

**Republic of Armenia: Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion—Staff Report; and Press Release on the Executive Board Consideration**

In the context of the fourth review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waiver of a performance criterion, the following documents have been released and are included in this package:

- the staff report for the Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion, prepared by a staff team of the IMF, following discussions that ended on March 13, 2007, with the officials of Republic of Armenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 30, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF; and
- a Press Release summarizing the views of the Executive Board consideration of the staff report that completed the review and request.

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

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

\*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

**Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion**

Prepared by the Middle East and Central Asia Department  
(in consultation with other departments)

Approved by Lorenzo Pérez and Adnan Mazarei

April 30, 2007

**Executive Summary**

**Armenia's economy performs very strongly.** All end-December 2006 quantitative and all but one structural performance criteria were observed. The main policy challenges are to broaden economic growth, raise tax revenues, and manage large foreign exchange inflows. The main conclusions of the report are:

**Fiscal policy remains appropriate.** Meeting the ambitious 2007 revenue target will require broadening the tax base and strengthening administration. The gas subsidy should expire by end-2008.

**The stance of monetary policy is appropriate.** Price developments need to be monitored closely given the uncertainties about the extent of dedollarization.

**The flexible exchange rate regime has contributed to price stability.** Policies to spur competition and productivity need to be strengthened in light of the significant appreciation of the dram.

**Fiscal and financial sector reforms remain key to sustaining growth and reducing poverty.** It will be important to implement the medium-term tax action plan to improve and modernize Armenia's tax system. Financial sector reforms will contribute to financial deepening and the lowering of interest rate spreads.

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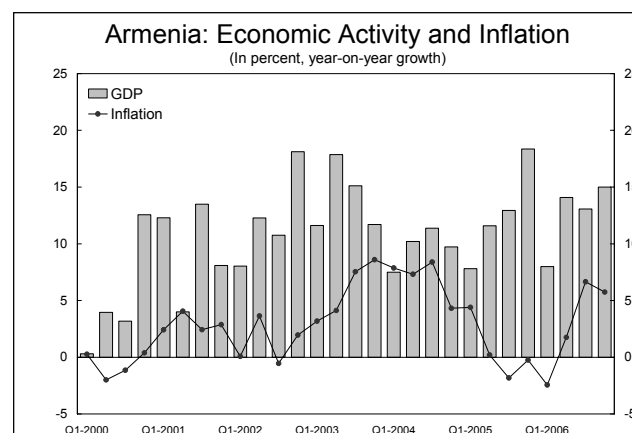
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## I. BACKGROUND TO THE DISCUSSIONS

1. **Armenia's economy continues to perform very well**, with double-digit growth and notable reductions in poverty (Table 1). The main policy challenges are to broaden economic growth, raise tax revenues, and manage foreign exchange inflows.
2. **The PRGF-supported program remains on track.** All end-December 2006 quantitative and all but one structural performance criteria were observed (Tables 2 and 3). A new insurance law (structural performance criterion) was submitted to parliament in January 2007 rather than December 2006.<sup>1</sup> The law was subsequently passed in April. The authorities requested that the quantitative performance criterion on tax revenues of the central government be changed to an indicative target, effective June 1, 2007, given their strong track record in meeting the target under the program.
3. **The political scene is dominated by parliamentary and presidential elections** scheduled for May 2007 and March 2008, respectively. Defense Minister Serge Sargsyan was recently appointed as prime minister, following the untimely death of Mr. Margaryan on March 25.
4. **Policy discussions** centered on macroeconomic prospects for 2007 and tax and financial sector reforms to sustain economic growth and further reduce poverty.

## II. RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

5. **Economic growth remains strong.** Real GDP increased by 13.4 percent in 2006, the fifth consecutive year of double-digit growth, led by construction, which grew by more than 37 percent. In the first two months of 2007, real GDP grew by 9.4 percent (year-on-year), led by nontradable sectors. The 2005 household survey shows a decline in overall **poverty** from 35 percent in 2004 to 30 percent in 2005.



<sup>1</sup> Moreover, two indicative targets were missed. The ceiling on reserve money was exceeded due to sizable unsterilized foreign exchange intervention, and the floor on the contributions to the State Fund for Social Insurance was missed by a small margin.

Armenia: Main Poverty Indicators 1/

	1998/99	2004	2005
Poverty	56.1	34.6	29.8
Poverty line (AMD)	17,663	19,373	20,289
Extreme Poverty	21.0	6.4	4.6
Urban areas			
Poverty	62.1	36.4	30.7
Extreme Poverty	26.2	7.5	5.3
Yerevan			
Poverty	58.4	29.2	23.9
Extreme Poverty	24.8	6.1	3.6
Other cities			
Poverty	65.5	43.9	37.8
Extreme Poverty	27.4	9.2	7.2
Rural areas			
Poverty	48.2	31.7	28.3
Extreme Poverty	14.1	4.4	3.2

Source: National Statistical Service.

1/ Poverty incidence is assessed as the percentage of population whose monthly per capita expenditures does not exceed the poverty line.

6. **Fiscal policy remained sound in 2006**, with an overall deficit of 1.9 percent of GDP (compared to the program target of 2.3 percent of GDP) (Table 4). Tax revenues increased by 19 percent in 2006, but the tax-to-GDP ratio remained low, reflecting low buoyancy of VAT revenues. Shortfalls in external financing for investment projects accounted for lower-than-programmed total expenditures. In the first two months of 2007, tax revenues and total expenditures grew by 25 percent and 17 percent year-on-year, respectively.

Armenia: Fiscal Indicators, December 2006

	Dec. 06 Prog.	Dec. 06 Act.
(In billions of drams)		
Tax revenue 1/	378.1	383.8
Total expenditures 1/	509.1	469.9
Overall balance 1/, 2/	-60.2	-50.2

1/ Cumulative flow from the beginning of the year until the end of December.

2/ Overall balance on a commitment basis.

7. **Monetary aggregates grew strongly, but inflation remained subdued.** End-of-period inflation increased to 5.2 percent in December 2006, reflecting higher food prices, while average inflation remained below 3 percent. Broad money growth remained high at 33 percent, reflecting monetization and dedollarization (Table 5). Reserve money grew by 41 percent owing to sizable Central Bank of Armenia (CBA) foreign exchange intervention in 2006, totaling US\$245 million (equivalent to 56 percent of end-2005 reserve money). To dampen inflationary pressures, the repurchase rate of the CBA was raised by 75 basis points between July and October 2006, to 4.75 percent. It was lowered to 4.5 percent in April 2007 against the backdrop of easing inflationary pressures.

## Armenia: Monetary Indicators, December 2006

	Dec. 06 Prog.	Dec. 06 Act.
	(In percent)	
12-month change in reserve money	25.1	41.1
12-month change in broad money	27.0	32.9
12-month change in credit to the economy	41.0	28.2
	(In millions of USD)	
Net international reserves 1/	542.1	880.6

1/ At program exchange rates, excluding the Special Privatization Account.

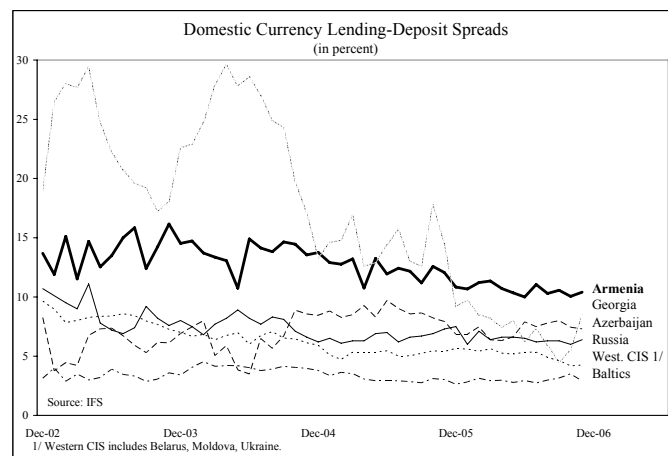
8. **Banking sector performance is improving, but interest rate spreads remain high** (Table 6 and Box 1). Banks are generally well-capitalized, liquid, and profitable, and the quality of loan portfolios has remained sound. Private credit growth, especially consumer and mortgage loans, remained strong (28 percent in 2006), but credit to the economy stayed below 10 percent of GDP.

### Box 1. Armenia's Financial Sector—Why are Interest Rate Spreads so High?

**Despite a prolonged period of macroeconomic stability and strong economic growth, financial intermediation in Armenia has lagged behind other transition countries, and interest rate spreads have remained higher than in most Central and Eastern European transition countries.**

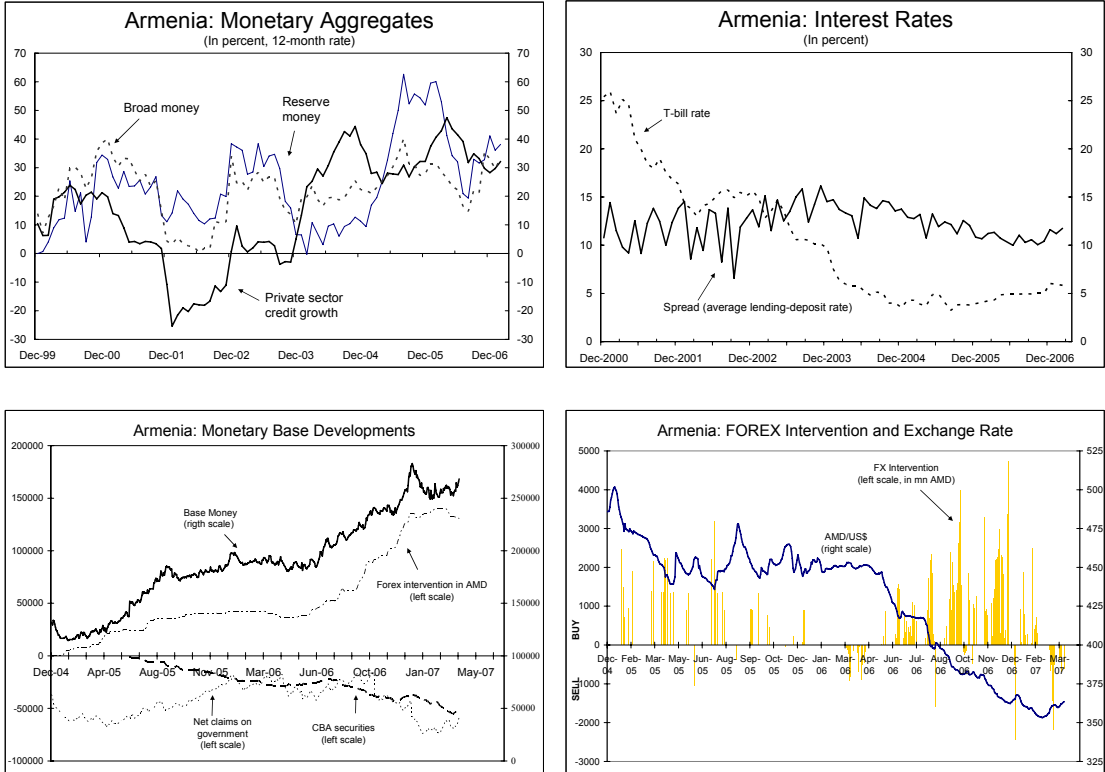
**Bank-specific factors, such as bank size, market power, reliance on non-interest income, and liquidity appear to explain a large proportion of cross-bank,**

**cross-time variation in spreads and margins** (see “*Bank Efficiency and Market Structure: What Determines Banking Spreads in Armenia?*” forthcoming Working Paper). Results from panel regressions using a bank-level dataset for 2002–06 suggest that there is large potential to increase cost efficiency and competition in the banking system.

