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REPUBLIC OF ARMENIA

June 2019

2019 ARTICLE IV CONSULTATION AND REQUEST FOR A STAND-BY ARRANGEMENT—PRESS RELEASES; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF ARMENIA

In the context of the Staff Report for the request for a Stand-by Arrangement, the following documents have been released and are included in this package:

- Two **Press Releases** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its May 17, 2019 consideration of the staff report on issues related to the Article IV Consultation and IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 17, 2019, following discussions that ended on February 26, 2019 with the officials of the Republic of Armenia on economic developments and policies underpinning the IMF arrangement. Based on information available at the time of these discussions, the staff report was completed on May 3, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of Armenia.

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

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

*Also included in the abovementioned 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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International Monetary Fund
Washington, D.C.

Press Release No. 19/173
FOR IMMEDIATE RELEASE
May 17, 2019

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$248.2 Million Stand-By Arrangement for Armenia

- The IMF approved a 36-month Stand-By Arrangement (SBA) for Armenia amounting to about US$248.2 million. The Armenian authorities have indicated that they will treat the arrangement as precautionary, and do not intend to draw on the new SBA unless shocks generate balance of payments needs.

- The SBA will support the authorities' efforts to strengthen the economic fundamentals and policy frameworks. It will also help effective implementation of structural reforms, particularly relating to governance and improving business climate.

- The authorities are committed to a sustainable fiscal path, supported by the fiscal rule, while creating space for critical spending in enhancing infrastructure and social spending.

The Executive Board of the International Monetary Fund (IMF) today approved a 36-month Stand-By Arrangement (SBA) for Armenia amounting to SDR 180 million (about US$248.2 million or about 139.75 percent of Armenia's quota in the IMF).

Upon the Board's approval, an amount equivalent to SDR 25.714 million (about US$35.5 million) becomes immediately available to Armenia, and the remaining amount will be made available, subject to six semi-annual reviews.

The Armenian authorities have indicated that they will treat the arrangement as precautionary, and do not intend to draw on the new SBA unless shocks generate balance of payments needs. In addition to providing insurance against shocks, the arrangement will support the authorities' efforts to strengthen the economic fundamentals and policy frameworks. It will also help effective implementation of structural reforms, particularly relating to governance and improving business climate.

Following the Executive Board discussion, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chairman, issued the following statement:

"Armenia has continued to make progress in recent years in maintaining macroeconomic and financial stability and in implementing structural reforms to promote growth. Economic activity has strengthened, and public debt has started to decline. Inflation is under control, the financial system remains stable, and international reserves are assessed to be adequate. Nonetheless, continuing reform efforts are needed to support a more balanced and inclusive growth, by reducing imbalances, improving the business climate and strengthening governance, and advancing measures to reduce poverty and unemployment.

"The three-year Stand-By Arrangement will support the authorities' objective of moving toward a more dynamic, sustainable, and inclusive economy. The precautionary nature of the arrangement will provide insurance against external shocks. The authorities are committed to a sustainable fiscal path, supported by the fiscal rule, while creating space for critical spending in enhancing infrastructure and social spending. These objectives need to be accompanied by measures to improve tax administration and modernize property taxation.

"Further strengthening of the monetary policy framework will improve the effectiveness of monetary policy and help bring inflation back to its medium-term target. Measures will also be taken to safeguard the financial system, further develop capital markets, and improve access to finance.

"The decisive implementation of a strong package of structural reforms will help foster sustainable and inclusive growth through measures that promote private sector development, attract more FDI, and increase diversification. Steps to enhance human capital and increase female labor force participation will also be helpful."

Annex

Since the completion of the 2014–17 IMF-supported program (See Press release No. 14/88), economic and financial stability has been maintained and macroeconomic policy implementation has been sound. Despite gradual improvements, poverty and unemployment remain relatively high, causing migration and a shrinking labor force.

Against this backdrop, the newly formed government, which took office after the 2018 peaceful political transition, launched a five-year economic program in February 2019. This watershed moment created a new opportunity for Armenia to deal with the oligarchical economic system and combat corruption. The government program is centered on advancing structural reforms to generate a broad-based inclusive growth and strong policies to maintain macroeconomic stability. To support this program, the authorities have requested a Stand-By Arrangement (SBA) with the Fund.

Program Summary

The government's program for 2019-23, supported by the SBA aims to maintain macroeconomic stability and promote higher and more inclusive growth. It is based on four pillars: (i) anchoring fiscal policy on the fiscal rule to maintain debt sustainability, and creating space for priority (social and capital) spending; (ii) further strengthening of the monetary policy framework and maintaining a flexible exchange rate system; (iii) safeguarding the financial system and improving access to finance; and (v) implementing a strong package of structural reforms, with renewed emphasis on inclusiveness and governance.

Promoting Growth-friendly Fiscal Consolidation. The new arrangement will support the authorities' prudent fiscal consolidation plan, guided by the fiscal rule, to bring central government debt to below 50 percent of GDP in the medium term. This will be accompanied by strong efforts to enhance revenue mobilization to help create space to boost growth-enhancing infrastructure and social spending. In addition, the authorities' tax reform plans will be accompanied by sustainable compensating measures to offset expected revenue shortfalls, and more targeted measures toward the poor to make the tax system more progressive. Meanwhile, structural fiscal reforms will aim to strengthen public financial management to buttress fiscal discipline and protect essential expenditure, including foreign-financed capital spending.

Enhancing Resilience and Promoting Deepening of the Financial Sector. Drawing on the 2018 financial sector assessment program, the Central Bank of Armenia will aim to (i) safeguard financial stability by improving the risk-based supervision framework; (ii) strengthen macroprudential measures in light of high levels of dollarization; (iii) enhance banks' foreign currency liquidity buffers; and (iv) further develop capital market to mobilize a growing supply of long-term domestic capital to fund economic developments and channeling it to the economy.

Reinvigorating Structural Reforms. The new program aims to help the authorities: (i) strengthen governance and institutions, which has been a long-standing issue; (ii) improve the business environment to attract investment and ignite more inclusive and durable growth; and (iii) enhance social safety net programs to include better education and health care access for the most vulnerable.

Table 1. Armenia: Selected Economic and Financial Indicators, 2016–23

	2016 Act.	2017 Act.	2018 Act.	2019	2020	2021 Projections	2022	2023
National income and prices:								
Real GDP (percent change)	0.2	7.5	5.2	4.6	4.5	4.5	4.5	4.5
Final consumption expenditure, Contrib. to Growth	-0.9	7.4	2.7	3.3	3.4	2.7	3.5	2.1
Gross fixed capital formation, Contrib. to Growth	-2.4	1.5	0.8	6.8	4.6	5.0	4.2	3.1
Changes in inventories, Contrib. to Growth	0.7	1.1	4.0	-4.6	0.0	0.0	0.0	0.0
Net exports of goods and services, Contrib. to Growth	3.1	-1.2	-1.8	-1.2	-3.4	-3.1	-3.2	-0.6
Gross domestic product (in billions of drams)	5,067	5,569	6,003	6,549	7,102	7,745	8,437	9,169
Gross domestic product per capita (in U.S. dollars)	3,524	3,872	4,186	4,533	4,764	5,068	5,386	5,710
CPI (period average; percent change)	-1.4	1.0	2.5	2.1	3.0	3.7	4.0	4.1
CPI (end of period; percent change)	-1.1	2.6	1.8	2.5	3.3	3.8	4.1	4.3
GDP deflator (percent change)	0.3	2.2	2.5	4.3	3.8	4.4	4.2	4.0
Unemployment rate (in percent)	20.2	18.6	18.1	17.9	17.7	17.8	17.7	17.6
Investment and saving (in percent of GDP)								
Investment	18.0	19.0	22.4	23.6	24.1	24.4	24.9	25.6
National savings	15.8	16.6	13.3	16.3	16.8	17.5	18.4	19.4
Money and credit (end of period)								
Reserve money (percent change)	13.1	-1.0	17.8	9.0	9.5	8.5	8.5	8.5
Broad money (percent change)	16.6	17.7	8.1	7.0	9.5	8.5	8.5	8.5
Private sector credit growth (percent change)	14.4	16.9	16.4	16.0	15.5	13.0	12.5	11.0
Central government operations (in percent of GDP)								
Revenue and grants	21.4	21.2	21.7	22.6	22.8	22.8	22.9	23.2
Of which: tax revenue	20.1	20.2	20.6	21.0	21.3	21.5	21.7	21.9
Expenditure	27.0	26.0	23.5	25.2	24.9	24.7	24.7	25.0
Overall balance on a cash basis	-5.6	-4.8	-1.8	-2.5	-2.1	-1.9	-1.8	-1.8
Public and publicly-guaranteed (PPG) debt	56.7	58.9	55.8	54.6	53.7	52.3	51.1	50.1
Central Government's PPG debt (in percent)	52.0	53.7	51.4	51.0	50.8	50.2	49.5	49.0
Share of foreign currency debt (in percent)	80.9	81.1	77.5	77.6	76.5	75.4	73.9	74.3
External sector								
Exports of goods and services (in millions of U.S. dollars)	3,500	4,307	4,669	5,074	5,361	5,744	6,137	6,625
Imports of goods and services (in millions of U.S. dollars)	-4,516	-5,710	-6,583	-7,132	-7,467	-7,892	-8,371	-8,875
Exports of goods and services (percent change)	11.6	23.0	8.4	8.7	5.7	7.2	6.8	7.9
Imports of goods and services (percent change)	2.2	26.4	15.3	8.3	4.7	5.7	6.1	6.0
Current account balance (in percent of GDP)	-2.3	-2.4	-9.1	-7.3	-7.3	-6.9	-6.5	-6.2
FDI (net, in millions of U.S. dollars)	272	228	266	296	318	346	376	407
Gross international reserves (in millions of U.S. dollars)	2,204	2,314	2,249	2,284	2,373	2,418	2,468	2,633
Import cover 1/	4.6	4.2	3.8	3.7	3.8	3.5	3.3	3.4
End-of-period exchange rate (dram per U.S. dollar)	484	484	484	…	…	…	…	…
Average exchange rate (dram per U.S. dollar)	480	483	483	…	…	…	…	…

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

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

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

Press Release No. 19/190
FOR IMMEDIATE RELEASE
May 31, 2019

IMF Executive Board Concludes 2019 Article IV Consultation with the Republic of Armenia

On May 17, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Armenia.

Armenia's economy continues to perform well. Activity expanded by 5.2 percent in 2018, aided by a pickup in private investment and continued recovery in remittances, and annual consumer price index (CPI) inflation fell to 1.9 percent in March. The current account deficit widened to 9.1 percent of GDP in 2018, primarily owing to stronger capital goods imports, weaker primary income, and some measurement issues. Fiscal consolidation is on track, supported by strong tax administration efforts, with public debt as a share of GDP declining in 2018. Monetary and financial conditions remain stable with limited pressure on the exchange rate. The banking sector is well-capitalized, and credit growth has been supporting economic activity. On the structural front, the fiscal rule was redesigned and improved in December 2017. A full-fledged pension reform came into effect in July 2018. A draft public-private partnership law has been prepared in consultation with international development partners, including the IMF. The new government has pledged to speed up reform, in particular to decisively combat corruption and improve governance, with a view to promoting inclusive and sustainable growth.

Looking ahead, growth is expected to moderate to a more sustainable level of 4.6 percent in 2019 and stabilize at 4.5 percent over the medium term. The authorities are aiming for higher medium-term growth supported by reform. CPI inflation is projected to converge to the Central Bank of Armenia's (CBA's) medium-term target of 4 percent over the next two years. The current account deficit is expected to improve to 7.3 percent of GDP in 2019, as transitory factors begin to fade, and gradually fall to a more sustainable level of around 6 percent of GDP, as exports continue to grow and imports moderate somewhat.

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

Downside risks to growth are mostly external. They include increased global trade tensions and turbulence in global financial markets, both of which could lower trading partners' growth, remittances, and commodity prices. On the upside, faster progress on the reform agenda could boost potential growth.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities' efforts in recent years to maintain macroeconomic stability and strengthen policy frameworks. Directors noted that Armenia remains vulnerable to external shocks and faces structural challenges in its transition toward a dynamic, private-sector led emerging market economy. In this context, they welcomed the new government's reform agenda, particularly anti-corruption efforts to improve governance and the business environment, to foster sustainable and inclusive growth. Directors emphasized that ownership and resolute implementation are key to the success of the reforms.

Directors supported the authorities' fiscal consolidation plans, guided by the fiscal rule, aiming to bring central government debt to below 50 percent of GDP in the medium term, while leaving adequate fiscal space for critical spending. They noted that the authorities' tax reform, including the simplification of the personal income tax system, is aimed at improving compliance and supporting economic activity. However, they cautioned that careful monitoring is needed to avoid a fall in revenues and a worsening of income distribution. Directors also underscored the need for accompanying sustainable compensating measures and strong tax administration efforts. Strengthening revenue mobilization would help preserve debt sustainability while also creating needed space for growth-enhancing infrastructure and social spending. In this regard, further efforts to improve public investment management were encouraged.

Directors considered that the current monetary policy stance remains appropriate and that policy should remain focused on bringing inflation back to its medium-term target. At the same time, they underscored the importance of continued exchange rate flexibility in responding to external shocks, maintaining foreign exchange reserves at an adequate level, and protecting competitiveness. Foreign exchange market interventions should be limited to preventing disorderly market fluctuations.

Directors encouraged further strengthening of the monetary and financial sector policy frameworks. To increase the effectiveness of inflation targeting and monetary transmission mechanism, they noted the need to develop a well-functioning interbank market, enhance communication, and promote de-dollarization. In supporting a more resilient financial sector and strengthening the macroprudential framework, Directors welcomed the authorities' commitment

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

to bolstering banks' foreign exchange liquidity buffers, and encouraged measures to develop capital markets further and increase access to finance.

Directors noted the importance of advancing structural reforms to foster sustainable and inclusive growth through measures that promote private sector development, attract more FDI, and increase diversification. They welcomed the government's strong commitment through its five-year program to strengthen governance, enhance competition, and improve the business climate. Measures to enhance human capital and foster female labor market participation were also encouraged.

It is expected that the next Article IV consultation with the Republic of Armenia will be held in accordance with the Executive Board decision on consultation cycles for members with Fund arrangements.

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Reserve money (percent change)	13.1	-1.0	17.8	9.0	9.5	8.5	8.5	8.5
Broad money (percent change)	17.5	18.5	7.4	7.0	9.5	8.5	8.5	8.5
Private sector credit growth (percent change)	6.0	16.5	17.2	16.0	15.5	13.0	12.5	11.0
Central government operations (in percent of GDP)								
Revenue and grants	21.4	21.2	21.7	22.6	22.8	22.8	22.9	23.2
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Average exchange rate (dram per U.S. dollar)	480	483	483	…	…	…	…	…

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

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

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

May 3, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND REQUEST FOR A STAND-BY ARRANGEMENT

KEY ISSUES

Context. Since the 2014–16 regional economic slowdown, economic activity has recovered, while policies have remained broadly in line with staff's advice. Supported by the upgraded fiscal rule, fiscal consolidation remains on track, and public debt has started to decline. Inflation is under control, the financial system remains stable, and pressures on the exchange rate have been limited. Nonetheless, important challenges remain. Importantly, the still-weak business climate and corruption constrain the economy's capacity to grow sufficiently rapidly to tangibly reduce poverty and unemployment. Moreover, the economy continues to be vulnerable to external shocks; public debt, while declining, is relatively elevated; and enhancing revenue mobilization remains a critical priority. Recognizing these challenges, the new government has pledged to revitalize efforts to fight corruption, improve competition, strengthen revenue administration, and build resilience to shocks. It has requested a new Fund-supported program to help achieve these objectives and move Armenia toward a more dynamic market economy.

Key policies. The authorities' efforts are centered on advancing structural reforms to generate higher, more inclusive, and resilient growth; and strong policies to maintain macroeconomic stability. They have announced a revenue-neutral growth-enhancing tax policy reform package, which includes measures to flatten the personal income tax profile, lower personal and corporate income tax rates, and simplify the special tax systems. They plan to accompany them by efforts to strengthen tax administration and reduce income inequality. Monetary policy will continue to focus on inflation targeting, supported by a flexible exchange rate.

Article IV discussions. Discussions focused on macroeconomic and structural policies to ensure macro and fiscal sustainability, foster higher and more broad-based growth, and strengthen resilience to shocks.

Elements of the new SBA. A 36-month SBA is proposed with access of 139.75 percent of quota (SDR 180.0 million). The arrangement is intended to be precautionary. It will provide insurance against external shocks and support the authorities' efforts to strengthen economic fundamentals and policy frameworks. In the event of a shock, access to IMF financing will maintain a reserve cover above 85 percent of the IMF reserve adequacy metric.

Approved By:
Thanos Arvanitis and Nathan Porter

Discussions were held during February 12–26, 2019. The mission met with Prime Minister Pashinyan, Deputy Prime Minister Grigoryan, Governor of the Central Bank of Armenia Javadyan, Minister of Finance Janjughazyan, Minister of Economy Khachatryan, State Revenue Committee Chairman Ananyan and other senior government officials, as well as representatives of the private sector and civil society. The team comprised H. Samiei (head), H. Tabarraei, and S. Yoon (MCD), Y. Ustyugova (Resident Representative), F. Raei (SPR), and Y. Xiao (FAD). S. Pompe and A. French (LEG) joined the mission to discuss governance-related issues. V. Janvelyan and L. Karapetyan (IMF Office) assisted the team. R. Doornbush and Sh. Harutyunyan (OED) attended most of the meetings. H. Bukhari and B. Laumann (MCD) provided assistance.

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CONTEXT

1. **Since the previous Article IV consultation and the completion of the 2014–17 EFF, macroeconomic stability has been maintained and macroeconomic policy implementation has been sound.** The 2014–15 external shocks generated significant challenges and created serious obstacles to policy implementation. Since then, the authorities' efforts, supported by close engagement with the Fund, have helped mitigate the macroeconomic impact of the shocks. Economic activity has strengthened, and the fiscal deficit and debt have started to decline. Inflation is under control, the financial system remains stable, and international reserves are assessed to be adequate, while pressures on the exchange rate have been limited.

Box 1. Implementation of Main Recommendations of the 2017 Article IV Consultation

The 2017 Article IV consultation called for: (i) maintaining a prudent fiscal path to reverse the increase in debt while creating room for higher capital expenditure; (ii) improving expenditure management, especially for foreign-financed projects; (iii) upgrading the fiscal rule to align it with international best practices; (iv) further improving inflation targeting framework; and (iv) accelerating implementation of reforms to promote growth. In addition, the 2018 FSAP made specific recommendations to improve supervision and financial intermediation, and bolster FX buffers. The authorities have made progress in several areas.

Fiscal performance in 2017–18 was broadly satisfactory. Following zero growth in 2016, a higher-than-budgeted fiscal deficit in 2017 helped jumpstart growth. By contrast, better-than-budgeted fiscal outturn in 2018 in part reflected lower capital expenditure, necessitating further efforts to improve expenditure management. A declining deficit stemmed the rise in public debt-to-GDP, which had significantly risen in 2014–15 (in large part reflecting dram's depreciation).

Monetary policy has focused on price stability and maintaining exchange rate flexibility. Monetary conditions have been accommodating, with lending rates falling in response to earlier monetary easing. With inflation getting close to the Central Bank of Armenia's (CBA's) medium-term 4 percent target, the CBA paused monetary easing for two years from February 2017 to January 2019.

The CBA has started implementing the 2018 FSAP recommendations. Banking supervision has been strengthened by implementing a risk-based approach. However, further work is needed to enhance banks' foreign exchange liquidity buffers and to foster better financial intermediation by developing capital markets and strengthening financial literacy.

Some progress has been made in implementing structural reforms. The fiscal rule was amended in December 2017 with IMF technical assistance (Annex I: Armenia's Revised Fiscal Rule). The new rule, in line with the new generation of fiscal rules, reduces the bias toward pro-cyclical fiscal policy and avoids large abrupt fiscal adjustments. To effectively manage foreign-financed capital spending, the authorities have been restructuring project implementation units. A full-fledged pension reform came into effect in July 2018. The new government has pledged to promote inclusive growth and tackle corruption head-on, although competition in the domestic market remains limited.

2. **Looking ahead, Armenia continues to face significant challenges, requiring an acceleration in the implementation of structural reform** (Table 1)**.** The still-weak business climate, corruption, and the absence of key growth drivers constrain the economy's capacity to grow solidly. Private consumption and investment are still relatively dependent on remittances, leaving the economy vulnerable to external shocks. Public debt, while declining, is relatively elevated and

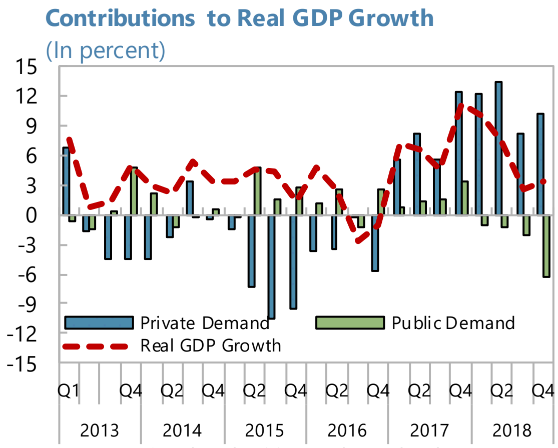
improving revenue mobilization remain critical to unlocking the potential for much needed growth-enhancing investment spending. Despite gradual improvements, poverty, income inequality, and unemployment remain relatively high, causing migration and a shrinking labor force.

3. **The 2018 peaceful political transition has generated a new momentum for reforms.** Widespread but peaceful protests led to the appointment of opposition leader Pashinyan as the new prime minister in April 2018. The National Assembly (NA) was dissolved in October and a snap parliamentary election in December 2018 resulted in a landslide victory for the alliance led by the new PM. A new government took office in January 2019 and launched its five-year program in February 2019. The new government has set fighting corruption and improving the business environment as its main priority.

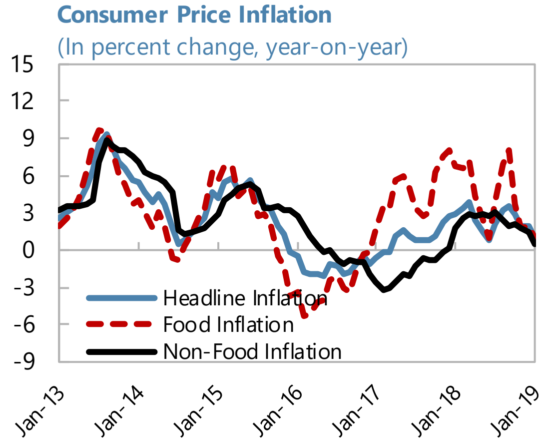
4. **Against this background, the government has requested a new Fund-supported program to support its economic plans.** The 2010–13 and 2014–17 Fund-supported programs helped mitigate the adverse macroeconomic effects of the global financial crisis and the 2014 external shock (Annex II: Ex-Post Peer Review Assessment)**.** However, the shocks hampered effective implementation of structural reforms, particularly relating to governance and the business climate.

RECENT DEVELOPMENTS

5. **Economic activity remains robust, while inflation is below expectations** (Figure 1 and Table 2)**.** Following unusually strong growth in 2017 (7.5 percent) and 2018H1 (8.5 percent), real GDP growth decelerated to 3 percent in 2018H2 reflecting weak public sector spending and a slowdown in trading partners. As a result, the economy grew by a more sustainable 5.2 percent in 2018 as a whole. On the production side, manufacturing and services sectors more than offset the contraction in agricultural and mining production. More recently, high-frequency indicators through March point to a continuation of the 2018 growth momentum. The output gap is estimated to be still negative but closing. Annual CPI inflation fell to 1.9 percent in March (reflecting both supply and demand conditions), below the lower end of CBA's medium-term target band of 4±1.5 percent.

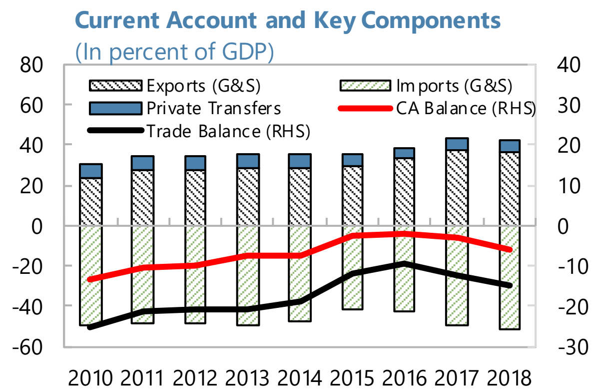


Sources: National authorities; and IMF databases.



Sources: National authorities; and IMF databases.

6. **The current account deficit widened significantly in 2018, on the back of strong imports and weaker primary income while some transitory factors also played a role** (Figure 2 and Table 3)**.** The current account deficit, which had narrowed to below 3 percent over 2015–17 due to adjustment to the 2014 regional shocks, widened to 9.1 percent in 2018. This reflects a rebound in imports on the back of recovery in domestic demand and some transitory factors. Two copper mines were temporarily shut down in 2018 on environmental concerns, resulting in some loss of export revenue. Some exports have been underreported, especially re-exports of certain import items such as cars within the Eurasian Economic Union (EEU). On the income accounts, a larger-than-normal repatriation of profits lowered primary income. Remittance inflows continued to recover, although net remittances remained broadly similar to 2017 in nominal terms.



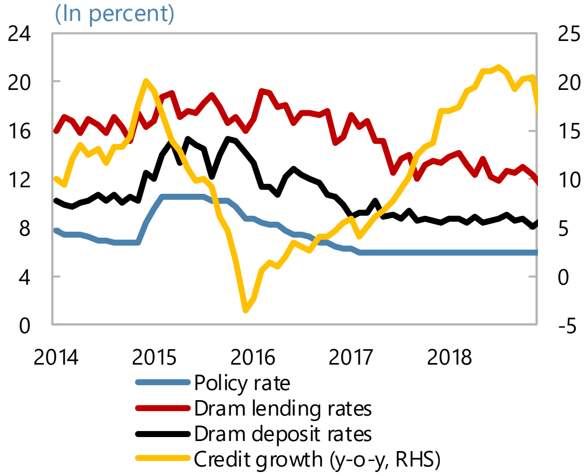
Sources: National authorities; and IMF databases.

7. **Fiscal consolidation remains on track, but spending has been well below plans** (Figure 3 and Table 4-1 and 4-2). The ambitious nominal revenue target for 2018 was achieved, supported by strengthened efforts in tax administration. Spending, however, was lower than budgeted, owing to delays in both current and foreign-financed capital expenditure. As a result, the 2018 fiscal deficit was 1.8 percent of GDP, significantly lower than the budget target of 2.7 percent of GDP.

8. **Monetary and FX market conditions remain stable** (Figure 4 and Table 5)**.** The CBA lowered its policy rate by 25 basis points to 5.75 percent in January for the first time since February 2017 in response to downward pressure on inflation. Conditions in the FX market have remained stable while interventions have been limited, on account of higher capital inflows. The CBA continues to provide short-term liquidity to banks, reflecting inadequate activity in the

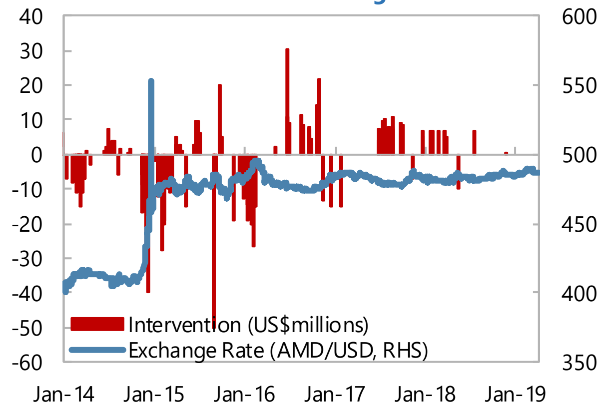
interbank market. Credit growth was 17.2 percent (y-o-y) at end-2018. The credit-to-GDP gap[1] is estimated by staff to be marginally negative.

Interest Rates and Credit Growth
(In percent)



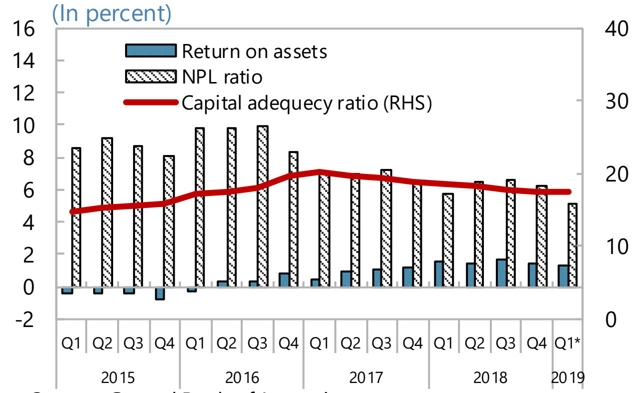
Source: Central Bank of Armenia.

FX Intervention and Exchange Rate



Sources: National authorities; and Bloomberg.

Financial Soundness Indicators
(In percent)



Source: Central Bank of Armenia
*2019 Q1 refers to data available as of Feb 2019

9. **Financial soundness indicators continue to improve, but some vulnerabilities remain** (Table 6)**.** The banking sector is well capitalized. Non-performing loans (NPLs) declined to 5.2 percent of total assets and return on assets improved to 1.4 percent at end-February 2019. Both deposit and credit dollarization for residents fell significantly in 2018, reflecting stable macroeconomic and financial conditions in recent years. Nonetheless, the 2018 FSAP suggested that FX liquidity cushions remain insufficient to withstand tail risk shocks.

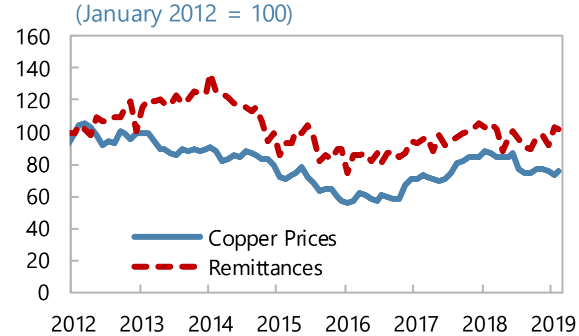
10. **Structural reforms are advancing.** The fiscal rule was redesigned and approved in December 2017. A draft public-private partnership (PPP) law has been prepared in consultation with international development partners, including the IMF. The government's five-year program for 2019–23, adopted by the NA in February 2019, embodies a new political will and strong commitment to fighting corruption, strengthening the rule of law, and enhancing human capital. The impact of reform efforts is already evident in tax administration.

[1] Defined as the difference between the credit-to-GDP ratio and its long-term trend.

OUTLOOK AND RISKS

11. Growth is projected to moderate to more sustainable levels in 2019 and over the medium term (Table 7)**.** It would slow slightly to 4.6 percent in 2019, reflecting weaker trading partners growth and copper prices; and stay around 4.5 percent over the medium term, in line with current estimates of potential growth, not taking into account planned reforms given the uncertainties. Inflation is projected to gradually pick up in 2019 but stay within the lower part of the CBA's target band. The current account deficit would improve to 7.3 percent of GDP in 2019 as transitory factors begin to fade. Over the medium term, the current account deficit is projected to gradually converge to around the norm of 6 percent of GDP, as exports continue to grow and imports to somewhat moderate.

Copper Prices and Remittances
(January 2012 = 100)



Sources: National authorities; and IMF databases.

12. The authorities believe that higher medium-term growth is achievable. In their view gains from reform, supported by higher investment in mining, tourism, agriculture, and services, could boost growth to 5–5½ percent per year. The authorities are also confident that the implementation of reforms will increase FDI and catalyze new greenfield investment (Box 2 and SIP on the macroeconomic impact of structural reforms in Armenia).

Box 2. Macroeconomic Effects of Structural Reforms

The long-run growth impact of the full implementation of the government's structural reform package could be substantial. Staff simulated economic effects of key fiscal and structural reforms by using a version of MCDMOD, a sub-module of the IMF's Flexible System of Global Models (FSGM). The simulation was conducted based on the government's five-year program, which covers three broad areas: (1) tax policy; (2) governance; and (3) labor market. The simulation results suggest that successful implementation of the reform package would yield substantial benefits for the economy in the long run.

- **Revenue-neutral tax policy reform.** The authorities' tax policy changes (see the details in ¶17) are assumed to be fully compensated by offsetting tax measures, and improved compliance and revenue administration. The reform would allow for higher disposable income and wealth, private consumption, and investment, which increases capital stock and production capacity. As a result, real GDP would increase by about 0.4 percent.

- **Governance.** Enhanced governance (see the details in paragraph 34), would result in higher total factor productivity. This would help expand the economy's productive capacity, with higher marginal products of labor and capital and thus higher real wages, consumption, and private investment. Staff simulation suggests that enhanced governance would gradually increase real GDP by about 1.5 percent.

Box 2. Macroeconomic Effects of Structural Reforms (Concluded)

- **Labor market reforms.** An increase in labor force has a strong impact on GDP. Labor reform measures (see the details in paragraph 35) are estimated to bring down the unemployment rate by 3 percentage points in a decade. This would result in increasing real GDP by about 2.5 percent.

13. **Risks to growth are mostly external.** Downside risks include increased global trade tensions, turbulence in global financial markets—both of which could lower trading partners' growth and commodity prices—or a pickup in regional geopolitical tensions related to US-Iran relations or Nagorno-Karabakh (notwithstanding the recent high-level dialogue) (Annex III: Risk Assessment Matrix). On the domestic front, faster progress on the reform agenda could generate an upside by expanding Armenia's economic potential.

14. **Potential negative shocks, if materialized, could have a large adverse impact on the economy, triggering the need to access IMF and other external resources.** An adverse scenario (see Annex IV: Illustrative Adverse Scenario) gauges the impact of an external shock (similar to that in 2014), involving a fall in remittances and commodity prices along with an increase in capital outflows due to an abrupt change in global risk appetite. Such a scenario could worsen the balance of payments, erode reserve coverage, dampen domestic demand, and have significant second-round effects on the economy. In response, to help absorb the external shock, in the first instant, the exchange rate would depreciate, accompanied by limited FX interventions to moderate extreme volatility. Some monetary policy tightening would also be needed to prevent second-round effects of exchange rate depreciation on inflation. The IMF arrangement (described below) could be tapped to smooth the adjustment process. This would reduce the need for additional major pro-cyclical fiscal adjustment, while preserving fiscal resources to cushion the impact of shock on vulnerable groups. That said, the above scenario is based on normal-sized shocks, and realization of tail risks could require higher financing and possibly more adjustment.

Armenia: Impact of a Plausible External Shock

	2019		2020		2021		2022	
	Baseline	Shock Scenairo	Baseline	Shock Scenairo	Baseline	Shock Scenario	Baseline	Shock Scenario
Real GDP growth (percent)	4.6	4.2	4.5	4.0	4.5	4.3	4.5	4.5
CPI inflation, average (percent)	2.5	2.3	3.3	2.4	3.8	3.1	4.1	4.1
Current account balance (percent of GDP)	-7.3	-7.9	-7.3	-7.4	-6.9	-7.2	-6.5	-6.1
Overall fiscal balance (percent of GDP)	-2.5	-2.5	-2.1	-2.5	-1.9	-2.5	-1.8	-2.1
Gross international reserves (US$ million)	2,284	1,944	2,373	1,839	2,417	1,656	2,467	1,837
Public debt (percent of GDP)	55.9	62.0	54.9	63.9	53.3	63.1	52.5	63.8

ARTICLE IV DISCUSSIONS

Given the benign cyclical position, policy discussions mainly focused on medium-term prospects and the new government's plans to generate higher, more inclusive, and resilient growth, while maintaining macroeconomic and fiscal stability.

