-0.2	0.4	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-7.9	-4.6	-2.8	-1.5	-2.3	-2.5	-2.3	-2.0	-1.8
Financing	7.9	4.6	2.8	1.5	2.3	2.5	2.3	2.0	1.8
Domestic financing	-3.5	2.8	1.7	0.2	1.2	-1.3	1.5	0.6	0.8
Banking system 4/	-1.3	2.8	1.5	0.5	0.6	-1.1	1.2	0.4	0.5
CBA	-1.7	1.8	0.6	-0.7	0.0	-1.5	0.9	0.0	0.1
Commercial Banks	0.5	1.0	0.9	1.2	0.6	0.4	0.3	0.3	0.4
Nonbanks	-2.2	0.0	0.2	-0.3	0.6	-0.2	0.3	0.3	0.3
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills	0.3	0.2	0.1	-0.6	0.1	-0.3	0.1	0.1	0.1
Promissory note/other	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-2.4	-0.1	0.1	0.3	0.4	0.1	0.2	0.2	0.2
Of which: financed with the Russian loan	-2.5	0.1	0.1	0.3	0.0	0.0	0.0	0.0	0.0
External financing	11.3	1.8	1.1	1.4	1.1	3.8	0.6	1.1	1.0
Gross inflow 5/ 3/	12.6	3.0	2.4	3.0	3.6	10.6	2.2	2.4	2.4
Amortization due	-0.2	-0.3	-0.3	-0.7	-1.6	-5.9	-0.9	-0.5	-0.5
Net lending	-1.1	-1.0	-0.9	-0.9	-0.9	-0.9	-0.8	-0.8	-0.8
Other financing	…	…	…	…	0.0	0.0	0.3	0.3	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	3,142	3,460	3,778	3,998	4,351	4,290	4,714	5,123	5,578
Program balance 7/	-11.3	-3.6	-3.6	-2.1	-2.8	-1.8	-3.0	…	…
Debt-creating fiscal balance 8/	-8.7	-5.9	-3.8	-2.5	-3.2	-1.9	-3.1	-2.8	-2.6
T-bill issuance	1.4	0.9	0.8	0.8	0.7	0.5	…	…	…

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

1/ From 2013, tax revenue includes social contribution.
2/ Composition of expense reclassified in November 2013 to account for wage bill more accurately.
3/ In 2013 includes 1.5 percent of GDP related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom (gross inflow), and the transfer (other expenditure) of the same amount from the government to ArmRusGasprom to liquidate liabilities. Excluding this transaction, the deficit would amount to 1 percent of GDP.
4/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.
5/ Includes IMF budget support.
6/ Prospective EU financing. The authorities have requested new Macro Financial Assistance from the EU.
7/ The program balance is measured as below-the-line overall balance minus net lending, except from 2010 to 2011Q1, where project financing is also subtracted.
8/ Sum of overall balance (above-the-line) and external net lending. In 2013, it excludes the transfer associated to the acquisition of ArmRusGazprom by Gazprom, since it was financed with the sale of the government's shares in the company.

Table 7. Armenia: Medium-Term Macroeconomic Framework, 2009–18
(In percent of GDP, unless otherwise specified)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Act.	Act.	Act.	Prel.			Projections			
National income and prices										
Real GDP (percent change)	-14.1	2.2	4.7	7.1	3.2	4.3	4.5	4.7	5.0	5.0
Gross domestic product (in millions of U.S. dollars)	8,648	9,260	10,142	9,950	10,547	11,216	11,609	12,039	12,770	13,806
Gross national income per capita (in U.S. dollars)	2,713	2,942	3,268	3,224	3,439	3,645	3,764	3,892	4,110	4,418
CPI inflation, period average (percent change)	3.5	7.3	7.7	2.5	5.8	5.0	4.0	4.0	4.0	4.0
Investment and saving										
Investment	33.8	29.4	27.0	22.8	23.9	24.4	24.9	25.5	26.2	26.9
Private	27.9	24.3	22.9	20.2	20.7	21.2	21.7	22.2	22.7	23.2
Public	5.9	5.2	4.1	2.6	3.3	3.2	3.2	3.3	3.5	3.7
National savings	18.0	14.6	16.1	11.6	15.5	17.3	18.1	18.9	19.7	20.4
Private	19.8	14.4	14.9	10.6	14.7	16.4	16.9	17.4	18.0	18.5
Public	-1.8	0.2	1.2	1.0	0.8	0.9	1.2	1.5	1.7	1.9
Central government operations										
Revenue and grants	20.9	21.2	22.1	22.3	23.3	23.5	23.3	23.6	23.8	24.0
Of which: tax revenue	16.1	16.4	16.7	18.1	22.5	22.7	22.7	23.0	23.3	23.5
grants	0.7	0.8	1.5	0.4	0.2	0.4	0.3	0.2	0.2	0.1
Expenditure	28.6	26.2	25.0	23.9	25.8	25.9	25.4	25.4	25.6	25.8
Current expenditure 1/	22.7	21.0	20.9	21.3	22.5	22.6	22.2	22.1	22.1	22.1
Capital expenditure	5.9	5.2	4.1	2.6	3.3	3.2	3.2	3.3	3.5	3.7
Overall balance on a cash basis 1/	-7.9	-4.6	-2.8	-1.5	-2.5	-2.3	-2.0	-1.8	-1.8	-1.8
Domestic financing	-3.5	2.8	1.7	0.2	-1.3	1.5	0.6	0.8	1.1	0.6
External financing 1/	11.3	1.8	1.1	1.4	3.8	0.6	1.1	1.0	0.7	1.2
Unidentified financing	…	…	…	…	0.0	0.3	0.3	0.0	0.0	0.0
Public and publicly-guaranteed debt	40.2	39.7	42.0	44.0	45.4	45.2	46.0	46.2	45.1	44.2
External sector										
Exports of goods and services	15.4	20.9	23.7	24.5	24.5	24.6	25.3	25.9	26.0	25.4
Imports of goods and services	42.6	45.5	47.3	49.3	47.6	46.0	46.2	46.5	45.9	44.7
Current account (in percent of GDP)	-15.8	-14.8	-10.9	-11.2	-8.4	-7.2	-6.8	-6.6	-6.5	-6.5
Current account (in millions of U.S. dollars)	-1,367	-1,373	-1,108	-1,115	-891	-802	-790	-789	-824	-897
Capital and financial account (in millions of U.S. dollars)	1,560	1,058	1,050	969	1,528	799	824	889	968	1,072
Of which: direct foreign investment 2/	725	562	447	474	549	413	432	472	496	521
public sector disbursements	907	219	180	255	964	251	280	305	365	421
Change in gross international reserves (in millions of U.S. dollars) 3/	-597	138	-4	70	-454	60	-85	-98	-104	-104
Arrears and debt relief (in millions of U.S. dollars)	0	0	0	0	0	0	0	0	0	0
Financing gap (in millions of U.S. dollars)	0	0	0	0	0	93	77	36	18	0
Of which: IMF	0	0	0	0	0	36	36	36	18	0
Other 4/	0	0	0	0	0	57	41	0	0	0
Gross international reserves in months of imports	5.7	4.7	4.6	4.3	5.2	4.9	4.9	4.9	4.8	4.7
Memorandum items:										
Debt-creating fiscal balance 5/	-8.7	-5.9	-2.2	-2.5	-1.9	-3.1	-2.8	-2.6	-2.6	-2.6

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

1/ In 2013 includes 1.5 percent of GDP related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom (gross inflow), and the transfer (other expenditure) of the same amount from the government to ArmRusGazprom to liquidate liabilities.
Excluding this transaction, the deficit would amount to 1 percent of GDP.
2/ In 2013, a credit for $155 million is registered in FDI to reflect the acquisition by Gazprom of 20 percent of the shares of ArmRusGazprom, while an offseting debit is registered in other capital (net) to reflect the corresponding reduction in liabilities of the latter with the former.
3/ A negative figure indicates an increase.
4/ Prospective EU financing. The authorities have requested new Macro Financial Assistance from the EU.
5/ Sum of overall balance (above-the-line) and external net lending. In 2014, it excludes the transfer associated to the acquisition of ArmRusGazprom by Gazprom, since it was financed with the sale of the government's shares in the company.

Table 8. Indicators of Capacity to Repay the Fund, 2011–19 1/

			Projections						
	2011	2012	2013	2014	2015	2016	2017	2018	2019
Fund obligations based on existing credit									
(in millions of SDRs)									
Principal	14.4	101.0	175.5	98.1	16.4	25.3	36.9	44.2	48.9
Charges and interest	7.9	5.4	1.6	2.3	2.0	1.8	1.7	1.4	1.1
Total obligations based on existing and prospective credit									
In millions of SDRs	22.4	108.9	177.7	100.6	18.9	27.9	39.5	47.5	55.8
In millions of U.S. dollars	35.3	166.8	269.1	153.6	29.1	43.2	61.1	73.5	86.3
In percent of gross international reserves	1.9	9.3	11.9	7.0	1.3	1.8	2.5	2.8	3.1
In percent of exports of goods and services	1.5	6.8	10.4	5.6	1.0	1.4	1.8	2.1	2.2
In percent of debt service 2/	33.6	66.0	65.3	55.1	16.5	25.0	34.0	40.2	46.9
In percent of GDP	0.3	1.7	2.6	1.4	0.3	0.4	0.5	0.5	0.6
In percent of quota	24.3	118.3	193.2	109.3	20.6	30.3	42.9	51.6	60.6
Outstanding Fund credit based on existing credit 2/									
In millions of SDRs	539.0	505.0	379.7	281.7	265.2	240.0	203.1	158.9	110.0
In billions of U.S. dollars	0.9	0.8	0.6	0.4	0.4	0.4	0.3	0.2	0.2
In percent of gross international reserves	45.5	43.0	25.5	19.6	17.9	15.6	12.7	9.5	6.0
In percent of exports of goods and services	35.4	31.7	22.3	15.6	13.9	11.9	9.5	7.0	4.4
In percent of debt service 2/	810.6	306.0	139.5	154.4	231.5	215.3	175.1	134.5	92.4
In percent of GDP	8.4	7.8	5.5	3.8	3.5	3.1	2.5	1.8	1.1
In percent of quota	585.8	548.9	412.8	306.2	288.3	260.8	220.7	172.7	119.5
Net use of Fund credit based on existing and prospective credit (in millions of SDRs)	58.0	-34.0	-120.5	-74.6	7.1	-1.8	-25.1	-45.2	-53.8
Disbursements	72.4	67.0	55.0	23.5	23.5	23.5	11.7	0.0	0.0
Repayments and repurchases	14.4	101.0	175.5	98.1	16.4	25.3	36.9	45.2	53.8
Memorandum items:									
Nominal GDP (in millions of U.S. dollars)	10,142.1	9,950.2	10,547.0	11,216.0	11,609.1	12,039.0	12,769.7	13,806.5	14,929.6
Exports of goods and services (in millions of U.S. dollars)	2,406.9	2,440.4	2,582.5	2,757.2	2,931.7	3,123.1	3,315.7	3,513.5	3,849.6
Gross international reserves (in millions of U.S. dollars)	1,869.5	1,799.4	2,253.0	2,193.1	2,278.0	2,375.6	2,480.1	2,584.5	2,820.5
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 9. Armenia: External Financing Requirements and Sources, 2013–17
(in millions of U.S. dollars unless otherwise indicated)

	2013	2014	2015	2016	2017
		Projections			
Gross Financing Requirements	2,931	1,736	1,785	1,845	1,946
External current account deficit (excl. transfers) (excluding official transfers)	1,680	1,608	1,619	1,639	1,701
Debt amortization and Fund repurchases	797	188	56	69	84
Gross international reserve accumulation	454	-60	85	98	104
Available financing	2,849	1,643	1,708	1,809	1,928
Capital Account and Current Transfers	2,849	1,643	1,708	1,809	1,928
Capital transfers (net)	74	73	72	71	71
of which: Foreign Direct Investment	549	413	432	472	496
Public Borrowing 1/	964	251	224	236	281
Private transfers	708	743	781	820	861
Commercial banks net flows	734	230	245	260	270
Financing gap	83	93	77	36	18
Exceptional Financing	83	93	77	36	18
Of which: IMF new program	0	36	36	36	18
Other 2/	0	57	41	0	0
Memorandum item:					
Current Account deficit, percent of GDP	-8.4	-7.2	-6.8	-6.6	-6.5
Fiscal balance, percent of GDP	-2.5	-2.3	-2.0	-1.8	-1.8
Net International Reserves	1,887	1,856	2,011	2,072	2,120
Gross Reserves	2,253	2,193	2,278	2,376	2,480
In months of prospective imports	5.2	4.9	4.9	4.9	4.8

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

1/ Includes $72 million of DPO with World Bank in 2013.

2/ Prospective EU financing. The authorities have requested new Macro Financial Assistance from the EU.

Table 10. Fund Disbursements and Timing of Review Under a 38-Month Arrangement Under the Extended Fund Facility

Date of Availability	Conditions	Amount (millions of SDRs)	Percent of Quota
		EFF	EFF
March 7, 2014	Board approval of the arrangement	11.74	12.76
September 30, 2014	Observance of end-June 2014 performance criteria and completion of first review	11.74	12.76
March 30, 2015	Observance of end-December 2014 performance criteria and completion of second review	11.74	12.76
September 30, 2015	Observance of end-June 2015 performance criteria and completion of third review	11.74	12.76
March 30, 2016	Observance of end-December 2015 performance criteria and completion of fourth review	11.74	12.76
September 30, 2016	Observance of end-June 2016 performance criteria and completion of fifth review	11.74	12.76
March 30, 2017	Observance of end-December 2016 performance criteria and completion of sixth review	11.77	12.79
	Total	82.21	89.36

Source: Fund staff estimates and projections.

Appendix I. Letter of Intent

Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Yerevan, February 17, 2014

Dear Madam Lagarde:

1. **Armenia has made significant progress in recovering from the global financial crisis and reorienting its economy**. External and fiscal imbalances have been reduced, and the engine of growth has shifted from construction to agriculture, industry, and services. Under the 2010–13 IMF-supported program, growth was reestablished following a contraction of 14 percent in 2009, the overall fiscal deficit was reduced by six percentage points of GDP to below the debt stabilizing level of 2 percent of GDP in both 2012 and 2013, and the external current account deficit was lowered from nearly 16 percent of GDP in 2009 to 8½ percent of GDP in 2013, as exports and remittances have grown strongly in recent years. Important structural reforms have taken place in tax policy and revenue administration, the financial sector, pensions, and the business environment. Six program reviews under the Extended Fund Facility (EFF) and Extended Credit Facility (ECF) arrangements were completed with few delays or missed targets.

2. **Despite this success, important challenges remain**. Poverty increased with the crisis, and unemployment remains high. While activity has recovered, growth slowed significantly in 2013. Social and investment outlays should be increased to strengthen growth and ensure that it is sustainable, resilient, and inclusive. The external current account deficit and high dollarization in the financial system remain sources of vulnerability. Reserves of the Central Bank of Armenia (CBA) are healthy and were boosted by proceeds from the September 2013 Eurobond and foreign exchange (FX) market purchases in 2013; however, reserves are expected to decline in 2014, due in part to payments to the IMF. The reduction of the external current account deficit has been supported by the significant fiscal adjustment, which has reflected capital underspending in recent years. Further external adjustment will need to be driven by the private sector, although stepped-up private investment is also required. While structural reforms advanced under the Fund-supported program, private and foreign investment has not picked up strongly, and further business environment improvements targeting improved competition, competitiveness, connectivity, and regional integration would help shift private activity from consumption to investment.

3. **Recognizing that these important medium-term challenges remain, we request the approval of a new 38-month arrangement under the EFF in an amount equivalent to SDR 82.21 million (89.4 percent of quota).** We believe that such an arrangement would be the most appropriate way to support our program, as laid out in our new Armenian Development Strategy 2013–2025 and described in the attached Memorandum of Economic and Financial Policies (MEFP). We also request that an amount equivalent to SDR 11.74 million be made available upon

approval of the program. We believe that the policies outlined in the MEFP are adequate to help us achieve our program objectives.

4. We will maintain a close policy dialogue with the Fund and stand ready to take additional measures, as appropriate, to ensure the achievement of our social and economic objectives under the Fund–supported 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 MEFP, in accordance with the Fund's policies on such consultation. We will also provide the Fund with information it requests for monitoring program implementation. The program's proposed performance criteria (PCs), indicative targets (ITs), and structural benchmarks (SBs) are set out in Tables 1 and 2 and described in the attached Technical Memorandum of Understanding (TMU).

5. 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/
David Sargsyan
Minister of Finance
Republic of Armenia

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

Attachment I. Memorandum of Economic and Financial Policies

A. Recent Developments

1. Economic activity slowed in 2013, while inflation picked up. After accelerating to over 7 percent in 2012, led by agriculture, agro-processing, mining, and services, growth slowed to just over 3 percent in 2013, with the trade and services sectors slowing and construction again declining. A deceleration in the global and regional economy, energy price hikes, a tight fiscal position, and a slowing of credit growth were contributing factors. Higher food prices and energy tariff increases in July drove headline inflation (y-o-y) to 9.3 percent in August, well above the target band of the Central Bank of Armenia (CBA) of 4±1.5 percent. Inflation subsequently declined to 5.6 percent at end-year. The CBA increased its policy rate by ½ percentage point to 8.5 percent in August 2013, the first change in nearly two years, in order to mitigate possible second-round effects associated with the increase of food, gas, and electricity prices. As inflation was declining rapidly and activity was weaker than expected, the CBA reversed its move in November and cut the policy rate to 7.75 percent in December.

2. We have continued our strict fiscal management. The underlying fiscal deficit in 2013 is projected at 1 percent of GDP, compared with 2.6 percent of GDP in the budget, although preliminary data suggest that the deficit may have been lower. A one-off gas-related transfer amounting to 1.5 percent of GDP, financed by privatization proceeds, would bring the headline fiscal deficit to around 2½ percent of GDP. Revenues achieved the planned amount, but expenditures were lower, due mainly to delays in implementation of externally-financed capital spending.

3. External adjustment accelerated in 2013. Exports and remittances each grew at a healthy pace, led by mining and agro-processing. Together with a modest rise of imports, this contributed to a significant improvement of the external current account deficit. We issued Armenia's debut Eurobond in September, raising $700 million, with a 7-year repayment term, and a yield of 6.25 percent. The offering was four times oversubscribed. We used the proceeds to repay the remainder of a 2009 crisis loan from Russia ($457 million), as well as to reduce domestic financing and boost reserves.

4. Monetary and financial conditions continue to be sound. Growth of broad money and private sector credit continued to decelerate in 2013, but remained relatively strong. Overnight interest rates have remained close to the policy rate and the center of the CBA's interest rate corridor (300 basis points). The banking system remained highly liquid and well-capitalized, although heavily dollarized (two-third of deposits and loans), and with some banks close to the regulatory minimum capital requirement (12 percent). FSIs weakened somewhat in 2013, with NPLs at over 4 percent in December and profitability declining slightly. With the improvement of the external current account, the Armenian dram (AMD) remained stable, and the CBA bolstered its foreign exchange (FX) reserves with purchases in the market. After sales last March, the CBA bought over $100 million, while the dram appreciated by about 3 percent in nominal terms vis-à-vis the dollar.

5. In September, President Sargsyan announced that Armenia will join the Eurasian Customs Union (ECU). Accession to ECU membership will take place according to a road map agreed in December with the Eurasian Commission and the other ECU member countries, Belarus, Kazakhstan, and Russia. Signing of a customs union agreement is expected to take place in May 2014, after negotiation and agreement on a wide range of issues and scores of documents and legislative acts, and followed by ratification by the National Assembly and parliaments of the other ECU states. While the ECU membership decision has meant that a deep and comprehensive free trade agreement (DCFTA) with the European Union (EU) did not go forward, we also remain strongly committed to continuing to strengthen our ties with the EU.

6. Agreement on a new five-year gas supply arrangement with the Russian Federation and Gazprom was reached in December 2013. The agreement contains a new base price of $189 per 1000 m3, which represents a 30 percent discount from what would have been a new price of $270 per 1000 m3. The agreement will ensure a stable and predictable price and save Armenian consumers hundreds of millions of dollars through 2018.

7. Other reforms have advanced. The new mandatory funded pension system was launched on January 1st of this year, and the regulatory and supervisory framework has been progressively put in place. Contributions to individual accounts started in January, and two top-tier European asset management firms are managing funds under the new system. In the financial sector, the CBA recently issued a new regulation on minimum requirements for commercial bank internal controls that will help to make the banking sector more efficient and sound. We have approved a new policy framework for civil aviation to increase competition, improve connectivity, and lower costs, and we are advancing on "open skies" liberalization of the sector. We also continue to make progress reducing red-tape and costs for households and companies through our Regulatory Guillotine initiative.

B. Outlook for 2014 and the Medium Term

8. Growth is expected to pick up in 2014 and over the medium-term. In the absence of shocks, growth is expected to rebound to 4.3 percent this year and reach a trend of 5 percent during the program period, predicated on continued implementation of structural reforms, enhanced regional integration, and a pick-up of public, private, and foreign investment. The slowing of growth in 2013 likely meant that a small negative output gap reemerged.

9. Inflation is expected to return to the CBA's target range in 2014. The main impact of the July electricity and gas tariff increases on inflation was absorbed in 2013, and demand pressures remain moderate due to the gradual growth recovery. Food inflation pressures—which in Armenia are highly linked to movements in international commodity prices—are expected to moderate in 2014, but remain a source of risk given the large food component in Armenia's consumption basket.

