IMF Country Report No. 16/380

REPUBLIC OF ARMENIA

December 2016

FOURTH REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF ARMENIA

In the context of the Fourth Review Under the Extended Arrangement and Request for Waiver and Modification of Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 7, 2016, following discussions that ended on September 28, 2016, with the officials of Republic 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 November 21, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Republic of Armenia.

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

Letter of Intent sent to the IMF by the authorities of Republic of Armenia*
Memorandum of Economic and Financial Policies by the authorities of Republic of Armenia*
Technical Memorandum of Understanding*
*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Press Release No. 16/546
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December 7, 2016

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IMF Executive Board Completes Fourth Review of Armenia's Extended Arrangement

The Executive Board of the International Monetary Fund (IMF) completed today the fourth review of Armenia's performance under a three-year arrangement under the Extended Fund Facility (EFF). The completion enables the release of SDR 15.65 million (about US$21.24 million), bringing total disbursements under the arrangement to SDR 66.52 million (about US$90.28 million). The extended arrangement for SDR 82.21 million (about US$111.57 million) was approved on March 7, 2014 (see Press Release No. 14/88).

In completing the review, the Executive Board also approved the authorities' request for a modification of the end-December 2016 fiscal balance performance criterion. The revenue shortfall has been mainly due to exogenous factors, and the higher capital expenditure, which is externally financed at concessional terms, in large part reflects a catch-up of past under-execution and provides some counter-cyclical support.

Following the Executive Board's discussion on Armenia, Mr. David Lipton, First Deputy Managing Director and Acting Chair, said:

"Program performance has been broadly satisfactory despite continued adverse external developments that have contributed to subdued domestic demand, weak revenues, and deflationary conditions. Looking forward, the outlook remains challenging, calling for sustained policy efforts to secure macroeconomic and financial stability and to foster sustainable and inclusive growth.

"Revenue shortfalls, together with counter-cyclical over-execution of foreign-financed projects, are expected to widen the 2016 fiscal deficit. Nevertheless, the authorities remain committed to fiscal consolidation and debt sustainability, as embodied in their fiscal rule, which aims to ensure that debt remains below 60 percent of GDP over the medium term. In this context, they have developed a fiscal consolidation plan for 2017 and beyond. It will be important to carry out this consolidation plan in a growth-friendly manner. Moreover, the new tax code should support the consolidation efforts, but it is also essential to implement measures that improve the prioritization and monitoring of foreign-financed capital expenditure and that further strengthen revenue administration.

"The central bank's monetary policy easing over the past year has helped reduce key market interest rates and supported a nascent recovery in bank lending. Going forward, the objective should be to bring inflation closer to the CBA's target of 4 percent, while maintaining exchange rate flexibility to respond to external shocks and strengthen competitiveness. At the same time, enforcing the new minimum capital requirements and integrating financial stability considerations into the CBA's operational framework will help support the financial sector's resilience and strengthen the macroprudential framework.

"Pursuing further structural reforms remains essential for fostering sustainable and inclusive growth. Strengthening domestic competition and regulatory reforms are pivotal to creating a more broad-based, private sector-led economy. In this context, the authorities' planned amendments to the law for enhancing economic competition protection is an important step."

Armenia: Selected Economic and Financial Indicators, 2014–18

	2014	2015	2016		2017		2018
	Act.	Prel.	CR No. 16/246 1/	Proj.	CR No. 16/246 1/	Proj.	Proj.
National income and prices:							
Real GDP (percent change)	3.6	3.0	2.2	2.4	2.5	2.7	3.0
Gross domestic product (in billions of drams) 2/	4,829	5,032	5,297	5,151	5,646	5,405	5,762
Gross domestic product per capita (in U.S. dollars)	3,889	3,521	3,589	3,568	3,715	3,626	3,790
CPI (period average; percent change)	3.0	3.7	-0.4	-1.4	4.0	1.6	3.5
CPI (end of period; percent change)	4.6	-0.1	1.0	-0.5	4.0	2.8	4.0
GDP deflator (percent change) 2/	2.3	1.2	2.7	0.0	4.0	2.2	3.5
Money and credit (end of period)							
Reserve money (percent change)	-0.1	3.9	5.8	4.9	6.7	8.8	8.0
Broad money (percent change)	8.9	10.7	5.5	13.9	6.7	10.5	8.0
Central government operations (in percent of GDP)							
Revenue and grants	22.0	21.5	21.5	21.2	21.6	21.8	22.2
Of which: tax revenue	21.1	20.1	20.0	19.5	20.5	20.2	20.6
Expenditure	24.0	26.4	25.6	27.1	24.4	24.6	24.2
Overall balance on a cash basis	-2.1	-4.8	-4.1	-5.9	-2.8	-2.8	-2.0
Public and publicly-guaranteed debt (in percent of GDP)	43.6	48.8	52.4	54.7	54.0	56.4	56.8
Share of foreign currency debt (in percent)	86.2	86.9	87.0	85.5	86.2	85.0	81.4
External sector							
Exports of G&S (in millions of U.S. dollars)	3,319	3,137	3,059	3,384	3,137	3,585	3,845
Imports of G&S (in millions of U.S. dollars)	-5,487	-4,418	-4,041	-4,327	-4,202	-4,672	-4,778
Exports of G&S (percent change)	5.2	-5.5	-2.6	7.9	2.5	5.9	7.3
Imports of G&S (percent change)	0.2	-19.5	-7.3	-2.0	4.0	8.0	2.3
Current account balance (in percent of GDP)	-7.6	-2.7	-3.0	-2.9	-3.4	-4.0	-2.6
Debt service ratio (in percent of exports of G&S) 3/	8.6	12.5	8.0	7.2	9.2	8.1	8.3
Gross international reserves (in millions of U.S. dollars)	1,489	1,771	1,858	1,953	1,959	1,981	2,137
Import cover 4/	4.0	4.9	5.3	5.0	5.4	5.0	5.2
End-of-period exchange rate (dram per U.S. dollar)	475	484	…	…	…	…	…
Average exchange rate (dram per U.S. dollar)	416	478	…	…	…	…	…

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

1/ Staff Report for the Third Review.
2/ 2015 the authorities started calculating GDP using the SNA 2008 methodology. They have revised GDP series from 2012 on.
3/ Based on public and publicly-guaranteed debt.
4/ Gross international reserves in months of next year's imports of goods and services, including the SDR holdings.

REPUBLIC OF ARMENIA

December 2016

FOURTH REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

KEY ISSUES

Background. External developments—notably relating to remittances and copper prices—have remained adverse, contributing to subdued domestic demand and deflationary conditions, but export performance has continued to be relatively strong. As a result, the current account deficit has narrowed further while pressures on the fiscal accounts have intensified. Cumulative tax revenues through September declined by ½ percent vis-à-vis the same period of last year, and show an even higher shortfall with respect to projections in the budget. On the positive side, the National Assembly approved the new Tax Code, which is expected to improve the tax environment considerably and boost medium-term revenues. Monetary conditions have stabilized, and the Central Bank of Armenia (CBA) has continued to unwind past tightening measures. Conditions in the banking sector remain challenging, with relatively high NPLs and low credit growth, but the sector remains well capitalized, and the CBA's policy of increasing minimum capital requirements has led to an orderly consolidation process. A new Cabinet with a technocratic profile was appointed in September with the objective of strengthening economic management. New parliamentary elections are expected to take place in April/May 2017, as Armenia continues its transition from a presidential to a parliamentary system.

Outlook and risks. The outlook remains challenging. Growth is expected to reach about 2½ percent in 2016, as the external environment continues to be weak and the effects of past positive one-off factors dissipate. Domestic demand is expected to remain subdued and inflation to remain slightly negative by end-year. The headline fiscal deficit is expected to widen to almost 6 percent of GDP, although the cyclically adjusted primary balance is projected to fall slightly vis-à-vis 2015. The higher deficit reflects weak tax revenues combined with countercyclical stepping up of the implementation of foreign-financed (concessional) capital expenditures, primarily in the second half of the year. Next year is also expected to be challenging for growth and the fiscal accounts, particularly with the triggering of Armenia's fiscal rule, which significantly limits the size of the fiscal deficit. Near-term risks remain high, as weaker external conditions could significantly impact Armenia via lower exports and remittances. Growth is expected to improve in the medium term along with stronger activity in trading partners, while fiscal conditions are expected to benefit from medium-term measures embedded in the new Tax Code.

Program performance. Program performance remained broadly satisfactory, but clouded by fragile fiscal conditions. Specifically: (i) all end-June and continuous performance criteria, as well as all end-June indicative targets were met; (ii) the inflation path has been in line with the trajectory envisaged in the monetary policy consultation clause (MPCC); and (iii) most structural benchmarks (SBs) were met—including the passing of the Tax Code and the risk assessment of budgetary lending operations. However, the end-December 2016 fiscal balance target is projected to be missed by a wide margin, as revenues continue to underperform in the second half of the year, and foreign-financed capital expenditures catch up.

Policy discussions. Discussions focused on the policy response to the current macroeconomic environment, characterized by low growth, fiscal fragility, and deflationary conditions. After two years of accommodation, fiscal policy will need to consolidate in 2017 to meet the requirements of Armenia's fiscal rule and ensure debt sustainability. The approval of the Tax Code by the National Assembly constitutes a key step to improve the tax environment and increase tax revenues in the medium term, but the government needs to implement additional measures to improve revenue administration, prevent tax evasion, and better monitor the execution of foreign financed capital expenditures. Further monetary policy easing is recommended, consistent with the inflation forecast targeting framework and complemented by the flexible exchange rate regime. The significant easing conducted by the CBA over the past year is expected to support a recovery in private sector demand and help bring 2017 inflation closer to the CBA's 4 percent medium-term target. The CBA will continue to oversee the increase in the banking sector's minimum capital requirements, as well as additional efforts (e.g., mergers and/or acquisitions) toward further consolidation. Structural reforms will maintain a key role in the near future, particularly to strengthen the financial conditions and functioning of the electricity sector and to enhance domestic competition.

Program issues. The authorities are requesting a modification of the end-December 2016 fiscal balance target. Staff supports the authorities' request. The revenue shortfall has been mainly due to exogenous factors, and the higher capital expenditure, which is externally financed at concessional terms, in large part reflects a catch-up of past under-execution and provides some counter-cyclical support. In addition, the activation of the fiscal rule in 2017, the new mechanisms to enhance monitoring of capital expenditure projects (new structural benchmarks under the program), and the measures embedded in the recently approved Tax Code provide assurances regarding fiscal discipline and medium-term debt sustainability.

Approved By:
Juha Kähkönen and Yan Sun

Discussions were held between September 14–29 with Prime Minister Karapetyan, Deputy Prime Minister Gabrielyan, CBA Chairman Javadyan, Finance Minister Aramyan, Energy and Natural Resources Minister Manukyan, other senior officials, and representatives of the private sector, civil society, and the diplomatic community. The team comprised H. Samiei (head), P. Rodriguez and S. Yoon (MCD), M. Perks (SPR), and R. Rozenov (FAD). T. Daban (Resident Representative) and M. Aleksanyan, A. Manookian, and V. Janvelyan (IMF Office) assisted. Y. Yakhin (OED) joined most of the meetings. N. Aivazova and C. Prado de Guzman (MCD) provided assistance.

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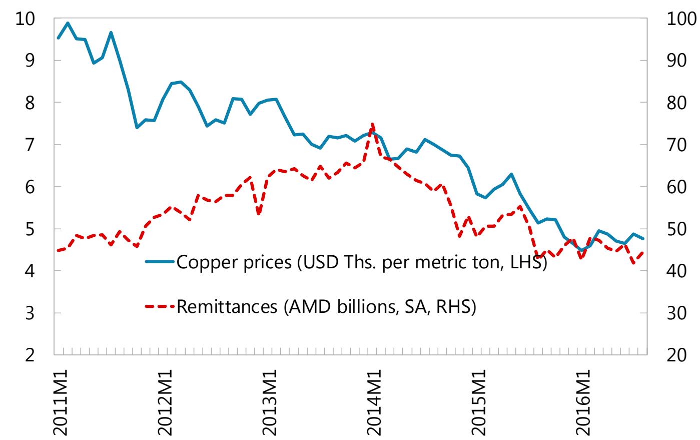
APPENDIX

CONTEXT AND RECENT DEVELOPMENTS

1. External economic conditions remain difficult, although exports have remained relatively strong. Copper prices and remittances have stabilized at very low levels, posting large annual declines in the first eight months of the year—around 18 percent and 11 percent, respectively. Export volumes, however, have continued to grow strongly in 2016, in part due to the impact of a new copper mine, but also due to higher exports to the Middle East and Russia (Annex I). While total external receipts—exports of goods and services plus remittances—posted a 1½ percent increase in the first half of 2016, they remained nearly 13 percent below the figure observed in the first half of 2014.

Armenia. Copper Prices and Remittances



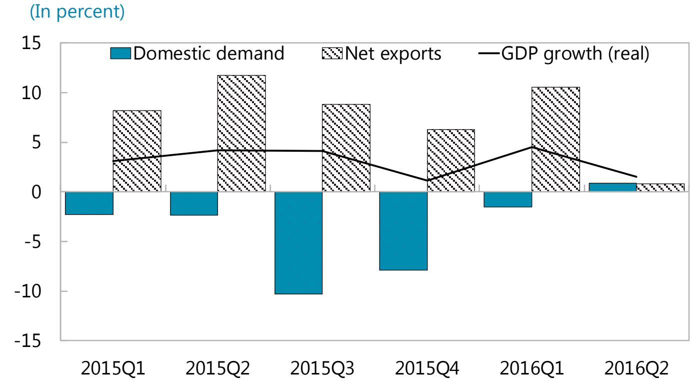
Sources: National authorities and IMF databases.

2. Despite a pick-up in activity in 2016Q1, weak growth and deflationary conditions have persisted, while the current account deficit has narrowed further.

- Real economic activity grew at nearly 4½ percent in the first quarter on account of very strong exports, but weakened to just 1½ percent in the second quarter as the exports impact waned, with lower contributions from mining and agriculture. The contribution of domestic demand, although positive in the second quarter for the first time since 2014, has remained quite low. High frequency indicators of economic activity suggest that the weak growth carried forward to the third quarter.

Armenia. Contributions to Real GDP Growth 1/

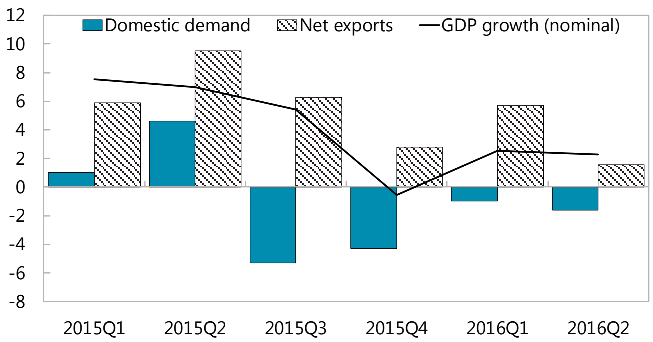
(In percent)



Sources: National Authorities and IMF staff calculations.
1/ Differences between real GDP growth and its components is due to statistical discrepancy.

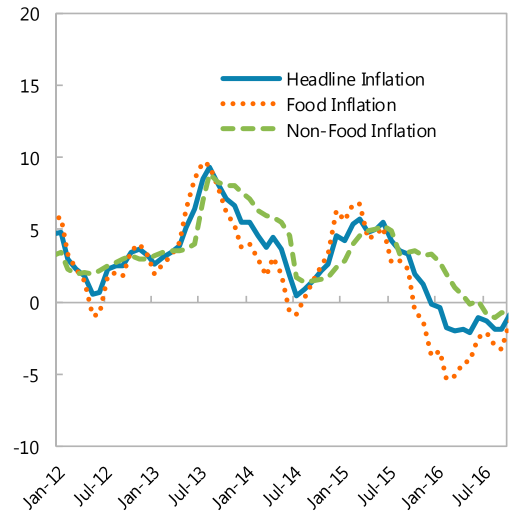
- Deflation has continued and nominal GDP posted just a 2½ percent growth in the first half of the year. At the consumer level, year-on-year deflation reached 0.9 percent at end-October, with food prices declining over 1¼ percent and nonfood prices around ¾ percent.

Armenia. Contributions to Nominal GDP Growth 1/
(In percent)



Sources: National Authorities and IMF staff calculations.
1/ Differences between nominal GDP growth and its components is due to statistical discrepancy.

Consumer Price Inflation
(In Percentage Change)

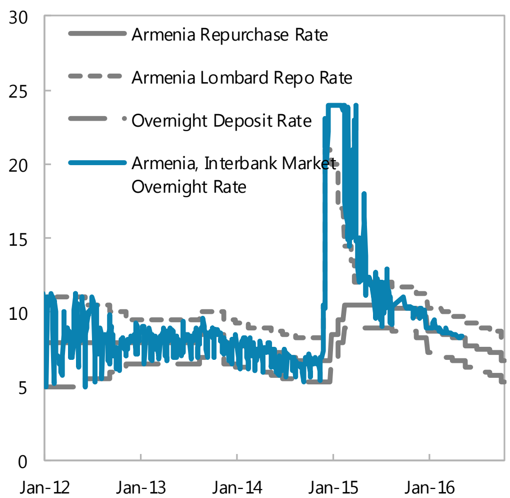


- Given weak demand and subdued commodity prices, imports of goods and services declined nearly 4 percent in the first half of the year. This, combined with the strong export performance, translated into a narrowing of the current account deficit to just USD 167 million—or about 30 percent less than in the first half of 2015.

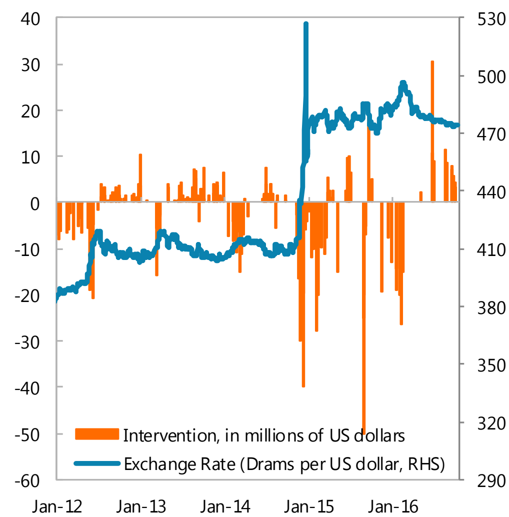
3. **Pressures on the fiscal accounts have intensified, in part owing to lower-than-expected tax revenues, but the new Tax Code was approved by the National Assembly (NA).** Tax collections through September showed a decline of around ½ percent vis-à-vis the same period of 2015, and an even higher decline with respect to budget projections. The shortfall largely reflected weak domestic demand and imports, which led to a continued decline in VAT collections, more than offsetting relatively strong performances in PIT and profit taxes. In addition, VAT refunds increased considerably relative to 2015H1 on the back of robust export growth. The fiscal deficit was kept in check in 2016H1 due to under-execution in both current and capital outlays, with the overall budget deficit for 2016H1 at about 1¾ percent of the projected 2016 GDP. Nonetheless, implementation of foreign-financed capital expenditures has been catching up rapidly in 2016H2 (see below). The NA approved on second reading in late September the new Tax Code, which is expected to improve the tax environment and boost revenues by about 2 percent of GDP in the medium term.

4. Monetary conditions have stabilized and the CBA has continued to unwind past tightening measures. Given weak imports and robust exports growth, pressures in the FX market have diminished. The CBA has continued to recoup the FX sales conducted in the first quarter, and by early November net purchases had actually been positive for the year ($44 million). In addition, in line with its inflation forecast targeting framework, the CBA has continued to ease monetary policy, including by reducing FX deposits reserve requirements for the first time since early 2015. With the recent measures, the policy rate has now fallen to 6¾—around the pre-tightening levels of late-2014—and FX deposits reserve requirements have fallen to 18 percent—still above the 12 percent rate maintained in 2014 to discourage dollarization.

Interest Rate Corridor
(In Percent)



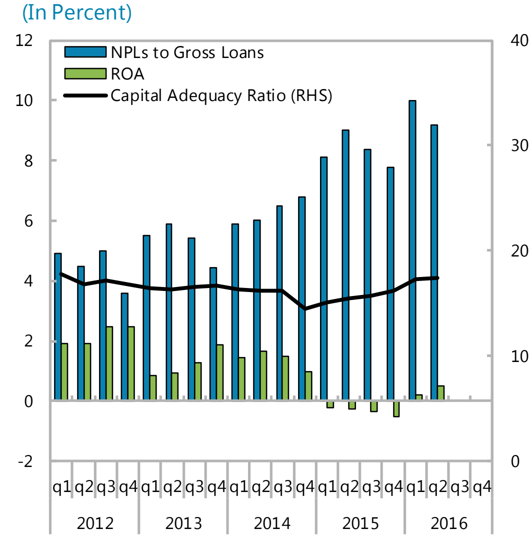
FX Intervention and Exchange Rate



Source: National authorities.

5. Banking sector performance is still affected by high NPLs, but capital adequacy remains high and deposits continue to grow. Profitability continues to be low (although turning slightly positive in the first half of 2016), and NPLs were still over 9 percent of total loans at end-June—a legacy of the 2014 depreciation. Bank capitalization, however, remains high, in part due to efforts by banks to comply with the CBA-mandated increase in minimum capital requirements, which has also led to three mergers. Banking sector deposits continued to grow, with dram deposit growth reaching 28 percent at end-September.

Financial Soundness Indicators
(In Percent)



Source: Central Bank of Armenia.

6. A new government was appointed in September. PM Karapetyan took office in early September after the resignation of PM Abrahamyan. The new Cabinet has a technocratic profile and is targeting an improvement in economic management. In the first weeks in its post, the Cabinet presented the 2017 budget to the NA and worked closely with it on the passing of the new Tax Code. New parliamentary elections are expected to take place in April/May 2017, as Armenia continues its transition from a presidential to a parliamentary system.

OUTLOOK AND RISKS

7. The outlook remains challenging. Growth is expected to reach about 2.4 percent in 2016, as weak activity in trading partners continues and the positive effects of the 2015 one-off factors dissipate. The fiscal deficit is expected to widen to almost 6 percent of GDP, with over-performance in the implementation of capital expenditures in the second half of the year and weak tax revenues. Next year is also expected to be challenging for growth and the fiscal accounts. Some recovery in credit and domestic demand is expected due to the impact of monetary easing and recent capital increases in the banking sector. However, GDP growth is likely to be held back by the need to significantly reduce the fiscal deficit in the context of Armenia's fiscal rule (see below). The outlook is more favorable from 2018 on as the recovery in Russia strengthens and budgetary pressures ease. Higher exports from a new gold mine could also support growth and tax revenues in the medium term.

8. Near-term risks are still high. Global economic conditions remain a source of risk (Annex II) and could all adversely affect Armenia via lower exports and remittances. Furthermore, these risks could lead to tighter and more volatile global financial conditions (e.g., due to flight to quality in international financial markets), which could diminish Armenia's financing options and make the roll-over of external debt more expensive. Geopolitical conditions also remain a source of risks, particularly following regional tensions in April. Nonetheless, there is also some upside potential if Russia's growth recovers faster than expected and/or if the removal of international sanctions to Iran leads to higher tourism and investment opportunities.

FOURTH REVIEW UNDER THE EXTENDED ARRANGEMENT

A. Program Performance

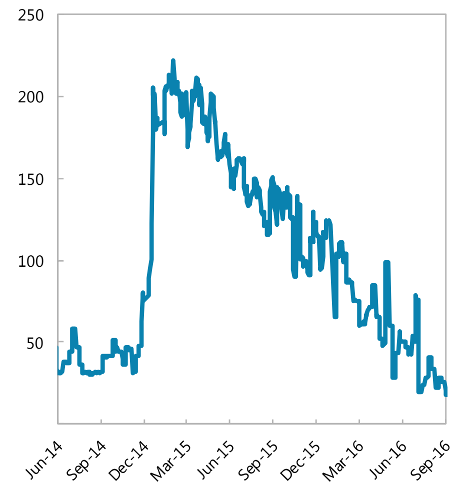
9. Program performance remained broadly satisfactory, but was clouded by fragile fiscal conditions.

- *All end-June and continuous PCs were met*: The NIR PC was met as the CBA took advantage of the strength in the FX market to partially recoup the sales conducted earlier in the year. The fiscal balance PC was also met, as under-execution in expenditures helped offset the revenue shortfall. The budgetary lending PC and the two continuous PCs on public debt arrears and absorption by the government of losses/liabilities of companies were also met.

- *Inflation has been in line with the monetary policy consultation clause (MPCC)*, which envisages a gradual transition from the current deflation to the medium-term 4 percent target (see below). While some deviations versus the inflation forecast were observed at end-June and end-September, the trajectory of inflation has remained within the ±1½ percent band (around the inflation forecast) embedded in the MPCC.

- *All Indicative targets (ITs) were met*: The net domestic assets (NDA) of the central bank remained significantly below the indicative ceiling under the program, as the increase in private sector bank deposits allowed the CBA to further unwind the large increase in repo operations conducted in late 2014 and early 2015. The social spending floor, as well as the ceiling on new government-guaranteed external debt, were also met.

Repurchase Agreements
(In billions of Armenian drams)



Source: National Authorities.

- *Most SBs were met*: The new Tax Code was passed by the NA. Furthermore, the Ministry of Finance (MoF) completed a review of the government's lending operations, and identified key risks and management improvements. The CBA has continued to oversee the increase in capital requirements in the banking sector, and has prepared an adequate contingency plan to manage noncompliance, if any. The NA has approved the laws on the implementation of International Swaps and Derivatives Association (ISDA) Master Agreements, aimed at supporting the development of derivatives and hedging markets in Armenia. There has been progress in terms of improving the competition law, but the amendments to the law were not submitted to the National Assembly by end-September since the government is now seeking more ambitious modifications than initially envisaged (MEFP, paragraph 20).

- *However, the end-December program fiscal balance target is projected to be missed by a wide margin (by nearly 1¾ percent of GDP)*. The headline fiscal deficit is likely to exceed previous estimations by a similar amount.

B. Policy Discussions

Fiscal Policy

10. The fiscal deficit in 2016 is expected to be significantly above earlier targets, on the back of continuing revenue weakness and capital budget over-executions.

- *Tax revenues*: Tax collections have been undermined by a combination of exogenous shocks and larger-than-anticipated effects from past policy changes (prior to the Third Review). Nominal GDP is now estimated at nearly 5½ percent lower than at the time of original budget, and over 2¾ percent lower than at the time of the Third Review. Moreover, the composition of demand has been unfavorable for revenue, with declining private consumption and growth mainly driven by net exports. On the production side, sectors that have experienced the strongest pick up (mining, entertainment) have a limited impact on tax collections. The impact of past policy decisions, while difficult to estimate precisely, could be as large as ½ percent of GDP. In this context, tax revenues are expected to be 7½ percent lower than the budget and 5½ percent lower than the Third Review projections, which translate into revenue shortfalls in the order of 1½ and 1 percent of GDP, respectively.

- *Expenditures*: The capital expenditure budget is projected to be over-executed, contributing about 1 percent of GDP to the headline budget deficit. The authorities noted that this was primarily due to stepped-up implementation of foreign-financed infrastructure projects, reflecting in part delays in previous years (Box 1). They have identified current expenditure savings of about 0.2 percent of GDP but further cuts will be difficult given the tight spending envelope.

- *Fiscal deficit*: As a result, the fiscal deficit in 2016 is expected to reach around 5.9 percent of GDP, significantly higher than the 4.1 projected at the time of the Third Review. As noted above, this deterioration results from the revenue shortfall (1 percent of GDP) and higher foreign-financed capital expenditure (1 percent of GDP), partially offset by some expenditure cuts (0.2 percent of GDP). Staff agreed with the authorities' proposal to modify the December 2016 fiscal target in view of the significant tightening next year (see below). The projected 2016 deficit represents a deterioration in nominal terms and as a share of GDP vis-à-vis 2015, but the fiscal stance, as measured by the change in the cyclically adjusted primary balance, falls slightly.