A. Fiscal Policy: Promoting Growth-Friendly Fiscal Consolidation

15. Staff and authorities agreed that the key medium-term challenge is preserving debt sustainability, while maintaining space for investment and social spending (MEFP ¶5)**.** Following the 2014 external shocks, central government public debt climbed steadily to a peak of 53.7 percent of GDP at end-2017 before falling to 51.4 percent of GDP at end-2018.[2] In line with the upgraded fiscal rule, the authorities prepared a corrective action plan to bring central government debt to below 50 percent of GDP by 2023. This would require reducing (and maintaining) the fiscal deficit at around 2 percent of GDP in the coming years (Annex V: Public Debt Sustainability Analysis). Staff supports this fiscal path, which is underpinned by the authorities' 2019–21 medium-term expenditure framework (MTEF), reflecting efforts in both revenue mobilization and spending restraint, and strikes a realistic balance between reducing debt and preserving capital and social spending.

16. The 2019 budget is an appropriate step toward achieving these objectives (MEFP ¶6)**.** Based on the spending envelope in the budget, staff projects a fiscal deficit of 2½ percent of GDP in 2019. The fiscal stance is slightly expansionary (Figure 3), following a more-than-expected adjustment of about 3 percent of GDP in 2018 on the back of significant underspending relative to the budget. Fiscal revenues are projected to be boosted by about ½ percent of GDP, compared with 2018, reflecting measures embedded in the 2016 tax code and the government's ongoing efforts to strengthen tax administration (as already demonstrated in 2018). On the expenditure side, current spending is kept constant as a share of GDP, while social spending is increased by 9 percent and capital spending by 27 percent relative to the 2018 budget.

17. The authorities have announced a tax policy package, to become effective in 2020, to support medium-term growth. The package includes measures to flatten the personal income tax (PIT), lower personal and corporate income tax rates (CIT), and simplify the special tax regimes. In their view, these reforms should enhance compliance and yield a positive impact on competitiveness and growth, particularly as the PIT and CIT rates are relatively high compared with peers (for example, Georgia and Russia). Moreover, they viewed the current PIT structure is only nominally progressive, given widespread underreporting by high-income taxpayers. In addition to income tax changes, to support small businesses, micro-enterprise taxation will be streamlined and the scheduled reduction of the value-added tax (VAT) threshold will be cancelled.

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[2] Total government debt, including the central bank, amounts to 55.8 percent of GDP at end-2018.

18. There was agreement that the reform should include measures to fully offset the revenue and distributional impact of the reform (MEFP ¶7–9)**.** In line with recent IMF TA on tax policy, staff pointed to the adverse effects of a flat tax rate and stressed the necessity of offsetting measures to prevent potential revenue losses and ameliorate the likely impact on equity. It further noted that while positive effects are possible in the medium term, they require bold efforts to strengthen tax administration.

- **The authorities have proposed measures to offset the fall in revenues**. The measures include introducing new taxes on tobacco, and gambling, indexing excise tax rates to inflation, removing selected tax exemptions, and increasing gambling and financial sector license fees. The yields from these measures, supported by administrative efforts, are estimated to fully offset the expected revenue losses from the income tax and turnover threshold changes. The authorities also agreed to develop contingency plans in case of additional revenue shortfalls, given the uncertainties in forecasting revenues. To this end, they will consider reducing ad hoc VAT exemptions and rationalization of tax expenditures for the profit tax regime during the program period.

Armenia: Expected Impacts of Tax Reform (percent of GDP)

	2020	2021	2022	2023
Income tax and small business tax changes:				
Flattening PIT	-0.4	-0.5	-0.6	-0.7
Lowering CIT (affecting 2021 onwards)	0.0	-0.1	-0.1	-0.1
Keeping the higher turnover/VAT threshold	-0.2	-0.1	-0.1	-0.1
Total	-0.5	-0.8	-0.9	-1.0
Offsetting measures:				
Taxation on tobacco, and gambling, license fees	0.2	0.2	0.2	0.2
Increased excise taxes on alcohol, tobacco, natural gas, etc, and tax indexation	0.2	0.3	0.5	0.6
Reduction in govt.'s pension contribution	0.0	0.1	0.1	0.1
Unquantifiable tax measures (reducing exemptions and shadow economy)	0.1	0.2	0.1	0.1
Total	0.5	0.8	0.9	1.0

- **The authorities are also committed to developing measures to protect the poor in terms of improving fairness.** They argued that the distributional impact of the changes will likely be limited. In particular, the impact of the PIT change is negligible given current underreporting and the increase in fuel excise taxes has limited impact on the poor. At the same time, the authorities have been working with the World Bank to build a model to further analyze the distributional effect and identify mitigating measures. Moreover, under the program, the authorities are committed to a wide range of structural reforms, within their fiscal envelope, with positive impacts on equity and poverty reduction (see below ¶33).

19. As a critical complementary reform, staff welcomed the preparatory work for overhauling property taxation to improve the progressivity of the tax system and generate more revenues over time (MEFP ¶10)**.** The Cadastre Committee has completed the work on new evaluation zoning and elaborated on the methodology of assessment for real estate taxation based on market prices. A law will be submitted to the NA (June 2019 structural benchmark (SB)) to establish a market evaluation procedure in 2020, with collection based on this procedure starting in 2021. Staff urged the authorities to maintain the reform momentum by implementing the next steps of the property tax reform by reviewing the rate structure and nontaxable threshold, as well as devising a mechanism to help the low-income population, in line with the IMF TA recommendations.

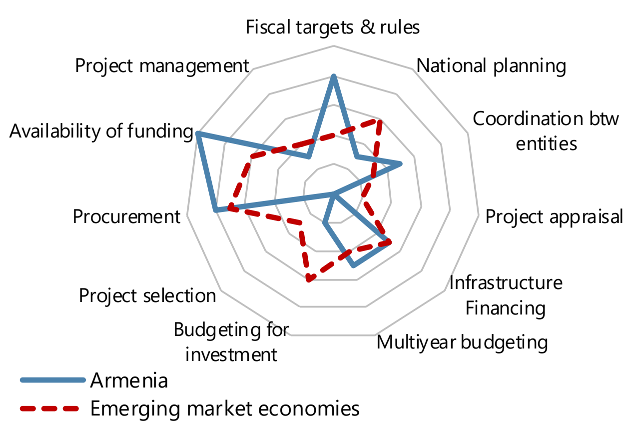
20. Further enhancing tax administration is essential to mobilize revenues and support the tax policy measures (MEFP ¶11)**.** The authorities are conducting a comprehensive diagnostic study of factors preventing tax collection from reaching the country's estimated tax potential (December 2019 SB). Staff analysis suggests that there is room for increasing Armenia's tax potential by improving governance and economic fundamentals, as well as reducing inefficiencies in tax administration and tax policies. They plan to develop an action plan to implement key recommendations from the recent Fund TA on tax administration, including developing a compliance strategy and improving core tax administration functions (June 2019 SB). In this regard, follow-up Fund TA is planned in 2019 including a tax gap TA mission. In addition, the authorities intend to start preparations for effective implementation of a tax return system for individuals.

21. Structural expenditure reforms are ongoing, aiming to support fiscal sustainability and inclusive growth (MEFP ¶12–13)**:**

- **Budget process.** The government continues to work toward adopting a program budgeting framework to improve efficiency of budget expenditures and enhancing the credibility of the MTEF by introducing rolling-base budgeting in the budget cycle.

- **Public investment management.** Drawing on the Fund Public Investment Management Assessment (PIMA) TA recommendations, developing a complete PIM framework is crucial to better prioritizing and selecting investment projects, linking them with the priorities in the government's program. The experience of undesirable underspending in 2017–18 also highlights the need for improving the management of foreign-financed capital spending. In this regard, the authorities plan to incorporate the project implementing units into relevant ministries. They believe such a restructuring will help to more effectively control the implementation of donor-financed projects, reduce the volatility in budget execution and optimize the use of public resources.

Design of Public Investment Management Institutions



Staff urged them to carefully manage the transition process to avoid disruptions in budget execution.

- **Fiscal risks management.** The government intends to clarify the functions and responsibilities related to fiscal risk management under the new government architecture and to build capacity to transition from mainly fiscal risk reporting to risk assessment. Importantly, the government is committed to submitting to the NA a draft PPP law that follows best international practice by establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships (June 2019 SB). A PPP database will also be created. To improve fiscal transparency, the government is committed to publishing and implementing the fiscal transparency evaluation action plan and strengthening transparency in public procurement.

- **Enhancing social spending.** The program budgeting framework, together with a stronger public procurement system will help ensure targeted, cost-effective, and efficient use of public finance in this area. The government will continue galvanizing donor's expertise and support to priority reform areas for developing human capital and enhancing social protection.

B. Monetary Policy: Strengthening the Inflation Targeting Framework

22. Monetary conditions remain accommodative, given subdued inflation (MEFP ¶15)**.** Core and headline inflation have been falling since the third quarter of 2018, reflecting demand-side factors including a slowdown in consumption, as well as supply-side factors such as muted pressure from food prices. In response to continued low inflation, the CBA lowered its policy rate by 25 basis points to 5.75 percent in January for the first time since February 2017. Given that the CBA targets medium-term inflation expectations, and with the still negative (albeit small) output and credit gaps, the accommodating monetary stance is assessed to be appropriate. The interest rate and credit channels have been active as both lending and deposit rates have declined over the past two years, contributing to a pickup in credit to private sector. Real interest rates, however, have increased recently due to a faster decline in inflation.

23. The inflation targeting (IT) framework has helped the CBA anchor inflation (MEFP ¶17)**.** To strengthen monetary policy transmission channels, staff urged the CBA to make further efforts to develop capital markets, reduce dollarization, and enhance transparency through better communication. Repo transactions are picking up, although from a low base, and the CBA has clarified that seven-day repo is the main liquidity management instrument and that the three-month repo would be used only for structural liquidity management purposes. In addition, to support the CBA in liquidity management, the Ministry of Finance (MoF) should continue to regularly share its cash flow forecast with the CBA. As noted by the 2018 FSAP, there is room to improve liquidity management further, including through more transparency in the CBA's liquidity forecasting.

24. The CBA noted that any further policy rate changes will be data dependent and consistent with the monetary policy consultation clause (MPCC). It argued that there is some room to cut the policy rate further, if needed, without creating capital outflow risks or higher deposit dollarization. Furthermore, although credit growth has been strong, the credit gap, although closing, is estimated to be still negative. The CBA stressed that it will continue to balance the central bank's dual mandate of price and financial stability within a coherent and coordinated policy framework.

25. Maintaining the flexible exchange rate regime has supported the IT framework (MEFP ¶16)**.** The CBA noted that it considers the exchange rate as a key shock absorber in protecting competitiveness and maintaining international gross reserves at adequate levels. Staff and the CBA agreed that FX intervention should be limited to addressing large and disorderly swings.

C. Financial Sector Policy: Enhancing Resilience and Promoting Deepening

26. The financial sector has continued to expand, but it remains dominated by banks. Most banks are subsidiaries of foreign banks. The non-bank sector is nascent with a small but growing insurance sector, which has expanded in the past decade, but remains around 1 percent of the financial system's total assets. The share of non-bank credit sector has also increased significantly over the same period, but its share remains below 1 percent of the total.

27. Macro-financial risks have been limited, but a recent pickup in credit growth warrants close monitoring. Although credit quality has been gradually improving, banks' low profitability coupled with abundant access to liquidity can incentivize banks to adopt risk-taking behavior. Furthermore, still-high credit dollarization is a source of vulnerability to external shocks through credit and liquidity risks.

28. Drawing on the 2018 FSAP recommendations and the CBA's strategy for 2018–20, the CBA continues to strengthen financial stability and improve access to credit (MEFP ¶19–21)**.** To safeguard financial stability and foster a robust and inclusive financial system, continued reform efforts are key:

- **Upgrading banking supervision.** The CBA has already adopted risk-based supervision, which should allow for a more granular assessment of banks' capital needs. Efforts are now focused on refining risk-based differentiation in capital levels, enforcing large exposure limits, and amending the definition of NPLs in line with international best practices.

- **Strengthening macroprudential measures in light of high levels of dollarization.** Specifically, the CBA should introduce a capital conservation buffer and a surcharge for domestic systemically-important banks as planned. In parallel, the CBA is adopting measures such as stressed loan-to-value (LTV) limits to address credit risk from unhedged FX exposures. It will also start working on addressing data gaps related to income information, which is necessary for adopting a debt- service-to-income ratio.

- **Fostering foreign currency liquidity buffers and reforming the FX reserve requirement regime as a macroprudential tool.** Given banks' insufficient FX liquidity cushions, the CBA is preparing a time-bound action plan and communication strategy in line with the 2018 FSAP recommendations (September 2019 SB).

- **Develop capital market to mobilize a growing supply of long-term domestic capital to fund economic developments and channeling it to the economy**. To this end, the authorities are reviewing the existing legislative framework for securities as a precondition for successful capital market development and preparing a capital market development program (September 2019 SB).

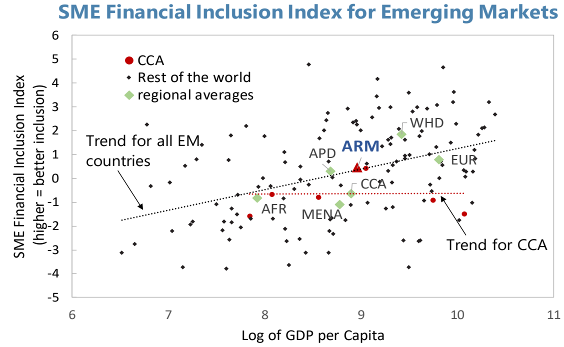
- **Enhancing corporate transparency to facilitate access to finance.** The authorities are working on steps to improve accounting standards and audit requirements and to implement efficiency review of the existing SME support programs.

Box 3. SME Access to Finance in Armenia

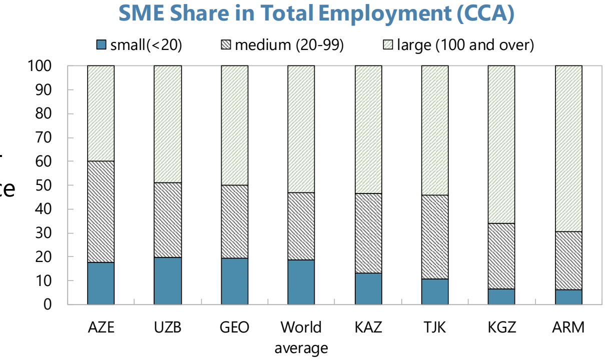
Despite some improvement, most SMEs still have limited access to finance. Armenia fares better than the average among CCA countries in terms of SME financial inclusion measures, based on a multidimensional index[1] that captures both access and usage of financial services by SMEs. Armenian SMEs also enjoy higher access to bank credit facilities relative to other CCA countries. That said, access to finance for most SMEs remains limited compared to the rest of the world and large firms dominate the economy with more power to get credit.

While SME's are important for Armenia's economy, structural challenges hinder further financial deepening in access to finance. The share of SMEs to total number of firms is the lowest among CCA countries, but still they hire about 30 percent of workers in Armenia. Banks' capacity to grant medium- and long-term financing is constrained by their limited funding structure, which relies largely on short-term deposits. At the same time, for SMEs, given the absence of universal accounting standards and audit requirements, and deficiencies in the credit bureau coverage, banks apply high risk premium to lending rates and require substantial collateral.

SME Financial Inclusion Index for Emerging Markets

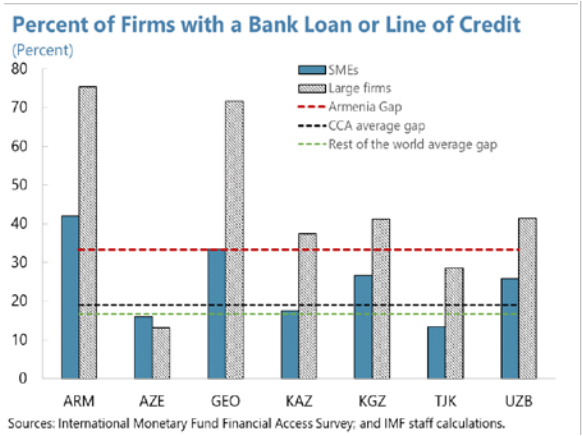


SME Share in Total Employment (CCA)

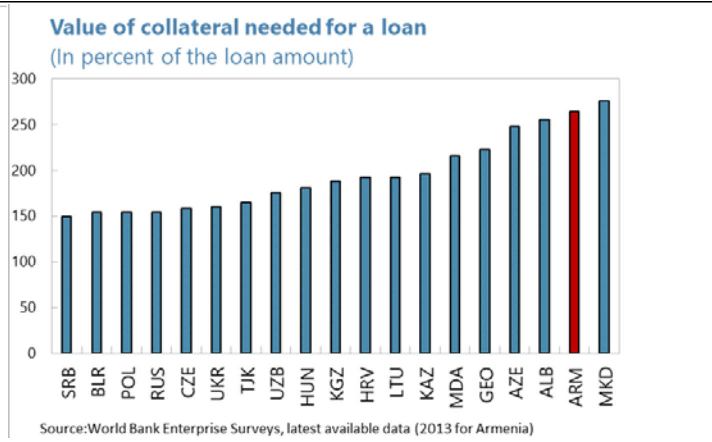


Source: World Bank Enterprise Surveys, latest available data.

[1] Baduel *et al.* forthcoming IMF Working Paper.



Sources: International Monetary Fund Financial Access Survey; and IMF staff calculations.

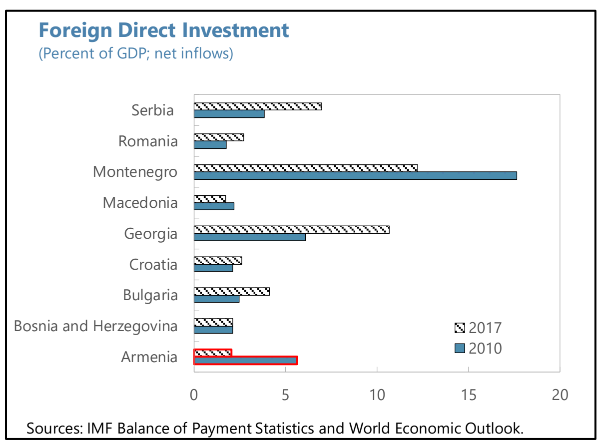


Source:World Bank Enterprise Surveys, latest available data (2013 for Armenia)

D. External Sector Policy: Maintaining External Stability

29. The external position is moderately weaker than implied by fundamentals and desirable policy settings, and some vulnerabilities remain (Annex VI: External Sector Assessment). Armenia's current account deficit has fluctuated significantly over the years, declining from 15 percent of GDP over 2008–10 to single digits in recent years, as exports have increased from 10 percent of GDP to 21 percent of GDP over this period. Despite this improvement, some vulnerabilities remain:

- **External balance sheets and external debt**. The stock of net international liabilities remains elevated and its composition is tilted toward FX-denominated debt. With limited FDI, the current account is mainly financed by debt-creating inflows, further contributing to the stock of debt liabilities over time. The external debt sustainability analysis suggests that external debt remains highly sensitive to exchange rate shocks and that maintaining a cautious approach to external borrowing while accelerating efforts to attract FDI for financing of projects remain important. Compared to peers, Armenia's FDI flows in recent years have been on the lower side, suggesting further room for improvement.



Sources: IMF Balance of Payment Statistics and World Economic Outlook.

- **Exchange rate assessment.** Staff analysis based on the EBA-lite methodologies suggest that exchange rate was moderately overvalued by 6–8 percent in 2018 (Annex VI). In coming to this assessment, the EBA-lite model estimates were adjusted to capture Armenia-specific factors such as a persistent need for investment-related imports and narrow export base which tend to structurally affect the current account balance. The authorities further argued that given the difficulty of establishing CA norms in transition economies, a wide range of CA values and exchange rate valuations may be in line with fundamentals. They also noted that the lack of exchange rate pressures despite the widening of the current account provides further evidence that the exchange rate may not be misaligned.

- **Reserve adequacy**. While somewhat weaker than 2017, reserves remain adequate. In 2018, international reserves stood at 106 percent of the IMF's reserve adequacy metric (ARA) for floating exchange rate regimes (the *de facto* classification) and are projected to remain around that level over 2019–21. Reserves in 2018 were also adequate according to other indicators such as the 3 months import coverage and short-term debt coverage. In the case of adverse external shocks, there could be pressure on central bank reserves (IMF FSSA for Armenia 2018) arising from FX demand by banks which hold nonresident FX deposits. Plans to boost FX liquidity buffers in line with the 2018 FSAP recommendations would over time reduce this risk. Going forward, continued efforts to maintain reserve adequacy would further boost confidence and provide insurance against external shocks.

30. Continued exchange rate flexibility, fiscal consolidation, and structural reforms toward a more dynamic export sector should help mitigate the risks. Given the sizable negative NIIP position, vulnerability to external shocks, and high dollarization, continued exchange rate flexibility would help protect reserve buffers and maintain competitiveness. Exports have grown significantly over the last decade, and there are positive signs of diversification into textiles and high-tech sectors. Further concerted efforts by the authorities to enhance non-price competitiveness, trade integration, and diversification are key. In this regard, staff encouraged the authorities to leverage the EEU membership to pursue deeper integration beyond the EEU to increase exports, improve standards, enhance domestic competition, invest in infrastructure, and reduce vulnerabilities (Annex VII: Impact of Armenia's accession to the Eurasian Economic Union). The authorities stressed the need for enhancing the quality of infrastructure to achieve higher and more sustainable private-sector export-led growth, given that external conditions expected to remain somewhat weaker for the foreseeable future, Also, the authorities emphasized that improving the quality of export and import data is crucial to accurately diagnose the country's export competitiveness.

E. Structural Reforms: Advancing Sustainable and Inclusive Growth

31. Improving governance and strengthening institutions have been a long-standing challenge (MEFP ¶25)**.** The government has enacted anti-corruption strategies and established institutions over the past several years. However, progress in combatting corruption has been slow, reflecting limited resolve in enforcing the established strategies and legislation. Armenia performs poorly compared to regional comparators on corruption-specific indicators (Box 4 and SIP on anti-corruption enforcement priorities). The new government has demonstrated more determination by pledging to tackle corruption head-on. In line with staff's advice, the government intends to (i) submit a law on a single autonomous anti-corruption body in line with international standards (September 2019 SB); (ii) enact a law to establish a registry of beneficial ownership information, prioritizing the extractive sector (June 2019 SB); and (iii) implement the law related to asset declarations of high-ranking officials and their associated other preventive measures. Reforms to enhance tax administration (¶20), strengthen procurement (¶21), and increase trade integration (¶30) would further reduce vulnerabilities to corruption.

Box 4. Corruption and Governance

Despite the government's efforts, Armenia's performance in tackling corruption is below the average of regional peers. *The Global Competitiveness Report 2017–18* identifies corruption as a significant obstacle to conducting business in Armenia. *Doing Business 2019* scores Armenia weakly in construction permits, paying taxes, and resolving insolvency. This creates vulnerabilities to corruption. Other reports point to law enforcement agencies as endemically corrupt. Several areas require immediate and urgent attention. First, anti-corruption functions are fragmented with several agencies' conducting investigations. The dilution of resources and skill sets weakens investigative capacity and undermines detection of entrenched and institutionalized corruption networks. Second, a law was passed to replace the asset declaration system managed by the Ethics Commission of the High-Ranking Officials of Armenia with one administered by the Commission for the Prevention of Corruption (CPC). However, the CPC has yet to be established. Until this happens, the current system is liable to collapse. Finally, investigation and prosecution of corruption cases suffer high attrition rates. Many investigations never reach court, and courts struggle to manage workloads, leading to delays and further attrition.

With public support, the new government is stepping up efforts to achieve meaningful reform in the anti-corruption and governance space. To deal with the existing disintegrated anti-corruption functions, the government is committed to concentrating resources into a single, autonomous anti-corruption agency, which would help consolidate investigative functions. To effectively enforce the asset declaration system, the government is taking steps to establish the CPC and to improve its analysis and verification of declarations. To strengthen governance in court case process, the government should take steps to greater transparency in pre-court triaging, changing the rules of procedure notably extending the processing of cases and further improvement of court management systems with, for example, complex corruption cases adjudicated by specialist judges.

32. The authorities are stepping up efforts to improve the business environment to attract investment and ignite more inclusive and durable growth (MEFP ¶23). The government's five-year program for 2019–23 includes bold reforms. Staff welcomes the authorities' intent to prepare a new business environment improvement action plan for promoting new investment and improving the regulatory framework to deal with core issues identified by the 2019 World Bank Doing Business Report (February 2020 SB). The authorities are committed to conducting an efficiency review of the existing government's SME assistance programs to improve the SME support system (April 2020 SB) and developing a framework to establish a public oversight body and the Chamber of Accountants and Auditors—a crucial step toward improving financial transparency (March 2020 SB). At the same time, staff encouraged the authorities to improve bankruptcy procedures to ensure an effective mechanism for business rescue. The authorities note that enhancing contract enforcement is crucial to improving the business climate. To this end, they plan to introduce efficiency measures for the courts and an electronic notarization system.

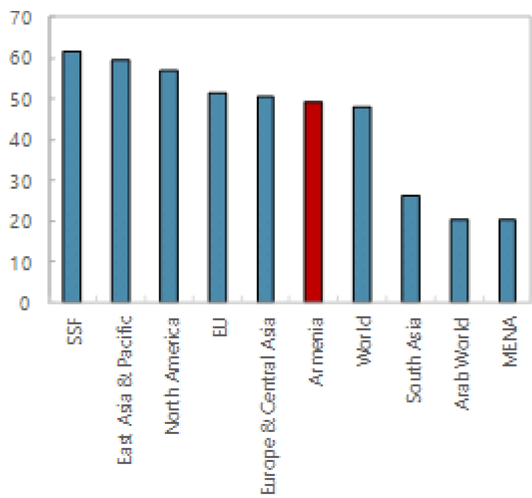
33. Although Armenia has relatively well-functioning social safety net programs, their coverage remains insufficient to protect vulnerable groups (MEFP ¶24)**.** Many households experience multiple deprivations, including low levels of education and access to health; insufficient access to economic opportunities; and inadequate access to good housing conditions, well-functioning infrastructure, and public services. According to the World Bank's assessment, only one out of three poor people is covered by the government's family benefit program—Armenia's flagship cash transfer program. The administration of social benefits (social services, pensions, and employment services) is fragmented, resulting in coverage gaps. Staff and the authorities agreed to improve social spending's adequacy and efficiency to enhance the existing social and family benefit scheme. To this end, the authorities intend to adopt a social assessment system for families, to create integrated social centers across regions, and to conduct multi-dimensional surveys for developing specific and targeted measures with assistance from the World Bank. At the same time, with the aim of a phased introduction of the universal health coverage financing system, the government is preparing a concept note to set coverage for beneficiaries and to establish a structure for the system. Finally, staff stressed the importance of the full implementation of the 2018 pension reform to guarantee sustainability of pension benefits in the context of strengthening the social protection system.

34. Various macroeconomic challenges prevent the country from creating more employment opportunities (MEFP ¶24). Since 2010 total employment has contracted by about 15 percent against the traditionally positive relationship between growth and job creation, while the unemployment rate has stayed at around 18 percent. The youth unemployment rate, at nearly double of the national average, is the highest in the CCA region. Despite the replete pool of unemployed, more businesses have been reporting labor shortages due to inadequate job relevant skills in the workforce. This suggests that structural bottlenecks, including those related to quality education and skill mismatches, are among the factors hindering job placement and private sector job creation, particularly in high-productivity sectors. A durable reduction of unemployment calls for a multi-pronged approach with a broad package of reforms. To this end, the authorities are developing an employment strategy to better target the existing active labor market programs. (December 2019 SB). At the same time, the government is committed to increasing financial support to enhance childcare systems for boosting female labor participation (see Box 5 and SIP on expanding women's role in the economy). Given that low level of labor productivity constrains the supply side of the labor market, staff urged the authorities to strengthen education and training to raise productivity growth and reduce inequality and poverty. With assistance from the World Bank, the authorities are committed to (i) restructuring and modernizing the tertiary education system (December 2019 SB); and (ii) developing a comprehensive education reform strategy to increase equitable access to pre-school education (June 2020 SB).

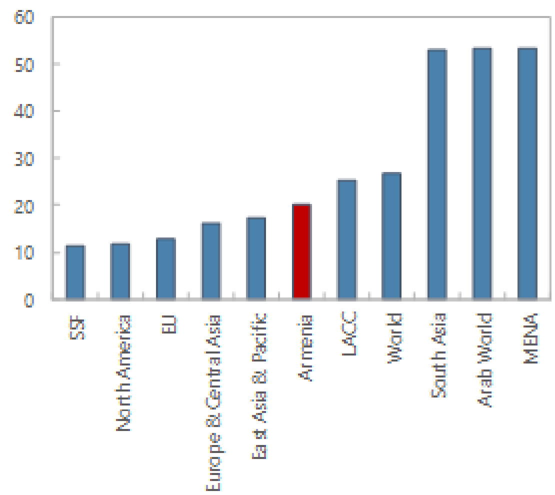
Box 5. Women's Role in the Economy

A large portion of Armenian women does not participate in the labor market and economic activity. Armenia's female labor force participation (LFP) rate, at around 53 percent, is broadly in line with global and peer country averages. But a large gender gap in LFP rates suggests that there is a significant untapped economic potential from women in Armenia.

Female LFP Rate, 2017
(In percent)



Gender Gap in LFP Rates, 2017
(In percentage points)



Sources: World Development Indicators and IMF staff calculations.
Note: Gap is defined as a difference between male and female labor participation rates.

Women can help address a number of pressing challenges facing Armenia. First, they can counterbalance the severe demographic pressure on economic growth from shrinking and aging labor force by boosting labor supply. Armenia's population has declined from around 3.5 million people in 1990 to just under 3 million today on account of low birthrates and emigration, and is projected to continue to fall. The labor force shrank by 13 percent just over the last decade. Second, women could reverse the decline in labor productivity growth given their higher educational attainment of compared to men. Thus, bringing more women into the labor force could yield significant economic benefits. Staff analysis suggests that eliminating the gap between male and female LFP with high educational attainment could raise the real GDP by up to 6 percent, depending on the labor market capacity to absorb new labor.

Promoting female employment requires an integrated set of policies. Elements of actions include (i) improving the provision of childcare and care for people with disabilities; (ii) promoting better access to information technology to facilitate job search and increase opportunities for flexible work arrangements; (iii) improving education system to provide equal opportunities to succeed in the labor market for both males and females; and (iv) implementing gender budgeting. These should coincide with efforts to tackle the slack in the labor market and create jobs. Early action is needed as the impact of policy efforts to raise women's role in economy will take time to materialize.

35. **Staff and the authorities agreed that successful implementation of structural reforms requires better coordination within the government**. Staff emphasized the importance of close coordination to ensure the government's strong intent to pursue reforms. The authorities agreed that a clear delineation of responsibilities is key to incentivizing the implementations of reforms and stressed that a unit of the Prime Minister's office could be established to achieve smooth coordination and strong ownership. Staff and the authorities

agreed that building on the strong partnership with the international donor community, it will be important to sustain strong donor financial support and capacity building to help ensure successful implementation of structural reforms.

THE NEW STAND-BY ARRANGEMENT

Drawing on the Article IV assessment, the new program aims to provide an anchor for the authorities' macroeconomic and reform agenda and insurance against external shocks. Given currently adequate external financing, the authorities intend to treat the stand-by arrangement as precautionary.

A. Objectives

36. There was agreement that a new Fund-supported program should help the authorities achieve their medium-term objectives through a more decisive implementation of policies and could provide useful insurance in the case of shocks. The program will focus on: (i) anchoring fiscal policy on the fiscal rule to maintain debt sustainability, and creating space for priority (social and capital) spending; (ii) upgrading the monetary policy framework and maintaining a flexible exchange rate system; (iii) safeguarding the financial system, including by reforms to boost banks' FX liquidity buffers, and improving access to finance; and (v) implementing a strong package of structural reforms, with renewed emphasis on growth inclusiveness and governance.

37. Key program benchmarks draw on the government's program and are set in line with the Article IV policy recommendations. The benchmarks entail reducing and maintaining the fiscal deficit to below 2 percent of GDP, resulting in a fall in central government debt below 50 percent of GDP by the end of the program. To this end, the program includes a semi-annual performance criterion (PC) on the fiscal balance, as well as other fiscal indicative targets (ITs) and SBs. Monetary conditionality, in line with the inflation-targeting framework, continues to be based on the MPCC and an IT on NDA. The latter monitors the CBA's liquidity operations. A PC on NIR helps maintain that the CBA's reserve coverage above 100 percent of the ARA metric, implying a moderate rise in NIR over the program period. Ongoing external vulnerabilities warrant maintaining ITs on average concessionality of new external debt (excluding the Eurobond) and a limit on annual new government-guaranteed external borrowing. Structural reform measures will help the government achieve sustainable and inclusive growth with a renewed focus on combating corruption and strengthening governance. The program continues to set an IT on social spending to help address poverty and inequality.

B. Program Modalities

38. Staff proposes a 3-year stand-by arrangement. Although there is no immediate financing gap, staff projects that under a plausible adverse scenario, Armenia's external position would weaken, with a resulting fall in reserves to 80 percent of ARA metric—even after assuming some exchange rate depreciation and import compression (Annex IV). The precautionary program will allow access to IMF financing of $250 million (140 percent of quota) during 2019–22, which would help smooth the adjustment process and preserve reserve buffers to above 85 percent of IMF's ARA metric of reserve adequacy (Annex IV). Given the already ambitious fiscal consolidation plan and tight expenditure control, staff considers additional fiscal adjustment for burden sharing as undesirable. That said, above-level access is based on normal-size shocks, and the realization of tail risks could require higher access and possibly more adjustment, as well as further financial assistance from international development partners.

39. Full implementation of the measures under the program would strengthen Armenia's resilience to shocks. Accelerating structural reforms under the program should reduce vulnerabilities and bring down fiscal and external risks to manageable levels. Given that Armenia has long been under the Fund-supported financing program, the precautionary nature of the program would help the authorities gradually shift away from Fund financial support over time. Nevertheless, in addition to risks to the outlook discussed above, potential reform slippage represents a major risk that could weaken the authorities' abilities to implement policy measures.

40. Staff proposes semi-annual reviews to monitor progress under the program. Given no imminent risk to macro-stability, the access will be made available in equal disbursements in line with the implications of the adverse shock scenario (Table 8). An updated safeguards assessment has been initiated and will be completed by the first review. Progress has been made in implementing most recommendations of the 2014 safeguards assessment, but some recommendations (including strengthening judiciary safeguards relating to the dismissal of Board members and refraining from engaging in some non-core businesses) remain outstanding.

C. Capacity to Repay

41. Armenia's repayment capacity is adequate and risks to the program are manageable. Armenia's capacity to repay the Fund has improved: total outstanding credit declined to 179.6 percent of quota at end-March 2019 (Table 9). Although Armenia has current obligations to the Fund, full drawing of the proposed access would not significantly affect the level of total debt which is mostly concessional. Key risks include geopolitical events, a protracted slowdown in major trading partners, and stress from global financial volatility or trade tensions. A failure to decisively improve the business environment is an important implementation risk, while Armenia remains vulnerable to geopolitical developments. That said, the authorities' long track record of sound macroeconomic policies is expected to continue, which should help with a break-through on the structural front. Armenia's repayment capacity is expected to remain strong with the continuing fiscal consolidation, broadly adequate reserves, growth-supporting reforms embedded in the program reinforcing this assessment. Strong implementation of the IMF-supported program is essential to mitigate economic, social, and political risks.