10. Fiscal policy aims to provide an impulse this year, while continuing to rebuild buffers and place public debt on a downward trend. The overall fiscal deficit will increase in 2014 from the underlying 2013 outturn, with additional outlays to address important capital and social objectives. We expect to reduce the deficit in 2015 and 2016 back to and below the debt stabilizing deficit level of 2 percent of GDP. This further adjustment is important, as budgetary financing will be increasingly on non-concessional terms. We aim to meet spending needs with gradually increasing revenues.

11. The external current account is expected to strengthen further over the medium-term, reaching its estimated sustainable position during the program period. The external adjustment should be led by the private sector, as the headline fiscal deficit is not expected to be reduced significantly further. The current account deficit is projected to decline by a further 2 percentage points of GDP during 2014–17, reflecting continued strong growth of mining and food exports and lower gas imports. Exports are expected to be supported by infrastructure improvements, structural reforms, continued gains in Russian markets, and inroads in the rest of the ECU and the EU. The external improvement could be even larger if new mines and industrial projects now under development or consideration come on-line. FDI has been sluggish in recent years, but we are confident that our efforts to pursue further structural reforms, business environment improvements, and ECU membership will contribute to higher FDI over the medium-term. Following a peak of IMF repurchases in 2013–14, CBA gross reserves are expected to remain stable at above 4 months of imports over the medium-term, a level warranted by the high level of dollarization.

12. We remain mindful of downside risks present in the global economy and their potential impact on Armenia. Exports and remittances have remained strong, but could fade if the slowdown in Russia deepens. A tightening of global financing conditions could diminish capital inflows to Armenia, slowing investment and growth. On the other hand, agreement with the Russian Federation on a lower gas price limits risks of higher domestic energy prices for the next five years.

C. The New Program

13. The new program aims at consolidating stability and implementing further reforms to support Armenia's continuing transition towards a dynamic emerging market economy. The program targets consolidation of the fiscal adjustment through a gradual continuing increase of tax revenues. This would place debt on a downward path while providing additional resources for social and investment needs. Continued official budgetary support and financing in key social and physical infrastructure areas will be important. Monetary and exchange rate policies will target low inflation and support the external adjustment, while the CBA will maintain its buffers at healthy levels and strengthen its capacity to respond to shocks. The program also supports strong structural reforms to promote greater competition, competitiveness, and regional integration and thereby, higher investment, exports, and growth. These are complex reforms that call for a medium-term arrangement. At the same time, the program aims to be an "exit" from IMF support, with Armenia sustaining market access.

Fiscal Policy

14. Over the next three years, we intend to consolidate the post-crisis fiscal adjustment and to begin to reduce public debt, while addressing social and investment needs. We will seek a gradual reduction of the fiscal deficit in order to achieve a debt-reducing balance during the program. To this effect, we will increase revenues in a growth-friendly way that focuses on tax policy gaps and efficiency- and equity-enhancing tax policy and revenue administration gains, while limiting adverse business climate impacts. This will allow us to reduce the stock of tax credits that has built up in recent years and thereby stimulate private activity and augment spending on public infrastructure, while maintaining a well-targeted safety net and achieving the debt-reducing path for the deficit. We will strengthen execution of public investment spending to enhance predictability of the fiscal path and ensure that the fiscal policy properly addresses the intended targets. A further key objective is to strengthen institutional arrangements for assessing and managing fiscal risks.

15. The 2014 budget represents an important step to achieve these objectives. With growth slowing, it will provide a positive fiscal impulse through increased domestically-financed capital spending and higher pensions and civil service wages after several years of restraint and erosion, which have led to worsening social indicators among the elderly and difficulties attracting and retaining well-qualified staff. The budget will also cover new pension reform transition costs. We consider that tax policy measures could further depress activity and will focus our efforts on 2015 and beyond, continuing this year with efficiency-enhancing revenue administration reforms. The budget targets a headline deficit of 2.3 percent of GDP, over 1 percent of GDP higher than the 2013 outturn (excluding the gas-related transfer). This is above the debt reducing level of 1.8 percent of GDP targeted at the end of the program period, but in line with the projected path under the 2010–13 Fund-supported program. Financing is expected to come from a range of sources, including use of the Eurobond proceeds, official lending, and domestic treasury securities. Some of the Eurobond proceeds (AMD 32.3 billion, 0.7 percent of GDP) will be used for net lending on commercial terms to SMEs and exporters via three state institutions that have a strong track record in managing lending and support operations, including via commercial banks, with the banks taking full credit risk. Use of Eurobond resources to replace previously-planned domestic debt issuance is expected to generate savings on domestic interest costs. We will maintain a prudent fiscal reserve from the remaining proceeds at the CBA.

16. Pensions and public sector wages will increase this year. This is intended to address several critical civil service employment issues. Wages for many categories have not been increased since the crisis, leading to loss of qualified staff and poor governance incentives. Structural changes will introduce a more consistent wage policy, including introducing a grid structure based on clear job descriptions and standardized salaries across different government agencies and levels. We are working with the World Bank to strengthen performance assessments and flexibility in hiring and termination of staff, and will seek cost savings in the year ahead where possible. For example, we will rationalize the civil service and military grade structure, addressing grade inflation that occurred with previous reforms, with targeted grandfathering. The wage bills of state non-commercial organizations (hospitals, schools) will continue to be managed independently and autonomously and on the basis of payment by the state for specific services. This will help strictly control the broader public employment wage bill. Pension outlays will also increase in 2014, as we begin to address the severe, post-crisis erosion of pension levels. While we have set an ambitious political goal for further increases in the minimum wage, civil service wages, and pensions over the medium term, we recognize that achieving this goal must be consistent with fiscal sustainability and making adequate provisions for growth-enhancing capital outlays. Wage and pensions policy will also take into account the implications of increases for inflation, competitiveness, the private sector, and unemployment.

17. We will increase domestically-financed capital spending this year. As with wages and pensions, outlays in this area have eroded in recent years, and we will step up spending for road maintenance and school rehabilitation. Fiscal underspending in recent years has been largely related to externally-financed capital projects. Here, we believe that sustained progress on the North South Highway will now take place, although arrangements for Phases II and III of the project are complex, involving work with multiple agencies (ADB, EIB, the Eurasian Development Bank, and possibly others). If this project and other externally-financed infrastructure spending move forward at a faster-than-expected pace in 2014 and beyond, we will reach understandings with the Fund for modification of the program targets to allow for additional spending. We will also consider ways to strengthen and speed up the implementation of capital expenditures, particularly on donor-funded projects, without losing quality or introducing financial control concerns (e.g., by improving the tendering and contract execution stages). We will continue to make available to the public information on project assessments, tenders, implementation, and performance audits, particularly for large, complex projects.

18. We continue to place importance on poverty reduction and targeted social spending under the new program. Despite progress recently reflected in data for 2012, the poverty rate continues to be high in Armenia. Accordingly, we increased the minimum wage by 29 percent in July 2013 and will increase it by a further 11 percent in July 2014. The program should retain an indicative target (IT) on social spending, but cover a wider base than under the 2010–13 Fund-supported program., namely, the social assistance budget, including the flagship family benefits program, one-time childbirth benefits, childcare benefits for children less than two years of age, and benefits programs for families with disabled members or disabled children. We have made significant progress in our efforts to modernize the legal framework for social assistance and state benefits and to integrate and streamline the wide range of social services to improve efficiency and service quality. As such, 2014 will be the first year of operation of a transformed social benefits system. The new law on state benefits has been adopted by the National Assembly and a set of government decrees are being prepared to implement the new law. The new law on social assistance will be considered in parliament in early 2014 and will also be followed by a set of government legal acts for implementation. The two laws integrate the results of a pilot program involving 19 one-stop service centers where the functioning of the integrated system has been tested and refined, including social work and case management approaches. Over the next three years, we will put in place another 35 one-stop centers around Armenia. In the 2014 budget, we have redistributed funding for the unemployed from payment of modest unemployment benefits to measures that more actively help the unemployed integrate into the labor market, such as financial support for training, work skills, trips for job interviews, and job matching and placement.

19. We will strengthen monitoring and control of fiscal risks, including those related to public utilities, concessions, and PPPs. We will create a risk management unit at the Ministry of Finance by end-2014 (structural benchmark). The unit will help establish an effective monitoring and assessment framework by inventorying, maintaining, and assessing information on concessions, regulated utilities, state-owned enterprises (notwithstanding the extent of state shareholding or line-ministry affiliation), and PPPs. The unit will analyze potential fiscal risks from these and other sources (macro, financial, environmental, etc.) for the annual budget statement and decision-making. We will also prepare a policy paper on PPP strategy, including policy objectives, definitions, further legislative requirements, and proposal for a robust institutional set-up by end-2014. We would very much welcome TA from the IMF.

20. We aim to strengthen tax revenues during the program period through efficiency-enhancing revenue administration and tax policy measures. Our efforts will aim to consolidate the significant revenue gains that took place under the previous program, including an increase of the tax revenue-to-GDP ratio by over 2.5 percent of GDP in 2012–13, while focusing on compliance and policy gaps to help level the playing field and limit adverse business environment and poverty impacts. This approach will help us move away from a past practice of setting ambitious goals and targeting existing taxpayers to focusing efforts on areas where there is low compliance. In 2015, our efforts will allow us to reduce the stock of tax credits by 0.3 percent of GDP, while keeping the overall revenue-to-GDP ratio constant. The reduction of tax credits will support private activity by easing working capital constraints for taxpayers and supporting hiring, purchases, and investment. During 2016–17, we aim to generate revenue gains of 0.3 percent of GDP per year. These additional revenues will allow us to increase public investment spending and reduce the deficit. Higher customs revenues from higher ECU common external tariffs will also likely mean additional budgetary revenues.

21. In revenue administration, we will continue efforts to improve efficiency and transparency, while supporting revenue gains. In line with past IMF advice, we have enhanced our taxpayer registry and can now distinguish taxpayers by status of operations and tax liabilities of different types, with regular updates. Action areas in 2014 and beyond include the following:

- Implementation of a modern tax compliance program aimed at identifying and addressing major risks to revenues and promoting greater self-compliance through a continually more business-friendly service orientation and allocation of resources to areas that have the highest impact on increasing compliance and reducing tax gaps. We have recently strengthened our assessment of tax gaps at three regional inspectorates, and will extend this work to a comprehensive national strategy. Our National Plan for Fighting Tax Avoidance, Tax Fraud and Shadow Turnover will be an important part of the compliance program. To facilitate our activities, we will establish a Risk Management Unit (RMU) in the SRC by June 2014 (structural benchmark), with technical assistance support from the IMF. The RMU will prepare a compliance strategy for 2015 and beyond, with comprehensive annual action plans, monitoring, and ex post evaluation of tax payments.

- We will enhance coverage and capacity of the SRC's large taxpayer unit (LTU). We will increase the number of large taxpayers covered by the LTU by about 10 percent to 510 large taxpayers in 2014 and also increase LTU staff by 10 percent through reorganization. We will also augment the analytical capacity of the LTU by: (i) improved use of third-party information, (ii) strengthening sectoral analysis, and (iii) training and capacity building.

- Customs administration is a critical area for the business environment. We revised the customs code this year to require the SRC to respond more promptly to customs declarations. We have identified a number of additional urgent areas for modernization of the customs legislation, and we have drafted amendments to the customs code to: introduce an authorized economic operators (AEO) system; improve the appeals procedures; introduce an advance tariff information system; extend the scope of electronic declaration of goods; and introduce the possibility of postponing the payment of customs duties and taxes by introducing a systems for financial guarantees. These legislative changes aim to improve the business environment and facilitate trade. We will present the proposals to the National Assembly by March 2014 (structural benchmark). In the area of customs operations, we will enhance our post-clearance audit procedures, risk-management techniques, and IT tools to allow for incorporation of risk management feedback into the IT system and for electronic declarations. Furthermore, we will establish regulations for the AEO system by end-2014 to facilitate trade facilitation for trusted traders. We are assessing how our customs reforms will need to be oriented for ECU membership, for example, through development of a special transit regime via Georgia to Russia, the nearest ECU member state. We will seek TA from the IMF to identify additional ways to strengthen customs operations.

- Finally, to facilitate enhanced dialogue with taxpayers at a strategic level and thereby identify and address broad taxpayer concerns on tax policy and revenue administration issues, we will schedule two meetings per year on tax issues with both the business support council and the SME council, respectively. The agendas will be set well in advance to facilitate preparation and the exchange of views. This will complement other platforms and forums for taxpayer relations (e.g., appeals committee, call centers, taxpayer service centers, SRC business environment unit).

22. On tax policy, our efforts will focus on assessing and addressing remaining policy gaps. We have refined the draft law on transfer pricing to bring it in line with OECD guidelines and international practices, and we will resubmit it by March 2014 to parliament. Other legal changes to be submitted to parliament in 2014 for application from 2015 include: increasing of the natural resource user fee for non-metallic minerals, and unification of property and land taxes. Other outstanding areas for tax policy action may have adverse impacts on the poor or on the business environment, and therefore, require further consideration before deciding on a course of action. To this effect, during 2014, we will assess the incidence of tax policy changes and the scope for possible actions in 2015 and beyond for possible new tax instruments (e.g., new excises), increases of some tax rates (e.g., specific excise tax rates), and reducing or eliminating exemptions (e.g., for specific sectors, products, or forms of income). Additional areas for work will include strengthening of VAT refund procedures and more effective taxation of unfinished or undeveloped urban real estate sites. Addressing adverse impacts of many of these measures may be possible, but also complex and costly from an administration standpoint. To support our tax revenue efforts, the MOF and the State Revenue Committee (SRC) will strengthen analysis of tax gaps and potential gains, with support from IMF technical assistance. Finally, the MOF and SRC will also prepare by September 2014 (structural benchmark) a policy paper on strengthening collections from high-wealth individuals (HWI), covering necessary tax policy changes (e.g., dividend and capital gains taxation), revenue administration actions and legal or regulatory changes (risk and compliance profiles and audit), and the institutional set-up. Once again, IMF TA would be important.

D. Monetary and Exchange Rate Policy

23. Monetary policy will continue to be implemented within an inflation-targeting framework, complemented by exchange rate (ER) flexibility. Guided by its inflation target range, the CBA will continue to monitor current and expected inflation and output to determine whether changes to the policy rate and monetary operations are needed. The CBA will continue to limit its intervention in the foreign exchange (FX) market, so that the ER can move according to fundamentals and support external adjustment. During and after the crisis, the CBA drew down its reserves to provide FX market support and smooth volatility, but the CBA was able to rebuild buffers in 2013 with the Eurobond issuance and net purchases on the domestic FX market. Going forward, we consider it important to maintain buffers, particularly using periods when market conditions provide opportunities to acquire reserves without affecting overall market trends. We are confident that our policies will contribute to gradual dedollarization of savings, which would provide a further opportunity to build reserves. While we may pursue an additional modest reduction in reserve requirements on dram deposits, we see little scope for additional use of prudential measures to target dedollarization. We will conduct an assessment of the role these measures played in helping reduce dollarization from its 2009 peak.

24. The new program will move gradually to inflation targeting-based conditionality. As a first step, the program will be guided less by monetary aggregates than the 2010–13 Fund-supported program, as the targets on net domestic assets (NDA) will now include a cushion, implying that short-term liquidity operations—which may not be required given inflationary conditions—will no longer be needed to meet program targets. In addition, we propose that the reserve money indicative target (IT) will be replaced by conditionality on projected inflation (the midpoint of the forecast band of either 4±1.5 percent or an agreed path to return to this target band). A performance criterion (PC) on net international reserves would support our efforts to maintain adequate buffers. During the course of the program and following a durable reduction of inflation to within the CBA's target band, we will propose to drop the NDA PC and introduce an inflation-consultation clause conditionality, thereby aligning the conditionality framework with our current decision making process. In the meantime, we will continue efforts to analyze, model, and report on inflation and inflationary processes in Armenia and to strengthen CBA communications, in line with past and prospective IMF technical assistance.

25. We will continue to strengthen our operational framework for monetary policy. As noted, we will continue to enhance our communications with markets and the public to provide guidance on policy actions and ensure that inflation remains anchored at the target range. This will include use of an expanded range of communication channels, such as periodic press conferences and through strengthening the communications content of the inflation report, with further support from the IMF. This will be important for markets and the public to understand the nature of shocks and our policy responses, particularly now, as inflation is now above the target range. We will also continue to improve the interbank money market, in particular by supporting trade of one-day and seven-day instruments. We will also explore other policy actions to strengthen liquidity management within both the interbank and FX markets, including enhanced coordination between the CBA and the MOF. We will assess prospects to further reduce the width of the interest rate corridor around the policy rate, particularly in the context of the shift in program conditionality towards inflation targeting. We will continue to explore options to work with FX market participants to address occasional large purchases of FX that place undue, temporary pressures on the market. Finally, we will assess remaining obstacles to developing the FX derivatives market and FX risk hedging instruments for the economy and market participants.

E. Financial Sector Stability and Development

26. Financial sector policies will continue to promote both resilience to shocks and financial deepening. In 2013, the CBA approved a new regulation on commercial bank internal controls under the Basel II Pillar II framework—the regulation will become effective in mid-2014. The CBA has also prepared a timeline for Basel III implementation, and by June 2014, we will issue regulations on capital requirements and prepare the methodology on identifying domestic systemically-important banking institutions (SIBIs) (structural benchmark), with a phase-in period to apply between issuance of the regulations and full adoption. Given the high level of dollarization in our financial sector, we will continue to strengthen our monitoring capacity and work with local banks to enhance their management of FX exposure and risk. We will improve the quality of information received from banks on potential currency mismatches of large borrowers by standardizing reporting templates, and we will amend by December 2014 the regulation on the calculation of large exposures to align it to international best practices in the areas of (i) exposures to banks and sovereigns and (ii) consideration of collateral (structural benchmark). In this context, we will continue discussions with Fund staff regarding other areas of the large exposures regulation, including deductions from capital. We will also begin to implement a gradual increase in minimum FX liquidity ratios. As inflationary conditions ease, we will assess the impact of recent changes to the composition of reserve requirements, interactions with minimum FX liquidity ratios, and impacts on dollarization. In line with the 2012 FSAP Update recommendations, we will introduce measures to strengthen our crisis management infrastructure, including submitting legislative changes to the National Assembly by September 2014 on rules related to the Deposit Guarantee Fund (structural benchmark). To improve the operating environment for banks, we will prepare a policy paper with stakeholders by June 2014 on legal, regulatory, and institutional changes to simplify registration and execution of collateral (structural benchmark). This will be followed by submission of legislation to the National Assembly by June 2015. We will propose further improvements to the legislative framework for financial market development, including by submitting to the National Assembly by September 2014 an amendment to the securities law to facilitate access of foreign participants in Armenia's capital market, bringing our framework in line with international standards and best practices (structural benchmark). We have arranged with the local exchange NASDAQ/OMX-Armenia to start clearing/settling of Armenian treasury securities through Euroclear/ClearStream, so that they will be more readily available to potential foreign investors. Recent and forthcoming dram-denominated bond issuances by the IFIs would also provide an impulse to market development and issuances by Armenian corporates. Finally, we are working on creating the legal and operational environment for a modern mortgage finance system in order to assist housing affordability, financial market development, and banking sector soundness.

27. We have successfully launched our pension reform at the beginning of 2014. The last two key milestones of the reform—the licensing of two high-quality asset managers and the selection by the public of the company that will manage their respective pensions—have been completed, and contribution to individual accounts started in January. In connection with this reform, we will continue our efforts to further improve domestic debt management and the functioning of the primary and secondary government debt markets. This will be particularly important as pension reform is expected to expand the investor base in government debt markets.

F. External Debt

28. While we have established access to international financial markets, we will continue to work closely with official creditors under the new program. The debut sovereign bond issuance in September was a major step, as it allowed us to repay crisis support from Russia and provided budget financing, which has helped ease domestic interest costs. In addition, Armenia now has a long-term benchmark rating and interest rate, which will facilitate market access by other Armenian borrowers. Consistent with our efforts to rebuild buffers, the Eurobond has also allowed us to establish higher targets for international reserves. Official financing, especially on concessional terms, has been important for Armenia's development and addressing the impacts of the global crisis. We will continue close cooperation with official lenders, seeking concessional project and budget support where possible. As such financing is likely to become increasingly less available over time to Armenia and as poverty and infrastructure needs remain high, we propose that the program include an adjustor to permit use of project and budget support in excess of the programmed amounts, if such financing is available.

29. We are mindful that our first market issuance should be accompanied by clear and continuous signals about the soundness of our public finances and payment capacity and by increased debt management expertise. Accordingly, we will limit government guarantees of concessional or nonconcessional external financing under the program (indicative target). We will also build on sustained progress achieved in debt management in recent years by strengthening the compilation of comprehensive data and the analysis and monitoring of debt. We are also making institutional, professional, and legal and regulatory improvements needed for enhanced monitoring and managing of market-based external and domestic borrowing with the help of World Bank and IMF debt management TA.

G. Structural Reforms

30. We are continuing to pursue strong structural reforms essential for improving institutions, the business climate, competition, openness, and diversification and for addressing key risks. Our structural reforms will support export growth and a stronger capital account and thereby contribute to the external adjustment. A number of these reforms were part of the EU harmonization agenda and the DCFTA that we negotiated, and we intend to resolutely continue these efforts, where compatible with the ECU.