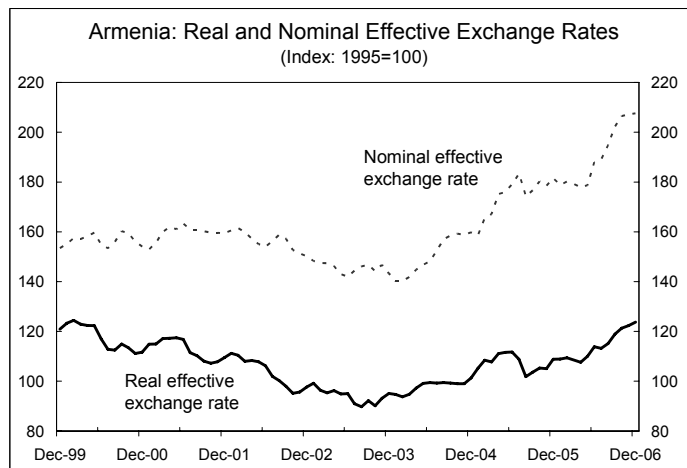




## Armenia: Monetary Indicators



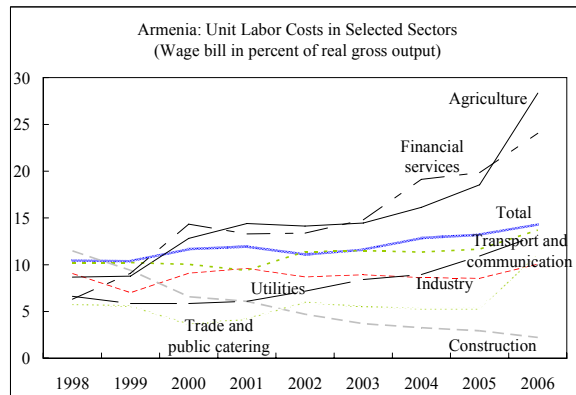
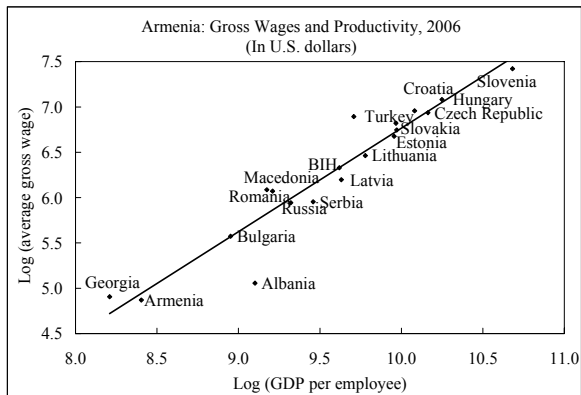
9. **The dram has appreciated significantly** since mid-May 2006, reflecting strong foreign exchange inflows and the weakening of the U.S. dollar. In 2006, it appreciated by 19.2 percent against the U.S. dollar (13.7 percent in real effective terms), despite sizable CBA interventions.<sup>2</sup> Nevertheless, the exchange rate does not yet appear to be overvalued (Box 2). In the first quarter of 2007, the dram has remained broadly stable, and the CBA has used foreign exchange sales for liquidity management purposes.



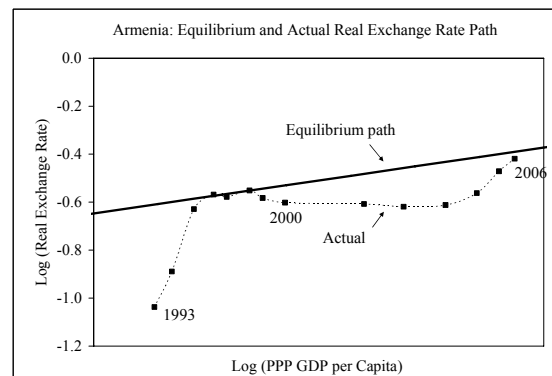
<sup>2</sup> While the dram appreciation has helped to dampen inflationary pressures, the pass-through to domestic prices of certain imported goods is limited by the presence of import monopolies.

### Box 2. External Competitiveness

**Armenian wages remain competitive, but unit labor costs are rising.** Compared to other transition economies, Armenian wages are low. While unit labor costs fell in construction, thanks to rapid productivity growth, they have been rising in other sectors, particularly in agriculture, financial services, trade, and utilities.

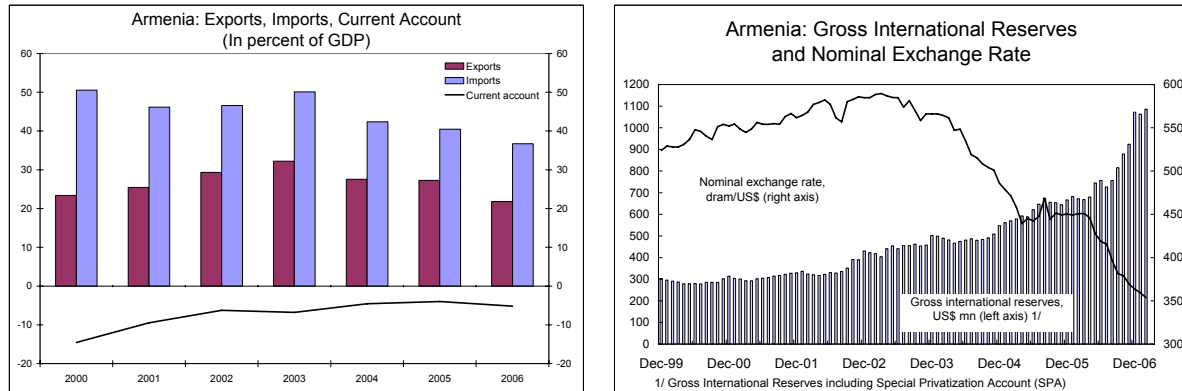


**The real exchange rate is estimated to be close to equilibrium**, based on the estimated equilibrium relationship between the real exchange rate and GDP per capita (a proxy for productivity) for a sample of 180 countries (Country Report No. 06/433). Nevertheless, the appreciation has caused problems for exporters with contracts in U.S. dollars who have not hedged exchange rate risk.



10. **Despite a deterioration in the trade balance, the current account deficit remained broadly unchanged due to strong remittances** in 2006 (Table 7). Exports increased by only 3 percent, mostly on account of a drop in the export of diamonds and metals.<sup>3</sup> Imports grew by 20 percent, reflecting strong investment, rising incomes, and an appreciating dram. Net private transfers grew by 46.5 percent on the back of continued inflows to the real estate sector and remittances. Moreover, gross international reserves increased by US\$405 million (to US\$1.1 billion) due to foreign exchange intervention and FDI.

<sup>3</sup> Preliminary data for the first two months of 2007 show non-diamond exports increasing by 34 percent year-on-year.



11. **Progress continues in fiscal reforms** (MEFP, ¶7). Regarding **tax policy**, parliament passed legislation to expand the tax base to include construction and gambling and to change the income tax base calculation from cash to accrual. In **tax administration**, progress was made with developing an electronic risk-based selection system for audit and VAT refunds, and strengthening coordination between State Tax Service (STS) and State Customs Committee (SCC). In the area of **expenditure management**, amendments to improve the monitoring of state Non-Commercial Organizations (NCOs) (mainly schools) were submitted to parliament.

12. **Financial sector reforms have aimed at improving banking sector efficiency and deepening financial intermediation**, focusing on bank corporate governance and implementing the first pillar of Basel II provisions (MEFP, ¶8). To reduce the shadow economy, the CBA has adopted measures to foster non-cash payments and domestic currency use. Furthermore, the CBA is working on attracting reputable international banks, and on strengthening the insurance sector, the securities market, and the pension system (MEFP, ¶9).

### III. POLICY DISCUSSIONS

#### A. Macroeconomic Framework and Medium-Term Outlook

13. **The macroeconomic outlook is strong** (MEFP, ¶11). Real GDP growth is expected to be 9 percent in 2007, unchanged from the previous forecast. End-year CPI inflation is projected to be 4 percent, in line with the announced inflation target. The growth momentum is expected to continue in 2008 on the back of a booming nontradable sector, with GDP projected to grow by 8 percent. The authorities plan to update the 2003 PRSP by mid-2007.

#### B. Macroeconomic Policies

##### Fiscal policy

14. **The 2007 budget envisages improved revenue performance and better execution of expenditures, in line with PRSP objectives** (MEFP, ¶12–14). Tax revenues are targeted

to increase by 0.8 percent of GDP relative to the 2006 outcome on account of measures taken to date,<sup>4</sup> and planned improvements in tax administration. Total expenditures are budgeted to increase by 1.4 percentage points of GDP compared to 2006, mainly due to higher donor-financed capital expenditure; social spending is projected to increase by 0.5 percent of GDP.

15. **The budgeted fiscal deficit for 2007 (2.3 percent of GDP) strikes an appropriate balance between the country's spending needs and the goal of macroeconomic stability.** While the revenue target is ambitious, the authorities noted the strong political support and significant scope for improving tax administration. If revenue developments during the first half of the year suggest that the end-2007 deficit target cannot be met, the authorities will reduce expenditures accordingly (MEFP, ¶13). The authorities will also let the current gas subsidy expire after 2008 and agreed not to introduce any new general energy subsidies (MEFP, ¶23) (Box 3). The fiscal deficit including the gas subsidy could be as high as 3.4 percent of GDP for 2007.<sup>5</sup> To reduce medium-term fiscal risks, it would be necessary to phase out the subsidy by end-2008. The authorities recognize the need to have an exit strategy, but no specific plans have yet been formulated.

### **Monetary and exchange rate policies**

16. **Monetary policy will focus on maintaining price stability** (MEFP, ¶15). The monetary program envisages a slower buildup in foreign reserves relative to 2006 and seeks to limit reserve money growth to 25 percent. It targets an inflation rate of 4 percent (with a band of  $\pm 1.5$  percentage points).

17. **Coordination between the Treasury and the CBA in the areas of debt and liquidity management has improved.** To this end, informal agreement has been reached on the issuances of treasury and CBA securities and on the segmentation of the yield curve (MEFP, ¶16). The government intends to recapitalize the CBA by issuing non-interest bearing, non-marketable promissory notes that will be repaid on demand. In the staff's view, this does not help debt market development or monetary policy implementation. The CBA has increased issuance of securities to withdraw excess liquidity, promote activity on the interbank market, and strengthen the monetary transmission mechanism, thereby improving the institutional prerequisites for the adoption of full-fledged inflation targeting in the medium term.

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<sup>4</sup> It is estimated that the gas import price hike will yield additional VAT revenues of 0.25 percent of GDP; the elimination of VAT exemptions at the border will yield 0.15 percent of GDP; and several tax policy measures (related to construction; fees on emissions and imports of used cars; the presumptive tax rate for lotteries and gambling; and restrictions to the simplified tax regime) will yield at least an additional 0.2 percent of GDP.

<sup>5</sup> The increase in tariffs necessary for eliminating the subsidy under the current contract price is 50 percent.

### Box 3: Gas Subsidy

In April 2006, the gas import price doubled from US\$55 to US\$110 per 1,000 cubic meters, still significantly lower than in neighboring countries. As a result, the authorities introduced a temporary subsidy that was financed by the sale of a power plant for about US\$250 million (Country Report No. 06/196). About US\$190 million are used to finance the subsidy through end-2008, with the remaining US\$60 million accruing to the budget. While the latter amount is not reflected in the 2007 budget, it could potentially be used to finance the subsidy in the event actual consumption volumes exceed projected amounts.

The current treatment of the subsidy in the fiscal accounts is asymmetric. While payment of the subsidy and its financing are not reflected as an expenditure item, tax revenues from the subsidized component of the tariff are accounted for in the budget.

#### Armenia: Gas Subsidy (As percent of GDP)

	2006	2007	2008
Estimated additional VAT from higher gas prices 1/	0.12	0.17	0.15
Gas subsidy 2/	0.85	1.15	1.04
Financing of gas subsidy from privatization 3/	0.80	0.71	0.74
Other privatization proceeds going to the budget 4/	0.00	0.12	0.53

Source: Fund staff estimates.

1/ VAT not paid by consumers. Projections adjusted downwards for large consumers who are intermediate producers.

2/ Projections based on consumption growth for small and large consumers of 15 and 5 percent respectively in 2007 and zero in 2008.

3/ As described in the government decree of April 6, 2006, N449-N.

4/ As described in the same decree to be paid to the state budget. However, no payment included in the 2007 budget.

18. **The authorities reiterated their commitment to a flexible exchange rate regime.** Foreign exchange interventions will only be used to dampen exchange rate volatility and manage liquidity (MEFP, ¶15). In light of the continued appreciation pressures on the dram, the authorities recognize that increasing productivity, including by improving the business climate and enhancing competition, will be crucial.