Armenia. Fiscal Balance, 2012–17

(In percent of GDP or percent of potential GDP)

	2012	2013	2014	2015	2016	2017
Overall fiscal balance	-1.5	-1.6	-1.9	-4.8	-5.9	-2.8
Cyclically adjusted fiscal balance	-1.9	-2.2	-2.4	-4.9	-5.1	-1.9
Cyclically adjusted primary fiscal balance	-1.0	-1.1	-1.1	-3.4	-3.2	0.2

Source: IMF staff estimates.

Box 1. Foreign-Financed Capital Expenditure

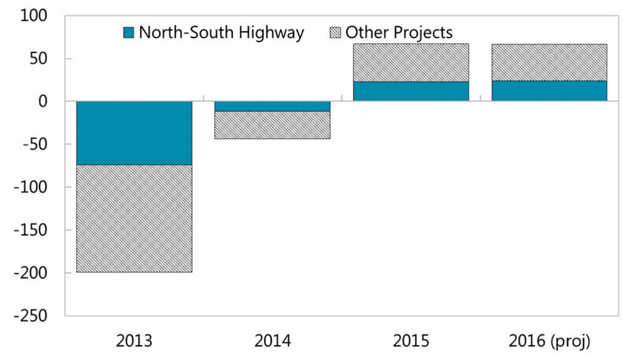
In recent years, Armenia has had difficulties executing foreign-financed (f-f) capital expenditure. In 2013–14, under-execution of projects approached $250 million—around 45 percent of the total budgeted amount and 2¼ percent of GDP. A key reason for this poor performance was the delay in the very large North-South Highway project as a result of complex issues with land acquisition, resettlement, and archeological work. This delay accounted for around one-third of all under-execution.

In the context of chronic under-execution and large external shocks, the authorities took action to improve execution and increase f-f capital expenditure in 2015. They introduced stronger monitoring mechanisms to address execution shortcomings, notably through monthly reporting by project implementation units (PIUs) based in the Office of the Prime Minister (April 2015 Structural Benchmark). The revised 2015 budget increased f-f capital expenditure from $108 million to $158 million.

As a result of these efforts, however, there was a significant over-execution in 2015. A combination of increased spending on existing projects (e.g., water-supply and sanitation, and road network improvement) and successful implementation of a number of relatively large new projects (e.g., Seismological Protection for Schools) in Q4, ultimately led to a significant over-execution of around $50 million in 2015.

Execution of Foreign-Financed Projects - 2013-2016 1/

US dollar (millions)



Source: MoF

1/ Execution is relative to the budget. For 2015, execution is relative to the supplementary budget.

Execution is projected to continue to catch up in 2016, but to remain within the budget in 2017. Although execution through September 2016 appears broadly in line with budget projections, significant additional disbursements in Q4 are now expected to result in over-execution of around $110 million (1 percent of GDP). "Catch-up" in implementation of the North-South Highway, following the resolution of earlier impediments, is expected to account for one third of the overshooting. The remainder is likely to be concentrated in a small number of projects, including: the Rural Asset Creation project—budgeted but significantly underestimated; the Rehabilitation of the M6 Highway—unbudgeted; and, potentially, a defense project—financed by a long-term and low-interest loan. For 2017, the authorities are taking steps to ensure execution remains within the budget, which would keep f-f capital expenditures in the order of $97 million. In particular, the authorities are enhancing program monitoring (see proposed SBs below) and have imposed a moratorium on signing new external loans for f-f projects.

11. **With government debt reaching 50 percent of GDP, the 2017 budget envisages a significant fiscal consolidation, in line with Armenia's fiscal rule.** The weaker fiscal performance this year is triggering Armenia's fiscal rule.[1] Consistent with the law, the government has submitted to the NA a draft budget (to be approved by end-year) that envisages an overall fiscal deficit of 2.8 percent of GDP. This represents a significant consolidation which is predicated on a combination

[1] According to this rule, which is stipulated in the Law on State Debt and does not include escape clauses, government debt cannot exceed 60 percent of previous year's GDP and when it reaches 50 percent, the budget deficit in the following year should be no more than 3 percent of the average GDP for the last three years.

of revenue increases and spending cuts. Revenue gains are expected as a result of measures included in the Tax Code, notably excise tax increases (0.2 percent of GDP), as well as an improvement in revenue administration (0.3 percent of GDP), which has been stated as a key priority of the new government. Non-interest current expenditure increases only marginally in nominal terms on account of higher social spending (mainly reflecting an increase in the number of pensioners), whereas in most other areas expenditure has either been frozen or even reduced. Interest expenditures, on the other hand, are expected to increase nearly 0.2 percent of GDP. The burden of adjustment will fall heavily on capital spending which is set to contract by almost 2 percent of GDP. Although not optimal, this composition of adjustment reflects the substantial over-execution of foreign-financed projects this year. The authorities' view, which is supported by staff, is that halting project implementation to contain the 2016 deficit at this stage would be counterproductive. Instead, it was agreed that spending on foreign-financed projects should be contained in 2017 through strengthened monitoring and implementation (December 2016 and March 2017 SBs) to minimize the risk of expenditure overruns. In addition, the budget law specifies risk mitigation measures to control the deficit (for instance in the event of revenue shortfalls) through limiting spending to 90 percent of the budgeted amounts, either in targeted areas or across the Board.

Armenia: Composition of Fiscal Adjustment in 2017

(As percent of GDP)

	Change from 2016
Total revenue and grants	0.6
Total expenditure	-2.5
Current expenditure	-0.6
Capital expenditure	-1.9
Overall balance	3.1

Source: IMF staff estimates.

12. The new Tax Code will support medium-term fiscal consolidation and will create room for recovery of capital expenditure. The Tax Code is expected to raise the tax-to-GDP ratio by about two percentage points by 2021, with the largest revenue increase materializing in 2018-19. Following extensive discussions in the NA, some changes were made to the Code between first and second readings to respond to stakeholders concerns and gain broader support for the reforms. In particular:

- The threshold of the top PIT bracket was raised and the rate was increased from 33 to 36 percent to shift the tax burden to the highest income earners.
- Tax credit up to the amount of the dividend tax paid was introduced and the accelerated depreciation of fixed assets was maintained to stimulate investment in the domestic economy.
- Taxation of gaming (lotteries and betting) was increased significantly to strengthen revenue.
- The planned ad valorem excise rate increase for tobacco was reduced to optimize the effect on revenue given the risks of evasion.
- The new turnover tax threshold was set to AMD 58 mn (the level before the 2015 increase), rather than AMD 40 mn as initially envisaged, to support SMEs.

Since some of these changes entailed revenue losses, following discussions with staff, the authorities proposed, and the NA approved, offsetting measures to preserve the overall revenue gain of about 2 percent of GDP over the medium term. These measures include new control mechanisms for unregistered employment, enlargement of the list of goods subject to labeling, removing the VAT exemption on tourist packages, and tightening the VAT criteria for restaurants. The revenue-generation capacity of the Tax Code is critical for maintaining debt sustainability (Annex III).

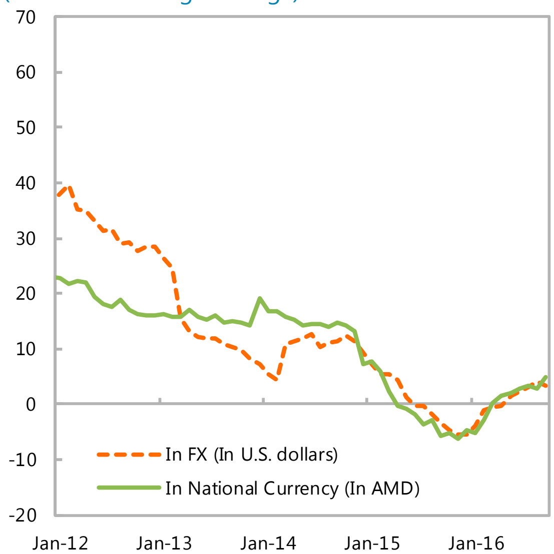
13. A review of government lending operations has been completed by the Fiscal Risk Assessment Division (FRAD) (September 2016 SB)**.** The review, which benefitted from IMF TA, focused on 13 large borrowers in the energy, water, transport, and construction sectors, covering around 80 percent of the outstanding loan portfolio. Assessment of the borrowers' financial standing was made with a view to gauging the companies' capacity to repay their debt. The findings of the FRAD report can serve as a basis to develop proposals for improving the budgetary lending process and minimizing the ensuing fiscal risks.

14. Support for the pension reform remains strong, despite challenges. The full-scale implementation of the pension reform was postponed to July 2018 (from July 2017) due to technical challenges and fiscal pressures resulting from the increase in matching contributions after participation becomes mandatory for the private sector. The cost for the budget associated with the copayment is estimated at about ¼ percent of GDP. As the revenue outlook improves underpinned by the Tax Code, this additional expenditure could be accommodated without crowding out other expenses or jeopardizing sustainability. In the meantime, the budgetary support for the Pension System Awareness Center and the pension reform outreach campaign will continue (December 2016 SB).

Monetary and Exchange Rate Policies

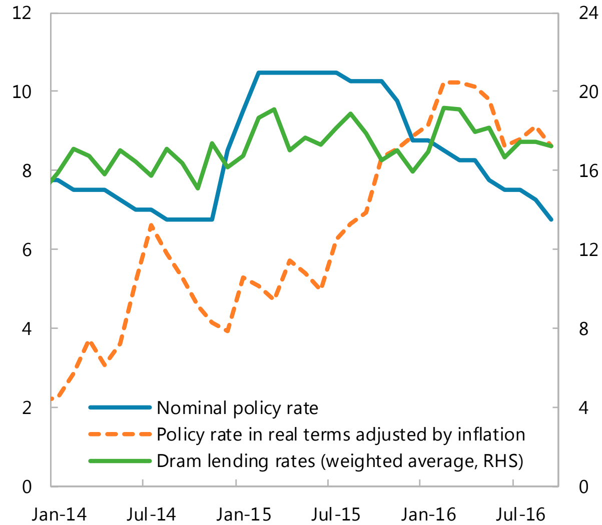
15. Monetary policy actions have eased financial conditions. As a result of the CBA's monetary policy easing—which gained momentum in the last quarter of 2015 and has continued since—some market interest rates, especially on government paper, have declined significantly. In addition, bank credit growth to the private sector is showing some signs of recovery. Recent policy actions—which include the reduction in FX deposits reserve requirements—are likely to reinforce these trends.

Armenia: Credit Growth
(In YoY Percentage Change)



Sources: Central Bank of Armenia; and IMF staff calculations.

Armenia: Selected Interest Rates
(In percent)



Sources: Central Bank of Armenia; and IMF staff calculations.

16. **In the context of CBA's inflation targeting framework and the program's MPCC, the CBA will continue to monitor the impact of recent policy actions and assess the need for further easing.** Despite lower policy rates, with both inflation and inflation expectations at much lower levels than in late 2014, the policy rate in real terms is still quite high. Deflationary pressures will likely continue during the rest of 2016, reflecting weak domestic demand and lower import prices. Moreover, increased uncertainty in the economic outlook has not only raised risk premiums for banks (and thus lending rates) but also increased private sector savings. In staff's view, these developments suggest that the CBA still has space to lower rates further to support domestic demand and help bring inflation back to its 4 percent target level. The CBA will continue to monitor developments closely in the period ahead and currently it projects inflation to reach the lower-end of the CBA confidence band (4 percent ± 1.5 percentage points) by end-2017.

17. **The CBA is undertaking sustained efforts to improve and upgrade its monetary policy framework.** It is improving its institutional communication strategy, which would help bolster the credibility of the CBA, enhance policy transparency, and strengthen the monetary transmission channel. Moreover, it is incorporating financial stability considerations into its operational policy framework as required by the recent constitutional amendments. In addition to institutional improvements, the key targets of the CBA include: developing an operational financial stability index, introducing a financial sector module into its macroeconomic model, and enhancing coordination between the monetary policy and financial stability departments of the CBA. With Fund TA support, the CBA is developing an analytical tool by extending the current forecasting and policy analysis system to take into account factors influencing financial stability, such as credit growth, deleveraging, and dollarization.

18. The current favorable FX environment provides a good opportunity to continue to strengthen the flexible exchange rate regime. Since the Third review, the CBA has limited FX interventions to purchases to mitigate modest seasonal appreciation pressures and rebuild buffers. Looking ahead, staff and the authorities agreed that two-way flexibility of the dram will remain essential for supporting necessary adjustment to external pressures and maintaining adequate international reserve buffers, with intervention limited to smoothing excessive volatility and transitory pressures. Based on updated staff estimates, the real effective exchange rate continues to be close to its equilibrium value. Gross international reserves also remain at an adequate level under most standard metrics (Annex IV).

19. The CBA has made progress in implementing the recommendations of the 2014 Update Safeguards Assessment, but further work remains. The CBA has adopted a charter to clarify Board members' roles and responsibilities, and also strengthened its oversight and control of entities engaged in financial sector development and infrastructure in which the CBA holds equity investment. In addition, starting from FY 2016, the CBA intends to further enhance its transparency practices by including in its annual report the objectives, risks, and risk-mitigation efforts associated with its holdings in subsidiaries. Further legislative changes to the Central Bank Law to strengthen the CBA's autonomy are pending.

Financial Sector Policy

20. Given challenging conditions in the banking sector, the authorities are taking steps to strengthen the macroprudential framework. The reduction in FX deposits reserve requirements (held in drams) is expected to provide additional dram liquidity and improve bank profitability, thereby supporting the functioning of financial markets. While the financial system appears well capitalized and liquid, the authorities remain vigilant regarding the risk associated with the low bank profitability and high NPLs (particularly for FX loans). Furthermore, the CBA remains committed to building a stronger macroprudential framework and tools and, in line with Basel III guidelines, is moving forward with a draft law that will enable it to introduce, if necessary, counter-cyclical buffer requirements and charges for systemically important banks. The CBA is also enhancing stress testing practices by improving the accuracy of estimates of probabilities of default with micro-level data, which should help better monitor and assess vulnerabilities in the banking sector.

21. Implementation of the CBA's new higher minimum bank capital requirements remains on track, but progress in divesting the PanArmenian bank (PAB) has been limited. The raising of the minimum capital requirement from 5 billion drams to 30 billion drams will come into force from January 2017. Banks have continued to make progress toward compliance and the CBA is confident that the vast majority of banks will be able to achieve the objective by the deadline, through either raising new capital or mergers and acquisition (M&As).[2] Nevertheless, the CBA has developed contingency plans in the event that some banks may not comply with the new requirements (September 2016 SB). The CBA expects the new minimum capital requirements will increase economies of scale in the sector, which will lead to further consolidation and improved efficiency over the medium term. Progress toward the divestment of the CBA's shares in PAB has been limited, but the authorities remain committed to devising a comprehensive divestment plan (December 2016 SB).

Structural Reforms

22. Reforms to the energy sector are advancing. The financial recovery plan of the electricity sector is progressing along several dimensions: (i) expensive short-term commercial debt of state-owned electricity generators has been refinanced with lower-interest and longer-term debt with the World Bank; (ii) debts of the privately-owned Electricity Networks of Armenia (ENA) to state-owned electricity generators have been repaid; (iii) tariff subsidies have been terminated (as planned), and a new tariff structure—including new methodologies for tariff margin formulas for both distribution and generation companies—has been implemented; and (iv) a government decree has been issued prohibiting non-core business-related expenditures, borrowing, and lending by state-owned electricity generators. Nairit, the chemical power plant that had also accumulated debts with the electricity sector, remains under bankruptcy procedures, and budget and off-budget spending on the plant is being limited to maintaining the public safety of the industrial site. In parallel, the rehabilitation of the nuclear power plant is proceeding and the government is exploring options for building new thermal power plants to replace maturing plants.

23. There has also been significant progress in reforms to support the business environment, particularly in the areas of: domestic competition and regulatory reforms, bankruptcy reform and collateral registration, and connectivity and international integration (MEFP, paragraph 20). Integration with other Eurasian Economic Union (EEU) members continues to move forward, and, among other actions, Armenia is planning the adoption of the new customs code for the EEU in 2017 and is implementing measures to join the unified electronic declaration system. Negotiations on a new trade agreement with the EU are also advancing. While the scope of the new EU agreement will be limited by Armenia's EEU commitments (e.g., common external tariffs), there is room for significant improvements, particularly in investment and competition.

C. Other Program Issues

24. The authorities are requesting a modification of the end-December 2016 fiscal deficit ceiling. The revenue shortfall has been mainly due to exogenous factors, and the higher capital

[2] At this point, 11 banks have already met the minimum capital requirement, 5 more have already secured the funds needed to comply with the new requirements and are in the process of getting the CBA official verification, and the remaining 2 banks are expected to comply by end-December 2016. Regarding mergers, one has already been completed, while two others have been announced and are in the process of completion.

expenditure, which is externally financed at concessional terms, reflects a catch-up of past under-execution and provides counter-cyclical support. The passing of the new Tax Code, the added discipline derived from the triggering of the fiscal rule in 2017, and the stricter monitoring of foreign-financed capital expenditure provide adequate assurances regarding fiscal responsibility and constitute compensatory measures for the revised fiscal balance target.

STAFF APPRAISAL

25. **Program performance has remained broadly satisfactory, but clouded by fragile fiscal conditions.** All performance criteria and indicative targets were met, inflation has been consistent with the MPCC, and all but one of the structural benchmarks for end-September 2016 were met. However, weak domestic demand and imports have translated into large tax revenue shortfalls, which, together with counter-cyclical over-execution of foreign-financed investment projects, are certain to raise the 2016 deficit significantly above earlier projections. This will not only require a modification of the program's fiscal deficit ceiling, but also trigger the authorities' own debt-based fiscal rule, which requires a large reduction in the 2017 deficit.

26. **In this context, and after two years of fiscal accommodation, the program envisages a range of fiscal consolidation measures.** The approval of the new Tax Code by the National Assembly constituted a crucial step to improve the tax environment and increase medium-term tax revenues. In addition, the program includes two new structural benchmarks to improve prioritization and monitoring of foreign-financed capital expenditures, and measures to strengthen revenue administration. The fiscal consolidation triggered by the fiscal rule is bound to have an adverse impact on economic activity in 2017. While this is not optimal from a growth perspective, it remains important to ensure fiscal discipline and to maintain public debt below the 60 percent of GDP absolute ceiling stated in the fiscal rule. The tight expenditure conditions enforced by the fiscal rule in 2017 are expected to ease in 2018 and beyond, as the tax policy measures embedded in the Tax Code start to generate additional revenue.

27. **Further monetary policy easing should help achieve a gradual return of inflation to the CBA's target.** Monetary easing since the last quarter of 2015 has helped reduce key market interest rates and supported a nascent recovery in bank credit. Nonetheless, weak domestic demand and deflationary conditions have persisted, and the CBA appropriately sought a more ambitious easing in recent months, including by reducing FX reserve requirements. While there is still room for further monetary easing, it will be important to monitor the inflation developments and the impact of recent policy measures to fine tune monetary policy. The stabilization in the foreign exchange market has allowed the CBA to strengthen its reserve position by recouping the FX sales conducted earlier in the year. With the real exchange rate currently estimated close to equilibrium, the flexible regime should help the exchange rate to reflect market forces more closely and strengthen competitiveness.

28. **Financial sector policy should continue to focus on supporting the resilience of the sector and strengthening the macroprudential framework.** To this end, it will be important to

ensure a smooth transition of the sector to the new minimum capital requirements. The CBA's actions in this area, including the preparation of contingency plans, have been appropriate. The CBA has also made progress in the introduction of macroprudential tools in line with Basel III, which should help strengthen its capacity to deal with cyclical and systemic developments in the sector. Given the highly dollarized financial system and the CBA's new constitutional mandate, a key priority going forward for the CBA is to incorporate financial stability into its policy rule. In this regard, the CBA's intention of integrating a financial sector module into the existing CBA's macroeconomic model constitutes a step forward to achieve this objective.

29. Structural reforms remain essential to support the economic activity and foster sustainable and inclusive growth. The significant progress in reform of the electricity sector is welcome, and should be used as a stepping stone to further strengthen the sector. In this regard, ensuring appropriate levels of investment and fostering private sector participation will remain critical. Strengthening domestic competition and regulatory reforms is pivotal to create a more broad-based private sector-led economy. In this context, the planned amendments to the law for enhancing economic competition protection and the broadening of access to finance through bankruptcy reform and collateral registration are welcome. Deepening integration, with both traditional and nontraditional partners, should also remain high in the structural reform agenda.

30. Staff supports completion of the review and the authorities' request for a purchase in the amount equivalent to SDR 15.65 million. Risks to the program remain elevated, but are manageable, and Armenia's repayment capacity and track record remain satisfactory. The program remains fully financed and external financing is highly concessional. The authorities are committed to sound macroeconomic policies and structural reforms, and the approval of the new Tax Code significantly strengthens medium-term fiscal conditions. Staff supports the modification of the end-December fiscal balance PC on the basis of the compensatory measures being taken.

Table 1. Armenia: Selected Economic and Financial Indicators, 2012–18

	2012	2013	2014	2015	2016		2017		2018
	Act.	Act.	Act.	Prel.	Country Report 16/246	Proj.	Country Report 16/246	Proj.	Proj.
National income and prices:									
Real GDP (percent change)	7.1	3.3	3.6	3.0	2.2	2.4	2.5	2.7	3.0
Final consumption expenditure, Contrib. to Growth	6.9	1.5	0.6	-5.4		-0.2		2.5	0.7
Gross fixed capital formation, Contrib. to Growth	-0.5	-1.7	-0.6	0.6		1.2		0.3	0.8
Changes in inventories, Contrib. to Growth	-0.9	0.0	-0.7	-0.9		0.5		0.2	0.0
Net exports of goods and services, Contrib. to Growth	3.2	0.0	4.5	6.1		2.9		-0.3	1.5
Statistical Discrepancy in GDP, Contrib. to Growth	-1.6	4.2	-0.8	2.5		-1.9		0.0	0.0
Gross domestic product (in billions of drams) 2/	4,266	4,556	4,829	5,032	5,297	5,151	5,646	5,405	5,762
Gross domestic product per capita (in U.S. dollars)	3,576	3,732	3,889	3,521	3,589	3,568	3,715	3,626	3,790
CPI (period average; percent change)	2.5	5.8	3.0	3.7	-0.4	-1.4	4.0	1.6	3.5
CPI (end of period; percent change)	3.2	5.6	4.6	-0.1	1.0	-0.5	4.0	2.8	4.0
GDP deflator (percent change) 2/	5.4	3.4	2.3	1.2	2.7	0.0	4.0	2.2	3.5
Poverty rate (in percent)	32.4	32.0	30.0	...	...	...	...	...	...
Investment and saving (in percent of GDP)									
Investment	22.8	20.7	20.8	21.0	19.6	21.7	20.0	21.8	22.1
National savings	12.8	13.4	13.2	18.3	16.6	18.7	16.6	17.8	19.5
Money and credit (end of period)									
Reserve money (percent change)	1.9	29.9	-0.1	3.9	5.8	4.9	6.7	8.8	8.0
Broad money (percent change)	19.6	15.2	8.9	10.7	5.5	13.9	6.7	10.5	8.0
Commercial banks' 3-month lending rate (in percent)	18.5	18.3	19.4	15.7	...	...	...	...	...
Central government operations (in percent of GDP)									
Revenue and grants	20.9	22.2	22.0	21.5	21.5	21.2	21.6	21.8	22.2
Of which: tax revenue 3/	17.0	21.0	21.1	20.1	20.0	19.5	20.5	20.2	20.6
Expenditure 4/	22.4	23.8	24.0	26.4	25.6	27.1	24.4	24.6	24.2
Overall balance on a cash basis	-1.4	-1.0	-2.1	-4.8	-4.1	-5.9	-2.8	-2.8	-2.0
Public and publicly-guaranteed debt (in percent of GDP)	41.2	40.8	43.6	48.8	52.4	54.7	54.0	56.4	56.8
Share of foreign currency debt (in percent)	85.8	85.2	86.2	86.9	87.0	85.5	86.2	85.0	81.4
External sector									
Exports of goods and services (in millions of U.S. dollars)	2,918	3,156	3,319	3,137	3,059	3,384	3,137	3,585	3,845
Imports of goods and services (in millions of U.S. dollars)	-5,131	-5,476	-5,487	-4,418	-4,041	-4,327	-4,202	-4,672	-4,778
Exports of goods and services (percent change)	6.4	8.2	5.2	-5.5	-2.6	7.9	2.5	5.9	7.3
Imports of goods and services (percent change)	4.3	6.7	0.2	-19.5	-7.3	-2.0	4.0	8.0	2.3
Current account balance (in percent of GDP)	-10.0	-7.3	-7.6	-2.7	-3.0	-2.9	-3.4	-4.0	-2.6
FDI (net, in millions of U.S. dollars) 5/	481	475	388	168	274	272	278	410	352
Debt service ratio (in percent of exp. of goods and serv.) 6/	8.2	27.9	8.6	12.5	8.0	7.2	9.2	8.1	8.3
Gross international reserves (in millions of U.S. dollars)	1,799	2,253	1,489	1,771	1,858	1,953	1,959	1,981	2,137
Import cover 7/	3.9	4.9	4.0	4.9	5.3	5.0	5.4	5.0	5.2
Nominal effective exchange rate (percent change) 8/	-2.4	-0.9	3.9	2.8	...	...	...	...	...
Real effective exchange rate (percent change) 8/	-3.3	1.2	4.0	2.9	...	...	...	...	...
End-of-period exchange rate (dram per U.S. dollar)	404	406	475	484	...	...	...	...	...
Average exchange rate (dram per U.S. dollar)	402	410	416	478	...	...	...	...	...
Memorandum item:									
Population (in millions)	3.0	3.0	3.0	3.0	...	...	...	...	...

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

1/ Staff Report for the Third Review.

2/ In the first quarter of 2015 the authorities started calculating GDP using the SNA 2008 methodology. They have revised GDP series from 2012 on, but pre-2012 series remain calculated using the SNA 1993 methodology.

The increase in the GDP deflator in 2012 is due to this methodological change. Without this methodological change, the GDP deflator in 2012 is -1.2 percent.

3/ In 2013, tax revenue includes social contribution.

4/ 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. A surplus of 0.6 percent of GDP is obtained when this transaction is excluded.

5/ 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.

6/ Based on public and publicly-guaranteed debt.

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

8/ A positive sign denotes appreciation.