31. ECU membership is expected to create important opportunities for Armenia. An immediate benefit is access to imported natural gas at a price determined by the domestic price in Russia, transport costs, and a 30 percent discount through waiver of an export tariff levied in Russia. Membership will also lead to lower import prices for oil and petroleum products, diamonds, and possibly other goods (e.g., fertilizer, paper, aluminum, steel, leather). Membership should provide a strong boost to Armenia's exports to its traditional markets, by removing customs and non-trade barriers. It will also facilitate travel and work arrangements for Armenians in Russia and other ECU countries. At the same time, customs tariffs will increase. The average ECU common external effective tariff rate (ETR) is higher (9.6 percent) than Armenia's ETR (2.4 percent). We are seeking, where possible, agreement with the ECU on exclusions from the common external tariff, or transition periods, so that input costs do not rise significantly. This will be particularly important for socially-important goods, raw materials, and goods and services that would affect Armenia's WTO obligations. Key areas include agriculture and agro-processing, construction, mining, and transport. The conclusion of WTO transition periods for other ECU members (Russia), the gas price agreement, and cost-reducing and efficiency-enhancing structural reforms will also help mitigate a rise in Armenia's average ETR under the ECU. Higher tariffs, while imposing a burden on Armenian consumers, will mean additional budgetary revenues from the common customs pool.

32. ECU membership is also expected to lead to new external financing for important infrastructure and industrial projects in Armenia. These could include extension of the operating life of the Metsamor nuclear station, design and construction of a new reactor at Metsamor, further improvement of the national rail and road networks, and investment in the Yerevan-based synthetic-rubber producer, Nairit. We see prospects for greater foreign investment interest in the agro-processing, financial, information technology, light industry (furniture, textiles) and services sectors. Upgrading the national electric transmission network and completing a second high-voltage transmission line to southern Armenia are other important objectives. We will pursue options for financing for these (and other) projects in a way that targets concessional support, maximizes private sector involvement, and strictly limits government exposure and use of public funds. We will continue to consult with the IMF and the World Bank in advance of taking on any liabilities, including guarantees.

33. Armenia remains committed to deepening its relationship with the EU. We will carry out to the extent possible reforms to harmonize with EU standards and institutions agreed with the EU in the context of the DCFTA and compatible with ECU membership. These reforms will support our agenda of modernization and integration of the Armenian economy and contribute to export growth and diversification. We will continue cooperation with the EU under the Eastern Partnership initiative and look forward to continued EU macro-financial support, technical assistance, and twinning arrangements.

34. A new five-year gas agreement with the Russian Federation and Gazprom will facilitate stable and predictable prices, significant savings, and external adjustment. The agreement, which has been ratified by the National Assembly, will run through end-2018. We have published the agreement and associated documents, meeting a prior action for the new program. The agreement is based on a new border price of $189 per 1000 m3, representing a discount from existing and previously-expected future prices, with adjustment going forward based on changes in gas prices in Russia and U.S. CPI inflation. The new discounted base price was secured through waiver of a 30 percent export tariff by Russia. The agreement also involved sale of the government's remaining 20 percent stake in ArmRusGaz (ARG) to Gazprom for approximately $155 million, a positive valuation, given the ARG's recent financial difficulties and limited possibility for gas sales to other markets via Armenia. The privatization proceeds will be transferred to ARG to extinguish liabilities, and Gazprom will write-off claims on ARG of the same magnitude. This transaction will be fully reflected in the 2013 budget and the program fiscal accounts. The increase of domestic gas prices in July 2013 and the lower border prices have improved the finances of the gas operations of ARG, so that it is no longer incurring losses. Under the program, we will carefully monitor the operations and finances of ARG and other utilities on a frequent basis and act quickly to investigate and assess any worsening. We will not absorb any losses or liabilities or make payments on behalf of ARG or other utilities or companies (performance criterion). Finally, while we consider that the gas price agreement offers stable and competitive prices for the next five years, we also consider that the Armenian economy and consumers should to become more energy efficient to reduce vulnerabilities, cope with shocks, and be prepared for possible price adjustments after the agreement expires. We will work with the World Bank and other partners to prepare a study of policy options (energy efficiency investments, tariff adjustments, targeted protection for vulnerable groups) by end-2014 (structural benchmark).

35. In addition to the structural reforms discussed in other sections, focus areas under the new program will include:

- ***Business climate.*** Under our regulatory guillotine program, legislative packets for improving efficiency, reducing overlap, and streamlining regulations and red-tape for households and companies have been approved by the government in health, road transportation, and public utilities. Six additional packets are now being developed, from a total of 17 areas to be addressed by 2015. All six packets—covering entrepreneurship, tax, customs, social issues, foreign affairs and international relations, and culture—will be submitted for Cabinet approval by June 2014 (structural benchmark). In addition, we will introduce the practice of regulatory impact assessment for new regulations by June 2015 to help clearly identify cost and benefits of new regulations and to monitor effectiveness once they are in place. We expect to mainstream the regulatory guillotine by bringing it formally and permanently into the Ministry of Economy in 2015. Further, we have issued another Doing Business Action Plan for 2014, following similar efforts in recent years. The 2014 plan focuses on measures to improve contract enforcement, the insolvency process, arrangements for payment of taxes, and foreign trade. We will streamline insolvency processes, make them more predictable, improve incentives, and reduce time and costs, including in the courts. Accordingly, the Ministry of Economy and Ministry of Justice will map the entire bankruptcy process by June 2014 to identify the obstacles and gaps that need to be addressed by changes in the legislation (structural benchmark), and then prepare legislative proposals.

- ***Competition.*** A number of countries have vested their competition authorities with investigative, subpoena, and "dawn raid" powers; others vest these powers only with law enforcement agencies. We will continue to work to build consensus for providing these powers to the State Committee for Protection of Economic Competition (SCPEC). In the meantime, we have submitted to the National Assembly a packet of legal changes in the competition area, including clearer definitions of dominance and market abuse, stronger fines, and procedural changes (e.g., on timing of payment of fines). We hope for passage by March 2014. We will also put in place by June 2014 memoranda of cooperation between the SCPEC and the State Revenue Committee, the Economic Crimes Unit of the National Police, and the Office of the Public Prosecutor, covering investigative subpoena, and "dawn raid" operations, information required by the SCPEC, and participation by SCPEC staff in on-site examinations (structural benchmark). This year, we will also introduce a leniency program—an important element in detecting and addressing cartel activity, strengthen assessment and enforcement of proposed mergers, and prepare a concept paper on shifting the role of SCPEC from price monitoring to consumer protection. Finally, we will also submit to parliament by September 2014 legislation allowing for parallel import of products through alternative distribution channels (e.g., regional distributors of international pharmaceutical products in other countries). Parallel import should lead to greater competition and lower costs.

- ***Inspection reforms.*** We have been working on a major initiative to streamline inspection agencies and functions, eliminate overlaps and outdated approaches, introduce risk-based supervision and inspection, implement standard checklists, improve information systems, implement electronic management systems, and reduce corruption risks in inspection agencies, including through better training and remuneration. These efforts are intended to help reduce business costs and strengthen competitiveness, as well as improve the safety of services and products provided in the Armenian market. We have initiated a pilot merger of the inspection agencies of the Ministries of Health and Labor. Completion of this merger and initiation of a unified database for inspection agencies are expected by end-2014. We will submit a new draft law on inspection and inspection agencies to the National Assembly by March 2014 (structural benchmark). During the next few years, we will reduce the number of inspection agencies by half.

- ***Trade promotion.*** The quality infrastructure project is a critical initiative that we have been carrying out with EU assistance covering harmonization of standards, accreditation, technical control and certification, and market supervision practices. These systems help ensure the compliance and safety of our products and services, a key requirement for enhanced trade. We will continue to pursue this initiative. During the course of the program, we will clarify the strategy and rationalize the various enterprise development and promotion agencies—the PanArmenian Bank, the Armenian Development Agency, the Export Insurance Credit Agency, and SME-focused agencies.

- ***Civil aviation.*** Following the ceasing of operations of Armavia, the private national flag carrier in early 2013, we worked with the World Bank, other international agencies, and management consultants to develop a new policy framework for the civil aviation sector. The framework was approved in October and aims to increase competition, improve connectivity, enhance service quality, and lower costs. Key elements of the framework include: (i) promotion of competition and a move to open skies (limiting protection of particular airlines, for example, through frequency or capacity restrictions); (ii) transparency in publishing agreements in the sector; and (iii) splitting up the functions of the Directorate General for Civil Aviation (DGCA)—in particular policymaking, policy execution (negotiation of agreements), technical regulation, infrastructure operations, monitoring and enforcement, and accident investigation—to provide greater efficiency and transparency and address possible conflict of interests. With support from the World Bank and USAID, we are developing a road map for reforms, and will submit to the cabinet a plan to restructure the DGCA and establish the new set-up by April 2014 (structural benchmark). The new structure for the sector should be in place by May. The Ministry of Economy will become the lead policy agency and revisit 47 bilateral international aviation agreements—17 of which are now active in terms of flights—to reflect open skies principles. We have proposed or will propose bilateral open skies agreements with Russia, Ukraine, Israel, and Iraq. Connected with these reforms, the government has addressed the EU to begin negotiations on a Common Aviation Area Agreement, which would have a significant impact on aviation liberalization (open skies have been in place with the U.S. since 2008).

36. We are pleased that external financing may become available to support extension of the Metsamor Nuclear Power Station until 2022 ($300 million). Significant additional resources ($500 million) will be needed to subsequently decommission the plant, and we will explore the possibility of making a proposal by June 30, 2014 to the Public Service Regulatory Commission for an additional provision in the electricity tariff structure for more funding for continuing security and reliability outlays (now financed with support by donors) and decommissioning. We will also work with the World Bank on a study to support the introduction of seasonal variation of electricity tariffs to better reflect differences in underlying costs in the winter and summer and generate efficiency gains. If the study is positive, it would lead to a proposal for adoption of new methodology for seasonal tariff-setting. Other areas for analysis and action under the program include tariffs for alternative electricity sources (solar), adjustment of water and irrigation tariffs to ensure cost recovery and reduce subsidies from the state budget, continued expansion of metering in the water sector, and actions to reduce technical losses in municipal water systems. KfW and the AsDB are lead agencies in the water sector, assisting in our move to concession and lease arrangements for consolidated water operations in Yerevan and in the rest of Armenia, respectively, by 2016.

H. Conclusion

37. Program monitoring. The program will be monitored through semi-annual reviews. The first review is expected to be completed on or after September 30, 2014 and will assess performance as of end-June 2014. The second program review is expected to be completed on or after March 31, 2015.

Table 1. Armenia: Quantitative Targets, 2011–13 1/

	2011	2012	2013			2014			
	Dec.	Dec.			Dec.	Mar. 2/	Jun.	Sep. 2/	Dec.
	Act.	Act.	Proj.	Proj.	Proj.	Prog.	Prog.	Prog.	Prog.
Performance Criteria									
Net official international reserves (stock, floor, in millions of U.S. dollars)	794	830	712	1446	1068	952	950	968	1026
Net domestic assets of the CBA (stock, ceiling) 3/	201	231	255	13	231	259	274	296	318
Program fiscal balance (flow, floor) 4/	-187	-86	24	-4	-69	-44	-61	-77	-139
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	0	0	0	0	0
Absorption of losses or liabilities and making of payments on behalf of utilities and other companies (flow, ceiling, continuous criterion)						0	0	0	0
Indicative Targets									
Inflation (mid-point, percent) 5/					5.6	5.9	5.3	4.6	4.0
Average concessionality of newly contracted external debt (flow, floor, in percent) 6/	34	30	30	30	30	30	30	30	30
New government guaranteed external debt (stock, ceiling, in millions of U.S. dollars) 7/						100	100	100	100
Social spending of the government (flow, floor) 8/	29	33	16	25	34	11	23	35	48
Memorandum items:									
Budget support grants	28	36	38	45	48	48	48	48	55
o.w. EU MFA grant	19	19	19	19	19	19	19	19	19
Budget support loans	46	114	114	114	144	154	154	163	191
o.w. non-IMF loans	24	76	76	76	105	115	115	125	153
Project financing	44	47	19	40	83	6	21	36	83
KFW and IBRD loan disbursements	11	23	25	27	27	32	35	37	40
Reserve money	671	684	659	723	888	737	743	776	828

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU.
2/ Indicative target.
3/ NDA ceiling will be considered met if the outcome is within AMD 15 billion of the 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/ End of period, year-on-year headline inflation. Mid-point within a +/- 1.5 range.
6/ Assessed on a calendar year basis.
7/ Includes both concessional and non-concessional debt.
8/ Defined as 100 percent of the budgeted amount of the family benefit program and lump-sum financial aid. Starting 2014, the mission will work with the authorities to define a wider base.

Table 2. Armenia: Structural Benchmarks Under the Fund-Supported Program

Item	Measure	Time Frame (End of Period)	Outcome	Comment /Status
Prior Action				
	- Publish the new five-year gas agreement with Russia and Gazprom and associated documents			Completed
Structural Benchmarks				
Tax administration				
	- Submit to the National Assembly legislative amendments to the customs code to introduce an Authorized Economic Operators (AEO) system, improve the appeals procedures, introduce an advance tariff information system, extend the scope of electronic declaration of goods, and introduce the possibility of postponing the payment by introducing a systems for financial guarantees	March 2014	Improve business environment and facilitate trade	
	- Establish a Risk Management Unit (RMU) in the State Revenue Committee (SRC) to develop and implement a modern tax compliance strategy	June 2014	Improve efficiency, transparency, and evenhandedness of revenue administration	
Tax policy				
	- Prepare a policy paper on strengthening collections from high-wealth individuals (HWI), covering necessary tax policy changes (e.g., dividend and capital gains taxation), revenue administration actions and legal or regulatory changes (risk and compliance profiles and audit), and the institutional set- up	September 2014	Strengthen tax revenue collections	
Public Financial Management				
	- Establish a fiscal risk management unit at the Ministry of Finance that analyzes and manages fiscal risks related to concessions, regulated utilities, state-owned enterprises (notwithstanding the extent of state shareholding or line-ministry affiliation), and PPPs in an integrated manner	December 2014	Strengthen monitoring and control of fiscal risks	
Financial sector				
	- Issue regulations to require banks to set minimum capital requirements for common equity and Tier 1 capital according to the Basel III recommendations, and prepare the methodology on identifying domestic systemically important banking institutions (SIBIs)	June 2014	Improve banking sector regulation and supervision	
	- Prepare a policy paper with stakeholders on legal, regulatory, and institutional changes to simplify registration and execution of collateral	June 2014	Improve the operating environment for banks	
	- Submit to National Assembly legislation to shorten the depositor pay-out period of the DGF.	September 2014	Improve bank resolution framework	
	- Submit to the National Assembly an amendment to the securities law to facilitate access of foreign participants in Armenia's capital market, bringing the framework in line with international standards	September 2014	Develop financial market	
	- Amend in a manner consistent with the 2012 FSAP Update recommendations the regulation on the calculation of large exposures to align it to international best practices in the areas of (i) weight of exposures to banks and sovereigns, and (ii) consideration of collateral.	December 2014	Improve banking sector regulation and supervision	
Regulatory and competition policy				
	- Submit to the National Assembly a new draft law on inspection and inspection agencies, for introduction of risk based inspection, maximization of the automation, and elimination of the overlaps by reducing agencies	March 2014	Improve business environment	
	- Submit to the Cabinet a plan to restructure the Directorate General for Civil Aviation and establish the new set-up for moving towards open skies	April 2014	Increase competition, improve connectivity, and lower costs	
	- Submit to the National Assembly six Regulatory Guillotine legislative packages, covering entrepreneurship, tax, customs, social issues, foreign affairs and international relations, and culture, in addition to completion of packets in 2012-13	June 2014	Improve business environment	
	- Map the entire bankruptcy process to identify the obstacles and gaps that need to be addressed by changes in the legislation	June 2014	Improve business environment	
	- Put in place memoranda of cooperation between the SCPEC and the SRC, the Economic Crimes Unit of the National Police, and the Office of the Public Prosecutor, covering investigative subpoena, and “dawn raid” operations, information required by the SCPEC, and participation by SCPEC staff in on-site examinations	June 2014	Improve business environment	
Energy				
	- Issue a study of policy options (energy efficiency investments, tariffs, and targeted protection for vulnerable groups)	December 2014	Improve efficiency of energy sector	

Attachment II. 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 EFF arrangement as per the Letter of Intent dated February 17, 2014.

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 410 dram per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

A. Quantitative Targets

3. The program sets performance criteria and indicative targets for defined test dates (see Table 1 in the 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);
- Floor on the program fiscal balance; and,
- Ceiling on absorption of losses or liabilities and making of payments on behalf of utilities and other companies (continuous).

The program sets the following indicative targets:

- Headline inflation;
- Floor on average concessionality of newly contracted external debt;
- Ceiling on new government guaranteed external 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. **Headline inflation** is defined as the year-on-year rate of change of the Consumer Price Index as measured by Armenia's National Statistics Service. The indicative target will be considered met if headline inflation falls within a range of +/- 1½ percentage point around the mid-point target.

6. **Net domestic assets** are defined as reserve money minus NIR, minus other assets not included in gross official international reserves, minus commercial bank required and excess reserves at CBA in FX, plus medium and long-term foreign liabilities (i.e., liabilities with a maturity of one year or more) of the CBA, plus other foreign liabilities not included in official reserve liabilities, minus the balance of outstanding Fund purchases credited to the government account at the CBA. NDA is composed of net CBA credit to the general government plus outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money and other items net. The ceiling will be considered as met if the outcome is within AMD 15 billion of the indicative target sets in Table 1 attached to the LOI.

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 to non-residents, 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 here defined following the *Government Financial Statistics Manual* (GFS 2001) and *System of National Accounts* (1993 SNA). It includes the general government and nonfinancial public enterprises (as defined in paragraph 13).

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 (SPA) or the treasury sub-account containing privatization proceeds in drams, less amortization paid by the central government to private resident nonbank agents.

- **Net external financing** equals total debt-increasing disbursements from non-residents to the central government (including Fund net purchases credited directly to the government accounts at the CBA) less total amortization from the central government to non-residents. Net external financing also includes any privatization proceeds received from non-residents in foreign currency and not held in the SPA. 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 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 arrangements under the previous Fund-supported program and consolidation of the accounts of these units in the Treasury, there is no longer a need for such exclusion, and these activities are now fully accounted for in the program fiscal balance.

[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.

11. Foreign currency proceeds from selling enterprises are deposited 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. Finally, as noted in ¶8, privatization proceeds received from non-residents in foreign currency and not held in the SPA are also treated as a financing item (sale of financial assets) and recorded below the line.

12. Absorption of losses or liabilities and making of payments on behalf of utilities and other companies. The program sets a continuous ceiling on absorption by the public sector (central and local governments and covering the state budget and state debt plus the CBA) of losses or liabilities from outside the budgetary sector. Absorption of losses or liabilities is defined as direct payment by the government of the losses or liabilities of other parties or coverage of losses or liabilities by other transactions, such as debt-for-equity swaps or a write-off of tax obligations or other state claims. The government is defined as the central government and covers obligations of the state budget and state debt. The ceiling is set at zero, and excludes AMD 10.718 billion, (approximately $26.1 million) of subsidies in the 2014 budget for Yerevan Metro, Yerevan Electric Transport, Irrigations Systems, Armenian Water and Sanitation, Nor Akunk, and irrigation water intake entities. During the program period, there may be occasions when absorption of a limited amount of losses or liabilities, or making limited payments on behalf of utilities or other companies would facilitate a positive outcome (e.g., a major foreign investment transaction, poverty alleviation or equity enhancement, or prevention of even greater losses that would endanger financial stability). In such instances, the Armenian authorities will discuss the circumstances and possible options with the Fund staff prior to any transaction. Any modification of the PC to make any such payments or absorb any losses will require approval by the IMF Executive Board.

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

- The grant element is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by OECD. For debt with a maturity of at least 15 years, the ten-year-average CIRR is used to calculate the PV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR is used. The margins for differing repayment periods (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more) are added to the ten-year and six-month CIRR averages.

- The public sector here comprises the general government (central, plus local governments and covering the state budget and state debt), the central bank, and nonfinancial public enterprises (enterprises and agencies in which the government holds a controlling stake—typically owns more than 50 percent of the shares, but which are not consolidated in the budget).

- For program purposes, the guarantee of a debt arises from any explicit legal obligation of the public sector to service a debt in the event of nonpayment by the debtor (involving payments in cash or in kind), or from any implicit legal or contractual obligation of the public sector to finance partially or in full any shortfall incurred by the debtor.

14. Ceiling on government guaranteed external debt. In addition to the indicative floor on average concessionality, a separate ceiling (IT) of $100 million for the program period applies to government guarantees of the total of concessional and non-concessional external financing. The issuance of debt guarantees will be measured at the exchange rates listed in Table 1. The above limit covers debt guarantees issued by the general government to entities outside the general government. Guarantee issuance will be monitored on a monthly basis and the Ministry of Finance will provide data within 21 days from the end of the month.

15. The program sets a floor on **social 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, one-time childbirth benefits, childcare benefits for children less than two years of age, and benefits programs for families with disabled members or disabled children.

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

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

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

- **Budget support grants to the public sector** are defined as grants received by the general government for direct budget support from external donors and not related to project financing.

- **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 purchases by 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 floor on NIR will be adjusted upwards by the amount of any funds received in respect of deposits held at regional financial institutions.

- **The ceiling on NDA** will be adjusted downward (upward) by the cumulative amount of any excess (shortfall) 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 $50 million per year in either direction. The floor on the program fiscal balance on a cash basis will also be adjusted downward (upward) by the cumulative total amount of the project financing received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $100 million in either direction.