## C. Structural Reforms

### Fiscal reforms

19. **Fiscal reforms remain the centerpiece of the program** (see MEFP, ¶18–22). The authorities are finalizing a medium-term tax action plan to improve and modernize the tax system, in line with FAD recommendations; the tax action plan is expected to be approved by the government in July. In **tax policy**, the authorities intend to complete a unified tax code and broaden the tax base by limiting access to the simplified tax regime (MEFP, ¶19). In **tax administration**, the authorities intend to eliminate recording commissions and modify cameral audits, which are designed to verify amounts declared in returns, as part of the move toward self-assessment; they also intend to strengthen information technology in the areas of risk-based tax audits and VAT refunds (MEFP, ¶21). **Expenditure management reforms**

will center on improving budget implementation, introducing a new budget classification, and improving the financial reporting framework for NCOs (MEFP, ¶23).

### **Financial sector reforms**

20. **Banking sector reforms are crucial for lowering interest rate spreads and deepening financial intermediation.** The CBA aims at improving market transparency to enhance the ability of bank customers to obtain information on banks' financial terms; increasing competition, including by encouraging the entry of reputable banks; and improving efficiency of the unified regulation and supervision framework (MEFP, ¶24). The CBA is also developing legislation on securitization and mortgage-backed securities to promote the development of the mortgage market.

21. **Pension, insurance, and securities market reforms are important for developing the Armenian financial sector and improving the availability of long-term investment and financing instruments.** A pension reform framework envisaging a multi-pillar pension system has been drafted with technical assistance from the World Bank and other donors. The new system is expected to start operating in January 2009. Further measures are planned to develop the institutional infrastructure supporting the insurance sector (MEFP, ¶25). Regarding securities market reform, the CBA is negotiating with Scandinavian OMX to operate the Armenian stock exchange and has identified qualified companies as candidates for Initial Public Offerings. In this regard, the authorities are considering introducing tax incentives to encourage companies to list on the stock exchange. The mission argued that such measures are likely to be ineffective, based on international experience.

## **IV. STAFF APPRAISAL**

22. **The Armenian economy performs very strongly.** Prudent macroeconomic policies, large external inflows, and ongoing structural reforms have contributed to the impressive growth performance and decline in poverty of recent years. Sustaining growth and poverty reduction will require continued sound macroeconomic policies as well as structural reforms to diversify the economy, fiscal reforms to finance productivity-enhancing infrastructure and social spending, and financial sector reforms to improve the quality and depth of financial intermediation.

23. **Fiscal policy remains appropriate.** The 2007 budget rightly emphasizes improving revenue performance. Meeting the revenue target will require a concerted effort to broaden the tax base and strengthen tax administration without resorting to ad hoc discretionary measures. On the expenditure side, improving the capacity to absorb increases in social spending is necessary to reduce poverty. Staff welcomes the authorities' plan to allow the gas subsidy to expire by end-2008, but the absence of a detailed exit strategy is a concern. Staff urges the authorities to gradually reduce the subsidy through 2007–08 to minimize the impact of the tariff increase, and to ensure cost recovery, thus reducing medium-term fiscal risks.

24. **The stance of monetary policy is appropriate.** However, the rapid increase in monetary aggregates in 2006 and uncertainties about the extent of dedollarization carry inflationary risks. Accordingly, price developments should be monitored closely. Staff welcomes the CBA's efforts to improve monetary operations and liquidity management, which should help strengthen the monetary transmission mechanism and support the move to full-fledged inflation targeting in the medium term. In this regard, the recent agreement with the Ministry of Finance on the coordination of liquidity and debt management is important.

25. **The flexible exchange rate regime has contributed to price stability, but policies to spur competition need to be strengthened.** While the dram does not yet appear to be overvalued, it is nevertheless vital to continue with structural reforms to improve productivity and, more generally, the business climate to avoid competitiveness problems resulting from real appreciation.

26. **Fiscal and financial sector reforms remain key to sustaining growth and reducing poverty.** It will be important to adopt and implement the medium-term tax action plan to improve and modernize Armenia's tax system, particularly if the ambitious tax revenue target for 2007 is to be achieved. In tax policy, staff places emphasis on finalizing the unified tax code and limiting access to the simplified and presumptive tax regimes. In tax administration, it places priority on strengthening information technology and improving tax audits and the VAT refund system. In the area of expenditure management staff advised caution in moving toward a new budget classification too fast.

27. **The planned financial sector reforms will contribute to financial deepening and the lowering of interest rate spreads through improving efficiency and competition.** In the banking sector, staff welcomes efforts to improve market transparency and to encourage the entry of reputable banks. In the nonbank financial sector, the focus on pension, insurance, and securities market reforms should improve the availability of long-term investment and financing instruments.

28. **Armenia's performance under the PRGF arrangement has been very good.** Based on the authorities' track record and the strength of the 2007 program, staff supports their request for the completion of the fourth review, a waiver for the non-observance of the structural performance criterion on submitting to parliament a new insurance law, and changing the performance criterion on tax revenues to an indicative target.

Table 1. Armenia: Selected Economic and Financial Indicators, 2002–07

	2002	2003	2004	2005		2006		2007
				Act.	Prog.	Est.	Proj.	
(Annual percentage change, unless otherwise indicated)								
National income and prices								
Real GDP growth	13.2	14.0	10.5	14.0	11.0	13.4	9.0	
Gross domestic product (in billions of drams)	1,362	1,625	1,908	2,244	2,578	2,665	3,021	
Gross domestic product (in millions of U.S. dollars)	2,373	2,807	3,578	4,911	6,114	6,406	7,625	
Gross domestic product per capita (in U.S. dollars)	739	874	1,113	1,524	1,892	1,989	2,348	
CPI (period average)	1.1	4.7	7.0	0.6	2.8	2.9	4.5	
CPI (end of period)	2.0	8.6	2.0	-0.2	5.0	5.2	4.0	
GDP deflator	2.4	4.6	6.3	3.2	3.5	4.8	4.0	
Unemployment rate (in percent)	9.4	10.1	9.6	8.1	...	7.2	...	
Poverty rate (in percent)	...	42.9	34.6	29.8	...	...	...	
Investment and saving (in percent of GDP)								
Investment	21.7	24.3	24.9	29.7	30.5	29.2	30.3	
National savings	15.4	17.5	20.4	25.7	25.5	25.2	25.3	
Money and credit (end of period)								
Reserve money	38.4	6.6	11.4	51.9	25.1	41.1	25.2	
Broad money	34.0	10.4	22.3	27.8	27.0	32.9	24.0	
Commercial banks' 3-month lending rate (in percent)	22.0	22.5	17.5	18.3	...	17.0	...	
Central government operations (in percent of GDP)								
Revenue and grants	18.8	17.8	15.4	15.7	17.4	15.8	16.7	
<i>Of which</i> : tax revenue	14.6	14.0	14.0	14.3	14.7	14.4	15.2	
Expenditure and net lending	19.3	18.9	17.1	18.3	19.7	17.6	19.0	
Overall balance on a commitment basis	-0.4	-1.1	-1.7	-2.6	-2.3	-1.9	-2.3	
Overall balance on a cash basis	-2.6	-1.5	-1.6	-2.6	-2.3	-1.9	-2.3	
Stock of domestic expenditure arrears	0.5	0	0	0	0	0	0	
Government and government-guaranteed debt (in percent of GDP)	46.6	40.9	32.4	24.2	22.2	21.7	16.6	
Share of foreign currency debt (in percent)	94.4	93.5	93.0	91.3	91.1	90.4	87.4	
Primary balance of the energy sector (in percent of GDP) 1/	-0.4	0.0	0.1	0.1	...	...	...	
External sector								
Exports of goods and services (in millions of U.S. dollars)	698	903	985	1,337	1,437	1,407	1,548	
Imports of goods and services (in millions of U.S. dollars)	-1,107	-1,406	-1,514	-1,984	-2,309	-2,340	-2,690	
Exports of goods and services	29.3	29.5	9.0	35.7	7.5	5.3	10.0	
Imports of goods and services	13.2	27.0	7.7	31.1	16	18.0	14.9	
Current account (in percent of GDP)	-6.2	-6.8	-4.5	-3.9	-4.9	-4.0	-5.0	
FDI (net, in millions of U.S. dollars)	111	121	217	252	267	287	316	
External debt-to-exports ratio (NPV, in percent)	131	60	59	60	47	52	51	
Debt service ratio 2/	9.8	15.6	9.7	5.7	4.2	4.2	3.3	
Gross international reserves (in millions of U.S. dollars) 3/	430	502	547	667	790	1072	1246	
Import cover 4/	3.7	4.0	3.3	3.4	3.6	4.8	5.0	
Nominal effective exchange rate 5/	-5.8	-4.6	11.5	13.6	...	14.3	...	
Real effective exchange rate 5/	-10.8	-2.6	6.5	7.4	...	13.6	...	
End-of-period exchange rate (dram per dollar)	585	566	486	450	...	364	...	
Average exchange rate (dram per dollar)	573	579	533	458	...	416	...	
Memorandum item:								
Population (in millions)	3,210	3,212	3,214	3,223	...	3,221	...	

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

1/ Comprises state-owned energy companies. Data for 2002 includes the electricity distribution company, Armelnet, which was privatized in late-2002. Data for 2003–04 exclude Armelnet and two generation companies that were also privatized.

2/ In percent of exports of goods and services.

3/ Gross international reserves excluding the special privatization account (SPA).

4/ Gross international reserves in months of next year's imports of goods and services.

5/ A positive sign denotes appreciation. Base year 1995=100. The calculations are based on 1999–2001 average trade weights.



Table 2. Armenia: Quantitative Targets, June 2006–December 2006 1/  
(End of period ceilings on stocks, unless otherwise specified)

	2006				
	Jun.	Actual 2/	Prog.	Actual 3/	Dec.
	Prog.			Prog.	Est. 2/
Net domestic assets of the CBA 4/	-29.8	-54.2	-32.0	-49.4	-115.4
Net banking system credit to the government	-1.2	-13.4	7.1	-3.8	-31.8
Domestic arrears of the central government	0	0	0	0	0
Tax revenues of the central government (floor) 5/	162.1	167.9	259.1	268.8	383.8
Balance of the central government on a cash basis (floor) 5/ 6/	-31.9	-14.5	-48.5	-31.8	-50.4
Reserve money (band/level) 3/	(199-207)	199.1	(216-225)	231.1	283.0
Contributions to the State Fund for Social Insurance (floor) 3/ 5/	34.0	33.6	52.4	52.6	73.3
Contracting or guaranteeing of new nonconcessional external debt 5/ 7/	0	0	0	0	0
External arrears (continuous criterion)	0	0	0	0	0
Net official international reserves (floor)	492.0	510.4	543.9	528.0	812.2

1/ All items as defined in the technical memorandum of understanding.

2/ Performance criterion.

3/ Indicative target.

4/ At program exchange rate of 450 dram per U.S. dollar for 2006.

5/ Cumulative flow from the beginning of the calendar year until the end of the month indicated.

6/ AMD 8 billion from the privatization of Zangzeur is classified as financing (below-the-line) from June 2006 onwards.

7/ Includes debt with maturity of more than a year, as well as obligations with maturity of one year or less, excluding normal import-related credit and sales of treasury bills to nonresidents.

Table 3. Armenia: Status of Measures Under the Fourth Review of the PRGF 1/

Measure	Proposed Time Frame (End of Period)	Type of Conditionality	Status
<u>Tax administration</u>			
Strengthen the IT capacity of the State Tax Service (STS):			
(i) Establish an electronic risk-based selection system for VAT cross-checks, audits, and refunds. Issue an STS decree specifying the procedures and a timeline that envisages full technical implementation by the end of 2007.	December 2006	Structural Benchmark	Observed
<u>Public financial management</u>			
Submit to parliament amendments to the law on state noncommercial enterprises to narrow their definition and their activities and define the functions of the management bodies.	December 2006	Structural Benchmark	Not observed. The amendments were submitted to parliament in January 2007.
<u>Financial Sector</u>			
Submit to parliament an amendment to the Law on Banking Secrecy, which would allow the CBA to publish violations of and sanctions against commercial banks that do not comply with the Law on Banks and Banking.	December 2006	Structural Benchmark	Observed
Submit to parliament a new Insurance Law that corresponds to the standards of the International Association of Insurance Supervisors.	December 2006	Structural Performance Criterion	Not observed. The amendments were submitted to parliament in January 2007.

1/ As agreed to in the Memorandum of Economic and Financial Policies of November 1, 2006.