Table 2. Armenia: Balance of Payments, 2012–21

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

	2012	2013	2014	2015	2016		2017	2018	2019	2020	2021
	Act.	Act.	Act.	Prel.	Country Report 16/246	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	-1,058	-813	-883	-279	-326	-312	-430	-292	-272	-425	-589
Trade balance	-2,112	-2,196	-2,055	-1,186	-921	-880	-1,007	-835	-783	-901	-1,063
Exports, fob	1,516	1,636	1,698	1,624	1,622	1,856	2,026	2,255	2,450	2,536	2,586
Imports, fob 1/	-3,628	-3,832	-3,754	-2,810	-2,543	-2,736	-3,033	-3,090	-3,233	-3,437	-3,648
Services (net)	-102	-124	-113	-95	-61	-63	-81	-99	-117	-137	-159
Credits	1,402	1,520	1,621	1,513	1,438	1,528	1,558	1,590	1,621	1,654	1,703
Debits	-1,504	-1,644	-1,734	-1,607	-1,498	-1,591	-1,639	-1,688	-1,739	-1,791	-1,863
Income (net) 2/	423	683	541	435	155	124	131	97	62	25	26
Transfers (net)	733	825	744	566	501	506	527	544	566	588	607
Private	625	704	641	421	386	391	407	419	436	453	467
Official	108	121	104	146	115	115	120	125	130	135	140
Capital and financial account	848	1,758	261	869	302	385	387	512	577	603	776
Capital transfers (net)	108	84	70	65	78	78	88	88	90	91	93
Foreign direct investment (net) 2/	481	475	388	168	274	272	410	352	364	377	392
Portfolio investment (net)	1	-9	-42	-29	-36	-35	-32	-34	-33	-33	-33
Public sector borrowing (net)	225	376	216	635	276	347	177	186	236	144	274
Disbursements	255	914	257	898	354	426	283	313	382	803	440
Amortization	-30	-537	-41	-262	-79	-79	-107	-128	-147	-660	-167
Other capital (net)	34	832	-371	30	-290	-276	-256	-80	-80	25	50
Errors and omissions	191	0	-33	-345	0	0	0	0	0	0	0
Overall balance	-18	644	-650	290	-24	72	-43	220	305	179	187
Financing	18	-644	650	-290	-120	-216	-79	-220	-305	-179	-187
Gross international reserves (increase: -)	70	-454	764	-282	-87	-182	-27	-156	-230	-101	-116
Use of Fund credit, net	-52	-190	-113	-9	-33	-33	-52	-64	-75	-77	-72
Purchases/disbursements	103	84	36	16	...	...	...	...	...	...	...
Repurchases/repayments	-155	-274	-149	-25	-33	-33	-52	-64	-75	-77	-72
Financing gap	0	0	0	0	144	144	122	0	0	0	0
IMF EFF	0	0	0	0	44	44	22	...	...	...	...
Other 3/	0	0	0	0	100	100	100	...	...	...	...
Memorandum items:											
Current account (in percent of GDP)	-10.0	-7.3	-7.6	-2.7	-3.0	-2.9	-4.0	-2.6	-2.3	-3.4	-4.4
Trade balance (in percent of GDP)	-19.9	-19.7	-17.7	-11.3	-8.6	-8.2	-9.3	-7.4	-6.5	-7.1	-7.9
Gross international reserves (end of period)	1,799	2,253	1,489	1,771	1,858	1,953	1,981	2,137	2,367	2,469	2,584
In months of next year's imports	3.9	4.9	4.0	4.9	5.3	5.0	5.0	5.2	5.4	5.7	5.3
Merchandise export growth, percent change	5.9	7.9	3.8	-4.4	-0.3	14.3	9.2	11.3	8.6	3.5	2.0
Merchandise import growth, percent change	2.4	5.6	-2.0	-25.1	-8.5	-2.6	10.8	1.9	4.6	6.3	6.2
Non-gas merchandise imports growth, percent change	0.5	5.7	1.0	-27.2	-8.4	-1.5	12.2	1.2	4.5	6.3	6.2
Nominal external debt	7,456	8,682	8,274	8,902	9,284	9,402	9,706	9,748	9,829	9,919	10,176
o.w. public external debt	3,738	3,902	3,825	4,414	4,766	4,884	5,157	5,279	5,440	5,505	5,712
Nominal external debt stock (in percent of GDP)	70.2	78.1	71.3	84.5	86.5	88.1	89.5	86.0	82.2	78.7	76.1
External public debt-to-exports ratio (in percent)	128.1	123.6	115.3	140.7	155.8	144.3	143.8	137.3	133.6	131.4	133.2
External public debt service (in percent of exports)	8.2	27.9	8.6	12.5	8.0	7.2	8.1	8.3	8.5	20.5	7.7

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/ Financing from the Eurasian Fund for Stability and Development. First disbursement occurred in December 2015.

Table 3. Armenia: Monetary Accounts, 2012–17
(In billions of drams, unless otherwise indicated)

	2012	2013	2014	2015	2016				2017			
	Act.	Act.	Act.	Act.	Act.	Prel.	Proj.		Proj.			
					Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Central Bank of Armenia												
Net foreign assets	467.2	655.8	437.4	566.2	486.8	450.5	564.4	611.5	556.4	577.3	583.6	616.1
Net international reserves	538.7	768.7	569.2	723.8	648.1	608.7	727.6	776.0	724.1	744.3	753.7	785.4
Other	-71.5	-112.9	-131.8	-157.6	-161.3	-158.2	-163.2	-164.5	-167.8	-167.0	-170.1	-169.3
Net domestic assets	216.6	232.2	449.4	355.1	363.0	326.5	333.6	355.1	358.7	387.1	405.1	435.3
Claims on general government (net)	-93.3	-175.9	-102.1	-120.2	-98.7	-66.7	-92.9	-118.7	-114.9	-122.2	-100.8	-90.9
Of which: central government (net)	-80.5	-160.1	-83.9	-105.6	-77.9	-44.1	-34.1	-59.9	-56.1	-63.4	-42.0	-32.1
Claims on banks	152.9	174.0	312.5	225.0	194.0	120.8	147.1	146.2	129.5	138.7	151.8	171.0
CBA bills 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other items (net)	157.0	234.1	239.0	250.3	267.7	272.4	279.4	327.6	344.0	370.6	354.1	355.3
Reserve money	683.8	888.1	886.8	921.3	849.8	777.0	897.9	966.6	915.0	964.4	988.7	1,051.4
Currency issue	440.1	446.8	412.3	413.6	349.2	387.2	408.1	448.3	384.9	420.6	443.7	497.6
Deposits	243.7	441.2	474.4	507.7	500.6	389.8	489.8	518.3	530.1	543.8	545.0	553.8
Deposits in drams	157.7	202.4	337.7	324.6	337.3	281.0	298.7	313.6	324.3	337.0	337.2	345.0
Deposits in foreign currency	86.0	238.8	136.7	183.1	163.3	108.8	191.1	204.7	205.8	206.8	207.8	208.8
Banking system												
Net foreign assets	-124.2	-58.8	-373.1	-160.6	-201.9	-217.4	-142.8	-96.2	-151.3	-130.3	-124.0	-91.5
Net domestic assets	1,471.2	1,610.9	2,062.8	2,030.4	2,091.9	2,159.5	2,164.8	2,226.3	2,294.0	2,376.9	2,396.3	2,446.4
Claims on government (net)	17.0	-9.6	79.5	85.1	115.7	174.2	216.0	211.9	219.9	216.6	242.2	256.1
Of which: claims on central government (net)	29.8	6.1	97.8	99.8	136.4	196.8	274.8	270.7	278.7	275.4	301.0	314.9
Claims on rest of the economy	1,587.9	1,781.7	2,147.3	2,069.9	2,107.2	2,133.3	2,125.2	2,208.5	2,272.0	2,385.4	2,374.1	2,400.3
Other items (net)	-133.7	-161.2	-163.9	-124.6	-130.9	-148.0	-176.4	-194.1	-197.9	-225.0	-220.0	-210.0
Broad money	1,347.0	1,552.1	1,689.8	1,869.8	1,890.0	1,942.1	2,022.0	2,130.1	2,142.7	2,246.6	2,272.3	2,354.9
Currency in circulation	384.3	384.9	349.2	346.9	298.4	333.7	356.2	381.6	334.2	367.1	391.9	431.0
Deposits	962.7	1,167.2	1,340.6	1,522.8	1,591.7	1,608.3	1,665.8	1,748.5	1,808.5	1,879.5	1,880.4	1,923.9
Domestic currency	355.9	470.2	483.8	547.2	583.3	626.9	643.5	683.4	728.9	764.6	775.1	828.2
Foreign currency	606.8	697.0	856.7	975.7	1,008.4	981.5	1,022.3	1,065.2	1,079.6	1,114.9	1,105.4	1,095.7
Memorandum items:												
Exchange rate (in drams per U.S. dollar, end of period)	403.6	405.6	475.0	483.8	480.8	476.7	...	...	...	...	...	...
NIR, program definition, at program exchange rates (USD millions)	830	1,068	796	1,013	896	945	1,037	1,160	1,060	1,122	1,149	1,242
12-month change in reserve money (in percent)	1.9	29.9	-0.1	3.9	7.3	-5.0	2.3	4.9	7.7	24.1	10.1	8.8
12-month change in broad money (in percent)	19.6	15.2	8.9	10.7	15.4	12.7	15.5	13.9	13.4	15.7	12.4	10.5
12-month change in dram broad money (in percent)	12.8	15.5	-2.6	7.3	11.2	14.2	20.4	19.1	20.6	17.8	16.7	18.2
12-month change in private sector credit (in percent)	26.9	12.2	20.5	-3.6	1.7	3.7	4.3	6.7	7.8	11.8	11.7	8.7
Velocity of broad money (end of period)	3.2	2.9	2.9	2.7	2.7	2.6	2.5	2.4	2.4	2.3	2.3	2.3
Money multiplier	2.0	1.7	1.9	2.0	2.2	2.5	2.3	2.2	2.3	2.3	2.3	2.2
Dollarization in bank deposits 2/	63.0	59.7	63.9	64.1	63.4	61.0	61.4	60.9	59.7	59.3	58.8	57.0
Dollarization in broad money 3/	45.0	44.9	50.7	52.2	53.4	50.5	50.6	50.0	50.4	49.6	48.6	46.5
Currency in circulation in percent of deposits	39.9	33.0	26.0	22.8	18.7	20.8	21.4	21.8	18.5	19.5	20.8	22.4
Stock of foreign currency deposits (in millions of U.S. dollars) 4/	1,576	1,700	2,090	2,380	2,459	2,394	2,493	2,598	2,633	2,719	2,696	2,673
Banking system financing of the central government (cumulative)	19.1	-23.7	91.6	2.0	36.7	97.0	175.0	170.9	7.9	4.7	30.3	44.2
Banks' deposits at CBA to deposits in banking system (in percent)	25.3	37.8	35.4	33.3	31.5	24.2	29.4	29.6	29.3	28.9	29.0	28.8

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

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

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

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

4/ At the program exchange rate.

Table 4. Armenia: Financial Soundness Indicators for the Banking Sector, 2012–16
(In percent, unless otherwise indicated)

	2012	2013	2014	2015				2016	
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep	Dec	Mar.	Jun.
Capital adequacy									
Total regulatory capital to risk-weighted assets	16.8	16.7	14.5	15.1	15.4	15.7	16.2	17.3	17.4
Capital (net worth) to assets	15.9	15.3	14.0	14.4	14.6	14.2	14.7	15.0	15.7
Asset composition									
Sectoral distribution of loans (in billions of drams)									
Industry (excluding energy sector)	250	223	266	246	245	236	226	220	228
Energy sector	75	95	112	104	94	108	111	101	112
Agriculture	101	118	150	161	163	154	149	150	153
Construction	100	109	124	115	115	113	107	123	114
Transport and communication	48	54	52	53	55	81	77	77	72
Trade/commerce	321	352	386	363	352	334	345	373	369
Consumer credits		366	452	436	423	414	423	429	426
Mortgage loans		143	172	169	171	174	179	177	179
Sectoral distribution of loans to total loans (percent of total)									
Industry (excluding energy sector)	15.5	12.2	12.0	11.6	11.8	11.4	10.5	9.9	10.2
Energy sector	4.6	5.2	5.1	4.9	4.5	5.2	5.2	4.6	5.0
Agriculture	6.3	6.5	6.8	7.6	7.8	7.5	6.9	6.8	6.8
Construction	6.2	6.0	5.6	5.4	5.5	5.5	4.9	5.1	5.1
Transport and communication	3.0	3.0	2.3	2.5	2.6	3.9	3.6	3.5	3.2
Trade/commerce	19.9	19.3	17.4	17.2	16.9	16.2	16.0	16.8	16.5
Consumer credits		20.1	20.3	20.7	20.3	20.0	19.6	19.4	19.0
Mortgage loans		7.9	7.8	8.0	8.2	8.4	8.3	8.0	8.0
Foreign exchange loans to total loans	64.7	63.8	64.7	67.7	67.1	66.7	66.7	67.9	67.1
Asset quality									
Nonperforming loans (in billions of drams)	58	80	150	171	188	173	166	218	203
Watch (up to 90 days past due)	27	41	73	78	85	72	75	97	60
Substandard (91-180 days past due)	19	20	44	56	61	54	48	57	71
Doubtful (181-270 days past due)	13	19	33	37	41	47	43	63	72
Loss (>270 days past due)	77	108	173	195	218	249	288	293	312
Nonperforming loans to gross loans	3.6	4.5	6.8	8.1	9.0	8.4	7.8	10.0	9.2
Provisions to nonperforming loans	55.1	49.5	41.3	39.1	38.1	40.7	42.9	40.6	46.0
Spread between highest and lowest rates of interbank borrowing in AMD	1.0	2.2	4.0	10.5	3.0	1.0	1.8	0.4	4.5
Spread between highest and lowest rates of interbank borrowing in FX	9.5	6.3	3.5	0.8	0.0	0.0	5.0	1.0	0.0
Earnings and profitability									
ROA (profits to period average assets)	2.5	1.9	1.0	-0.2	-0.3	-0.3	-0.5	0.2	0.5
ROE (profits to period average equity)	14.7	12.0	6.4	-1.7	-1.8	-2.4	-3.5	1.0	3.3
Interest margin to gross income	40.6	37.1	35.7	28.2	29.2	29.2	28.9	28.8	29.4
Interest income to gross income	80.0	79.1	77.3	78.2	77.9	77.2	76.5	78.4	78.0
Noninterest expenses to gross income	34.2	33.0	31.7	28.9	29.0	29.0	29.4	28.6	28.9
Liquidity									
Liquid assets to total assets	25.6	29.1	25.1	24.1	25.2	27.2	28.0	29.2	28.0
Liquid assets to total short-term liabilities	126	142	129	137	138	147	142	158	154
Customer deposits to total (non-interbank) loans	93	106	98	100	103	108	112	113	110
Foreign exchange liabilities to total liabilities	64.9	64.1	63.5	64.1	64.4	65.6	65.7	65.6	63.2
Sensitivity to market risk									
Gross open positions in foreign exchange to capital	3.8	3.7	14.6	8.6	7.5	5.8	6.5	5.2	5.6
Net open position in FX to capital	1.6	0.1	-11.1	-4.6	-3.3	-2.2	-2.8	-2.3	0.0

Source: Central Bank of Armenia.

Table 5. Armenia: Central Government Operations, 2012–18
(In billions of dram)

	2012	2013	2014	2015	2016		2017		2018
	Act.	Act	Act.	Prel.	Country Report 16/246	Proj.	Country Report 16/246	Proj.	Proj.
Total revenue and grants	892.6	1011.5	1064.6	1084.1	1136.2	1090.3	1222.1	1180.5	1276.4
Total revenue	875.7	1000.7	1050.1	1056.3	1103.4	1054.7	1200.3	1152.8	1252.1
Tax revenues	723.4	956.6	1018.4	1011.3	1061.8	1003.5	1156.0	1091.1	1184.9
VAT	340.4	371.7	401.0	380.1	409.9	337.4	436.9	379.7	410.0
Profits, simplified and presumptive	164.5	167.6	120.9	106.8	112.0	123.2	122.3	129.3	140.7
Personal income tax	91.7	256.9	301.1	311.7	327.1	329.4	348.7	345.6	375.0
Customs duties	41.3	44.3	48.4	61.5	54.2	51.0	59.4	54.5	57.6
Other	85.6	116.1	147.0	151.2	158.6	162.5	188.8	182.0	201.7
Social contributions 1/	129.1	17.9	4.8	10.5	13.4	13.4	14.3	14.3	27.8
Other revenue	23.2	26.2	26.9	34.4	28.2	37.8	30.0	47.4	39.4
Grants	16.9	10.8	14.5	27.8	32.8	35.6	21.8	27.7	24.3
Total expenditure	956.3	1084.1	1158.4	1328.0	1355.6	1395.6	1377.8	1330.6	1393.4
Expenses 2/	852.4	980.6	1048.7	1179.6	1221.1	1207.3	1240.8	1235.0	1281.0
Wages	194.3	215.6	253.4	296.2	309.5	310.3	310.8	310.0	314.9
Social Contributions	4.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments to individual pension accts.	0.0	0.0	9.5	20.8	26.8	26.8	28.5	28.7	55.6
Subsidies 3/	4.6	4.9	8.4	19.8	18.9	15.0	8.2	6.6	6.8
Interest	40.2	46.7	61.6	74.1	100.2	100.6	98.1	119.3	114.6
Social allowances and pensions	287.4	294.0	335.0	368.5	386.6	382.3	399.8	388.2	397.7
Pensions/social security benefits	197.5	198.4	218.1	246.8	250.3	250.3	258.1	249.7	258.9
Social assistance benefits	89.9	95.6	117.0	121.7	136.3	132.0	141.7	138.5	138.8
Employer social benefits	12.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Goods and services 4/	132.6	140.9	112.2	125.3	71.0	117.1	74.2	122.8	127.3
Grants	71.4	78.2	82.9	102.2	105.6	105.6	108.0	103.6	106.0
Other expenditure 5/	117.1	200.3	185.6	172.8	202.5	149.7	213.2	155.9	158.0
Transactions in nonfinancial assets	103.9	103.5	109.7	148.4	134.5	188.3	137.0	95.6	112.4
Acquisition of nonfinancial assets 6/	106.6	105.0	111.2	150.5	134.5	188.2	137.0	95.5	112.4
Disposals of nonfinancial assets	2.7	1.6	1.6	2.1	0.0	-0.1	0.0	-0.1	0.0
Overall balance (above-the-line)	-63.8	-72.6	-93.8	-244.0	-219.4	-305.3	-155.7	-150.1	-116.9
Statistical discrepancy	2.1	28.6	-7.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-61.6	-43.9	-101.4	-244.0	-219.4	-305.3	-155.7	-150.1	-116.9
Financing	61.6	43.9	101.4	244.0	219.4	305.3	155.7	150.1	116.9
Domestic financing	6.8	-43.9	75.7	33.6	74.9	129.9	36.4	59.5	84.3
Banking system 7/	20.1	-23.7	91.6	2.0	89.0	120.5	31.7	42.4	93.9
CBA	-26.3	-79.6	76.3	-21.7	54.9	-4.7	-0.5	8.2	34.2
Commercial Banks	46.4	55.9	15.4	23.7	34.2	125.2	32.1	34.1	59.7
Nonbanks	-13.2	-20.2	-16.0	8.6	-14.1	9.4	4.8	17.1	-9.6
Privatization proceeds	0.0	0.0	0.0	7.7	0.0	0.0	0.0	0.0	0.0
T-Bills/other	-24.6	-62.7	7.3	-5.1	8.4	21.6	7.9	5.9	10.3
Promissory note/other	0.0	63.3	-6.5	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	11.4	-20.9	-16.7	6.0	-22.5	-12.2	-3.1	11.2	-19.9
External financing	54.8	87.8	25.8	162.5	95.2	127.2	68.4	40.8	32.6
Gross inflow 5/ 8/	118.4	373.1	106.8	345.6	175.2	209.8	166.3	141.2	159.3
Amortization due	-27.9	-246.4	-38.6	-118.7	-33.3	-35.3	-48.2	-50.7	-73.5
Net lending	-35.6	-38.9	-42.4	-64.3	-46.8	-47.3	-49.6	-49.6	-53.2
Other financing 9/	0.0	0.0	0.0	47.8	49.3	48.3	50.8	49.8	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	4,266	4,556	4,829	5,032	5,297	5,151	5,646	5,405	5,762
Program balance 10/	-85.9	-40.4	-160.5	-298.6	-261.6	-357.6	-180.5	-177.6	-162.1
Primary balance 11/	-47.8	-85.6	-91.2	-228.2	-188.5	-264.2	-110.3	-69.3	-75.4
Debt-creating fiscal balance 12/	-99.4	-48.2	-136.2	-308.3	-266.2	-352.6	-205.3	-199.8	-170.2
Government securities issuance	30.8	20.4	16.7	15.6	42.0	108.0	40.0	40.0	70.0

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

1/ From 2014, social contributions include contributions to the second pillar of the pension system.
2/ Composition of expense reclassified in November 2013 to account for wage bill more accurately. A further reclassification of expenses was made in 2015 whereby some spending on goods and services was classified in other categories.
3/ In 2015 reflects the payment of wage arrears for Nairit and the electricity subsidy to households and SMEs. In 2016, an additional subsidy of AMD 2 billion is assumed to cover the electricity tariff differential for households and SMEs.
4/ Changes in expense on goods and services relative to the Third Review reflect classification issues. In particular, spending on education which was previously reflected in "other expenditure" is now classified under "goods and services."
5/ 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 exp.) of the same amount from the gov't to ArmRusGazprom to liquidate liabilities. Excluding this transaction, the deficit amounts to AMD 43.6 bil. or 1 percent of GDP.
6/ Includes acquisition of military equipment.
7/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.
8/ Includes IMF budget support in 2011-12.
9/ EFSD financing ($100 million in 2015-17). First disbursement occurred in December 2015.
10/ 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.
11/ Sum of overall balance (above the line), interest expense, and domestic and external net lending.
12/ 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, 2012–18
(In percent of GDP)

	2012	2013	2014	2015	2016		2017		2018
	Act.	Act.	Act.	Prel.	Country Report 16/246	Proj.	Country Report 16/246	Proj.	Proj.
Total revenue and grants	20.9	22.2	22.0	21.5	21.5	21.2	21.6	21.8	22.2
Total revenue	20.5	22.0	21.7	21.0	20.8	20.5	21.3	21.3	21.7
Tax revenues	17.0	21.0	21.1	20.1	20.0	19.5	20.5	20.2	20.6
VAT	8.0	8.2	8.3	7.6	7.7	6.6	7.7	7.0	7.1
Profits, simplified and presumptive	3.9	3.7	2.5	2.1	2.1	2.4	2.2	2.4	2.4
Personal income tax	2.1	5.6	6.2	6.2	6.2	6.4	6.2	6.4	6.5
Customs duties	1.0	1.0	1.0	1.2	1.0	1.0	1.1	1.0	1.0
Other	2.0	2.5	3.0	3.0	3.0	3.2	3.3	3.4	3.5
Social contributions 1/	3.0	0.4	0.1	0.2	0.3	0.3	0.3	0.3	0.5
Other revenue	0.5	0.6	0.6	0.7	0.5	0.7	0.5	0.9	0.7
Grants	0.4	0.2	0.3	0.6	0.6	0.7	0.4	0.5	0.4
Total expenditure	22.4	23.8	24.0	26.4	25.6	27.1	24.4	24.6	24.2
Expense 2/	20.0	21.5	21.7	23.4	23.1	23.4	22.0	22.8	22.2
Wages	4.6	4.7	5.2	5.9	5.8	6.0	5.5	5.7	5.5
Social Contributions	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments to individual pension accts.	0.0	0.0	0.2	0.4	0.5	0.5	0.5	0.5	1.0
Subsidies 3/	0.1	0.1	0.2	0.4	0.4	0.3	0.1	0.1	0.1
Interest	0.9	1.0	1.3	1.5	1.9	2.0	1.7	2.2	2.0
Social allowances and pensions	6.7	6.5	6.9	7.3	7.3	7.4	7.1	7.2	6.9
Pensions/social security benefits	4.6	4.4	4.5	4.9	4.7	4.9	4.6	4.6	4.5
Social assistance benefits	2.1	2.1	2.4	2.4	2.6	2.6	2.5	2.6	2.4
Employer social benefits	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Goods and services 4/	3.1	3.1	2.3	2.5	1.3	2.3	1.3	2.3	2.2
Grants	1.7	1.7	1.7	2.0	2.0	2.0	1.9	1.9	1.8
Other expenditure 5/	2.7	4.4	3.8	3.4	3.8	2.9	3.8	2.9	2.7
Transactions in nonfinancial assets	2.4	2.3	2.3	2.9	2.5	3.7	2.4	1.8	2.0
Acquisition of nonfinancial assets 6/	2.5	2.3	2.3	3.0	2.5	3.7	2.4	1.8	2.0
Disposals of nonfinancial assets	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-1.5	-1.6	-1.9	-4.8	-4.1	-5.9	-2.8	-2.8	-2.0
Statistical discrepancy	0.0	0.6	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-1.4	-1.0	-2.1	-4.8	-4.1	-5.9	-2.8	-2.8	-2.0
Financing	1.4	1.0	2.1	4.8	4.1	5.9	2.8	2.8	2.0
Domestic financing	0.2	-1.0	1.6	0.7	1.4	2.5	0.6	1.1	1.5
Banking system 7/	0.5	-0.5	1.9	0.0	1.7	2.3	0.6	0.8	1.6
CBA	-0.6	-1.7	1.6	-0.4	1.0	-0.1	0.0	0.2	0.6
Commercial Banks	1.1	1.2	0.3	0.5	0.6	2.4	0.6	0.6	1.0
Nonbanks	-0.3	-0.4	-0.3	0.2	-0.3	0.2	0.1	0.3	-0.2
Privatization proceeds	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0
T-Bills/other	-0.6	-1.4	0.2	-0.1	0.2	0.4	0.1	0.1	0.2
Promissory note/other	0.0	1.4	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	0.3	-0.5	-0.3	0.1	-0.4	-0.2	-0.1	0.2	-0.3
External financing	1.3	1.9	0.5	3.2	1.8	2.5	1.2	0.8	0.6
Gross inflow 5/ 8/	2.8	8.2	2.2	6.9	3.3	4.1	2.9	2.6	2.8
Amortization due	-0.7	-5.4	-0.8	-2.4	-0.6	-0.7	-0.9	-0.9	-1.3
Net lending	-0.8	-0.9	-0.9	-1.3	-0.9	-0.9	-0.9	-0.9	-0.9
Other financing 9/	0.0	0.0	0.0	0.9	0.9	0.9	0.9	0.9	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	4,266	4,556	4,829	5,032	5,297	5,151	5,646	5,405	5,762
Program balance 10/	-2.0	-0.9	-3.3	-5.9	-4.9	-6.9	-3.2	-3.3	-2.8
Primary balance 11/	-1.1	-1.9	-1.9	-4.5	-3.6	-5.1	-2.0	-1.3	-1.3
Debt-creating fiscal balance 12/	-2.3	-1.1	-2.8	-6.1	-5.0	-6.8	-3.6	-3.7	-3.0
Government securities issuance	0.7	0.4	0.3	0.3	0.8	2.1	0.7	0.7	1.2

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

1/ From 2014, social contributions include contributions to the second pillar of the pension system.
2/ Composition of expense reclassified in November 2013 to account for wage bill more accurately. A further reclassification of expenses was made in 2015 whereby some spending on goods and services was classified in other categories.
3/ In 2015 reflects the payment of wage arrears for Nairit and the electricity subsidy to households and SMEs. In 2016, an additional subsidy of AMD 2 billion is assumed to cover the electricity tariff differential for households and SMEs.
4/ Changes in expense on goods and services relative to the Third Review reflect classification issues. In particular, spending on education which was previously reflected in "other expenditure" is now classified under "goods and services."
5/ 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 exp.) of the same amount from the gov't to ArmRusGazprom to liquidate liabilities. Excluding this transaction, the deficit amounts to AMD 43.6 bil. or 1 percent of GDP.
6/ Includes acquisition of military equipment.
7/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.
8/ Includes IMF budget support in 2011-12.
9/ EFSD financing ($100 million in 2015-17). First disbursement occurred in December 2015.
10/ 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.
11/ Sum of overall balance (above the line), interest expense, and domestic and external net lending.
12/ 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, 2012–21
(In percent of GDP, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	Act.	Act.	Act.	Prel.			Projections			
National income and prices										
Real GDP (percent change)	7.1	3.3	3.6	3.0	2.4	2.7	3.0	3.5	3.5	4.0
Gross domestic product (in millions of U.S. dollars)	10,619	11,121	11,610	10,529	10,671	10,846	11,335	11,962	12,611	13,374
Gross national income per capita (in U.S. dollars)	3,718	3,961	4,070	3,667	3,610	3,670	3,822	4,020	4,224	4,479
CPI inflation, period average (percent change)	2.5	5.8	3.0	3.7	-1.4	1.6	3.5	4.0	4.0	4.0
Investment and saving										
Investment	22.8	20.7	20.8	21.0	21.7	21.8	22.1	22.6	23.0	23.2
Private	20.3	18.5	18.6	18.0	18.0	20.0	20.1	20.2	20.3	20.4
Public	2.4	2.3	2.3	2.9	3.7	1.8	2.0	2.4	2.7	2.8
National savings	12.8	13.4	13.2	18.3	18.7	17.8	19.5	20.4	19.6	18.8
Private	11.9	12.7	12.9	20.2	21.0	18.8	19.6	19.6	18.7	17.7
Public	0.9	0.7	0.3	-1.9	-2.3	-1.0	-0.1	0.7	0.9	1.1
Central government operations										
Revenue and grants	20.9	22.2	22.0	21.5	21.2	21.8	22.2	22.7	22.8	22.9
Of which: tax revenue	17.0	21.0	21.1	20.1	19.5	20.2	20.6	21.1	21.3	21.4
grants	0.4	0.2	0.3	0.6	0.7	0.5	0.4	0.2	0.1	0.1
Expenditure	22.4	23.8	24.0	26.4	27.1	24.6	24.2	24.4	24.5	24.7
Current expenditure	20.0	21.5	21.7	23.4	23.4	22.8	22.2	22.0	21.8	21.8
Capital expenditure	2.4	2.3	2.3	2.9	3.7	1.8	2.0	2.4	2.7	2.8
Overall balance on a cash basis	-1.4	-1.0	-2.1	-4.8	-5.9	-2.8	-2.0	-1.7	-1.7	-1.7
Domestic financing	0.2	-1.0	1.6	0.7	2.5	1.1	1.5	0.7	1.6	0.7
External financing	1.3	1.9	0.5	3.2	2.5	0.8	0.6	1.0	0.1	1.1
Other financing	...	0.0	0.0	0.9	0.9	0.9	0.0	0.0	0.0	0.0
Public and publicly-guaranteed debt	41.2	40.8	43.6	48.8	54.7	56.4	56.8	56.7	55.3	54.6
External sector										
Exports of goods and services	27.5	28.4	28.6	29.8	31.7	33.1	33.9	34.0	33.2	32.1
Imports of goods and services	48.3	49.2	47.3	42.0	40.6	43.1	42.2	41.6	41.5	41.2
Current account (in percent of GDP)	-10.0	-7.3	-7.6	-2.7	-2.9	-4.0	-2.6	-2.3	-3.4	-4.4
Current account (in millions of U.S. dollars)	-1,058	-813	-883	-279	-312	-430	-292	-272	-425	-589
Capital and financial account (in millions of U.S. dollars)	848	1,758	261	869	385	387	512	577	603	776
Of which: direct foreign investment	481	475	388	168	272	410	352	364	377	392
public sector disbursements	255	914	257	898	426	283	313	382	803	440
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	144	122	0	0	0	0
Of which: IMF	0	0	0	0	44	22	...	...	...	...
Other	0	0	0	0	100	100	...	...	...	...
Gross international reserves in months of imports	3.9	4.9	4.0	4.9	5.0	5.0	5.2	5.4	5.7	5.3
Memorandum items:										
Debt-creating fiscal balance 1/	-2.3	-1.1	-2.8	-6.1	-6.8	-3.6	-2.8	-2.5	-2.5	-2.5

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

1/ Sum of overall balance (above-the-line) and external net lending.