STAFF APPRAISAL

42. Macroeconomic policy performance has been sound but structural challenges remain. Improvements in macroeconomic conditions in recent years are encouraging and raise expectations of sustained progress. Fiscal consolidation has been on track, while monetary and financial policies have safeguarded financial stability and helped rebuild external buffers. Looking ahead, however, the country faces tough structural challenges in its ambitions to become a dynamic emerging market economy. Growth remains volatile and narrowly based, reflecting a slow transition toward a competitive private sector-led economy; the country continues to be vulnerable to external shocks, owing to limited export diversification and still-high dollarization; and poverty and unemployment remain relatively high, causing labor migration.

43. The new Fund-supported program aims to address some of these challenges, and would help pave the way for gradual exit from Fund financial assistance. The program will support the authorities' efforts to further strengthen policy frameworks, bolster policy buffers, and carry out fundamental reform to promote robust and sustainable growth and reduce vulnerabilities. At the same time, the precautionary nature of the program will provide insurance against external shocks, while helping Armenia shift away from IMF financial support over time.

44. The authorities' objective of growth-friendly fiscal consolidation requires bold and frontloaded efforts, especially in mobilizing revenues. Staff supports the authorities' prudent fiscal consolidation plan, guided by the fiscal rule, which aims to bring central government debt to below 50 percent of GDP in the medium term. In this context, strong efforts to enhance revenue mobilization is crucial to creating space to boost growth-enhancing infrastructure and social spending. Tax policy should aim to eliminate loopholes and ensuring greater equity, while tax administration efforts should focus on developing a compliance strategy and improving core tax administration functions. Staff commends the authorities' efforts, which already contributed to higher-than-projected revenue collection in 2018. Strengthening public financial management, furthermore, will help buttress fiscal discipline and protect essential expenditure, including foreign-financed capital spending. Underspending in areas of social and capital spending, in particular (as occurred in 2018), is highly undesirable for Armenia's development.

45. The authorities' tax reform plans must be accompanied by supporting measures. Although the income tax reform aims to enhance compliance and promote medium-term growth, it will lead to a short-term fall in revenues and worsen income distribution. In addition, the long-term positive effect can materialize only if supported by bold tax administration measures. Sustainable compensating measures are essential to fully offset the expected revenue shortfalls. At the same time, the authorities should consider targeted measures toward the poor to make the tax system more effectively progressive. In this context, efforts to overhaul property taxation and its fairness, including by completing the new valuation zoning and preparing a draft law to implement market price-based valuation, are commendable.

46. Monetary policy should continue to focus on anchoring inflation expectation, with the exchange rate acting as a key shock absorber. The CBA's IT framework has served well and remains an appropriate anchor for monetary policy. The effectiveness of the framework should be further strengthened by developing a well-functioning interbank market and enhancing the CBA's communication capabilities. Reserve buffers remain adequate and the current account is projected to converge to norm in the medium term. However, vulnerabilities remain, particularly given the sharp increase in external debt in recent years. Two-way exchange rate flexibility and limiting intervention to dealing with disorderly market conditions should help ensure adjustment to changes in fundamentals. Fiscal consolidation and maintaining robust buffers, together with flexibility of the dram, should support further reduction of the external current account deficit to sustainable levels.

47. Financial sector policies should enhance financial sector resilience to shocks and financial sector deepening. In its efforts, the CBA is drawing on the recommendations of the 2018 FSAP, including by strengthening banking supervisory framework. Further reform is needed to strengthen banks' FX liquidity buffers to cover liquidity risks and to encourage prudent FX intermediation. At the same time, it is important to foster better financial intermediation by developing capital markets and improving financial literacy. In this context, the authorities' commitment to preparing a plan to develop capital markets and reviewing the existing SME assistance scheme is welcome.

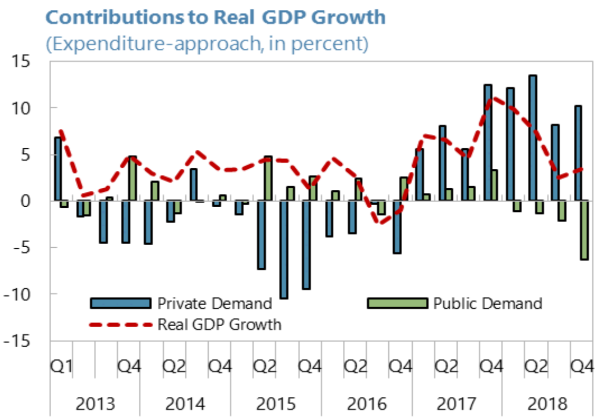
48. Structural reforms toward a dynamic market economy, based on good governance and fair competition, are central to promoting inclusive growth over the longer term. Business environment reforms should overcome long-standing concerns about uneven competition, weak governance, and extensive informality. The government's five-year program rightly identifies many of the shortcomings, providing a strategic roadmap for reforms. Determination and commitment are key to success in carrying out the planned reforms.

49. Staff supports the authorities' request for a 36-month Fund-supported program with access equivalent to SDR 180.0 million (139.75 percent of quota). The attached Letter of Intent and MEFP provides a strong set of policies to pursue the objectives of the program. Semi-annual reviews are expected to work well, as was the case under the previous Fund-supported program.

50. Staff recommends that the next Article IV Consultation be held on the 24-month cycle accordance with the September 28, 2010 Decision on Article IV Consultation Cycles, No. 14747-(10/96).

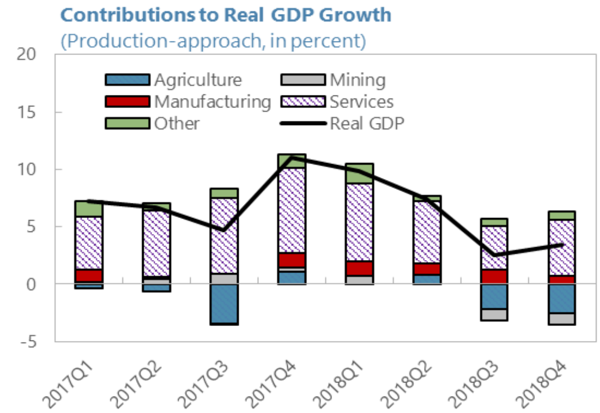
Figure 1. Armenia: Real Sector Developments

Growth in 2018 was mainly driven by the private demand



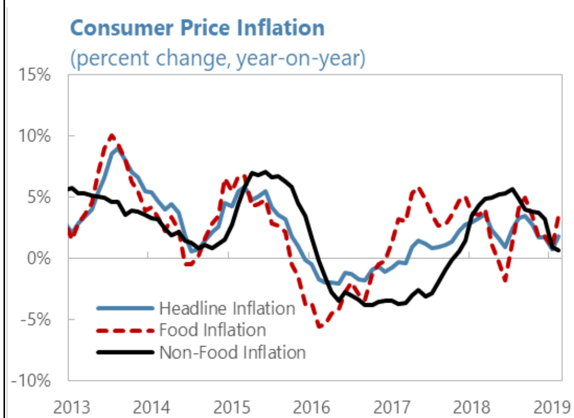
Sources: National authorities; and IMF databases.

Service and manufacturing sectors are expanding, while growth in mining and agricultures was negative in 2018



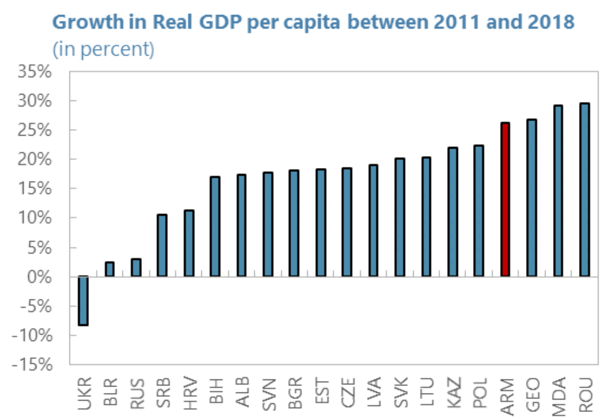
Sources: National authorities; and staff calculations.

Both food and non-food inflation are below expectations.



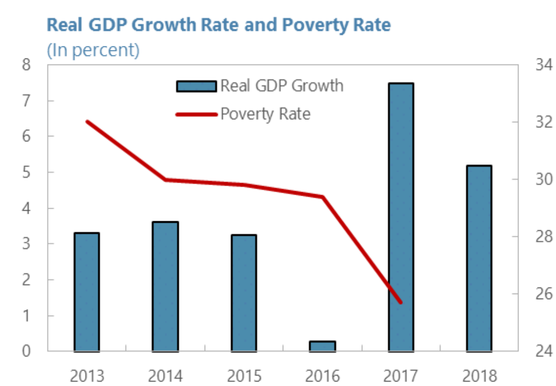
Sources: National authorities; and staff calculations.

Armenia's per capita income growth is high, compared with peers



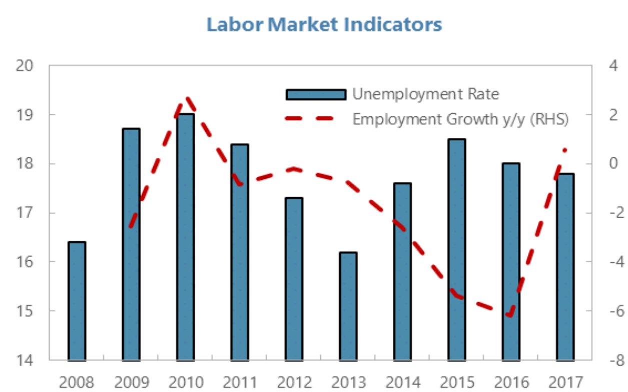
Source: IMF World Economic Outlook 2018

Robust GDP growth helped poverty rates fall significantly.



Sources: National authorities; and staff calculations.

Employment growth increased in recent years, although unemployment rate is still high.

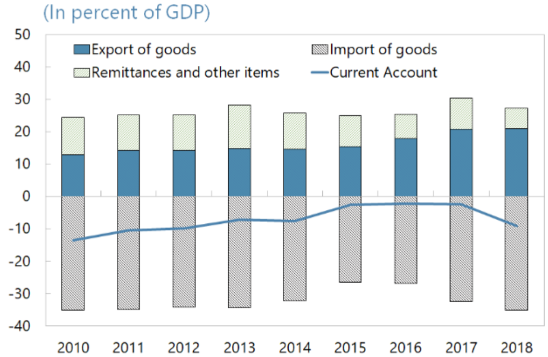


Sources: National authorities; and staff calculations.

Figure 2. Armenia: External Developments

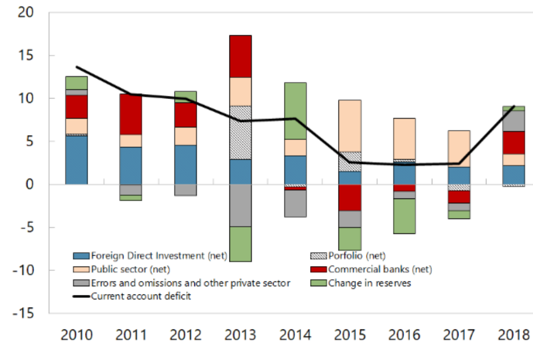
With the recovery of domestic demand and imports to pre-2014 levels, current account deficit widened to 8.2 percent in 2018.

Current Account
(In percent of GDP)



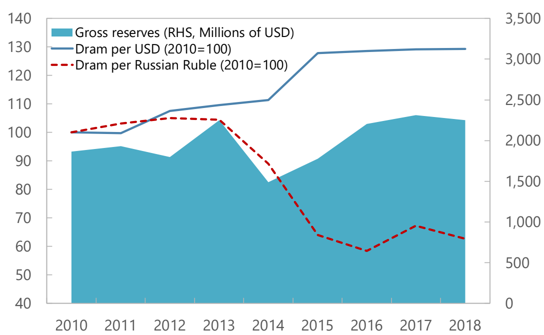
Current account in 2018 was financed mainly by private inflows, while loan disbursements to public sector were significantly lower as project execution slowed.

Financing of the Current Account Deficit
(In percent of GDP)



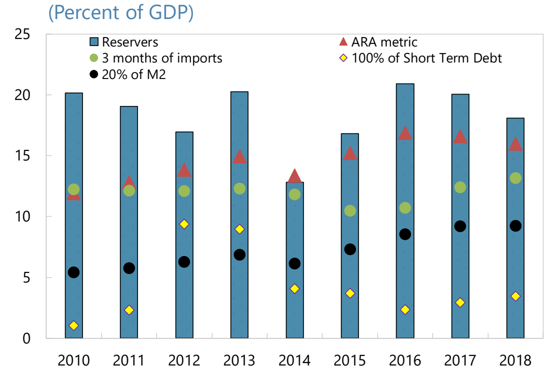
There has been limited exchange rate pressure since 2014, and reserves have recovered since

Exchange Rates and Gross International Reserves



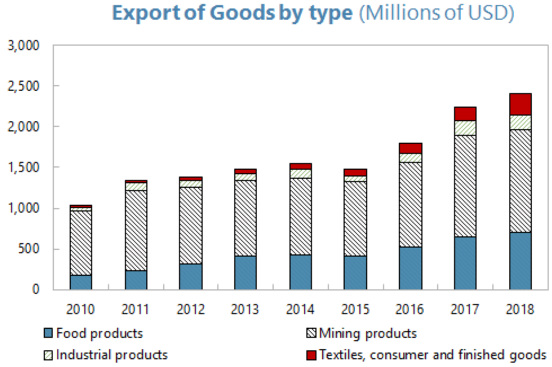
Reserve coverage has been adequate according to various metrics.

Reserve Adequacy Indicators
(Percent of GDP)



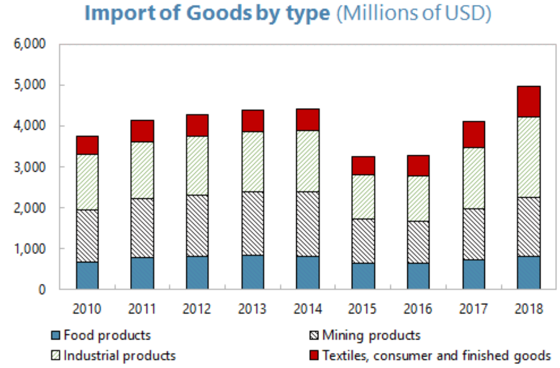
Exports have more than doubled since 2010 and are somewhat more diversified.

Export of Goods by type (Millions of USD)



The imports of capital goods and durables which had declined over 2015–16 has picked up again.

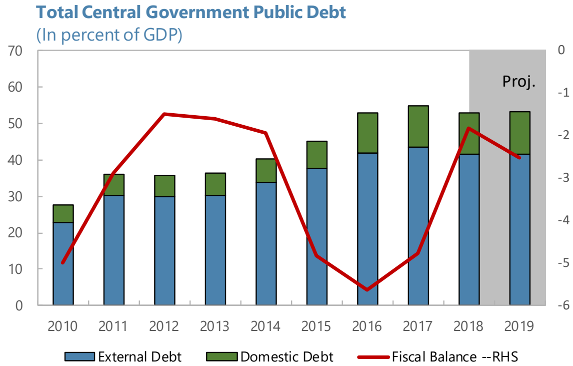
Import of Goods by type (Millions of USD)



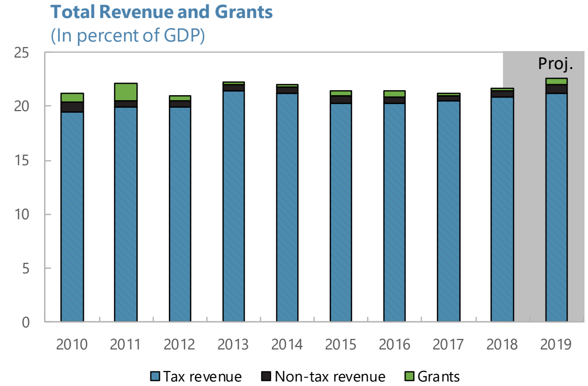
Sources: National authorities and IMF staff calculations.

Figure 3. Armenia: Fiscal Developments

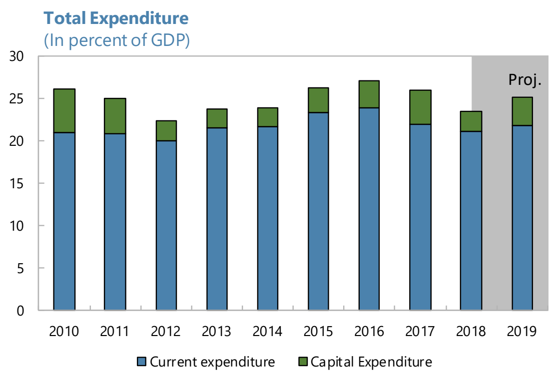
Following the 2014 external shock, central government public debt peaked at end-2017 before falling in 2018.



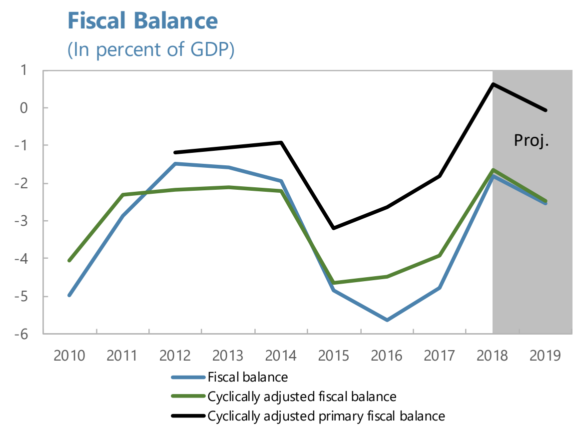
Revenues had been stable and started to increase following the 2016 tax code change.



Current expenditure had been contained recently, while capital expenditure under-executed during 2017–18.



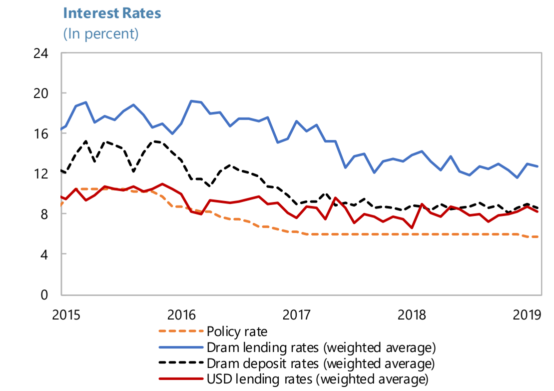
Cyclically adjusted deficit shrunk as a result of the recent consolidation.



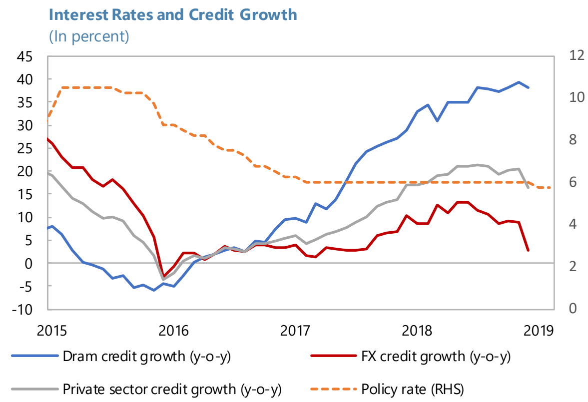
Sources: National authorities and IMF staff calculations.

Figure 4. Armenia: Monetary Developments

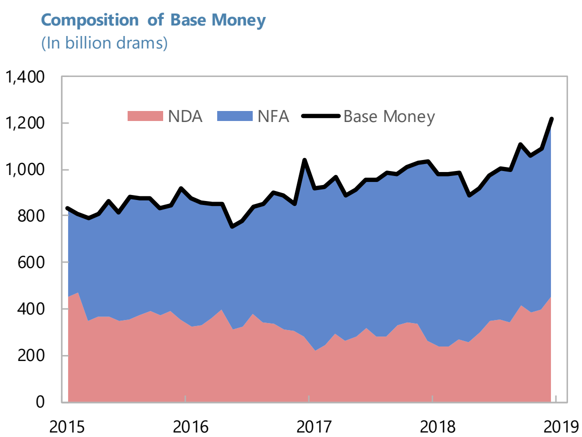
A fall in both deposit and lending rates has been moderating since the second half of 2018–19.



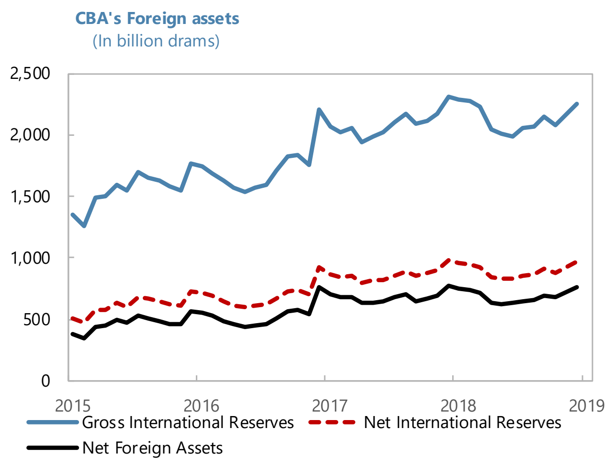
Credit growth, which had picked up, has been moderating since the second half of 2018.



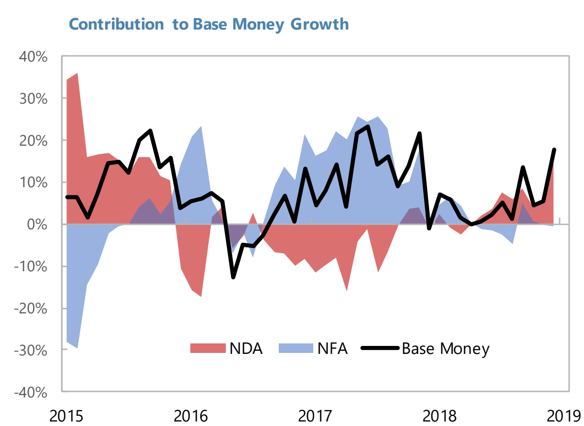
The money base has increased in 2018.



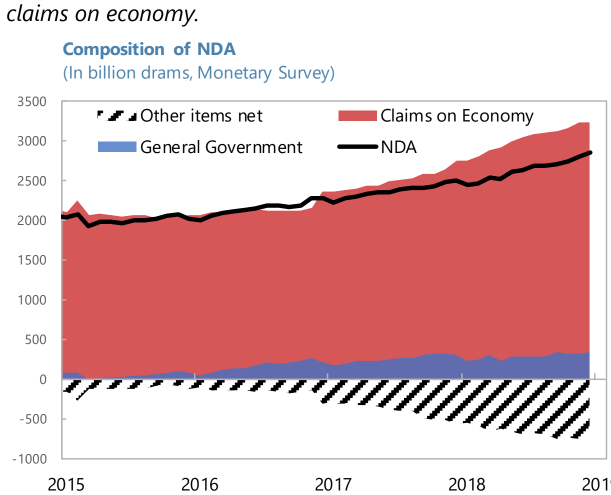
The CBA's foreign assets have been increasing after a temporary decline following the revolution.



The base money growth in 2018 was mainly due to the increase in NDA.



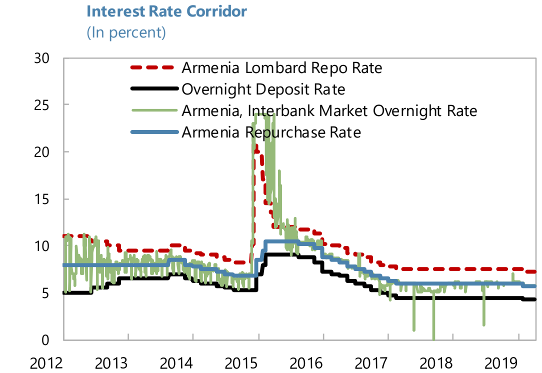
The main component in the rise of NDA was the growth in claims on economy.



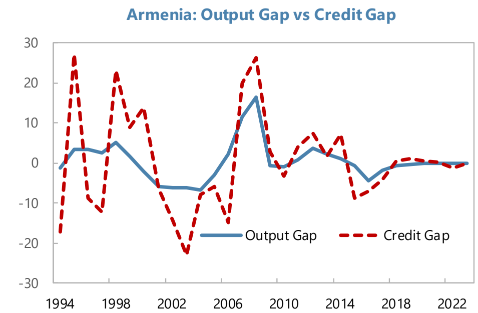
Sources: Central Bank of Armenia and IMF staff calculations.

Figure 5. Armenia: Financial Developments

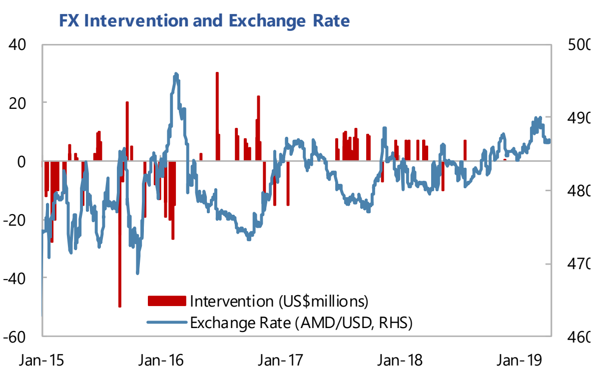
The CBA has lowered its policy rate by 25 basis points in January for the first time since January 2019.



The credit-to-GDP gap is estimated to be marginally negative.

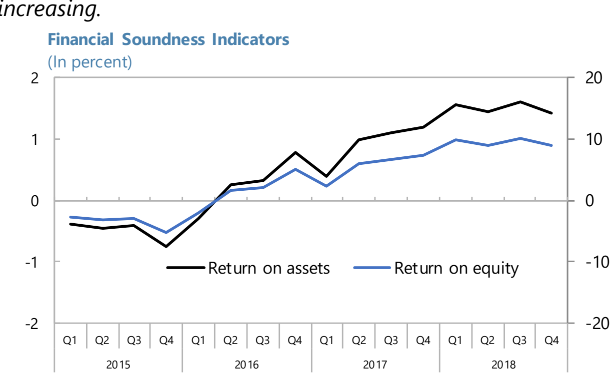


The exchange rate has been stable with CBA's limited intervention.



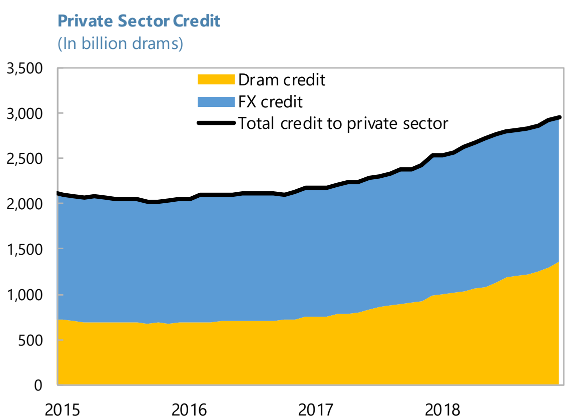
Sources: National authorities; and Bloomberg.

With stable monetary and financial conditions, profitability is increasing.

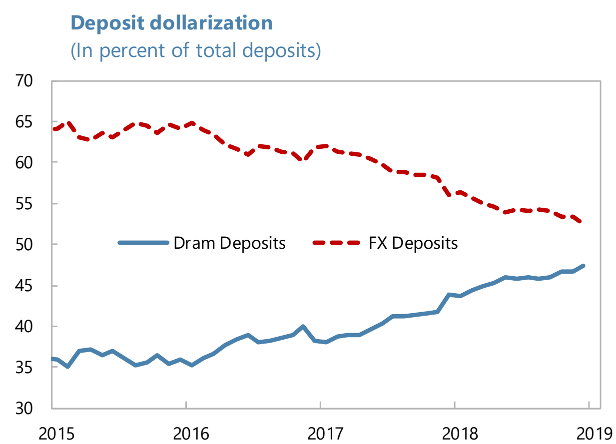


Source: Central Bank of Armenia

Given stable exchange rates, credit dollarization has fallen.



Deposit dollarization has declined as well.



Sources: Central Bank of Armenia and IMF staff calculations.

Table 1. Armenia: Inclusive Growth Indicators

	Indicator	EM Average
Growth		
GDP per capita growth (percent; 2015-17 average)	3.6	1.6
Gross Fixed Capital Formation (percent of GDP; 2015-17 average)	19.7	23.9
Poverty and Inequality		
Poverty headcount ratio at $3.20/day (percent of population; 2016)	14.1	14.4
Multidimensional poverty (percent of population)	0.6	8.6
Prevalence of stunting (% of children under 5, 2016)	9.4	15.8
GINI Index (2016)	32.5	38.9
Child mortality (per 1,000, 2016)	13.4	38.9
Growth in mean consumption (growth, %, bottom 40th percentile)	2.3	2.5
Human Development and Access to Services		
Human Development Index (2015)	0.7	0.7
Life expectancy at birth (years, 2016)	74.6	73.2
Access to electricity (% of population, 2016)	100.0	95.0
Net school enrollment, secondary, total (% population, 2009)	92.3	74.9
Individuals using internet (% population, 2016)	67.0	54.3
Literacy rate (% population, 2011)	99.7	90.9
Government		
Commitment to reducing inequality index (2017)	0.43	0.37
Government spending on social safety net programs (percent of GDP, 2018)	1.4	1.8
Coverage of social safety net programs in poorest quintile (% population, 2014)	n.a.	56.3
Government expenditure on education, total (% GDP, 2016)	2.8	4.7
Health expenditure, domestic general government (% of GDP, 2015)	1.6	3.5
Access to Finance		
Account at a financial institution (% age 15+, 2017)	45.3	55.8
Domestic credit to private sector (% GDP, 2017)	48.8	48.8
Loans to SMEs (% of GDP,)	n.a.	10.5
Financial Inclusion Index (IMF, 2017)	n.a.	0.4

	Indicator	EM Average
Labor Markets (ILO estimates)		
Unemployment rate (% of total labor force, 2017)	18.2	8.7
Female unemployment rate (% of female labor force, 2017)	18.5	11.4
Youth unemployment rate (% of total labor force ages 15-24, 2017)	38.6	20.4
Labor force participation (% of total population ages 15+, 2017)	60.1	59.7
Female labor force participation (% of female population ages 15+, 2017)	51.4	45.0
Youth labor force participation (% of population ages 15-24, 2017)	40.2	39.2
Business Environment[1]		
Ease of Doing Business (DTF, 2018)	72.5	60.8
Registering property (DTF, 2018)	87.8	59.3
Enforcing Contracts (DTF, 2018)	66.0	55.3
Paying Taxes (DTF, 2018)	72.5	67.0
Getting electricity (DTF, 2018)	78.5	68.7
Trading across borders (DTF, 2018)	72.5	69.2
Global Competitiveness Index (2018)	4.2	4.1
Governance[1]		
Global Competitiveness Index - Institutions Index (2017)	4.1	3.7
Government Effectiveness (WGI, 2016)	-0.1	-0.1
Regulatory Quality (WGI, 2016)	0.2	-0.1
Rule of Law (WGI, 2016)	-0.1	-0.2
Control of Corruption (WGI, 2016)	-0.6	-0.2
Corruption Perceptions Index (2017)	35.0	40.4
Gender Equity and Inclusion		
Account at a financial institution (female vs male, %, 2014)	69.4	85.1
Female employment to population ratio (%, 2017)	41.9	40.5
Literacy rate (female vs male, %, 2011)	99.9	94.7
Net school enrollment, secondary (female vs male, %, 2015)	105.2	102.6
Gender Gap Index (2017)	0.7	0.7

Better than EM Average (green) **Worse than EM Average** (pink)

Sources: IMF World Economic Outlook, World Bank, World Economic Forum, International Labour Organization, Transparency International, UNDP, Oxfam International.

1 / Indicators use official sources and surveys to summarize perceptions of the quality of governance and business environments, but note that uncertainties around Armenia's point for governance indicators.