Table 4. Armenia: Central Government Operations, 2005-07

	2005		2006				2007				Jan.-Dec. Proj. 1/, 2/			
	Jan.-Dec. Act.	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4					
		Act.	Act.	Rev. Prog. 1/	Act.	Rev. Prog. 1.	Est.	Rev. Prog. 1.	Est.	Q1		Q2	Q3	Q4
Total revenue and grants	351.9	79.9	100.3	115.8	108.7	145.0	130.9	449.0	419.8	102.3	122.9	136.1	144.4	505.7
Total revenue	342.1	79.5	97.4	108.8	107.6	114.8	123.2	408.5	407.7	100.6	120.8	131.6	137.5	490.5
Tax revenue	321.5	74.5	93.4	101.0	100.9	110.5	115.0	378.1	383.8	93.4	110.8	122.2	132.5	458.8
Value-added tax	146.8	31.8	37.7	...	44.3	...	52.1	...	165.9	...	...	...	...	...
Excises	38.6	9.0	8.4	...	11.1	...	11.3	...	39.9	...	...	...	...	...
Profits, simplified, and presumptive taxes	66.2	16.6	26.5	...	20.8	...	24.2	...	88.1	...	...	...	...	...
Personal income tax	26.6	7.6	7.8	...	9.0	...	11.0	...	35.5	...	...	...	...	...
Customs duties	16.5	3.6	4.5	...	4.7	...	5.5	...	18.3	...	...	...	...	...
Other taxes	26.8	5.9	8.4	...	11.0	...	11.0	...	36.2	...	...	...	...	...
Nontax revenue	8.2	2.4	1.3	2.1	2.2	2.8	2.1	17.8	7.9	3.8	2.4	2.5	3.4	12.2
Capital revenue	12.4	2.5	2.8	5.7	4.4	1.5	6.1	12.6	15.9	3.4	7.6	6.9	1.6	19.5
Grants	9.8	0.4	2.9	7.0	1.1	30.2	7.6	40.5	12.1	1.7	2.1	4.5	6.9	15.1
Of which : MCA (for 2007) and Lincy	0.0	0.0	0.0	5.3	0.0	21.6	1.0	26.9	1.0	0.9	0.9	1.4	1.4	4.5
Total expenditure	409.8	83.5	116.7	141.9	126.7	167.1	143.0	509.1	469.9	116.3	141.7	146.3	169.8	574.1
Current expenditure	304.1	69.2	85.1	98.7	88.4	99.0	106.5	352.0	349.2	...	...	...	...	406.2
Wages	44.1	10.3	11.9	13.3	11.9	14.9	14.9	55.9	49.0	...	...	...	...	59.3
Subsidies	14.9	2.9	4.1	2.6	5.7	9.9	3.6	19.5	16.4	...	...	...	...	19.8
Interest	10.3	2.4	2.0	2.6	2.0	2.6	2.6	9.8	9.0	...	...	...	...	11.4
Transfers	83.2	19.6	22.8	21.7	26.2	23.1	33.0	87.2	101.6	...	...	...	...	114
Goods and services	151.5	34.0	44.3	58.4	42.5	43.8	52.5	179.6	173.2	...	...	...	...	97.9
Capital expenditure and net lending	105.7	14.3	31.6	43.2	38.3	68.0	36.5	157.1	120.7	...	...	...	...	217.8
Capital expenditure	92.4	11.0	27.3	38.6	33.8	63.2	32.2	140.1	104.2	...	...	...	...	167.9
Net lending	13.3	3.4	4.2	4.6	4.6	4.8	4.3	17.0	16.4	...	...	...	...	146.5
Overall balance (commitment)	-57.9	-3.7	-16.3	-26.1	-18.0	-22.1	-12.2	-60.2	-50.2	-14.0	-18.8	-10.2	-25.4	-68.4
Statistical discrepancy/financing gap	-0.2	3.0	2.4	0.0	0.8	5.5	-6.5	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
Overall balance (cash)	-58.0	-0.6	-13.9	-26.1	-17.2	-27.5	-18.7	-60.2	-50.4	-14.0	-18.8	-10.2	-25.4	-68.4
Deficit/financing	58.0	0.6	13.9	26.1	17.2	27.5	18.7	60.2	50.4	14.0	18.8	10.2	25.4	68.4
Domestic financing	42.5	-2.2	1.1	20.2	11.4	16.3	12.3	27.4	22.6	11.4	3.7	3.7	3.4	22.2
Bank financing	29.5	-2.4	-8.1	6.6	10.1	10.2	-8.9	6.2	-9.3	1.2	-5.7	3.6	3.2	2.3
Central Bank of Armenia (net) 3/	25.8	-1.1	-8.5	5.9	10.2	8.0	-13.3	4.3	-12.7	-0.2	-8.0	2.7	0.8	-4.7
Commercial Banks (net)	3.7	-1.4	0.4	0.7	0.0	2.2	4.3	2.0	3.4	1.4	2.4	0.9	2.3	7.0
Nonbank financing (net)	0.5	0.2	9.3	0.1	1.3	0.2	1.9	1.8	32.0	0.2	0.3	0.1	0.3	0.8
Special Privatization Account (net) 3/	0.0	0.0	0.0	13.5	0.0	5.8	19.3	19.4	19.3	10.1	9.1	0.0	0.0	19.2
Privatization proceeds	12.5	0.0	8.0	0.0	0.0	0.0	0.0	0.0	8.0	0.0	0.0	0.0	0.0	0.0
External financing 4/	15.5	2.8	12.8	5.9	5.8	11.2	6.4	32.8	27.8	2.6	15.1	6.5	22.0	46.2
Gross inflow	22.7	5.4	14.1	8.5	7.8	12.8	7.6	40.8	34.9	4.7	16.2	8.1	23.2	52.3
Of which: PRSC	...	0.0	9.2	0.0	0.0	0.0	0.0	9.2	9.2	0.0	10.0	0.0	0.0	10.0
Amortization due	-7.2	-2.5	-1.4	-2.6	-2.0	-1.5	-1.2	-8.0	-7.1	-2.2	-1.1	-1.6	-1.2	-6.1

(In billions of drams)

Table 4. Armenia: Central Government Operations, 2005-07 (concluded)

	2005		2006				2007		
	Jan.-Dec.	Act.	Q1	Q2	Q3	Q4	Jan.-Dec.	Jan.-Dec.	
	Act.	Act.	Act.	Act.	Rev. Prog. 1/	Rev. Prog. 1/	Est.	Est.	
(In percent of GDP unless specified otherwise)									
Total revenue and grants	15.7	3.0	3.8	4.5	4.1	5.6	4.9	15.8	16.7
Total revenue	15.2	3.0	3.7	4.2	4.0	4.5	4.6	15.8	16.2
Tax revenue	14.3	2.8	3.5	3.9	3.8	4.3	4.3	14.4	15.2
Value-added tax	6.5	1.2	1.4	...	1.7	...	2.0	6.2	...
Excises	1.7	0.3	0.3	...	0.4	...	0.4	1.5	...
Profits, simplified, and presumptive taxes	3.0	0.6	1.0	...	0.8	...	0.9	3.3	...
Personal income tax	1.2	0.3	0.3	...	0.3	...	0.4	1.3	...
Customs duties	0.7	0.1	0.2	...	0.2	...	0.2	0.7	...
Other taxes	1.2	0.2	0.3	...	0.4	...	0.4	1.4	...
Nontax revenue	0.4	0.1	0.0	...	0.1	...	0.1	0.7	0.4
Capital revenue	0.6	0.1	0.1	0.2	0.2	0.1	0.2	0.6	0.6
Grants	0.4	0.0	0.1	0.3	0.0	1.2	0.3	0.5	0.5
Total expenditure	18.3	3.1	4.4	5.5	4.8	6.5	5.4	17.6	19.0
Current expenditure	13.6	2.6	3.2	3.8	3.3	3.8	4.0	13.7	13.4
Wages	2.0	0.4	0.4	0.5	0.4	0.8	0.6	2.2	...
Subsidies	0.7	0.1	0.2	0.1	0.2	0.4	0.1	0.8	0.6
Interest	0.5	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.4
Transfers	3.7	0.7	0.9	0.8	1.0	0.9	1.2	3.8	...
Goods and services	6.8	1.3	1.7	2.3	1.6	1.7	2.0	7.0	...
Capital expenditure and net lending	4.7	0.5	1.2	1.7	1.4	2.6	1.4	4.5	5.6
Capital expenditure	4.1	0.4	1.0	1.5	1.3	2.5	1.2	5.4	4.8
Net lending	0.6	0.1	0.2	0.2	0.2	0.2	0.2	0.7	0.7
Overall balance (commitment)	-2.6	-0.1	-0.6	-1.0	-0.7	-0.9	-0.5	-2.3	-2.3
Statistical discrepancy/financing gap	0.0	0.1	0.1	0.0	0.0	0.2	0.0	0.0	0.0
Overall balance (cash)	-2.6	0.0	-0.5	-1.0	-0.6	-1.1	-0.7	-1.9	-2.3
Deficit/financing	2.6	0.0	0.5	1.0	0.6	1.1	0.7	2.3	2.3
Domestic financing	1.9	-0.1	0.0	0.8	0.4	0.6	0.5	1.1	0.8
Bank financing	1.3	-0.1	-0.3	0.3	0.4	0.4	-0.3	0.2	0.1
Central Bank of Armenia (net) 3/	1.2	0.0	-0.3	0.2	0.4	0.3	-0.5	0.2	...
Commercial Banks (net)	0.2	-0.1	0.0	0.0	0.0	0.1	0.2	0.1	...
Nonbank financing (net)	0.0	0.0	0.3	0.0	0.0	0.0	0.1	1.2	0.0
Special Privatization Account (net) 3/	0.0	0.0	0.0	0.5	0.0	0.2	0.7	0.8	0.6
Privatization proceeds	0.6	0.0	0.3	0.0	0.0	0.0	0.0	0.3	0.0
External financing 4/	0.7	0.1	0.5	0.7	0.2	0.4	0.2	1.5	1.5
Gross inflow	1.0	0.2	0.3	0.3	0.3	0.5	0.3	1.3	1.7
Amortization due	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	-0.3	0.3
Memorandum items									
Estimated net additional VAT from higher gas prices 5/	...	...	...	...	...	...	...	0.1	0.2
Gas subsidy 6/	...	0.0	0.2	...	0.2	...	0.4	0.8	1.2
Financing of gas subsidy from privatization 7/	...	...	...	...	...	...	...	0.8	0.7
Other privatization proceeds 8/	...	...	...	...	...	...	...	0.0	0.1
Underlying balance (excl. grants and interest, commitment)	-2.6	-0.1	-0.6	-1.2	-0.6	-1.9	-0.6	-3.5	-2.4
Primary balance (excl. interest, commitment)	-2.1	0.0	-0.5	-0.9	-0.6	-0.7	-0.4	-2.0	-1.9
Domestic expenditure arrears (stock in billions of drams)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government and government-guaranteed debt	24.2	...	...	...	...	...	...	22.2	16.6
Of which: domestic debt	2.1	...	...	...	...	...	...	2.0	2.1
Nominal GDP (annual, in billions of drams)	2,244	2,665	2,578	2,665	2,578	2,578	2,665	2,578	3,021

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

1/ "Prog." refers to the program agreed to in November 2006. Relative to the budget, the staff presentation makes the following adjustments: (i) estimated military wages are reclassified from other goods and services to Wages; (ii) external grants, external interest, and external financing are converted at the program exchange rate of AMD 450 per U.S. dollar for 2006 and AMD 357 per U.S. dollar for 2007.

2/ According to the budget.

3/ As the SPA is not included in net claims on central government (NCCG), timing differences between the conversion of SPA funds into domestic currency deposits (which are included in NCCG) and their spending can affect the consistency between the CBA financing in the fiscal accounts and the change in NCCG in the monetary accounts. However, in any quarter the change in the sum of SPA plus NCCG in the monetary accounts equals the sum of CBA plus SPA financing in the fiscal accounts.

4/ The 2007 IMF column includes USD 28 million in PRSC disbursements and the principal portion of debt relief provided by the UK (the interest portion is included in grants).

5/ VAT on the subsidized component of the tariff not paid by consumers.

6/ Projections based on consumption growth for small and large consumers of 15 and 5 percent respectively in 2007 and zero in 2008.