Table 8. Armenia: Indicators of Capacity to Repay the Fund, 2012–20 1/

					Projections				
	2012	2013	2014	2015	2016	2017	2018	2019	2020
Fund obligations based on existing credit (in millions of SDRs)									
Principal	101.0	180.2	98.1	17.9	23.8	36.9	45.2	52.8	54.6
Charges and interest	7.6	5.5	2.4	1.6	1.3	1.9	1.7	1.6	1.2
Total obligations based on existing and prospective credit									
In millions of SDRs	108.6	185.7	100.5	19.5	25.2	39.1	47.2	54.8	54.8
In millions of U.S. dollars	166.3	282.2	152.6	27.3	35.2	54.9	66.4	77.4	77.6
In percent of gross international reserves	9.2	12.5	10.2	1.5	1.8	2.8	3.1	3.3	3.1
In percent of exports of goods and services	5.7	8.9	4.6	0.9	1.0	1.5	1.7	1.9	1.9
In percent of debt service 2/	69.3	32.0	53.5	7.0	14.4	19.0	20.8	22.3	9.0
In percent of GDP	1.6	2.5	1.3	0.3	0.3	0.5	0.6	0.6	0.6
In percent of quota	118.0	201.9	109.2	21.2	19.6	30.4	36.7	42.5	42.5
Outstanding Fund credit based on existing credit 2/									
In millions of SDRs	505.0	379.7	305.1	299.0	290.8	253.9	208.8	156.0	101.3
In millions of U.S. dollars	773.4	577.0	463.4	418.3	406.6	356.3	293.8	220.2	143.5
In percent of gross international reserves	43.0	25.6	31.1	23.6	20.8	18.0	13.7	9.3	5.8
In percent of exports of goods and services	26.5	18.3	14.0	13.3	12.0	9.9	7.6	5.4	3.4
In percent of debt service 2/	322.2	65.4	162.4	107.0	166.6	123.4	91.8	63.4	16.7
In percent of GDP	7.3	5.2	4.0	4.0	3.8	3.3	2.6	1.8	1.1
In percent of quota	548.9	412.8	331.6	325.0	225.8	197.2	162.1	121.1	78.7
Net use of Fund credit based on existing and prospective credit (in millions of SDRs)	-34.0	-125.2	-74.6	-6.1	7.5	-21.2	-45.2	-52.8	-54.6
Disbursements	67.0	55.0	23.5	11.7	31.3	15.7	0.0	0.0	0.0
Repayments and repurchases	101.0	180.2	98.1	17.9	23.8	36.9	45.2	52.8	54.6
Memorandum items:									
Nominal GDP (in millions of U.S. dollars)	10,619	11,121	11,610	10,529	10,671	10,846	11,335	11,962	12,611
Exports of goods and services (millions of U.S. dollars)	2,918	3,156	3,319	3,137	3,384	3,585	3,845	4,072	4,190
Gross international reserves (millions of U.S. dollars)	1,799	2,253	1,489	1,771	1,953	1,981	2,137	2,367	2,469
Debt service (in millions of U.S. dollars) 2/	240.0	881.7	285.4	391.1	244.1	288.8	319.9	347.4	860.9
Quota (in millions of SDRs)	92.0	92.0	92.0	92.0	128.8	128.8	128.8	128.8	128.8

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, 2014–17
(In millions of U.S. dollars, unless otherwise indicated)

	2014	2015	2016	2017
	Act.	Prel.	Proj.	
Gross Financing Requirements	1,054	1,414	1,113	1,142
External current account deficit (excl. transfers)	1,628	846	819	956
Debt amortization and Fund repurchases	190	287	112	158
Gross international reserve accumulation	-764	282	182	27
Available financing	1,054	1,370	970	1,020
Capital Account and Current Transfers	1,014	1,354	970	1,020
of which: Capital transfers (net)	70	65	78	88
Foreign Direct Investment	388	168	272	410
Public Borrowing	216	635	347	177
Private transfers	641	421	391	407
Commercial banks net flows	-39	-313	-42	20
Financing gap	0	44	144	122
Exceptional Financing	0	44	144	122
Of which: IMF EFF program	0	0	44	22
Other 1/	0	0	100	100
Memorandum item:				
Current Account deficit, percent of GDP	-7.6	-2.7	-2.9	-4.0
Fiscal balance, percent of GDP	-2.1	-4.8	-5.9	-2.8
Net International Reserves	1,215	1,533	1,684	1,707
Gross Reserves	1,489	1,771	1,953	1,981
In months of prospective imports	4.0	4.9	5.0	5.0

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

1/ Financing from EFSD.

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

Date of Availability	Conditions	Amount (millions of SDRs)	Percent of Quota 1/
		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 continuous performance criteria, and completion of first review	11.74	12.76
March 30, 2015	Observance of end-December 2014 performance criteria and continuous performance criteria, and completion of second review 2/	11.74	12.76
March 30, 2016	Observance of end-December 2015 performance criteria and continuous performance criteria, and completion of third review	15.65	12.15
September 30, 2016	Observance of end-June 2016 performance criteria and continuous performance criteria, and completion of fourth review	15.65	12.15
March 30, 2017	Observance of end-December 2016 performance criteria and continuous performance criteria, and completion of fifth review	15.69	12.18
	Total	82.21	63.83

Source: Fund staff estimates and projections.

1/ Armenia's quota increased from SDR 92 million to SDR 128.8 million in February 2016.
2/ This review was based on end-June 2015 PCs, which became the controlling PCs.

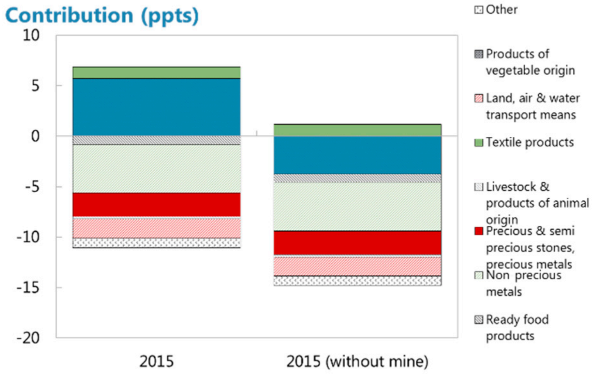
Annex I. Exports Developments

Despite a difficult external environment and falling international prices, export performance proved surprisingly resilient in 2015 and have strengthened further in 2016. In 2015, goods exports held up relatively well, falling by only around 4 percent in value terms, with an increase in export volumes of around 8 or 9 percent. Export performance has continued to strengthen in 2016, with preliminary data suggesting that the value of exports grew by around 20 percent y-o-y between January and August 2016, with export volumes growing by 30 percent.

This strong performance has taken place during a period of relative exchange rate stability. The real effective exchange rate remains at close to its average level since 2007 and marginally stronger than in preceding years. As such, the strong export performance of 2015 and 2016 cannot be explained by a significant depreciation of the dram and associated improvements in price competitiveness.

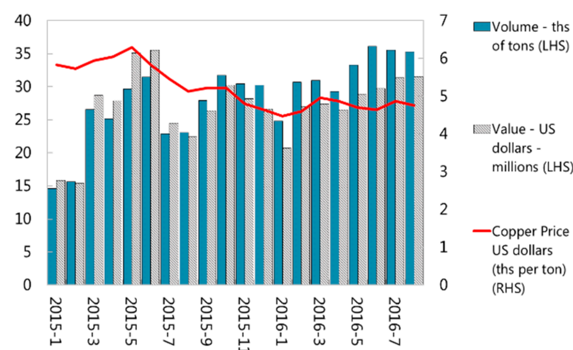
The resilience of exports in 2015 was in large part due to the opening of the new copper mine, though it's impact has been less of a factor in 2016. The Teghut copper mine opened in January 2015 and reached full production in March 2015, generating an average of around 18,000 tons per month of copper concentrate. This significantly boosted the value of both mineral and overall goods exports, offsetting the large decline in international commodity prices. The right panel below illustrates the positive impact of the new mine—without the mine mineral exports would have made a significant negative contribution to export growth, likely resulting in a contraction of around 15 percent in 2015.[1] The impact of the mine on export growth in 2016 will be much lower—with the base effect fading and persistently low copper prices, growth of copper exports in value terms is likely to be negative.

Export Growth by Commodity - 2015
Contribution (ppts)



Source: NSS Trade Data

Copper concentrate exports

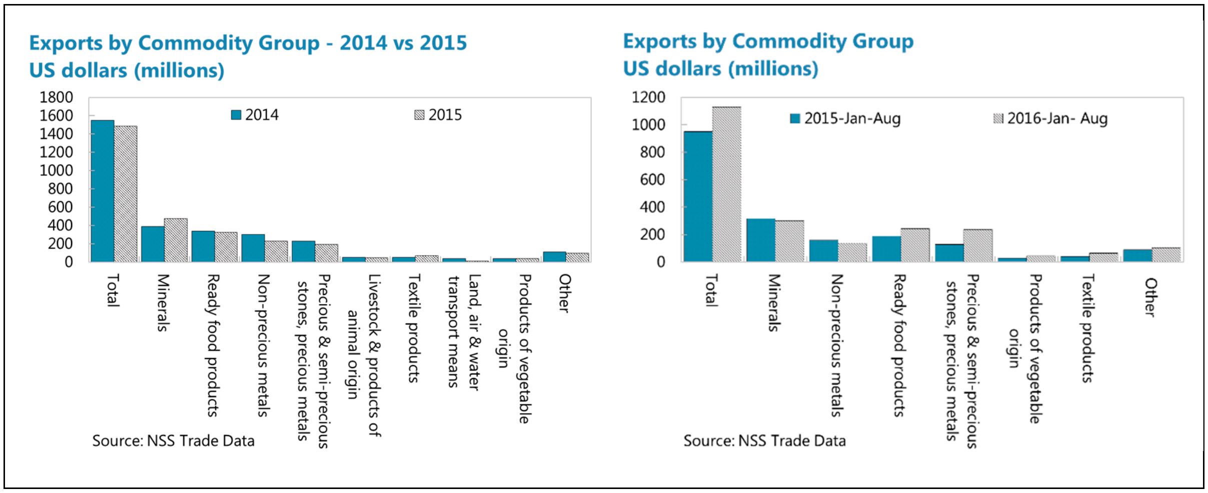


NSS Trade Data, IMF data

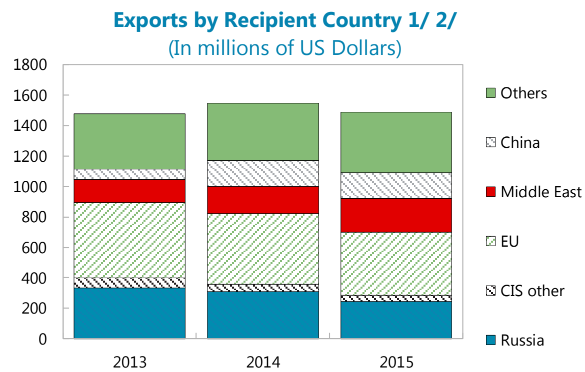
Other (non-mineral) export groups proved remarkably resilient in 2015, and broad-based momentum has been sustained in 2016 despite the challenging external environment. As the figure below illustrates, exports of most other major export goods remained relatively stable in value

[1] Estimate assumes copper export volumes remain unchanged in 2015 (from 2014) with a 15 percent lower copper price, on average.

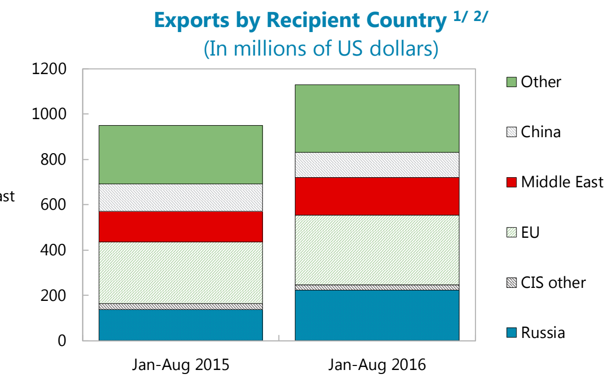
terms, despite the fall in international prices. Notably, the value of 'textile' exports rose significantly 36 percent, with Russia and Italy key destinations, while the value of 'ready prepared food' exports fell only marginally 4 percent. Of the key export groups, only "non-precious metal' exports saw a significant fall in value (25 percent), in line with the large decline in international prices. All key non-mineral export groups have made a positive contribution to export growth, which reached 17 percent between January and August 2016. Exports of "ready prepared foods" grew by 29 percent y-o-y (*6 ppts*), while "textile" exports grew by 59 percent (2 ppts); and "vegetable products" continued to grow strongly by 49 percent *(2 ppts*). Notably, exports of "precious and semi-precious stones" rose by 85 percent y-o-y (*11 ppts*).



In 2015 the resilience of non-mineral exports was supported by diversification into new geographical markets. Exports to traditional markets declined significantly: exports to Russia fell by around 20 percent in value terms, driven by the depreciation of the Ruble; and exports to the EU fell by 11 percent. Despite this decline, exports remained relatively buoyant as a result of a rotation towards new markets. Following strong growth in exports to China in 2013 and 2014, exports in 2015 remained broadly stable, with increased volumes of copper concentrate exports offsetting most of the fall in international prices. There was also a significant increase in the value exports to the Middle East (25 percent), particularly exports to Iraq, which grew by over 60 percent, reflecting strong demand for tobacco and alcohol. This demand appears to have underpinned the strong performance of "ready prepared food products," more generally.



Source: NSS Trade Data
1/ Middle East includes Iran, Iraq, and United Arab Emirates
2/ China includes Hong Kong



Source: NSS Trade Data
1/ Middle East Includes Iran, Iraq and United Arab Emirates
2/ China includes Hong Kong

In contrast, export growth in 2016 has been driven a rebound in exports to traditional markets. Around half of the export growth between January and August 2016 is the result of a recovery in exports to Russia (9 percent), dominated by alcoholic beverages and agriculture produce. Diversification into Middle Eastern markets appears to have been sustained, but exports to China between January and August 2016 were lower than in the same period in 2015, with the increase in the volume of copper exports offset by lower prices (roughly 15 percent) and softening of Chinese domestic demand.

Growth Contribution by Recipient Country / Group

Recipient Country	Growth (percent)	Contribution (ppt)
Russia	62	9
Middle East	23	3
EU countries	14	4
Other	15	4
China	-6	-1
CIS Other	-18	-1

The recovery in the value of exports to Russia appears to be volume-driven and is likely to reflect a range of factors. The rebound in exports to roughly the same levels seen in 2014 is notable given that international commodity prices have remained low and economic activity in Russia in 2016 has continued to decline. Consumption fell by 7.5 percent in 2015 and is projected to continue falling by 2.5 percent in 2016. The recovery in exports therefore appears to be volume-driven and not in line with the developments in general domestic demand. A number of factors could be at play:

- *The impact of Russian import sanctions.* There is some anecdotal evidence that sanctions on the import of agricultural products, raw materials, and food originating from EU and Turkey may have resulted in some import substitution toward Armenian products, particularly agricultural and textile exports. The increase in demand for Armenian exports appears to have coincided with the sanctions on Turkey in November 2015. Armenian exports to Russia between January and June 2016 were around US $100 million higher than they during the same period of 2015. During the same period Russian imports from Turkey fell by around US $950 million. Earlier sanctions on the EU (August 2014) may also have had an impact, albeit delayed due to the severity of the recession in 2015.

- *Supply-side gains.* The recent introduction of greenhouses and more productive techniques in the agricultural sector, appears to have played its role in expanding production to meet this increased Russian demand.

- *Entry to the Eurasian Economic Union (EEU)*. Accession to the EEU most likely helped maintain access to these markets, in a difficult external environment. Moreover, there were a number of specific trade benefits for Armenia. For example, Russia's removal of a 30 percent tariff on precious stone exports, may have opened up new opportunities for the Armenian jewelry industry. This could be a key driver of the rapid growth of precious stone and precious metals exports.

- *Reorientation from domestic to external demand.* In some industries, including the alcohol industry, there is some evidence that production has remained relatively stable, while exports have increased. With depressed domestic demand causing significant headwinds for producers, this may indicate a shift in focus towards export markets.

The current pace of export growth is likely to slow through 2016 and 2017, though a new gold mine is expected to provide a significant boost to exports from 2018 onwards. Prospects for further inroads into Middle Eastern markets appear to be strong and the rebound in Russian exports may continue to support export growth in 2016. However, there will significant headwinds elsewhere. As the base effect of the mine fades, mineral exports are likely to have an increasingly negative impact on export growth. Moreover, with a subdued global outlook, including for China, and the expectation of persistently low commodity prices, mineral exports are unlikely to be a strong driver of export growth in 2017 and beyond. The expectation of a modest recovery for Russia and subdued consumption over the medium-term, also likely to limit the potential for further export growth, even in sanctions persist. Looking further ahead, the new Amulsar gold project is expected to begin production in 2017 with exports to follow in 2018. Annual production is projected at around 100,000 ounces, which would equate to around US $250 million of exports at the current international gold prices (US $1,300 per ounce).

Nevertheless, the recent prolonged closer of the overland trade route with Russia also demonstrates the fragility of recent gains. The Upper Lars border checkpoint (Stepantsminda, Georgia), the only overland commercial route and direct ground transportation link between Armenia and Russia, was closed for over a month in May this year, following a landslide. This is the latest in a long history of closures, and highlights the limitations imposed on Armenian trade by geography and the lack of resilient transport infrastructure. Long-term efforts at establishing alternative trade routes remains a structural priority for Armenia.

Annex II. Risk Assessment Matrix

Potential Deviations from the Baseline (July G-RAM)[1]

Nature/source of risk	Relative likelihood	Possible impact if risk is realized	Policy response
Global Risks			
Economic fallout from political fragmentation: • **Rise in populism and nationalism in large economies—**especially those with near-term elections—could slow down or even reverse policy coordination and collaboration; international trade liberalization; financial, and labor flows; and lead to unsustainable policies, weighing on global growth and exacerbating financial market volatility. • **Protracted uncertainty associated with negotiating post-Brexit arrangements** could weigh on confidence and investment more than expected—most prominently in the UK and the rest of Europe with possible knock-on effects elsewhere. Increased barriers could also dampen the longer-run economic performance of affected countries more than expected. • **Heightened risk of fragmentation/security dislocation in part of the Middle East, Africa, and Europe,** leading to a sharp rise in migrant flows, with negative global spillovers.	High Medium High	**Staff assessment: High** Effects would be strong, comprising effects via trade and remittances. Renewed migrant flows remain a possibility if security conditions deteriorate in neighboring countries.	Maintain exchange rate flexibility as a shock absorber. Strengthen social safety nets to cushion impact of shocks on most vulnerable sectors and provide humanitarian help if necessary.
Tighter and more volatile global financial conditions: • **Sharp rise in risk premia with flight to safety:** Investors withdraw from specific risk asset classes as they reassess underlying economic and financial risks in large economies, or respond to unanticipated Fed tightening, and increases in U.S. term premia, with poor market liquidity amplifying volatility. Safe haven currencies—especially the US dollar—surge creates balance sheet strains for FX debtors.	Medium	**Staff assessment: Low/Medium** Financing options may be diminished in the context of tight and volatile global financial conditions. Furthermore, negative effects via trade and remittances could occur, particularly in case of an appreciation of the US dollar.	Maintain exchange rate flexibility as a shock absorber. Prepare contingency plans for financial spillovers and enhance monitoring of FX risks.

[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.

Weaker-than-expected global growth: • **Significant China slowdown and its spillovers:** Key near term risks are a loss of investor confidence, disorderly corporate defaults, a sharp fall in asset prices, and a quicker fading of the stimulus impact. Weak domestic demand further suppresses commodity prices, roils global financial markets, and reduces global growth (Likelihood: low in short-term, medium thereafter). • **Significant slowdown in other large EMs/frontier economies.** Turning of the credit cycle and fallout from excess household and corporate (FX) leverage as investors withdraw from EM corporate debt, generating disorderly deleveraging, with potential spillbacks to advanced economies. • **Structurally weak growth in key advanced and emerging economies:** Weak demand, low productivity growth, and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms, leading to lower medium-term path of potential growth (the Euro area, Japan, and the United States) and exacerbating legacy financial imbalances especially among banks (the Euro area) (high likelihood). Tighter financial conditions and insufficient reforms undermine medium-term growth in emerging markets (medium likelihood).	Low/ Medium Medium High/ Medium	**Staff assessment: Medium** Mining exports, an important area for export growth and source of foreign exchange earnings and tax revenue would be hit hard.	Diversify export destination and products. Maintain exchange rate flexibility as a shock absorber. Strengthen social safety nets to cushion impact of shocks.
Persistently lower energy prices, triggered by supply factors reversing more gradually than expected.	Low	**Staff assessment: Medium/High** Negative indirect effects through remittances, trade, finance, and investment channels via major trading partners.	Diversify export destination and products. Maintain exchange rate flexibility as a shock absorber. Strengthen social safety nets to cushion impact of shocks.
Country-Specific Risks			
Regional conflict: • Risks from sharp, renewed NK-related tensions	**Assessment**: - High	**Staff assessment: High** Conflict would involve severe impacts, including possible regional military action.	Prepare and implement contingency plans.

Annex III. Public Debt Sustainability Analysis

Results from the debt sustainability analysis (DSA) using staff's baseline projections indicate that Armenia's public debt remains sustainable but the high share of foreign currency debt and debt held by foreign residents continues to be an important source of vulnerability. The relatively large fiscal adjustment needed to stabilize debt is a risk. Alternative scenarios and stress tests suggest that an adverse growth shock would have the largest impact on debt dynamics and government financing needs.

Background

Widening of the fiscal deficit on the back of subdued economic activity has been the main driver of Armenia's public debt increase in the last two years. The gross debt-to-GDP ratio rose to 49 percent in 2015 and is expected to increase further to 55 percent due to weaker-than-budgeted revenue, combined with stepped up capital. Unlike 2014, exchange rate developments did not contribute significantly to the debt dynamics but the share of external debt increased slightly in 2015, reaching 87 percent of total. In 2016, the issuance of dram-denominated government securities increased significantly, including due to more favorable market conditions, and as a result domestic debt rose by 29 percent in January-September.

The DSA is based on an updated set of macroeconomic assumptions. Although real GDP growth projections have been revised up relative to the Third Review, nominal GDP is expected to be lower, reflecting ongoing deflationary pressures. Inflation is only expected to return slowly to the authorities' 4 percent target over the medium term. Further, the composition of demand is assumed to change in a more revenue-friendly way as the currently depressed private consumption and investment gradually recover. Tax collections have continued to underperform in 2016 and are likely to remain unchanged in nominal terms from 2015. At the same time, capital expenditure is expected to be significantly higher due to over-execution of foreign-financed projects which would bring the overall fiscal deficit to nearly 6 percent of GDP. The primary deficit (including net lending) is projected to increase from 4.5 to 5.1 percent of GDP in 2016 and decline sharply to 1.3 percent of GDP in 2017, consistent with Armenia's fiscal rule (see below).

Public DSA results

Government debt will likely exceed 50 percent of GDP this year, triggering the debt brake. Armenia's total public debt as a share of GDP is projected to reach 55 percent in 2016 and increase further in 2017–18. Excluding the central bank, debt will exceed the 50 percent threshold set in the Law on State Debt which will trigger the deficit rule. According to this rule, the fiscal deficit next year should be no more than 3 percent of the average GDP of the previous three years (equivalent to about 2.8 percent of 2017 GDP).

Debt dynamics improve over the medium term. As consolidation gains momentum, debt stabilizes and starts to decline after 2018, reflecting also favorable macroeconomic developments captured in the interest-growth differential. Under the baseline, the share of FX-denominated debt in total debt decreases due to a more rapid increase in amortization relative to new disbursements. Government's gross financing needs are expected to hover around 7 percent of GDP during 2016–19, rising to 10 percent of GDP in 2020 when the 2013 Eurobond matures. External financing will continue to be contracted primarily on concessional terms, in the form of project-related loans and budget support from multilateral donors. Domestic financing, although increasing, is expected to remain relatively small with an increasing average maturity.

Baseline projections are subject to significant uncertainty. Historically, growth, interest and exchange rates in Armenia have been quite volatile which implies wide confidence bands around the central projection. Assuming a symmetric distribution of shocks, a fan chart for the public debt-to-GDP ratio points to a range between 37 and 80 percent (corresponding to the 10^{th} – 90^{th} percentile) in 2017 and between 24 and 100 percent in 2021. An asymmetric fan chart, which rules out real exchange rate appreciation, suggests that debt could range between 40 and 113 percent of GDP (10^{th} to 90^{th} percentile) in the end of the projections horizon.

There are risks to fiscal consolidation under the baseline. As noted above, the headline overall deficit is set to decline by more than 3 percent of GDP in 2017 compared to 2016. Adjustment of such magnitude is challenging, both politically and economically. The government has shown determination to adhere to the fiscal rule and has presented to parliament a budget that achieves the required consolidation on account of higher revenue, freeze or reduction of non-interest current spending and lower capital expenditure. Consolidation over the medium term will rely on a combination of expenditure restraints and revenue increases, underpinned by the new Tax Code which will become effective in 2017.