B. Data Reporting

17. 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	Monthly	Within 25 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		official exchange rates		
	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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Monthly	Within 30 days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Monthly	Within 30 days of the end of each month
	On-lending via commercial banks	On lending via the CBA and government (from the Russian loan, KfW, WB, ADB, etc.) by type of on-lending projects (including loan disbursements and repayments)	Monthly	Within 10 days of the end of each month.
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Transfers	Non-commercial transfers of individuals	Monthly	Within 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	Monthly	Within 45 days of the end of each month for government arrears

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		domestic interest payments		
	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 and lending operations, and inflow of grants to the central government; expenditure data will be provided according to both economic and functional classifications, consistent with the GFSM2001 methodology	Monthly	Within one month following the end of each quarter.
	Financial information on utilities and other major companies with a state interest	Profit and loss indicators for regulated utilities, for companies with state shareholding of 50 percent or greater, and for companies with state shareholding of 0–50 percent and annual sales or outstanding liabilities of AMD 10 billion.	Quarterly	Within 60 days of 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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
				quarter
		Detailed balance of payments data	Quarterly	Within 60 days of the end of each quarter
	CPI	By category	Monthly	Within 5 days of the end of each month
State Revenue Committee	Tax arrears	By type of tax	Monthly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)
		For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	Tax credits	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues and by economic sectors (i.e. Agriculture, Industry, Mining, Construction, Trade and Services), in both net and gross terms	Monthly	Within 45 days of the end of each (monthly data provided on a quarterly basis)
	Tax Revenues	Tax Revenue by Economic Sectors (i.e. Agriculture, Industry, Mining, Construction, Trade and Services)	Monthly	Within 45 days of the end of each quarter (monthly data provided on a quarterly basis)
	VAT refund claims in arrears	Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90 day statutory processing period. Number of refund applications processed per month.	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax inspectorate	Monthly	Within 45days after the end of each month
	Import data	1. Total value of recorded imports, breaking out raw diamond imports;	Quarterly	Within 30 days of the end of each

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		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		quarter
	Automated VAT refunds	Number of refunds that were processed automatically (share of total refunds); total value of automated and automatic refunds and offsets; average waiting time (days) to receive refund	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Risk-based selection approach	Percentage of selected companies chosen on the basis of risk-based approach, identified revenue from risk-based audits	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)

Table 1. Armenia: (Program) Exchange Rates of the CBA
(As of July 31, 2013 in U.S. dollars per currency rates)

Country	Drams Per Currency	Dollars Per Currency
Australian dollar	371.95	0.9072
Canadian dollar	398.33	0.9715
Swiss franc	440.91	1.0754
Danish krone	73.06	0.1782
Euro	544.28	1.3275
Pound sterling	627.83	1.5313
Japanese yen	4.18	0.0102
Norwegian krone	69.14	0.1686
Russian ruble	12.47	0.0304
Swedish krone	62.47	0.1524
SDR	621.04	1.5147

Table 2. Armenia: KFW, AsDB, and IBRD SME Loan Disbursements [1]

(In millions of U.S. dollars)

Dec-12	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
59.4	65.3	64.8	66.1	78.2	84.8	91.4	98.0

[1] Cumulative from end of the previous year.

Table 3. Armenia: External Disbursements to the Public Sector [1]

(In millions of U.S. dollars)

	Dec-12	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Project financing	122	49	97	202	14	51	88	203
Budget support loan	296	296	278	350	374	374	399	466
Budget support grant	94	97	111	116	116	116	116	133
of which: EU MFA 2/	50	50	47	47	47	47	47	47

1/ Budget support cumulative from the end of the previous year. Project financing cumulative during the same year.
2/ Change in September 2013 reflects valuation adjustment related to the new program exchange rates.

Annex I. Accession to the Eurasian Customs Union[1]

Background

1. In September, President Sargsyan announced that Armenia would seek membership in the Eurasian Customs Union (ECU)[2], rather than conclude a free trade agreement (DCFTA) with the EU. ECU membership is not compatible with the EU DCFTA, although the authorities have indicated that they will pursue "dual track" integration where possible. In December, Armenia and the other ECU member countries agreed a "roadmap" of Armenia's accession, possibly as early as in mid 2014.

Potential Implications of ECU membership

2. While the exact arrangements for Armenia's membership in the ECU are not yet fully clear (timing, tariff rates, revenues), the decision to join the ECU will have important implications for Armenia's trade policy and development strategy:

- *Trade impacts*. Adoption of significantly higher ECU tariffs (9.2 percent weighted average) could lead to a significant increase in Armenia's tariffs (3.1 percent). Higher tariffs could lead to trade diversion from non-ECU to ECU countries, and higher cost for Armenia's domestic production and exports. Cost-reducing reforms would be needed to mitigate negative impacts[3].

- *Tariff revenue*. Revenues from customs tariffs derive to a common pool and are shared among ECU members according to an agreed formula. Armenia's customs tariff revenues are likely to be higher than at present, although the exact outcome is difficult to assess. Negotiations are ongoing to adjust the revenue-sharing formula and on possible exclusions for Armenia from higher tariff rates.

- *Non-tariff barriers*. ECU members benefited from the easing of customs barriers, improvement of cross-border infrastructure, and reduced payments for trade facilitation. These benefits may be less likely for Armenia, given the likely continued maintenance of a customs inspection regime, due to Armenia's lack of contiguous borders with other ECU members and the need for transit

[1] Prepared by Kentaro Katayama.

[2] The treaty to establish the ECU was signed by Russia, Belarus, and Kazakhstan in October 2007. Common tariffs were launched in January 2010, and a common customs territory came into force in July 2010. Internal physical border controls were eliminated in July 2011.

[3] The authorities have indicated that they will seek substantial exclusions from application of higher ECU tariffs, in part because many of Armenia's WTO bound tariffs are lower than the ECU tariffs. Russia's agreement with the WTO is to decrease its tariff rates from 10 percent (simple average) to 7.8 percent by 2019, with half of the tariffs unchanged. ECU common tariffs will gradually decline in line with these changes, easing cost pressures.

across Georgia.[4] Customs clearance has reportedly become more cumbersome for shipments entering from non-ECU countries.

- *Gains from increased market size*. Gains from increased market size may be important, as ECU country consumers are already well acquainted with Armenia processed food products and beverages. However, exports to other ECU countries have not always been limited solely by trade barriers, but also by business environment issues in ECU member states (text table). In addition, over half of Armenia's exports comprise minerals and metals, which are unlikely to be affected by ECU membership. Another common benefit from free-trade arrangements is the enhanced development of supply chains. The lack of contiguous borders for Armenia and high transport costs may limit these gains.

Table A.I.1: Business Environment Ranking

	Armenia	Russia	Kazakhstan	Belarus
Ease of Doing Business Ranking 1/				
Total	37	92	50	63
Starting a Business	6	88	30	15
Protecting Investors	22	115	22	98
Trading Across Borders	117	157	186	149
Paying Taxes	103	56	18	133
The Global Competitiveness Ranking 2/				
	79	64	50	-

1/ The World Bank, Doing Business 2014.

2/ World Economic Forum, The Global Competitiveness Report 2013-2014.

- *Path of modernization and structural reforms.* Further benefits from free-trade arrangements include accelerated transfer of know-how and modern technology, as well as an accelerated path for structural reforms. The EU DCFTA and Association Agreement had been an important anchor for actions in a range of structural areas through harmonization with EU (e.g., domestic competition, regulation, and institutions). These benefits may be weaker under with ECU membership

Other benefits and costs

- *Gas prices*. Agreement on discounted gas supplies through 2018 was linked to ECU accession, yielding savings of up to 1½ percent of GDP per year.

- *Financial support and technical assistance*. EU financial and technical assistance has been important in recent years. The Armenian authorities are working with the EU to continue this support, where possible. New financial support from Russia and other ECU member countries is possible, for example, for extension of the Metsamor nuclear power station and construction of new station, and could extend to Russian state-owned enterprises (e.g., Russian Railways, Rosneft, Gazprom).

- *FDI*. ECU accession could position Armenia as a platform for activities by non-ECU firms in Russia, given perceptions that Armenia's business environment is better. However, Armenia's distance from Russia may be a constraining factor.

[4] There may be a possibility of introducing a special regime involving sealed cargoes and special transit monitoring, but this will take time to establish and may prove complex and costly to administer.

Conclusion

3. **Table A.I.2 provides a summary of the possible gains and losses from ECU membership**. In the short term, Armenia will benefit from an improvement in the BOP through lower import gas prices. In addition, joining the ECU could provide less expensive raw materials and improved access to the larger regional market, particularly important for Armenia's non-mining exports, especially processed agricultural products and light industrial goods.[5] However, overall benefits will depend on the authorities' capacity to reach agreement on a favorable calendar and set of exclusions for adoption of potentially much higher ECU external common tariffs. These risks call for a decisive pace of implementation of structural reforms under the new Fund-supported program to foster growth, provide clear signals to investors, and mitigate impacts of potentially higher tariff rates.

Table A.I.2: Summary of Potential Implications from ECU membership

	Positive	Potentially negative
Growth	➢ Possible ECU/Russian support for investment in infrastructure ➢ Lower import prices on raw materials from Russia	➢ Uncertainty on structural reform path ➢ Lower competitiveness by higher tariffs on industrial products ➢ Possibly lower FDI from Europe
Inflation	➢ Lower import prices on natural gas and raw materials	➢ Higher tariffs on food stuffs, machinery and other goods
Fiscal	➢ Higher customs revenue	➢ Lower EU financial support
BOP	➢ Lower gas prices ➢ Enhanced export to the ECU	

[5] ECU membership could lead to extensive new financing for infrastructure and industrial projects, including the Metsamor nuclear power plant, national rail and road networks, and Nairit, as well as to investment interest in agro-processing, information technology, financial, light industry, and services. Some investors may see Armenia's relatively favorable business environment as a positive platform for operations in other ECU member countries.

Annex II. Risk Assessment Matrix

Nature/source of risk	Relative likelihood[1]	Possible impact if risk is realized
	Global Risks	
Side-effects from global financial conditions: -Surge in global financial market volatility related to exit from unconventional monetary policies -Distortions from a protracted period of low interest rates	**Staff assessment:** -High (surge in volatility) -Medium (distortions)	**Staff assessment: Low/Medium** The current account deficit is a source of vulnerability, along with reversal of bank flows. Sound policy framework, Eurobond funding, and official support help mitigate risks. Enhanced monitoring of unhedged borrowers and greater bank FX liquidity coverage will help mitigate financial sector risks.
Protracted slow growth in advanced/emerging economies: —Advanced: larger deleveraging or potential growth surprises —Emerging: early maturing of the cycle or incomplete reforms.	**Staff assessment:** -High (Europe) -Medium (elsewhere)	**Staff assessment: Medium** Effects would be via remittance, trade, finance, and investment channels, particularly if Russia is affected.
Financial stress in the Euro area reemerges	**Staff assessment:** Medium	**Staff assessment: Medium** Effects would be significant if Russia is affected.
Sustained decline of commodity prices triggered by deceleration of global demand and excess capacity (medium-term)	**Staff assessment:** Medium	**Staff assessment: Medium/High** Reserves are sufficient to address an immediate shock (metals exports). Negative impacts could be mitigated by lower oil prices.
	Country-Specific Risks	
Inflows Reduction of remittances from Russia	**Staff assessment:** Low/Medium	**Staff assessment: Medium** Remittances are not strongly concentrated, but could be hit by the end of the Sochi Olympics,
Regional conflict Risks from renewed conflict with Azerbaijan over Nagorno-Karabakh.	**Staff assessment:** Low/Medium Tensions high, but no evident conflict trigger.	**Staff assessment: High** Conflict would involve severe impacts and likely other countries (Russian, Turkey).
Policy response in most cases would involve an acceleration of structural reforms, use/accumulation of reserves to mitigate volatility, and ER flexibility for longer-lasting impacts.		

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non mutually exclusive risks may interact and materialize jointly.

Annex III. Program Objectives, Policy Areas and Key Measures

OBJECTIVES:	**Macroeconomic stabilization**	**Reduction of vulnerabilities**	**Support transition to a dynamic, emerging market economy**		
KEY POLICY AREAS:	Support growth pickup in 2014, consolidate fiscal adjustment and inflation targeting framework	Continue external adjustment, further establishing buffers; strengthen financial sector regulation and supervision	Improve governance and transparency	Promote greater competition, competitiveness, and integration	Strengthen social safety nets
KEY MEASURES:	1. Fiscal impulse in 2014, ceiling on fiscal deficit [PC]	1. Tight reserves floor (PC) and exchange rate flexibility	1. Fiscal risk management unit [SB]	1. Further strengthen competition framework [SB]	1. Extend coverage of the Family Benefits Program [SB]
	2. Tax policy measures to increase government revenues (excises, broader tax base) [SB]	2. Strengthen banking sector prudential regulation (capital requirements, domestic SIFIs, large exposures), resolution framework (deposit guarantee fund), and banks' operating environment (registration and execution of collateral) [SBs]	2. Improve public employment system	2. Customs reform (authoritized economic operators system, appeals procedure, advance tariff information system, among others) [SB]	2. Increase pensions
	3. Revenue administration reforms (i.e., customs administration, risk management units, tac compliance strategy) [SB]	3. Address vulnerabilitites related to currency mismatches (e.g., FX liquidity ratios, reporting templates)		3. Improve bankruptcy procedures [SB] and capital market integration (securities law) [SB]	3. Implement new integrated social services system and extend coverage of the system nationwide.
	4. Ceiling on debt guarantees by government [IT]			4. Civil aviation reform [SB]	
	5. Gradual move to inflation-targeting-based conditionality [IT]			5. Implement roadmap for ECU accession with supportive timeline and exclusions.	
	6. Strengthening inflation targeting framework by refining monetary instruments and improving communications			6. Continue "Regulatory Guillotine" reform [SB]	
				7. Explore policy options for energy sector reform [SB]	
				8. Make progress on critical infrastructure projects.	

Annex IV. Reserve Metrics and Exchange Rate Assessment[1]

Armenia is making progress in rebuilding its international reserves, which declined markedly in the post-crisis years. The current level of reserves is broadly adequate by most standard metrics, although the economy remains vulnerable to shocks and high dollarization calls for extra reserve cushions. Despite the major adjustment in 2013, the external current account deficit is still sizeable at around 8½ percent of GDP, and staff's estimates suggest that a further adjustment of the dram in real terms is needed over the medium term.

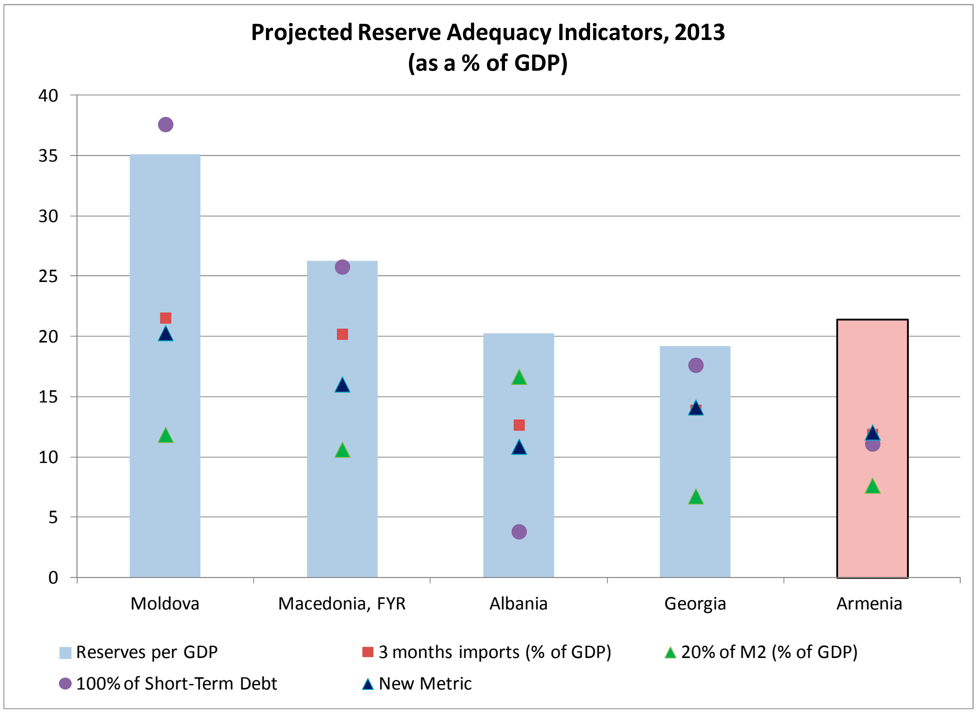
1. **Armenia's reserves appear broadly adequate.** Gross international reserves covered 5.2 months of imports at end-2013 and are projected to gradually decline to 4.7 months by 2018. This coverage level is adequate, based on standard import and debt metrics, as well as when assessed in relation to the IMF's composite metric. Reserves adequacy indicators also look favorable in comparison with peer countries (see chart). Still, current reserve levels are not excessive, and staff has called on the authorities to seek a cushion greater than suggested by the benchmarks. This is motivated by Armenia's propensity and vulnerability to shocks and by the relatively high degree of dollarization, 63 percent and 60 percent for credit and deposit dollarization, respectively, as of December 2013. The high degree of dollarization, in particular, calls for higher reserve adequacy in order to support confidence in the banking system.

2. **Staff's estimates suggest that an adjustment of the dram in real terms would be needed in the medium-term to bring the external current account into equilibrium.** CGER-type, model-based approaches indicate a moderate real exchange rate overvaluation (see text table). The *macrobalance approach* suggests a current account norm of -4.7 percent of GDP, about 1.8 percentage points less than the underlying current account in the medium-term. Based on an elasticity of the current account to the real effective exchange rate of -0.15 percent, this would imply a moderate exchange rate misalignment. The *external sustainability approach* estimates a current account norm for Armenia which stabilizes the NFA/GDP of the country around its norm. Comparing this current account norm (-5.6 percent of GDP) with its underlying value, while using the above-mentioned elasticity, implies a small REER overvaluation. Finally, the reduced form *equilibrium real exchange rate approach* also suggests a small overvaluation.

3. **These methodologies are subject to limitations and are sensitive to assumptions; they should therefore be viewed with some caution.** And while the exact magnitude of overvaluation is difficult to determine with certainty the results do tend to confirm the view suggested by the evolution of the balance of payments, that the real ER remains moderately overvalued, despite considerable improvement in the external current account in the last few years.

[1] Prepared by Zsofia Arvai.

Armenia: Projected Reserve Adequacy Indicators, 2013



Annex V. Public Sector Debt Sustainability Analysis[1]

Staff analysis suggests that Armenia's gross public debt remains sustainable, although it stays at an elevated level over the medium term. The debt-to-GDP ratio will be 44–46 percent during 2013–18, with the 2018 debt-stabilizing primary surplus at -1.2 percent of GDP (deficit). This compares favorably with the underlying primary balance (0.2 percent of GDP in 2013 excluding capital transfer to ARG) and with forecasts for the projection period. Gross financing needs will be moderate as the 2013 Eurobond was used to repay a loan from Russia, repayment to the Fund has peaked, and fiscal consolidation continues at a moderate pace. Stress tests show that real GDP growth—based on historical experience—is the biggest concern. The large size of past shocks suggests that there is a 25 percent probability that gross public debt will be above 60 percent of GDP in 2018, as illustrated in fan charts. However, the results are influenced by data for the crisis year 2009.

Background

1. Armenia is transitioning to emerging market status. Armenia graduated from eligibility for Fund concessional financing and low-income country (LIC) status in April and issued its first Eurobond in September ($700 million). About two-thirds of the Eurobond proceeds were used to fully repay a 2009 loan from Russia. The remaining proceeds will be used for budget financing—replacing domestic debt issuance—and net lending to the economy, so that the Eurobond will have a limited impact on gross public debt and will not worsen net debt (unless the onlending is not repaid).

2. Public debt increased in 2009 in response to the crisis and has remained at an elevated level. The gross-public-debt-to-GDP ratio increased from 16 percent in 2008 to over 40 percent in 2009–10, reflecting crisis-related bilateral and multilateral external borrowing and the sharp decline of nominal GDP (in dram and dollars). The debt ratio has since remained at an elevated level.

3. The underlying macroeconomic framework points to a gradual move of the dram to its medium-term equilibrium level. After a slowdown in 2013, GDP growth is expected to pick up to a trend of 5 percent by 2017. After the sharp fiscal consolidation in recent years, the primary balance is expected to improve at a moderate pace. Inflation is expected to return to the CBA's target range of 4±1.5 percent in 2014 and remain there throughout the projection period. The dram is expected to gradually depreciate by about 7 percent in real terms over the next several years, helping reduce the external current account deficit and achieving its medium-term equilibrium level by 2018.

[1] Prepared by Takuji Komatsuzaki.

Public DSA Results

4. **While heat map and debt profile vulnerability indicators appear to show that the main risks are public debt held by non-residents in foreign currencies, a closer look suggests that the debt structure actually mitigates risks.** The high share of non-residents holding foreign currency-denominated debt does not raise concerns on rollover immediately, given that the most of this debt is held by official lenders, and the rest is a long-term bond with amortization only in 2020. Nevertheless, the dominance of foreign currency-denominated debt points to the vulnerability to balance sheet effects and the importance of sound macroeconomic policy. Furthermore, the authorities are advised to use the room before 2020 to make the debt maturity structure robust.