7/ As described in the government decree of 6th April, 2006, N449-N.

8/ As described in the same decree to be paid to the state budget. No payment was incorporated in the 2007 budget.

Table 5. Armenia: Monetary Accounts, 2005-07

	2005			2006			2007					
	Mar.		June	Mar.		June	Mar.		June	Dec.		
	Act.	Prog. 1/	Act.	Prog. 1/	Act.	Prog. 1/	Act.	Prog. 1/	Act.	Prog. 1/		
Central Bank of Armenia												
Net foreign assets	249.9	254.4	243.2	253.6	279.3	270.5	289.9	321.8	322.3	332.5	352.7	381.4
Net international reserves	220.3	242.8	213.7	242.5	269.0	245.9	282.8	329.9	331.0	341.9	362.8	392.3
Special privatization account	38.5	20.5	38.6	20.5	17.8	32.7	19.2	0.0	0.0	0.0	0.0	0.0
Medium and long-term	-8.9	-8.9	-9.1	-8.8	-8.8	-8.1	-12.0	-8.0	-8.7	-9.4	-10.1	-10.8
Net domestic assets	-49.4	-61.4	-54.1	-50.3	-51.1	-39.4	-39.0	-38.8	-52.2	-50.5	-35.5	-27.1
Claims on general government (net) 2/	-17.4	-39.1	-22.5	-27.1	-22.9	-25.4	-9.1	-57.7	-47.8	-46.7	-44.1	-43.2
Of which: central government (net) 2/	6.6	-15.1	5.5	-3.1	2.8	7.2	10.9	-16.2	-6.3	-5.2	-2.5	-1.7
Claims on banks	4.0	4.0	10.6	5.1	10.5	10.6	13.7	7.9	0.6	1.3	9.0	14.7
KfW	11.7	11.7	11.9	12.8	12.5	11.9	15.7	11.9	12.6	13.3	14.0	14.7
Monetary instruments (net) excluding CBA bills	-7.7	-7.7	-1.3	-7.7	-2.0	-1.3	-2.0	-4.0	-12.0	-12.0	-5.0	0.0
CBA bills	-21.2	-28.4	-29.1	-29.6	-36.9	-35.0	-43.9	-39.0	-55.9	-53.7	-45.7	-44.4
Other items (net)	-38.5	-20.5	-38.6	-20.5	-19.2	-32.7	-19.2	0.0	0.0	0.0	0.0	0.0
SPA	23.7	22.6	25.4	21.8	17.4	43.0	19.5	50.0	50.9	48.6	45.2	45.8
Autonomous OIN	200.6	193.0	189.1	202.7	228.2	231.1	250.9	283.0	270.1	282.0	317.2	354.3
Reserve money	155.3	149.4	141.3	157.2	180.0	182.9	204.0	226.8	217.5	228.2	256.8	289.0
Currency issue	45.3	43.5	47.8	45.4	48.2	48.2	47.0	56.2	52.6	53.8	60.4	65.3
Deposits												
Banking system												
Net foreign assets	275.0	271.9	270.4	269.7	283.8	280.0	283.3	332.5	327.1	333.8	350.5	375.8
Net domestic assets	90.5	94.7	88.0	115.4	138.4	125.4	170.9	153.2	155.0	166.7	188.7	226.6
Claims on government (net)	5.2	2.6	-1.3	-13.4	7.1	-3.8	-3.9	-31.8	-30.6	-36.3	-32.7	-29.6
Of which: claims on central government (net)	29.1	26.6	26.7	22.8	25.2	28.7	35.4	9.7	10.9	5.2	8.8	12.0
Claims on rest of the economy	188.3	190.7	201.6	203.2	241.4	225.5	265.5	241.5	262.5	285.3	293.5	314.1
Other items (net)	-102.9	-98.6	-112.3	-86.7	-88.8	-96.3	-90.6	-56.4	-76.8	-82.3	-72.1	-57.9
Broad money	365.6	366.6	358.5	385.1	422.2	405.4	464.3	485.7	482.1	500.5	539.2	602.3
Currency in circulation	140.4	140.4	130.3	148.2	171.0	172.7	195.0	211.5	202.5	215.2	237.8	270.0
Deposits	221.2	226.2	228.2	236.8	251.2	232.7	269.3	274.3	279.6	285.3	301.4	332.3
Domestic currency	80.5	83.2	80.6	90.5	96.7	104.2	111.4	130.9	142.2	151.7	166.6	196.8
Foreign currency	140.8	143.0	147.6	146.3	154.5	128.5	157.8	143.4	137.4	133.6	134.8	135.5
Memorandum items												
Exchange rate (in drams per U.S. dollar, end of period)	450.2	...	450.9	...	418.8	...	381.5	...	362.1	...	...	...
Program e-rate	...	450.0	...	450.0	...	...	450.0	...	357.0	...	357.0	357.0
Special privatization account (in millions of U.S. dollars)	85.6	45.6	85.8	45.6	42.6	72.6	42.6	0.0	0.0	0.0	0.0	0.0
NIR (in millions of U.S. dollars) 3/	439.9	...	334.5	...	544.0	...	...	837.4	...	...	...	...
NIR (in millions of U.S. dollars) 4/	458.4	494.6	332.3	492.0	543.9	528.0	577.2	812.2	877.6	910.6	967.8	1,050.8
NDA of the CBA (in billions of drams) 5/	-42.5	-40.9	-15.1	-29.8	-32.0	-49.4	-19.8	-115.4	-52.2	-50.5	-35.5	-27.1
12-month change in reserve money (in percent)	51.9	56.1	53.0	34.4	31.3	32.9	25.1	41.1	42.8	41.6	37.2	25.2
12-month change in broad money (in percent)	27.8	31.5	28.6	27.0	27.0	21.9	27.0	32.9	34.5	35.0	33.0	24.0
12-month change in private sector credit (in percent)	32.2	35.2	42.9	31.3	44.3	34.8	41.0	28.2	30.2	30.2	30.2	30.1
Velocity of broad money (end of period)	6.1	6.2	6.3	6.0	5.9	6.2	5.6	5.5	5.6	5.6	5.4	5.0
Money multiplier	1.8	1.9	1.9	1.9	1.9	1.8	1.9	1.7	1.8	1.8	1.7	1.7
Dollarization in bank deposits 6/	63.6	63.2	64.7	61.8	61.5	55.2	58.6	52.3	49.1	46.8	44.7	40.8
Dollarization in broad money 7/	38.5	39.0	41.2	38.0	36.6	31.7	36.6	29.5	28.5	26.7	25.0	22.5
Currency in circulation in percent of deposits	65.2	62.1	57.1	62.6	68.1	74.2	72.4	77.1	72.4	75.4	78.9	81.3
Stock of FCD (in millions of U.S. dollars)	312.7	317.7	327.2	325.2	343.4	336.9	350.8	394.5	384.9	374.3	377.6	379.6
Banking system financing of the central government (cumulative)	25.2	-2.5	-2.4	-6.4	-4.0	-0.4	6.2	-19.4	1.2	-4.5	-0.9	2.3

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

1/ At program exchange rate of 450 dram per U.S. dollar for 2006 and program exchange rate of 357 dram per U.S. dollar for 2007.

2/ See footnote 3 of Table 4.

3/ At actual exchange rates, excluding the SPA and foreign currency reserve money.

4/ At program exchange rates, excluding the SPA and foreign currency reserve money.

5/ Defined as reserve money minus NIR plus medium- and long-term liabilities (at program exchange rate of 450 dram per U.S. dollar for 2006 and program exchange rate of 357 dram per U.S. dollar for 2007).

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

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

Table 6. Armenia: Financial Soundness Indicators for the Banking Sector, 2003–06  
(In percent, unless otherwise indicated)

	2003			2004			2005			2006				
	Dec.	Mar.	Jun.	Dec.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.			
<b>Capital adequacy</b>														
Total regulatory capital to risk-weighted assets	33.8	35.5	34.3	33.7	32.3	32.3	36.4	31.7	33.6	33.7	33.8	33.7	35.3	34.9
Tier I regulatory capital to risk-weighted assets	32.2	33.5	32.3	31.7	30.2	30.2	33.7	29.6	31.9	31.7	31.6	30.0	31.4	32.7
Capital (net worth) to assets	18.1	16.9	17.9	17.5	17.8	17.8	19.3	19.5	20.6	21.5	21.3	22.0	24.3	22.9
<b>Asset composition</b>														
<b>Sectoral distribution of loans (billions of drams)</b>														
Industry (excluding energy sector)	19.0	19.4	20.6	23.8	29.0	29.0	26.0	26.9	28.9	30.4	33.5	34.6	34.0	34.3
Energy Sector	10.7	9.5	11.6	11.6	6.6	6.6	5.6	6.5	7.4	8.7	6.3	8.3	7.2	5.0
Agriculture	8.2	8.4	9.0	7.6	8.6	8.6	10.0	12.5	10.7	11.3	12.1	13.3	11.6	14.2
Construction	4.8	5.4	5.1	5.9	5.3	5.3	5.9	6.0	7.4	7.9	8.5	8.2	9.8	11.5
Transport and communication	0.7	0.8	1.0	1.2	1.2	1.2	2.2	3.3	3.0	3.7	4.1	4.9	3.7	3.9
Trade/commerce	21.5	23.1	24.9	28.8	31.1	31.1	30.6	32.8	34.8	42.2	44.0	47.1	49.7	49.6
<b>Sectoral distribution of loans to total loans (percent of total)</b>														
Industry (excluding energy sector)	20.1	19.1	18.3	19.4	22.2	22.2	19.7	18.4	18.3	17.0	17.5	16.6	16.1	16.2
Energy Sector	11.4	9.4	10.3	9.4	5.0	5.0	4.2	4.5	4.7	4.8	3.3	4.0	3.4	2.3
Agriculture	8.6	8.2	8.0	6.2	6.6	6.6	7.6	8.5	6.8	6.3	6.3	6.4	5.5	6.7
Construction	5.1	5.3	4.5	4.8	4.0	4.0	4.5	4.1	4.7	4.4	4.5	3.9	4.6	5.5
Transport and communication	0.7	0.8	0.9	1.0	0.9	0.9	1.7	2.3	1.9	2.0	2.1	2.4	1.8	1.9
Trade/commerce	22.7	22.7	22.1	23.4	23.8	23.8	23.2	22.4	22.1	23.5	23.0	22.7	23.5	23.4
Foreign exchange loans to total loans	72.7	74.6	72.1	71.8	70.4	70.4	73.6	70.2	66.6	63.7	64.6	59.8	57.5	52.8
<b>Asset quality</b>														
Nonperforming loans (billions of drams)	6.7	5.8	4.3	5.0	3.1	3.1	4.0	4.0	4.1	3.8	6.5	6.6	9.1	6.0
Watch (up to 90 days past due)	4.9	3.0	2.5	2.9	1.5	1.5	2.8	2.7	2.8	2.9	4.9	4.6	5.6	3.6
Substandard (91–180 days past due)	0.9	1.8	1.5	0.9	0.4	0.4	0.8	0.9	0.6	0.5	1.2	1.4	2.5	1.0
Doubtful (181–270 days past due)	0.9	1.0	0.4	1.2	1.1	1.1	0.5	0.4	0.7	0.5	0.5	0.6	1.0	1.4
Loss (>270 days past due)	11.6	9.8	10.1	9.3	3.3	3.3	2.1	2.5	2.2	1.9	3.1	3.0	4.0	2.5
Nonperforming loans to gross loans	5.4	4.4	3.1	3.3	2.1	2.1	2.5	2.3	2.2	1.9	3.1	3.0	4.0	2.5
Provisions to nonperforming loans	34.3	41.8	47.8	50.4	77.0	77.0	58.8	61.3	65.5	70.7	48.7	51.5	43.7	64.3
Spread between highest and lowest rates of interbank borrowing in AMD	2.6	2.3	2.5	2.5	2.0	2.0	1.8	3.5	0.5	3.7	1.5	2.0	0.5	3.0
Spread between highest and lowest rates of interbank borrowing in foreign currency	3.7	2.0	2.7	1.0	1.0	1.0	0.9	4.0	6.1	1.0	0.0	1.3	0.5	2.3
<b>Earnings and profitability</b>														
ROA (profits to period average assets)	2.7	2.7	2.9	3.2	3.2	3.2	2.9	2.8	3.2	3.1	3.6	3.6	3.8	3.6
ROE (profits to period average equity)	14.4	16.2	16.2	18.0	18.4	18.4	15.8	14.7	16.8	15.5	16.6	16.6	17.2	15.9
Interest margin to gross income	42.0	46.0	46.8	44.6	44.2	44.2	43.4	39.6	40.5	41.1	48.8	49.6	46.9	47.1
Interest income to gross income	62.7	67.9	67.8	64.6	63.7	63.7	63.9	58.2	59.4	59.8	70.0	70.2	66.3	66.3
Noninterest expenses to gross income	48.5	45.7	47.0	45.5	46.5	46.5	45.2	54.5	49.9	49.7	45.3	45.9	43.3	45.1
<b>Liquidity</b>														
Liquid assets to total assets	47.5	46.5	44.6	47.6	47.1	47.1	46.3	45.2	45.7	44.2	44.7	40.8	42.3	41.2
Liquid assets to total short-term liabilities	101.3	100.3	96.1	99.9	98.7	98.7	107.9	106.1	109.9	110.5	110.3	105.9	104.5	106.1
Customer deposits to total (non-interbank) loans	177.1	175.0	160.3	175.0	177.3	177.3	161.4	148.1	149.3	140.5	142.5	121.2	121.1	130.8
Foreign exchange liabilities to total liabilities	73.2	75.1	72.6	74.1	73.3	73.3	72.4	71.1	69.5	66.8	68.2	64.5	59.3	56.0
<b>Sensitivity to market risk</b>														
Gross open positions in foreign exchange to capital	13.8	10.8	12.5	9.9	7.4	7.4	10.5	5.6	5.3	4.9	4.3	3.9	11.9	4.4

Source: Central Bank of Armenia.