The heat map highlights vulnerabilities stemming from the large external public debt. The high share of FX debt and debt held by non-residents remains an important risk factor for debt sustainability. A depreciation of the exchange rate would worsen the debt outlook as indicated by the relevant stress test (see below). This a potential risk in light of the prospects of CBA's loosening of monetary policy. However, this risk is mitigated by the fact that over 90 percent of the debt is long-term, mostly provided by official creditors, and at fixed interest rates (see table).

Structure of government debt (percent of total)

	Dec-15	Sep-16
By initial maturity		
Short-term	1.0	2.3
Medium-term	6.9	8.0
Long-term	92.1	89.7
By type of interest rate		
Floating	10.5	11.5
Fixed	89.5	88.5

Source: RA Ministry of Finance

Scenarios assuming a constant primary balance and key variables at their historical averages underscore the need for consolidation. The paths of public debt and gross financing needs deviate significantly from the baseline under the constant primary balance and historical scenarios; the debt ratio rises to over 70 percent and financing needs to close to 20 percent of GDP in 2020 if the primary balance remains at the current level. This implies that without active policy measures aimed at reducing the fiscal deficit, debt sustainability would be jeopardized.

Stress tests suggest that real GDP growth shocks have the largest impact on debt indicators. An adverse shock to growth, whereby real GDP contracts by 5.0 percent and 4.7 percent in 2017 and 2018, respectively, causes public debt to increase to 78 percent of GDP, and public gross financing needs exceed 13 percent of GDP by 2018. This scenario, however, is based on historical GDP growth which, as noted above, has been characterized by quite high volatility, and the realization of shocks of such magnitude is relatively unlikely. Stress tests based on standardized primary balance, real interest and ER shocks reveal a moderate deterioration relative to the baseline, with real exchange rate depreciation having a somewhat larger impact.

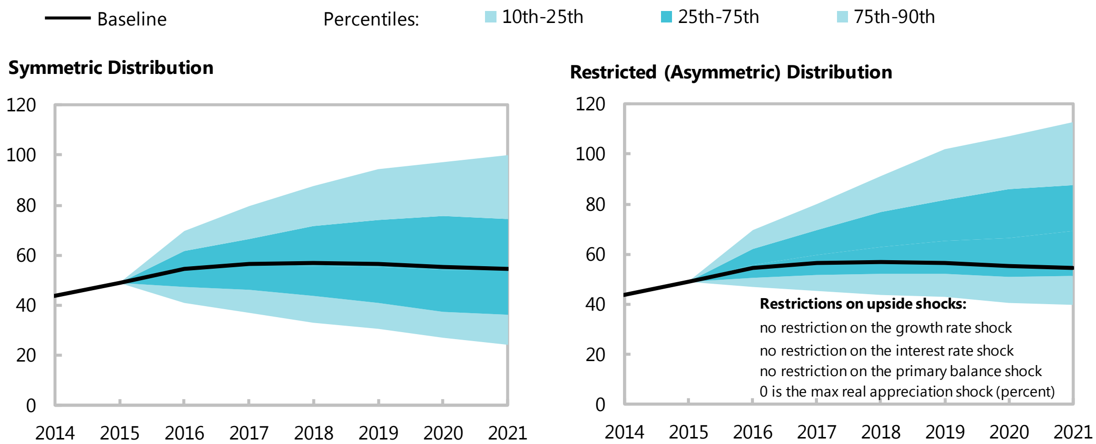
Armenia Public DSA Risk Assessment

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

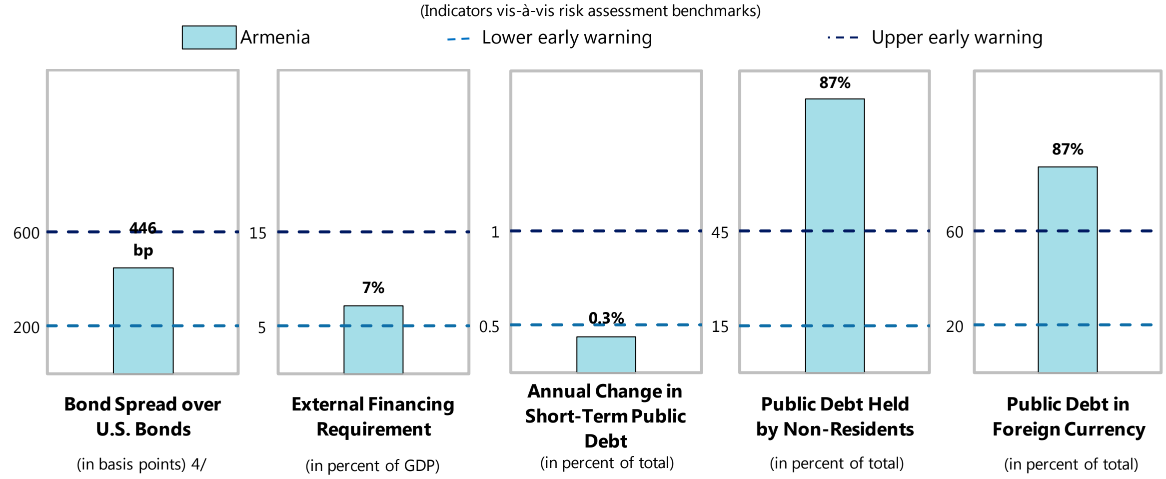
Evolution of Predictive Densities of Gross Nominal Public Debt

(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.

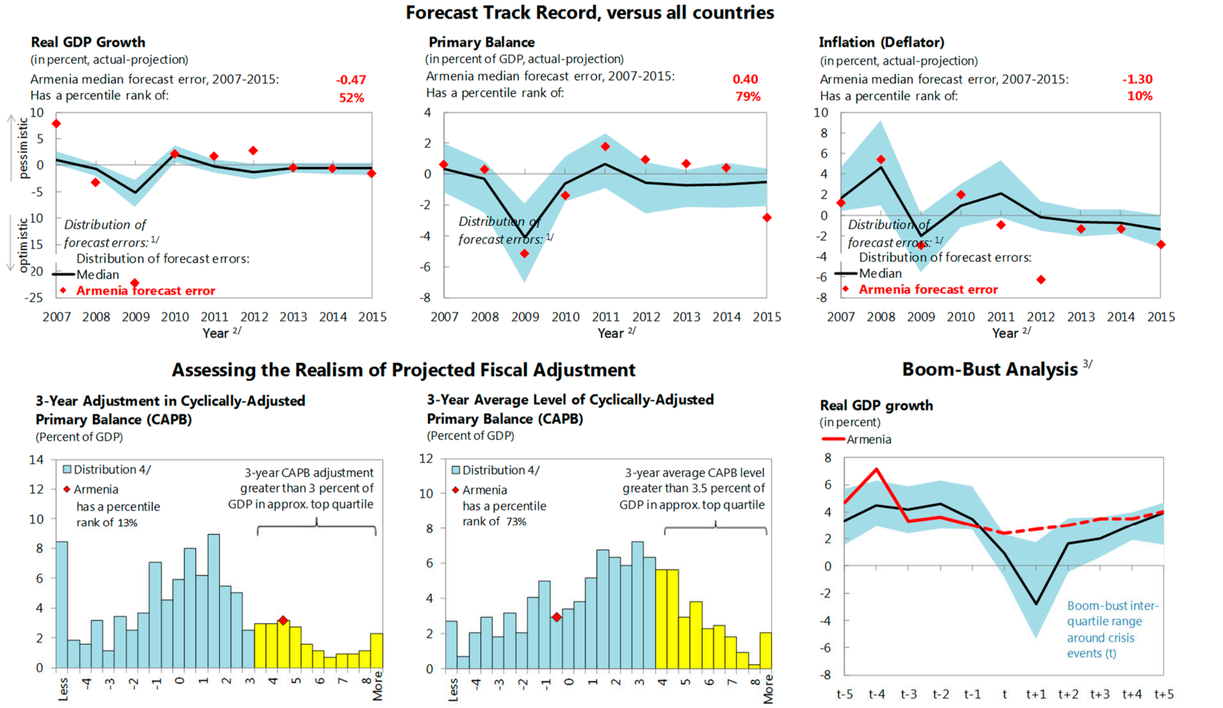
2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

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, 18-May-16 through 16-Aug-16.

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 positive output gap for 3 consecutive years, 2013-2015 and a cumulative increase in private sector credit of 4 percent of GDP, 2012-2015. For Armenia, t corresponds to 2016; for the distribution, t corresponds

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)

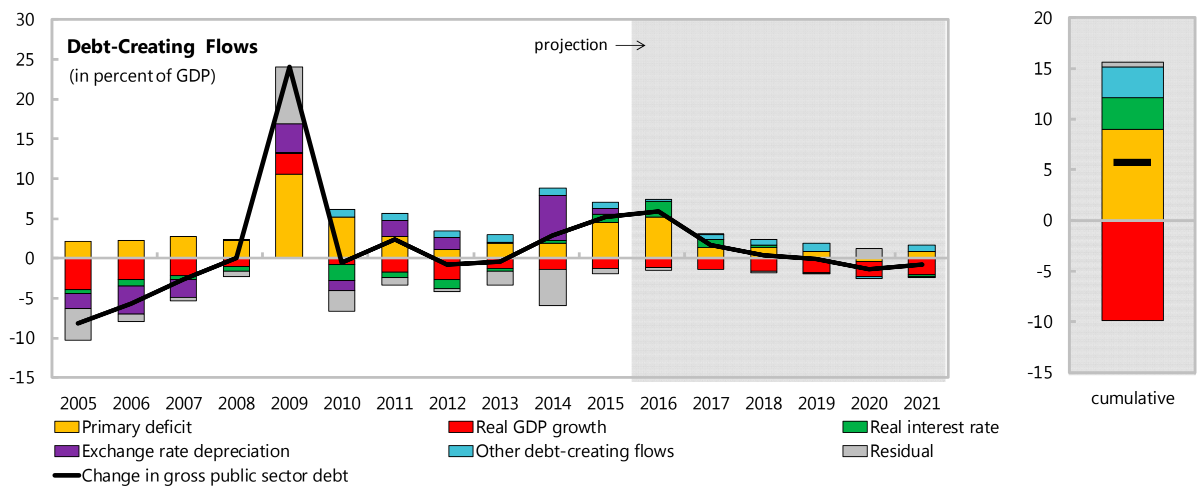
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	31.0	43.6	48.8	54.7	56.4	56.8	56.7	55.3	54.6
Public gross financing needs	6.4	5.0	9.8	8.9	5.6	6.8	6.9	10.2	7.8
Net public debt		35.8	41.3	47.1	49.3	49.9	50.0	50.1	49.8
Real GDP growth (in percent)	5.7	3.6	3.0	2.4	2.7	3.0	3.5	3.5	4.0
Inflation (GDP deflator, in percent)	4.6	2.3	1.2	0.0	2.2	3.5	4.0	4.0	4.0
Nominal GDP growth (in percent)	10.5	6.0	4.2	2.4	4.9	6.6	7.6	7.6	8.2
Effective interest rate (in percent) [4/]	2.3	3.3	3.5	4.3	4.3	4.3	4.1	4.1	3.6

As of August 16, 2016		
Sovereign Spreads		
Spread (bp) 3/		372
CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	B1	n.a.
S&Ps	BB-	n.a.
Fitch	B+	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.9	2.87	5.18	5.9	1.7	0.4	-0.1	-1.4	-0.7	5.8	
Identified debt-creating flows	1.4	7.40	5.85	7.1	2.4	1.7	0.9	-1.6	0.1	10.5	
Primary deficit	3.4	1.9	4.5	5.1	1.3	1.3	0.9	-0.5	0.9	9.0	-0.8
Primary (noninterest) revenue and grants	20.4	22.0	21.5	21.2	21.8	22.2	22.7	22.8	22.9	133.6	
Primary (noninterest) expenditure	23.8	23.9	26.1	26.3	23.1	23.5	23.5	22.3	23.8	142.5	
Automatic debt dynamics [5/]	-2.4	4.6	0.4	1.8	0.6	-0.3	-1.0	-0.9	-1.6	-1.5	
Interest rate/growth differential [6/]	-2.2	-1.0	-0.3	0.9	-0.3	-1.2	-1.9	-1.9	-2.3	-6.7	
Of which: real interest rate	-0.7	0.4	1.0	2.0	1.1	0.4	0.0	0.0	-0.3	3.1	
Of which: real GDP growth	-1.5	-1.4	-1.3	-1.1	-1.4	-1.6	-1.8	-1.8	-2.0	-9.9	
Exchange rate depreciation [7/]	-0.2	5.7	0.7	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.4	0.9	0.9	0.2	0.6	0.7	1.0	-0.2	0.8	3.0	
Domestic net lend./drawdown of gov. dep.	0.0	0.0	-0.4	-0.7	-0.4	-0.3	0.1	-1.1	0.0	-2.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
External net lending	0.4	0.9	1.3	0.9	0.9	0.9	0.8	0.8	0.8	5.3	
Residual, including asset changes [8/]	-0.5	-4.5	-0.7	-0.4	0.2	-0.3	-0.1	1.2	-0.1	0.5	



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).

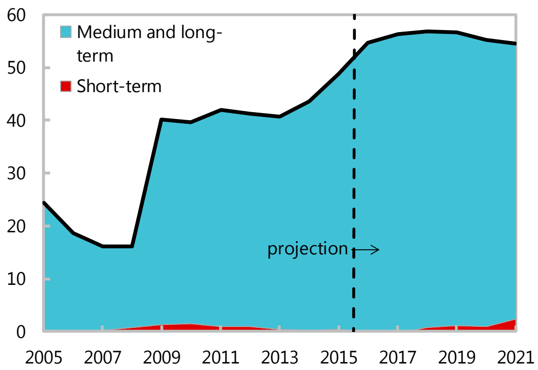
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

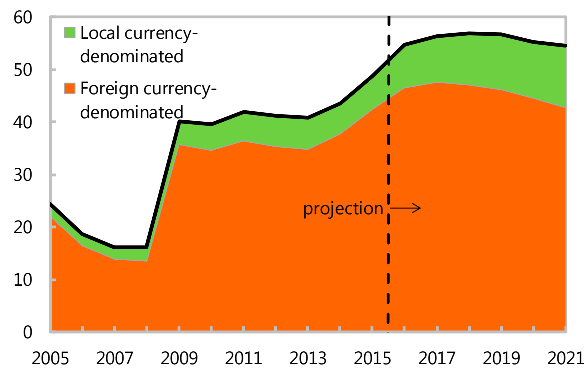
Armenia Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



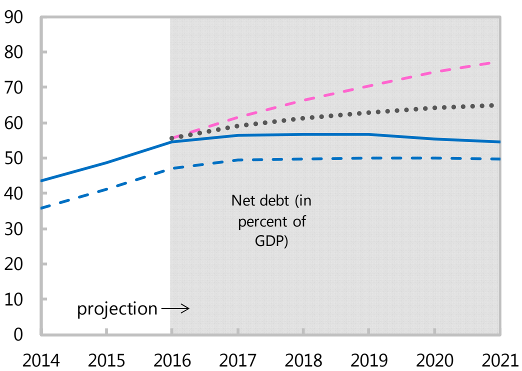
By Currency
(in percent of GDP)



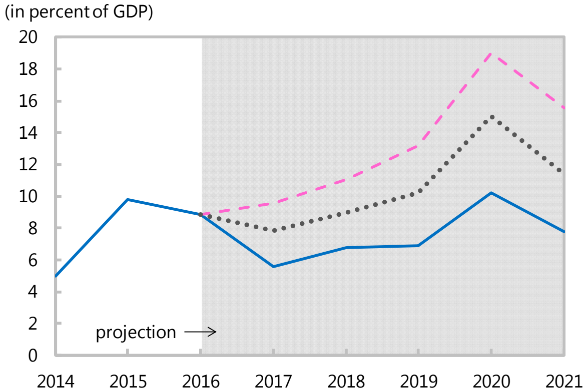
Alternative Scenarios

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)

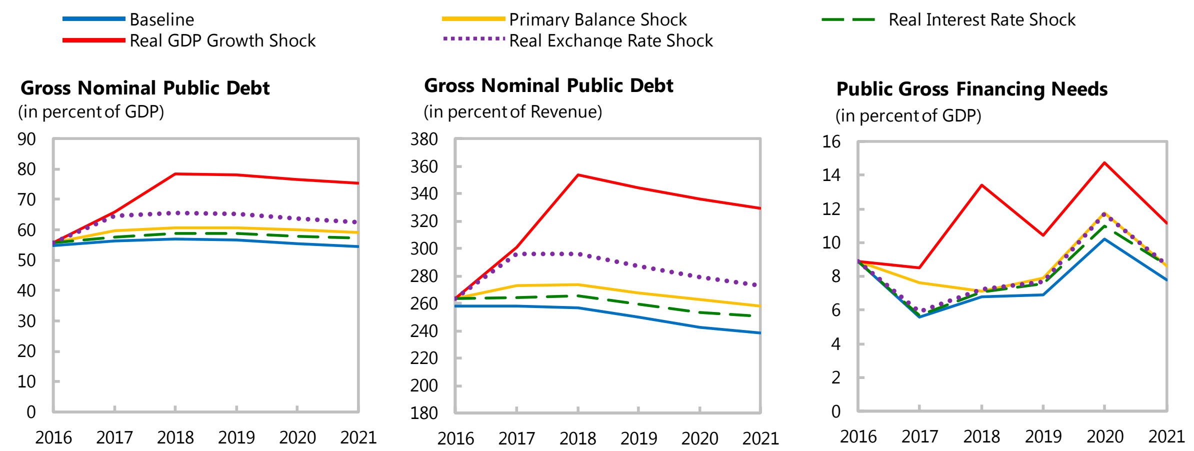
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.4	2.7	3.0	3.5	3.5	4.0
Inflation	0.0	2.2	3.5	4.0	4.0	4.0
Primary Balance	-5.1	-1.3	-1.3	-0.9	0.5	-0.9
Effective interest rate	4.3	4.3	4.3	4.1	4.1	3.6
Constant Primary Balance Scenario						
Real GDP growth	2.4	2.7	3.0	3.5	3.5	4.0
Inflation	0.0	2.2	3.5	4.0	4.0	4.0
Primary Balance	-5.1	-5.1	-5.1	-5.1	-5.1	-5.1
Effective interest rate	4.3	4.3	4.4	4.3	4.2	3.7

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.4	4.4	4.4	4.4	4.4	4.4
Inflation	0.0	2.2	3.5	4.0	4.0	4.0
Primary Balance	-5.1	-3.5	-3.5	-3.5	-3.5	-3.5
Effective interest rate	4.3	4.3	4.0	3.5	3.2	2.3

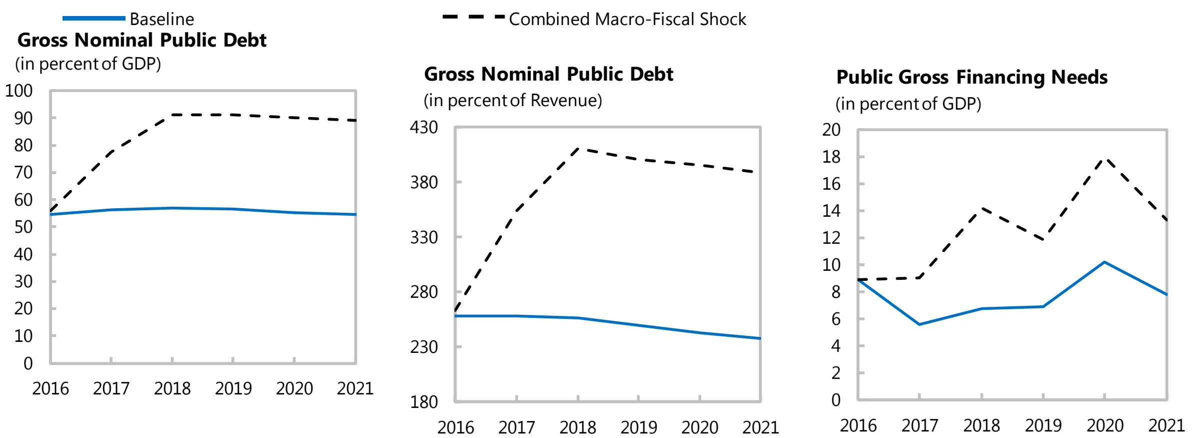
Source: IMF staff.

Armenia Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2016	2017	2018	2019	2020	2021
Primary Balance Shock						
Real GDP growth	2.4	2.7	3.0	3.5	3.5	4.0
Inflation	0.0	2.2	3.5	4.0	4.0	4.0
Primary balance	-5.1	-3.2	-1.3	-1.1	-0.2	-0.9
Effective interest rate	4.3	4.3	4.4	4.2	4.2	3.7
Real Interest Rate Shock						
Real GDP growth	2.4	2.7	3.0	3.5	3.5	4.0
Inflation	0.0	2.2	3.5	4.0	4.0	4.0
Primary balance	-5.1	-1.3	-1.3	-0.9	0.5	-0.9
Effective interest rate	4.3	4.3	4.5	4.6	4.7	4.4
Combined Shock						
Real GDP growth	2.4	-5.0	-4.7	3.5	3.5	4.0
Inflation	0.0	0.3	1.6	4.0	4.0	4.0
Primary balance	-5.1	-3.6	-6.3	-1.1	-0.2	-0.9
Effective interest rate	4.3	4.8	4.3	4.6	4.7	4.4

	2016	2017	2018	2019	2020	2021
Real GDP Growth Shock						
Real GDP growth	2.4	-5.0	-4.7	3.5	3.5	4.0
Inflation	0.0	0.3	1.6	4.0	4.0	4.0
Primary balance	-5.1	-3.6	-6.3	-0.9	0.5	-0.9
Effective interest rate	4.3	4.3	4.4	4.5	4.4	3.8
Real Exchange Rate Shock						
Real GDP growth	2.4	2.7	3.0	3.5	3.5	4.0
Inflation	0.0	7.8	3.5	4.0	4.0	4.0
Primary balance	-5.1	-1.3	-1.3	-0.9	0.5	-0.9
Effective interest rate	4.3	4.8	4.1	4.0	3.9	3.5

Source: IMF staff.

Annex IV. Exchange Rate Assessment, Reserve Adequacy, and External Debt Sustainability

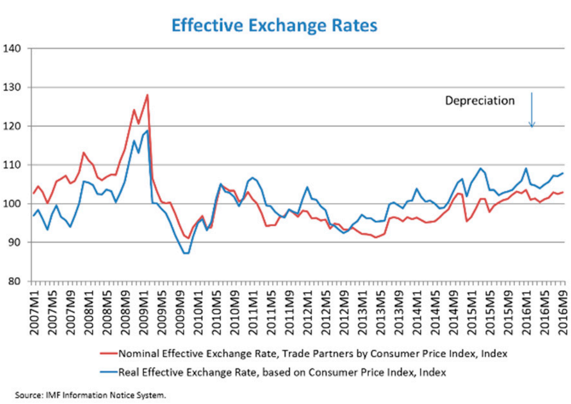
Exchange Rate Assessment

The external position remains broadly consistent with fundamentals and desirable policy settings. Staff estimates suggest that the dram remains close to its equilibrium level. Estimates of the real effective exchange rate (REER) alignment are based on the IMF's External Balance Approach-lite (EBA-lite) and are largely unchanged since the Third Review:

- The *macro-balance* (MB) approach, suggests a current account norm of –4.1 percent of GDP for 2015, relative to the projected balance of –2.9 percent for 2016. This translates into an REER undervaluation of 6.0 percent.

- The *external sustainability* (ES) approach estimates a current account norm of –4.9 percent of GDP to stabilize the ratio of Net IIP to GDP at the revised end-2015 level of –77.6 percent of GDP. When compared with the medium-term projection for the current account of –4.4 percent of GDP (down from –5.2 percent of GDP at the last review), this implies a current account gap of –0.5 and a marginal REER undervaluation of 2.5 percent. Alternatively, a –4.4 percent current account deficit is consistent with stabilization of the IIP position at –75 percent of GDP over the medium term.

- Following a small depreciation through end-August 2016, the *REER* approach estimates an overvaluation of 7 percent—lower than the 12 percent at the last review.



Estimated Real Exchange Rate Misalignment
(In percent of GDP, unless indicated otherwise)

	Macrobalance approach (EBA-lite)	REER approach (EBA-lite)	External sustainability (EBA-lite)
Current account norm	-4.1		-4.9
Underlying current account 1/	-2.9		-4.4
CA gap	1.2		0.5
Elasticity	-0.19		-0.19
Real exchange rate gap 2/	-6.0	7.0	-2.5

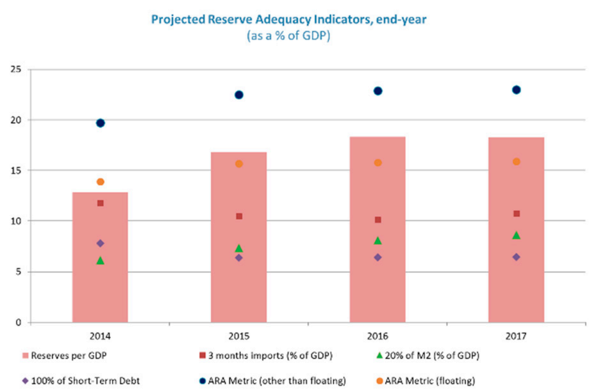
1/ 2016 projection for the macrobalance and 2021 projection for the external sustainability approach.

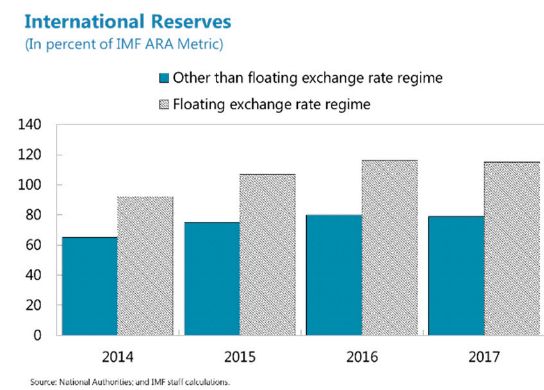
2/ Movement in real exchange rate needed to close the gap between norm and underlying current account. REER approach uses REER projection for 2016.

Based on the MB and ES approaches, the current account norm remains within the –4 to –5 percent of GDP range. The difference in estimations of misalignment is driven by the underlying (actual) current account balances used. The MB approach uses the –2.9 percent 2016 projection, reflecting a number of temporary factors, including the large contraction in imports. The ES approach instead uses the –4.4 percent of GDP 2021 projection, which reflects staff's projection for a gradual widening of the deficit with the recovery of imports. Applying the medium-term projection to the MB approach would imply an REER overvaluation of around 1.6 percent. This suggests a misalignment range of 2.5 percent under-valuation to 7 percent over-valuation, with a mid-point equating to a 2.5 percent overvaluation.

Reserve Adequacy

Armenia's foreign exchange reserves remain at an adequate level, based on most standard metrics. Gross international reserves are projected to increase from US $1.77 billion at end-2015 to US $1.95 billion by end-2016, driven by further CBA fx purchases and a pick-up in inflows, reflecting large multilateral and bilateral donor disbursements to the government in Q4. By most standard metrics, reserve coverage appears broadly adequate. Gross reserves are projected to remain stable at around 5 months of imports throughout the projection period to 2021. Under the Funds reserve adequacy metric (ARA) for floating exchange rate regimes (Armenia's current exchange rate regime classification) reserves are projected to reach around 116 percent of the metric by end-2016 and remain broadly stable through 2017 (i.e., within the 100–150 percent adequacy range). In contrast, reserves would only be around 80 percent of the ARA metric for "non-floating" exchange rate regimes, highlighting the importance of the authorities' continued commitment to increased two-way exchange rate flexibility and limited intervention.