5. **Fan charts show that there is a 25 percent probability that gross public debt will be above 60 percent of GDP in 2018.** This result is based on historical shocks, and reflects the large shocks that have occurred, especially to GDP and the exchange rate. The gross public debt-to-GDP ratio could range from 23 percent to 80 percent by 2018 (10^{th} to 90^{th} percentiles). Exchange rate appreciation is ruled out in the asymmetric fan charts, where the results show that the gross public debt-to-GDP ratio could range from 34 percent to 90 percent within the 10^{th} and 90^{th} percentiles.

6. **Forecasts have historically been pessimistic for GDP growth, but similar to comparators for the primary balance and inflation.** Projections of GDP growth in Armenia have typically been pessimistic, except for the output collapse in 2009. Reflecting this, Armenia's median forecasting error is at 92 percentile, implying that forecasts were more pessimistic than 92 percent of Armenia's comparator countries. Primary balance and inflation forecasts have been similar to comparators, with most projections and median forecasting errors falling within 25^{th} and 75^{th} percentiles. Armenia is subject to boom and bust analysis because its credit-to-GDP ratio increased by 17 percentage points (from 23 percent to 40 percent) in 2009–2012. It should be noted that this episode differs significantly from other boom-bust events. For example, it takes place right after the bust in 2009. Moreover, credit-to-GDP ratio remains relatively low.

7. **The planned fiscal consolidation is feasible.** The high projected maximum primary balance adjustment reflects adjustments that have already taken place during 2010–13. Going forward, no further significant primary balance adjustment is envisaged. Rather, the focus will be on raising revenues in order to secure sufficient resources for priority spending.

8. **Gross public debt is expected to remain at around 44–46 percent of GDP during the 2013–18 projection period.** The gross public debt ratio is expected to increase from 45.4 percent of GDP in 2013 to just over 46 percent of GDP in 2016 due to the difference between Eurobond issuance and the Russian loan repayment in 2013, some depreciation of the dram in 2014–16, and annual lending to Nagorno-Karabakh of 0.8–0.9 percent of GDP on highly concessional terms. These factors offset the debt-reducing effects from the primary balance and the interest-growth differential. The debt ratio is expected to decrease in 2017–18, as the pace of nominal depreciation slows as the exchange rate approaches its medium-term equilibrium and as real GDP growth increases to the trend level of 5 percent.

9. **Net public debt in Armenia is substantially lower than gross public debt and expected to remain around 36–40 percent of GDP throughout the projection period.** Lower net public debt reflects net lending operations to the domestic economy in Armenia. The modalities of these operations are fairly complex, with funds being channeled through a variety of programs from different sources and to different targets of lending, including SMEs, renewable energy and housing finance, and gas and mining companies. The lending operations are managed on commercial terms and the track record of repayment has been good. These asset are not liquid, however, and therefore the debt sustainability analysis focuses on gross debt.

10. **The 2018 debt-stabilizing primary balance is -1.2 percent of GDP, one percentage point of GDP weaker than the projected level**. The interest–growth differential remains favorable, as Armenia is expected to continue to receive some low-interest, long-term foreign financing during the projection period.

11. **Gross financing needs are moderate in the medium term.** The projected gradual fiscal consolidation, the peak of repayments to the Fund in 2013–14, and the repayment of the Russian loan mitigate gross financing needs. The Eurobond issuance has created large repayment or rollover needs outside the projection period of the DSA, in 2020.

12. **The baseline scenario envisages continued provision of medium- and long-term debt and gradual development of the domestic debt market.** Foreign currency debt will continue to account for the bulk of gross public debt, accounting for over 80 percent of total public debt even in 2018.

13. **Alternative scenarios based on historical shocks and a constant primary balance at the 2013 level affect debt dynamics and gross financing needs moderately.** Historical scenarios based on setting all key variables to their historical averages (and thereby incorporating past shocks to output and the primary fiscal balance) lead to high gross financing needs. A constant primary balance at the 2013 level leads to a gradually increasing debt-to-GDP ratio.

14. **Stress tests show that real GDP growth shock worsens the debt indicators the most, followed by contingent liability and real exchange rate shocks**. This reflects a history of relatively high volatility of output and exchange rates. Under the real GDP growth shock, growth would be -4.4 percent in 2014 and -4.1 percent in 2015, a large deviation from the baseline. The combined shock scenario shows dynamics similar to the real GDP shock, suggesting the dominance of the real GDP shock. A contingent liability shock also leads to an elevated public debt dynamics.

15. **Excluding the extraordinary shocks in 2009 makes the size of deviation from the baseline somewhat smaller, but the overall message remains unchanged.** In the analysis of these alternative scenarios, the historical scenario now shows a declining gross debt to GDP ratio and more manageable public gross financings needs, due to higher real GDP growth and a stronger primary balance. In stress tests, the gross public debt to GDP ratio remains below 60 percent throughout for all of the basic tests, including the real GDP growth shock. Fan charts show less dispersion in potential ranges of the gross public debt-to-GDP ratio. In particular, there is a

25 percent probability that it gross public debt exceeds 55 percent of GDP in 2018. Finally, stress tests continue to show real GDP growth shock as the largest risk, but again gross debt-to-GDP ratio remains below 60 percent.

Conclusion

16. Staff analysis suggests that Armenia's public debt remains sustainable, but stays at an elevated level in the medium-term. Armenia's gross public debt-to-GDP ratio will be 44–46 percent during the 2013–18 projection period, with the 2018 debt-stabilizing primary surplus at -1.2 percent of GDP, about 1 percentage point weaker than projected. Gross financing needs are moderate, as proceeds from the September 2013 Eurobond were used to repay a large loan from Russia, repayment to the Fund has peaked, and fiscal consolidation has taken place and is expected to continue at a moderate pace.

17. Stress tests show that shocks to real GDP growth are the biggest concern. The large size of past exogenous shocks in Armenia suggests that there is a relatively high probability for debt dynamics to substantially deviate from the baseline scenario, as illustrated in fan charts.

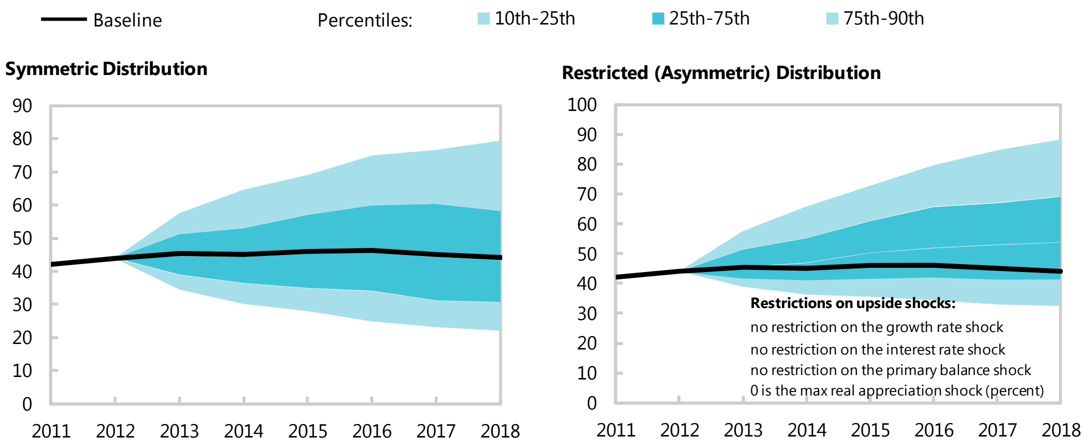
Armenia Public DSA Risk Assessment

Heat Map

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

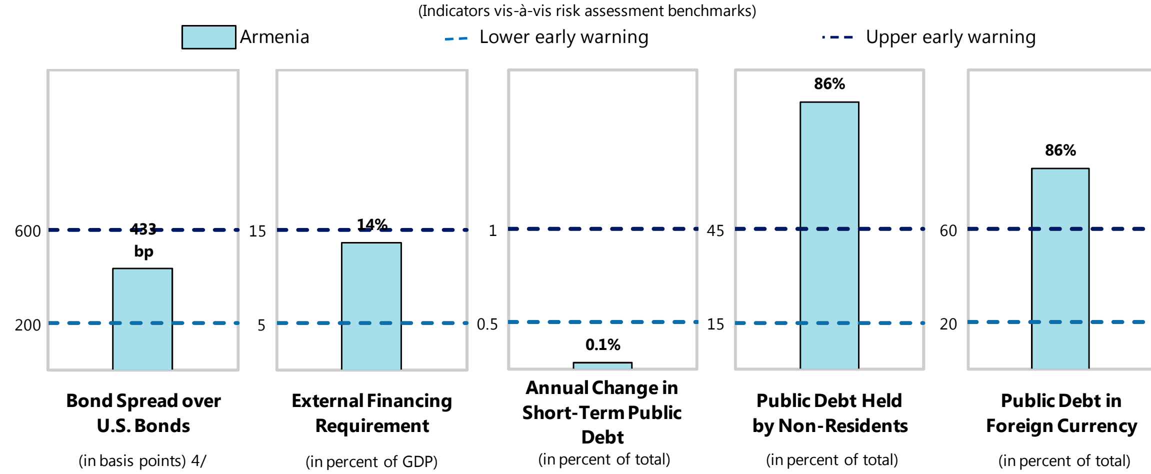
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

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

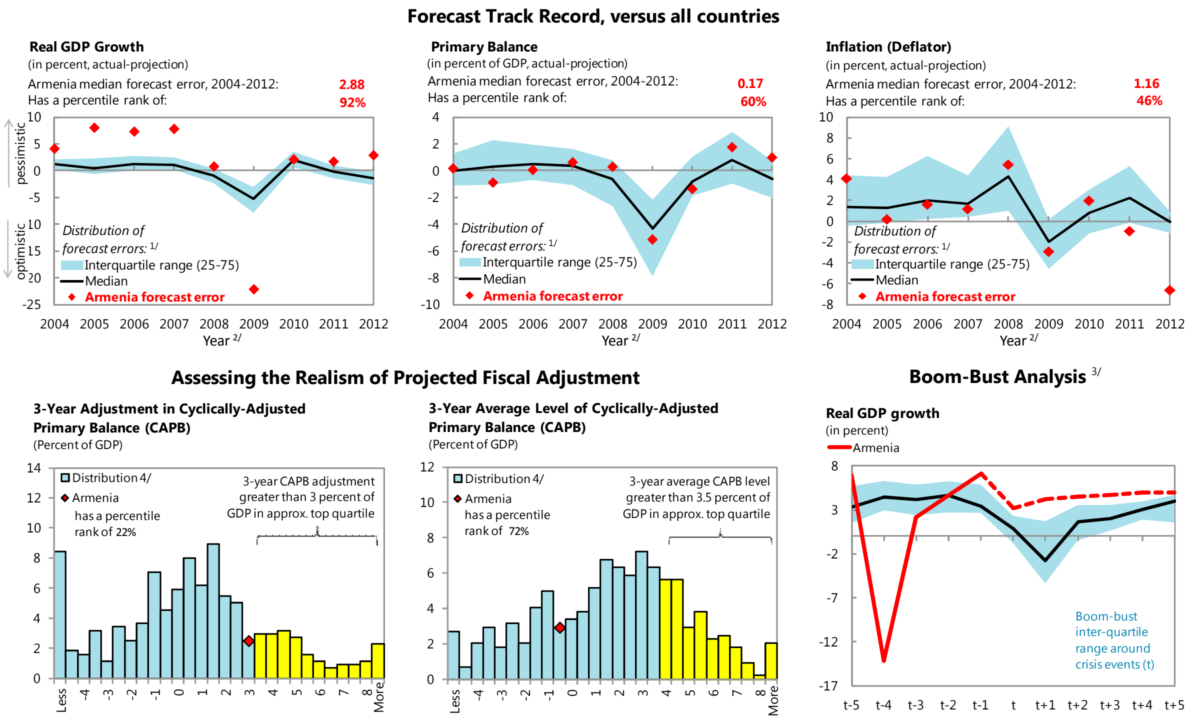
2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

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

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

4/ An average over the last 3 months, 20-Aug-13 through 18-Nov-13.

Armenia Public DSA - Realism of Baseline Assumptions



Source : IMF Staff.

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

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

3/ Armenia has had a cumulative increase in private sector credit of 17 percent of GDP, 2009-2012. For Armenia, t corresponds to 2013; for the distribution, t corresponds to the first year of the crisis..

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

Armenia Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

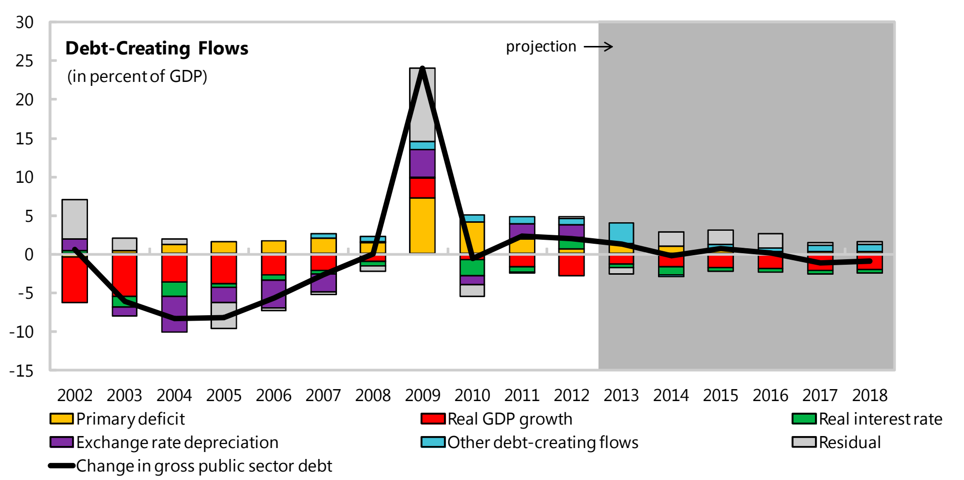
Debt, Economic and Market Indicators [1]

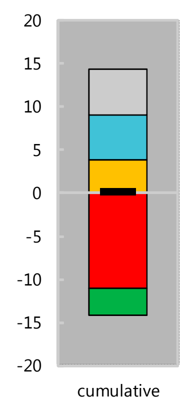
	Actual			Projections					
	2002-2010 [2]	2011	2012	2013	2014	2015	2016	2017	2018
Nominal gross public debt	30.6	42.0	44.0	45.4	45.2	46.0	46.2	45.1	44.2
Public gross financing needs	4.9	4.9	4.6	10.4	4.9	4.5	3.8	3.9	4.6
Net public debt		32.0	34.5	36.1	37.0	38.6	39.6	39.1	38.7
Real GDP growth (in percent)	8.4	4.7	7.1	3.2	4.3	4.5	4.7	5.0	5.0
Inflation (GDP deflator, in percent)	4.4	4.2	-1.2	4.0	5.4	4.0	4.0	4.0	4.0
Nominal GDP growth (in percent)	13.2	9.1	5.9	7.3	9.9	8.7	8.9	9.2	9.2
Effective interest rate (in percent) [4]	2.0	2.6	2.5	3.0	3.3	3.3	3.2	3.1	3.2

As of January 16, 2014		
Sovereign Spreads		
Spread (bp) 3/		364
CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	Ba2	n.a.
S&Ps	BB-	n.a.
Fitch	BB-	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2002-2010	2011	2012	2013	2014	2015	2016	2017	2018	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	-0.7	2.36	1.98	1.4	-0.2	0.8	0.2	-1.1	-0.9	0.2	
Identified debt-creating flows	-1.9	2.44	1.76	2.8	-0.2	0.8	0.2	-1.1	-0.9	1.6	
Primary deficit	2.1	1.9	0.6	1.3	1.0	0.6	0.3	0.3	0.3	3.8	-1.2
Primary (noninterest) revenue and grants	18.9	22.1	22.3	23.3	23.5	23.3	23.6	23.8	24.0	141.5	
Primary (noninterest) expenditure	21.1	24.0	22.9	24.6	24.5	24.0	23.9	24.1	24.3	145.4	
Automatic debt dynamics [5]	-4.4	-0.4	0.3	-1.2	-0.9	-0.4	-0.6	-2.2	-2.1	-7.4	
Interest rate/growth differential [6]	-3.4	-2.4	-1.3	-1.8	-2.7	-2.2	-2.4	-2.6	-2.5	-14.1	
Of which: real interest rate	-0.8	-0.7	1.5	-0.5	-0.9	-0.4	-0.4	-0.5	-0.4	-3.0	
Of which: real GDP growth	-2.6	-1.7	-2.8	-1.3	-1.8	-1.9	-2.0	-2.1	-2.1	-11.1	
Exchange rate depreciation [7]	-1.1	2.0	1.6	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.4	0.9	0.9	2.7	-0.3	0.6	0.5	0.8	0.9	5.2	
Dom. net lending, drawdown of govt. dep.	0.0	0.0	0.0	1.8	-1.1	-0.2	-0.3	0.0	0.0	0.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
External net lending to Nag.-Karabakh	0.4	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.9	5.1	
Residual, including asset changes [8]	1.2	-0.1	0.2	-0.9	1.8	1.8	1.8	0.4	0.3	5.3	





Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Bond Spread over U.S. Bonds.

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

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

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

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

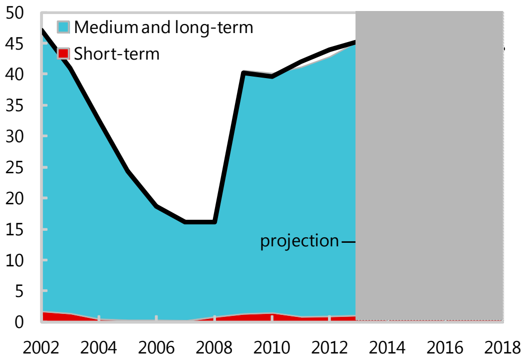
8/ For projections, this line includes exchange rate changes during the projection period.

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

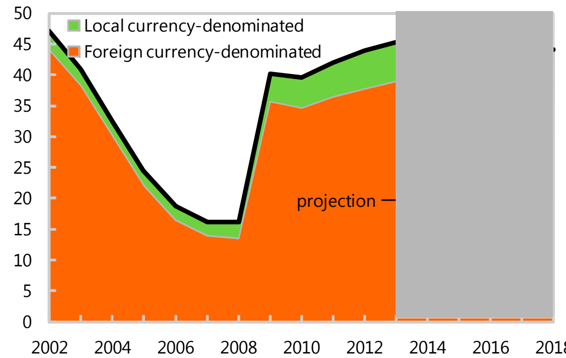
Armenia Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



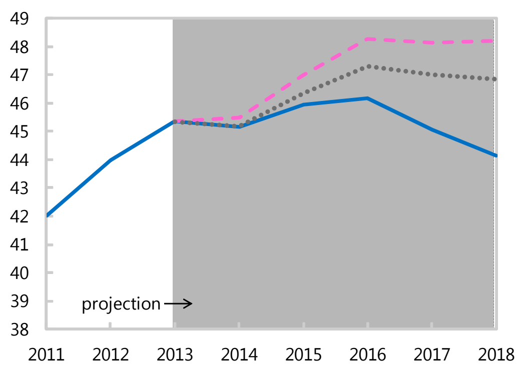
By Currency
(in percent of GDP)



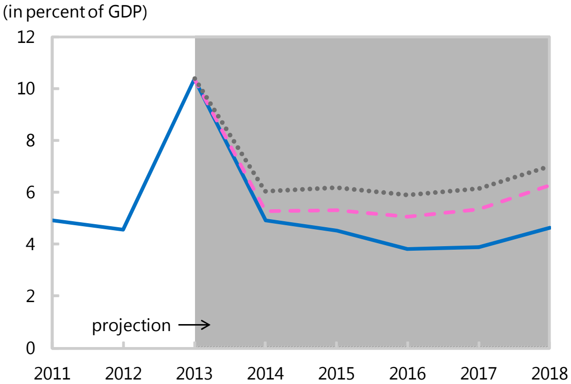
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

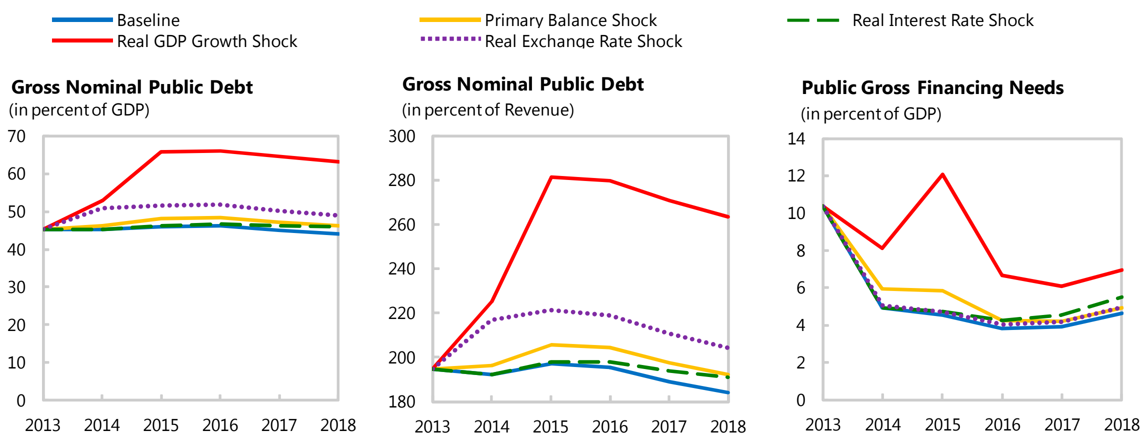
Baseline Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	3.2	4.3	4.5	4.7	5.0	5.0
Inflation	4.0	5.4	4.0	4.0	4.0	4.0
Primary Balance	-1.3	-1.0	-0.6	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.3	3.3	3.2	3.1	3.2
Constant Primary Balance Scenario						
Real GDP growth	3.2	4.3	4.5	4.7	5.0	5.0
Inflation	4.0	5.4	4.0	4.0	4.0	4.0
Primary Balance	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Effective interest rate	3.0	3.3	3.3	3.3	3.2	3.3

Historical Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	3.2	7.2	7.2	7.2	7.2	7.2
Inflation	4.0	5.4	4.0	4.0	4.0	4.0
Primary Balance	-1.3	-2.2	-2.2	-2.2	-2.2	-2.2
Effective interest rate	3.0	3.3	3.3	3.1	3.0	3.1

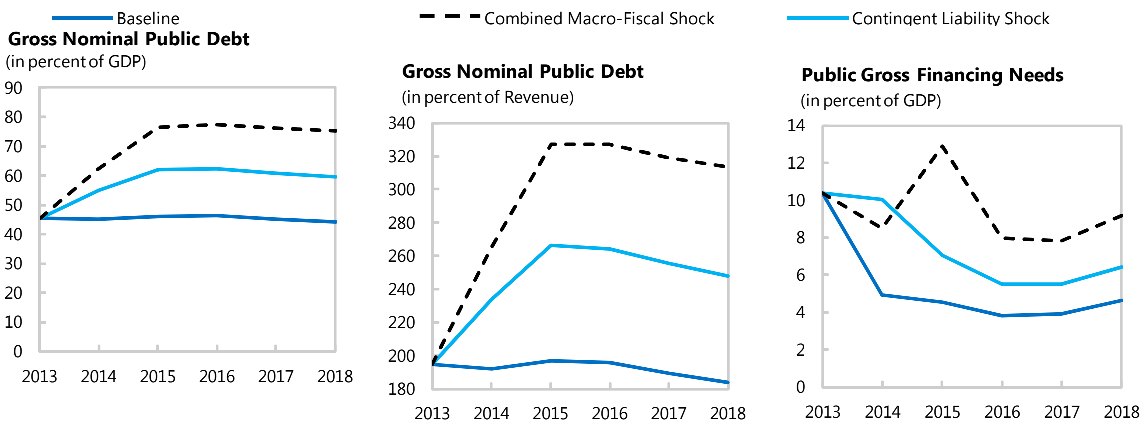
Source: IMF staff.