Table 7. Armenia: Balance of Payments, 2005–10  
(In millions of U.S. dollars, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010
		Est.	Projections			
Current account	-193	-254	-384	-440	-459	-498
Trade balance	-588	-879	-1,082	-1,202	-1,274	-1,357
Exports, fob	1,005	1,037	1,141	1,255	1,381	1,512
Imports, fob	-1,593	-1,916	-2,223	-2,457	-2,655	-2,868
Services (net)	-59	-54	-59	-61	-69	-72
Credits	332	370	407	452	486	527
Debits	-391	-424	-467	-513	-554	-599
Income (net)	45	99	127	142	163	172
Transfers (net)	409	580	631	681	721	759
Private	342	501	601	661	701	743
Official	67	79	30	20	21	16
Capital and financial account	330	663	542	564	610	638
Capital transfers (net)	51	70	63	61	63	64
Foreign direct investment (net)	252	287	316	335	355	376
of which: Privatization/debt swap	57	75	0	0	0	0
Retained earnings/new investment	194	212	316	335	355	376
Portfolio investment (net)	-2	9	0	0	0	0
Public sector (net)	36	68	109	210	164	167
Disbursements	50	83	126	225	183	190
of which: World Bank program support	...	20	...	...	...	...
Amortization	-14	-16	-17	-14	-19	-22
Other capital (net) 1/	-6	228	54	-42	28	30
Errors and omissions	5	17	0	0	0	0
Overall balance	142	426	158	124	151	140
Financing	-141	-426	-196	-129	-151	-140
Gross international reserves (increase: -)	-120	-405	-174	-105	-130	-121
Use of Fund credit, net	-24	-21	-23	-25	-22	-21
Disbursements	10	10	...	...	...	...
Repurchases/repayments	-33	-31	-23	-25	-22	-21
Exceptional financing	1	1	1	1	2	2
Debt relief 2/	1	1	1	1	2	2
Financing gap	...	...	38	5	0	0
IMF	...	...	10	5	0	0
World Bank	...	...	28	0	0	0
Memorandum items:						
Current account (in percent of GDP)	-3.9	-4.0	-5.0	-5.1	-4.8	-4.8
Gross international reserves (end of period)	667	1072	1246	1351	1481	1602
In months of imports	3.4	4.8	5.0	5.1	5.1	5.2
Merchandise export growth, percent change	36.1	3.2	10.0	10.0	10.0	9.5
Merchandise import growth, percent change	33.1	20.3	16.0	10.5	8.0	8.0
Nominal external debt 3/	1,099	1,206	1,343	1,469	1,586	1,727
Nominal external debt stock (in percent of GDP) 3/	22	19	18	17	17	17
NPV of external debt in percent of exports 4/	60	52	51	52	53	54
External debt service in percent of exports 3/	5.7	4.2	3.3	3.1	3.0	3.1

Sources: Armenian authorities; and Fund staff estimates.

1/ For 2006, about \$100 million of the increase in other capital (net) is arising from the conversion of the Special Privatization Account, a depository of the proceeds from sales of government assets to nonresidents.

2/ Debt relief from the United Kingdom through 2015 (in respect of IDA credits).

3/ Based on government and government-guaranteed medium- and long-term debt as at end-2006.

4/ Based on the low-income country debt sustainability analysis presented in Country Report No. 06/433.

Table 8. Armenia: Medium-Term Macroeconomic Framework, 2005–10

	2005	2006	2007	2008	2009	2010
		Est.		Projections		
(In percent of GDP, unless otherwise specified)						
<b>National income and prices</b>						
Real GDP growth (percent change)	14.0	13.4	9.0	8.0	6.0	6.0
Gross domestic product (in millions of U.S. dollars)	4,911	6,406	7,625	8,694	9,540	10,469
Gross national income per capita (in U.S. dollars)	1,538	2,020	2,387	2,708	2,958	3,228
CPI inflation, end-of-period (annual percent change)	-0.2	5.2	4.0	3.0	3.0	3.0
<b>Investment and saving</b>						
Investment	29.7	29.2	30.3	30.6	30.7	30.5
Government	4.1	3.9	4.8	5.0	4.5	4.0
Other	25.6	25.3	25.5	25.6	26.2	26.5
National savings	25.7	25.2	25.3	25.5	25.9	25.7
Government	1.5	2.0	2.6	2.4	2.5	2.0
Other	24.2	23.2	22.7	23.1	23.4	23.7
<b>Government operations</b>						
Revenue and grants	15.7	15.8	16.7	16.8	17.2	17.4
<i>Of which:</i> tax revenue	14.3	14.4	15.2	15.6	16.0	16.4
grants 1/	0.4	0.5	0.5	0.9	0.8	0.6
Expenditure	18.3	17.6	19.0	19.4	19.2	19.4
<i>Of which:</i> social expenditure 2/	5.9	6.0	6.5	7.0	7.0	7.0
Current expenditure	13.6	13.1	13.4	13.7	14.0	14.7
Capital expenditure	4.1	3.9	4.8	5.0	4.5	4.0
Net lending	0.6	0.6	0.7	0.7	0.7	0.7
Overall balance (including grants) 3/	-2.6	-1.9	-2.3	-2.6	-2.0	-2.0
Domestic financing	1.9	0.8	0.7	0.4	0.4	0.5
External financing	0.7	1.0	1.5	2.2	1.6	1.5
Government and government-guaranteed debt	24.2	21.7	16.6	15.6	15.0	14.3
<b>External sector</b>						
Exports of goods and services	27.3	22.0	20.3	19.6	19.6	19.5
Imports of goods and services	40.5	36.5	35.3	34.2	33.6	33.1
Current account (in percent of GDP)	-3.9	-4.0	-5.0	-5.1	-4.8	-4.8
Current account (in millions of U.S. dollars)	-193	-254	-384	-440	-459	-498
Capital and financial account (in millions of U.S. dollars)	330	663	542	564	610	638
<i>Of which:</i> direct foreign investment	252	287	316	335	355	376
public sector disbursements	50	83	126	225	183	190
Change in gross international reserves (in millions of U.S. dollars) 4/	9100	0	-147	-105	-130	-121
Arrears and debt relief (in millions of U.S. dollars)	1	1	1	1	2	2
Financing/gap (in millions of U.S. dollars)	-9042	-405	11	5	0	0
<i>Of which:</i> IMF	0	0	10	5	0	0
World Bank	0	0	28	0	0	0
External debt (NPV, in percent of exports of goods and services)	60	52	51	52	53	54
Debt service (in percent of exports of goods and services)	5.7	4.2	3.3	3.1	3.0	3.1
Gross international reserves in months of imports	0.0	0.0	0.6	0.9	1.3	1.6

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

1/ For 2007-10, the figures include preliminary projections for disbursements under the U.S. Millennium Challenge Account.

2/ Defined as total expenditure on health, education, and social security.

3/ Differences between the overall balance and the total financing are due to a statistical discrepancy between the balance on a cash and commitment basis.

4/ A negative figure indicates an increase.



Table 9. Armenia: Indicators of Fund Credit, 2003–11

	2003	2004	2005	2006	2007	2008	2009	2010	2011
				Act.		Projections			
	(In units indicated)								
Existing and prospective Fund outstanding credit 1/									
In millions of SDRs	144.4	140.1	123.4	108.8	99.9	86.2	71.0	56.9	42.4
In percent of exports 2/	22.4	21.1	13.6	11.4	9.5	7.4	5.6	4.1	2.8
In percent of external debt	18.4	17.6	16.6	13.3	10.9	8.6	6.6	4.8	3.4
In percent of gross reserves	40.2	38.0	27.3	14.9	11.8	9.4	7.1	5.2	3.6
In percent of quota	157.0	152.3	134.2	118.3	108.6	93.7	77.2	61.8	46.1
Existing Fund outstanding credit 1/									
In millions of SDRs	144.44	140.1	123.4	108.8	90.1	73.0	57.8	43.7	29.3
In percent of exports 2/	22.4	21.1	13.6	11.4	8.6	6.3	4.6	3.2	1.9
In percent of external debt	18.4	17.6	16.6	13.3	9.9	7.3	5.4	3.7	2.3
In percent of gross reserves	40.2	38.0	27.3	14.9	10.6	8.0	5.7	4.0	2.5
In percent of quota	157.0	152.3	134.2	118.3	97.9	79.4	62.9	47.5	31.8
Prospective Fund outstanding credit 1/									
In millions of SDRs	...	...	...	...	9.9	13.2	13.2	13.2	13.2
In percent of exports 2/	...	...	...	...	0.9	1.1	1.0	1.0	0.9
In percent of external debt	...	...	...	...	1.1	1.3	1.2	1.1	1.0
In percent of gross reserves	...	...	...	...	1.2	1.4	1.3	1.2	1.1
In percent of quota	...	...	...	...	10.7	14.3	14.3	14.3	14.3
Repurchases, repayments, and charges due from existing and prospective drawings									
In millions of SDRs	...	...	...	...	16.0	17.5	15.6	14.5	14.7
In percent of exports 2/	...	...	...	...	1.5	1.5	1.2	1.0	1.0
In percent of external debt	...	...	...	...	1.7	1.8	1.4	1.2	1.2
In percent of gross reserves	...	...	...	...	1.9	1.9	1.5	1.3	1.2
In percent of quota	...	...	...	...	17.3	19.1	16.9	15.7	16.0
Repurchases and charges due from existing drawings									
In millions of SDRs	...	...	...	...	15.9	17.5	15.5	14.4	14.6
In percent of exports 2/	...	...	...	...	1.5	1.5	1.2	1.0	1.0
In percent of external debt	...	...	...	...	1.7	1.8	1.4	1.2	1.2
In percent of gross reserves	...	...	...	...	1.9	1.9	1.5	1.3	1.2
In percent of quota	...	...	...	...	17.3	19.0	16.9	15.6	15.9
Repurchases and charges due from prospective drawings									
In millions of SDRs	...	...	...	...	0.0	0.1	0.1	0.1	0.1
In percent of exports 2/	...	...	...	...	0.0	0.0	0.0	0.0	0.0
In percent of external debt	...	...	...	...	0.0	0.0	0.0	0.0	0.0
In percent of gross reserves	...	...	...	...	0.0	0.0	0.0	0.0	0.0
In percent of quota	...	...	...	...	0.0	0.1	0.1	0.1	0.1

Sources: Armenian authorities; and Fund staff estimates.

1/ End of period stocks.

2/ Exports of goods and services.