External Debt Sustainability

Armenia's external debt-to-GDP ratio remains high but is projected to gradually improve over the medium-term. The ratio of external debt to GDP was around 85 percent at end-2015, having risen substantially from 71 percent at end-2014. In the baseline scenario, the ratio is projected to continue rising slowly in 2016 and 2017 to 89.5 percent before gradually falling back to around 76 percent by end-2021. This path is broadly consistent with the previous assessment, with the higher peak in 2017 reflecting higher government borrowing for foreign-financed capital projects and increased imports relating to the new gold mine. The larger and faster debt reduction over the medium term is driven by additional exports generated by the mine. Public sector debt is projected to grow more quickly than private sector debt. The strengthening of the current account position remains the key driver of the improvement over the medium term, with the non-interest current account deficit projected to remain significantly below the estimated debt stabilizing level of –4.8 percent. Non-debt creating flows are projected to continue offsetting the non-interest current account deficit, even as the latter widens over the medium-term with the expected recovery of imports. Automatic debt dynamics continue to play a smaller role in the evolution of external debt, but are expected to turn positive (i.e., debt-reducing) over the projection period with the pickup in growth and gradual fall in nominal external interest rates.

The sustainability of external debt remains sensitive to most standardized shocks. Shocks to growth, the non-interest current account and the combined shock scenario all result in a significant increase in external debt to between 88 and 92 percent of GDP. Consistent with previous assessments, a one-time 30 percent real ER depreciation would have an even larger impact on external debt, increasing the ratio by 30 percentage points to 108 percent of GDP by 2021. External debt remains more resilient to interest rate shocks because of the large share of concessional financing in external public debt.

Armenia: External Debt Sustainability Framework, 2011–21
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2011	2012	2013	2014	2015	10-Year Historical Average	10-Year Standard Deviation	2016	2017	2018	2019	2020	2021	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	71.5	70.2	78.1	71.3	84.5			**88.1**	**89.5**	**86.0**	**82.2**	**78.7**	**76.1**	**-4.8**
2 Change in external debt	5.1	-1.3	7.9	-6.8	13.3			3.6	1.4	-3.5	-3.8	-3.5	-2.6	
3 Identified external debt-creating flows (4+8+9)	0.4	2.2	-0.1	1.0	8.4			-1.6	-2.2	-3.1	-3.6	-2.4	-1.5	
4 Current account deficit, excluding interest payments	8.5	7.8	5.1	5.0	-0.5			-0.4	0.7	-0.5	-0.7	0.5	1.9	
5 Deficit in balance of goods and services	21.5	20.8	20.9	18.7	12.2			8.8	10.0	8.2	7.5	8.2	9.1	
6 Exports	27.0	27.5	28.4	28.6	29.8			31.7	33.1	33.9	34.0	33.2	32.1	
7 Imports	48.5	48.3	49.2	47.3	42.0			40.6	43.1	42.2	41.6	41.5	41.2	
8 Net non-debt creating capital inflows (negative)	-4.3	-4.5	-4.3	-3.3	-1.6			-2.5	-3.8	-3.1	-3.0	-3.0	-2.9	
9 Automatic debt dynamics 1/	-3.8	-1.1	-0.9	-0.7	10.4			1.3	0.9	0.6	0.1	0.1	-0.5	
10 Contribution from nominal interest rate	2.0	2.2	2.2	2.6	3.1			3.3	3.2	3.1	3.0	2.9	2.5	
11 Contribution from real GDP growth	-2.8	-4.9	-2.2	-2.7	-2.4			-2.0	-2.3	-2.6	-2.9	-2.7	-3.0	
12 Contribution from price and exchange rate changes 2/	-2.9	1.7	-1.0	-0.6	9.7			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	4.8	-3.5	8.0	-7.8	4.9			5.2	3.5	-0.4	-0.2	-1.2	-1.1	
External debt-to-exports ratio (in percent)	264.5	255.5	275.1	249.3	283.8			277.8	270.7	253.5	241.4	236.8	237.3	
Gross external financing need (in billions of US dollars) 4/	2.0	2.7	2.6	2.5	1.9			1.5	1.7	1.6	1.6	2.3	2.1	
in percent of GDP	19.5	25.1	23.8	21.9	17.6			13.8	15.3	13.9	13.5	18.5	15.5	
Scenario with key variables at their historical averages 5/								**88.1**	**87.5**	**85.2**	**83.6**	**81.1**	**78.8**	**-10.3**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	4.7	7.1	3.3	3.6	3.0	4.4	7.7	2.4	2.7	3.0	3.5	3.5	4.0	
GDP deflator in US dollars (change in percent)	4.6	-2.3	1.4	0.8	-12.0	4.4	12.8	-1.0	-1.0	1.5	2.0	1.9	2.0	
Nominal external interest rate (in percent)	3.2	3.1	3.3	3.4	4.0	2.2	2.2	4.0	3.7	3.7	3.7	3.7	3.4	
Growth of exports (US dollar terms, in percent)	24.0	6.4	8.2	5.2	-5.5	9.1	17.0	7.9	5.9	7.3	5.9	2.9	2.4	
Growth of imports (US dollar terms, in percent)	8.4	4.3	6.7	0.2	-19.5	8.8	20.6	-2.0	8.0	2.3	4.0	5.1	5.4	
Current account balance, excluding interest payments	-8.5	-7.8	-5.1	-5.0	0.5	-7.8	4.9	0.4	-0.7	0.5	0.7	-0.5	-1.9	
Net non-debt creating capital inflows	4.3	4.5	4.3	3.3	1.6	5.4	2.2	2.5	3.8	3.1	3.0	3.0	2.9	

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

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

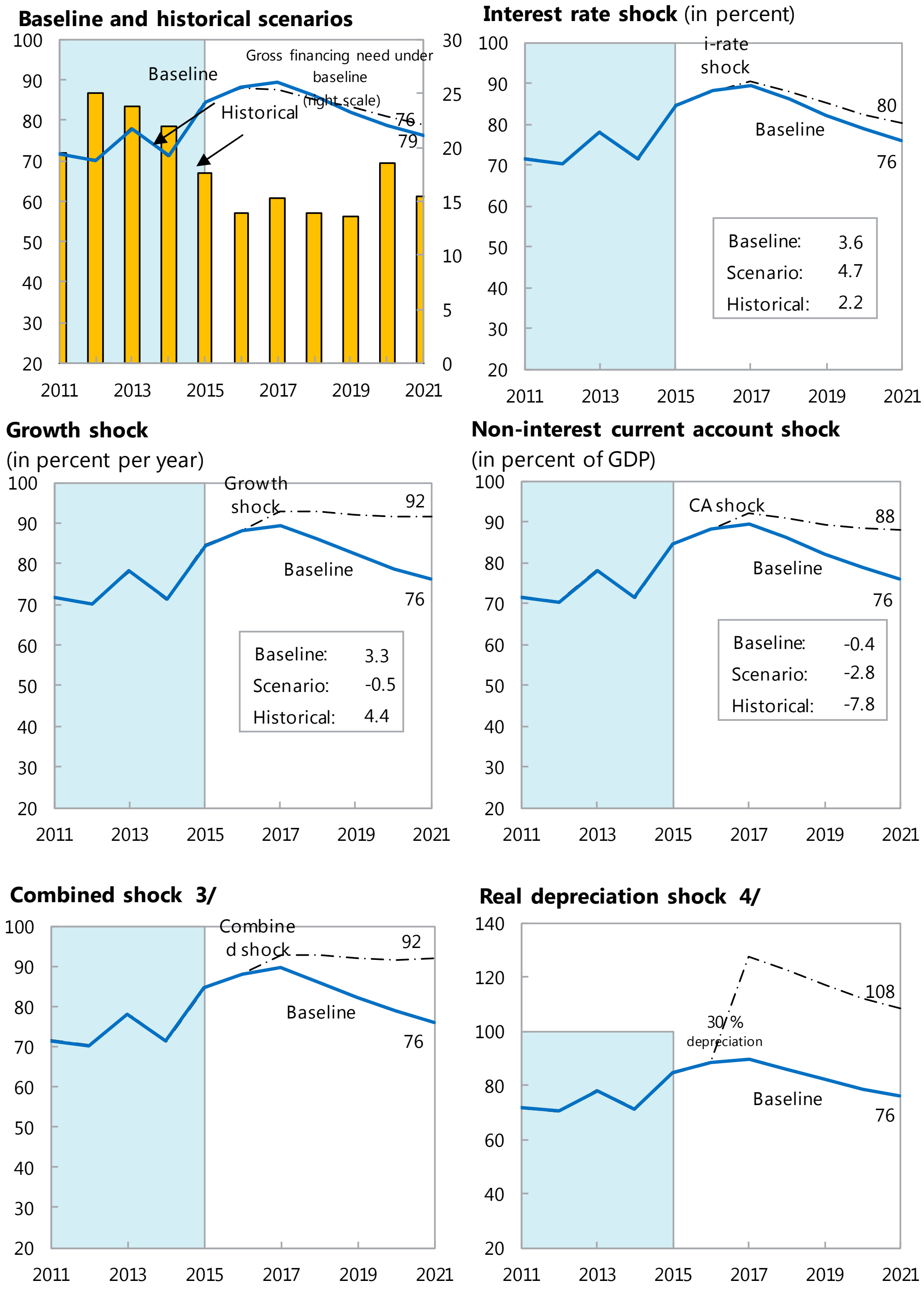
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Armenia: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2017

Appendix I. Letter of Intent

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

Yerevan, November 15, 2016

Dear Madam Lagarde:

1. **Armenia's economic performance remains under pressure from adverse external and domestic conditions.** On the external front, we continue to experience an environment characterized by sluggish growth in our main trading partners, declining remittances, and depressed commodity export prices. Although Armenian exporters have made inroads in non-traditional markets and a new copper mine came on line last year, both contributing to stronger export growth, export receipts still remain around the same level as two years ago. On the domestic front, household and corporate balance sheets remain weak, limiting credit activity and domestic demand. In this context, GDP growth in the first half of the year reached only 2¾ percent—below 3 percent in 2015—and inflation remained in the negative territory. The weakening of economic activity and domestic demand has helped consolidate the narrowing of the current account deficit. However, it has also led to much weaker revenues and, along with countercyclical over-execution of capital spending, contributed to a higher fiscal deficit than projected in the 2016 budget.

2. **The short-term outlook remains challenging, but medium-term prospects are more promising.** With domestic demand only gradually recovering, economic growth is expected to remain modest—in the order of 2½-2¾ percent—in 2016-17. However, growth prospects are likely to be brighter in the medium term. Russia is projected to come out of recession by mid-2017, while the positive impact of looser monetary policy and higher bank capital will continue to filter through the economy. On the fiscal side, the new Tax Code will help underpin medium-term debt sustainability. The growth outlook remains subject to risks, such as further volatility in the global economy in the context of tighter monetary policy in advanced economies and/or lower growth in emerging markets. Nevertheless, we are confident that the reduction in external imbalances, diversification of the export base, and a stronger tax system, will increase the resilience of the economy to global spillovers.

3. **Performance under the IMF-supported program continues to improve, but fiscal conditions remain fragile.** All end-June and continuous performance criteria (PCs) for the government and central bank accounts, as well as the inflation target, were met. In addition, the end-June indicative ceiling for net domestic assets of the central bank and the social expenditure floor were also met. Nonetheless, tax revenues continued to underperform, and the end-June fiscal

deficit PC was met because of under-implementation of government expenditure. Revenue performance weakened further in 2016H2 and, as a result, fiscal fragility is likely to remain a challenge for the remainder of the IMF-supported program.

4. **We have made progress with key elements of our structural reform agenda.** Chief among these achievements was the adoption by the National Assembly (NA) of a new Tax Code, which overhauled the existing tax legislation (September 2016 SB). The new code aims at increasing efficiency and fairness by unifying the previously fragmented tax system and tackling inconsistencies. It is also expected to increase the tax-to-GDP ratio by about two percentage points by 2021—a critical step in ensuring that debt remains on a sustainable medium-term path. In addition, with support from the World Bank, we have made significant progress in implementing the financial recovery plan for the electricity sector, including setting a new tariff structure, refinancing all commercial debts of state-owned enterprises, and improving the governance and management of publicly-owned electricity operators. Furthermore, we have strengthened our capacity to assess fiscal risks by completing a review of government lending operations (September 2016 SB), and continued to advance pension reform by providing financial support in the 2017 government budget to raise awareness and assist outreach (December 2016 SB). We have also made progress in negotiating a new cooperation agreement with the European Union (EU) that is compatible with Armenia's membership of the Eurasian Economic Union (EEU).

The Program for 2016–17

5. **Our policy objectives remain to support sustainable and inclusive growth, while maintaining macroeconomic stability.** The CBA has been easing monetary conditions since the second half of 2015 to help the economy abate deflationary pressures and support the gradual return of inflation back to target, while implementing plans to increase capital buffers in the banking system. The impact of these policies is expected to support credit conditions, providing a boost to domestic demand and growth in the coming year. In the past two years, fiscal policy has been accommodating in the face of external shocks, but consolidation will begin in 2017. We will continue to implement structural policies to reform strategic sectors and minimize the drain on public resources, improve our business environment, and broaden our connectivity and integration with the rest of the region and the world.

Fiscal Policy

6. **Fiscal policy continues to face serious challenges.** The change in composition of GDP, which has reduced the taxable base, and the weakness of domestic demand, have significantly impacted tax revenue in 2016. Growth has been driven primarily by net exports, while consumption has remained subdued, reflecting in part the continued decline in remittances. Lower imports by EEU member countries, especially Russia, have resulted in a decline in receipts from the EEU customs pool, while larger-than-anticipated effects from past policy changes have also contributed to revenue underperformance. Although the fiscal deficit PC for June was met owing to slower execution of expenditure, the end-year target is beyond reach. Against the background of an

estimated revenue shortfall of about 1 percent of GDP relative to the Third Review, largely due to factors outside of the government's control, we have already identified potential savings in current spending of about AMD 10 billion (0.2 percent of GDP). At the same time, following the resolution of technical and legal obstacles that previously delayed the implementation of some large foreign-financed infrastructure projects, in particular the North-South Highway, we now expect an over-execution of capital expenditure of around 1 percent of GDP in 2016. As a result, the budget deficit is expected to be 5.9 percent of GDP this year, compared to 4.1 percent projected at the time of the Third Review. This implementation "catch-up" has provided timely support to the economy in an environment of weak demand. Nevertheless, we recognize the importance of ensuring that debt remains on a sustainable path and have therefore halted the signing of new contracts for foreign-financed projects and will introduce measures to ensure that execution remains in line with the budget in 2017 (see paragraph 10).

7. Fiscal consolidation in 2017 will be significant. We have prepared a draft budget that envisages a reduction of the overall deficit to 2.8 percent of GDP in 2017. While not optimal, the size of the adjustment is dictated by our fiscal sustainability framework. This framework, as stipulated in the RA Law on Public Debt, prevents general government debt from exceeding 60 percent of GDP, and, to that end, establishes a braking mechanism that is triggered once the debt ratio reaches 50 percent of GDP. This mechanism limits the fiscal deficit in the following year to three percent of the average GDP for the previous three years. Given the current projections for revenue and expenditure, and the additional debt financing needed to cover the budget deficit, we expect the 50 percent threshold to be breached by the end of this year and the deficit rule to be triggered. Consolidation will be achieved mostly through spending measures with some contributions on the revenue side. Current nominal spending as a whole will be kept unchanged from the 2016 budget, except for interest payments which will increase significantly, reflecting additional borrowing this year. In addition, capital expenditure will be reduced substantially from the level projected in 2016 (see paragraph 10). On the revenue side, we expect gains due to improvement in revenue administration, the planned increase in excise taxes on alcohol and tobacco, and an increase in the gaming tax. If the structure of demand improves and revenues recover more quickly than expected, additional fiscal space will be used to boost infrastructure spending.

8. Tax policy remains one of the key pillars of our medium-term adjustment strategy. Over the last three years, considerable effort has been devoted to the preparation of a new Tax Code, which consolidates the existing legislation, removes inconsistencies, and addresses structural weaknesses in the tax system. The reform has been guided by several key principles: (i) a shift to indirect taxation which is relatively less distortionary and therefore more conducive to growth; (ii) enhancing equity and fairness by introducing more progressivity, broadening the tax base, and closing loopholes; and, (iii) revenue generation to underpin fiscal consolidation while supporting essential social expenditure and investment in infrastructure. Specifically, the measures envisaged for 2017-21 include a gradual increase in excise rates for alcohol, tobacco, and fuels; broadening the VAT base by reducing exemptions; lowering the turnover tax threshold; reducing the personal income tax (PIT) rate for the lowest-income bracket; and introducing taxation of dividends for residents. The draft Tax Code was submitted to the NA in April and passed the first reading. Since then, we have introduced some amendments to address stakeholder concerns and gain broader support for the reforms. These include**:**

- Increasing the progressivity of the PIT by raising both the top marginal rate from 33 to 36 percent and the threshold for the top income bracket to shift the tax burden from upper middle income to the highest income earners.

- Introducing an investment tax credit, up to the amount of the dividend tax paid, if the dividend is used to acquire equity in the same domestic company. This will encourage investment and help reduce the debt bias in corporate financing.

- Reducing the turnover tax threshold to AMD 58 million from 2019 - slightly higher than the AMD 40 million level proposed in the earlier draft of the code. This decision reflects the difficulties that SMEs have experienced recently. If warranted, a further reduction will be proposed after assessing the impact of this change.

- Increasing the taxation of gaming (lotteries and betting) - one of the fastest growing subsectors in 2016 – through a five-fold increase in the license fee and strengthening control mechanisms.

- Reducing the planned ad valorem excise rate for tobacco to 15 percent to optimize the effect on revenue, given risks of evasion and a shift of consumption to lower price segments. We stand ready to reconsider the rates after one year.

- Retaining the current depreciation schedules (except for other fixed assets) for the purposes of the CIT in order to continue to provide investment incentives.

Since some of the above provisions would entail loss of revenue, we have proposed compensatory measures to offset this loss. These include new control mechanisms for unregistered employment, enlargement of the list of goods subject to labeling, removal of the VAT exemption on tourist packages and a tightening of the VAT criteria for restaurants, with an overall estimated effect of about AMD 10 billion. The Tax Code was approved by the NA on 4 October 2016 and we are committed to its full implementation.

9. In addition, strengthened revenue administration measures will support tax collection. We are determined to improve compliance and reduce the size of the shadow economy by fighting tax evasion and avoidance. Leveling the playing field will not only bring more revenue to the budget but will also foster competition and enhance growth. Tax audits will be strengthened with a focus mostly on large companies that are often perceived as privileged, while audits of SMEs will be risk-based and carried out in a way that minimizes interference with their operations. In addition, the new Tax Code contains a number of provisions aimed at increasing the transparency and efficiency of the tax system, reducing compliance costs and supporting revenue collection. These include transfer pricing regulations (in line with international best practices), a system of taxpayers' single accounts, regulations pertaining to tax audits and procedures for appeal, and stricter and clearer penalties for non-compliance.

10. Significant spending restraint will be necessary to preserve fiscal sustainability. The need to reduce the budget deficit in 2017 to a level consistent with our fiscal rule will impose a severe constraint on our expenditure policy. We will keep non-interest current expenditure broadly the same in nominal terms as in the 2016 budget program. This will be achieved by offsetting spending increases under contractual obligations (e.g., on pension spending due to a larger number of retirees) with cuts in non-priority areas. A further reduction in expenses, however, does not seem feasible given the low level of expenditure in the last two years and the need to retain a small reserve for contingencies. We will aim to protect and increase the efficiency of social spending. Within the spending envelope, we have been able to increase the size of the family benefit by AMD 1000 on account of identified savings. Integrated social service centers, of which 19 are already operational, will help increase the efficiency of social service delivery. While we continue to attach high importance to capital spending, capital expenditure in 2017 will fall considerably relative to the 2016 level. In that context, we will improve the prioritization of foreign-financed projects based on transparent criteria and robust cost-benefit analysis, while maintaining a strong dialogue with key stakeholders. To ensure that execution remains on track with the budget and MTEF, the Minister of Finance will establish a new mechanism to strengthen monitoring and coordination between the Budget block, Treasury and the External Relations unit (December 2016 SB). The Minister of Finance will receive monthly reports on project implementation risks and, where necessary, follow-up with government agencies to ensure compensatory measures. These reports will be shared with IMF staff. To underpin this mechanism, we will also build a centralized database of all ongoing, planned and pledged projects (March 2017 SB).

11. We will continue monitoring and analyzing fiscal risks. The Fiscal Risk Assessment Division (FRAD) has prepared an analysis of fiscal risks related to concessions, regulated utilities, state-owned enterprises, and public-private partnerships (PPPs) in the energy, transport, and water sectors. This analysis will be included in the 2017 budget documentation. Further, reflecting the large stock of loans made from the budget and the expansion of government lending operations in recent years, FRAD undertook a comprehensive review of domestic budgetary lending (September 2016 SB). The review, which benefitted from IMF TA, aimed to assess the loan performance, identify key risks and develop proposals for management improvements. The report, which focused on 13 large borrowers in the energy, water, transport and construction sectors, covering around 80 percent of the outstanding loan portfolio, was shared with IMF staff.

12. We remain committed to implementing our flagship pension reform. As of end-June, around 154,000 thousand people have registered in the new pension system since the law was approved in 2014, with over half working in the private sector. The Ministry of Finance will continue its role as a reform 'champion' to support efforts to increase awareness and prepare for the expansion of the reform in July 2018 when enrollment in the system will become mandatory for all workers. To this end, the 2017 Budget maintains funding for the Pension System Awareness Center and the Outreach Campaign (December 2016 SB).

Monetary and Exchange Policy

13. Monetary and financial conditions have shown some signs of easing, supported by the unwinding of monetary policy tightening undertaken in late 2014. Since the last review, the CBA has continued to cut the policy interest rate gradually in order to contain inflation expectations. Most recently, the nominal rate was cut by 50 basis points to 6.75 percent, bringing it back to the level that prevailed when pressures hit in late 2014. As a result, some market interest rates (in particular, yields on government paper) have declined since October 2015 and credit growth is showing some signs of recovery. However, deflationary pressures will likely continue during the rest of 2016, reflecting weak domestic demand and lower import prices.

14. We will continue to ease monetary policy judiciously, consistent with our inflation targeting framework and MPCC conditionality. Our focus remains on allowing inflation to gradually return and stabilize around the CBA's medium-term target 4 percent by 2018. We are closely monitoring the situation and stand ready to take additional actions where necessary to ensure that the quarterly inflation path remains on track. At the same time, we are stepping up efforts to strengthen the transmission channel, including by improving communication with the financial sector and the business community.

15. Progress has been made toward integrating the dual objectives of price and financial stability within a coherent and coordinated policy framework. Internal communication between the monetary policy and financial stability departments of the CBA has been strengthened at both staff and managerial levels to ensure institutional coherence in formulating policy tools. The immediate focus is on developing an internal operational financial stability index to measure and monitor credit, liquidity and market risks. With the help of IMF TA, the CBA is strengthening its analytical tools to institutionalize the dual mandate, in particular, by taking into account factors that influence financial stability, such as credit growth, deleveraging and dollarization.

16. Our key exchange rate policy objectives are to ensure two-way flexibility, while continuing to strengthen reserve buffers where conditions permit. Since the Third Review, the stronger current account and favorable seasonal developments have enabled the CBA to continue rebuilding FX reserves. Net purchases totaling over US $100 million in Q2 and Q3 exceeded the net sales made in Q1. We expect the large current account reduction of 2015 to be sustained in 2016, with the deficit projected to remain below 3 percent of GDP (almost 5 percentage points lower than in 2014) buoyed by stronger net export performance. In this context, we consider that the dram exchange rate remains close to its equilibrium level. Looking forward, we remain committed to the principles of a floating exchange rate regime, while standing ready to deploy limited intervention to smooth excessive fluctuations and mitigate transitory pressures. Consistent with this approach, we will continue to enhance reserve buffers and strengthen communication with market participants. Greater exchange rate flexibility will also play an important role in helping improve the monetary policy transmission mechanism.

Financial Sector Stability and Development

17. Our plan to strengthen the resilience and efficiency of the banking sector remains on track. Banks continue to make progress toward meeting the higher minimum capital requirements that will become effective in January 2017**.** As of end-October 2016, around AMD 125 billion of new capital has been injected in 2016, building on the AMD 75 billion injected in 2015. Three mergers have already taken place, with further mergers or acquisitions possible before the end of the year. Competition is expected to lead to further consolidation in 2017 and beyond. Eleven banks already meet the minimum capital requirements, five more have secured the funds needed to comply with the new requirements and are in the process of getting official CBA verification, while the remaining banks (two banks) are expected to comply by end-December 2016. The banks that did not comply by end-June 2016, were required to present revised strategies by end-September, with concrete plans and actions to meet the requirement by the deadline. Nevertheless, the CBA has prepared a contingency plan for non-complying banks (September 2016 SB), which has been reviewed by IMF staff. The CBA will continue to assist banks in contacting potential investors, but will not provide financial support, except under the lender-of-last resort or systemic provisions of the CBA Law. With the implementation deadline approaching, the CBA will continue to provide IMF staff with regular updates, including all necessary information to enable close and continuous assessment of banking conditions and capitalization.

18. Decisive efforts are also underway to strengthen the macroprudential framework. FX market conditions have been improving and deposit dollarization has declined somewhat. Against this background, the CBA recently lowered the FX deposit reserve requirement (held in drams) from 20 to 18 percent—a further step in unwinding the large increase from 12 percent to 24 percent made in 2014. While this relaxation has provided additional dram liquidity that should help with credit growth, reserve requirements remain a key regulatory tool in the delivery of our dedollarization strategy. Despite positive developments in dedollarization and capital buffers, overall conditions in the banking sector remain challenging. Non-performing loans (NPLs) remain high and profitability low, which will require the CBA to use a more enhanced macroprudential framework. As a result, and in line with Basel III, a draft supplement to the Law on Banks and Banking has been submitted to the government that introduces counter-cyclical buffer requirements and additional macroprudential measures (e.g., relating to loan-to-value and debt-to-income ratios). To better monitor and assess the vulnerabilities in the banking sector, the CBA will also continue to enhance stress testing practices. In particular, we will improve the accuracy of estimates of probabilities of default by using micro-level data that include banks' sectoral loan portfolios. If necessary, the CBA also stands ready to intensify its asset quality review for banks to safeguard financial stability.

19. Progress has been made in dealing with structural issues in the banking sector. Legal measures to develop domestic capital markets are advancing. Draft legislation for International Swaps and Derivatives Association (ISDA) Master Agreements that had been submitted to the government and presented to the NA (September 2016 SB) was approved in October and came into effect in November. The CBA is preparing a comprehensive plan for the full divestment of its shares in PanArmenian Bank (PAB) within a defined timeframe (December 2016 SB). Interested private investors will be required to present solid business and funding plans and commit to purchasing all CBA's shares within a defined time period. This will be accompanied by a thorough due diligence shared with IMF staff. In the meantime, while the CBA remains a shareholder, it will ensure that PAB continues to meet prudential requirements on par with international best practices and that any debt issuance is approved by the CBA in consultation with IMF staff.

Structural Reforms

20. We will continue to reform strategic sectors that have become a drain to public resources. We plan to build upon the financial recovery plan in the electricity sector by further improving the current strategy to further involve the private sector, while continuing to protect the most vulnerable sectors and small enterprises, and maintaining the regained financial soundness of the sector. At the same time, we will continue to move forward with the modernization of the Nuclear Power Plant and explore options for building new thermal power plants to replace maturing plants. We will also develop economically viable renewable energy potential and improve energy efficiency in various sectors of the economy. Our goal is to maximize private sector participation in building new power generation capacity in order to minimize pressures on the budget. We will also advance the resolution of other state companies, which have in recent years represented a burden for the energy sector and, more generally, on public resources. Throughout this process, the public sector will not absorb losses or liabilities or make payments on behalf of utility companies or other companies (continuous PC). Budget and off-budget spending on the Nairit chemical plant will be strictly limited to maintaining the public safety of the industrial site. While we are studying proposals from private investors regarding its potential partial rehabilitation, the bankruptcy procedure against the company is advancing and our plan remains to decommission the plant after the completion of the court bankruptcy proceeding.