Armenia Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2013	2014	2015	2016	2017	2018
Primary Balance Shock						
Real GDP growth	3.2	4.3	4.5	4.7	5.0	5.0
Inflation	4.0	5.4	4.0	4.0	4.0	4.0
Primary balance	-1.3	-2.0	-1.7	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.3	3.4	3.4	3.2	3.4
Real Interest Rate Shock						
Real GDP growth	3.2	4.3	4.5	4.7	5.0	5.0
Inflation	4.0	5.4	4.0	4.0	4.0	4.0
Primary balance	-1.3	-1.0	-0.6	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.3	3.8	4.1	4.3	4.8
Combined Shock						
Real GDP growth	3.2	-4.4	-4.1	4.7	5.0	5.0
Inflation	4.0	3.2	1.8	4.0	4.0	4.0
Primary balance	-1.3	-3.8	-6.4	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.7	3.9	4.7	4.8	5.3

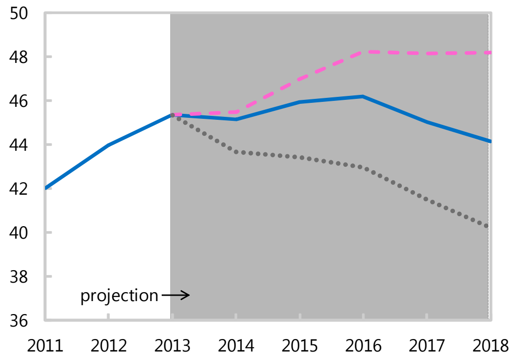
	2013	2014	2015	2016	2017	2018
Real GDP Growth Shock						
Real GDP growth	3.2	-4.4	-4.1	4.7	5.0	5.0
Inflation	4.0	3.2	1.8	4.0	4.0	4.0
Primary balance	-1.3	-3.8	-6.4	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.3	3.6	3.9	3.7	3.8
Real Exchange Rate Shock						
Real GDP growth	3.2	4.3	4.5	4.7	5.0	5.0
Inflation	4.0	11.0	4.0	4.0	4.0	4.0
Primary balance	-1.3	-1.0	-0.6	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.7	3.1	3.1	3.0	3.1
Contingent Liability Shock						
Real GDP growth	3.2	-4.4	-4.1	4.7	5.0	5.0
Inflation	4.0	3.2	1.8	4.0	4.0	4.0
Primary balance	-1.3	-5.5	-0.6	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.7	3.8	3.6	3.4	3.5

Source: IMF staff.

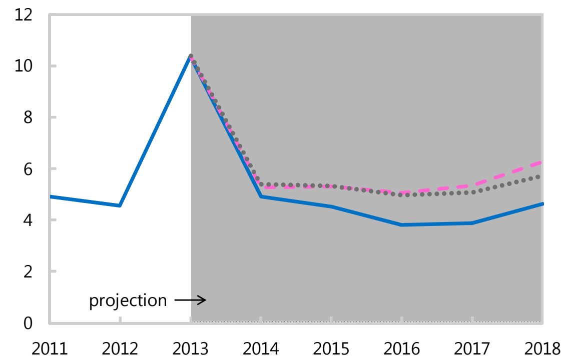
Alternative Scenarios (excl. 2009)

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions (excl. 2009)
(in percent)

Baseline Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	3.2	4.3	4.5	4.7	5.0	5.0
Inflation	4.0	5.4	4.0	4.0	4.0	4.0
Primary Balance	-1.3	-1.0	-0.6	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.3	3.3	3.2	3.1	3.2
Constant Primary Balance Scenario						
Real GDP growth	3.2	4.3	4.5	4.7	5.0	5.0
Inflation	4.0	5.4	4.0	4.0	4.0	4.0
Primary Balance	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Effective interest rate	3.0	3.3	3.3	3.3	3.2	3.3

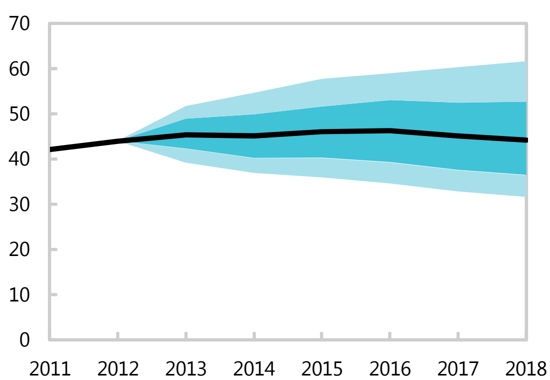
Historical Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	3.2	9.6	9.6	9.6	9.6	9.6
Inflation	4.0	5.4	4.0	4.0	4.0	4.0
Primary Balance	-1.3	-1.7	-1.7	-1.7	-1.7	-1.7
Effective interest rate	3.0	3.3	3.2	3.1	2.9	3.0

Source: IMF staff.

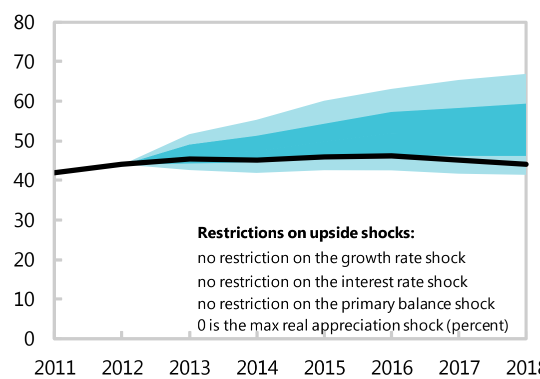
Evolution of Predictive Densities of Gross Nominal Public Debt (excl. 2009)
(in percent of GDP)

Baseline   Percentiles: 10th-25th   25th-75th   75th-90th

Symmetric Distribution

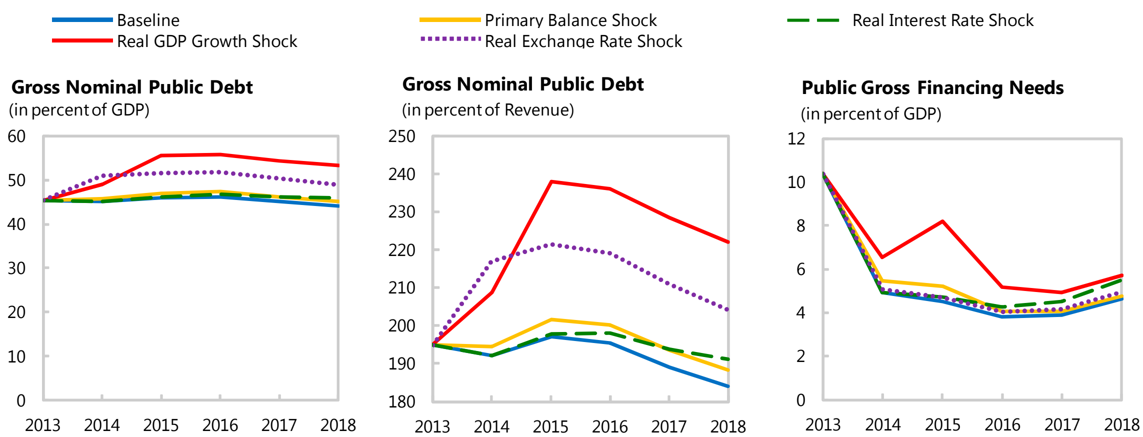


Restricted (Asymmetric) Distribution

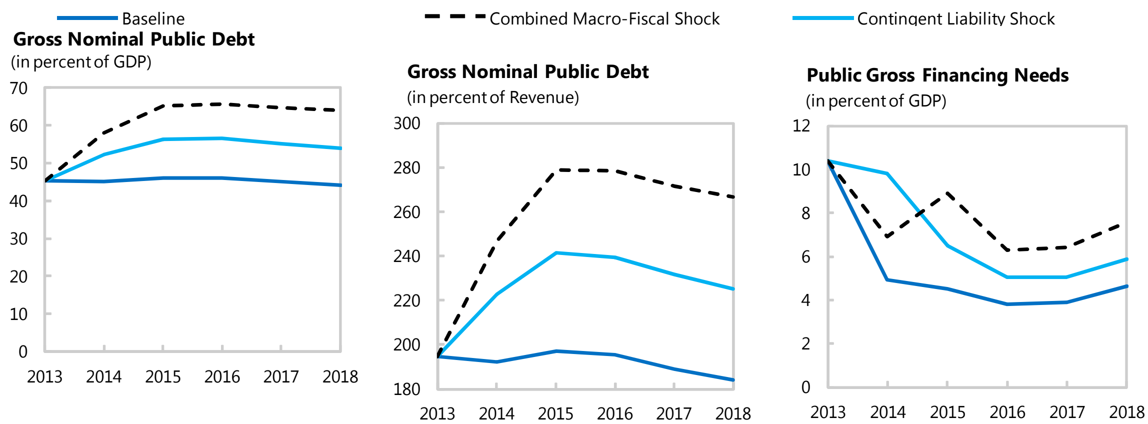


Armenia Public DSA - Stress Tests

Macro-Fiscal Stress Tests (excl. 2009)



Additional Stress Tests (excl. 2009)



Underlying Assumptions (excl. 2009)

(in percent)

Primary Balance Shock	2013	2014	2015	2016	2017	2018
Real GDP growth	3.2	4.3	4.5	4.7	5.0	5.0
Inflation	4.0	5.4	4.0	4.0	4.0	4.0
Primary balance	-1.3	-1.5	-1.2	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.3	3.4	3.3	3.1	3.3
Real Interest Rate Shock						
Real GDP growth	3.2	4.3	4.5	4.7	5.0	5.0
Inflation	4.0	5.4	4.0	4.0	4.0	4.0
Primary balance	-1.3	-1.0	-0.6	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.3	3.8	4.1	4.3	4.8
Combined Shock						
Real GDP growth	3.2	-0.3	0.0	4.7	5.0	5.0
Inflation	4.0	4.2	2.9	4.0	4.0	4.0
Primary balance	-1.3	-2.4	-3.4	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.7	3.7	4.3	4.5	5.0

Real GDP Growth Shock	2013	2014	2015	2016	2017	2018
Real GDP growth	3.2	-0.3	0.0	4.7	5.0	5.0
Inflation	4.0	4.2	2.9	4.0	4.0	4.0
Primary balance	-1.3	-2.4	-3.4	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.3	3.4	3.6	3.4	3.5
Real Exchange Rate Shock						
Real GDP growth	3.2	4.3	4.5	4.7	5.0	5.0
Inflation	4.0	11.0	4.0	4.0	4.0	4.0
Primary balance	-1.3	-1.0	-0.6	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.7	3.1	3.1	3.0	3.1
Contingent Liability Shock						
Real GDP growth	3.2	-0.3	0.0	4.7	5.0	5.0
Inflation	4.0	4.2	2.9	4.0	4.0	4.0
Primary balance	-1.3	-5.5	-0.6	-0.3	-0.3	-0.3
Effective interest rate	3.0	3.7	3.8	3.6	3.4	3.6

Source: IMF staff.

Annex VI. External Debt Sustainability Analysis[1]

1. Armenia's external debt-to-GDP ratio remains high, but is expected to decline in the medium term. The external debt ratio was 76.2 percent of GDP at end-2012, and it is projected to rise to around 77 percent of GDP in 2014, before declining to around 74 percent by 2018. The ratio improved rapidly in the mid-2000s reaching a low of 29½ percent of GDP in 2008. The improvement was largely due to exchange rate appreciation and growth, as well as increasing non-debt creating FDI inflows, partly offset by modest external current account deficits. Subsequently, the debt-to-GDP ratio increased with the global financial crisis (as a result of higher nominal debt and deprecation of the dram and lower GDP). Large external current account deficits—partly offset by FDI flows—were the most important factor in the deterioration in the external debt-to-GDP ratio in the crisis and post-crisis periods, with some contribution from the nominal interest rate.

2. Staff's estimates for the debt-stabilizing non-interest external current account deficit is 6.9 percent of GDP. In staff's baseline projections, the change in external debt is dominated by continuing non-interest external current account deficits, which average about 4 percent of GDP during 2014−18. This is offset by projected non-debt creating FDI, whereas automatic debt dynamics have a smaller impact. The baseline projections depend on improvements in the external outlook and strong structural reforms underpinning a pick-up of economic activity from current levels and attracting FDI inflows.

3. External sustainability is sensitive to standard shocks other than the nominal interest rate. The external debt ratio increases to 86–88 percent of GDP under standardized shocks to growth and the non-interest external current account, as well as under the combined scenario (chart below). A one-time 30 percent real ER depreciation would raise the debt ratio by around 35 percentage points of GDP above the baseline path to 110 percent of GDP in 2018. Given the very large share of concessional financing in external debt, external sustainability is robust to a standardized shock to the interest rate.

[1] Prepared by Zsofia Arvai.

Table 1. Armenia: External Debt Sustainability Framework, 2008-2018
(In percent of GDP, unless otherwise indicated)

		Actual							Projections						
		2008	2009	2010	2011	2012			2013	2014	2015	2016	2017	2018	**Debt-stabilizing non-interest current account 6/**
1	**Baseline: External debt**	29.5	56.4	66.4	71.5	76.2			**79.3**	**77.0**	**77.7**	**78.1**	**76.5**	**73.9**	**-6.9**
2	Change in external debt	-2.0	26.9	10.0	5.1	4.7			3.0	-2.2	0.7	0.4	-1.6	-2.6	
3	Identified external debt-creating flows (4+8+9)	-3.5	18.1	6.8	2.0	6.8			0.9	0.3	-0.3	-0.9	-1.1	-0.8	
4	Current account deficit, excluding interest payments	11.1	14.6	13.6	9.0	8.9			6.0	4.5	4.2	3.9	3.9	4.0	
5	Deficit in balance of goods and services	-55.8	-58.0	-66.4	-71.0	-73.8			-72.1	-70.5	-71.5	-72.4	-71.9	-70.2	
6	Exports	15.1	15.4	20.9	23.7	24.5			24.5	24.6	25.3	25.9	26.0	25.4	
7	Imports	-40.7	-42.6	-45.5	-47.3	-49.3			-47.6	-46.0	-46.2	-46.5	-45.9	-44.7	
8	Net non-debt creating capital inflows (negative)	-8.7	-8.0	-4.2	-3.1	-5.8			-5.2	-3.7	-3.7	-3.9	-3.9	-3.8	
9	Automatic debt dynamics 1/	-5.9	11.5	-2.5	-3.8	3.7			0.2	-0.5	-0.7	-0.9	-1.1	-1.0	
10	Contribution from nominal interest rate	0.8	1.2	1.2	2.0	2.3			2.5	2.6	2.6	2.7	2.6	2.5	
11	Contribution from real GDP growth	-1.7	5.6	-1.2	-2.8	-5.2			-2.3	-3.2	-3.3	-3.5	-3.7	-3.5	
12	Contribution from price and exchange rate changes 2/	-4.9	4.7	-2.6	-2.9	6.6			...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	1.5	8.8	3.1	3.1	-2.1			2.1	-2.5	0.9	1.3	-0.5	-1.8	
	External debt-to-exports ratio (in percent)	195.9	365.3	317.3	301.3	310.8			323.8	313.4	307.7	301.0	294.5	290.4	
	Gross external financing need (in billions of US dollars) 4/	2.0	2.0	2.0	2.0	2.5			2.8	2.4	2.4	2.4	2.6	2.8	
	in percent of GDP	16.8	23.1	21.4	19.4	24.7	10-Year	10-Year	26.3	21.7	20.4	20.3	20.2	19.9	
	Scenario with key variables at their historical averages 5/								**79.3**	**70.2**	**63.3**	**57.5**	**52.2**	**47.6**	**-11.4**
							Historical	Standard							
	Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
	Real GDP growth (in percent)	6.9	-14.1	2.2	4.7	7.1	7.2	8.6	3.2	4.3	4.5	4.7	5.0	5.0	
	GDP deflator in US dollars (change in percent)	18.4	-13.6	4.8	4.6	-8.4	8.7	12.8	2.7	2.0	-1.0	-1.0	1.0	3.0	
	Nominal external interest rate (in percent)	3.0	3.0	2.3	3.2	3.2	2.3	0.8	3.4	3.5	3.5	3.5	3.5	3.6	
	Growth of exports (US dollar terms, in percent)	-1.1	-24.0	45.0	24.3	1.4	15.0	19.9	5.8	6.8	6.3	6.5	6.2	6.0	
	Growth of imports (US dollar terms, in percent)	32.3	-22.4	14.4	13.9	2.3	17.5	18.0	2.3	2.6	4.1	4.3	4.8	5.3	
	Current account balance, excluding interest payments	-11.1	-14.6	-13.6	-9.0	-8.9	-7.1	5.3	-6.0	-4.5	-4.2	-3.9	-3.9	-4.0	
	Net non-debt creating capital inflows	8.7	8.0	4.2	3.1	5.8	5.6	1.8	5.2	3.7	3.7	3.9	3.9	3.8	

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

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

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

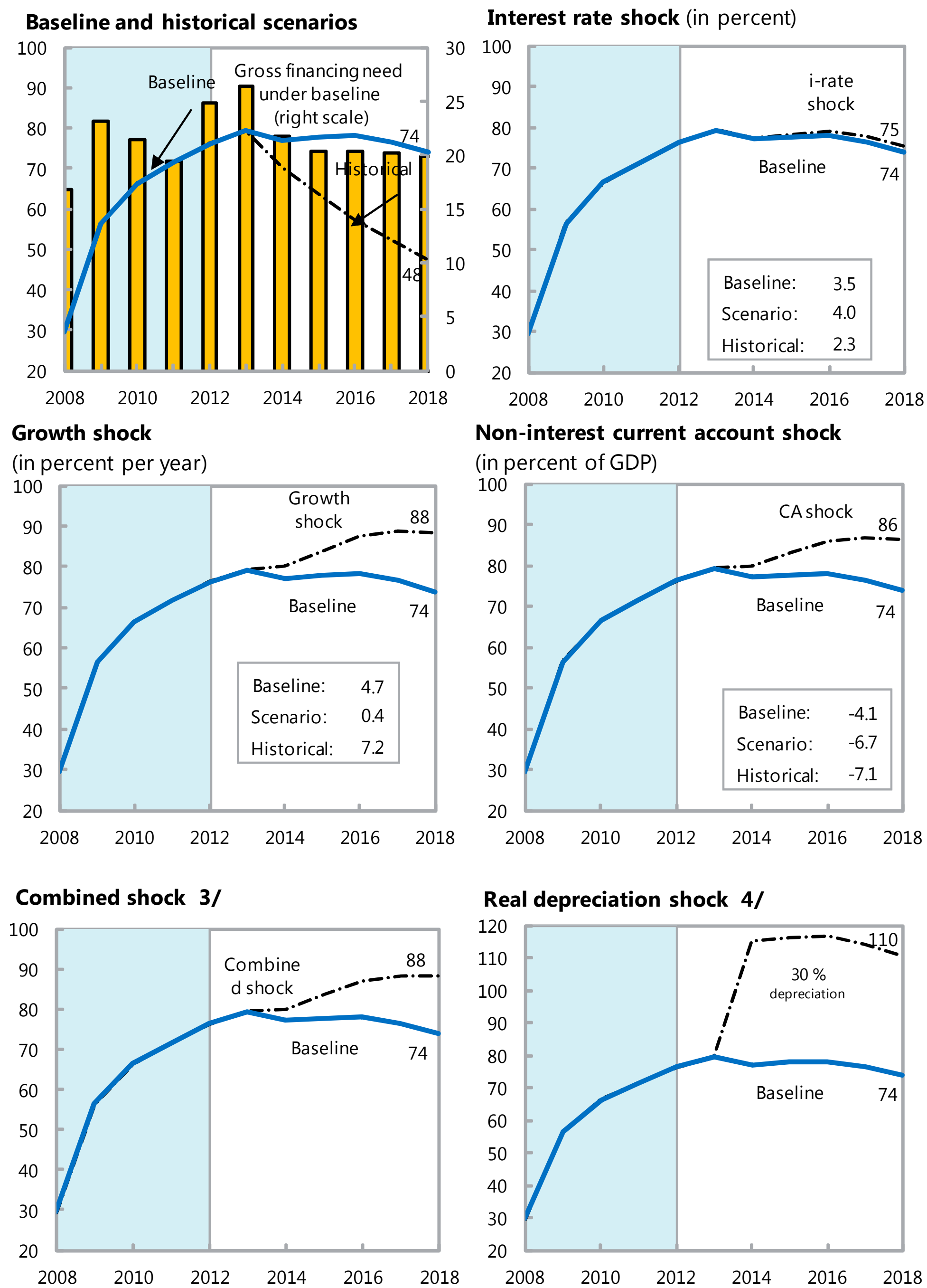
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

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

(External debt in percent of GDP)



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

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

REQUEST FOR ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—INFORMATIONAL ANNEX

February 20, 2014

Prepared By

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

CONTENTS

FUND RELATIONS

(As of December 31, 2013)

Membership Status:
Joined 05/28/1992; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	92.00	100.00
Fund holdings of currency	320.43	348.29
Reserve Tranche Position	0.00	0.00

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	87.99	100.00
Holdings	1.23	1.40

Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
Stand-By Arrangements	95.02	103.29
ECF Arrangements	151.32	164.48
Extended Arrangements	133.40	145.00

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	06/28/2010	07/02/2013	133.40	133.40
EFF	06/28/2010	06/24/2013	133.40	133.40
Stand-By	03/06/2009	06/27/2010	533.60	350.43

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

	Forthcoming				
	2014	2015	2016	2017	2018
Principal	98.08	16.43	25.29	36.88	44.19
Charges/interest	2.30	1.99	1.84	1.65	1.37
Total	**100.38**	**18.42**	**27.13**	**38.52**	**45.56**

Safeguards Assessment

Under the Fund's safeguards 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. A safeguards monitoring visit to the CBA was completed in September 2012. The visit made recommendations to strengthen: (i) controls over management of foreign reserves; and (ii) CBA oversight arrangements. A new safeguards assessment is expected in the first half of 2014.