Table 2. Armenia: Selected Economic and Financial Indicators, 2016–23

	2016 Act.	2017 Act.	2018 Act.	2019	2020	2021 Proj.	2022	2023
National income and prices:								
Real GDP (percent change)	0.2	7.5	5.2	4.6	4.5	4.5	4.5	4.5
Final consumption expenditure, Contrib. to Growth	-0.9	7.4	2.7	3.3	3.4	2.7	3.5	2.1
Gross fixed capital formation, Contrib. to Growth	-2.4	1.5	0.8	6.8	4.6	5.0	4.2	3.1
Changes in inventories, Contrib. to Growth	0.7	1.1	4.0	-4.6	0.0	0.0	0.0	0.0
Net exports of goods and services, Contrib. to Growth	3.1	-1.2	-1.8	-1.2	-3.4	-3.1	-3.2	-0.6
Gross domestic product (in billions of drams)	5,067	5,569	6,003	6,549	7,102	7,745	8,437	9,169
Gross domestic product (in millions of U.S. dollars)	10,546	11,537	12,428	13,459	14,147	15,051	15,995	16,959
Gross domestic product per capita (in U.S. dollars)	3,524	3,872	4,186	4,533	4,764	5,068	5,386	5,710
CPI (period average; percent change)	-1.4	1.0	2.5	2.1	3.0	3.7	4.0	4.1
CPI (end of period; percent change)	-1.1	2.6	1.8	2.5	3.3	3.8	4.1	4.3
GDP deflator (percent change)	0.3	2.2	2.5	4.3	3.8	4.4	4.2	4.0
Unemployment rate (in percent)	20.2	18.6	18.1	17.9	17.7	17.8	17.7	17.6
Investment and saving (in percent of GDP)								
Investment	18.0	19.0	22.4	23.6	24.1	24.4	24.9	25.6
National savings	15.8	16.6	13.3	16.3	16.8	17.5	18.4	19.4
Money and credit (end of period)								
Reserve money (percent change)	13.1	-1.0	17.8	9.0	9.5	8.5	8.5	8.5
Broad money (percent change)	17.5	18.5	7.4	7.0	9.5	8.5	8.5	8.5
Private sector credit growth (percent change)	6.0	16.5	17.2	16.0	15.5	13.0	12.5	11.0
Central government operations (in percent of GDP)								
Revenue and grants	21.4	21.2	21.7	22.6	22.8	22.8	22.9	23.2
Of which : tax revenue	20.1	20.2	20.6	21.0	21.3	21.5	21.7	21.9
Expenditure	27.0	26.0	23.5	25.2	24.9	24.7	24.7	25.0
Overall balance on a cash basis	-5.6	-4.8	-1.8	-2.5	-2.1	-1.9	-1.8	-1.8
Public and publicly-guaranteed (PPG) debt (in percent of GDP)	56.7	58.9	55.8	54.6	53.7	52.3	51.1	50.1
Central Government's PPG debt (in percent)	52.0	53.7	51.4	51.0	50.8	50.2	49.5	49.0
Share of foreign currency debt (in percent)	80.9	81.1	77.5	77.6	76.5	75.4	73.9	74.3
External sector								
Exports of goods and services (in millions of U.S. dollars)	3,500	4,307	4,669	5,074	5,361	5,744	6,137	6,625
Imports of goods and services (in millions of U.S. dollars)	-4,516	-5,710	-6,583	-7,132	-7,467	-7,892	-8,371	-8,875
Exports of goods and services (percent change)	11.6	23.0	8.4	8.7	5.7	7.2	6.8	7.9
Imports of goods and services (percent change)	2.2	26.4	15.3	8.3	4.7	5.7	6.1	6.0
Current account balance (in percent of GDP)	-2.3	-2.4	-9.1	-7.3	-7.3	-6.9	-6.5	-6.2
FDI (net, in millions of U.S. dollars)	272	228	266	296	318	346	376	407
Gross international reserves (in millions of U.S. dollars)	2,204	2,314	2,249	2,283	2,372	2,416	2,467	2,632
Import cover 1/	4.6	4.2	3.8	3.7	3.8	3.5	3.3	3.4
End-of-period exchange rate (dram per U.S. dollar)	484	484	484	…	…	…	…	…
Average exchange rate (dram per U.S. dollar)	480	483	483	…	…	…	…	…

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

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

Table 3. Armenia: Balance of Payments, 2016–23

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

	2016 Act.	2017 Act.	2018 Prel.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.
Current account	-238	-280	-1,131	-977	-1,027	-1,038	-1,044	-1,047
Trade balance	-944	-1,375	-1,766	-1,898	-1,937	-1,969	-2,044	-2,049
Exports, fob	1,891	2,385	2,606	2,840	3,013	3,246	3,482	3,810
Imports, fob	-2,835	-3,761	-4,372	-4,738	-4,950	-5,215	-5,526	-5,859
Services (net)	-71	-28	-148	-160	-168	-179	-190	-202
Credits	1,610	1,922	2,063	2,234	2,348	2,498	2,655	2,815
Debits	-1,681	-1,949	-2,211	-2,394	-2,516	-2,677	-2,845	-3,016
Income (net)	224	463	162	372	384	389	430	429
Transfers (net)	553	660	621	710	694	721	760	775
Private	392	445	462	528	508	558	556	590
Official	161	215	159	182	186	164	204	185
Capital and financial account	466	586	757	1,073	1,193	1,153	1,137	1,243
Capital transfers (net)	35	46	68	67	70	70	70	70
Foreign direct investment (net)	272	228	266	296	318	346	376	407
Portfolio investment (net)	34	-87	-31	42	54	12	13	14
Public sector borrowing (net)	499	493	168	398	-174	247	380	338
Disbursements	571	585	320	556	525	476	625	595
Amortization	-72	-92	-152	-158	-699	-229	-245	-257
CBA	0	0	0	0	0	0	0	0
Other capital (net)	-373	-93	286	269	925	478	299	415
Errors and omissions	193	-170	341	0	0	0	0	0
Overall balance	421	137	-33	96	166	116	94	196
Financing	-421	-137	33	-96	-166	-116	-94	-196
Gross international reserves (increase: -)	-429	-110	65	-34	-89	-44	-51	-165
Use of Fund credit, net	8	-27	-32	-63	-77	-72	-43	-31
Financing gap	0	0	0	0	0	0	0	0
Identified financing								
IMF	0	0	0	0	0	0	0	0
Memorandum items:								
Current account (in percent of GDP)	-2.3	-2.4	-9.1	-7.3	-7.3	-6.9	-6.5	-6.2
Trade balance (in percent of GDP)	-9.0	-11.9	-14.2	-14.1	-13.7	-13.1	-12.8	-12.1
Gross international reserves (end of period)	2,204	2,314	2,249	2,283	2,372	2,416	2,467	2,632
In months of next year's imports	4.6	4.2	3.8	3.7	3.8	3.5	3.3	3.4
Merchandise export growth, percent change	16.4	26.2	9.3	9.0	6.1	7.7	7.3	9.4
Merchandise import growth, percent change	0.9	32.6	16.3	8.4	4.5	5.4	6.0	6.0
Nominal external debt	9,725	10,228	10,512	11,152	11,827	12,482	13,118	13,840
o.w. public external debt	4,806	5,495	5,533	5,863	5,613	5,790	6,127	6,435
Nominal external debt stock (in percent of GDP)	92.2	88.7	84.6	82.9	83.6	82.9	82.0	81.6
External public debt-to-exports ratio (in percent)	137.3	127.6	118.5	115.6	104.7	100.8	99.8	97.1
External public debt service (in percent of exports)	6.6	6.7	7.9	8.1	17.8	7.8	6.9	6.3

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

Table 4a. Armenia: Central Government Operations, 2016–23

(In billions of Armenian drams)

	2016 Act.	2017 Act.	2018 Act.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.
Total revenue and grants	1,085.2	1,181.9	1,300.0	1,482.2	1,616.0	1,764.4	1,934.6	2,126.9
Total revenue	1,056.9	1,168.6	1,290.0	1,442.7	1,595.7	1,751.8	1,921.6	2,114.2
Tax revenues	1,016.2	1,123.9	1,238.2	1,373.4	1,512.3	1,665.9	1,827.4	2,011.8
VAT	342.4	392.1	438.2	461.0	521.3	568.5	619.3	696.9
Profits, simplified and presumptive	130.4	113.6	170.4	170.3	184.7	201.4	219.4	238.4
Personal income tax	327.5	341.3	356.6	401.8	447.4	487.9	531.5	577.6
Customs duties	55.4	72.6	80.2	89.8	82.4	88.5	96.3	74.6
Other	160.5	204.4	192.8	250.4	276.4	319.7	360.9	424.3
Social contributions	13.4	15.8	17.4	14.2	30.8	33.6	36.6	39.8
Other revenue	27.3	28.9	34.5	55.1	52.6	52.2	57.6	62.6
Grants	28.3	13.3	10.0	39.5	20.3	12.6	13.1	12.7
Total expenditure	1,370.6	1,448.3	1,409.7	1,648.1	1,765.9	1,911.9	2,084.2	2,291.9
Expenses	1,209.4	1,225.7	1,273.3	1,428.0	1,491.4	1,593.7	1,700.6	1,818.6
Wages	305.7	299.1	306.8	340.4	353.6	374.8	397.3	421.1
Social Contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments to individual pension accts.	25.6	13.0	29.0	56.8	61.7	64.7	69.7	74.7
Subsidies 1/	13.3	1.5	24.3	23.4	25.4	27.7	30.2	32.8
Interest	98.3	119.8	139.0	158.1	157.9	193.0	201.4	200.7
Social allowances and pensions	378.5	397.9	419.3	454.2	492.2	527.8	571.8	624.1
Pensions/social security benefits	249.4	267.3	294.7	310.4	340.9	367.8	402.7	445.9
Social assistance benefits	129.0	130.6	124.6	143.8	151.3	160.0	169.1	178.2
Employer social benefits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Goods and services 2/	122.4	104.4	123.8	107.0	116.0	129.7	144.8	161.3
Grants	102.4	109.1	111.5	97.7	106.0	118.5	132.3	147.4
Other expenditure 3/	163.3	180.8	119.6	190.3	178.6	157.4	154.8	159.7
Transactions in nonfinancial assets	161.2	222.6	136.4	220.1	274.6	318.2	383.7	473.4
Acquisition of nonfinancial assets	166.0	223.5	140.3	220.1	274.6	318.2	383.7	473.4
Disposals of nonfinancial assets	4.8	1.0	3.9	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-285.4	-266.3	-109.7	-165.9	-150.0	-147.5	-149.6	-165.1
Statistical discrepancy	-55.7	-7.7	32.4	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-341.1	-274.0	-77.4	-165.9	-150.0	-147.5	-149.6	-165.1
Financing	341.1	274.0	77.4	165.9	150.0	147.5	149.6	165.1
Domestic financing	102.5	86.5	42.2	31.1	298.2	79.7	5.9	42.0
Banking system	145.2	80.4	42.8	62.8	355.6	78.2	7.3	51.9
CBA	-42.1	18.0	-28.0	24.4	-13.1	-20.4	0.0	0.0
Commercial Banks	187.2	62.4	70.8	38.4	368.7	98.6	7.3	51.9
Nonbanks	-42.7	6.1	-0.6	-31.8	-57.4	1.5	-1.4	-9.9
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills/other	-14.8	-7.5	-13.5	-7.3	-70.4	-18.8	-1.4	-9.9
Promissory note/other	0.0	-94.1	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-27.9	107.7	12.9	-24.4	13.1	20.4	0.0	0.0
External financing	190.6	187.5	35.2	134.8	-148.3	67.7	143.6	123.1
Amortization due	-33.7	-47.8	-68.5	-78.8	-351.0	-110.5	-116.1	-122.8
Net lending	-50.0	-46.8	-50.8	-57.1	-60.9	-66.7	-69.7	-75.8
Other financing 4/	48.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Nominal GDP (in billion of drams)	5,067.3	5,568.9	6,002.7	6,548.7	7,102.2	7,745.0	8,436.9	9,168.6
Program balance 5/	-410.0	-202.5	-156.9	-196.4	-197.8	-193.8	-219.3	-240.8
Primary balance 6/	-265.0	-85.7	-8.5	-89.3	-39.9	-0.8	-17.9	-40.2

Sources: Ministry of Finance, Central Bank of Armenia, and Fund staff estimates and projections.
1/ In 2016, an additional subsidy of AMD 2 billion is assumed to cover the electricity tariff differential for households and SMEs.
2/ 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."
3/ Includes acquisition of military equipment.
4/ EFSD financing ($100 million in 2015-17).
5/ The program balance is measured as below-the-line overall balance minus net lending.
6/ Sum of overall balance (above the line), interest expense, and domestic and external net lending.

Table 4b. Armenia: Central Government Operations, 2016–23

(In percent of GDP, unless otherwise specified)

	2016 Act.	2017 Act.	2018 Act.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.
Total revenue and grants	21.4	21.2	21.7	22.6	22.8	22.8	22.9	23.2
Total revenue	20.9	21.0	21.5	22.0	22.5	22.6	22.8	23.1
Tax revenues	20.1	20.2	20.6	21.0	21.3	21.5	21.7	21.9
VAT	6.8	7.0	7.3	7.0	7.3	7.3	7.3	7.6
Profits, simplified and presumptive	2.6	2.0	2.8	2.6	2.6	2.6	2.6	2.6
Personal income tax	6.5	6.1	5.9	6.1	6.3	6.3	6.3	6.3
Customs duties	1.1	1.3	1.3	1.4	1.2	1.1	1.1	0.8
Other	3.2	3.7	3.2	3.8	3.9	4.1	4.3	4.6
Social contributions	0.3	0.3	0.3	0.2	0.4	0.4	0.4	0.4
Other revenue	0.5	0.5	0.6	0.8	0.7	0.7	0.7	0.7
Grants	0.6	0.2	0.2	0.6	0.3	0.2	0.2	0.1
Total expenditure	27.0	26.0	23.5	25.2	24.9	24.7	24.7	25.0
Expense	23.9	22.0	21.2	21.8	21.0	20.6	20.2	19.8
Wages	6.0	5.4	5.1	5.2	5.0	4.8	4.7	4.6
Social Contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments to individual pension accts.	0.5	0.2	0.5	0.9	0.9	0.8	0.8	0.8
Subsidies 1/	0.3	0.0	0.4	0.4	0.4	0.4	0.4	0.4
Interest	1.9	2.2	2.3	2.4	2.2	2.5	2.4	2.2
Social allowances and pensions	7.5	7.1	7.0	6.9	6.9	6.8	6.8	6.8
Pensions/social security benefits	4.9	4.8	4.9	4.7	4.8	4.7	4.8	4.9
Social assistance benefits	2.5	2.3	2.1	2.2	2.1	2.1	2.0	1.9
Employer social benefits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Goods and services 2/	2.4	1.9	2.1	1.6	1.6	1.7	1.7	1.8
Grants	2.0	2.0	1.9	1.5	1.5	1.5	1.6	1.6
Other expenditure 3/	3.2	3.2	2.0	2.9	2.5	2.0	1.8	1.7
Transactions in nonfinancial assets	3.2	4.0	2.3	3.4	3.9	4.1	4.5	5.2
Acquisition of nonfinancial assets	3.3	4.0	2.3	3.4	3.9	4.1	4.5	5.2
Disposals of nonfinancial assets	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-5.6	-4.8	-1.8	-2.5	-2.1	-1.9	-1.8	-1.8
Statistical discrepancy	-1.1	-0.1	0.5	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-6.7	-4.9	-1.3	-2.5	-2.1	-1.9	-1.8	-1.8
Financing	5.9	4.9	1.3	2.5	2.1	1.9	1.8	1.8
Domestic financing	2.0	1.6	0.7	0.5	4.2	1.0	0.1	0.5
Banking system	2.9	1.4	0.7	1.0	5.0	1.0	0.1	0.6
CBA	-0.8	0.3	-0.5	0.4	-0.2	-0.3	0.0	0.0
Commercial Banks	3.7	1.1	1.2	0.6	5.2	1.3	0.1	0.6
Nonbanks	-0.8	0.1	0.0	-0.5	-0.8	0.0	0.0	-0.1
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills/other	-0.3	-0.1	-0.2	-0.1	-1.0	-0.2	0.0	-0.1
Promissory note/other	0.0	-1.7	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-0.6	1.9	0.2	-0.4	0.2	0.3	0.0	0.0
External financing	3.8	3.4	0.6	2.1	-2.1	0.9	1.7	1.3
Amortization due	-0.7	-0.9	-1.1	-1.2	-4.9	-1.4	-1.4	-1.3
Net lending	-1.0	-0.8	-0.8	-0.9	-0.9	-0.9	-0.8	-0.8
Other financing 4/	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Nominal GDP (in billion of drams)	5,067	5,569	6,003	6,549	7,102	7,745	8,437	9,169
Program balance 5/	-8.1	-3.6	-2.6	-3.0	-2.8	-2.5	-2.6	-2.6
Primary balance 6/	-5.2	-1.5	-0.1	-1.4	-0.6	0.0	-0.2	-0.4

Sources: Ministry of Finance, Central Bank of Armenia, and Fund staff estimates and projections.
1/ In 2016, an additional subsidy of AMD 2 billion is assumed to cover the electricity tariff differential for households and SMEs.
2/ 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."
3/ Includes acquisition of military equipment.
4/ EFSD financing ($100 million in 2015-17).
5/ The program balance is measured as below-the-line overall balance minus net lending.
6/ Sum of overall balance (above the line), interest expense, and domestic and external net lending.

Table 5. Armenia: Monetary Accounts, 2016–20

(In billions of drams, unless otherwise indicated)

	2016	2017	2018				2019				2020
			Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	
	Act.	Act.	Act.				Est.	Proj.			Proj.
Central Bank of Armenia											
Net foreign assets	764.3	766.6	716.0	625.0	697.1	761.9	722.1	755.1	758.6	762.1	786.3
Net international reserves	928.1	977.0	928.1	828.5	906.0	967.5	927.8	960.7	964.2	967.7	991.9
Other	-163.8	-210.4	-212.1	-203.6	-208.9	-205.6	-205.6	-205.6	-205.6	-205.6	-205.6
Net domestic assets	278.0	265.4	270.6	350.9	413.9	453.7	341.5	320.3	452.4	562.9	679.2
Claims on general government (net)	-162.3	-144.3	-166.0	-177.8	-161.6	-172.3	-172.6	-174.0	-176.3	-179.7	-234.1
Of which: central government (net)	-142.0	-121.0	-132.1	-119.1	-119.9	-137.8	-138.2	-139.5	-141.9	-145.2	-199.7
Claims on banks	153.3	107.6	126.4	184.0	266.0	299.1	299.1	299.1	299.1	299.1	299.1
CBA bills 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.0
Other items (net)	287.0	302.1	310.2	344.7	309.5	326.9	215.1	195.2	329.7	443.5	610.3
Reserve money	1,042.3	1,032.0	975.8	986.6	1,111.0	1,215.6	1,063.7	1,075.4	1,211.0	1,325.0	1,450.9
Currency issue	455.4	516.1	463.1	506.0	524.5	566.7	415.7	424.9	538.3	618.6	676.5
Deposits	586.9	515.9	523.5	469.8	586.5	648.9	648.0	650.5	672.7	706.4	789.0
Deposits in drams	326.7	329.2	375.9	374.9	396.6	392.7	394.6	388.5	401.9	426.8	462.5
Deposits in foreign currency	260.2	186.8	147.6	94.9	189.9	256.2	253.4	262.0	270.8	279.6	326.5
Banking system											
Net foreign assets	-91.7	64.2	35.2	-69.4	-80.1	-82.6	-130.3	-105.4	-109.9	-114.4	-132.2
Net domestic assets	2,271.8	2,502.3	2,529.1	2,632.8	2,715.5	2,857.7	2,887.5	2,872.7	2,970.8	3,141.9	3,426.7
Claims on government (net)	224.6	302.0	293.4	261.2	330.6	333.6	340.8	348.0	355.1	362.3	359.9
Of which: claims on central government (net)	244.9	325.3	327.4	320.0	372.3	368.1	375.2	382.4	389.6	396.7	394.3
Claims on rest of the economy	2,368.3	2,758.5	2,884.6	3,047.8	3,117.9	3,232.0	3,346.2	3,535.5	3,616.8	3,749.1	4,330.2
Other items (net)	-321.1	-558.3	-648.9	-676.3	-733.0	-707.9	-799.4	-1,010.7	-1,001.1	-969.5	-1,263.5
Broad money	2,180.1	2,566.5	2,564.4	2,563.4	2,635.5	2,775.1	2,757.2	2,767.3	2,860.9	3,027.5	3,294.5
Currency in circulation	390.9	425.8	403.2	444.9	458.3	477.0	447.6	493.9	508.8	529.5	587.9
Deposits	1,789.2	2,140.7	2,161.2	2,118.5	2,177.2	2,298.1	2,309.5	2,273.4	2,352.1	2,498.0	2,706.6
Domestic currency	682.8	940.6	972.3	968.5	1,000.2	1,089.8	1,089.5	1,085.2	1,121.2	1,222.3	1,371.0
Foreign currency	1,106.4	1,200.1	1,188.8	1,150.0	1,177.0	1,208.3	1,220.1	1,188.2	1,230.9	1,275.7	1,335.6
Memorandum items:											
Exchange rate (drams per U.S. dollar, end of period)	483.9	484.1	480.1	480.0	479.9	483.8	486.8	489.8	492.8	495.8	508.2
NDA of the CBA (in billions of drams)											
12-month change in reserve money (in percent)	13.1	-1.0	0.6	3.1	13.5	17.8	9.0	9.0	9.0	9.0	9.5
12-month change in broad money (in percent)	16.6	17.7	15.4	13.6	10.8	8.1	7.5	8.0	8.6	9.1	8.8
12-month change in dram broad money (in percent)	20.1	27.3	25.7	29.1	27.8	14.7	11.7	11.7	11.8	11.8	20.2
12-month change in private sector credit (in percent)	6.0	16.5	20.0	22.4	20.6	17.2	16.0	16.0	16.0	16.0	15.5
Velocity of broad money (end of period)	2.3	2.2	2.2	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.2
Money multiplier	2.1	2.5	2.6	2.6	2.4	2.3	2.6	2.6	2.4	2.3	2.3
Dollarization in bank deposits 2/	61.8	56.1	55.0	54.3	54.1	52.6	52.8	52.3	52.3	51.1	49.3
Dollarization in broad money 3/	50.7	46.8	46.4	44.9	44.7	43.5	44.3	42.9	43.0	42.1	40.5
Currency in circulation in percent of deposits	21.8	19.9	18.7	21.0	21.1	20.8	19.4	21.7	21.6	21.2	21.7

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).

Table 6. Armenia: Financial Soundness Indicators for the Banking Sector, 2015–19

(In percent, unless otherwise indicated)

	2015	2016	2017				2018				2019
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Feb.
Capital adequacy											
Total regulatory capital to risk-weighted assets	16.2	20.0	20.0	19.5	19.1	18.6	18.7	18.2	17.9	17.7	17.6
Capital (net worth) to assets	14.7	16.2	16.3	16.1	16.1	15.7	16.0	16.0	15.5	15.0	15.0
Asset composition											
Sectoral distribution of loans (in billions of drams)											
Industry (excluding energy sector)	225.9	227.1	229.6	230.8	244.9	256.3	270.3	322.3	335.3	327.9	348.0
Energy sector	111.2	162.2	194.7	210.9	203.0	191.4	207.2	212.9	193.4	182.2	184.6
Agriculture	148.9	140.1	143.9	152.4	144.3	144.2	152.9	157.7	158.7	143.3	142.8
Construction	106.6	102.8	108.3	118.7	125.5	143.8	149.9	144.1	165.3	161.2	169.4
Transport and communication	77.1	79.7	68.9	70.0	75.8	73.8	76.4	78.3	75.1	106.4	107.3
Trade/commerce	345.5	335.8	343.9	355.6	390.4	419.6	419.9	432.3	426.1	441.1	438.1
Consumer credits	423.1	434.2	451.2	466.6	472.6	511.4	548.6	585.7	629.1	701.1	726.3
Mortgage loans	179.0	183.7	182.4	186.2	191.3	209.0	210.5	219.9	231.1	255.2	264.1
Sectoral distribution of loans to total loans (percent of total)											
Industry (excluding energy sector)	10.5	10.6	10.4	10.0	10.1	8.8	10.2	11.5	11.9	11.1	11.5
Energy sector	5.2	6.5	6.5	9.1	8.4	7.4	7.9	7.6	6.8	6.3	6.1
Agriculture	6.9	8.7	8.9	6.6	6.0	5.6	5.8	5.6	5.6	4.8	4.7
Construction	4.9	4.8	4.9	5.1	5.2	5.6	5.7	5.2	5.8	5.6	5.6
Transport and communication	3.6	3.7	3.1	3.0	3.1	2.9	2.9	2.8	2.7	3.6	3.6
Trade/commerce	16.0	15.7	15.6	15.4	16.1	16.3	15.9	15.7	15.1	14.7	14.5
Consumer credits	19.6	20.3	20.5	20.2	19.5	19.9	20.8	21.0	22.2	24.1	24.0
Mortgage loans	8.3	8.6	8.3	8.0	7.9	8.1	8.0	7.9	8.2	8.7	8.7
Other sectors	25.0	29.7	30.0	30.7	31.6	33.5	30.9	30.6	29.9	29.8	29.9
Foreign exchange loans to total loans	66.7	64.6	64.1	64.4	64.6	63.5	63.3	62.1	59.9	57.1	57.1
Asset quality											
Nonperforming loans (in billions of drams)	166.0	162.2	166.0	155.6	184.7	146.7	146.7	181.8	203.6	146.4	163.2
Watch (up to 90 days past due)	75.0	50.8	53.4	46.4	52.7	40.7	44.1	72.7	69.0	48.0	66.1
Substandard (91-180 days past due)	48.0	45.0	42.4	43.7	53.8	58.3	46.7	48.4	53.8	40.9	44.4
Doubtful (181-270 days past due)	43.0	66.4	70.1	65.6	78.3	47.7	56.0	60.7	80.7	57.5	52.7
Loss (>270 days past due, in billions of drams)	288.4	354.3	372.4	390.8	404.1	442.5	448.2	453.0	461.2	495.8	507.7
Nonperforming loans to gross loans	7.8	6.7	6.8	6.3	7.3	5.5	5.4	6.3	6.9	4.8	5.2
Provisions to nonperforming loans	42.9	52.0	52.5	54.6	51.3	51.5	53.9	47.6	48.8	56.6	51.3
Spread between highest and lowest rates of interbank borrowing in AMD	1.8	0.8	0.3	0.5	0.3	0.8	0.0	0.3	0.1	1.5	0.8
Spread between highest and lowest rates of interbank borrowing in FX	5.0	0.0	0.0	0.0	0.5	0.3	0.5	5.0	4.3	3.8	1.8
Earnings and profitability											
ROA (profits to period average assets)	-0.5	1.1	1.1	1.3	1.2	1.2	1.4	1.5	1.5	1.2	1.4
ROE (profits to period average equity)	-3.5	7.0	6.4	7.9	7.6	7.7	8.7	9.6	9.5	7.6	9.6
Interest margin to gross income	28.9	29.2	29.9	30.2	30.7	30.6	32.0	32.1	32.1	32.1	32.0
Interest income to gross income	76.5	76.7	78.9	78.9	78.5	77.2	76.9	76.0	75.6	75.1	75.5
Noninterest expenses to gross income	29.4	29.1	26.7	28.1	28.7	29.9	41.0	35.4	32.9	33.4	30.3
Liquidity											
Liquid assets to total assets	28.0	32.5	32.0	32.2	32.2	32.1	30.8	27.0	28.1	27.3	26.7
Liquid assets to total short-term liabilities	142.4	170.8	164.6	157.1	144.5	141.7	148.7	132.1	126.5	116.6	112.3
Customer deposits to total (non-interbank) loans	112.5	115.0	115.6	115.0	117.5	117.0	118.3	107.3	110.7	111.9	110.3
Foreign exchange liabilities to total liabilities	65.7	62.6	61.3	61.1	61.2	60.0	60.2	59.5	59.3	58.3	58.4
Sensitivity to market risk											
Gross open positions in foreign exchange to capital	6.5	6.9	4.9	4.2	3.8	4.0	2.7	2.7	4.3	6.1	5.1
Net open position in FX to capital	-2.8	-3.3	-1.2	-2.5	-1.8	-1.4	-0.4	0.8	-1.3	-3.2	-1.6

Source: Central Bank of Armenia

Table 7. Armenia: Medium-Term Macroeconomic Framework, 2016–24

(In percent of GDP, unless otherwise specified)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
	Act.	Act.	Act.			Proj.			
National income and prices									
Real GDP (percent change)	0.2	7.5	5.2	4.6	4.5	4.5	4.5	4.5	4.5
Gross domestic product (in millions of U.S. dollars)	10,546	11,537	12,428	13,459	14,147	15,051	15,995	16,959	17,971
Gross national income per capita (in U.S. dollars)	3,599	4,028	4,241	4,658	4,893	5,199	5,531	5,854	6,212
CPI inflation, period average (percent change)	-1.4	1.0	2.5	2.1	3.0	3.7	4.0	4.1	4.1
CPI inflation, end of period (percent change)	-1.1	2.6	1.8	2.5	3.3	3.8	4.1	4.3	4.0
Investment and saving									
Investment	18.0	19.0	22.4	23.6	24.1	24.4	24.9	25.6	25.6
Private	14.8	15.0	20.1	20.2	20.2	20.3	20.3	20.4	20.4
Public	3.2	4.0	2.3	3.4	3.9	4.1	4.5	5.2	5.2
National savings	15.8	16.6	13.3	16.3	16.8	17.5	18.4	19.4	20.0
Private	18.2	17.4	12.9	15.5	15.1	15.3	15.6	16.0	16.6
Public	-2.5	-0.8	0.4	0.8	1.8	2.2	2.8	3.4	3.4
Central government operations									
Revenue and grants	21.4	21.2	21.7	22.6	22.8	22.8	22.9	23.2	23.1
Of which: tax revenue	20.1	20.2	20.6	21.0	21.3	21.5	21.7	21.9	21.9
grants	0.6	0.2	0.2	0.6	0.3	0.2	0.2	0.1	0.1
Expenditure	27.0	26.0	23.5	25.2	24.9	24.7	24.7	25.0	24.9
Current expenditure	23.9	22.0	21.2	21.8	21.0	20.6	20.2	19.8	19.7
Capital expenditure	3.2	4.0	2.3	3.4	3.9	4.1	4.5	5.2	5.2
Overall balance on a cash basis	-5.6	-4.8	-1.3	-2.5	-2.1	-1.9	-1.8	-1.8	-1.8
Domestic financing	2.0	1.6	0.7	0.5	4.2	1.0	0.1	0.5	0.8
External financing	3.8	3.4	0.6	2.1	-2.1	0.9	1.7	1.3	1.0
Other financing	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Underlying balance	-5.2	-4.0	-0.2	-1.8	-1.1	-0.9	-0.9	-1.0	-1.1
Public and publicly-guaranteed (PPG) debt	56.7	58.9	55.8	54.6	53.7	52.3	51.1	50.1	49.2
Central Government's PPG debt	0.0	0.0	0.0	-1.1	-2.0	-3.4	-4.7	-5.6	-6.6
External sector									
Exports of goods and services	33.2	37.3	37.6	37.7	37.9	38.2	38.4	39.1	39.4
Imports of goods and services	42.8	49.5	53.0	53.0	52.8	52.4	52.3	52.3	52.2
Current account (in percent of GDP)	-2.3	-2.4	-9.1	-7.3	-7.3	-6.9	-6.5	-6.2	-5.6
Current account (in millions of U.S. dollars)	-238	-280	-1,131	-977	-1,027	-1,038	-1,044	-1,047	-1,010
Capital and financial account (in millions of U.S. dollars)	466	586	757	1,073	1,193	1,153	1,137	1,243	1,109
Of which: direct foreign investment	272	228	266	296	318	346	376	407	449
public sector disbursements	571	585	320	556	525	476	625	595	555
Gross international reserves in months of imports	4.6	4.2	3.8	3.7	3.8	3.5	3.3	3.4	3.3

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

Table 8. Armenia: Fund Disbursements and Timing of Reviews Under an SBA

Date of Availability	Conditions	Amount (millions of SDRs)[1/]	Percent of Quota (cumulative)
May 17, 2019	Board approval of the arrangement	25.714	19.96
September 30, 2019	Observance of end-June 2019 performance criteria and continuous performance criteria, and completion of first review	25.714	39.93
March 31, 2020	Observance of end-December 2019 performance criteria and continuous performance criteria, and completion of second review	25.714	59.89
September 30, 2020	Observance of end-June 2020 performance criteria and continuous performance criteria, and completion of third review	25.714	79.86
March 31, 2021	Observance of end-December 2020 performance criteria and continuous performance criteria, and completion of fourth review	25.714	99.82
September 30, 2021	Observance of end-June 2021 performance criteria and continuous performance criteria, and completion of fifth review	25.714	119.79
March 31, 2022	Observance of end-December 2021 performance criteria and continuous performance criteria, and completion of sixth review	25.716	139.75
	Total	180.000	139.75

Source: Fund staff estimates and projections.

Table 9. Armenia: Indicators of Capacity to Repay the Fund, 2018–24 1/

	2018	2019	2020	2021	2022	2023	2024
		Projections					
Fund obligations based on existing credit							
(in millions of SDRs)							
Principal	22.6	44.0	54.6	50.7	30.3	21.4	12.7
Charges and interest	0.0	3.0	3.6	3.0	2.4	1.9	1.6
Fund obligations based on existing and prospective credit 2/							
(in millions of SDRs)							
Principal	22.6	44.0	54.6	50.7	39.9	60.0	67.4
Charges and interest	0.0	3.5	5.3	5.8	6.2	5.4	4.1
Total obligations based on existing and prospective credit 2/							
In millions of SDRs	22.6	47.5	59.9	56.5	46.1	65.4	71.5
In millions of US$	32.0	66.1	84.1	79.7	65.5	93.4	0.0
In percent of Gross International Reserves	1.4	3.4	4.6	4.8	3.6	4.4	0.0
In percent of exports of goods and services	0.7	1.3	1.6	1.4	1.1	1.5	0.0
In percent of debt service	11.7	22.2	10.4	29.6	26.1	35.2	0.0
In percent of GDP	0.3	0.5	0.6	0.5	0.4	0.6	0.0
In percent of quota	17.5	36.9	46.5	43.8	35.8	50.7	55.5
Outstanding Fund credit based on existing drawings							
In millions of SDRs	234.1	187.3	132.7	82.0	51.7	30.4	17.6
In billions of US$	0.33	0.26	0.19	0.12	0.07	0.04	0.00
In percent of Gross International Reserves	14.7	11.4	7.7	4.5	2.8	1.7	0.0
In percent of exports of goods and services	7.1	5.1	3.5	2.0	1.2	0.7	0.0
In percent of debt service	121.0	87.6	23.2	43.5	30.9	19.4	0.0
In percent of GDP	2.7	1.9	1.3	0.8	0.5	0.3	0.0
In percent of quota	181.8	145.4	103.0	63.7	40.2	23.6	13.7
Outstanding Fund credit based on existing and prospective drawings 2/							
In millions of SDRs	234.1	238.7	235.5	236.3	222.1	162.1	94.8
In billions of US$	0.33	0.33	0.33	0.33	0.32	0.23	0.00
In percent of Gross International Reserves	14.7	17.1	18.0	20.1	17.2	11.0	0.0
In percent of exports of goods and services	7.1	6.7	6.3	6.0	5.3	3.6	0.0
In percent of debt service	121.0	111.4	41.0	124.0	125.6	87.4	0.0
In percent of GDP	2.7	2.5	2.4	2.3	2.0	1.4	0.0
In percent of quota	181.8	185.3	182.9	183.5	172.4	125.9	73.6
Net use of Fund credit (millions of SDRs) existing and prospective 2/	-22.6	7.4	-3.2	0.8	-14.2	-60.0	-67.4
Disbursements	0.0	51.4	51.4	51.4	25.7	0.0	0.0
Repayments and Repurchases	22.6	44.0	54.6	50.7	39.9	60.0	67.4
Memorandum items (adverse scenario):							
Nominal GDP (in millions of US$)	12,428	13,414	13,937	14,701	15,578	16,492	17,464
Exports of goods and services (in millions of US$)	4,669	4,937	5,226	5,586	5,977	6,432	6,899
Gross International Reserves (in millions of US$)	2,249	1,944	1,839	1,656	1,837	2,101	2,316
Quota (millions of SDRs)	128.8	128.8	128.8	128.8	128.8	128.8	128.8
Memorandum items (baseline scenario):							
Nominal GDP (in millions of US$)	12,428	13,459	14,147	15,051	15,995	16,959	17,971
Exports of goods and services (in millions of US$)	4,669	5,074	5,361	5,744	6,137	6,625	7,074
Gross International Reserves (in millions of US$)	2,249	2,284	2,415	2,575	2,581	2,514	2,357

Sources: IMF staff estimates and projections.

1/ Indicators shown in this table cover both GRA and PRGF credit.

2/ Assumes access of 180 million SDR over 2019-2022 and semi-annual disbursements. The ratios in the corresponding lines use GDP, reserves and debt service in the adverse scenario case.

Annex I. Revised Fiscal Rules

1. Armenia's original fiscal rules, adopted in 2008, were due for an overhaul to align with international best practice after a decade. Although the original debt brake and budget balance fiscal rules provided a simple and straightforward link with public debt sustainability, they lacked cyclical considerations and could aggravate economic difficulties, especially with the growth-enhancing infrastructural investment projects.

2. With the help of Fund technical assistance (TA), amendments to the Law on Public Debt and the Law on Budget System were adopted by the National Assembly in December 2017 to introduce the revised fiscal rules. The revised rules are calibrated to balance various considerations to provide a sustainable and credible anchor for the fiscal framework. The main provisions of the rules in the legislation are:

- **Debt limit:** The upper threshold for central government debt (excluding central bank debt) remains 60 percent of GDP.

- **Automatic corrective mechanism:** (a) If the government debt is between 50 to 60 percent of GDP, the government shall present an action plan in its medium-term expenditure framework (MTEF) to gradually bring the government debt below 50 percent of GDP; (b) if the government debt exceeds 60 percent of GDP, the government shall submit an action plan by the Standing Committees on Financial, Credit and Budget and Economic Issues of the National Assembly (NA) for consideration to bring the projected path of government debt below 60 percent of GDP, and include this plan to the MTEF. In supporting the corrective mechanisms: (i) if the government debt exceeds 40 percent of GDP, the fiscal deficit should not exceed capital expenditure; and (ii) if the government debt exceeds 50 percent of GDP, the maximum increase in current expenditure (excluding debt service costs) is limited by the parameters set out in a separate government degree. [1]

- **Escape clauses.** The expenditure limits shall not apply in exceptional cases when negative economic developments arise due to large-scale natural and man-made disasters, military operations, and economic shocks. The emergency will be announced by the government based on an assessment of the magnitude of the shock.