21. We will maintain our policies to improve the business environment, and broaden our integration with the rest of the region and the world. Policies in previous years have been successful in improving Armenia's business regulations, with recent progress achieved in the areas of enforcing contracts, facilitating trade, and dealing with construction permits. At the moment, our focus is on the following reform areas:

- ***Domestic competition and regulatory reforms.*** We have prepared a set of amendments to the law on economic competition protection including: clarifying and strengthening responsibility measures for anti-competitive behavior; clarifying the main definitions of the law; setting new violations of the law; and, regulating the mechanisms for the exemption of the responsibility measures for anti-competitive agreements (Leniency Programs). However, we have decided to seek more comprehensive reforms before submitting the draft law to the NA (September 2016 SB) and have prepared draft legislation that includes changes in the specifications pertaining to Armenia's accession to the EEU (application of general rules for competition protection) and also introduces the possibility of penalties for public and private sector officials.

- ***Bankruptcy reform and collateral registration.*** The NA has approved amendments to the bankruptcy law aimed at strengthening: the judicial specialization in handling bankruptcy cases; qualification criteria for bankruptcy administrators; recovery procedures; and, the early-mitigation system to reduce/avoid bankruptcy risks. In addition, we have introduced a unified online electronic database for registering movable assets, with the aim of facilitating the use of movable property as collateral for lending purposes. We plan to seek the NA's approval of a draft law on collateral, which would criminalize deliberate damage to collateral and liberalize the free disposition of collateral, including that under judicial seizure.

- ***Connectivity and international integration.*** We continue to make progress in improving Armenia's connectivity via our "Open Skies" policy. Although, a Common Aviation Agreement with the EU is unlikely to be concluded this year, preparations are underway to enable a rapid conclusion once negotiations start. Furthermore, we remain focused on improving our economic cooperation with our main trading partners - the EEU and the EU. We are in the process of seeking a new framework agreement with the EU. The negotiations of the treaty's trade and investment chapter are ongoing. In addition, we remain committed to the successful conclusion of the Single Support Framework for EU support to Armenia for 2017-2020.

Conclusion

22. We request that the IMF Executive Board complete the Fourth Review under the extended arrangement. We request that an amount equivalent to 15.65 SDR million be made available upon completion of the review. We also request a modification of the end-December 2016 fiscal deficit PC.

23. 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 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).

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

Very truly yours,

/s/
Karen Karapetyan
Prime Minister
Republic of Armenia

/s/
Vardan Aramyan
Minister of Finance
Republic of Armenia

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

Table 1. Armenia: Quantitative Targets, 2015-17

	2015	2016												2017
	Dec.	Mar.			Jun.			Sep.			Dec.			Mar.
	Act.	EBS 15/119 2/	Adj. Prog.	Act.	EBS 16/51	Adj. Prog.	Prel.	EBS 16/51 2/	Adj. Prog.	Proj.	EBS 16/51	Rev. Prog.	Proj.	Prog. 2/
Performance Criteria														
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,013	954	904	896	955	903	945	984	887	1,037	1,055	1,055	1,160	1,018
Net domestic assets of the CBA (stock, ceiling) 3/	395	387	401	395										
Program fiscal balance (flow, floor) 4/	-299	-58	-55	-48	-135	-126	-125	-195	-184	-214	-266	-358	-358	-31
Budget domestic lending (cumulative flow, ceiling)	21	15	15	3	23	23	18	23		23	23	23	23	15
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	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	0	0	0	0		0	0	0	0	0
MPCC														
Inflation (mid-point, percent) 5/					-1.7	-1.7	-1.1	-1.2	-1.2	-1.7	0.4	0.4	-0.5	1.2
Indicative Targets														
Inflation (mid-point, percent) 5/	-0.1	3.0	3.0	-2.0	3.3									
Net domestic assets of the CBA (stock, ceiling) 3/					426	446	363	400	434	366	464	464	380	390
Avg. concessionality of newly contracted ext. debt (flow, floor, in percent) 6/	19										30	30	30	30
New government guaranteed external debt (stock, ceiling, in millions of USD) 7/	0	50		0	50	50	0	50		0	50	50	0	50
Social spending of the government (flow, floor) 8/	55	13		13	27	27	28	42		42	57	57	57	13
Memorandum items:														
Budget support grants (cumulative from end of previous year)	64	66		66	66		66	66		66	70		70	70
o.w. EU MFA grant	19	19		19	19		19	19		19	19		19	19
Budget support loans (cumulative from end of previous year)	381	398		381	401		381	418		381	459		471	471
o.w. non-IMF loans	343	360		343	363		343	379		343	420		433	433
Project financing (cumulative during the same year)	91	19		16	54		45	82		73	109		144	17
KFW and IBRD loan disbursements (cumulative from end of prevous year)	70	76		72	75		75	83		80	88		84	87
Reserve money	921	866		850	888		777	912		898	975		967	915

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU.
2/ Indicative target.
3/ PC until december 2015 (indicative target afterwards). NDA ceiling will be considered met if the outcome is within AMD 15 billion of the target.
4/ Below-the-line overall balance excluding net lending.
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 spending on the family benefit program and lump-sum financial aid, one-time childbirth benefits, and childcare benefits for children less than two years of age.

Table 2. Armenia: Existing and New Structural Benchmarks Under the Extended Arrangement

Area	Measure	Time Frame (End of Period)	Status/comment
Public Financial Management	Complete review of budgetary lending operations to identify risks and management improvements.	June 2016	Revised and extended to September 2016
Tax Policy	Secure parliamentary approval of further excise tax rate increases from 2017 to bring gradually them in line with rates in other EEU member countries.	March 2016	Not Met (because it was included in the the Tax Code)
	Submit to the National Assembly final proposed tax code containing reduction/elimination of exemptions (VAT, income tax) and of other tax policy gaps (sectoral coverage, tax types) to deliver revenue gains.	March 2016	Not Met (Completed with delay to enable incorporation of IMF staff recommendations)
Energy Sector	Adopt by Cabinet of energy sector financial recovery plan involving new loans from IFIs to restructure expensive short-term debt; agreement on a repayment plan for accumulated debt to energy suppliers; a strict prohibition on expenses, borrowing and lending by energy companies outside of their core mandate; tariff adjustments, where needed; and a new tariff mechanism to more quickly transfer the risk of deviations from the planned energy-generation mix to consumers, in line with best international practices.	March 2016	Met

Table 2. Armenia: Existing and New Structural Benchmarks Under the Extended Arrangement (Continued)

Area	Measure	Time Frame (End of Period)	Responsible Agency	Status/comment
Tax policy	Adopt a Tax Code consistent with the prior action for the Third Review of the EFF Arrangement.	Sep. 2016	Ministry of Finance	Met
Public Financial Management	Complete a review of lending operations, including operations related to real estate projects in Yerevan, to identify risks and management improvements.	Sep. 2016	Ministry of Finance	Met
	Issue a Minister of Finance decree establishing a strong coordination and monitoring system for foreign-financed projects to ensure execution remains consistent with the budget and MTEF, including through: (i) improving coordination between the budget block, Treasury and the External Relations unit; and (ii) preparing monthly execution reports that assess risks to implementation and inform discussions with the Office of the Prime Minister and relevant government agencies on necessary corrective actions.	Dec. 2016	Ministry of Finance	New SB
	Build a centralized database of all ongoing, planned and pledged foreign-financed projects to underpin stronger monitoring and coordination and inform future development strategies, MTEFs and budgets.	Mar. 2017	Ministry of Finance	New SB
Financial sector	Prepare contingency plans specifying a strategy to deal with banks that may not potentially manage to comply with the new minimum capital requirement.	Sep. 2016	Central Bank	Met
	Submit to the National Assembly the draft laws to ensure implementation of ISDA Master Agreements.	Sep. 2016	Central Bank	Met
	Prepare a comprehensive plan for full divestment of the CBA shares in PanArmenian Bank (currently fully owned by the CBA).	Dec. 2016	Central Bank	In progress
Pension Reform	Maintain support for the Pension System Awareness Center and the pension reform outreach campaign in the 2017 budget.	Dec. 2016	Ministry of Finance	In progress
Regulatory and competition policy	Submit to the National Assembly amendments to the law on domestic competition, specifying higher penalties for anti-competitive behavior, the possibility of penalties for public and private sector officials, and clarifying the main definitions of the law (abuse of dominance, unfair competition, among others)	Sep. 2016	Ministry of Economy	Not Met. Authorities have prepared amendments, but will delay submission to the NA to seek more ambitious reforms

Attachment I. Technical Memorandum of Understanding

1. This memorandum sets out understandings between the Armenian authorities and the IMF staff regarding the definition of performance criteria (PCs) and indicative targets (ITs), adjusters, and data reporting requirements for the Extended Arrangement as per the Letter of Intent and Memorandum of Economic and Financial Policies (LOI/MEFP) dated November [18], 2016 and previous letters of intent dated May 30, 2016, October 22, 2015, February 17, 2014 and December 3, 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.

Quantitative Targets

3. The program sets PCs, ITs, and the Monetary Policy Consultation Clause (MPCC) for defined test dates (see Table 1 in the LOI/MEFP).

The program sets the following PCs:

- Floor on the net official international reserves (NIR) of the Central Bank of Armenia (CBA); Ceiling on external public debt arrears (continuous);
- Floor on the program fiscal balance;
- Ceiling on domestic budgetary lending; 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 ITs:

- Ceiling on the net domestic assets (NDA) of the CBA; Floor on average concessionality of newly contracted external debt;
- Ceiling on new government guaranteed external debt; and,
- Floor on social spending of the government.

The program sets the following MPCC:

- Headline inflation.

4. The net official international reserves (NIR) (stock) of the Central Bank of Armenia (CBA) will be calculated as the difference between total gross official international reserves (excluding commercial bank required and excess reserves at CBA in FX) and gross official reserve liabilities.

- Gross official international reserves are defined as the CBA's holdings of monetary gold (excluding amounts pledged as collateral), holdings of Special Drawing Rights (SDRs), including 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).[1] 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 convertible currencies other than the U.S. dollar shall be converted into dollar-equivalent values using the convertible exchange rates as specified in Table 1.

5. MPCC headline inflation is defined as the year-on-year rate of change of the Consumer Price Index as measured by Armenia's National Statistics Service. The MPCC will be considered met if headline inflation falls within a range of +/- 1½ percentage point around the mid-point target specified in Table 1 in the LOI/MEFP.

- If the observed headline inflation falls outside the +/- 1½ percentage point range around the mid-point target for end-June 2016 and end-December 2016 test dates, the authorities will complete a consultation with the Executive IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for program deviations, taking into account compensating factors; and (iii) proposed remedial actions if deemed necessary. When the consultation with the IMF Executive Board is triggered, access to Fund resources will be interrupted until the consultation takes place.

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[1] Convertible currencies are limited to: U.S. dollar, U.K. pound, euro, Japanese yen, SDR, Australian dollar, Canadian dollar, and Swiss franc.

- If the observed headline inflation falls outside the +/- 1½ percentage point range around the mid-point target for end-September 2016 and end-March 2017 test dates, the authorities will conduct discussions with the Fund staff.

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 targets sets in Table 1 attached to the LOI/MEFP.

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.[2] The ceiling on external payment arrears is set at zero.

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);[3] (2) any other disbursement or transaction that increases nonbanks' claims on the central government plus withdrawals from the Special Privatization Account (SPA) or the treasury sub-account containing privatization proceeds in drams, less amortization paid by the central government to private resident nonbank agents.

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

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

- **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.

- **A budgetary ER** of 475.4 drams per one US dollar will be used for foreign currency-denominated transactions included in the 2017 budget with the exception of the amounts received for project implementation units (PIU) for which the prevailing ER at the time of the transaction was used. Any additional unbudgeted transactions for 2017 will take place at the market exchange rate. Under the existing budgetary ER framework arrangement, for 2016, the ER stated in the Budgetary Address, 473.4 drams per one US dollar, will be used for foreign currency-denominated transactions included in the 2016 budget, with the exception of the amounts received for PIU for which the prevailing ER at the time of the transaction will be used. In addition, if new foreign currency-denominated transactions are introduced at any time, these will take place at the prevailing ER at the time of the transaction. The framework arrangement will not be modified (in substance), but may be clarified as this would imply noncompliance with the program continuous PC on ER arrangements and multiple-currency practices.

9. External and domestic net lending, which are recorded as financing items, are *excluded* from the calculation of the program fiscal balance, which is calculated from the financing side (see ¶8). This effectively treats net lending as an expenditure item when loans are made and as a revenue item when the loans are repaid.

10. Transactions related to the extension of the operating life of the Metsamor nuclear power station—which will take place via lending from the Russian Federation to the Ministry of Finance of Armenia and from the MoF of Armenia to the Armenian Nuclear Power Plant JSC—will be excluded from the measure of the program fiscal deficit.

11. Some project implementation units maintain accounts at the CBA. Grants received by these units are recorded in the fiscal accounts as external grants on the revenue side and as foreign-financed expenditure on the expenditure side. In addition, any loans to finance investments that are intermediated through the banking system are recorded in the financial accounts as a financing item below the line and are thus excluded from net lending.

12. Foreign currency proceeds from selling enterprises are credited to the SPA and their use is reflected in the state budget. In addition, the Government will ensure full transparency of revenues and spending from the sales of major assets (beyond regular day-to-day operations) of enterprises with state ownership. This will include presentation of use of funds from the sale of the hydroelectric assets of the Vorotan Cascade Company, including for electricity subsidies and payment of wage arrears of Nairit. The SPA is held at the CBA and the proceeds are invested abroad together with the CBA's international reserves. These proceeds are included in the definition of the monetary accounts of the CBA as part of net foreign assets with a counter entry in other items net. Any withdrawal from the SPA will be accounted for as privatization proceeds used to finance the budget and will be recorded below the line. Domestic currency proceeds from selling enterprises to residents are deposited in a sub-account of the treasury single account and are also treated as a financing item and recorded below the line. Finally, as noted in ¶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.

13. **Domestic budgetary lending** is defined as the gross amount of new loans made to resident individuals, enterprises, or entities financed from the state budget or other general government resources. This includes, but is not limited to, loans financed from the Economic Stabilization Fund and lending under existing or prospective government programs, such as agricultural sector support and real estate development programs, among others. Lending operations related to targeted projects financed with external loans and grants will be excluded from the calculation of the ceiling on budget domestic lending.

14. **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 of losses or liabilities from outside the budgetary sector. The public sector is defined as institutions covering the state budget and state debt—including the central and local governments—plus the CBA and enterprises or other entities with state ownership or control. Absorption of losses or liabilities is defined as direct payment by the public sector 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 ceiling is set at zero, and excludes AMD 9.7 billion, (approximately $20.3 million) of subsidies in the 2017 budget for Yerevan Metro, Yerevan Electric Transport, Irrigations Systems, Armenian Water and Sanitation, Nor Akunk, Lori Water and Sanitation, Shirak Water and Sanitation, and irrigation water intake entities. For 2016, the ceiling will exclude subsidies to these same entities of not more than AMD 16.9 billion. The ceiling will also exclude government support for the electricity tariff differential, which should not exceed $12 million. 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). The PC will be considered to be met, if new subsidy amounts do not exceed AMD 2.5 billion. In the case of new subsidies, the Armenian authorities will discuss the circumstances and possible options with the Fund staff prior to transactions more than AMD 500 million. Any modification of the PC to make any such payments or absorb any losses will require approval by the IMF Executive Board, at the time of the next review.

15. **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 concessionality floor is calculated on a calendar-year basis.

- 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 rate used for this purpose is a unified discount rate set at 5 percent.

- 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.

16. **Ceiling on government guaranteed external debt.** In addition to the indicative floor on average concessionality, a separate, cumulative ceiling (IT) of $50 million for the program period applies to new 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 (excluding the CBA). Guarantee issuance will be monitored on a monthly basis and the Ministry of Finance will provide data within 21 days from the end of the month.

17. 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 95 percent of the budgeted amount of the family benefit program and maternity benefits, one-time childbirth benefits, and childcare benefits for children less than two years of age.

18. 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 commercial loans (e.g., Eurobonds), loans from bilateral and multilateral donors for budget support, and Fund purchases credited directly to the government accounts at the CBA.

- **Project financing to the public sector** is defined as disbursements of loans from bilateral and multilateral donors for public sector projects.

- **The floor on NIR** will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of budget support 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 the Inter State Bank as well as for privatization proceeds received from non-residents in foreign currency and not held in the SPA.

- **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 $50 million in either direction.

- **The ceiling on domestic budgetary lending** will be adjusted upward by the amount of undisbursed funds under domestic budgetary lending programs approved in the previous year.

B. Data Reporting

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA	CBA balance sheet	Summary	Daily	The following working day
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at	Monthly	Within seven days of the end

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		actual official exchange rates		of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks by chart of accounts at actual official exchange rates	Monthly	Within 25 days of the end of each month
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Daily	The following working day
	Foreign exchange market	Official exchange rates (buying and selling); daily trade volume, and weighted average exchange rate of the interbank, intrabank and Nasdaq-OMX	Daily	Within 1 day
	Foreign exchange market	CBA foreign exchange operations, (exchange rate, volume)	Daily	Within 1 day
	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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	T-bill and coupon bond financing, CBA securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Weekly	Last working day of the week
	Banking data	Sectoral distribution of loans and deposits; dollarization of loans and deposits; loan maturities; interbank rate, by volume and maturity; T-bill rate, bond yield; deposit and lending rates, by maturity; monthly weighted average interest rate on government bonds	Monthly	Within 25 days of the end of each month
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Monthly	Within 30 days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Monthly	Within 30 days of the end of each month
	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 31 of the end of each month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
	Balance of payments	Detailed balance of payments data	Quarterly	Within 92 days of the end of each quarter
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	Monthly	Within 21 days of

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		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		the end of each month. For project implementation units, within 21 days of the end of each month (preliminary data) and within 45 days of the end of each month (final data)
	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions	Monthly	Within 7 days of the end of each month
	Domestic expenditure arrears	All unpaid claims outstanding at the end of the month which includes wages, social contributions (including for pensions), family allowances, and amortization and domestic interest payments	Monthly	Within 45 days of the end of each month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month
	Treasury single account (TSA)	Detailed breakdown of central treasury account, including deposits at the central treasury, community budgets, off budget account, monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.	Monthly	Within 7 days of the end of each month
	Consolidated central government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general	Central and local governments, and	Quarterly	Within 60 days of

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	government	Non-Commercial Enterprises that belong within the general government (NCEs)		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
	Pension system	Number of participants in the pension second pillar, social payments and funded contributions	Monthly	Within two months of the end of each quarter (monthly data provided on a quarterly basis)
NSS	Balance of payments	Detailed export and import data (issues that have arisen in 2015 with EEU trade data need to be overcome as soon as possible)	Monthly	Within 28 days of the end of each month
		Detailed export and import data	Quarterly	Within 45 days of the end of each quarter
	CPI	By category	Monthly	Within 5 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
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, 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 type of tax	Monthly	Within 45 days of the end of each quarter (monthly data provided on a quarterly basis)
	VAT and turnover tax	Number of registered taxpayers	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	VAT refund claims in arrears	Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90 day statutory processing period. Number of refund applications processed per month.	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax inspectorate	Monthly	Within 45days after the end of each month
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty free recorded imports; 3. Number of total transactions	Quarterly	Within 30 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		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		
	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-15	Mar-16	Jun-16		Sep-16		Dec-16		Mar-17
Act.	Act.	EBS/15/119	Act.	EBS/16/51	Prog.	EBS/16/51	Prog.	Prog.
171	176	193	183	202	196	215	204	213

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-15	Mar-16	Jun-16		Sep-16		Dec-16		Mar-17
	Act.	Proj.	EBS/15/119	Act.	EBS/16/51	Prog.	EBS/16/51	Prog.	Prog.
Project financing	223	39	91	111	136	178	182	352	40
Budget support loans	929	929	971	929	1,111	929	1,111	1,149	1,149
Budget support grants	157	161	160	161	160	161	175	172	172
of which: EU MFA	47	47	47	47	47	47	47	47	47

1/ Budget support cumulative from the end of the previous year. Project financing cumulative during the same year.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

December 2016

FOURTH REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—INFORMATIONAL ANNEX

Prepared By

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

CONTENTS

FUND RELATIONS

(September 30, 2016)

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

General Resources Account:

	SDR Million	Percent of Quota
Quota	128.80	100.00
Fund holdings of currency	298.49	231.75
Reserve Tranche Position	0.00	0.00

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	87.99	100.00
Holdings	0.29	0.33

Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
ECF Arrangements	131.74	102.28
Extended Arrangements	169.69	131.74

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	03/07/2014	05/06/2017	82.21	50.87
ECF	06/28/2010	07/02/2013	133.40	133.40
EFF	06/28/2010	06/24/2013	133.40	133.40

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

			Forthcoming		
	2016	2017	2018	2019	2020
Principal	10.61	36.88	45.17	52.83	54.63
Charges/interest	0.46	1.73	1.51	1.45	1.10
Total	**11.07**	**38.60**	**46.68**	**54.27**	**55.73**

Safeguards Assessment

An update safeguards assessment was concluded in August 2014 with respect to the Extended Fund Facility approved in March 2014. The assessment found that the CBA maintains safeguards in its financial reporting practices, external audit mechanism, and internal audit function. However, the assessment recommended amendments to the central bank law to strengthen the CBA's governance arrangements, and also to provide the CBA with marketable, interest-bearing government securities to cover its losses. In addition, the assessment noted that the CBA has investments in enterprises engaged in financial sector development and infrastructure, including a credit card processing company, a mortgage finance company, and a cash collection agency. In its audited financial statements, the CBA now presents a consolidated position inclusive of these enterprises, and is in the process of implementing the safeguards recommendation to provide details on risks, risk-mitigation efforts, and divestment strategies.

The CBA and Ministry of Finance (MoF) have made progress in implementing the recommendations of the most recent Safeguards Assessment, but further work remains. The CBA has adopted a charter for its board members to clarify roles and responsibilities. The CBA has investments in enterprises engaged in financial sector development and infrastructure, including a credit card processing company, a mortgage finance company, and a cash collection agency. The CBA has worked with its external auditors to present a consolidated position inclusive of these enterprises and an annex to its annual report describing the rationale for the investments and management of the enterprises. In the future, the annex should cover risks, risk-mitigation efforts, or divestment strategies. Also, pending legislation to provide the CBA with marketable, interest-bearing government securities to cover losses has not advanced in parliament.

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. Following a sequence of interventions to rebuild reserves in the last three quarters of 2013, the de facto exchange rate arrangement was reclassified from floating to crawl-like arrangement, effective March 12, 2013. More recently, the de facto exchange rate arrangement has been reclassified to floating from a crawl-like arrangement, effective November 4, 2014. The official exchange rate is quoted daily as a weighted average of the buying and selling rates in the foreign exchange market.

Armenia maintains one multiple currency practice, which arises from a 2007 agreement between the MoF and CBA to settle some budgetary transactions at an agreed accounting ER throughout the fiscal year. The authorities are not requesting and staff does not recommend the Board's approval to maintain this MCP. A previous MCP related to the conversion of Funds to make a September 2015 Eurobond coupon payment has expired.

Armenia maintains no other 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 2014 Article IV consultation with Armenia was concluded on December 22, 2014. 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 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, 2010–16

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
Public Finance Management	Short-term	March 2014	MoF
Fiscal Risk	Short-term	November 2014	MoF
Tax administration (LTI)	Short-term	April 2015	MoF
Customs Administration	Short-term	May 2015	MoF
Public Financial Management	Short-term	May-June-September 2015, February, May 2016	MoF
Tax Policy	Short-term	November 2015	MoF
Legal Department			
Banking Law	Short-term	June 2011	CBA
AML/CFT	Short-term	Various	MoF
Monetary and Capital Markets Department			
Contingency planning, crisis preparedness Workshop on Inflation Targeting (with IMF Research Dept.)	Short-term Workshop	March–April 2010 April–May 2011	CBA CBA
Bank resolution framework	Short-term	June 2011	CBA
Medium-term debt management strategy	Short-term	December 2011	CBA

Armenia: Technical Assistance from the Fund, 2010–16 (concluded)

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
Safeguard Assessment	Short-term	March 2014	CBA
Central Bank Communication	Short-term	April 2014	CBA
Inflation Targeting	Short-term	April 2014	CBA
Inflation Targeting	Short-term	April, November 2015	CBA
Inflation Targeting	Short-term	March, September 2016	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 COLLABORATIONS—JMAP IMPLEMENTATION

(As of October 15, 2016)

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
World Bank's Country Partnership Strategy for Armenia (2013-17)	Country Partnership Strategy Performance and Learning Review for Armenia (extending the CPS until 2018)	Submitted to the World Bank's Board of Directors for consideration	May 2016
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 will be closed in January 2017
	Tax Administration Modernization Project (US$12 m)	Semi Annual	WB Board approval July 2012, effective since Dec. 2012, closing date is December, 2017;
	DPO series to support competitiveness and ensure sustainability (US$ 197m)	Quarterly	Board date for DPO-2 ($75 mln) : November 12, 2014 DPO-3 ($50 mln)): December 7, 2015 DPO-4 ($50 mln))– December 2016
	New Health Project for Disease Prevention and Control (US$30m)	Semi Annual	WB Board approved – March 2013
	Public Sector Modernization (III) and PFM project (US$26.5 mln)		Board Date –Sept. 30 , 2015, effective since March 2016

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
	Power Sector Financial Recovery Project ($ 32 mln)	Quarterly	WB Board approved – April 28, 2016
	Analytic Work Programmatic Poverty work	Continuous	Annual Series, 2015 report Delivered in June 2015 and Disseminated in November 2015.
	Programmatic Fiscal work (fiscal incidence assessment, public sector wage assessment, review of social assistance programs)	Completed	The 2015 report was finished June 2015, disseminated in November, 2015
	PER on Quasi-fiscal activities, Macro-Fiscal sustainability and fiscal Subsidies	Completed	Finalized in June, 2016, dissemination – by November 2016
	New Country Economic Memorandum on Drivers of Dynamism	Completed	Finalized in June 2015,
	Assessment of EEU membership on Armenia's economy	Completed	Finalized and disseminated in Dec 2014, Policy workshop -in December 2014
	Promoting Productive employment in Armenia – a note on labor market activation		Start – June 2016, delivery - June 2017
	Systematic Country Diagnoses (SCD)	On-going	Concept Note – in December 2016, delivery –June, 2017
	Selected Technical Assistance IDF grant for guillotine exercise		Start: 2013, closed in June 2015
	Macro-monitoring		Start: January 2016 End: June 2016

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
	One-stop shop for providing construction permits CGE model-based technical assistance to simulate trade and growth projections ($120K) Technical Assistance on Tax Policy ($150K) Technical Assistance on Tax Policy (75K)		Start: 2013, closed in June 2015 Start October 2015, delivered June 2016 Start: July 2015 End: June 2016, Start: June 2016, End: June 2017 Mobilized to support MoF for Tax Code preparation and discussion,
2. IMF work program in the next 12 months	Fifth EFF Review and A-IV Consultation **Selected Technical Assistance/Training** FAD (follow-up on Pub. Financial Management) MCM/RES (Inflation targeting)	March 2017 TBD TBD	May 2017 TBD TBD

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

(As of October 15, 2016)

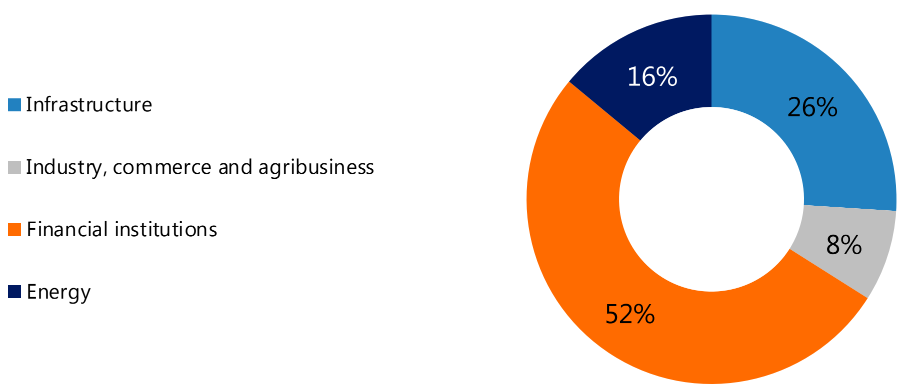
EBRD Scorecard

1. **The EBRD is the largest single investor in Armenia.** To date, the Bank has committed almost €1,067 million in over 153 projects in all major sectors of the economy.