Table 10. Armenia: Poverty Indicators and Millennium Development Goals, 1990–2015

	1990	1998/99	2000	2003	2004	2005	2015 Target
(In percent of total population unless otherwise stated)							
<b>1 Eradicate extreme poverty and hunger</b>							
Population below US\$2.15 (PPP) a day 1/	...	35.8	...	...			...
Overall poverty rate	...	56.3	50.9	42.9	34.6	29.8	19.7
Rural poverty	...	47.7	45.7	47.5	31.7	28.3	...
Extreme Poverty	...	26.1	16.2	7.4	9.2	4.6	4.1
Prevalence of child malnutrition (in percent of children under 5)	...	3.3	2.6	...			1.4
<b>2 Achieve universal primary education</b>							
Net primary enrollment ratio (in percent of relevant age group)	...	...	84.5	94.4	97		100
Youth literacy rate (in percent of group ages 15-24)	99.5	99.7	99.8	...	100		100
<b>3 Promote gender equality</b>							
Ratio of girls to boys in primary and secondary education (in percent)	...	...	104.0	101.1	102.8		100
Ratio of young literate females to males (in percent of group ages 15-24)	99.7	99.8	100.1	...	100.1		...
Proportion of seats held by women in national parliament (in percent)	36.0	6.0	3.0	...	5		...
<b>4 Reduce child mortality</b>							
Under 5 mortality rate (per 1,000 live births)	60.0	47.0	37.0	35.0	32.0		20.0
Infant mortality rate (per 1,000 live births)	26.0	...	33.0	30.0	29.0		8.7
Immunization, measles (in percent of children under 12 months)	94.8	91.0	92.0	94.0	92.0		...
<b>5 Improve maternal health</b>							
Maternal mortality ratio (modeled estimate, per 100,000 live births)	40.1	32.9	21.8	18.6	...		10.0
Births attended by skilled health staff (in percent of total)	99.7	98.8	96.8	...	...		...
<b>6 Combat HIV/AIDS, malaria and other diseases</b>							
Prevalence of HIV, female (in percent of group ages 15-24)	...	0.0	0.2	0.1	0.1		Stabilize and reduce
Incidence of tuberculosis (per 100,000 people)	26.3	39.2	63.5	70.1	78.3		Stabilize and reduce
Tuberculosis cases detected under DOTS (in percent)	...	8.0	51.4	43.3	43.6		Stabilize and reduce
<b>7 Ensure environmental sustainability</b>							
Nationally protected areas (in percent of total land area)	...	7.4	7.6	7.6	7.6		...
GDP per unit of energy use (PPP \$ per kg oil equivalent)	...	3.5	3.3	4.8	5		...
CO2 emissions (metric tons per capita)	...	1.0	1.1	...	...		...
Access to an improved water source (% of population)	...	...	...	92	...		...
Access to improved sanitation (% of population)	...	...	...	84	...		...
<b>8 Develop a Global Partnership for Development</b>							
Fixed line and mobile telephones (per 1,000 people)	157.0	145.2	144.9	178.4	259.7		...
Personal computers (per 1,000 people)	...	5.3	9.2	15.8	66.1		...
<b>General indicators</b>							
Population (in millions)	3.5	3.1	3.1	3.2	3.2	3.2	...
Adult literacy rate (in percent of group ages 15 and over)	97.5	98.3	98.5	98.6	99.4		...
Total fertility rate (births per woman)	2.6	1.2	1.2	1.1	1.3		...
Life expectancy at birth (years)	71.7	73.0	73.6	74.8	75		...
Gini index of inequality (consumption)	...	...	34.4	27.1	31		...
Gini index of inequality (total income)	...	57.0	52.8	44.0	41.0		...

Sources: World Bank, and Armenian authorities.

Goal 1: Halve, between 1990 and 2015, the proportion of people whose income is less than \$2.15 a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

Goal 2: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

Goal 3: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

Goal 4: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

Goal 5: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

Goal 6: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

Goal 7: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water.

Goal 8: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth.

1/ 2000 and 2003 poverty surveys based on different methodology than in other years.

**Attachment I. Republic of Armenia: Letter of Intent**

Mr. Rodrigo de Rato  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431

April 19, 2007

Dear Mr. de Rato:

In the attached Memorandum of Economic and Financial Policies, we summarize progress to date in implementing our PRGF-supported program and set out our economic and financial policies for 2007. We request hereby the completion of the fourth review under the PRGF arrangement and the disbursement of SDR 3.28 million.

The PRGF-supported program is on track. The Armenian economy continues to perform very well and all quantitative and all but one structural performance criteria under the PRGF arrangement for end-December 2006 were observed. We request a waiver for the nonobservance of the structural performance criterion on submitting to parliament a new insurance law that corresponds to the standards of the International Association of Insurance Supervisors, as the law was submitted to parliament with a slight delay. We also request that the performance criterion on tax revenues of the central government be changed to an indicative target, effective June 1, 2007.

Despite the impressive progress achieved in recent years, we recognize that a number of challenges remain to sustain high economic growth and reduce poverty. To this end, our economic program for 2007 contains specific measures to strengthen tax policy and administration as well as the financial sector.

The Government of the Republic of Armenia believes that the policies and measures set forth in the attached memorandum are adequate to achieve the objectives of the program, and stands ready to take any additional measures that may be appropriate for this purpose. The Government will consult with the IMF in advance on the adoption of these measures in accordance with the IMF's policies on such consultation. The Government intends to make these understandings public and authorizes the IMF to publish this letter, the attached memorandum, and the staff report.

Sincerely yours,

/s/

Vartan Khachatryan  
Minister of Finance and Economy  
Republic of Armenia

/s/

Tigran S. Sargsyan  
Chairman of the Central Bank  
Republic of Armenia

**Attachment II. Republic of Armenia: Memorandum of Economic and Financial Policies  
April 19, 2007**

1. This memorandum sets forth the government's economic objectives and policies for 2007, the third year of the program supported under the IMF's Poverty Reduction and Growth Facility (PRGF). These policies constitute an integral part of the government's medium-term strategy for poverty reduction as envisaged in the Poverty Reduction Strategy that will be updated in mid-2007.

**I. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM**

2. The Armenian economy continued to register strong growth in 2006, and a notable reduction in poverty. **Real GDP** grew by 13.4 percent in 2006, the fifth consecutive year of double-digit growth, led by the construction sector, which grew by 37 percent in real terms. The end-2006 **inflation** rate increased to 5.2 percent, largely on account of higher energy and food prices, while average inflation in 2006 remained below 3 percent. Thanks to high growth and low inflation, **poverty** declined further. According to the most recent household survey, the share of the population below the poverty line fell from 35 percent in 2004 to 30 percent in 2005, driven by a drop in urban poverty.

3. Our **fiscal outturn** was better than expected in 2006. The central government cash deficit of AMD 42.2 billion (1.6 percent of GDP) was well below the programmed level of AMD 60 billion, partly due to lower-than-programmed external financing.<sup>6</sup> Tax revenues increased by 19 percent in 2006, slightly higher than programmed, driven by improved collection of corporate and personal income taxes by the State Tax Service (STS), and elimination of VAT exemptions at the border. However, the tax-to-GDP ratio increased by only 0.1 percent, instead of by 0.4 percent as planned. Both current and capital expenditures fell in percent of GDP, although execution of capital spending improved relative to previous years.

4. **Broad money** growth remained high at 33 percent, on the back of continued monetization and dedollarization. Reserve money growth decelerated somewhat, from 52 percent in 2005 to 41 percent year-on-year in 2006, but was higher than programmed, owing to sizable foreign exchange intervention by the Central Bank of Armenia (CBA), totaling US\$245 million in 2006. Since May, the dram faced renewed appreciation pressures, reflecting strong foreign exchange inflows and a weaker U.S. dollar vis-à-vis other major currencies. The dram appreciated by 19.2 percent against the U.S. dollar in 2006.

5. Notwithstanding strong remittances inflows, our external current account deficit widened slightly to 4.0 percent of GDP in 2006, partly reflecting dram appreciation. **Exports**

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<sup>6</sup> This incorporates nontax revenues of AMD 8 billion (0.3 percent of GDP) related to the privatization of Zangezur. In the IMF classification, these revenues are classified as a financing item, in which case the overall deficit is 0.3 percent of GDP higher.

grew by only 3 percent in 2006, compared with 36 percent in 2005, largely reflecting a fall in export volumes of diamonds (due, in part, to weak world demand) and a drop in molybdenum prices. At the same time, **imports** continued to grow robustly, at about 20 percent, on account of dram appreciation and buoyant investment, leading to a widening trade deficit. This was offset by a significant improvement in the capital and financial account.<sup>7</sup> In particular, foreign direct investments increased significantly—by about 14 percent in 2006—with large inflows concentrated in mining, airport infrastructure, metallurgy, and telecommunications. As a result, gross international reserves increased to US\$1.1 billion (4.8 months of imports) in 2006.

6. We observed all **quantitative performance criteria** and implemented all **structural performance criteria and structural benchmarks** for end-December 2006. However, sizable unsterilized foreign exchange intervention by the CBA caused us to exceed the indicative target on reserve money, and we implemented two structural measures with a slight delay. Specifically, a new insurance law and amendments to the law on state noncommercial organizations (NCOs) were submitted to parliament in January 2007; these were end-December 2006 structural measures.

7. We have continued to strengthen tax and customs administration, as well as budget execution.

- In the area of **tax policy**, we have made several important legislative changes. In December 2006, parliament approved amendments to tax legislation that will increase taxation of the construction sector<sup>8</sup> and of gambling activities.<sup>9</sup> In the same month, it also adopted a new law on environmental protection tariffs.<sup>10</sup> Additional legislation was submitted to parliament to change the calculation of the income tax bases from cash to accrual so as to unify the calculation period of income tax and social contributions (structural performance criterion, end-March 2007). However, the tax policy measures that were supposed to be submitted to parliament by end-2006 under our harmonization agreement with the European Union were delayed to end-2007 because of a change in the agreement.
- In **tax administration**, we have also continued to implement important reforms. To improve its IT capacity, the STS issued a decree that specified the procedures and a

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<sup>7</sup> In December 2006, we received the first two tranches (amounting to US\$1.4 million) of a total MCA allocation of US\$236 million, to be disbursed over a five-year period.

<sup>8</sup> These amendments involve changes in the laws on (a) profit tax (imposed on legal entities); (b) simplified tax (imposed on commercial organizations and individual entrepreneurs); (c) VAT; and (d) income tax.

<sup>9</sup> These amendments involve a higher tax rate for lottery organizations, an expanded tax base to include internet gambling activities, and new penalties on non-registered gambling activities.

<sup>10</sup> The new law increases the fees on chemical emissions and introduces environmental fees for imported cars.

timeline for full technical implementation of an electronic risk-based selection system for VAT cross-checks, audits and refunds by the end of 2007 (structural benchmark, end-December 2006). To improve audit capacities, we have submitted legislation to parliament to require the recording of taxpayers at the location of their main economic activity (structural performance criterion, end-March 2007), and we have improved the coordination between the STS and the State Customs Committee (SCC) by allowing direct access to each others' databases. Finally, the government has decided to accept cash register receipts (with a annual limit of AMD 1 million) and payment card receipts for tax-verification purposes.

- In **customs administration**, we have made progress in three important areas, with technical assistance from the World Bank and other donors. First, as a result of introducing risk-based methods of customs control, green channel selection rose from zero percent in 2005 to around 15 percent in 2006. Second, as a result of expanding the Direct Trader Input (DTI) system, including to Araratyan Customs House, a significant share of all Armenia's import declarations are currently covered by the system. Third, increased staffing and training at the Post Clearance Audit unit has resulted in improved compliance.
- On the **expenditure side**, we submitted to parliament amendments to the law on state NCOs to streamline their definition and activities and to define the functions of their management bodies, which should help to improve their monitoring (structural benchmark, end-December 2006). We have also continued to implement reforms in strategic and performance-based budgeting, by linking the annual budgeting process with the medium-term expenditure framework (MTEF), and by implementing program budgeting in four pilot ministries.

8. We have continued to strengthen the **banking sector** and its regulatory and supervisory framework. We submitted to parliament an amendment to the Law on Banking Secrecy which will allow the CBA to publish violations of and sanctions against commercial banks that do not comply with the Law on Banks and Banking (structural benchmark, end-December 2006). In addition, the CBA concluded a review of corporate governance at banks, started working on implementing the first pillar of Basel II Accord provisions,<sup>11</sup> and proposed measures to stimulate non-cash payments and the use of the domestic currency in transactions. Moreover, parliament passed legislations designed to increase transparency and accountability of the central bank to the inflation target.