Exchange Rate Arrangement

The de jure arrangement is "free floating." The de facto arrangement was reclassified to "floating" from a "stabilized arrangement," effective March 3, 2009. More recently, and following a sequence of interventions to rebuild reserves in the last three quarters of 2013, the de facto exchange rate arrangement has been reclassified from floating to crawl-like arrangement, effective March 12, 2013. This reflects the appreciation of the Armenian dram within a 2 percent band against the U.S. dollar during the last three quarters of 2013.The official exchange rate is quoted daily as a weighted average of the buying and selling rates in the foreign exchange market.

Armenia maintains no multiple currency practices or 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).

Article IV Consultations

The 2012 Article IV consultation with Armenia was concluded on December 7, 2012. Armenia is subject to a 24-month consultation cycle.

FSAP Participation and ROSCs

A joint World Bank-IMF mission assessed Armenia's financial sector as part of a Financial Sector Assessment Program (FSAP) update during February 1–14, 2012. The Financial Sector Stability Assessment (FSSA) report was approved by the Executive Board in June 2012. The most recent previous FSAP update took place in 2005.

Resident Representative

Ms. Teresa Daban Sanchez, since August 2013.

Technical Assistance

The following table summarizes the Fund's technical assistance (TA) to Armenia since 2010.

Armenia: Technical Assistance from the Fund, 2010–13

Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Tax administration	Short-term	March –May 2010	MoF, SRC
Tax administration	Short-term	August - November 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 (mining)	Short-term	June 2011	MoF
Budget process	Short-term	October 2011	MoF
Public Financial Management	Short-term	November 2012	MoF
Tax Administration	Short-term	April 2013	MoF, SRC
Tax Administration	Short-term	September 2013	MoF, SRC
Fiscal Risk	Short-term	October 2013	MoF, SRC
Tax Administration	Short-term	December 2013	MoF, SRC
Legal Department			
Banking Law	Short-term	June 2011	CBA
AML/CFT	Short-term	Various	MoF
Monetary and Capital Markets Department			
Contingency planning, crisis preparedness	Short-term	March–April 2010	CBA
Workshop on Inflation Targeting (with IMF Research Dept.)	Workshop	April–May 2011	CBA
Bank resolution framework	Short-term	June 2011	CBA
Medium-term debt management strategy	Short-term	December 2011	CBA
FSAP update	Short-term	February 2012	CBA
Inflation targeting (with IMF Research Dept.)	Short-term	February-March 2012	CBA
Inflation targeting	Short-term	November 2012	CBA
Inflation targeting	Short-term	January 2013	CBA
Bank prudential framework	Short-term	April 2013	CBA
Monetary and Foreign Exchange Policy	Short-term	June 2013	CBA
Statistics Department			
National accounts	Short-term	September 2010	NSS
BOP and external debt statistics	Short-term	October 2011	CBA
National accounts	Short-term	April 2012	NSS

Monetary statistics	Short-term	April 2012	CBA
National accounts	Short-term	May 2012	NSS
Monetary statistics	Short-term	October 2012	CBA
Construction Price Index	Short-term	September 2013	NSS

WORLD BANK AND IMF COLLABORATION—JMAP IMPLEMENTATION

(As of January 20, 2014)

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
1. Bank program in the next 12 months	***Selected Ongoing and New Operations***		
	Public Sector Modernization Project II (US$9m)	Semi Annual	Project Implementation started in Sept. 2010 and closing is Dec. 2014
	Tax Administration Modernization Project (US$12 m)	Semi Annual	WB Board approval July 2012, effective since Dec. 2012, closing date is Dec, 2015
	New DPO series to support competitiveness and ensure sustainability (US$ 172m)	Quarterly	Targeted Board date for DPO-2: September 2014 DPO-3: September 2015
	New Health Project for Disease Prevention and Control (US$30m)	Semi Annual	WB Board approved – March 2013
	Public Sector Modernization (III) and PFM project	Semi Annual	Targeted Board Date – December 2014
	Analytic Work		
	Programmatic Poverty work	Continuous	Annual Series, 2014 report due in June 2014 and November 2014.
	Programmatic Fiscal work (fiscal incidence assessment, public sector wage assessment, review of social assistance programs)		Dissemination in December 2014
	New Country Economic Memorandum		
	Promoting Productive employment in Armenia – a note on labor market conditions		Policy workshop in December 2014
	Selected Technical Assistance		
	IDF grant for guillotine exercise	Ongoing	2014-15
	Macro-monitoring		
	One-stop shop for providing construction permits		

2. IMF work program in the next 12 months	Article IV Consultation and First EFF Review **Selected Technical Assistance/Training** FAD (follow-up on Revenue administration) FAS (Public Financial Management) MCM/RES (Inflation targeting)	September 2014 TBD March 2014 April 2014	November 2014 TBD June 2014 July 2014T
3. Joint work program			

RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

(As of January 23, 2014)

1. **As of December 31, 2013, the EBRD had approved 127 projects in Armenia, covering the power, transport, agribusiness, municipal and infrastructure, manufacturing and services, property, telecommunications, and financial sectors**. Total commitments amounted to around EUR 661 million. During the year 2013, the EBRD signed 11 projects with a total volume of EUR 49.2 million. In 2013 the Bank committed EUR 49.2 million to Armenia through 11 transactions.

2. **EBRD has signed six sovereign projects in Armenia to-date. 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**. 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 under a concession agreement. In April 2007, the EBRD approved a EUR 7 million loan to the State Committee for Water Systems - owner of the water and wastewater assets located in the small municipalities outside of Yerevan. The proceeds of this loan have been used to improve wastewater treatment in five municipalities located near Lake Sevan. In March 2010, EBRD signed a first EUR 5.0 million sovereign loan with Yerevan Metro Company. This project addresses rehabilitation needs including safety upgrades and energy efficiency. In August 2012, EBRD signed its second EUR 5.0 million sovereign loan with Yerevan Metro to address issues related to water ingress into the tunnels. In November 2012, the EBRD signed a €10 million loan to the Armenian government for the construction of a new bridge at Bagratashen, which is the main border crossing point between Armenia and Georgia. This project is part of the EU's Integrated Border Management regional initiative.

3. **Most of the Bank's projects (87%) in Armenia are in the private sector.** In addition to the loan to Electric Networks of Armenia (see section 5 below), the Bank approved an additional loan to Zvartnots International Airport in the amount of EUR 29.6 million (supplemented by investments from ADB and DEG). This project followed on from the successful completion, in May 2007, of the first phase of the Passenger Terminal, for which the Bank provided a EUR 14.8 million loan together with DEG (USD 10 million). This project involved the construction and purchase of equipment for the second phase of the Passenger Terminal complex at Zvartnots International Airport and facilitated the completion of Airport Terminal development reallocating all operations (arrivals and departures) from the old Airport building. The loan was a commercial facility with no sovereign support. Other private sector finance includes relatively smaller loans to private companies and equity participation in a number of companies in various sectors including pharmaceuticals and the financial sector.

4. **In the banking sector, a first equity participation in the Commercial Bank of Greece-Armenia (EUR 1.1 million) was approved in late 1999**. Now there are four local banks where EBRD participates in equity: Armeconombank, Byblos Bank Armenia, Ararat Bank and ProCredit Bank.

5. **The Armenia Multi-Bank Framework Facility II (AMBFF II), established to provide loans and equity to commercial banks and leasing companies in Armenia, was approved by the EBRD Board in March 2006 for an amount of $40 million, and then extended for another $80 million in November 2007**. In late 2009, the EBRD approved a further $100 million extension to AMBFF II in order to support increased financial intermediation and the development of the financial sector in Armenia as well as to contribute to economic development by providing medium to long-term funding to selected Armenian financial intermediaries. Another extension to this Facility of $100 million was approved in mid-2011. The Facility seeks to develop new products for financial institutions, including provision of local currency loans, agricultural credit lines and mortgage financing. Additional technical assistance is provided through the program to partner banks.

6. **The EBRD expanded its relationship with partner banks in Armenia from four to twelve (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 corporate. By means of co-financing lines, the Bank has entered such new sectors as healthcare and telecoms, in addition to significantly expanding 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.

7. **As of end December 2013, the EBRD has disbursed about EUR 77 million in local currency to Armenian commercial banks and micro financing institutions**. Another EUR 30 million equivalent in Armenian drams are in the pipeline. The Currency Exchange (TCX) provides Armenian dram hedging to the EBRD. In parallel, the EBRD and IMF are assisting the government and the CBA to implement reforms aiming to facilitate financing in dram, reduce the level of dollarization, and to foster the development of local capital markets. EBRD considers Armenia a key focus country for local capital market development.

8. **In early 2012, EBRD together with other international financial institutions supported the creation of the Caucasus Growth Fund**. This fund is managed by the Small Enterprise Assistance Funds (SEAF), a global fund manager, and is be the first institutional quality fund to provide debt and equity to SMEs in the Caucasus region.

9. **Supporting development of renewable energy is another core activity of the Bank**. To that end, the EBRD joined forces with the WB, USAID, and Cascade Credit (a financing arm of Cafesjian Foundation) to launch the Armenian Renewable Energy Program (AREP). The Bank's

participation took the form of a loan to Cascade Credit. The Bank also continued to finance renewable energy projects on its own through a Direct Lending Facility, with two such projects signed. In addition to renewable energy, the Bank returned to the mainstream segment of the sector, seeking to support post-privatization development with a loan to the Armenian 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 obsolete low-voltage infrastructure and improve energy efficiency. In December 2012, the EBRD provided a EUR 19 million loan to International Energy Corporation (IEC) to finance the rehabilitation of seven hydropower plants of the Sevan-Hrazdan Cascade. The project is bringing the Company's technical standards in line with best international practice.

10. **The EBRD launched the Enterprise Growth Programme (EGP) and Business Advisory Service programs in Armenia in 2003 to support micro, small, and medium-sized enterprises**. Since 2003, BAS has completed 936 projects in the amount of EUR 5.9 million, as well as 63 Market Development Activity (MDA) projects. EGP has delivered more than 25 projects. Among donors supporting this effort include Canada, Taipei China, the United Kingdom, the EU, EU - Eastern Partnership Multi-Beneficiary Technical Assistance, the United States, the Early Transition Countries Fund (ETCF), the EBRD, and EBRD Shareholder Special Fund (ESSF).

11. **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. TA has been put in place financed by the Government of Austria. The Bank has also launched a TA program to review and amend the legal, regulatory, institutional, operational and technical frameworks for energy efficiency in the residential sector. In 2013 two of the largest banks joined the program signing loans of USD 6.5m in total to be on-lent to industrial and residential EE sub-projects. USD 2.8m has been already successfully allocated. EBRD will continue offering financing and capacity building to Armenian commercial banks to support investments in this sector. The residential sector in Armenia is a large energy consumer with significant potential for energy savings and carbon emission reductions.

12. **As part of inspection reform and doing business programs, the EBRD is assisting the government toward improvement of the business environment**. The EBRD supported the roll-out of a corporate governance code in cooperation with the Ministry of Economy, the Central Bank, the Stock Exchange and the IFC. The Bank is also providing assistance to the Public Services Regulatory Commission for telecommunications sector regulation. This assistance is being financed by the Government of Finland.

13. **The EBRD's current country strategy was approved in May 2012**. The key priorities of the EBRD for the coming three years are: (i) developing the financial sector and improving access to finance; (ii) improving municipal and urban transport infrastructure; (iii) developing agribusiness and high value-added, export-oriented industrial companies; and (iv) improving the regulatory and institutional framework for sustainable energy and mining.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ASDB)

(As of January 20, 2014)

1. **Armenia joined AsDB in September 2005, and is currently eligible for financing from AsDB's concessional Asian Development Fund (ADF), as well as its non-concessional Ordinary Capital Resources (OCR)**. AsDB's country operations business plan (COBP) for 2014–2016, approved in December 2013, identifies infrastructure development as priority area for AsDB's operations. AsDB is preparing a new 2014-2018 country partnership strategy for AsDB's Board consideration in 2014.

2. **As of December 31, 2014, the AsDB cumulative sovereign lending amounted to $753.67 million**. The Women's Entrepreneurship Support Sector Development Program, approved in October 2012, will promote gender-inclusive growth by improving the enabling environment and capacity of women entrepreneurs and micro and small enterprises (MSMEs). The program includes two components: (i) a program loan ($20 million) supporting reforms related to improving the business environment for women; and (ii) a financial intermediation loan ($20 million) through the German-Armenian Fund in which medium-term local currency loans will be made by participating financial institutions to MSMEs, with at least 50% of the loans going to women's MSMEs. In 2012, AsDB provided $40 million as additional financing for the Water Sector and Sanitation Sector Project, approved in 2007, for improving access to safe, reliable, and sustainable services in about 29 towns and up to 160 project villages, managed on commercial principles and with environmentally sound practices.

3. **In 2011, ADB approved a $400 million multi-tranche financing facility (MFF) for the Sustainable Urban Development Investment Program, which aims to help Armenia upgrade its urban transport services, to improve living conditions, and bolster economic opportunities in 12 of the country's major and secondary cities**. In 2011, AsDB approved Tranche 1 for $48.64 million to improve and extend the urban infrastructure and to strengthen the institutional capacity in Yerevan.

4. **In 2009, ADB approved a $500 million MFF to fund the North–South Road Corridor Investment Program**. In 2009 AsDB approved Tranche 1 ($60 million) for improving the Yerevan-Ashtarak section of the road. Tranche 2 ($170 million) approved in 2010 finances the upgrade of the road between Ashtarak and Talin. In 2013 AsDB approved Tranche 3 for $180 million to finance continuing construction of the road to Gyumri (co-financing from the European Investment Bank reduced AsDB's financing for Tranche 3 to $100 million while maintaining the total amount of financing for civil works). Tranche 3 will also finance engineering and economic studies of the southern sections of the North-South Road Corridor.

5. **The Crisis Recovery Support Program Loans ($80 million), approved in July 2009, helped Armenia through the global financial crisis by allowing it to protect budgetary social spending and implement anti-crisis measures in a time of economic contraction and declining fiscal revenues**.

6. **In 2007, AsDB approved a $30.6 million loan for the Rural Road Sector Project to help the government upgrade 220 kilometers of rural roads**. A supplemental financing of $17.32 million was approved in 2008 to address financial shortcomings of the project. A $36 million loan for the Water Supply and Sanitation Sector Project, approved in 2007, helped the government repair and replace water supply infrastructure in small towns and villages.

7. **With the exception of the North-South Road Corridor Tranche 2 and Tranche 3 investment program loans, all approved sovereign loans are from the AsDB's concessional ADF**. The Tranche 2 and Tranche 3 loans for the North-South road are from the AsDB's non-concessional OCR.

8. **AsDB has approved four private sector projects a total of $133 million in non-sovereign financing in Armenia and one trade finance program**. In May 2013, ADB signed a $25 million loan with International Energy Corporation to rehabilitate and to improve the reliability and safety of Sevan-Hrazdan Cascade Hydropower, in a program cofinanced with the European Bank for Reconstruction and Development (EBRD). In November 2011, AsDB approved a non-sovereign lending program totaling $65 million for four commercial banks to expand lending to small and medium-size enterprises (SMEs). One non-sovereign loan for $40 million was provided to Armenia International Airports for the Zvartnots Airport Expansion Project (Phase 2). The loan financed the construction of a new terminal building and purchase of equipment to supplement the existing concourse building, in a program cofinanced with EBRD and DEG (German Investment and Development Corporation). In 2007 AsDB extended a $3 million loan to a local bank for on-lending to small businesses. AsDB's Trade Finance Program works with three banks in Armenia and has supported over $19 million in trade.

9. **In addition to financing projects and programs, the AsDB is also involved in advisory services and capacity development**. These include technical assistance programs for urban development in secondary cities, improved access to finance for women entrepreneurs, infrastructure sustainability, power transmission rehabilitation, and solid waste management. In 2013 ADB approved a TA program to carry out seismic risk mitigation study of public buildings in four secondary towns. Armenia is also included in a number of AsDB's multi-country TA projects, providing assessments and development plans in topics of common interest across countries.

STATISTICAL ISSUES

(As of January 31, 2014)

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 IMF has supported this process through TA from the Statistics Department (STA), the Fiscal Affairs Department (FAD), and the Monetary and Capital Markets Department (MCM). An April 2008 data ROSC mission prepared a detailed evaluation of the quality of 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 has started compiling a new construction output price index based on more sound methodology. Until the new construction price index becomes available, the NSS should use other indicators for deriving construction aggregates at constant prices. The NSS should also implement new surveys to derive a proper benchmark for informal activities.

4. The 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 underlying problems associated with de-cumulating the cumulative output data distort the quarterly pattern. The NSS is currently working to produce GDP data at current and at constant prices to be fully in accordance with the SNA. The NSS received IMF TA on estimating quarterly GDP from discrete data sources only and is using statistical techniques that conform to international standards. Recent publications of the NSS have reflected this effort. The NSS has discontinued compiling GDP volume measures at the prices of the corresponding quarter of the previous year and instead adopted the recommendation of the IMF STA mission to 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 are essential for analysis of the business cycle. Since 2012, NSS has discontinued compiling GDP on average prices of 2005 and instead they just published GDP for 2009-2012 on average prices of year 2008. As of January 2011, the NSS also started compiling a monthly indicator of economic activity (IEA), following international best practices. The monthly GDP compilation was discontinued. The monthly IEA is an implicit volume index compiled by aggregation of monthly volume indices of output using gross output weights. The CPI covers 11 large population centers and Yerevan. Since January 2011, the CPI has been computed using 2010 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. A February data 2009 ROSC mission recommended development of an approach to include household expenditure on owner-occupied dwellings in the CPI calculations.

Government finance statistics

5. The budget execution reporting system compiles 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. Since 2010 these PIU accounts also are being moved gradually to the TSA. 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.

6. 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,

teachers, and doctors are reported in the category of goods and services and other expense, 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.

7. Since 2008, government finance statistics meet the classification requirements of the *Government Finance Statistics Manual 2001* (*GFSM 2001*) for the central government.

Monetary and financial statistics

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

9. 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. The CBA also produces the financial soundness indicator table every month, published on both the IMF and CBA websites.

External sector statistics

10. 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. The February 2010 STA mission provided advice 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. The responsibilities of compiling external sector statistics were *de facto* transferred to the CBA in January 2011, and since then, the CBA has compiled balance of payments, external debt, and IIP data for 2011. The transfer of responsibilities was smooth and during the short period after the transfer, the CBA undertook a number of important actions aimed at improving the compilation system. A follow up IMF STA mission in October 2011 undertook a comprehensive assessment of the institutional arrangements, data sources, methodology, and compilation practices for external sector statistics employed by the CBA, and advised on areas for improvement including further developing data sources and compilation practices.