3. The revised fiscal rules need to be accompanied by supporting PFM reforms. The rules, which have been already operational since the legislation amendment. The government prepared a first corrective action plan in 2018, which specified a time bound adjustment path to bring government debt below 50 percent of GDP by 2023. In order to ensure the sustainability and effectiveness of the revised rules, the government needs to work toward gradually improving

[1] The government decree specifies that: (i) when government debt is above 50 percent of GDP, the growth rate of current expenditure has to be lower than the average growth rate of nominal GDP in the past seven years; (ii) when government debt is above 60 percent of GDP, the growth rate of current expenditure has to be 0.5 percentage points lower than the average growth rate of nominal GDP in the past seven years, and total current expenditure cannot exceed the total amount of tax revenue and stamp duties.

the PFM system, including strengthening the efficiency of the MTEF/annual budget processes and the credibility of the MTEF. In line with TA recommendations, the government should adopt a separate expenditure rule irrespective of the debt rule, which would help make fiscal policy more stable (less procyclical) and add predictability to the budget process over the medium term.[2] Moreover, although refinements are sometimes needed, as credibility is key to the success of any rules, the government should demonstrate its commitment to the revised fiscal rules by resisting any unjustified pressure to alter their main parameters and specifications.

[2] This could be first implemented as an informal multi-year expenditure rule as the authorities build capacity and experience. In a second stage, the expenditure rule could be made legally binding.

Annex II. Ex-Post Peer Review Assessment

Introduction

1. **Since Armenia joined the Fund in 1992, successive Fund-supported programs have helped anchor the authorities' stabilization efforts.** The 2012 Ex-Post Assessment (EPA)[1] found that during 2005–12 Fund-supported programs helped Armenia maintain macroeconomic stability and mitigate the adverse effects of external shocks, although progress on structural reforms was mixed. The EPA highlighted long-lasting issues such as the need to strengthen revenue collection, improve the business climate, move toward greater exchange rate flexibility, and enhance monetary policy effectiveness.

2. **This Annex provides a brief assessment of performance since the 2012 EPA and draws lessons for future program design and Fund engagement.** This period covers the latter part of an EFF/ECF arrangement (2010–13), with an access of SDR 266.8 million (290 percent of quota), and a subsequent EFF arrangement (2014–17), with an access of SDR 82.2 million (89 percent of quota). [The assessment also includes the authorities' views collected during the negotiations of a new arrangement in March 2018.]

Program Objectives, Performance, and Key Challenges

ECF/EFF (2010–13)

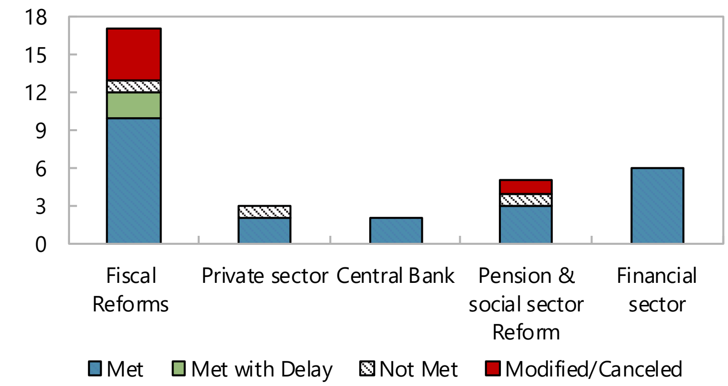
- **Program objectives and design.** The main objectives of this program were to restore external and fiscal sustainability, maintain financial sector stability, and promote growth and poverty reduction. Furthermore, the shift from the 2009 SBA arrangement to an EFF/ECF blend arrangement allowed greater focus on medium-term structural issues and provided more favorable repayment terms.

- **Program performance.** Macroeconomic performance under the program was satisfactory (Figure 1). After a sharp contraction in GDP in 2009 (14 percent), growth rebounded to average over 4 percent in 2010–14. Inflation declined from 8.5 percent in 2010 to 5.4 percent in 2013. Fiscal deficits were significantly smaller than the initial program targets, while gross international reserves increased marginally from 4.6 months of imports in 2010 to 4.9 months in 2013. Tax collection improved significantly, with revenues rising by 3.6 percentage points of GDP over the course of the program. Overall, policies largely delivered on the objectives of the program, with the majority of performance criteria (PCs) and structural benchmarks (SBs) met (Table 1). However, two PCs, the NIR target for June 2012, and the NDA target for June 2011, were missed due to heavy FX intervention induced by a weaker-than-expected external environment and a brief delay in budget support loans.

[1] IMF Country Report No. 13/34.

- **Performance on structural reforms.** Structural benchmarks continued to focus mainly on the fiscal sector. Several measures to improve tax administration were adopted. Important structural reforms, such as establishment of a legal and regulatory framework for pension system, were undertaken with support from Fund's technical assistance. In addition, some macro prudential measures to address financial dollarization (e.g., liquidity coverage ratios by major currencies) were implemented. Nonetheless, success in meeting some structural benchmarks in the areas of social protection and competition was limited.

Performance on Structural Benchmark (2010 EFF/ECF)



- **Key challenges.** Despite these achievements, significant challenges and vulnerabilities remained. In particular, while the current account deficit improved significantly (by almost 7 percent points of GDP), it remained large (7 percent of GDP in 2013) and pressure on external reserves was emerging. Continuous Fund engagement was deemed necessary to foster macro-critical structural reforms, catalyze support from other IFIs, support preparations for possible access to international capital markets, and consolidate macroeconomic stability to achieve higher growth.

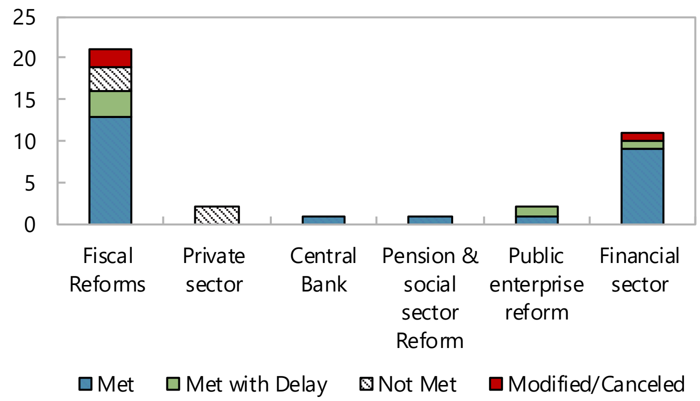
EFF (2014–17)

- **Program objectives and design.** To address the above-mentioned challenges, the successor EFF arrangement aimed at supporting the transition to a more dynamic emerging market economy. In this context, and given the country's graduation from PRGT eligibility, the program was designed to facilitate access to international capital markets and a shift away from Fund financial support. Structural reform measures focused on increasing potential growth (by promoting greater competition and improving governance), improving revenue collection, and strengthening the inflation targeting framework, all of which were key recommendations of the 2012 EPA. The choice of the EFF was justified by the focus on medium-term structural issues, while relatively low access reflected the objective of exiting from Fund support.

- **Program performance.** Unexpected external shocks resulted in deviations from program policies in 2015. During 2014–15, a sharp fall in remittances from Russia, lower commodity prices, and global and regional currency movements caused serious FX pressures and lowered fiscal revenues by almost 2 percent of GDP (Figure 2). The authorities responded by tightening the monetary conditions and increasing FX intervention, which helped stabilize the FX market and contain inflation but lowered reserve buffers and limited adjustment in the exchange rate. Furthermore, accommodating fiscal policy helped mitigate the negative impact on growth but led to higher deficits and debt. These, together with other fiscal measures (such as higher budget lending and raising the VAT threshold) and a challenging policy environment, led to several non-observed PCs and a delay in the completion of the second review (Table 2). The review was completed in November 2015, following the implementation of two prior actions and five new SBs, and the establishment of a new PC on budgetary domestic lending. After the second review, renewed policy efforts improved program performance and helped restore macroeconomic stability**.** All, but one, performance criteria were met during the remainder of the program and overall macroeconomic performance was satisfactory. However, the impact of shocks on activity and fiscal revenue required fiscal policy to be more accommodating. As a result, deficit targets had to be relaxed somewhat prior to the third and fourth reviews to reduce the pro-cyclicality of fiscal policy and the impact on growth. On the external side, more limited intervention and higher exports receipts contributed to a buildup of gross reserves and greater exchange rate flexibility.

- **Performance on structural reforms.** Despite some setbacks, there was some progress in structural reforms in line with program objectives. In particular: (i) the financial position of the energy sector improved; (ii) a new tax code was introduced to improve the tax environment and boost medium-term revenues; (iii) a monetary policy consultation clause was adopted in line with the policy adopted in 2014 on review-based conditionality in countries with evolving monetary policy frameworks; and (iv) budget contingency planning and the deposit guarantee system were strengthened. In this regard, the Fund's technical assistance was instrumental, particularly in the areas of tax policy, tax administration, inflation targeting, and more recently, fiscal rules. A number of TA recommendations were implemented as part of the Fund-supported program.

Performance on Structural Benchmark (2014 EFF)



- **Key challenges.** Progress on other reform agenda, particularly to improve the business climate, was limited due to a shift in the program focus on short-term mitigation policies in the wake of unexpected external shocks and the difficult policy environment. Going forward, there is an urgent need to pursue structural reforms focused on improving business climate, strengthening governance, and reducing unemployment and income inequality.

Key Lessons for a Potential New Arrangement

3. Four key lessons can be drawn from the 2010–13 ECF/EFF and 2014–17 EFF arrangements.

- In response to external shocks, the programs allowed for some flexibility, especially in the fiscal area, to mitigate the adverse impact on growth. This suggests that fiscal adjustment should be mindful of both debt sustainability and, to the extent that fiscal space allows, of domestic demand conditions.

- Continued technical assistance played an important role in building capacity and assisting the authorities in addressing macro-critical issues, including in the areas of tax policy, fiscal rules, and inflation targeting. Going forward, capacity building and strong implementation of TA recommendations will remain essential to support the authorities' reform agenda.

- Program design in the 2014–17 EFF, notably adjustors on concessional foreign-financed capital spending, to some extent allowed investment to be protected from the shocks. Given the country's limited administrative capacity and difficulties of coordination with IFIs and donors, foreign-financed project inflows are difficult to project with any precision. Going forward, however, to improve fiscal policy it is imperative that project planning and implementation is improved further.

- Although some progress in structural reform was achieved, the programs may have overestimated the speed at which reform could be undertaken, particularly on issues related to improving the business climate, diversification, and poverty reduction. External shocks, and at times inadequate ownership, exacerbated the problem. Going forward, it is encouraging that the government's commitment to reforms has improved as witnessed by the development of a five-year reform program with detailed action plans in each sector.

4. The authorities concurred with staff's assessment. Looking ahead, the authorities welcomed continued Fund engagement and indicated their strong interest in a successor Fund-supported program.

Figure 1. Armenia: Macroeconomic Performance (Request versus Actual), 2010–13 ECF/EFF
(In percent of GDP, unless otherwise indicated)

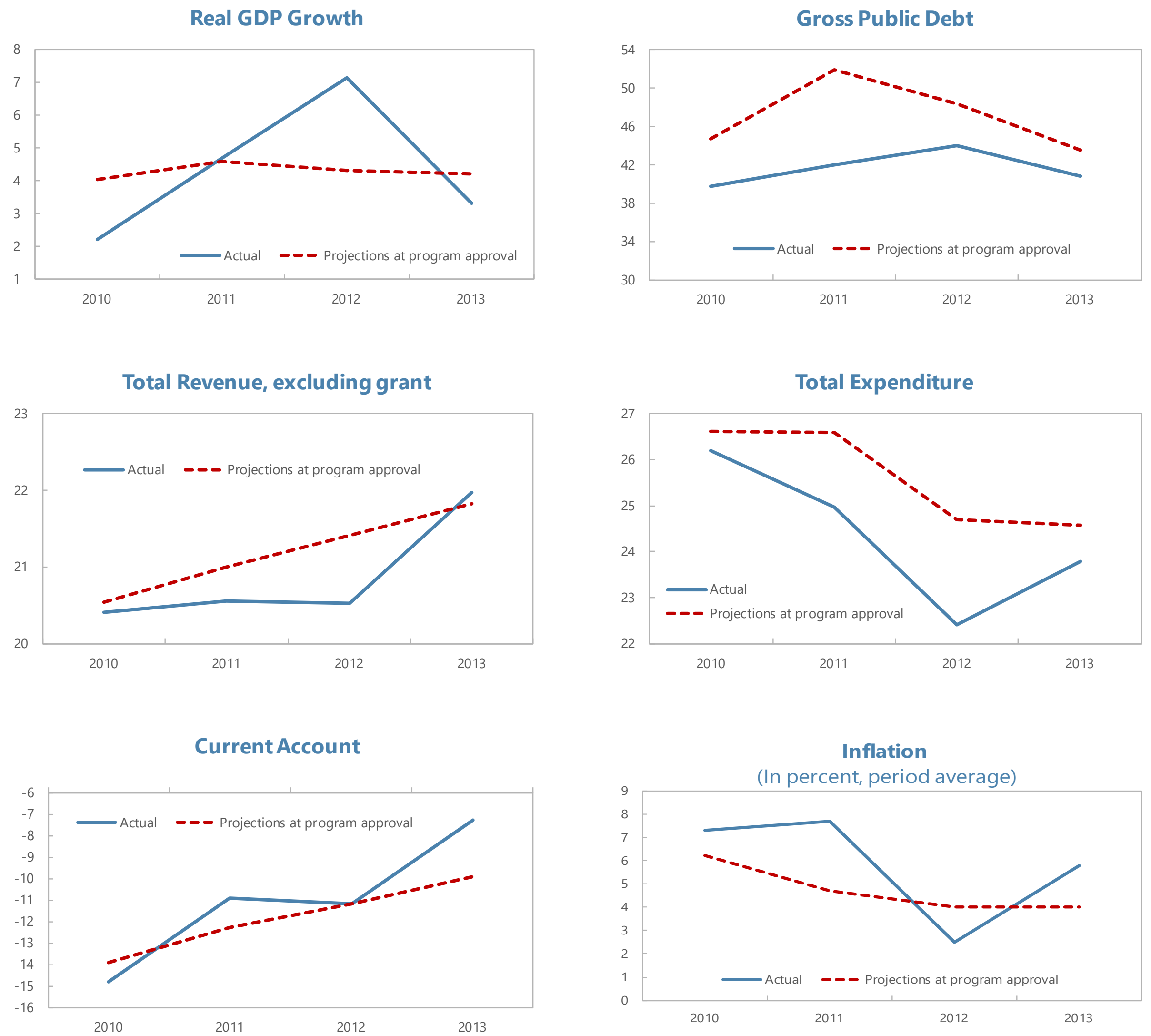
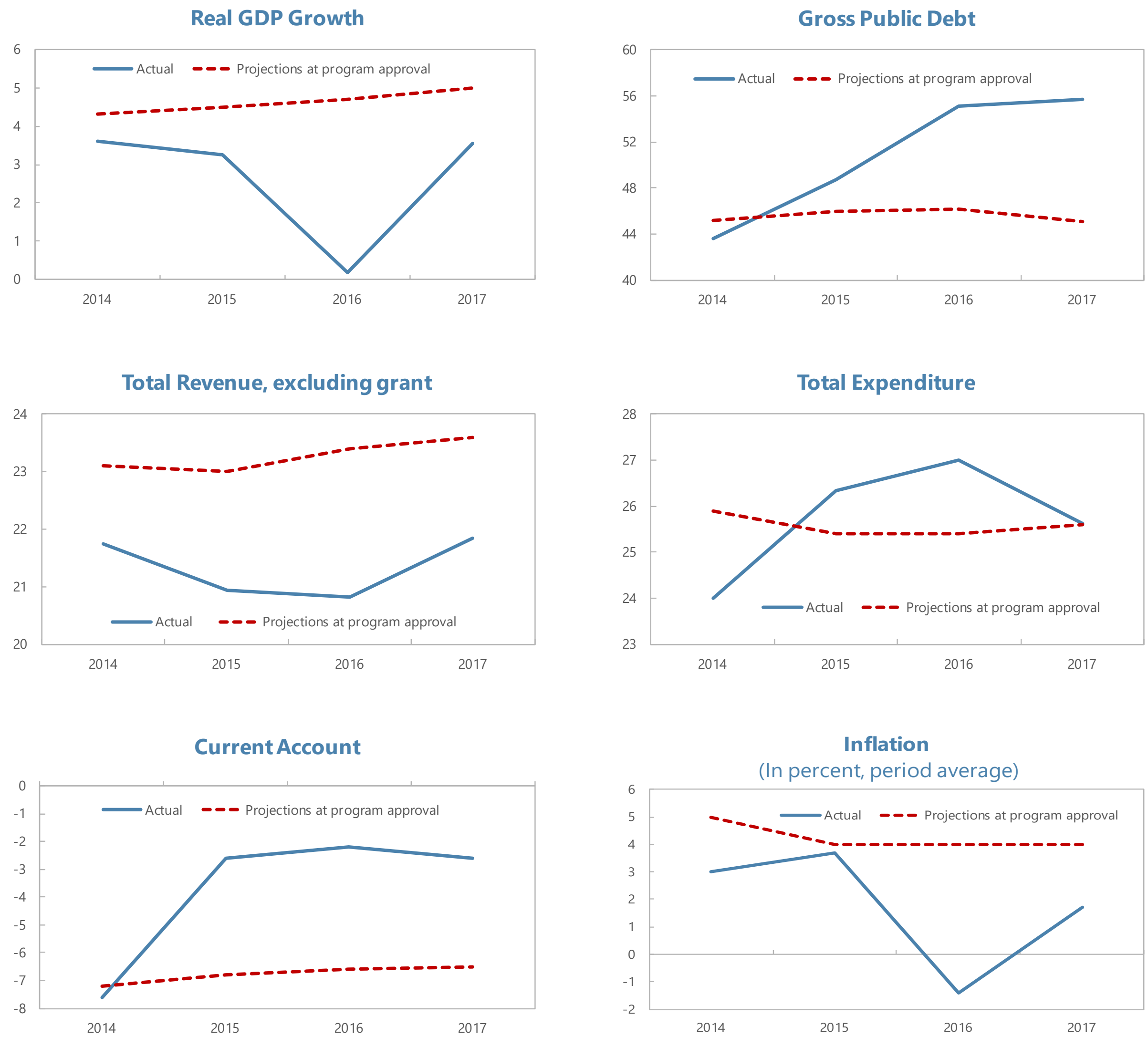


Figure 2. Armenia: Macroeconomic Performance (Request versus Actual), 2014–17 EFF

(In percent of GDP, unless otherwise indicated)



Annex III. Risk Assessment Matrix[1]

Nature/source of risk	Relative likelihood	Possible impact if risk is realized	Policy response
Global Risks			
Rising protectionism and retreat from multilateralism. In the near term, escalating and sustained trade actions threaten the global trade system, regional integration, as well as global and regional collaboration. Additional barriers and the threat of new actions reduce growth both directly and through adverse confidence effects (increasing financial market volatility). In the medium term, geopolitical competition and fraying consensus about the benefits of globalization lead to economic fragmentation and undermine the global rules-based order, with adverse effects on growth and stability.	High	**Low/Medium** Russia as Armenia's main trading partner and other EEU member countries have the ambition to expand the EEU, Furthermore, Armenia has recently signed a treaty for more cooperation with the EU. Economic relationship with China and Iran is also expanding.	Prepare and implement contingency plans for potential trade and financial spillovers. Maintain exchange rate flexibility.
Sharp tightening of global financial conditions. This causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; capital account pressures; and a broad-based downturn. The tightening could be a result of: • **Market expectation of tighter U.S. monetary policy** triggered by strong wage growth and higher-than-expected inflation. • **Sustained rise in risk premium** in reaction to concerns about debt levels in some euro area countries; a disorderly Brexit; or idiosyncratic policy missteps in large emerging markets.	 Low Medium	**High** DSA suggests that Armenia's external debt is not sensitive to interest shocks given that most of debt is concessional. Nonetheless, higher international interest rates would impose higher costs on the potential rollover of $500 million Eurobonds in 2020.	Continue the de-dollarization efforts. Maintain exchange rate flexibility. Strengthen banking supervision and provision in the event of higher NPLs in dollar.
Weaker-than-expected global growth: The global growth slowdown could be synchronized as weakening outlooks in the U.S., Europe and China feed off each other and impact on earnings, asset prices and credit performance. • **U.S.:** Confidence wanes against a backdrop of a long expansion with stretched asset valuations, rising leverage, and unwinding of the fiscal stimulus, leading to abrupt closure of the output gap rather than a smooth landing. • **Europe:** In the near term, weak foreign demand makes euro area businesses delay investment, while faltering confidence reduces private consumption. Adverse financial market reaction to debt sustainability concerns further dampens	 Medium High	**Medium** Mining exports, a source of foreign exchange earnings and tax revenue, would be hit. Remittances could fall after some recovery in 2017–18, in case economic growth in major trading partners slows down.	Diversify export destination and products. Accelerate structural reforms to improve the business climate for FDI. Strengthen social safety nets to cushion the impact of shocks.

[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.

growth. A disorderly Brexit could cause market disruption with negative spillovers. In the medium term, disregard for the common fiscal rules and rising sovereign yields for high-debt countries test the euro area policy framework, with adverse impact on confidence and growth. • **China:** In the short term, intensification of trade tensions and/or a housing market downturn prompt a slowdown, which is not fully offset by policy easing. Deleveraging is delayed and financial stresses, including capital outflow and exchange rate pressures, emerge. In the medium term, insufficient progress in deleveraging and rebalancing reduces growth and raises the probability of a larger disruptive adjustment. There would be negative spillovers on the global economy through trade volumes, commodity prices, and financial markets.	Medium		
Intensification of security risks in parts of Africa, Asia, Europe, Latin America, and/or the Middle East cause regional socio-economic and political disruptions, with potential global spillovers.	High	**Medium** Intensification of tension in neighboring countries in the Middle East and renewed sanctions on Iran could also reduce trade and investment.	Accelerate structural reforms and prepare contingency plans for potential spillovers. Strengthen social safety nets to cushion impact of shocks on vulnerable sectors.
Large swings in energy prices. Risks to prices are broadly balanced, reflecting offsetting—but large and uncertain—supply and demand shocks. In the near term, uncertainty surrounding the shocks translates to elevated price volatility, complicating economic management and adversely affecting investment in the energy sector. As shocks materialize, they may cause large and persistent price swings. While, on aggregate, higher oil prices would harm global growth, they would benefit oil exporters.	Medium	**Medium/High** Negative indirect effects via major trading partners.	Diversify trade partners. Improve the business climate for international investors.
Cyber-attacks on critical global financial, transport or communication infrastructure and broader private and public institutions trigger systemic financial instability or widespread disruptions in socio-economic activities.	Medium	**Low/Medium** A widespread cyber-attack has not been reported in Armenia yet. However, in such an event, a deeper analysis in needed to determine the system's interconnectedness and vulnerabilities.	A risk-based regulatory approach should ensure that no relevant risks remain unregulated—either stemming from traditional banks or created by technology.
Country-Specific Risks			
Regional conflict: Risks from sharp, renewed Nagorno-Karabakh-related tensions.	Low	**High/Medium** Conflict would have severe impacts, including possible regional military action.	Continue with dialogue. Prepare and implement contingency plans.

Annex IV. Illustrative Adverse Scenario

1. Armenia remains vulnerable to external shocks that could have an adverse impact on the economy, balance of payments, and reserve coverage. Under the baseline scenario, Armenia does not face a financing gap and reserve coverage is adequate (Table 3). However, an external shock could reduce capital inflows and erode reserve buffers.

2. Scenario. Staff simulates a plausible adverse scenario to explore the likely impact of lower remittances and commodity prices along with an increase in capital outflows due to an abrupt change in global risk appetite. Key assumptions and simulation results are discussed below.

- **Commodity prices.** In an adverse scenario, staff assumes a temporary decline in copper and oil prices by around one standard deviation of historical change in prices. The magnitude of the shock is also in line with the magnitude of the 2013–14 shock episode but is assumed to be temporary in nature with prices recovering starting 2021 and reaching close to baseline projections by 2023.

3. Remittances. In the baseline, remittances are projected to reach $790 million in 2019, whereas, under an adverse scenario, staff projects remittances to decline by about 20 percent in 2019–20, which is similar to decline associated with the 2014 commodity shock episode but with a lower magnitude as remittances haven't recovered fully compared to pre-2014 crisis period.

- **Capital outflow.** In addition to the commodities and remittances shocks, similar to the 2014 shock, staff assumes a slowdown in capital and financial inflows. Given the high degree of financial dollarization, this shock can exacerbate further the impact of other shocks and trigger depreciation pressures. This could lead to heightened country risk, which would make the country face difficulties in attracting capital inflows (including from international capital markets). Against this backdrop, capital and financial inflows are estimated to be lower by around $650 million during 2019–22 compared to staff's baseline projections. The $500 million eurobond maturing at 2020 is expected to be rolled over but at a higher cost of additional 300 bps due to tighter financial conditions (in line with the rise in the EMBIG Armenia spread observed during 2014 shock).[1]

4. Effects. Commodity price and remittances shocks will lead to a current account deterioration in the first year, although import compression will compensate for some of deterioration in the following years. Meanwhile, the rollover and capital outflow shocks will lead to a weaker capital and financial account. These developments in the external account could trigger second-round effects in the economy: the exchange rate would come under pressure and its pass-through to inflation will result in a faster increase in prices. Private domestic demand and

[1] The separate 2018 FSAP liquidity stress test results suggest that the banking system's funding gaps in FX would amount to 24 percent of the CBA's gross international reserves at end-May 2018 in a stress scenario.

fiscal revenues would be also adversely affected due to lower remittances and exports. Financing conditions would also worsen, with higher borrowing costs affecting the budget. Finally, debt as a share of GDP increases significantly on account of exchange rate depreciation, high share of FX-denominated debt in total debt and lower GDP growth.

5. Policies would be geared toward macroeconomic stability and smoothing the adjustment process, to help absorb the external shock, in the first instant, the exchange rate would depreciate, accompanied by limited FX interventions to moderate extreme volatility. Some monetary policy tightening would also be needed to prevent second-round effects of exchange rate depreciation on inflation. Fiscal policy should be geared towards preserving stability and protecting the vulnerable groups. At first step, procyclical fiscal adjustment may not be desirable. However, fiscal adjustment may be needed if the shock deepens, and if exchange rate depreciation increases debt burden and erodes confidence. It should be noted that the above-level access is based on normal-size shocks, and the realization of tail risks could require higher access and possibly more adjustment, as well as further financial assistance from international development partners.

Armenia: Potential Impact of Adverse Shocks
(in millions of US dollars, unless otherwise indicated)

	2019		2020		2021		2022	
	Baseline	Shock	Baseline	Shock	Baseline	Shock	Baseline	Shock
1. Current account	-977	-1,065	-1,027	-1,145	-1,037	-1,154	-1,043	-949
Exports of G&S	5,074	4,937	5,361	5,126	5,741	5,486	6,133	5,977
Imports of G&S	-7,132	-7,054	-7,466	-7,279	-7,889	-7,674	-8,367	-8,109
Incomes and transfers (net)	1,081	1,051	1,078	1,008	1,110	1,033	1,191	1,183
2. Capital & financial account	1,074	923	1,193	1,037	1,153	992	1,136	1,173
3. Overall balance (3=1+2)	97	-142	166	-108	116	-162	93	224
4. Financing								
Gross international reserves (increase -)	-35	205	-89	185	-44	233	-50	-181
Use of Fund credit (repurchase/repayment)	-63	-63	-77	-77	-72	-72	-43	-43
Gross international reserves	2,284	2,044	2,373	1,859	2,417	1,626	2,467	1,807
Reserve adequacy without Fund support (ARA, percent)	104	94	106	83	113	77	114	84
Under the proposed IMF program disbursements:								
Proposed financing by the Fund in the shock senario		10		70		150		21
Gross international reserves		2,054		1,939		1,856		2,058
Reserve adequacy with Fund support (ARA, percent)		94		87		87		95

Source: IMF staff simulations.

6. Implication. This illustrative scenario highlights the pressure on existing buffers. A Fund-supported program can provide a useful insurance in the case of shocks. The scenario shows that access at 140 percent of quota (SDR 180.29 million or about $250 million) can be justified to maintain international reserves above 85 percent of the ARA metric under the plausible downside scenario.

Armenia: Impact of a Plausible External Shock

	2019		2020		2021		2022	
	Baseline	Shock Scenairo	Baseline	Shock Scenairo	Baseline	Shock Scenario	Baseline	Shock Scenario
Real GDP growth (percent)	4.6	4.2	4.5	4.0	4.5	4.3	4.5	4.5
CPI inflation, average (percent)	2.5	2.3	3.3	2.4	3.8	3.1	4.1	4.1
Current account balance (percent of GDP)	-7.3	-7.9	-7.3	-7.4	-6.9	-7.2	-6.5	-6.1
Overall fiscal balance (percent of GDP)	-2.5	-2.5	-2.1	-2.5	-1.9	-2.5	-1.8	-2.1
Gross international reserves (US$ million)	2,284	1,944	2,373	1,839	2,417	1,656	2,467	1,837
Public debt (percent of GDP)	55.9	62.0	54.9	63.9	53.3	63.1	52.5	63.8

Source: staff projections and simulations.

Annex V. Public Debt Sustainability Analysis[1]

Results from an updated DSA using staff's baseline projections indicate that Armenia's public debt remains sustainable, but the high share of foreign currency debt 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.

1. Debt dynamics improve over the medium term. Government debt started to decline in 2018. Public debt, which stood at 58.9 percent of GDP at end-2017, is estimated to have reached 55.8 percent at end-2018, reflecting favorable macroeconomic developments, tax administration efforts, and underspending. The authorities remain committed to a fiscal consolidation path that aims to put public debt on a downward trend over the medium term. Under the baseline, the share of FX-denominated debt in total debt will be decreasing due to a more rapid increase in amortization relative to new disbursements. External financing will continue to be contracted primarily on concessional terms, in the form of project-related loans and limited budget support from multilateral donors. Domestic financing is expected to remain relatively small, although increasing and with longer average maturity.

2. Baseline projections are subject to significant uncertainty. Historically, growth rates, interest rates, 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 36 and 77 percent (corresponding to the 10^{th}–90^{th} percentile) in 2019 and between 23 and 84 percent in 2023. An asymmetric fan chart, which rules out real exchange rate appreciation, suggests that debt could range between 35 and 96 percent of GDP (10^{th}–90^{th} percentile) in the end of the projections horizon.

3. The heat map highlights vulnerabilities stemming from the large external public debt and increasing share of short-term 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). However, dram has faced appreciation pressure lately and the FX risks in the short-term is tapered. Although most of Armenia's debt remains long term, the increasing share of short-term debt poses some risks.

4. Scenarios assuming 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 historical scenario; the debt ratio rises to well above 70 percent in 2013. This would result in putting debt sustainability at risk and financing needs increases to close to

[1] The coverage of public debt is general government debt including the central bank's debt.

12 percent of GDP in 2023. This implies that without active policy measures aimed at reducing the fiscal deficit, debt sustainability would be jeopardized.

5. Stress tests suggest that real GDP growth shocks have the largest impact on debt indicators. An adverse shock to growth,[2] whereby real GDP contracts by almost 2 percent in 2019–20 in each year, causes public debt to increase to 82 percent of GDP, and public gross financing needs exceed 21 percent of GDP by 2020. This scenario, however, is based on historical GDP growth which, as noted above, has been characterized by high volatility, and the realization of shocks of such magnitude is relatively unlikely. Stress tests based on standardized primary balance, real interest and exchange rate shocks[3] reveal a moderate deterioration relative to the baseline, with real exchange rate depreciation having a somewhat larger impact.

[2] The shock assumes that real GDP growth is reduced by 1 standard deviation of real GDP growth rates over the past 10 years.

[3] The shock assumes the maximum historical movement of the REER over the past 10 years.

Figure A1. Armenia Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

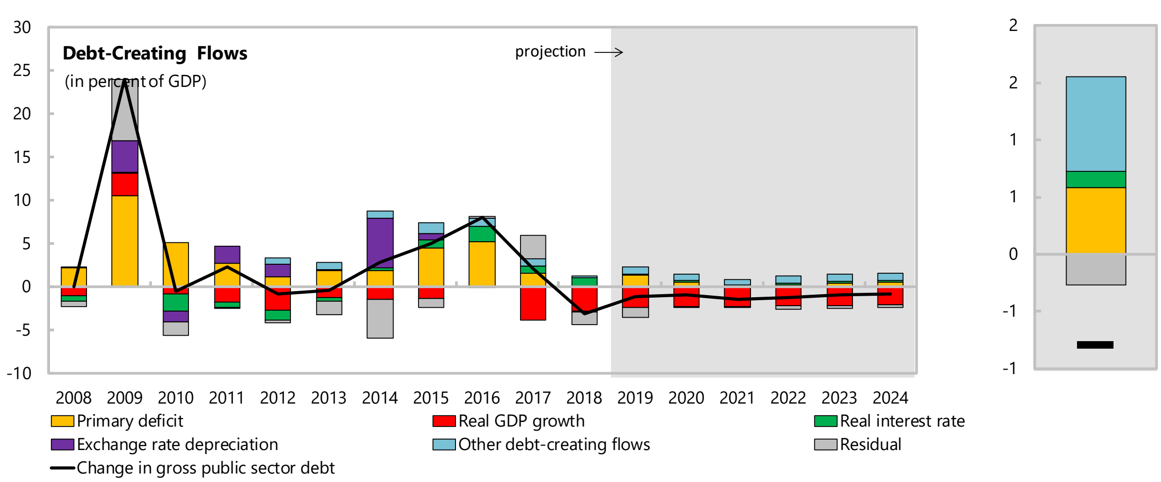
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	41.0	58.9	55.8	54.6	53.7	52.3	51.1	50.1	49.3
Public gross financing needs	7.9	6.6	6.1	7.5	10.2	6.4	6.4	6.2	6.1
Net public debt		52.1	49.7	48.7	48.4	47.7	46.8	46.2	45.8
Real GDP growth (in percent)	1.9	7.5	5.2	4.6	4.5	4.5	4.5	4.5	4.5
Inflation (GDP deflator, in percent)	3.7	2.2	2.5	4.3	3.8	4.4	4.2	4.0	3.9
Nominal GDP growth (in percent)	5.7	9.9	7.8	9.1	8.5	9.1	8.9	8.7	8.6
Effective interest rate (in percent) [4/]	2.9	4.2	4.2	4.7	4.4	5.1	5.0	4.7	4.4

As of March 31, 2019		
Sovereign Spreads		
Spread (bp) 3/		369
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							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	4.5	2.1	-3.1	-1.1	-0.9	-1.4	-1.3	-0.9	-0.8	-6.4	
Identified debt-creating flows	4.8	-0.6	-1.6	1.1	0.2	-0.4	0.1	0.3	0.4	1.7	
Primary deficit	3.9	1.5	0.1	1.4	0.6	0.0	0.2	0.4	0.6	3.2	-0.2
Primary (noninterest) revenue and grants	21.4	21.2	21.7	22.6	22.8	22.8	22.9	23.2	23.1	137.4	
Primary (noninterest) expenditure	25.3	22.8	21.8	24.0	23.3	22.8	23.1	23.6	23.7	140.6	
Automatic debt dynamics [5/]	0.3	-2.9	-2.0	-1.2	-1.0	-1.0	-0.9	-1.0	-1.0	-6.1	
Interest rate/growth differential [6/]	-1.0	-3.0	-1.9	-2.2	-2.0	-2.0	-1.9	-1.9	-1.9	-12.0	
Of which: real interest rate	-0.2	0.9	0.9	0.1	0.2	0.2	0.3	0.2	0.1	1.2	
Of which: real GDP growth	-0.9	-3.9	-2.8	-2.3	-2.3	-2.2	-2.2	-2.1	-2.1	-13.2	
Exchange rate depreciation [7/]	1.4	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.5	0.8	0.2	0.9	0.7	0.6	0.8	0.8	0.8	4.6	
Domestic net lend./drawdown of gov. dep.	0.0	0.0	-0.5	0.0	-0.2	-0.3	0.0	0.0	0.0	-0.4	
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	0.5	0.8	0.8	0.9	0.9	0.9	0.8	0.8	0.8	5.1	
Residual, including asset changes [8/]	-0.3	2.8	-1.5	-1.1	-0.1	-0.1	-0.4	-0.3	-0.3	-2.3	

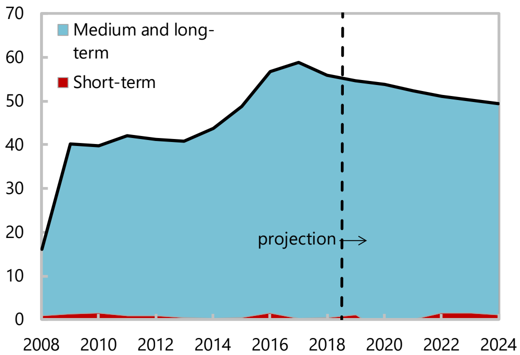


Source: IMF staff.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ Bond Spread over U.S. Bonds.
4/ Defined as interest payments divided by debt stock at the end of previous year.
5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate;
a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
8/ 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.