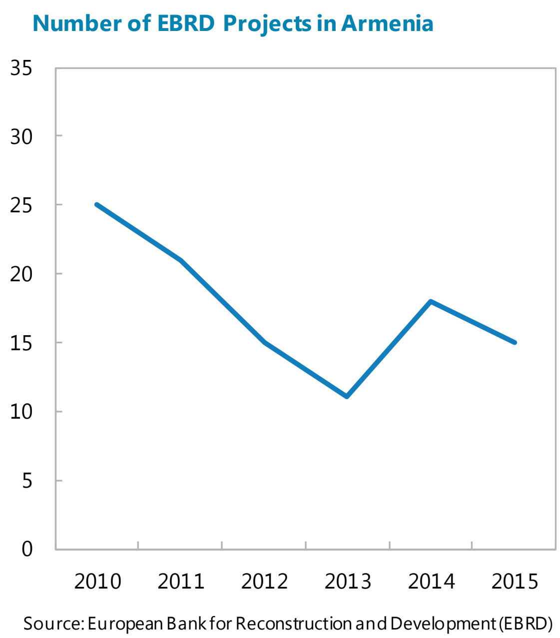
EBRD Activity in Armenia to Date (last updated April 1st 2016)	
153 Numbers of projects to date	**€1,067 million** Cumulative EBRD investment
€738 million Cumulative disbursements	**88 percent** Private sector share of portfolio

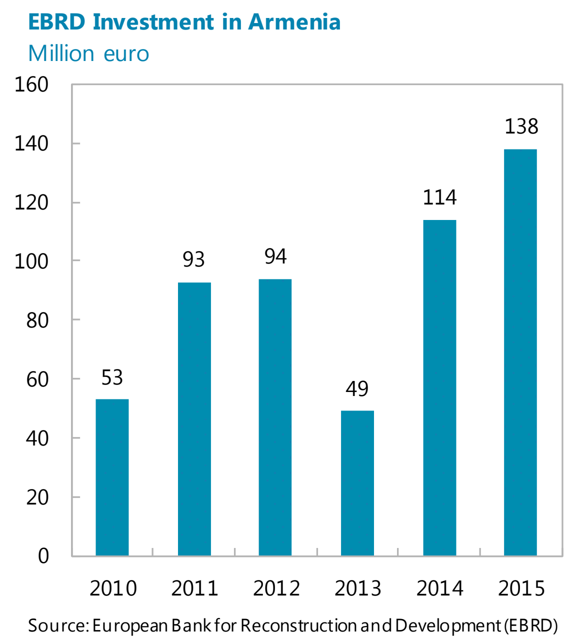
Portfolio Composition

Current portfolio: 305 million euro*



Source: European Bank for Reconstruction and Development (EBRD)
*Includes undisbursed commitments





Milestone deals for the last 2 years

- ***EBRD and government of Armenia sign a contribution agreement on Armenia's participation in E5P***

2. In 2015 the EBRD and the Ministry of Energy and Natural Resources of Armenia have signed an agreement on Armenia's participation in the Eastern Europe Energy Efficiency and Environment Partnership (E5P). Armenia has already contributed € 250 K out of €1 million to E5P which will enable Armenia to access grant funds of €20 million for priority energy efficiency investments in the municipal sector. The E5P is a multi-donor fund providing grants to support energy efficiency projects that aim to improve energy efficiency and the environment in the Eastern Partnership countries. The main objective of the initiative is to use grants to leverage loans dedicated to municipal energy efficiency and environmental projects, for example the rehabilitation of water and wastewater systems, solid waste management, street lighting and the insulation of public buildings.E5P is part of the strategic response to energy issues, allowing municipal authorities to invest in projects that make the most of opportunities for energy savings. As a partnership, E5P also includes a strong commitment to policy dialogue, allowing partners to address policy issues in their efforts to find practical solutions to problems municipalities face when investing in energy efficiency measures.

- ***Yerevan Street Lighting project***

3. The Yerevan Street Lighting project (€ 3.6 million) signed in May 2015, will introduce energy efficient lighting technologies in the 28 streets of the City, along with modern control system to serve the wider city during the years to come. This project is an important landmark as it is the first project to benefit an E5P grant facility (€ 1.9 million) since the facility became operational in Armenia in March 2015.

➢ ***Kotayk and Gegharkunik Solid Waste management project***

4. In 2014–16 the EBRD provided a €5.5 million loan to Armenia to finance the construction of the country's first European Union compliant solid waste landfill. The loan is complemented by a €3.5 million capital grant provided by the European Union Neighborhood Investment Facility (EU NIF) and €2 million capital grant provided by the Eastern Europe Energy Efficiency and Environment Partnership (E5P). The new landfill, to be located in the city of Hrazdan in Kotayk Province and managed by twelve participating municipalities of Kotayk and Gegharkunik regions – Hrazdan, Abovian, Charentsavan, Tsakhkadzor, Byureghavan, Yeghvard, Nor Hachn, Sevan, Vardenis, Martuni, Gavar and Chambarak – will be operating as a commercially sustainable unit with modern solid waste management systems, covering the collection and disposal of municipal solid waste. This will provide major environmental and social benefits for some 521,000 people in the area covered by the facility.

➢ ***Yerevan Solid Waste management project***

5. In 2015, the EBRD provided a €8 million loan to Armenia to finance the construction of a solid waste landfill in Yerevan that complies with EU regulations. The loan is co-financed by a €8 million credit line from the European Investment Bank and a capital grant of €8 million from the European Union Neighborhood Investment Facility (EU NIF) and capital grant of €2 million from the Eastern Europe Energy Efficiency and Environment Partnership (E5P).

6. The new landfill will meet international standards and operate as a commercially sustainable unit with modern solid-waste management systems, covering the collection and disposal of municipal solid waste. The facility, located on the outskirts of Yerevan, will provide major environmental and social benefits for the 1.1 million residents of the Armenian capital.

➢ ***Gyumri Urban Roads Project***

7. In 2016 the EBRD provided a €14.6 million loan to Armenia to finance the road rehabilitation and the street lighting modernization of Gyumri city. The project is expected to be co-financed with an investment grant in the total amount of up to EUR 7.3 million. The €2.65 million capex grant is co- financed from the EBRD Shareholder Special Fund ("SSF") in 2016, while the rest amount €4.65 will be co-financed from SSF and E5P during the 2017-2018.

8. The project will enable the City of Gyumri to rehabilitate major streets and modernise street lighting including installation of new Light Emitting Diode (LED) luminaries, a control and monitoring system, together with pole and power cable replacements. The project will seek to enhance the City's capacity to implement large scale infrastructure projects, carry out competitive tendering of works and monitor the technical implementation in a proper manner. In addition, the project will result in increased private sector participation and improved safety standards in the City.

- ***<u>Supporting consolidation in Armenia's banking sector</u>***

9. In 2015 the EBRD made an equity investment of AMD 9.8 billion (equivalent to US$ 20.3 million) for up to 22.7 per cent of shares in Inecobank, a specialist MSME and retail bank in Armenia. Inecobank used the proceeds of the EBRD investment to finance the acquisition of ProCredit Bank Armenia, another local bank oriented towards micro, small and medium-sized enterprises (MSMEs). The merged bank will become a leading MSME lender in the country, serving over 10,000 businesses and 200,000 individuals. This investment marked a milestone, providing an excellent platform for more consolidation in the Armenian banking sector and further improving standards of corporate governance. With a strong management team in place, a more efficient branch network and well-tested products and services, the combined bank will be able to provide Armenian MSMEs with better access to finance.

10. Later the EBRD invested US$ 40 million in the acquisition of an equity stake in Ameriabank CJSC, a leading private bank in Armenia. This is the largest single-ticket equity deal the EBRD has signed in the region to date. As a first step the EBRD acquired a stake of around 20 percent for US$ 30 million. The remaining US$ 10 million will be used for future capital increases. The goal of the investment is to strengthen Ameriabank and prepare the bank for a future IPO.

- ***<u>EBRD launches SME Local Currency Program in Armenia</u>***

11. In 2016 Armenia has renewed a Memorandum of Understanding with the EBRD to become eligible for lending to local small and medium-sized enterprises (SMEs) in local currency under a new EBRD facility. In parallel with access to affordable local currency funds, the country continues to commit itself to a reform program which will improve, broaden and deepen local currency and capital markets in Armenia. To achieve this goal, the authorities will promote a macroeconomic, regulatory and market environment that supports local currency borrowing and lending with a detailed reform package. The signing follows the approval of the EBRD's Local Currency Program for SMEs in its countries of operations to mitigate their exposure to exchange rate movements. It includes a new €500 million SME Local Currency Lending Facility that will combine EBRD capital and donor resources to provide eligible companies with access to affordable funding.

12. The development of local currency finance remains a challenge in most of the Bank's countries of operations, some of which are among the countries that have the highest exposures to exchange rate movements anywhere in the world. SMEs that sell their goods and services domestically in local currency, but borrow in foreign currency, are highly exposed to this currency risk.

13. The EBRD's Local Currency and Local Capital Markets Initiative, launched in May 2010, aims to enhance the macroeconomic, regulatory and market framework to ensure long-term sustainable and liquid local currency markets. The initiative's goal is to strengthen local capital markets and encourage the use of local currencies in the Bank's countries of operations. In 2016 the EBRD signed 4 deals with the total amount of €7 million.

- ***EBRD's Caucasus Energy Efficiency Program (CEEP)***

14. Developing both demand for and supply of energy efficiency investments through credit lines issued under CEEP, and extending its scope beyond corporates to include retail lending. Since 2013, six Armenian banks and two credit organizations have joined the program, signing about than USD 31.5 million for on-lending to industrial and residential EE sub-projects. More than USD 14 m has been disbursed already by CEEP participant banks to its customers.

15. The EBRD Sustainable Energy Portfolio since 2006 amounts €119.4 million of financing across 33 projects. The number broken down by sector below:

Armenia EBRD Sustainable Energy Portfolio, 2006–16	Total	2016 YTD
Corporate energy efficiency	12.5	0.0
Sustainable energy financing facilities (Energocredit)	22.6	3.6
Cleaner energy production	42	0.0
Renewable energy	25.3	0.0
Municipal infrastructure energy efficiency	16.9	1.4
Total	**119.4**	**5.0**

- ***Zvartnots International Airport***

16. In 2015 the EBRD participated in a landmark international syndication (USD 30 m) for Zvartnots International Airport which will provide significant new resources for further investment in Armenia.

- ***EBRD launches new Strategy for Armenia***

17. In 2015 EBRD has adopted a new strategy for Armenia under which it will over the next four years give priority to enhancing the competitiveness of the private sector, improving the business environment, developing local the capital markets and funding infrastructure development.

18. Armenia's economic growth has slowed down this year as a result of the broader regional downturn which affects the country via reduced trade, remittances and investment flows. In addition, the depreciation of the Armenian dram and a decrease of foreign currency reserves have impacted the country's economy.

19. To speed up economic growth and support the government's ambitious reform program, which includes improving the business environment, the EBRD will focus on the following key priorities in its new strategy for Armenia:

- Enhancing private sector competitiveness: For Armenia's small and open economy, a significant improvement in competitiveness is key to attracting investment. The EBRD will continue financing the private sector. The Bank will target assistance for improvements to the regulatory and administrative environment and strengthen its assistance to micro, small and medium-sized enterprises.

- Developing capital markets and promoting local currency financing: As the authorities roll out mandatory pension reforms, the majority of pension fund investments will be channeled in local currency. Success will largely depend on the emergence of a healthy supply of capital market issues on the local market, and enough different investors to create market liquidity. The EBRD stands ready to support the development of the local capital market.

- Developing public utilities: Armenia's energy, transport and municipal infrastructure still needs much update. For this, it is important to increase private participation in public service provision. The Bank will support commercially viable energy and energy efficiency, transport and municipal service projects and engage in policy dialogue.

➢ ***<u>Advice for Small Businesses</u>***

20. Through the Advice for Small Businesses, the EBRD delivered technical assistance and consulting services to over 1,200 local advisory projects and 50 international advisory projects since 2003, helping high quality companies (including a significant number of rural businesses) improve their financial reporting, management capacity and marketing. Within this effort, during the last three years, international advisory has provided international expertise to 15 dynamic corporates, which has been particularly effective in helping them design and execute business development strategies. Over the life of the program, nearly 30 per cent of ASB clients secured financing within one year, 57 per cent hired additional employees, and over 91 per cent increased turnover.

➢ ***<u>EBRD recent policy dialogue activities</u>***

- Investment Council, a platform for policy dialogue between the Government and the private sector

- Assistance with regulatory framework on Armenian Post Bank

- TCs for shareholder's and CEO's on achieving robust capital structure and corporate governance

- Technical assistance and capacity building to improve the legal/regulatory frameworks for leasing and factoring

- MoU with Armenia to further lending to local SMEs in local currency and Action Plan with a focus on money markets and derivatives
- Assistance to CBA on bank consolidation process; jointly organized seminar for bank shareholders and CEO's
- Together with other donors coordinate to promote responsible mining and best practices through policy dialogue, including with NGOs, mining companies and the authorities.
- Preparation of background paper for policy dialogue for legislative changes aimed at enhancing the debt-taking capacity of Yerevan City.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ASDB)

(As of October 17, 2016)

1. **Armenia joined the AsDB in September 2005.** AsDB's first Country Partnership Strategy for Armenia for 2014–2018 (endorsed by AsDB's Board on 27 January 2015) focuses on three sectors: (i) transport, (ii) water supply and other municipal services, and (iii) energy. In August 2014, AsDB's Board approved the reclassification of Armenia for the purpose of access to ordinary capital resources and graduation from the Asian Development Fund resources, effective January 1, 2017.

2. **As of October 17, 2016, the AsDB cumulative sovereign lending amounted to $910 million for 16 loans.** In 2015 AsDB approved a Results-Based Loan of $88.5 million for the Seismic Safety Improvement Program. The program will support the government in seismic strengthening and renovation of priority school buildings and to improve seismic safety planning and management competencies.

3. **In 2014 AsDB approved a $37 million loan for the Power Transmission Rehabilitation Project** to help the government diversify energy sources, and rehabilitate and upgrade electricity transmission and distribution networks**.** The Infrastructure Sustainability Support Program ($49 million) was approved in August 2014 and helped improve road and water service provision through results-based public management and financing reforms. The program focused on critical expenditures, sustainability, and life-cycle costing to ensure investments in these two sectors are carefully prioritized and fully sustainable.

4. **In 2012 AsDB approved two public sector loans.** The Women's Entrepreneurship Support Sector Development Program, approved in October 2012, promotes gender-inclusive growth by improving the enabling environment and capacity of women entrepreneurs and micro, small, and medium-sized enterprises (MSMEs). The program includes two components: (i) a program loan ($20 million) supporting reforms to improve 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 18 towns and 92 project villages, managed on commercial principles and with environmentally sound practices.

5. **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 selected secondary cities. The Tranche 1 for $48.64 million (approved in 2011) and the tranche 2 for

$112.97 (approved in 2015) of the MFF will help improve and extend the urban infrastructure and to strengthen the institutional capacity in Yerevan.

6. **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 $100 million to finance continuing construction of the road to Gyumri (additional co-financing is provided by the European Investment Bank).

7. **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.

8. **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.

9. **With the exception of the Tranche 2 and Tranche 3 of the North-South Road Corridor Investment Program and the Tranche 2 of the Sustainable Urban Development Investment Program,** all approved sovereign loans are from the AsDB's concessional Asian Development Fund.

10. **ADB has approved $130 million in nonsovereign financing in Armenia for three private sector transactions.** In 2013, ADB signed a $25 million loan with International Energy Corporation to rehabilitate and 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. 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). AsDB’s Trade Finance Program works with four banks in Armenia and has supported over $39 million in trade across 55 transactions.

11. **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, export- and innovation- led industrial development, infrastructure sustainability, organization of an investment forum, and solid waste management. Armenia is also included in a number of AsDB's multi-country TA projects, providing assessments and development plans on topics of common interest across countries.

STATISTICAL ISSUES

(As of November 1, 2016)

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 since then. 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.

2. Data provision is adequate and sufficient for program monitoring. Program series, as defined in the Technical Memorandum of Understanding (TMU) are provided with the required timeliness. Monetary statistics include data on one bank's headquarters and some branches in Nagorno-Karabakh (as identified in the above-mentioned data ROSC). The program monetary variables specified in the TMU (based on these statistics) have been defined on a consistent manner over the program period since the program's approval by the Board.

Real sector statistics

3. 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. As of 2015, the NSS has been preparing the national accounts under the methodology of the *System of National Accounts 2008 (2008 SNA)*. GDP under this new methodology have been extended back to 2012, and there are plans to also cover earlier years.

4. 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.

5. 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. The CPI is currently computed using 2015 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

6. The budget execution reporting system compiles government finance data on a cash basis, supplemented with monthly reports on arrears and quarterly reports on receivables and payables. Daily revenue and cash expenditure data for the central government are available with a lag of one to two days and monthly data on central government operations are disseminated one month after the reporting period. The 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.

7. The budget presentation and the classification of items under the economic and functional classification of expenditures need to be made more transparent; for instance, the data have been subject to frequent reclassification, and wages for military personnel, 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.

8. 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

9. 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.

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

External sector statistics

11. In 2009, the Armenian authorities decided to transfer the responsibility for compiling the balance of payments, international investment position (IIP), and external debt statistics from the NSS to the CBA. 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.

12. The coverage of external sector data has improved in recent years, although some recent delays have emerged with the transitions towards the Eurasian Economic Union (EEU). Trade statistics are provided on a timely basis, and trade data by origin, destination, and commodity are generally available within a month. However, reporting problems have arisen in 2015 with EEU trade data. 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.

13. 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 November 1, 2016)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	Oct. 2016	10/31/2016	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Oct. 2016	10/31/2016	D	D	M
Reserve/Base Money	Oct. 2016	10/31/2016	D	D	D
Broad Money	Sep. 2016	11/1/2016	M	M	M
Central Bank Balance Sheet	Oct. 2016	10/31/2016	D	M	M
Consolidated Balance Sheet of the Banking System	Sep. 2016	11/1/2016	M	M	M
Interest Rates[2]	Oct. 2016	10/28/2016	W	W	M
Consumer Price Index	Sep. 2016	11/1/2016	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]— General Government[4]	Q2 2016	9/01/2016	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Q2 2016	9/01/2016	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Sep. 2016	10/31/2016	M	M	Q
External Current Account Balance	Q2 2016	10/1/2016	Q	Q	Q
Exports and Imports of Goods and Services	Q2 2016	10/1/2016	M	M	Q
GDP/GNP	Q2 2016	9/15/2016	Q	Q	Q
Gross External Debt	Q2 2016	10/1/2016	Q	Q	Q
International Investment Position[6]	Q2 2016	10/1/2016	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).

Statement by Richard Doornbosch, Alternate Executive Director for the Republic of Armenia
December 7, 2016

On behalf of the Armenian authorities we thank the IMF team, headed by Mr. Hossein Samiei, for the candid, constructive and friendly dialogue during their mission in Yerevan and for their valuable advice.

The authorities broadly agree with staff's assessment and recommendations in the report. They recognize that strengthening the fiscal position, improving the business environment, and harmonizing monetary and financial policies are among their main challenges. Progress along these policy fronts and improvement of the external conditions will pave the way for putting the Armenian economy on a viable growth path.

Program performance continues to improve, and all end-June and continuous performance criteria were met. Nevertheless, fiscal conditions remain fragile and the authorities request a modification of the end-December 2016 fiscal balance target. The expected deviation from the fiscal target performance criterion is a result of revenues shortfall due to weaker-than-expected economic conditions and capital expenditures (foreign-financed at concessional rates) that will support potential growth going forward. The program objectives — fostering strong economic growth, reducing fiscal and external vulnerabilities, and preserving macroeconomic and financial stability — remain the authorities' priorities.

Economic Activity and the External Sector

With exports accounting for nearly 30 percent of GDP and domestic consumption relying heavily on remittances income, the external conditions, especially in Russia, continue to play a major role in Armenia's economic performance. During the first half of 2016 remittances inflow fell by 13.4 percent (in dollar terms) relative to the same period a year ago, and by 41.1 percent relative to the first half of 2014 prior to the recession in Russia. Remittances are a significant source of income that finance domestic consumption. To give perspective of their magnitude, we note that during the first half of 2014 their value was equivalent to 19.5 percent of GDP, and that share declined to 12.3 percent during the first half of this year. As a result, households' consumption contracted for five consecutive quarters since the beginning of 2015 (in YoY terms to account for substantial seasonality). It finally started to stabilize during the second quarter of 2016. Exports, on the other hand, have been remarkably resilient with only a temporary dent at the beginning of 2015. As described by staff, geographical diversification, the opening of a new copper mine, and in 2016 also a rebound in exports to Russia, have helped to maintain a robust exports performance.

The weighing of external conditions is also evident in the composition of the CPI. While domestic demand is fragile, deflationary pressures are largely associated with the tradable sector. Headline CPI has declined by 0.9 percent in October (YoY) on the back of deflation in consumption goods (-2.1 percent YoY), while service prices have increased by 1.3 percent over the same period. While the latter is clearly lower than in previous years, reflecting the worsening of domestic economic conditions, these rates are indicative to the external roots of the economic weakness. We also note, albeit with caution, that headline CPI has recently started edging up, which could point to initial signs of some economic strengthening.

With resilient exports, stabilizing consumption and prices, accelerated execution of infrastructure projects alongside reforms to improve the business environment (as elaborated below), and projected recovery of the Russian economy (WEO), we see an accumulation of tailwinds that will certainly help to improve the economic environment.

Public Finances

Lower-than expected tax revenues and accelerated execution of capital expenditures have led to a widening of the fiscal deficit in 2016 relative to the projected level during the third review. Overall, the fiscal deficit in 2016 is expected to reach 5.9 percent of GDP. Nevertheless, going forward, fiscal consolidation in 2017 will be substantial and the current draft budget envisages a deficit of 2.8 percent of GDP.

The composition of growth in 2016, with stronger exports and subdued consumption, has significantly impacted tax revenues, which are expected to fall short by approximately one percent of GDP relative to the estimates during the third review. To partially offset the effect on the deficit, the government identified potential savings in current expenditure of about 0.2 percent of GDP. The authorities also take structural measures to augment their tax policy and increase revenues. After three years of preparations the National Assembly has recently approved the new Tax Code. The new Tax Code reduces tax distortions, closes previous loopholes, improves progressiveness, broadens the tax base, and reduces compliance costs. It is expected to raise the tax collection by 2 percent of GDP by 2021, with the largest revenue increase in 2018-19. The authorities are committed to the full implementation of the Tax Code, and in addition, they take revenue administration measures to improve compliance and reduce tax evasion.

Over-execution of capital spending is also expected to contribute about 1 percent of GDP to the fiscal deficit this year. With the resolution of technical and legal obstacles that previously delayed the implementation of some large foreign-financed infrastructure projects, the authorities are pushing forward with their implementation. We note that these projects are foreign-financed at concessional rates, thereby putting limited crowding out pressures on other investment opportunities. In addition, due to previous delays, the authorities are urged by their IFIs partners to catch-up with the implementation of these projects. Moreover, at this juncture, we see the execution of infrastructure projects as a counter-cyclical support to the economy that will also boost potential growth. We note that given the long-term nature of the investment projects, the exact timing of the expenditure (e.g. end-2016 or early-2017), while having implications for the size of the deficit in the current year and on meeting the end-December performance criterion, has little economic significance. That said, the authorities are taking steps to ensure that execution remains within the budget, including the enhancement of program monitoring and closure of project implementation offices to increase efficiency, they also suspend engagement in new foreign-financed projects.

Going forward, a debt-brake mechanism will go into effect in 2017 regardless of the program conditionality. The Law on Public Debt prevents general government debt from exceeding 60 percent of GDP, and once the debt ratio reaches 50 percent, as expected by end-2016, a braking mechanism is triggered. This mechanism limits the fiscal deficit in the following year to three percent of the average GDP for the previous three years. The draft budget for 2017 already entails significant consolidation measures with a deficit target of 2.8 percent of GDP.

Monetary and Exchange Rate Policy

Since the last review, the CBA has continued to gradually cut the policy interest rate in order to ease monetary conditions in the face of subdued economic activity, negative inflation rate, and the expected cut in public spending. In mid-November, the CBA's governing board cut the policy rate by an additional 0.25 percentage point to 6.5 percent, the lowest level in more than five years. Moreover, the reserve requirement against FX deposits (held in drams) was reduced, which is also expected to ease monetary conditions as it adds liquidity to the market. Nevertheless, the CBA notes that mainly supply factors weigh on economic activity. Therefore, and given the continuous easing cycle during the last two years, the economic slowdown does not necessarily imply excess supply and further rate cuts. We note that this view is also consistent with the composition of the CPI pointing to mainly imported deflation, as discussed above. As such, the authorities stress that future policy decisions remain, as always, data-dependent. For this reason, they are somewhat uncomfortable with the implied forward guidance for additional monetary easing as expressed in the staff report.

The authorities continue to ensure a two-way flexibility of the exchange rate. Narrowing current account deficit and favorable seasonal developments have created comfortable conditions for the CBA to rebuild its foreign reserves, and net purchases in the second and third quarters have exceeded the net sales made in the first quarter. Gross foreign reserves have increased around 22 percent since end-2014, when they were put under pressure due to a major external shock. Reserves are now estimated to cover five months of next year imports and are considered adequate. The authorities also consider the dram exchange rate to be close to its equilibrium level, and they are committed to maintaining a floating exchange rate regime, while standing ready to deploy limited interventions to smooth excessive exchange rate fluctuations. Exchange rate flexibility will also play an important role in helping to improve the transmission mechanism of monetary policy.

Finally, the CBA is taking steps to build a coherent and coordinated policy framework that will integrate its dual mandate of price and financial stability. The CBA envisages a framework which incorporates the interlinkages of monetary policy and financial stability, given the high level of financial dollarization, both during normal and crisis times. Furthermore, this will strengthen policy communication, which the CBA recognizes as one of its main policy tools. With the help of an IMF TA (conditional on financing), the CBA continues to develop its analytical tools, improve the incorporation of judgement in its policy decisions, and enhance coordination between relevant departments.

Structural Reforms

Improving the business environment is high on the new government's agenda and it takes directed measures to strengthen identified areas of weakness. Specifically, the authorities continue to strengthen the electricity sector by encouraging greater involvement of the private sector, strengthening the financial soundness of the sector, moving forward with the modernization of the nuclear power plant and exploring options for building new thermal power plants to replace maturing facilities. These measures will improve supply reliability and reduce electricity costs. To improve competition and regulatory framework, the authorities have prepared amendments to the law on economic competition protection to strengthen the antitrust framework, and the National Assembly has already approved amendments to the bankruptcy law. On international integration, the authorities continue to make progress with improving Armenia's connectivity via the "open skies" policy and the economic cooperation with its main trade partners, the EEU and the EU. In particular, negotiations of a trade treaty with the EU is ongoing. Finally, we note that in other areas, like starting a business and registering property, Armenia is ranked quite high — at or close to the top ten — in the World Bank's doing business indicators.