11. 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, for remittances, there are considerable discrepancies among available source data. Remittance data obtained from surveys are considerably lower than data obtained through the money transfer system. The absence of a comprehensive, continuously updated business register hampers the coverage of transactions and institutional units; in particular, the coverage of the financial account items for the private nonbank sector. There are also concerns with regard to the collection of data on international trade in services, specifically on import of services. The CBA is currently considering the implementation of an international transactions reporting system that would allow for collecting data on all cross-border payments and receipts going through the banking system.

12. Quarterly data on the international investment position are published by the CBA 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 January 31, 2014)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	January 2014	01/31/2014	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	January 2014	01/31/2014	D	D	M
Reserve/Base Money	January 2014	01/31/2014	D	D	D
Broad Money	Dec. 2013	01/31/2014	M	M	M
Central Bank Balance Sheet	Dec. 2013	01/31/2014	D	M	M
Consolidated Balance Sheet of the Banking System	Dec. 2013	01/31/2014	M	M	M
Interest Rates[2]	January 2014	01/31/2014	W	W	M
Consumer Price Index	Dec. 2013	01/31/2014	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]— General Government[4]	Q3 2013	11/31/2013	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Dec. 2013	01/31/2014	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec. 2013	01/31/2014	M	M	Q
External Current Account Balance	Q3 2013	11/31/2013	Q	Q	Q
Exports and Imports of Goods and Services	Q3 2013	11/31/2013	M	M	Q
GDP/GNP	Q3 2013	11/31/2013	Q	Q	Q
Gross External Debt	Q3 2013	11/31/2013	Q	Q	Q
International Investment Position[6]	Q3 2013	11/31/2013	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).

Press Release No. 14/88
FOR IMMEDIATE RELEASE
March 7, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$127.6 Million Extended Arrangement for Armenia

The Executive Board of the International Monetary Fund (IMF) today approved a 38-month SDR 82.21 million (about US$127.6 million, or 89.4 percent of Armenia's quota) Extended Fund Facility (EFF) arrangement with the Republic of Armenia to support the authorities' economic program. The approval enables the disbursement of SDR 11.74 million (about US$18.2 million), while the remaining amount will be phased over the duration of the program, subject to semi-annual program reviews.

The program aims to support a rebound in economic activity, further progress in poverty reduction, inflation stabilization, and a reduction in outstanding fiscal and external vulnerabilities.

Following the Executive Board discussion on Armenia, Ms. Nemat Shafik, Deputy Managing Director and Acting Chair, said:

"Armenia's performance under the 2010–13 Extended Fund Facility and Extended Credit Facility arrangements was sound. However, growth and inflation remain volatile, the external current account deficit continues to be large, and poverty and unemployment are still high. The new 38-month extended arrangement with the Fund aims to support the authorities in addressing these challenges and to sustain Armenia's access to international financial markets.

"Fiscal policy will play a central role in the program, supporting growth in 2014 and reducing the headline deficit over the rest of the program period to build up policy buffers. Delivering planned revenue gains and reducing the under execution of the public investment budget will be essential for successful implementation of the fiscal strategy. Another key measure in the fiscal area is setting up institutional structures to monitor and mitigate fiscal risks.

"Under the authorities' program, monetary policy will continue to be framed by inflation targeting in the context of a flexible exchange rate regime. For the financial sector, policy will be geared towards promoting resilience to shocks and greater financial deepening.

"Growth-enhancing structural reforms will also play a central role in the new program, given the objective of transforming Armenia into a dynamic emerging market. In this context, smooth accession to the Eurasian Customs Union, along with continuing growth of trade and other links with the European Union, will be essential to achieve diversification of markets, products, financial flows, and investors.

"Risks to the new program appear to be manageable, and Armenia's repayment capacity remains robust. The authorities have a long track record of sound macroeconomic policies but maintaining a strong ownership of the program will be essential to its successful implementation."

ANNEX

Recent developments:

Despite sound performance under the 2010–13 IMF-supported program, challenges to the Armenian economy remain, in terms of macroeconomic stabilization, reduction of vulnerabilities, and medium-term growth dynamics. Inflation and growth remain highly volatile, as the growth slowdown and inflation increase in 2013 have illustrated. The external current account deficit and dollarization remain high, keeping the economy vulnerable to shocks. Poverty and unemployment also remain high, and the transition towards an alternative to the pre-crisis construction-led growth model has been slow. Armenia took major financial and trade decisions in 2013, with a 7-year debut Eurobond issued in September, and the announcement that it would seek accession the Eurasian Customs Union.

Program Summary

As part of the program, fiscal policy will support the growth recovery in 2014 by providing a modest stimulus, before moving to a gradual consolidation stance in 2015–17. This will place public debt on a declining path during the program period. Revenue measures will support the consolidation and also create room for addressing social and investment needs.

Monetary and exchange rate policies will be guided by the authorities' framework of inflation targeting and exchange rate flexibility, with program policies focusing on continued improvements in monetary operations, communications, and modeling. Financial sector policies will target implementation of remaining recommendations of the IMF's 2012 Financial Sector Assessment Program (FSAP) Update, which aim to promote resilience to shocks and greater financial deepening.

Structural reforms will support medium-term growth by targeting improvements in the business climate, strengthening institutions, improving connectivity and competition, creating a stronger environment for private and foreign direct investment, and tackling key risks, especially in the energy sector.

Barring major shocks, Armenia's balance of payments gaps should close by the end of the program period and the country should be able to sustain access to international financial markets, paving the way for an exit from IMF support, provided that balance of payments difficulties are resolved, as expected.

Armenia: Selected Economic and Financial Indicators, 2009–16

	2009	2010	2011	2012	2013		2014	2015	2016
	Act.	Act.	Act.	Prel.	EBS/13/75	Proj.	Proj.	Proj.	Proj.
National income and prices									
Real GDP (percent change)	-14.1	2.2	4.7	7.1	5.1	3.2	4.3	4.5	4.7
Gross domestic product (in billions of drams)	3,142	3,460	3,778	3,998	4,351	4,290	4,714	5,123	5,578
Gross domestic product (in millions of U.S. dollars)	8,648	9,260	10,142	9,950	10,365	10,547	11,216	11,609	12,039
Gross domestic product per capita (in U.S. dollars)	2,661	2,838	3,097	3,033	3,153	3,208	3,405	3,517	3,640
CPI (period average; percent change)	3.5	7.3	7.7	2.5	4.0	5.8	5.0	4.0	4.0
CPI (end of period; percent change)	6.7	8.5	4.7	3.2	4.0	5.6	4.0	4.0	4.0
GDP deflator (percent change)	2.6	7.8	4.3	-1.2	4.0	4.0	5.4	4.0	4.0
Poverty rate (in percent)	34.1	35.8	35.0	...	...	...	...	...	...
Investment and saving (in percent of GDP)									
Investment	33.8	29.4	27.0	22.8	24.5	23.9	24.4	24.9	25.5
National savings	18.0	14.6	16.1	11.6	14.4	15.5	17.3	18.1	18.9
Money and credit (end of period)									
Reserve money (percent change)	13.8	-0.8	32.3	1.9	10.3	29.9	9.0	...	...
Broad money (percent change)	16.4	10.6	23.6	19.6	15.9	15.2	11.3	...	...
Velocity of broad money (end of period)	3.8	3.8	3.4	3.0	2.8	2.8	...	...	...
Commercial banks' 3-month lending rate (in percent)	19.1	17.7	20.7	18.5	...	18.3	...	...	...
Central government operations (in percent of GDP)									
Revenue and grants	20.9	21.2	22.1	22.3	23.2	23.3	23.5	23.3	23.6
Of which: tax revenue 1/	16.1	16.4	16.7	18.1	21.7	22.5	22.7	22.7	23.0
Expenditure 2/	28.6	26.2	25.0	23.9	25.5	25.8	25.9	25.4	25.4
Overall balance on a cash basis	-7.9	-4.6	-2.8	-1.5	-2.3	-2.5	-2.3	-2.0	-1.8
Public and publicly-guaranteed debt (in percent of GDP)	40.2	39.7	42.0	44.0	43.5	45.4	45.2	46.0	46.2
Share of foreign currency debt (in percent)	88.9	87.4	86.8	86.9	86.4	84.8	84.4	84.4	84.9
External sector									
Exports of goods and services (in millions of U.S. dollars)	1,336	1,937	2,407	2,440	2,699	2,583	2,757	2,932	3,123
Imports of goods and services (in millions of U.S. dollars)	-3,683	-4,212	-4,797	-4,907	-5,135	-5,022	-5,155	-5,365	-5,596
Exports of goods and services (percent change)	-24.0	45.0	24.3	1.4	8.3	5.8	6.8	6.3	6.5
Imports of goods and services (percent change)	-22.4	14.4	13.9	2.3	4.9	2.3	2.6	4.1	4.3
Current account balance (in percent of GDP)	-15.8	-14.8	-10.9	-11.2	-10.0	-8.4	-7.2	-6.8	-6.6
FDI (net, in millions of U.S. dollars) 3/	725	562	447	474	440	549	413	432	472
External debt (in percent of GDP)	56.4	66.4	71.5	76.2	76.0	79.3	77.0	77.7	78.1
o.w. public debt (in percent of GDP) 4/	35.7	34.7	36.4	38.2	37.6	38.5	38.1	38.8	39.2
Debt service ratio (in percent of exports of goods and services) 4/	5.4	4.7	4.2	9.8	15.6	34.1	10.4	6.3	6.7
Gross international reserves (in millions of U.S. dollars)	2,004	1,866	1,869	1,799	1,467	2,253	2,193	2,278	2,376
Import cover 5/	5.7	4.7	4.6	4.3	3.3	5.2	4.9	4.9	4.9
Nominal effective exchange rate (percent change) 6/	-8.4	-2.6	-2.8	-7.3	...	...	...	...	...
Real effective exchange rate (percent change) 6/	-7.5	1.3	0.0	-6.1	...	...	...	...	...
End-of-period exchange rate (dram per U.S. dollar)	378	363	385.8	403.6	...	405.6	...	...	...
Average exchange rate (dram per U.S. dollar)	363	374	372.5	401.8	...	406.8	...	...	...
Memorandum item:									
Population (in millions)	3.2	3.3	3.3	3.3	...	...	...	...	...

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

1/ From 2013, tax revenue includes social contribution.
2/ In 2013 includes 1.5 percent of GDP related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom, and the transfer (expenditure) of the same amount from the government to ArmRusGazprom to liquidate liabilities. Excluding this transaction, the deficit would amount to 1 percent of GDP.
3/ In 2013, a credit for $155 million is registered in FDI to reflect the acquisition by Gazprom of 20 percent of the shares of ArmRusGazprom, while an offseting debit is registered in other capital (net) to reflect the corresponding reduction in liabilities of the latter with the former.
4/ Based on public and publicly-guaranteed debt.
5/ Gross international reserves in months of next year's imports of goods and services, including the SDR holdings.
6/ A positive sign denotes appreciation.

Statement by Mr. Snel, Executive Director for Armenia and Mr. Hadzi-Vaskov, Advisor to the Executive Director March 7, 2014

The Armenian authorities would like to thank Executive Directors, Management, and staff for their continued support, constructive dialogue, and valuable advice on macroeconomic policies. Armenia's performance under the recently-completed three-year economic program, supported by arrangements under the EFF and the ECF, was sound. The program's objectives to restore economic growth, reduce fiscal and external vulnerabilities, and preserve financial stability were largely met, while all six reviews were successfully completed with few delays.

Economic growth has been restored following a contraction of 14 percent in 2009, and the driver of growth has shifted from construction to agriculture, industry, and services. The fiscal deficit as a share of GDP has been reduced by 6 percentage points to well below the debt stabilizing level of 2 percent of GDP in 2012 and 2013, while the external current account deficit as a share of GDP has declined by about 8 percentage points to 8.4 percent in 2013. At the same time, the authorities have followed Fund advice in implementing important structural reforms in the areas of revenue administration and tax policy, the pension system, the financial sector, and the overall improvement of the business environment. On the basis of its income per capita level and the manageable degree of short-term vulnerabilities, Armenia graduated from the PRGT in 2013.

Request for a new program

Notwithstanding the significant progress achieved over recent years, important challenges remain to reduce vulnerabilities related to the still-elevated external current account deficit, the high levels of dollarization, unemployment, and poverty, and to ensure more inclusive, resilient, and sustainable economic growth. Aiming to build on the progress achieved under the previous EFF/ECF arrangement, while recognizing that important medium-term challenges remain, the Armenian authorities request a new 38-month arrangement under the EFF in an amount equivalent to SDR 82.21 million (89.4 percent of quota).

The new program aims at consolidating macroeconomic stability, strengthening buffers against possible shocks, and enhancing medium-term growth through the implementation of further reforms in Armenia's progress towards a dynamic emerging market economy. Reiterating their full commitment to implementing the measures envisaged under their economic program, the authorities believe that support under the new EFF arrangement will be crucial for achieving their development objectives at the current juncture, while laying the path to a successful exit from Fund support.

Fiscal policy

After a moderate increase in 2014 to support growth and implementation of key infrastructure projects, the authorities aim at a gradual reduction of the fiscal deficit in order to start reducing the level of public debt, while continuing to address social and capital investment needs. In this regard, they are planning to increase revenues in a growth-friendly way, which focuses on addressing tax policy gaps and efficiency- and equity-enhancing tax policy and administration gains. Fiscal measures will aim to stimulate private activity and increase spending on public infrastructure, while maintaining a well-targeted safety net and achieving a debt-reducing deficit path from 2.3 percent of GDP in 2014 to 2 percent of GDP in 2015 and 1.8 percent of GDP in 2016. The authorities' key objectives include improving the execution of public investment spending and strengthening the institutional arrangements for assessing and managing fiscal risks through the establishment of risk management units at the State Revenue Committee (SRC) and the Ministry of Finance in 2014.

The 2014 budget targets a deficit of 2.3 percent of GDP, well in line with the projected path under the previous Fund-supported program. The budget is expected to provide a positive fiscal impulse through higher capital investment and increased pensions and civil service wages following several years of restraint and real erosion. On capital spending, the authorities plan to step up spending for road maintenance and school rehabilitation following years of restraint, while decisively addressing constraints that have led to fiscal underspending on externally-financed capital projects, most notably the North-South Highway. The increase in pensions and civil service wages seeks to limit the worsening of social indicators among the elderly and to address difficulties in attracting and retaining well-qualified staff given that wages for most categories have been frozen since the crisis. The authorities aim at achieving a more consistent wage policy through structural changes, including introducing a grid structure based on clear job descriptions and standardized salaries across different government agencies and levels. They are also working with the World Bank to strengthen performance assessments, and will seek cost savings where possible. At the same time, the authorities recognize that further developments in this area must be consistent with fiscal sustainability.

Notwithstanding recent progress, the poverty rate remains high, and the authorities continue to place importance on poverty reduction and targeted social spending. Following an increase in the minimum wage by 29 percent in July 2013, they are planning to raise it by an additional 11 percent in July 2014. Moreover, the authorities have made progress with their efforts to modernize the legal framework for social assistance and state benefits, as well as to integrate and streamline the wide range of social services in order to improve efficiency and service quality. Following the completion of the legal framework and pilot projects, the integrated social benefits system will become operational in 2014.

The authorities aim at strengthening tax revenues through efficiency-enhancing tax and customs administration improvements, and through tax policy measures starting from 2015. Following a significant increase in the tax revenue-to-GDP ratio by over 2.5 percentage points in 2012-2013, the authorities' efforts in 2014 will focus on improving compliance and closing policy gaps to level the playing field and limit adverse business environment effects. Key revenue administration measures envisaged under the program include implementation of a modern tax compliance system, modernization of legislation and procedures, enhancing the coverage and the capacity of the large taxpayer unit of the SRC, and facilitating greater transparency and enhanced dialogue with taxpayers. The authorities will continue to focus on assessing and addressing remaining tax policy gaps. The draft law on transfer pricing, which has been refined to bring it in line with OECD guidelines and international practice, will be submitted to Parliament, as will be other legal changes with application from 2015 on increasing the natural resource user fee for non-metallic minerals, and unification of property and land taxes. In light of the possible adverse effects on the poor and the business environment, the authorities will further assess the incidence of tax policy changes and the scope for possible actions in 2015 and beyond for possible new tax instruments, increases of some tax rates, and reduction or elimination of specific exemptions.

Monetary, exchange rate, and financial sector policies

The Central Bank of Armenia (CBA) will continue to implement monetary policy within an inflation-targeting framework with exchange rate flexibility. The foreign exchange market interventions will be limited to smooth excessive volatility and avoid market instability, and the exchange rate will move according to fundamentals and support external adjustment. Following a decline in reserves during and after the crisis, the CBA has rebuilt their level in 2013 with the Eurobond issuance and net purchases on the FX market. The CBA authorities continue to place high importance on maintaining buffers, and stand ready to use periods when market conditions provide opportunities to build reserves without affecting general market trends. The authorities remain confident that their policies will help in gradually reducing dollarization of savings, thereby providing an additional opportunity to acquire reserves.

The CBA authorities remain committed to continue strengthening the operational framework for monetary policy. They believe that further enhancing communications with markets and the public through periodic press conferences and strengthened content of the inflation report will help in providing more guidance on policy actions and help ensure that inflation stays within the target range. The CBA authorities will continue improving the operation of the interbank money market, will further explore policy options to strengthen liquidity management within the interbank and FX markets, and will assess the remaining impediments to developing the FX derivatives market and FX risk hedging instruments.

Promoting resilience to shocks and further financial deepening remain at the core of financial sector policies. The CBA has prepared a timeline for Basel III implementation, and will issue regulations on capital requirements and prepare the methodology on identifying domestic systemically-important banking institutions by June 2014. In light of the high level of dollarization, the CBA authorities will continue to strengthen the monitoring capacity and cooperation with local banks to enhance their management of FX exposure and risk. The CBA will also undertake the following reforms: improve the quality of information received from banks on potential currency mismatches of large borrowers; amend the regulation on the calculation of large exposures to align it with international practices; introduce measures to strengthen the crisis management infrastructure; implement legal, regulatory, and institutional changes to simplify registration and execution of collateral; facilitate access of foreign participants on Armenia's capital market; and create a legal and operational environment conducive to the development of a modern mortgage finance system.

Structural reforms

The authorities expect that the membership in the Eurasian Customs Union (ECU) will create significant economic opportunities, including through lower import prices for energy and other inputs, and enhanced access for Armenian exports through the removal of customs and non-trade barriers. Given that the average ECU effective tariff rate is substantially higher than Armenia's effective rate, the Armenian authorities are seeking exclusions from the common ECU external tariff where possible, or transition periods in order to limit rise in input costs and prices of sensitive goods. For this purpose, they have suggested including over 800 products in an exception list. The Armenian authorities expect that ECU membership will help mobilize new external financing for important infrastructure projects, including in energy and rail and road networks, as well as to improve prospects for FDI. The authorities reiterate their commitment to strictly limit government exposure and use of public funds in new projects and to consult with the Fund and the World Bank in advance of taking on any fiscal liabilities.

The Armenian authorities remain strongly committed to further strengthening its relationship with the EU. To the extent possible, they intend to resolutely move forward with reforms aimed at harmonization with EU standards and institutions wherever they are compatible with ECU membership. The implementation of these reforms is expected to support the modernization of the economy and contribute to export growth and diversification. Expecting to continue cooperation under the Eastern Partnership initiative, the Armenian authorities look forward to continued EU macro-financial support, technical assistance, and twinning projects.

The regulatory guillotine program, which covers legislative packets for improving efficiency, reducing overlap, and streamlining regulations and red-tape, continues to form a core part of the structural reforms agenda. Following progress in the areas of health, road transportation, and public utilities, the authorities currently develop legislative packets in six additional areas (entrepreneurship, tax, customs, social issues, foreign affairs, and culture) from a total of 17 areas that will be addressed by 2015. In accordance with their Doing Business Action Plan for 2014, the authorities plan to focus their efforts on areas that require further improvement, including contract enforcement, payment of taxes, the insolvency process, and facilitation of foreign trade.

The authorities will continue to work on strengthening competition, including by building consensus for providing investigative powers to the State Committee for Protection of Economic Competition (SCPEC), while putting in place memoranda of cooperation between the SCPEC and other state institutions in this area by June 2014. In the meantime, a packet of legislative changes has been submitted to Parliament, including clearer definitions of dominance and market abuse, stronger fines, and procedural changes. The authorities aim at introducing a leniency program and strengthening the role of SCPEC in consumer protection in the course of 2014.

With the goal of reducing business costs, strengthening competitiveness, and enhancing the safety of products and services, the authorities undertook an initiative for a comprehensive inspection reform. Completion of a pilot merger of inspection agencies and initiation of a unified database are expected by the end of 2014, and the authorities aim at reducing the number of inspection agencies by half over the next few years. Armenia's quality infrastructure is expected to be enhanced with EU assistance. The authorities have worked with the World Bank, other international agencies, and management consultants to develop a new policy framework for the civil aviation sector, approved in October 2013, which aims to increase competition, enhance service quality, and lower costs. The Government has addressed the EU to begin negotiations on a Common Aviation Area Agreement, which is expected to have a significant impact on liberalization in this sector.

Conclusion

The authorities reiterate their commitment to maintaining a close policy dialogue with the Fund and stand ready to take additional actions to ensure the achievement of their social and economic objectives under the Fund-supported program. They remain committed to extend their long track record of sound and prudent macroeconomic policies, address challenges and reduce vulnerabilities through the steadfast implementation of complex policy measures included in the program, and thereby facilitate the advancement to a dynamic emerging-market economy, and trace the path to a successful exit from Fund program support. Emphasizing the crucial role that Fund TA has been playing in supporting their reform agenda, the authorities are looking forward to further broad TA support, which they view as indispensable for the achievement of their reform objectives.