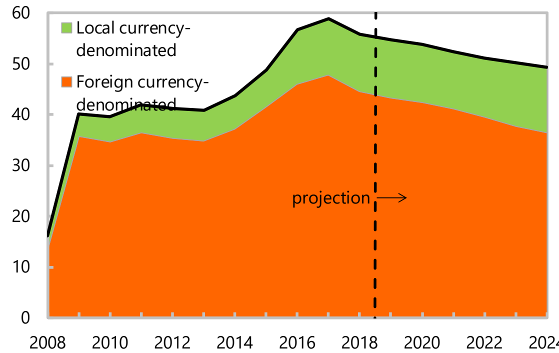
Figure A2. Armenia Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



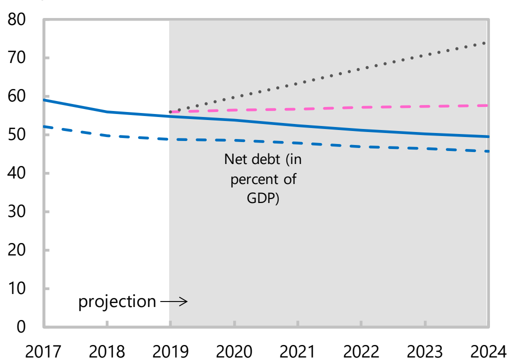
By Currency
(in percent of GDP)



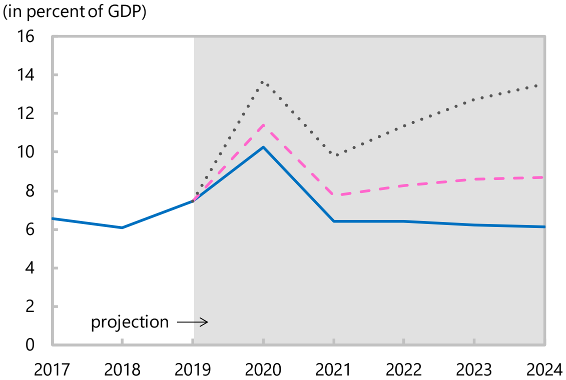
Alternative Scenarios

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)

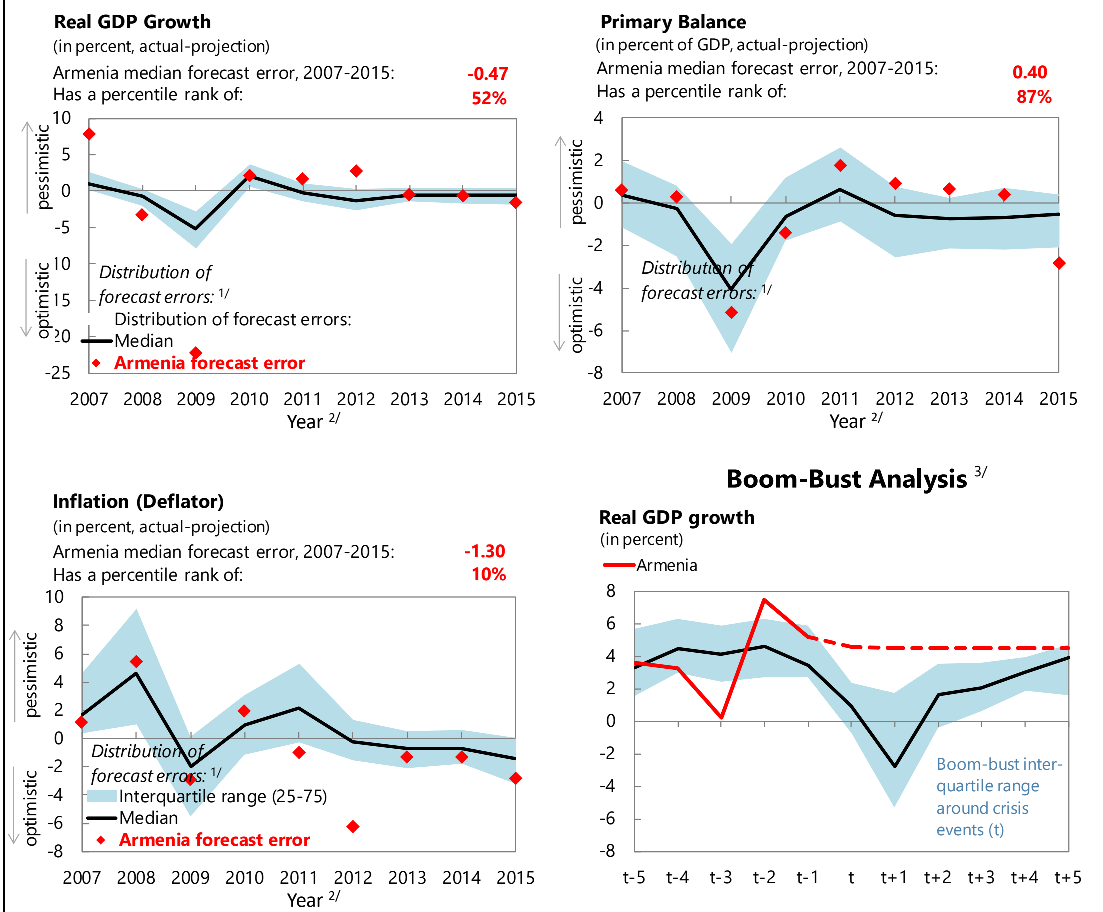
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	4.6	4.5	4.5	4.5	4.5	4.5
Inflation	4.3	3.8	4.4	4.2	4.0	3.9
Primary Balance	-1.4	-0.6	0.0	-0.2	-0.4	-0.6
Effective interest rate	4.7	4.4	5.1	5.0	4.7	4.4
Constant Primary Balance Scenario						
Real GDP growth	4.6	4.5	4.5	4.5	4.5	4.5
Inflation	4.3	3.8	4.4	4.2	4.0	3.9
Primary Balance	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Effective interest rate	4.7	4.4	5.1	5.1	4.8	4.6

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	4.6	2.3	2.3	2.3	2.3	2.3
Inflation	4.3	3.8	4.4	4.2	4.0	3.9
Primary Balance	-1.4	-3.5	-3.5	-3.5	-3.5	-3.5
Effective interest rate	4.7	4.4	5.0	5.1	4.7	4.5

Source: IMF staff.

Figure A3. Armenia Public DSA - Realism of Baseline Assumptions

Forecast Track Record, versus all countries



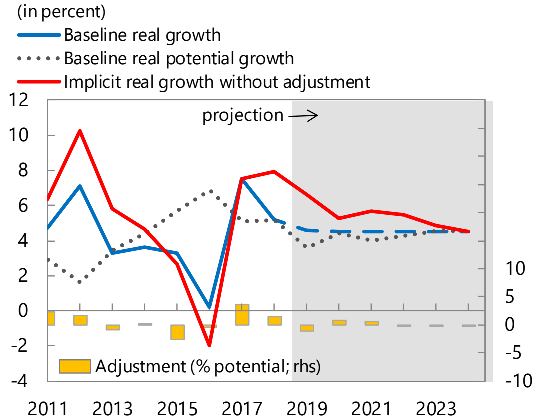
Source: IMF staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries
2/ Projections made in the spring WEO vintage of the preceding year
3/ Armenia has had a positive output gap for 3 consecutive years, 2016-2018 and a cumulative increase in private sector credit of 10 percent of GDP, 2015-2018. For Armenia, t corresponds to 2019; for the distribution, t corresponds to the first year of the crisis.

Figure A3. Armenia Public DSA - Realism of Baseline Assumptions (continued)

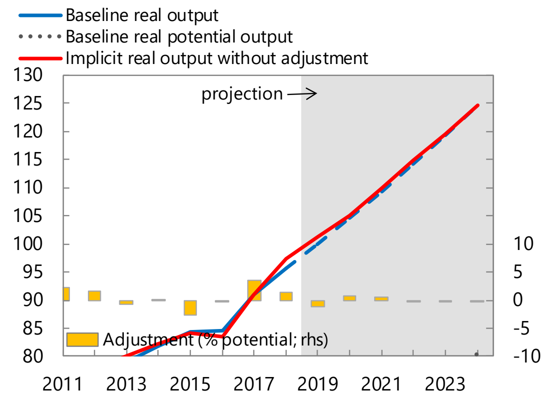
Growth and Level of Output in Absence of Fiscal Adjustment

Assumed multiplier of 0.89, persistence of 0.6

Real GDP Growth
(in percent)

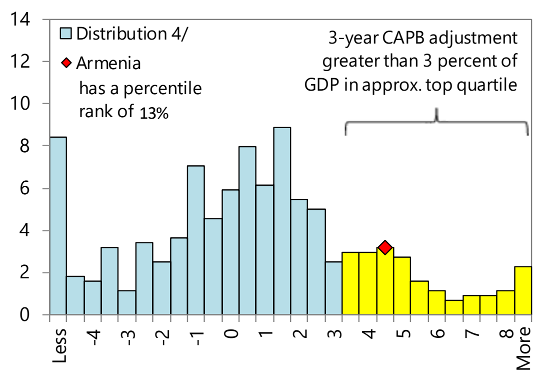


Real Output Level
(Baseline real output in 2019=100)

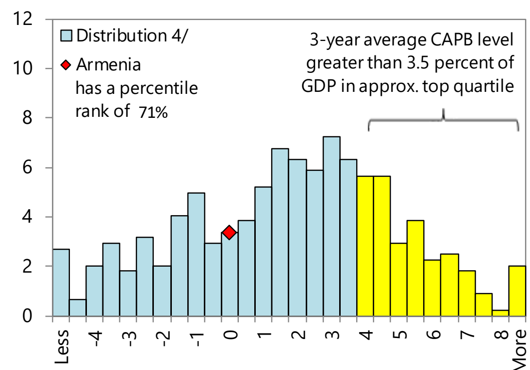


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



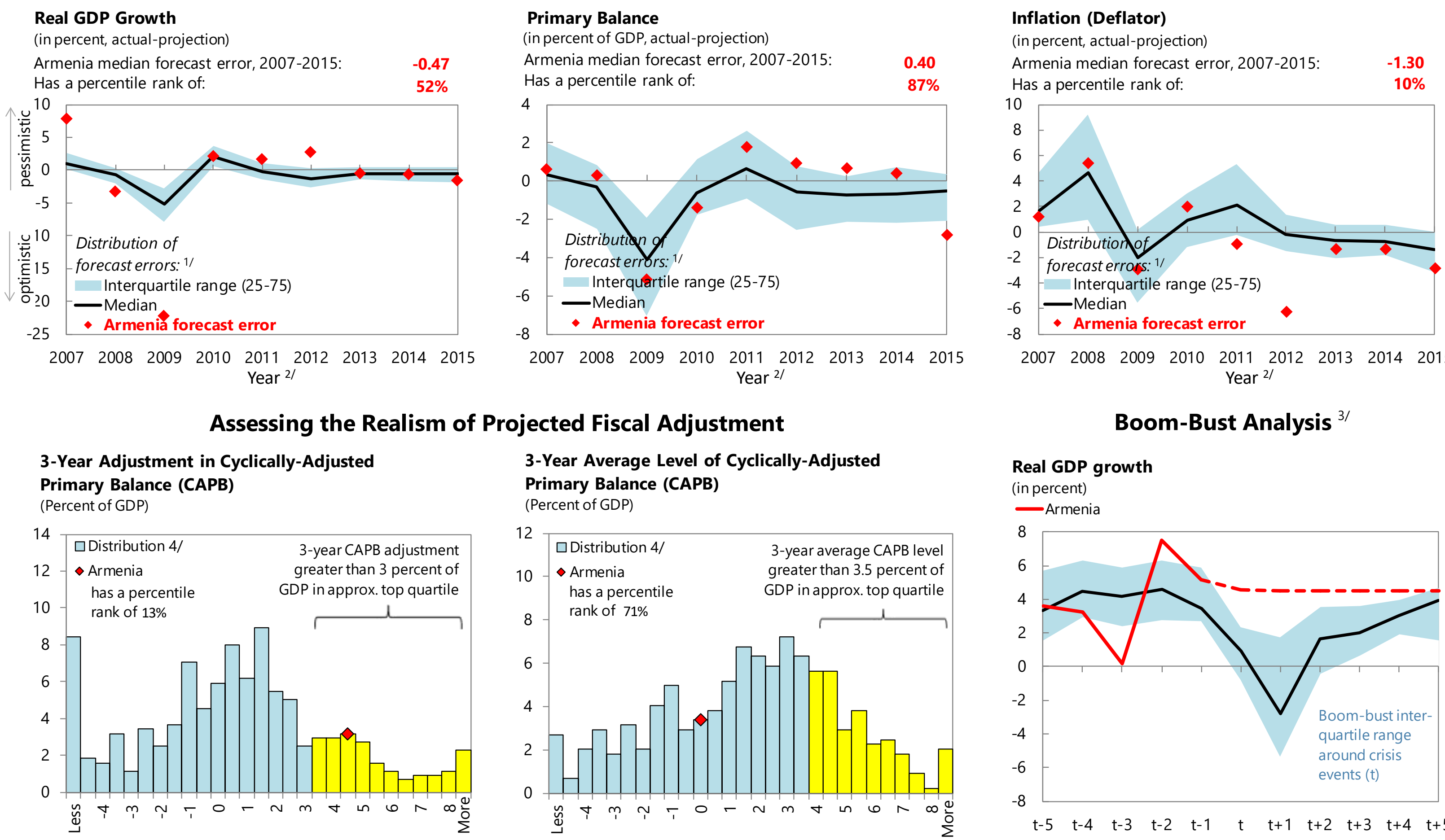
3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Source : IMF staff.
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.

Figure A3. Armenia Public DSA - Realism of Baseline Assumptions (concluded)

Forecast Track Record, versus all countries



Source : IMF Staff.

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

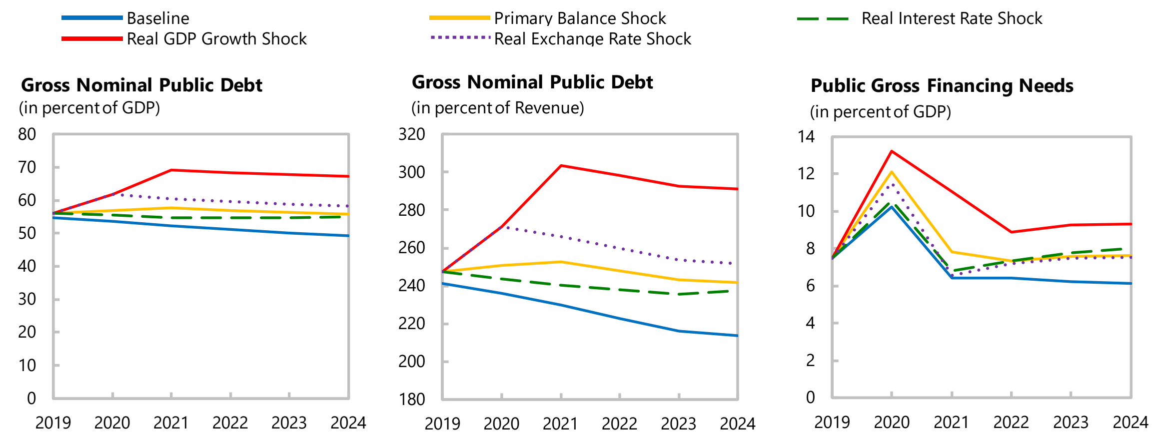
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Armenia has had a positive output gap for 3 consecutive years, 2016-2018 and a cumulative increase in private sector credit of 10 percent of GDP, 2015-2018. For Armenia, t corresponds to 2019; for the distribution, t corresponds to the first year of the crisis.

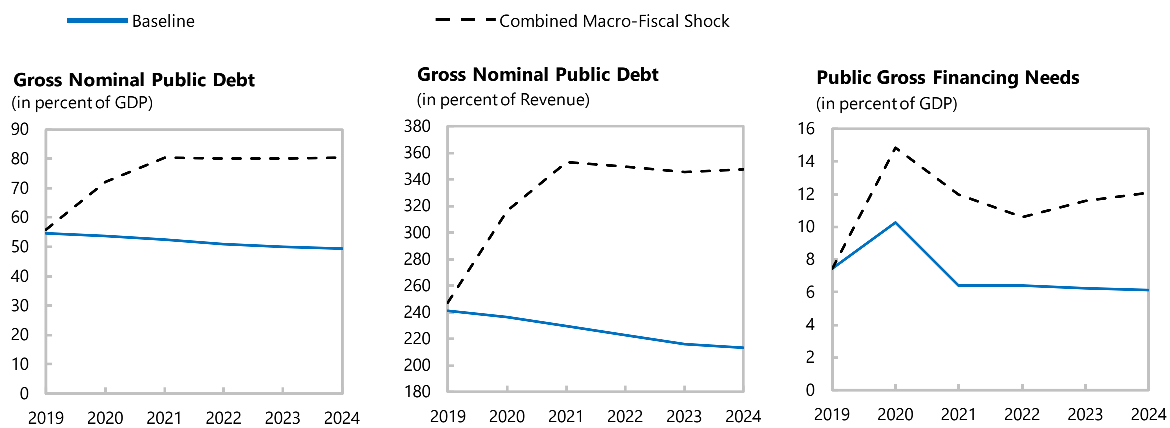
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure A4. Armenia Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2019	2020	2021	2022	2023	2024
Primary Balance Shock						
Real GDP growth	4.6	4.5	4.5	4.5	4.5	4.5
Inflation	4.3	3.8	4.4	4.2	4.0	3.9
Primary balance	-1.4	-2.1	-1.5	-0.2	-0.4	-0.6
Effective interest rate	4.7	4.4	5.2	5.3	4.9	4.7
Real Interest Rate Shock						
Real GDP growth	4.6	4.5	4.5	4.5	4.5	4.5
Inflation	4.3	3.8	4.4	4.2	4.0	3.9
Primary balance	-1.4	-0.6	0.0	-0.2	-0.4	-0.6
Effective interest rate	4.7	4.4	5.7	6.1	6.1	6.0
Combined Shock						
Real GDP growth	4.6	-1.7	-1.7	4.5	4.5	4.5
Inflation	4.3	2.2	2.8	4.2	4.0	3.9
Primary balance	-1.4	-2.4	-3.7	-0.2	-0.4	-0.6
Effective interest rate	4.7	5.0	5.6	6.2	6.2	6.1

	2019	2020	2021	2022	2023	2024
Real GDP Growth Shock						
Real GDP growth	4.6	-1.7	-1.7	4.5	4.5	4.5
Inflation	4.3	2.2	2.8	4.2	4.0	3.9
Primary balance	-1.4	-2.4	-3.7	-0.2	-0.4	-0.6
Effective interest rate	4.7	4.4	5.2	5.5	5.1	4.9
Real Exchange Rate Shock						
Real GDP growth	4.6	4.5	4.5	4.5	4.5	4.5
Inflation	4.3	9.4	4.4	4.2	4.0	3.9
Primary balance	-1.4	-0.6	0.0	-0.2	-0.4	-0.6
Effective interest rate	4.7	5.0	4.9	4.8	4.5	4.4

Source: IMF staff.

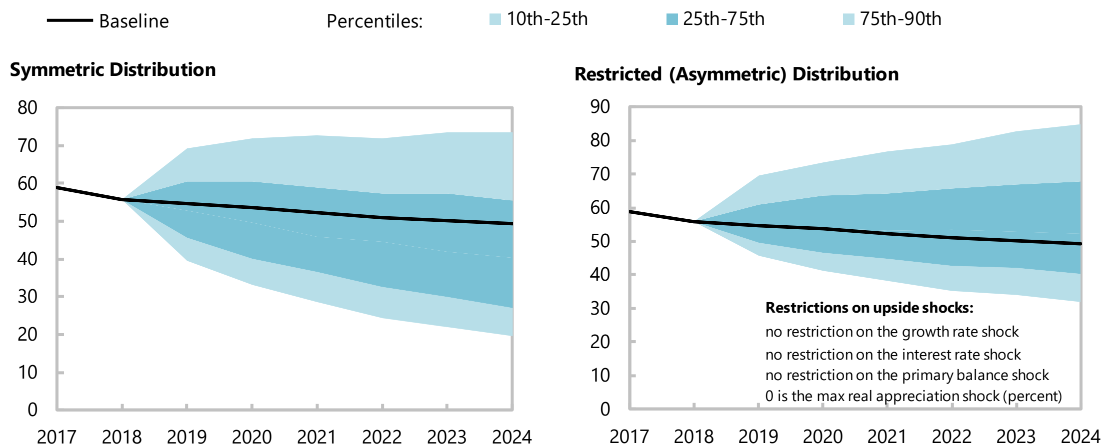
Figure A5. Armenia Public DSA Risk Assessment

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

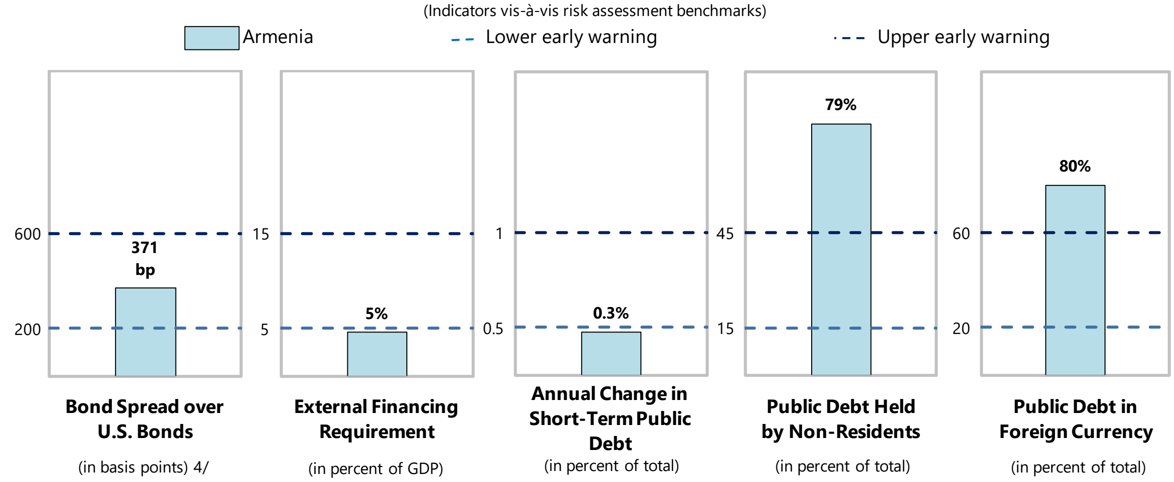
Evolution of Predictive Densities of Gross Nominal Public Debt

(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, 31-Dec-18 through 31-Mar-19.

Annex VI. External Sector Assessment

Armenia's external position in 2018 is assessed to be moderately weaker than implied by fundamentals and desired policies. The current account is expected to improve gradually over the medium term on the back of higher export growth while the need for investment-related imports persists but moderates. Going forward, continued prudent fiscal policy, exchange rate flexibility, and structural reforms to diversify the economy and boost competitiveness would further bolster buffers and support the economy's resilience.

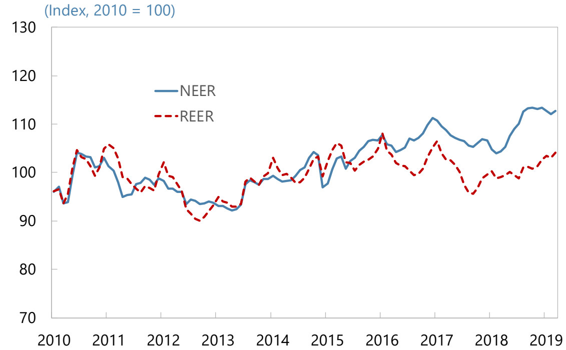
Current Account and Real Exchange Rate

1. **The *current account* (CA) gap is assessed to be in the range of [-3, -1] percent of GDP, a moderately weaker level than implied by fundamentals.** Using the EBA-lite model, Armenia's cyclically adjusted CA norm is estimated at -5.2 percent of GDP. This compares to a cyclically adjusted actual CA balance of -9.1 percent of GDP, implying a model-estimated current account gap of -3.9 percent. The positive contribution from the policy gap (0.65 percent of GDP) is small, and the CA residual—the part of CA gap that cannot be explained by the policy gap—is large at -4.5 percent of GDP. This could reflect important Armenia-specific factors that have driven the actual CA lower and/or would have driven the CA norm lower than the level predicted by model. These factors include a persistent need for investment-related imports, structurally narrow export bases which tend to structurally affect the current account balance. Therefore, staff assesses the CA norm to be -6.2, i.e. 1 percentage point of GDP lower. In addition, staff incorporates a 1 percentage point of GDP statistical adjustment for CA in 2018, reflecting the shortcomings in accounting for re-exports of goods (as discussed in para 6 main text), implying a staff-assessed CA gap of -1.9 percent of GDP after this adjustment, within the range of [-3, -1] percent, implying a moderately weaker external position then implied by fundamentals.

2. **The EBA-lite *REER* approach estimates an overvaluation of 6 percent, which is slightly lower than in the 2017 staff report (13 percent).** The CPI-based REER remained relatively stable over 2010–19, although it depreciated slightly in 2017 and recovered in 2018.

Real and Nominal Effective Exchange rates

(Index, 2010 = 100)



Source: IMF staf calculations.

3. **The latest *external sustainability* (ES) approach estimates a current account norm of -5.6 percent of GDP to stabilize the ratio of net international investment position (NIIP) at the estimated 2016 level of -80 percent of GDP.** This implies a CA gap of -2.5 percent in 2018 corresponding to overvaluation of about 8 percent.

4. **Overall staff considers the CA norm of 5–6 percent consistent with the goal of reducing vulnerabilities.** As the text table shows, the methods (including more conservative

NIIP in ES) point to some exchange rate overvaluation in the range of 6–8 percent, and CA deficit norm of 5–6 percent, which implies a CA gap in 2018 which is projected to be gradually closed in the medium term.

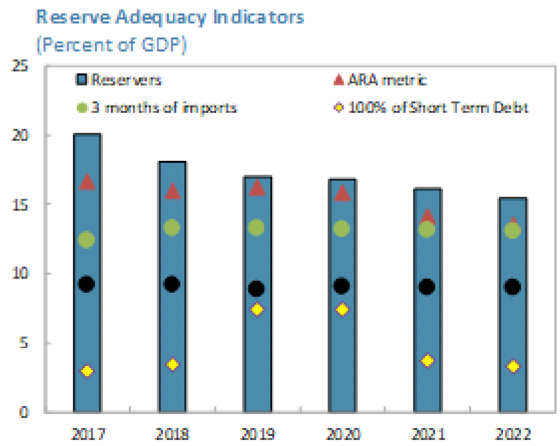
Annex Table VI. Armenia. External Sector Assessment
(In percent of GDP, unless indicated otherwise)

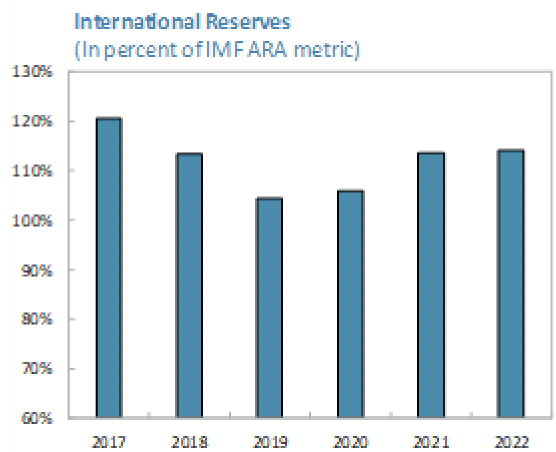
	External Sustainability (EBA-lite ES)	Current Account (EBA-lite CA)	REER (EBA-lite REER)
CA actual	-9.1	-9.1	
Cyclical contributions (from model)	0	0	
Additional temporary/statistical factors	1	1	
Cyclically adjusted CA	-8.1	-8.1	
CA norm	-5.6	-5.2	
Additional adjustments to the norm	0	1	
Cyclically adjusted CA norm	-5.6	-6.2	
CA gap	-2.5	-1.9	
o/w policy gap		-0.6	
Elasticity	-0.3	-0.3	
Real exchange rate gap 1/	8.3	6.3	6.0

1/ Movement in real exchange rate needed to close the gap between norm and underlying current account. Positive means overvaluation.
External Sustainability refers to scenario stabilizing NIIP at -80 percent of GDP (2016 level).

Reserve Adequacy

5. Armenia's foreign exchange reserves remain broadly adequate according to a range of indicators, but vulnerabilities are sizable and increased in 2018. In 2017, gross international reserves recovered to pre-2014 level and reached $2,314 million, driven by strong export receipts, and a pick-up in remittances, tourism receipts, and temporary investment income flows. However, the reserves are estimated to have declined somewhat to $2,249 million at end-2018, on the back of widening of the current account by more than 4 percent. Despite that, exchange rates remained broadly flat and central bank interventions were limited. This partly reflects financing of imports by FDI and other investment flows, including trade credits. Under the Fund's reserve adequacy metric (ARA) for floating exchange rate regimes – the current *de facto* classification – reserves are estimated at 113 percent at end-2018 and projected to remain above 100 percent of the ARA metric over 2019–24. The reserves appear to remain comfortable according to several other metrics as well: more than 3 months of imports, and ample coverage of short-term debt and broad money. Reserves in 2018 were also adequate according to other indicators such as the 3 months import coverage and short-term debt coverage. In the case of adverse external shocks, there could be pressure on central bank reserves (IMF FSSA for Armenia 2018) arising from FX demand by banks which hold nonresident FX deposits





External Debt Sustainability

6. Armenia's external debt-to-GDP ratio remains high but is projected to gradually improve over the medium-term. In the baseline scenario, debt is estimated to reach around 85 percent of GDP at end-2018, but gradually decline in the medium term. This path is broadly consistent with the previous assessment. However, the results of standardized shocks highlight vulnerabilities. Shocks to growth, the non-interest current account and the combined shock scenario all result in a significant increase in external debt to around 97 percent of GDP by the end of the projection period. Consistent with the previous assessment, a one-time 30 percent real exchange rate depreciation would have an even larger impact on external debt, increasing debt to over 125 percent of GDP. However, 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, 2014–24
(in percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	70.9	83.2	92.2	88.7	84.6			**83.5**	**84.3**	**84.5**	**84.3**	**84.4**	**83.3**	**-6.0**
Change in external debt	-7.1	12.3	9.0	-3.6	-4.1			-1.1	0.7	0.3	-0.2	0.1	-1.1	
Identified external debt-creating flows (4+8+9)	1.0	8.1	-0.2	-7.5	2.7			1.5	1.5	1.1	0.7	0.3	-0.4	
Current account deficit, excluding interest payments	6.7	1.6	1.1	1.2	7.8			5.9	6.0	6.0	5.8	5.6	5.1	
Deficit in balance of goods and services	18.7	12.1	9.6	12.2	15.4			15.4	15.0	14.5	14.4	13.7	13.4	
Exports	28.6	29.7	33.2	37.3	37.6			38.0	38.2	38.9	39.5	40.4	40.9	
Imports	47.3	41.9	42.8	49.5	53.0			53.4	53.2	53.5	53.8	54.1	54.3	
Net non-debt creating capital inflows (negative)	-3.3	-1.5	-2.6	-2.0	-2.1			-2.2	-2.3	-2.3	-2.4	-2.5	-2.6	
Automatic debt dynamics 1/	-2.4	8.0	1.3	-6.7	-2.9			-2.2	-2.3	-2.6	-2.7	-2.8	-2.9	
Contribution from nominal interest rate	0.9	0.9	1.2	1.2	1.3			1.4	1.3	1.0	0.9	0.8	0.7	
Contribution from real GDP growth	-2.7	-2.5	-0.2	-6.3	-4.2			-3.6	-3.6	-3.6	-3.6	-3.6	-3.6	
Contribution from price and exchange rate changes 2/	-0.6	9.6	0.3	-1.6	...			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-8.1	4.1	9.2	3.9	-6.8			-2.6	-0.7	-0.8	-0.9	-0.2	-0.8	
External debt-to-exports ratio (in percent)	248.1	280.0	277.8	237.5	225.2			219.8	220.6	217.3	213.8	208.9	203.5	
Gross external financing need (in billions of US dollars) 4/	1.9	0.7	0.6	0.5	1.5			1.4	2.0	1.6	1.6	1.6	1.6	
in percent of GDP	16.2	6.8	5.7	4.6	11.7	10-Year	10-Year	10.4	14.2	10.9	10.3	9.7	9.0	
Scenario with key variables at their historical averages 5/					84.6			**87.4**	**90.3**	**93.2**	**96.1**	**99.9**	**103.0**	**-4.2**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	3.6	3.3	0.2	7.5	5.2	2.3	6.2	4.6	4.5	4.5	4.5	4.5	4.5	
GDP deflator in US dollars (change in percent)	0.8	-12.0	-0.3	1.8	4.0	-1.1	6.6	2.8	0.6	0.7	0.8	0.9	0.9	
Nominal external interest rate (in percent)	1.1	1.2	1.4	1.5	1.6	1.1	0.3	1.8	1.6	1.2	1.1	1.0	0.9	
Growth of exports (US dollar terms, in percent)	5.2	-5.5	11.6	23.0	8.4	10.3	16.8	8.7	5.7	7.2	6.8	7.9	6.8	
Growth of imports (US dollar terms, in percent)	0.2	-19.5	2.2	26.4	15.3	6.9	18.3	8.3	4.7	5.7	6.1	6.0	5.8	
Current account balance, excluding interest payments	-6.7	-1.6	-1.1	-1.2	-7.8	-7.4	5.1	-5.9	-6.0	-6.0	-5.8	-5.6	-5.1	
Net non-debt creating capital inflows	3.3	1.5	2.6	2.0	2.1	4.2	2.9	2.2	2.3	2.3	2.4	2.5	2.6	

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

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

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

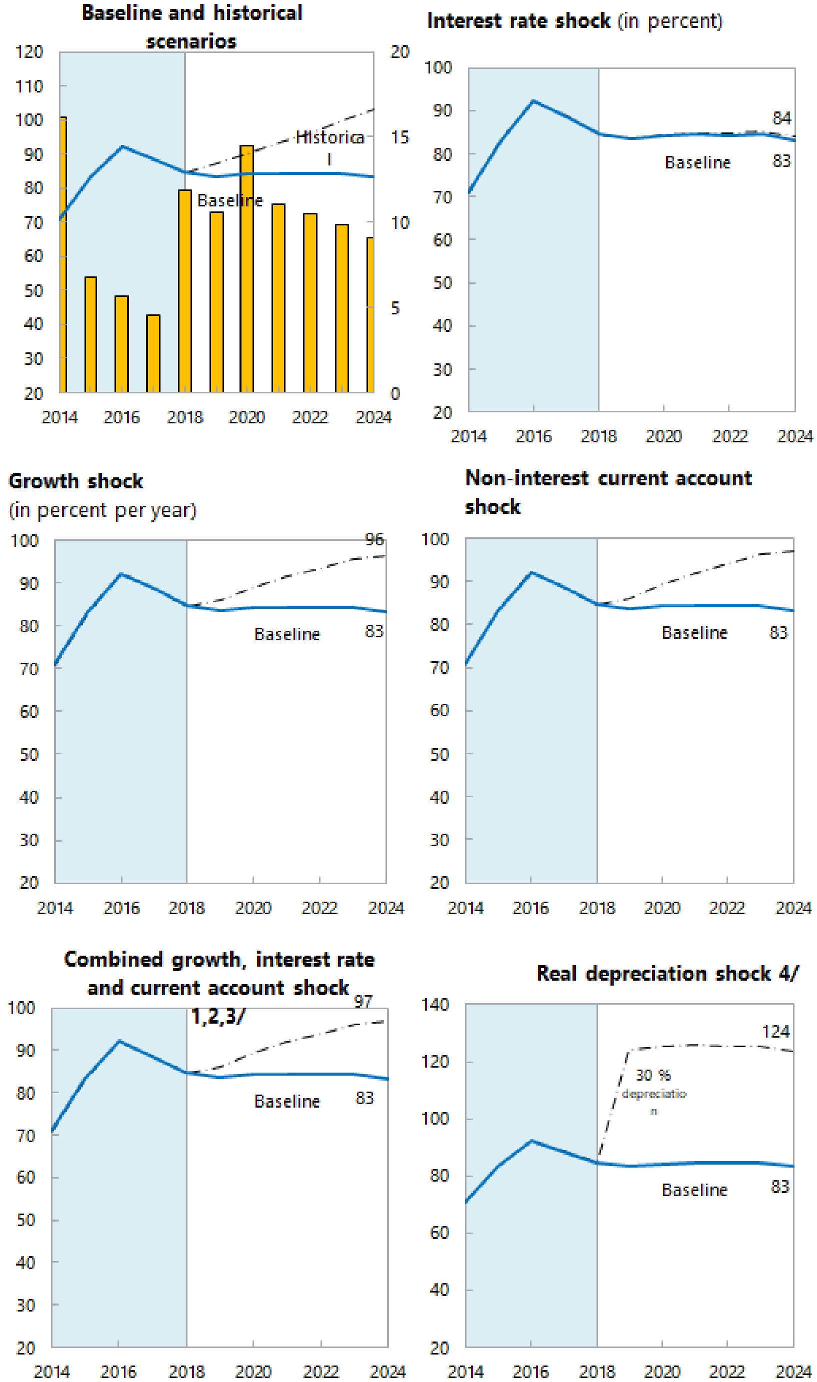
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

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

(External debt in percent of GDP)



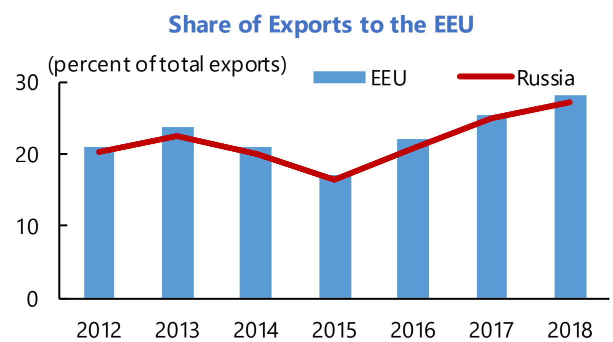
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. 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 2019

Annex VII. Effects of Armenia's Accession to Eurasian Economic Union

1. **In January 2015 Armenia became a founding member of the Eurasian Economic Union (EEU), which comprises Russia, Kazakhstan, Belarus, and the Kyrgyz Republic**. The EEU is a customs union and "single economic space" that calls for free movement of goods, services, capital, and people within its borders. The EEU membership provided an opportunity for Armenia to expand its exports and deepen integration, notably with Russia.

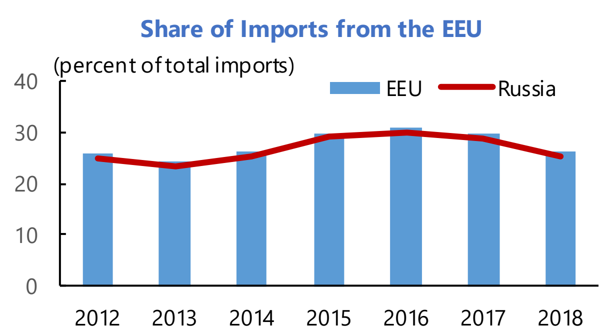
2. **The EEU can bring multiple benefits through deeper integration across a broad range of areas**. Greater diversification and larger markets would increase domestic competition, facilitate innovation, and contribute to building cross-border production chains. These, in turn, would increase exports outside the region and enhance job opportunities. While Armenia is already a member of the Free Trade Agreement Common Independent States, EEU membership is expected to eliminate the need for customs declarations and inspections, thus reducing non-tariff barriers and delays.

3. **Exports to the EEU countries has increased notably since 2015.** The share of exports to the EEU countries rose from 17.3 percent of total exports in 2015 to 27 percent in 2018. This was driven mainly by textile, pharmaceutical, and agricultural exports to Russia. As a result, share of exports to Russia has increased by 10.6 percentage points since 2015. By contrast, the share of exports to Belarus, Kazakhstan, and the Kyrgyz Republic remains unchanged (about 1 percent of total exports).



Source: UN Comtrade data and IMF staff calculations

4. **Meanwhile, the impact on imports has been mixed**. The share of imports from the EEU countries amounted to 26.3 percent of total imports in 2018, which is almost the same level as it was before the accession (26.1 percent in 2014). During 2015–17, the share of imports of iron, steel, and sugar products from Russia and the share of imports of dairy and agricultural products from Belarus have increased. This increase has been fully offset by declines in the share of imports of cereals from Russia and the share of imports of mineral products from Belarus.



Source: UN Comtrade data and IMF staff calculations

5. **Data limitation hampers a rigorous econometric analysis.** A gravity model, capable of assessing long-term bilateral trade determinants, can be considered to accurately assess trade effects of Armenia's accession to the EEU. Reliable estimation, however, is not possible given that bilateral trade data are available on an annual frequency only and the period under consideration is short.

Appendix I. Letter of Intent

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

Yerevan, May 2, 2019

Dear Ms. Lagarde:

1. **The 2018 peaceful political change was a watershed moment for Armenia.** It created an opportunity to deal with the oligarchical economic system, and combat corruption and vested interest. We have already started to address these issues by preparing a 5-year program.

2. **Despite the political transition, Armenia's economic performance has improved since 2016, guided by sound macroeconomic policies**. Following the economic slowdown of 2015–16 associated with adverse external shocks in late 2014, economic growth recovered in 2017 and remained strong in 2018. Fiscal consolidation, supported by the upgraded fiscal rule, has been intensified, and public debt as a percentage of GDP has started to decline. The Central Bank of Armenia has maintained low inflation and financial stability. Pressures on the exchange rate have been limited and international reserves have been bolstered. The banking system has shown resilience to the political transition, thanks to prudent risk management and strong supervision. Important structural reforms, including the full-scale implementation of the pension reform, have taken place.

3. **However, many challenges remain.** The economy continues to be vulnerable to external shocks; informal activity remains large; and weaknesses in the business climate and governance impede stronger growth. To tackle these challenges, the new government as pledged to carry out extensive structural reforms.

4. **Our program for 2019–23 includes a number of strategic tasks to expand Armenia's economic potential and promote inclusiveness.** These include: (1) strengthening competition; (2) enhancing governance; (3) developing human capital; and (4) developing infrastructure. In addition, we remain committed to preserving macroeconomic and financial stability as pre-requisites for sustainable economic growth. We believe that an IMF program can support our reform efforts and macroeconomic policies.

5. **The enclosed Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU) provide comprehensive details of our reform agenda and program.** In support of these, the government of Armenia requests a 36-month Stand-By Arrangement in the cumulative amount of SDR 180.0 million (139.75 percent of quota). While we believe that the new government's envisaged package of policies will increase resilience, a new IMF-supported program will provide insurance against external shocks. We intend to treat the program as precautionary.

6. We will maintain a close policy dialogue with the IMF to ensure the achievement of our economic objectives under the program. In addition, we will consult with the IMF in advance of any revisions to the policies contained in our MEFP, in accordance with the IMF's policies on such consultations; and will provide IMF staff with the data and information necessary for the purpose of monitoring the program.

7. We authorize the IMF to publish this Letter of Intent and its attachment (MEFP and TMU), as well as the accompanying staff report. These documents will also be posted on the official websites of the Armenian government after the approval by the IMF Board.

Very truly yours,

/s/
Nikol Pashinyan
Prime Minister

/s/
Arthur Javadyan
Chairman of the Central Bank of Armenia

/s/
Atom Janjughazyan
Minister of Finance

Attachment I. Memorandum of Economic and Financial Policies (MEFP)

1. **This memorandum reports on economic developments and outlines the economic and financial policy agenda of the new government and the Central Bank of Armenia (CBA)**. The government's program for 2019–23 aims at building an export-led competitive and inclusive economy. To this end, our strategic tasks include: (1) expanding opportunities for economic activities; (2) enhancing governance; (3) developing human capital; and (4) developing infrastructure. This policy agenda will be supported by our request for a 36-month Stand-by Arrangement. Our program aims to address Armenia's economic challenges, including the weak business environment; vulnerabilities to external shocks; revenue mobilization; and poverty and unemployment.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

2. **Economic performance has been solid and macroeconomic policy implementation has been sound.**

- **Armenia's economy posted 5.2 percent growth in 2018.** Following unusually strong economic activity in 2017, growth moderated to more sustainable levels, in part owing to a slowdown in trading partners. End-year inflation fell below the lower-end of the CBA's medium-term target band reflecting both supply and demand factors. The recorded current account deficit widened to 9.1 percent of GDP owing to strong imports, weaker investment income and remittances, and, possibly, one-off factors.
- **Fiscal consolidation is on track.** The tax-to-GDP ratio rose by 0.4 percentage points in 2018, supported by strong tax administration effort. Spending, however, was below the budget owing to delays in both current and foreign-financed capital expenditure. As a result, the 2018 fiscal deficit was 1.8 percent of GDP, significantly lower than the budget target of 2.7 percent of GDP.
- **Monetary and financial conditions remain stable.** The CBA lowered its policy rate by 25 basis points to 5.75 percent at end-January in response to low inflation; pressures on the exchange rate have been limited; credit growth has been strong; and the well-capitalized banking sector weathered the political transition of 2018 well.
- **Structural reforms are advancing.** The implementation of a full-fledged pension reform, which came into effect in July 2018, is on track. The details of the upgraded fiscal rule were approved by the cabinet in August. A draft public-private partnership (PPP) law was prepared in consultation with the international development partners, including the IMF. An electronic module for random selection of tax auditors was established in December 2018 to increase voluntary tax compliance and reduce tax evasion.

3. While we expect our policy actions and reforms to deliver visible economic benefits, we conservatively envisage the following macroeconomic scenario under the IMF program:

- **Real GDP growth** is projected to moderate to about 4½ percent in 2019, reflecting somewhat weaker global environment and copper prices. For the purpose of the IMF program, medium-term growth is conservatively assumed at 4½ percent, in line with current estimates of potential growth, based on historical data. Our objective, however, as stated in the new government's program, is to achieve at least 5 percent growth by implementing our reform program.
- **Inflation** is projected to stay within the lower part of the CBA's inflation tolerance band in 2019 and converge to 4 percent target over the medium term as the small negative output gap gradually closes.
- **The current account deficit** is expected to improve to 6.5 percent of GDP in 2019, as one-off factors begin to fade, and gradually narrow to around 5-6 percent of GDP over the medium term.

4. While we believe that the new government's envisaged package of policies will increase resilience, the precautionary nature of the IMF Stand-by arrangement will provide useful insurance against external shocks. It will also strengthen confidence and support our structural reform agenda. While we do not have balance of payments needs under our baseline projections, they could materialize in the event of external shocks. Such shocks could result from increased global trade tensions or turbulence in global financial markets, which could lower trading partners' growth and commodity prices, or a pickup in regional geopolitical tensions. While we have broadly adequate foreign exchange reserves and a well-capitalized and liquid banking system, an IMF arrangement will provide additional buffer to help us cope with negative shocks. We are also prepared to further adjust policies as necessary.

ECONOMIC POLICIES

Fiscal Policy

5. Our medium-term fiscal policy objective is to preserve debt sustainability, while maintaining space for investment and social spending. Our efforts toward achieving this objective, described in the 2019–21 medium-term expenditure framework (MTEF), will be guided by the fiscal rules revamped in 2017 with IMF support. We are committed to bringing down central government debt to below 50 percent of GDP within five years. Under the conservative macroeconomic assumptions of the program, this would require maintaining the fiscal deficit at around 2 percent of GDP in the coming years, while preserving capital and social spending to promote inclusive growth through strong revenue mobilization efforts.

6. The 2019 budget has been drawn up in line with this objective. Under the 2019 budget, current spending is set to remain broadly unchanged as a share of GDP compared to the 2018 budget, while capital spending is assumed to increase by ½ percent of GDP. Under the fiscal revenue projections in this MEFP, which are somewhat more conservative than the budget, tax revenues are expected to rise by 0.4 percent of GDP compared with 2018, reflecting measures embedded in the 2016 tax code and our continued effort to strengthen tax administration. As a result, the fiscal deficit is expected at 2½ percent of GDP in 2019 under the IMF-supported program. In the event of any revenue shortfalls, we will take compensating measures while striving to protect the social spending envelope.

Structural Fiscal Policies

7. **Our tax reform package is intended to promote compliance and medium-term growth.** The personal income tax (PIT) and corporate income tax (CIT) rates in Armenia are relatively high compared to the region, limiting incentives to work and invest. Moreover, the current PIT structure has not served its role in income redistribution, given widespread underreporting by high-income taxpayers. Thus, our tax reform rationally aims at enhancing competitiveness and compliance by flattening the PIT structure and reducing the CIT rate. The subsequent annual cuts in the PIT rate by 1 percentage point to bring it to 20 percent will be accompanied by restoring the equal shares of the government and the employees in the social contribution, which will contribute to alleviating fiscal losses. In addition, we wish to incentivize small businesses by streamlining micro-enterprise taxation and reversing the scheduled reduction of the VAT threshold in 2019. We expect the tax reform package to be adopted in the coming months.

8. **Since the tax rate cuts will entail short-term revenue losses, we have put together a package of tax policy and administration measures to fully offset the estimated losses and stand ready to take additional revenue measures if necessary.** The full short-term impacts of the revenue losses without offsetting measures are estimated close to 1 percent of GDP per year—until the anticipated expansion compliance materializes in the medium term. Hence, we are adopting a package of offsetting tax policy measures that includes: (1) increasing certain excise taxes on alcohol and tobacco; (2) indexing excise tax rates; (3) removing selected tax exemptions; and (4) increasing gambling and financial sector license fees. Our estimates suggest that these measures would yield 0.7–0.8 percent of GDP in revenues and, with support from tax administration efforts, fully offset the potential revenue losses. Given our strong commitment to fiscal sustainability and the corrective action plan under our fiscal rules, we stand ready to take additional compensating measures if these measures do not fully offset the losses. To this end, as one possible measure, we will explore ways to rationalize tax expenditures for the profit tax regime during the program period.

9. **Given our commitment to promoting inclusive growth, we are mindful of the tax reform's possible impact on equity.** While we believe that the reform package, including the PIT flattening and higher excises components, are likely to have only a negligible negative impact on equity, we have been working with the World Bank to build a model to fully analyze the distributional effect of the fiscal reform. Once the model is finalized by mid-2019, it will inform our policies and help identify mitigating measures if needed. Moreover, under this program, we

have identified a wide range of structural reforms with positive impacts on equity and poverty reduction (see ¶24).

10. We are fully committed to overhauling property taxation by 2021 to promote fairness and generate more revenues in the medium term. The Cadastre Committee has already completed the work on new evaluation zoning and elaborated the methodology of assessment for real estate taxation based on market assessments and contractual prices of the transactions during the past five years. We intend to submit a law entitled "On Establishing Market Evaluation Procedure for Real Estate Taxation", after consulting with stakeholders, to the National Assembly (NA) by June 2019 (structural benchmark—SB). The next steps in the property tax reform include reviewing the rate structure and nontaxable threshold, as well as devising the mechanism to help the low-income population, which are expected to be completed by December 2020. We will consider IMF TA recommendations, including (1) lowering the threshold for residential properties to a level that affects only low-income households (not more than 20 percent of the residential housing stock) and working purposefully toward means testing; (2) simplifying the tax rate structure to 3 distinct levels: one for commercial buildings/properties, one for residential properties, and one for agriculture; and (3) granting local governments the right of local rate setting as part of the local government decentralization initiative but within a centrally-set rate range. We will also enhance the electronic tax management system by December 2020 with a new module for the calculation and collection of property tax. Tax collection based on the new market-based valuation will start in January 2021.

11. The success of our tax policy reform hinges on our resolve to strengthen tax administration to ensure broader and more equitable compliance by taxpayers and combat deep-seated tax evasion. With this in mind, we are currently finalizing the draft of the state revenue committee tax administration strategy for 2019–2022. Our efforts to strengthen tax administration cover a number of areas.

- We will develop an action plan to implement key recommendations from the recent IMF TA, including (i) developing a compliance strategy that defines the main compliance risks and SRC responses to these risks, governance arrangements for the implementation of the compliance strategy, and measurement of the impact of SRC activities on tax compliance; (ii) establishing procedures for the ongoing regular cleansing and updating of the taxpayer register; (iii) developing a performance management process that monitors and ensures that SRC units effectively achieve on-time reporting and full payment of tax obligations by the registered taxpayers; (iv) discontinuing annual publication of the list of taxpayers selected for audit; and (v) eliminating preferential treatment for voluntary disclosure of underreporting after initiation of an audit (June 2019 SB). In this regard, we welcome continued IMF TA support on risk-based enforcement and tax gap analyses.
- We are conducting a comprehensive study to identify tax potential as well as factors preventing tax collection reaching this potential. Based on the findings of this study, we will design an action plan (December 2019 SB) to improve tax compliance and raise the

tax-to GDP ratio in the medium term. In this regard, we take note of the recent IMF TA recommendation that to avoid arbitrage opportunities and revenue leakages, legislative measures may be required to: (1) clarify the tax liabilities of "self-employed persons" who seek to circumvent their tax obligations; and (2) address the use of company loans and similar financial arrangements to arbitrage CIT and PIT liabilities.

- We will prepare an action plan by December 2019 on the steps required to introduce individual tax returns by end-2021. To start the process, we will improve the tax control toolkit for persons who have not issued a declaration or have submitted false information. This process can be facilitated by preparation of pre-filled tax returns. We believe that our concerted efforts to promote cashless economy will facilitate achieving broader compliance by taxpayers and combatting tax evasion.

12. Accelerating structural expenditure reforms to support fiscal sustainability and inclusive growth is another government priority.

- ***Budget process.*** We will continue transition to program budgeting to improve planning and managing the delivery of public services and increase efficiency of budget expenditures. Specifically, we are revising the contents and format of the medium-term expenditure program in order to streamline the budget process and eliminate repetition and possible inconsistencies between the MTEF and annual budget cycles. We are also working on enhancing the credibility of the MTEF and increasing its role in fiscal policy implementation by introducing rolling-base budgeting in the 2020 budget cycle in cooperation with the IMF.
- ***Public investment management.*** We will put strong emphasis on strengthening the public investment management (PIM) framework and improving the management of foreign-financed capital spending. To this end, the government has decided to incorporate all project implementing units (PIUs) into relevant ministries to eliminate redundant and overlapping functions, streamline responsibilities, and raise accountability. We believe such a restructuring will help us more effectively control the implementation of donor-financed projects, reduce the volatility in budget execution, and optimize the use of public resources. We will carefully manage the transition process, which is expected to be completed during 2019, to avoid disruptions in budget execution. In line with IMF PIMA recommendations, we regard having a sound and complete PIM framework as paramount for better managing the project pipeline, prioritizing and selecting investment projects, and linking them with the priorities in the government's program, as well as the MTEF and budget processes. After defining the responsible agencies within the ongoing formulation of the new government architecture, we will proceed to develop the legislation and procedures in line with best international practice, with the aim of developing a national investment plan of prioritized projects.
- ***Fiscal risks management.*** We are committed to strengthening fiscal risks management within the new government structure. We will aim to clarify the functions and responsibilities related to fiscal risk management among the government entities. In line

with the general principles of fiscal transparency, we will expand and improve the disclosure of fiscal risks in the MTEF and budget documents. Our short-term goal is to raise our capacity to transition from mainly fiscal risk reporting to risk assessment. We understand that the public-private partnership (PPP) framework is a procurement method that may raise efficiency and cost-effectiveness in the delivery of services but not genuinely generate fiscal space. Hence, we are committed to strengthening our legislative and institutional framework to monitor and control the associated fiscal risks. In this regard, we intend to submit to the NA a PPP law that follows best international practice by establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships (June 2019 SB). We will also create and maintain a database of all PPPs including the existing PPAs and possible PPAs under negotiation or newly proposed by June 2020.

- ***Fiscal transparency.*** We strongly believe that transparent public finance management is a cornerstone of fiscal stability and good governance. One of the important recent steps to increase fiscal transparency was the government's initiative to organize discussions of budget programs included in the draft state budgets in the leading committees of the National Assembly in advance of presenting them for formal discussions. We are also committed to publishing and implementing the Fiscal Transparency Evaluation action plan. As a first step, we are preparing to implement GFS2014. We will strengthen transparency in public procurement by publishing the results of the public procurement decisions in addition to developing a strategic procurement framework with the World Bank's assistance.

13. We will focus on enhancing the adequacy of social spending that is vital for Armenia's inclusive growth. We will continue increasing funding for the education and health sectors in line with the MTEF. We will maintain social expenditure above the indicative target setting the floor on the flow for the government's social spending. The program budgeting framework together with stronger public procurement system will help ensure targeted, cost-effective, and efficient use of public finance in this area. We will continue galvanizing donor's expertise and support to priority reform areas for developing human capital and enhancing social protection (¶24).

14. We will further enhance our public debt management. The debt management strategy will seek to expand financing sources, including by further developing and deepening the domestic bond market. This is particularly important considering the large redemption of a Eurobond due in 2020H2. To manage the orderly redemption of the Eurobond, we will consider various refinancing options, drawing on our medium-term debt management strategy framework and considering capital market development aspects.

Monetary Policy

15. The inflation targeting framework has worked well in maintaining stable inflation. In our view, the current monetary policy stance should guide inflation to gradually increase and stabilize around the CBA's inflation target 4 percent by 2021. We are closely monitoring the economic situation and stand ready to take additional actions where necessary to ensure that the quarterly inflation path remains on track. Any further policy rate changes will be data-dependent, consistent with our inflation targeting framework and monetary policy consultation clause (MPCC) conditionality. We will also continue to strengthen the monetary policy transmission channel, including by improving communication with the financial sector and the business community.

16. We will maintain the existing flexible exchange rate regime in line with the inflation targeting framework, while aiming to ensure international reserves adequacy. We believe that continued two-way exchange rate flexibility will help protect reserve buffers and maintain competitiveness. The interventions will be limited to smoothing excessive fluctuations and mitigating transitory pressures. To further bolster Armenia's resilience to external shocks, we are committed to maintaining the international reserves at adequate levels in line with the IMF reserve adequacy metrics.

17. We will continue to strengthen the inflation targeting framework. Guided by our mandate and FSAP recommendations, we will explore policy actions to further strengthen liquidity management and improve monetary policy transmission. The enhanced coordination between the CBA and the MOF will support these efforts, as the government will regularly share its cash flow forecast with the CBA to facilitate effective liquidity management (¶21). We will also continue to provide seven-day repos to strengthen signaling the stance of the monetary policy as well as for liquidity management purposes. Three-month repo instruments will be used only for structural liquidity management purpose. Moreover, we are committed to improve monetary policy transmission channels by deepening the interbank market and we will ensure that the central bank provides repo agreements only to address aggregate liquidity shortages in the market. Finally, our efforts to accelerate de-dollarization in the economy (¶20) will contribute to reinforcing monetary policy transmission channels.

18. The CBA will continue to balance the dual mandate of price and financial stability within a coherent and coordinated policy framework. To foster the credibility of the dual mandate, we are working on summarizing our macroprudential policy implementation strategy in a separate document, describing policy objectives, instruments and transmissions, decision making processes, communication strategy, and accountability. In the meantime, we will continue close communication between the monetary policy, financial stability and financial operations departments of the CBA at both staff and managerial levels to ensure institutional coherence in formulating policy tools.

Financial Sector Policy

19. Our policies will support financial sector stability and resilience. We have already strengthened bank supervision by adopting the risk-based supervision framework. We will now focus our efforts on refining risk-based differentiation in capital levels, enforcing large exposure limits, and amending the definition of non-performing loans to reflect international best practices. We will prepare a time-bound action plan and communication strategy to boost foreign currency liquidity buffers as described in the 2018 FSAP recommendations (¶19, 21, and 32) through a combination of liquidity tools (September 2019 SB).

20. We will further strengthen macroprudential toolkit in light of still high levels of dollarization. We will introduce a capital conservation buffer and a surcharge for domestic systemically-important banks as planned. We will start working on addressing data gaps related to income information in order to adopt a debt service-to-income ratio, if the data sources are sufficient and credible. During that period, as a measure to address credit risk from unhedged FX exposures and help the de-dollarization process we will start working on adoption of stressed Loan-to-value (LTV) limit.

21. Capital market development is essential to strengthening the monetary policy transmission and channeling domestic savings to productive investment. We will prepare a capital market development program (September 2019 SB) that will consist of a number of elements. We will review the existing primary and secondary legislative framework for securities as a precondition for successful capital market development. We will also work on creating a short-term benchmark rate that can be used as an effective reference for domestic banks and other money-market participants. The enhanced coordination between the CBA and the MOF (¶17) will also contribute to the development of money market rates.

Structural Reforms

22. The Government's Program for 2019–23 emphasizes our commitment to bold structural reforms to promote investment and advance sustainable and inclusive growth. Our priority is to prepare comprehensive and consistent time-bound action plans to operationalize the national agenda in the government's program for the coming years. In this regard, we will produce sectoral plans within 2019 where we will identify actions, targets and timeline to achieve stronger sustainable more inclusive growth. Promoting digitalization will underpin our reform efforts in all the reform areas.

23. We will decisively tackle the weaknesses in business environment on multiple fronts.

- ***Doing Business and competition.*** The government will prepare an action plan for 2020 by revising elements of the regulatory framework to address core issues identified by the 2019 World Bank Doing Business (February 2020 SB).
- ***SMEs.*** Developing small and medium entrepreneurship further is a prerequisite for inclusive economic growth. We will conduct an efficiency review of the existing government's SME support programs to identify ways to strengthen financial inclusion in an efficient and streamlined manner (April 2020 SB).
- ***Corporate governance.*** Sustained financial sector development and access to finance by the corporate sector requires improvements in transparency and accounting across all sectors of the economy. To advance corporate accounting and auditing reforms, we will

develop a framework to establish a public oversight body and the Chamber of Accountants and Auditors, which would work on improving corporate financial information and reducing SME financial reporting requirements (March 2020 SB).

- ***Contract enforcement.*** Enhancing contract enforcement is crucial to improving the business climate. To this end, we will develop a plan to strengthen debt enforcement through computerized processing for straightforward debt claims (as defined by EU Regulation 1896/2006).

24. We are putting strong emphasis on developing human capital and enhancing social protection to tackle poverty and unemployment.

- ***Labor market policies.*** Creating more employment opportunities to reduce high unemployment and lessen the incentives for emigration is an urgent priority. To this end, we are developing an employment strategy for 2019–23 the main principles of which are the equilibration of supply and demand of labor market, the development of the youth-focused employment policy, the prevention of long-term unemployment, the proactive and mutually beneficial cooperation with employers, as well as restraining poverty and stimulating social inclusion through employment promotion, matching the existing active labor market programs to the needs of both jobseekers and employers (December 2019 SB). At the same time, we will strive to boost female labor force participation. Among strategic issues we highlight the increase of service quality and the introduction of electronic services.

- ***Social protection.*** To reduce poverty and regional income disparity, we are strengthening the existing social and family benefit scheme, which will be supported also by introduction of universal income declarations for individuals. At the same time, we will continue implementing the existing initiatives, such as enhancing the system of integrated social services by introducing social assessment system of families, creating integrated social centers across regions, strengthening social worker programs and conducting multi-dimensional surveys for developing specific and targeted measures. We will use the expertise of the World Bank staff in this area. Finally, we remain strongly committed to the 2018 implementation of pension reform, which is the most important cornerstone of the social protection system.

- ***Education.*** Together with several development partners, we have been working toward restructuring and modernizing the tertiary education system to help meet the changing workforce needs of the 21st century economy. We plan to (1) develop a comprehensive education reform strategy to increase equitable access to pre-school education in line with the principles of inclusive and social justice, to improve general education programs and physical conditions of secondary schools (June 2020 SB); (2) operationalize the tertiary education management system (December 2019 SB); and (3) elaborate a comprehensive reform of pedagogical education.

- ***Health.*** With the aim of introducing the universal health coverage financing system, the government is preparing a concept note, which will set the coverage of beneficiaries and structure of the system.

25. Fighting corruption is the key pillar of our economic strategy. To this end, we are committed to the following steps that are critical for effective anti-corruption efforts.

- We will submit to the Parliament a draft law on a single autonomous anti-corruption entity in line with country best practices and international standards (Jakarta Principles) (September 2019 SB) which combines all detection and investigative functions (properly resourced and staffed with officials whose professional qualifications and integrity are ensured through a transparent vetting process; subject to a robust external oversight process; with adequate research, intelligence and analytical capabilities that can access all relevant information for its investigations; abrogate the jurisdiction of the other agencies accordingly).
- We will adopt legislation (June 2019 SB) to require the establishment of a registry of beneficial ownership information which is adequately resourced and staffed, and can conduct verification, first beginning with companies in the extractive industry, as identified in the EITI 2016 Standard.
- We will implement the CPC law on asset declarations by ensuring the five commissioners are appointed by June 2019 and ensure seamless continuation of the currently existing IT based platform for asset declarations.[1] We plan to secure the interoperability of the data systems for asset declarations with the tax declaration system.
- The MoJ will complete a report, in consultation with Fund staff, by December 2019, on the processing of corruption cases in the courts, including inflow, processing time, clearance rate, backlogs and workload assessment, and make recommendations to enhance efficiency of the court process.
- We will revise the Criminal Code to be in line with UNCAC and country best practice, including in relation to (i) eliminating threshold amounts on embezzlement (current Article 179 Criminal Code)) (ii) introducing criminal liability for legal persons (iii) complete, in consultation with Fund staff, a report comparing country best practice models by December 2019 to inform amending the statute of limitations term for corruption cases so that it commences at the point of discovery (not at the time of the completion of the act) and is suspended/terminated at the time of the decision of the first instance court (iv) retaining criminal liability in case of repayment for corruption crimes, notably in tax cases.

[1] Draft law – all regulations will enter into force into January 2020 to ensure all provisions for asset declarations are in force and implemented

- We will develop a proposal, with IMF support, to strengthen debt enforcement through computerized processing for straightforward debt claims (as defined by EU Regulation 1896/2006).

PROGRAM MONITORING AND SAFEGUARDS

26. The program will be monitored through quantitative performance criteria, indicative targets, a monetary policy consultation clause, and structural benchmarks. Semiannual program reviews will be based on end-June and end-December test dates. The first review is expected to be completed on or after September 30, 2019 and will assess performance as of end- June 2019. The second review is expected to be completed on or after March 31, 2020 and will assess performance as of end-December 2019. All quantitative performance criteria and indicative targets are listed in Table 1, and structural benchmarks are set out in Table 2. The Technical Memorandum of Understanding is also attached to describe the definitions of quantitative PCs and the monetary policy consultation clause as well as data provision requirements. During the Fund-supported program period, we will not introduce or intensify any exchange restrictions, introduce or modify multiple currency practice and will continue to comply with all obligations under Article VIII of the IMF's Articles of Agreements.

27. The CBA will continue to maintain a strong safeguards framework and internal controls environment. A new Safeguards Assessment will be conducted by the time of the First Review. As required by the IMF's safeguards policy, we will continue to engage independent external audit firms to conduct the audit of the CBA in accordance with International standards.

28. We believe that the policies set forth in this MEFP are adequate for achieving the objectives of the program, and we stand ready to take additional measures as necessary. We will maintain a close policy dialogue with the Fund.

Table 1. Armenia: Quantitative Performance Criteria 1/

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

	2018	2019				2020	
	Dec.	Mar.	Jun. 2/	Sep. 3/	Dec. 2/	Mar.	Jun.
	Act.	Est.	Prog.	Prog.	Prog.	Proj.	Proj.
Performance Criteria							
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,405	1,316	1,392	1,408	1,444	1,446	1,462
Program fiscal balance (flow, floor) 4/	...	-58	-99	-157	-196	-50	-70
Budget domestic lending (cumulative flow, ceiling)	...	0	15	15	15	15	15
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	0	0	0
MPCC 5/							
Inflation (upper-band, percent)	..	3.4	4.0	3.4	4.0	4.2	4.3
Inflation (mid-point, percent)	1.9	1.9	2.5	1.9	2.5	2.7	2.8
inflation (lower-band, percent)	..	0.4	1.0	0.4	1.0	1.2	1.3
Indicative Targets							
Net domestic assets of the CBA (stock, ceiling)	439	588	574	713	831	673	689
Avg. concessionality of newly contracted ext. debt (flow, floor, in percent) 6/	...	30	30	30	30	30	30
New government guaranteed external debt (stock, ceiling, in millions of USD) 7/	...	100	100	100	100	100	100
Social spending of the government (flow, floor) 8/	...	15	30	46	62	20	40
Memorandum items:							
Budget support grants (cumulative from beginning of each year)	...	0	0	9	9	0	9
o.w. EU MFA grant	...	0	0	9	9	0	9
Budget support loans (cumulative from beginning of each year)	...	0	48	72	104	0	59
o.w. non-IMF loans	...	0	48	72	104	0	59
Project financing loans (cumulative from beginning of each year)	...	67	87	130	166	0	98
Project financing grants (cumulative from beginning of each year)	...	0	10	22	30	0	12
KFW and IBRD loan disbursements (cumulative from beginning of each year)	...	0	13	21	43	0	13

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU, based on program exchange rates in the TMU.

2/ Quantitative performance criteria at test dates.

3/ Indicative target.

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

5/ If the end of period year-on-year headline inflation is outside the upper/lower bound, a formal consultation with the Executive Board as part of program reviews would be triggered.

6/ Assessed on a calendar year basis, excluding the Eurobond and any similar refinancing instruments.

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

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: Structural Benchmarks

Measures	Responsible Agency	Time Frame	Macro Criticality
Fiscal			
Design an action plan to improve tax compliance and raise tax-to GDP ratio in the medium term, based on a study identifying tax potential and factors preventing tax collection reaching this potential	Deputy Prime Minister's Office	December 2019	Improve tax administration and compliances
Create an action plan to implement key recommendations from IMF TA on tax administration on developing a compliance strategy and strengthening core functions and processes	State Revenue Committee (SRC)	June 2019	Improve tax administration and compliances
Submit a draft law "On Establishing Market Evaluation Procedure for Real Estate Taxation" to the National Assembly to implement a value-based recurrent property tax with appraised property values closely aligned to market prices	Deputy Prime Minister's Office	June 2019	Enhance revenue mobilization and fairness
Submit a public-private partnership (PPP) law to the National Assembly, establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships	Ministry of Economic Development and Investments (MoE)	June 2019	Incentivize FDI and investment in infrastructure projects
Monetary and Financial			
Prepare a time-bound action plan and communication strategy to boost foreign currency liquidity buffers as described in the 2018 FSAP recommendations (paras 19, 21 and 32) through a combination of liquidity tools	Central Bank of Armenia (CBA)	September 2019	Enhancing macro prudential measures
Develop a capital market development program	CBA, MoF	September 2019	Create access to long-term, local-currency finance and improve monetary policy transmission
Develop a framework for strengthening financial reporting and auditing to establish the public oversight body and the Chamber of Accountants and Auditor, focusing on improving corporate financial information and reducing SME financial reporting requirements with assistance by the World Bank	MOF	March 2020	Strengthening transparencies and improve SME's access to finance
Structural			
Submit to the National Assembly a draft law on a single autonomous anti-corruption entity in line with international standards, which combines all detection and investigative functions	Ministry of Justice (MoJ)	September 2019	Combat against corruptions
Adopt a legislation to require the establishment of a registry of beneficial ownership information, which is adequately resourced and staffed, and can conduct verification, first beginning with companies in the extractive industry, as identified in the EITI 2016 Standard	MoJ	June 2019	Combat against corruptions
Prepare an annual action plan to improve the business environment to address core issues identified by the 2019 Doing Business	MoE	February 2020	Improving the business climate
Conduct an efficiency review of the existing government SME support programs and consolidate support mechanisms, tools and programs	MoE with support from the CBA	April 2020	Improve effectiveness of the SME state support activities and enhance access to finance
Develop Armenia's employment strategy for 2019-23	Ministry of Labor and Social Affairs (MoL)	December 2019	Reduce unemployment and enhance inclusiveness of vulnerable groups in the labor market
Operationalize the tertiary education management system	Ministry of Education and Science,	December 2019	Improve growth inclusiveness
Develop a comprehensive education reform strategy	Ministry of Education and Science	June 2020	Enhance equitable access to education and improve physical conditions

Attachment II. Technical Memorandum of Understanding (TMU)

1. This memorandum sets out understandings between the Armenian authorities and the IMF staff regarding the definition of performance criteria (PCs) and indicative targets (ITs), adjusters, and data reporting requirements for the Standby Arrangement as per the Letter of Intent and Memorandum of Economic and Financial Policies (LOI/MEFP) dated April 26, 2019.

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

QUANTITATIVE TARGETS

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

The program sets the following PCs:

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

The program sets the following ITs:

- Ceiling on 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. Consultation with IMF Board would be triggered for end-June and the December 2019 test date if inflation falls below 1 percent or is above 4 percent. The consultation with the Board will be on the reasons for the deviation and the proposed policy response before further purchases could be requested under the SBA. Specifically, the consultation will explain (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for deviations from the specified band, taking into account compensating factors; and (iii) on proposed remedial actions, as deemed necessary.

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

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

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 external debt obligations of the government that have not been paid when due in accordance with the relevant contractual terms (taking into account any contractual grace periods). This PC excludes arrears on external financial obligations of the government subject to rescheduling.[2] This PC is to be monitored continuously by the authorities and any occurrence of new external arrears should be immediately reported to the Fund. 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.

- **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 486.55drams per one US dollar will be used for foreign currency-denominated transactions included in the 2019 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 2019 will take place at the market exchange rate. In addition, if new foreign currency-denominated transactions are introduced at any time, these will take place at the prevailing ER at the time

[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.

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. 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. **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, but excludes the Eurobond issuance and any similar refinancing instruments. 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.

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

16. 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.

17. 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.

- **Project support grants** are defined as grants received by the general government for public sector projects.

- **Budget support loans to the public sector** are defined as disbursements of commercial loans (e.g., Eurobonds), loans from bilateral and multilateral donors for budget support, and Fund purchases credited directly to the government accounts at the CBA.

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

- **The floor on NIR** will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of budget support loans, budget support grants or project financing grants compared to program amounts (excluding Fund purchases by the government) (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 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, budget support grants or project financing 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 $100 million per year in either direction. The floor on the program fiscal balance on a cash basis will also be adjusted downward (upward) by the cumulative total amount of the project financing loans received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $100 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.

DATA REPORTING

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

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
				reference period
	Interest rates and flows of the funds attracted and allocated by commercial banks	By currency and maturity	Weekly	Last working day of the week
	T-bill and coupon bond financing, CBA securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Weekly	Last working day of the week
	Banking data	Sectoral distribution of loans and deposits; dollarization of loans and deposits; loan maturities; interbank rate, by volume and maturity; T-bill rate, bond yield; deposit and lending rates, by maturity; monthly weighted average interest rate on government bonds	Monthly	Within 25 days of the end of each month
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Monthly	Within 30 days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Monthly	Within 30 days of the end of each month
	On-lending via commercial banks	On lending via the CBA and government (from, KfW, WB, ADB, etc.) by type of on-lending projects (including loan disbursements and repayments)	Monthly	Within 10 days of the end of each month.
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Transfers	Non-commercial transfers of individuals	Monthly	Within 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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
				quarter
	T-bill and coupon bond financing	By holders, i.e., CBA, resident banks, resident nonbanks, and nonresidents	Monthly	Within 7 days of each month
	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the CBA, and state-owned companies (by company); any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears	Monthly	Within 21 days of the end of each month. For project implementation units, within 21 days of the end of each month (preliminary data) and within 45 days of the end of each month (final data)
Ministry of Finance	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	Monthly	Within 7 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		account and the Republic correspondent account—flows during the month and end of month stocks.		
	Consolidated central government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Central and local governments, and Non-Commercial Enterprises that belong within the general government (NCEs)	Quarterly	Within 60 days of the end of each quarter
	Consolidated general government	Central and local governments, and NCEs that belong within the general government	Annual	Within 180 days of the end of each year
	Budget execution	All cash receipts, cash expenditures, including domestic and external debt-service payments, external and domestic borrowing and lending operations, and inflow of grants to the central government; expenditure data will be provided according to both economic and functional classifications, consistent with the GFSM2001 methodology	Monthly	Within one month following the end of each quarter.
National Statistical Service	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
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)

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		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	Quarterly	Within 30 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving non-duty-free recorded imports 5. Value of recorded imports where customs value was assessed using transaction prices, breaking out raw diamond imports; 6. Value of non-duty-free recorded imports where customs value was assessed using transaction prices; 7. Number of transactions involving recorded imports where customs value was assessed using transaction prices; 8. Number of transactions involving non duty-free recorded imports where customs value was assessed using transaction prices		
	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)
	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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
				data provided on a quarterly basis)

Table 1. Armenia: (Program) Exchange Rates of the CBA
(As of December 28, 2018 in U.S. dollars per currency rates)

		USD	AMD
AMD	Armenian Dram	0.002	1.00
XDR	SDR	1.387	670.79
USD	U.S. Dollar	1.000	483.75
CHF	Swiss Franc	1.015	491.12
GBP	Pound Sterling	1.264	611.61
JPY	Japanese Yen	0.009	4.38
EUR	EURO	1.144	553.65
RUB	Russian Ruble	0.014	6.97

Table 2. Armenia: KFW, AsDB, and IBRD SME Loan Disbursements in 2019–20 [1]
(In millions of U.S. dollars)

Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Act.	Proj.	Prog.	Prog.	Prog.	Proj.	Proj.
27.1	0.0	26.0	42.4	89.7	0	26.0

1/ Cumulative during the same year.

Table 3. Armenia: External Disbursements to the Public Sector in 2019–20[1]
(In millions of U.S. dollars)

	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
	Proj.	Prog.	Prog.	Prog.	Proj.	Proj.
Project financing loans	139	180	269	342	101	202
Project financing grants	0	21	45	63	12	24
Budget support loans	0	99	149	214	61	122
Budget support grants	0	0	18	18	0	18
of which: EU MFA	0	0	18	18	0	18

1/Cumulative during the same year.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

May 3, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND REQUEST FOR A STAND-BY ARRANGEMENT—INFORMATIONAL ANNEX

Prepared By

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

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FUND RELATIONS

(March 31, 2019)

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	278.48	216.21
Reserve Tranche Position	0.00	0.00

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	87.99	100.00
Holdings	1.52	1.72

Outstanding Purchases and Loans:	**SDR Million**	**Percent of Quota**
ECF Arrangements	81.60	63.35
Extended Arrangements	149.68	116.21

Latest Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
EFF	03/07/2014	06/23/2017	82.21	82.21
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				
	2019	2020	2021	2022	2023
Principal	43.99	54.63	50.65	30.27	21.39
Charges/interest	3.05	3.59	2.98	2.41	1.93
Total	**47.04**	**58.21**	**53.64**	**32.68**	**23.32**

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 maintained 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 had 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 divested the Panarmenian bank, in line with the safeguards assessment's recommendation, and in 2017 a new central bank law was enacted. While this new law enshrined the main principle of institutional autonomy, it needs to address other safeguards concerns, such as strengthening judiciary safeguards relating to the membership of Board members and the CBA's non-core activities.

The CBA's audits continue to be completed in a timely manner

Exchange Rate Arrangement

The *de jure* arrangement is "free floating." The CBA intervenes in the foreign exchange market only to smooth excessive exchange rate volatility, defined as short-term, high-frequency exchange rate movements caused by speculative or trend-following elements rather than underlying macroeconomic fundamentals. The CBA intervenes anonymously mainly via auctions of foreign exchange, or openly in the interbank market, or through the stock exchange. The *de facto* arrangement is classified as "floating". 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.

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 previous Article IV consultation with Armenia was concluded on June 23, 2017.

FSAP Participation and ROSCs

A joint World Bank-IMF mission assessed Armenia's financial sector as part of a Financial Sector Assessment Program (FSAP) update during June 26–July 11, 2018. The Financial Sector Stability Assessment report was approved by the Executive Board in November 2018. The most recent previous FSAP Update took place in 2012.

Resident Representative

Ms. Yulia Ustyugova, since August 2017.

Technical Assistance

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

Armenia: Technical Assistance from the Fund, 2012–19

Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Public financial management	Short-term	November 2012	MoF
Tax administration	Short-term	April 2013	MoF, SRC
Tax administration	Short-term	September 2013	MoF, SRC
Public finance management	Short-term	October 2013	MoF
Tax administration	Short-term	December 2013	MoF, SRC
Public finance management	Short-term	March 2014	MoF
Fiscal risk	Short-term	November 2014	MoF
Tax administration (LTI)	Short-term	April 2015	MoF
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
Fiscal risk management	Short-term	April-2015, June-July 2015 May 2016, April-May 2017 May 2018	MoF
Public finance management	Short-term	April 2015	MoF
Evaluate tax reform and revise draft legislation	Short-term	November, December 2015	MoF
Fiscal rules	Short-term	June-July, 2017	MoF
Tax administration	Short-term	March 2018, February, 2019	MoF, SRC
Fiscal Transparency Evaluation	Short-term	April, 2018	MoF
Public Investment Management Assessment (PIMA)	Short-term	June-July 2018	MoF
Tax policy	Short-term	July 2018	MoF

Public finance management	Short-term	April, September 2018 February, 2019	MoF
PIMA follow-up	Short-term	February, 2019	MoF
Legal Department			
AML/CFT	Short-term	Various	MoF
Monetary and Capital Markets Department			
FSAP update	Short-term	February 2012	CBA
Inflation targeting (with IMF Research Dept.)	Short-term	February-March 2012	CBA
Inflation targeting	Short-term	November 2012	CBA
Inflation targeting	Short-term	January 2013	CBA
Bank prudential framework	Short-term	April 2013	CBA
Monetary and foreign exchange policy	Short-term	June 2013	CBA
Safeguard assessment	Short-term	March 2014	CBA
Central Bank communication	Short-term	April 2014	CBA
Inflation targeting	Short-term	April 2014 April, November 2015	CBA
TA needs assessment for the Central Bank	Short-term	August 2016	CBA
Inflation targeting	Short-term	March, September 2016	CBA
Financial Stability Assessment Program (FSAP)	Short-term	February, July, 2018	CBA, MoF
Inflation-indexed bonds and domestic bonds market development	Short-term	September, 2018	CBA, MoF
Statistics Department			
National accounts	Short-term	April 2012	SC
Monetary statistics	Short-term	April 2012	CBA
National accounts	Short-term	May 2012	SC
Monetary statistics	Short-term	October 2012	CBA
Construction Price Index	Short-term	September 2013	SC
Price Statistics: Diagnostic	Short-term	October 2017	SC
Quarterly National Accounts	Short-term	January-February 2018	SC
Consumer Prices/Producer Price	Short-term	April, 2018	SC
Price Statistics	Short-term	November 2018	SC
Institute for Capacity Development			
Developing a model-based framework for FPA	Short-term	January-February, April, July, October-November 2018, January-February 2019	MoF

WORLD BANK AND IMF COLLABORATIONS

(As of March 2019)

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
World Bank Group's Country Partnership Framework (CPF) for Armenia (FY 2019 – FY 2023)	Country Partnership Framework for Armenia		April 2019
1. Bank program in FY18-FY19 (completed, on-going, and in the pipeline)	***Selected Ongoing and New Operations***		
	Tax Administration Modernization Project (US$12 million)	Semi Annual - completed	Closed, January 2019
	Development Policy Operation (US$ million – to be determined)	Quarterly – on going (identification stage)	November-December 2019
	Public Sector Modernization Project (III) (US$21 million)	Semi-Annual – on going	The current project closing date - December 31, 2020 – will be extended by two years
	Trade Promotion and Quality Infrastructure Project (US$50million)	Semi-Annual – on going	The current project closing date - June 30, 2020 – will be extended by two years
	Advisory Services & Analytics		
	Distributional Impact Analyses	On-going	May 2019.
	A Reform Assessment on Competition in Armenia: Fostering Market Contestability for Productivity and Prosperity	On-going	June 2019.
	Just-in-time Workshop Series	Completed	December 2018.
	FSAP finalization and financial sector work	On-going	July 29 2019.
	Systematic Country Diagnoses (SCD)	Completed	Published in November 2017
	Programmatic Technical Assistance on Public Financial Management in Armenia Macro-monitoring	On-going	December 2020
	Armenia Long-Term Finance – Capital Markets Development and Infrastructure Finance	On-going	November 2019

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
	Realizing Armenia's Technology Potential	On- going	July 2019
	Assessment of strategic procurement system with realistic cost estimation for Armenia ensuring value for money and better governance	On- going	June 2019
	Armenia Deposit Insurance (FIRST TA)	On– going	July 2021
	Portfolio Implementation Support and assessment of Alternative Procurement Arrangements (APA)	On– going	June 2019
	Looking Forward: Strategically Engaging in Select Reform Areas in Armenia	On- going	June 2019
2. IMF work program in the next 12 months	First SBA Review	September 2019	December 2019
	Second SBA Review	March 2020	June 2020
	Technical Assistance/Training		
	Public asset management	2nd half of 2019	2nd half of 2019
	Developing a model-based framework for FPA	Ongoing	Ongoing
	PIMA Follow-up and Budgetary Process Streamlining	2nd half of 2019	2nd half of 2019
	Tax administration	2nd half of 2019	2nd half of 2019
	CBA safeguards assessment	2nd half of 2019	2nd half of 2019

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

(As of March 2019)

1. The EBRD is the largest single investor in Armenia. To date, the Bank has committed almost €1,270 million in 175 projects in all major sectors of the economy. Private sector share of the cumulative investment is close to 90%. The Bank's current portfolio in Armenia is close to € 320 million for 56 portfolio projects. Private sector share of the current portfolio is approx. 85%. Current portfolio composition is as follows: 22% energy, 51% financial institutions, 6% industry, commerce and agribusiness, and 21% infrastructure. The Bank's annual investment in Armenia in 2018 was € 70 million.

EBRD Activities in Armenia

Fostering economic growth and employment by supporting small and medium enterprises (SMEs)

2. In the financial sector, the Bank has enhanced access to finance, particularly for SMEs, through dedicated credit lines to commercial banks and micro-credit organizations, direct debt, mezzanine and equity investments. The Bank partners with local financial institutions representing close to two-thirds of total bank assets. Through them, the Bank supports SMEs with focus on underserved segments (e.g. women-led businesses). Grant funding secured by the Bank helps local banks to expand their product range and allows to deliver technical assistance and capacity building. The Bank provides its partner banks with long term local currency to improve SMEs' access to local currency funding. Armenia is one of the countries where the Bank's Local Currency and Capital Markets Development Initiative has delivered sound results. The Bank's trade finance facilitation programme promotes international trade to, from and within the Bank's countries of operations. The Bank seeks to work with its partner banks in Armenia in view of sharing the risk of financing local companies through the EBRD Risk Sharing Facility. The Bank is also progressing towards launching, in 2019, the Armenia SME private equity fund.

Accelerating green economy transition by supporting the energy and natural resources sectors.

3. Energy and natural resources sector is an important pillar of the Bank's partnership with Armenia. The Bank works with the Electric Network of Armenia (ENA) to support implementation of ENA's investment program aimed at fundamental modernization of infrastructure. The Bank strongly supports efforts to scale up the share of renewable energy sources in Armenia. The Masrik-1 solar power plant project which the Bank works to co-finance in 2019 is expected to establish a benchmark for solar auctions in Armenia and to become the first utility-scale solar power plant in the region. Renewable energy auction design, implementation and funding represent the Bank's strategic policy priority. In the mining sector, timely resolution of the situation around the Amulsar gold mine project where the Bank is co-investor, is important for the investor confidence.

Developing municipal and transport infrastructure

4. In the context of municipal infrastructure, the Bank signed Yerevan street lighting project, Kotayk solid waste project, provided loan towards construction of a solid waste landfill in Yerevan, participated in a landmark international syndication for Zvartnots International Airport, supported an energy efficient street lighting and city street rehabilitation programme in Gyumri. Bearing in mind Armenia's public borrowing headroom, the Bank is committed to appraising further transport and municipal projects which are strongly supported by the authorities, and to working with the government to enhance private participation in public service provision and to mobilize investment grants, policy advisory and capacity building assistance.

Industry, Commerce and Agribusiness

5. The Bank supports high value-added corporates through direct investment (debt, equity, mezzanine), typically combined with significant hands-on capacity building assistance, helping smaller clients grow their businesses by providing crucial financial and technical support to implement capex intensive business plans. The Bank's ability to scale up the number and the volume of its private sector deals in areas of manufacturing and services, property and tourism, information and communication technologies and agriculture depends on the quality and scope of private investments in Armenia.

Advice for Small Business (ASB)

6. Through tailored business advice and know-how provision to SMEs, the Bank seeks to improve SMEs-level strategy formulation, operations efficiency, financial reporting, marketing, and energy efficiency. Most ASB clients in Armenia increase their turnover, improve productivity, see job creation and secure external funding to finance growth. In 2017, the Bank signed with the European Union a framework agreement on establishment of "SME Finance and Advice Facility" targeting improvement of business and investment climate for SMEs in Armenia, increasing business opportunities and access to finance for local SMEs.

Policy dialogue

7. The Bank continues to support the Business Support Office (the BSO) which the bank established to promote partnership and policy dialogue between the state and the private sector in Armenia. Other areas of policy dialogue in Armenia include local currency and capital market development, insolvency legislation, judicial capacity building, public private partnership legislation etc.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ASDB)

(As of March 2019)

1. Armenia joined the AsDB in September 2005. The AsDB's first Country Partnership Strategy for Armenia for 2014–18 (endorsed by the AsDB's Board on 27 January 2015) focuses on three sectors: (i) transport, (ii) water supply and other municipal services, and (iii) energy. As of January 1, 2017, Armenia was reclassified as a Group C country eligible for market-based ordinary capital resources only. The Country Partnership Strategy for 2019–23 is being prepared for the AsDB Board consideration in September 2019.

2. As of March 20, 2019, the AsDB cumulative sovereign lending amounted to $1,140.0 million for 20 loans. In 2017, AsDB approved a policy-based loan with two subprograms for Public Efficiency and Financial Markets Program to help the Government further strengthen fiscal sustainability and support the development of financial markets in Armenia through better public debt management and fiscal risk management. Subprogram 1 ($40 million) was approved in 2017 and subprogram 2 ($50 million) was approved in 2018.

3. In 2016, the AsDB approved a Policy-Based Loan of $90 million for phase 2 of the Infrastructure Sustainability Support Program, which focuses on improvements in infrastructure operations and sustainability. In 2016, AsDB also approved financing of $50 million for the Armenia-Georgia Border Regional Road (M6 Vanadzor-Bagratashen) Improvement Project. The road project will support the rehabilitation and upgrading 51.5 kilometers of the two-lane highway in northern Armenia and will enhance international connectivity, reduce the cost of transport, and improve facilities and safety. It has collaborative cofinancing of $56.4 million from the European Investment Bank (EIB).

4. In 2015, the AsDB approved a Results-Based Loan of $88.5 million for the Seismic Safety Improvement Program. The program supports the government in seismic strengthening and renovation of priority school buildings and will improve seismic safety planning and management competencies.

5. In 2014, the 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.

6. In 2011, the AsDB 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.

7. **In 2009, the AsDB approved a $500 million MFF to fund the North–South Road Corridor Investment Program.** In 2009, the 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, the 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).

8. **The AsDB has approved $376.4 million in non-sovereign financing in Armenia for eleven private sector transactions.** The AsDB's current portfolio of non-sovereign operations covers utilities and other infrastructure services, financial institutions, and agribusiness. In 2018, the bank approved a $32 million loan to agribusiness and logistics company, Spayka, for development of high-efficiency horticulture as part of an integrated supply chain to reach international markets. Also, in 2018, the AsDB approved a financing facility of $68.4 million for the construction and operation of a combined cycle thermal power plant in Yerevan. The project will deliver key energy infrastructure, generate employment during construction and operation, and create conditions for greater private sector participation in Armenia's energy sector.

9. **In 2017, the AsDB approved a $80 million debt financing facility for Electric Networks of Armenia CJSC for Distribution Network Rehabilitation, Efficiency Improvement, and Augmentation project**. In 2017, the AsDB also approved a $30 million senior loan to support the expansion of Ameriabank's SME portfolio and an equity investment of $30 million to support Ameriabank's future growth plans.

10. **In 2016, the AsDB approved a $6 million loan to a universal credit organization to expand lending to small and medium-size enterprises and the agriculture sector, primarily outside of the capital Yerevan.** In 2013, the AsDB 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 co-financed with the European Bank for Reconstruction and Development (EBRD). The AsDB's Trade Finance Program works with four banks in Armenia and has supported over $170.5 million in trade through 601 transactions as of December 2018.

11. **In addition to financing projects and programs, the AsDB is also involved in advisory services and capacity development.** These include technical assistance (TA) programs for export- and innovation- led industrial development, schools seismic strengthening, social sectors reforms, public efficiency and financial markets development, and analysis of Armenia's economic opportunities associated with trade regimes. 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 March 2019)

Background

1. **Data provision by Armenia is broadly adequate for surveillance but has some shortcomings.** 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 some branches in Nagorno-Karabakh (as identified in the above-mentioned data ROSC). The proposed program's monetary variables, as specified in the TMU based on these statistics, are defined on a consistent manner and in line with previous programs approved 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 quality of source data and compilation procedures in national accounts needs to improve further.** The size of household survey data is too small to appropriately calculate household consumption expenditure and some of exports data are underreported, which leads to underestimation of net exports. On the expenditure approach, changes in inventories are mainly derived as a residual and consequently volatile enough to cause for concern in economic analysis. In addition, the production approach has data collection issues, particularly in measuring agricultural outputs. Collecting the data in an inconsistent way has contributed to volatility in measured agricultural output.

6. **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 2009–12 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

7. **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.

8. 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.

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

10. 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

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

12. 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

13. 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.

14. 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 since 2015 with EEU trade data. Export and import data are produced from customs records. Trade data within EEU may be subject to incomplete coverage and under-invoicing. Price data for exports and imports are less readily available. Quarterly balance of payments statistics 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.

15. 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 April 5, 2019)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	March 2019	4/1/2019	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	March 2019	4/1/2019	D	D	M
Reserve/Base Money	March 2019	4/1/2019	D	D	D
Broad Money	March 2019	4/1/2019	M	M	M
Central Bank Balance Sheet	Jan 2019	3/15/2019	D	M	M
Consolidated Balance Sheet of the Banking System	Jan 2019	3/15/2019	M	M	M
Interest Rates[2]	March 2019	3/15/2019	W	W	M
Consumer Price Index	March 2019	4/5/2019	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]— General Government[4]	Q4 2018	2/15/2019	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Q4 2018	2/15/2019	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec 2018	2/28/2019	M	M	Q
External Current Account Balance	Q4 2018	3/31/2019	Q	Q	Q
Exports and Imports of Goods and Services	Q4 2018	3/15/2019	M	M	Q
GDP	Q4 2018	2/20/2019	Q	Q	Q
Gross External Debt	Q4 2018	3/31/2019	Q	Q	Q
International Investment Position[6]	Q4 2018	3/31/2019	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA).

Statement by Richard Doornbosch, Alternate Executive Director, and Shahane Harutyunyan, Advisor for the Republic of Armenia May 17, 2019

On behalf of the Armenian authorities, we would like to thank Mr. Hossein Samiei and his team for the constructive and collaborative dialogue during the mission in Yerevan, and for the continued support of the Fund. The comprehensive findings and policy advice are well-tailored to the authorities' reform agenda. The authorities confirm their strong ownership of the requested three-year Fund-supported program, and broadly agree with staff's appraisal and recommendations.

The 2018 peaceful political transition has created momentum in Armenia to accelerate structural reforms. The new government, which took office in January 2019 after the snap parliamentary elections at end-2018, is determined to promote inclusive and sustainable growth. The 2019-2023 government program focuses on strengthening competition, developing human capital, fighting corruption, enhancing governance and infrastructure.

Program Request: Precautionary Stand-by Arrangement

Armenia's long-standing engagement with the Fund both under surveillance and successive economic programs has been instrumental to maintaining macroeconomic and financial stability. Drawing on the most recent Fund-supported programs, the Armenian authorities acknowledge that **the blend three-year 2010-13 ECC/EFF program** has helped to mitigate the impact of the global financial crisis on the domestic economy. The latest **2014-2017 EFF arrangement** has anchored their stabilization efforts to stem the economic slowdown amid the 2014-2015 regional shocks.

Building on the progress achieved under the previous arrangements, and well-recognizing the remaining economic and structural challenges, **the Armenian authorities request a new 3-year Stand-by Arrangement (SBA) in an amount equivalent to SDR 180 million (139.75 percent of quota).** Given the adequate external financing and foreign exchange reserves, they intend to treat the arrangement as precautionary. The authorities believe that the arrangement will help push forward their comprehensive reform agenda while improving the country's resilience against external shocks. They confirm their strong commitment to the economic policies, quantitative targets and structural benchmarks set under the program and stand ready to further adjust policies as necessary.

Macroeconomic Developments and Outlook

Sound macroeconomic policies ensured robust economic performance. Following the subdued growth in 2016, economic activity strengthened significantly in 2017 (7.5 percent), and while remaining strong, moderated to a more sustainable 5.2 percent in 2018. The 2018 growth was mainly driven by manufacturing, service and trade sectors while agricultural and mining sectors contracted. The economy maintained the growth momentum in early 2019 - the economic activity indicator increased by 6.5 percent in January-March.

Fiscal consolidation, supported by the upgraded fiscal rules and strong tax administration efforts, remained on track. As a result, the fiscal deficit was below the budget target, reflecting also the underperformance in current and capital spending. Government debt declined to 51.4 percent of GDP. The current account deficit, after narrowing to below 3.0% over 2015-2017, widened to 9.1 percent of GDP in 2018, on the back of strong imports, weaker primary income and remittances, and some one-off factors. Monetary policy ensured a low inflation environment with annual headline inflation reaching 2.2 percent in April 2019. Following the increased monetary stimulus in January 2019, the CBA kept monetary conditions expansionary in March 2019 leaving the policy rate unchanged at 5.75 percent. International reserves remained broadly adequate, with limited exchange rate pressures. The financial system remains well-capitalized; and weathered the political transition well.

Looking ahead, the authorities believe that the government's 2019-2023 comprehensive reform agenda will deliver substantial economic benefits, raising the medium-term growth to 5.0-5.5 percent. However, under the scope of the IMF program, the authorities agreed on a more conservative 4.5 percent scenario. The inflation is expected to stay around the lower bound of the target range in 2019, gradually converging to the 4.0 percent target over the medium-term. The current account deficit is expected to improve in 2019 and gradually narrow over the medium-term.

Fiscal Policy and Reforms

The growth-friendly fiscal consolidation is underway. The authorities have prepared a corrective action plan, guided by the upgraded fiscal rules, to bring down the central government debt to below 50 percent of GDP by 2023. To achieve this objective, they are determined to maintain the fiscal deficit at around 2 percent of GDP supported by both strong revenue mobilization and spending constraint. That said, the authorities are committed to protecting the social spending envelope to promote sustainable and inclusive growth. The 2019 budget has been designed in line with this objective.

A tax reform package has been announced to promote export-oriented inclusive growth. The proposed tax package introduces a number of measures, including flattening of the personal income tax (PIT) structure; reducing the PIT and corporate income tax (CIT) rates; simplifying the special tax regimes; and cancelling the scheduled reduction of the VAT threshold. The Draft Law on «Making Amendments and Addenda to the Tax Code of the Republic of Armenia» has been submitted to the National Assembly (NA) in March 2019 for approval. The tax reform package is expected to become effective in 2020.

The authorities have adopted a package of tax policy measures to fully offset the potential revenue losses. These generally include the increase and indexation of certain excise taxes, the removal of selected tax exemptions, the increase in gambling and financial sector license fees, supported by strong tax administration efforts. The authorities are determined to take additional compensation measures if needed. Meanwhile, they are currently working with the World Bank on building a model to analyze the impact of the fiscal reform on equity and stand ready to take adequate mitigating measures if needed.

The authorities put the overhauling of the property taxation system high on their agenda. The Cadaster Committee has completed the work on the new evaluation zoning and has elaborated a new methodology based on market values and contractual prices. The draft law on "Establishing a Market Evaluation Procedure for Real Estate Taxation" has been submitted to the cabinet in March 2019 and it is currently in an active discussion process. The draft law is planned to be submitted to the NA for approval by June 2019. Going forward, the authorities are planning to review the tax rate structure and nontaxable threshold taking into consideration the IMF's recommendations, and to enhance the electronic tax management system by December 2020.The new system will become operational in January 2021.

The authorities stress the importance of an enhanced tax administration and structural expenditure reforms. The draft document on the 2019-2022 tax administration strategy is well-tailored to this objective, and the significant overperformance of tax revenues during the first months of 2019 confirms the authorities' strong commitment in this area. To this end, the authorities are determined to carefully consider all the recommendations and prior actions envisaged in the report, including the introduction of a tax return system by end-2021. On the expenditure reforms, the public-private partnership (PPP) law is planned to be submitted to the NA by June 2019 with a ceiling on government exposure from such partnerships.

Monetary Policy and Financial Stability

The CBA will continue to balance the dual mandate of price and financial stability. Inflation remained low in 2018 shaping below the lower end of the target range and rebounding to 2.2 percent in April 2019. In response to weaker-than-expected external demand and government spending, the CBA lowered the policy rate by 25 basis points to 5.75 percent in January for the first time since February 2017. The CBA considers the current monetary policy stance appropriate to stabilize the inflation around the 4.0 percent target over the medium-term. Meanwhile, the CBA closely monitors the macroeconomic developments and stands ready to adjust monetary conditions if needed, in line with the IT framework and MPCC clause under the program.

On the financial sector, the banking system remains well-capitalized; and financial soundness indicators, including dollarization, have continued to improve. On the back of declining lending and deposit rates, the credit growth picked up to 17.3% at end-2018. Supervisory and regulatory frameworks have been further strengthened; and the CBA has started implementing the 2018 FSAP recommendations.

Going forward, the CBA will continue to adhere to the **two-way exchange rate flexibility under the IT framework** while using limited interventions to smooth excessive fluctuations. The CBA is determined to explore policy actions to strengthen the liquidity management system, to deepen the interbank market, and enhance its communication strategies. Capital market development in coordination with the MOF is considered essential.

The CBA is determined to further strengthen the financial supervision framework in line with the 2018 FSAP recommendations. To this end, the efforts are focused on refining the risk-based differentiation in capital levels; the enforcement of large exposure limits; and the amendment of the definition of NPLs in line with international best practices. Most importantly, the CBA puts strong emphasis on creating a time-bound action plan and communication strategy to boost the foreign currency liquidity buffer as described in the 2018 FSAP recommendations**. On the macroprudential side,** the CBA stands ready to further strengthen the regulatory measures in line with staff's recommendations, including the introduction of a capital conservation buffer and a surcharge for domestic systemically important banks.

Structural Reforms

The authorities put structural reforms high on their agenda to promote sustainable and inclusive growth. The 2019-2023 government program is well-tailored to reaching this objective. Fighting corruption and enhancing governance is a top priority. The authorities believe that digitalization will help anchor their efforts in all the reform areas.

The authorities put strong emphasis on human capital development and social protection. The reforms in this area focus on labor market, education, health and social protection. To this end, the authorities have started developing a comprehensive employment strategy for 2019-23 aimed at reducing the long-term unemployment and increasing participation of vulnerable groups in labor market. The government is determined to elaborate a set of policies to increase female labor force participation. The authorities are planning to further strengthen the existing social and family benefit schemes. The reforms in the education system focus on increasing equitable access to pre-school education, improving general education programs and physical conditions of secondary schools, and operationalizing tertiary education management system. The pension reform, fully implemented since July 1, 2018, has mobilized a growing supply of long-term capital that will play an important role in providing pensions to Armenian citizens. Creating a pipeline of projects and capital market instruments to channel pension savings into the economy is a high priority.

The authorities are determined to improve the business environment. The efforts toward achieving this objective mainly focus on developing SMEs, enhancing corporate governance and contract enforcement. To this end, the authorities will prepare an action plan for 2020 to address the issues identified in the 2019 WB Doing Business Report. To enhance transparency and improve access to finance, they plan to conduct an efficiency review of the existing SME support programs.

The new government has pledged to fight corruption and improve governance. To achieve this objective, the government has prepared an anti-corruption strategy for 2019-2022 with a strong emphasis on implementation. They plan to submit to the NA a draft law on a single autonomous anti-corruption entity with combined detection and investigation functions by September 2019. The legislation on establishing a registry of beneficial ownership information is planned to be adopted by June 2019. The implementation of the CPC (Commission for Prevention of Corruption) law on asset declarations is underway, and the revision of the Criminal Code is processing.

Conclusion

Notwithstanding the progress achieved over the recent years, some important challenges remain, including a high share of foreign currency debt, still-high dollarization, social inequality, high poverty and unemployment. The economy remains vulnerable to external shocks. On the structural front, poor business climate, corruption and weak governance constrain the economy's capacity to achieve sustainable and inclusive economic growth. These call for immediate and well-articulated economic policies and structural reforms.

Against this background, the authorities have requested a new Fund-Supported program under the precautionary Stand-by Arrangement. They believe that the program will support their economic and financial reform agenda while providing an additional buffer to cope with adverse shocks. The authorities remain strongly committed to the full and timely implementation of the policies under the program. They reiterate their determination to maintain a close policy dialogue with the Fund. Meanwhile, they stand ready to consult in advance with the IMF on any revision to the policies under the program. The authorities acknowledge the crucial role that Fund technical assistance has played in building capacity and addressing macro-critical issues in the country. To this end, they look forward to further broaden the support to achieve their economic objectives.