9. We have also made progress in further developing the **nonbank financial sector**. In addition to the new insurance law, we will in April submit to parliament a new securities regulation law that corresponds to the standards of the International Organization of

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<sup>11</sup> These provisions include the development of minimum capital requirements that take into account credit risk, market risk, and operational risk.

Securities Commissions (structural benchmark, end-March 2007). Moreover, we approved a pension system reform strategy that emphasizes the importance of a multi-pillar system.

10. We continue to make progress in other areas of structural reforms. In the **energy sector**, technical and distribution losses continued to decline, and collections have remained at 100 percent. Overall collection rates in the **water and irrigation** sectors have also increased.

## II. THE 2007 PROGRAM

11. We remain committed to our growth and poverty-reduction strategy. Our macroeconomic policies will continue to focus on price stability and forceful implementation of tax and financial sector reforms. We expect real GDP growth to be 9 percent in 2007, unchanged from our previous forecast. End-2007 inflation is expected to be 4 percent.

### A. Fiscal Policy

12. The approved **2007 budget** aims for a deficit of AMD 68.5 billion (2.3 percent of GDP), consistent with the MTEF for 2007-09. Tax revenues and total expenditures are budgeted at AMD 458.8 billion (15.2 percent of GDP) and AMD 574.1 billion (19 percent of GDP), respectively.

13. On the **revenue** side, the budget envisages an increase in the tax-to-GDP ratio in 2007 of 0.8 percentage points of GDP (based on the budget's assumption of 13 percent of nominal GDP growth). While the target is very ambitious, we believe that the measures implemented to date and those envisaged in the 2007 program will significantly increase tax collection. If revenue developments during the first half of the year suggest that the end-2007 deficit target cannot be met, expenditures for the year will be reduced accordingly.

14. On the **expenditure** side, the share of spending on education, health and social security will not be less than 6.5 percent of GDP in 2007. Capital spending is budgeted to increase from 3.9 percent to 4.8 percent of GDP on account of continued improvements in budget execution and scaled-up donor assistance. In the event of higher-than-expected disbursements from Millennium Challenge Account (MCA) in 2007, a supplementary budget will be passed to allocate the funds to additional capital expenditure.

### B. Monetary and Exchange Rate Policies

15. Monetary policy will continue to focus on price stability. Given the continued strong growth in monetary aggregates in 2006 and the associated inflationary risks, the CBA is targeting a reduction in money supply growth in 2007. The monetary program seeks to limit reserve money growth to 25 percent and envisages a slower buildup in foreign reserves relative to 2006. We will maintain a flexible exchange rate policy and foreign exchange interventions will be used only as an instrument to manage liquidity and smooth out exchange rate volatility. The monetary program, based on conservative assumptions on velocity and the money multiplier, targets inflation of 4 percent (with a band of 1.5

percentage points). We intend to increase the stock of treasury bills by around AMD 8 billion, which will contribute to the development of the domestic government debt market and to the reduction of excess liquidity.

16. We have achieved further progress in strengthening the institutional prerequisites in support of an inflation targeting (IT) monetary framework and have continued to improve our operational framework, with the support of IMF technical assistance. The CBA now issues quarterly inflation reports, publishes the minutes of its monthly board meetings on monetary policy, and is refining a quarterly inflation projection model. It is also in the process of moving from an end-year to a continuous inflation target. While the monetary transmission mechanism is still weak, it is being strengthened by the recent increase in interbank money market activity and by the further issuance of CBA securities, which will help to reduce excess bank liquidity. Moreover, the CBA and the ministry of finance and economy (MoFE) have reached an agreement on the coordination of the issuance of treasury and CBA securities that allows for a segmentation of the yield curve. Over the medium term, the CBA intends to increase its holdings of treasury securities in order to strengthen its capacity to conduct reverse repo operations. For the purpose of CBA recapitalization, the government will no longer issue interest-bearing securities, but non-interest bearing promissory notes that will be repaid on demand.

### **C. Structural Reforms**

17. We will continue to press ahead with reforms to improve tax and customs collection, improve the tax system, and strengthen the financial sector.

#### **Fiscal reforms**

18. We will finalize a 2007–09 tax action plan to improve and modernize our tax system, prepared by the STS (structural benchmark, end-May 2007). The plan envisages a tax administration with fully automated business processes, risk-based compliance programs, and adequate staffing. In addition, the plan also includes several legislative changes in the area of tax policy. Specific measures for 2007 are discussed below.

19. In **tax policy**, we aim to broaden the tax base. Specifically, we intend to:

- submit to parliament amendments to all presumptive tax laws with the goal of indexing the presumptive tax rates to CPI (structural benchmark, end-June 2007);
- complete the general part of the unified tax code in consultation with stakeholders (structural benchmark, end-June 2007), and subsequently submit it to parliament (structural benchmark, end-December 2007). Furthermore, we will start working on the specific part of the tax code, which we intend to finalize in the first half of 2008, and to submit to parliament by the end of 2008.



- submit to parliament legislation limiting access to the simplified tax regime to the retail and the household services sectors (structural performance criterion, end-December 2007);
- submit legislation to parliament to help increase tax revenues from imported and domestically produced tobacco products, preferably by moving these products from the presumptive to the regular VAT and excise regime; alternatively, by raising the current tax rates on these products by at least 10 percent (structural benchmark, end-December 2007).

20. Over the medium term, we plan to take several additional measures. We will not introduce any new tax exemptions and aim to reduce existing exemptions in the context of unifying the tax code. In particular, we will allow the profit tax exemptions for foreign investors to expire in 2008, and will remove the exemption for agriculture in 2009 under our agreement with the WTO. We will also further limit the use of the simplified and presumptive tax regimes, with the aim of eventually moving all activities remaining under the simplified tax regime to the regular tax regime by 2010. When the capital market develops further, we will discuss the issue of taxing dividends paid to resident and nonresident natural persons and legal entities under the income and profit tax laws.

21. In **tax administration**, we will focus on improving tax audits, tax arrears collection, and the VAT refund system. In particular, we will

- submit to parliament legislation to change the filing process by (i) conducting cameral audits as part of the audit (not filing) process; and (ii) eliminating recording commissions, effective September 2008 (structural performance criterion, end-December 2007);
- strengthen the IT capacity of the STS by (i) introducing a unified computer network linking all inspectorates of the STS (structural benchmark, end-June 2007); (ii) developing and starting the pilot testing of an automated risk-based audit selection system (structural benchmark, end-June 2007); (iii) developing and starting the pilot testing of risk-based software for VAT refunds so as to accelerate their processing (structural benchmark, end-October 2007); and (iv) implementing the automated risk-based audit selection system (structural benchmark, end-December 2007);
- gradually shift from the manual processing of calculation and payment of tax liabilities to an electronic recording system, including updating and improving the existing software; and implementing a pilot tax inspectorate for the new electronic system by end-2007, with full implementation by end-2008;
- finalize and implement a tax arrears reduction strategy that will focus on the reduction of large arrears, including writing off uncollectible arrears.

22. In the area of **customs administration**, we will continue to work with the World Bank on introducing risk-based Asycuda selectivity at all customs locations, increasing the proportion of imports directed through the green channel, and improving the exchange of information between the STS and the SCC. We also plan to increase the effectiveness of DTI by implementing a comprehensive post-release review program for imports with the aim of determining the customs value, and by developing a guarantee mechanism (including the use of bank guarantees) for approved importers.

23. We recognize the importance of better targeting government **expenditures** to ensure adequate public investment and social spending as well as high expenditure quality. In this regard, we plan to continue developing our program budgeting framework, beginning with the four ministries that are focused on social spending. We will discontinue the current gas subsidy on January 1, 2009, and will not introduce any new general subsidies in the energy sector. In order to strengthen the financial reporting framework of NCOs, we are working with the World Bank and other donors to implement the remaining items of the NCO financial management and reporting action plan. Finally, we intend to use a new budget classification in the preparation for the 2008 budget that is compliant with GFSM 2001 standards as much as possible.

### **Financial sector reforms**

24. We will continue to move forward with **banking sector** reforms:

- To promote the development of the mortgage market, we will submit to parliament legislation allowing asset securitization and the issuance of mortgage-backed securities (structural benchmark, end-December 2007).
- To prevent opportunities for money laundering, we will submit to parliament an amendment to the law on Anti-Money Laundering and Combating the Financing of Terrorism in line with FATF 40+9 recommendations (structural benchmark, end-December 2007).
- To improve market transparency, we will take measures to enhance the ability of bank customers to obtain information on banks' financial terms from a single source, as mandated in the amendment to the Law "On Banks and Banking." In addition, we plan to develop a new methodology for rating financial institutions on the basis of how well they serve the community, similar to the Community Investment Act in the United States. The ratings will be based on publicly available information and will be regularly disclosed to the public. In the medium term, we intend to introduce legislation improving consumer protection, including standards of information disclosure and transparency, distance marketing, and alternative dispute resolution.
- To further increase competition, we are actively encouraging the entry of reputable international commercial banks. In 2006, Credit Agricole purchased a significant share in an Armenian bank (ACBA). In 2007 the Dutch company Postfinance will

establish postal bank services at Haypost, and German-based ProCredit Holding is planning to enter the Armenian banking market.

- To improve efficiency of the unified banking regulation and supervision framework, we will move from a model of institutional supervision (separately for banks, credit organizations, and insurance companies) to a functional or process-oriented structure, separating the main functions of (i) prudential requirements; (ii) market conduct; and (iii) consumer protection.
25. In the area of **nonbank financial sector** reforms, we intend to do the following:
- **Pension reform.** With technical assistance from the World Bank and other donors, the CBA has drafted a pension reform framework. Specific details on the various scenarios will be presented to the government later in 2007, based on which the final law will be submitted to the Parliament before the end of the year. The new pension system is expected to start operating in 2009.
  - **Insurance reform.** Further measures are planned for 2007 to develop the infrastructure supporting the insurance sector. These include (i) establishing procedures for the liquidation of insurance companies; (ii) introducing principles of corporate management based on international best practice; (iii) training actuaries and risk assessment specialists; (iv) creating a manual for conducting examinations in the insurance sector; and (v) creating a statistical center used for risk assessment and determination of insurance premium.
  - **Securities market reform.** In January, we received a Capital Market Review and Design Study from the Scandinavian stock market operator OMX, which provided detailed recommendations to develop the securities market. We actively encourage OMX to become the operator of the Armenian stock exchange (Armex). The CBA has already identified a number of companies that are interested in issuing securities by means of initial public offerings (IPOs), which would provide market capitalization of at least \$1.3 billion (17 percent of GDP) in 5 years time, of which 30 percent would be freely tradable.

### III. OTHER ISSUES

26. We intend to finalize a new three-year **anti-corruption strategy** by end-2007. Focus of this new strategy will be on implementation of legislative measures introduced in recent years. A first draft of the document is expected by late Summer 2007. In the **water and irrigation sectors**, we will continue with our efforts to improve efficiency and reduce losses, with the aim of reducing budgetary subsidies by AMD 1.5 billion over the next three years by lowering operational expenditures and increasing revenues.

#### **IV. PROGRAM MONITORING**

27. Program monitoring will be based on semi-annual quantitative performance criteria and indicative targets as well as structural performance criteria and benchmarks. The Technical Memorandum of Understanding (TMU) of October 2005 and the attached amendments to the TMU define the quantitative targets, the program adjustors, and specific reporting requirements. In particular, the performance criterion on tax revenues becomes an indicative target starting in June 2007. Completion of the fifth review under the PRGF arrangement, scheduled for November 16, 2007, will require observance of the revised quantitative performance criteria for end-June 2007, shown in Table 1, as well as the March 2007 structural performance criteria listed in Table 2. The completion of the sixth review under the PRGF arrangement, scheduled for May 16, 2008, will require observance of the quantitative performance criteria for end-December 2007, shown in Table 1, as well as the December 2007 structural performance criteria listed in Table 2.

Table 1. Armenia: Quantitative Targets, September 2006–December 2007 1/  
(End of period ceilings on stocks, unless otherwise specified)

	2006				2007			
	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
	Prog.	Actual 2/ Prog.	Est. 3/ Prog. 2/ Prog.	Prog. 3/ Prog.	Prog. 2/ Prog.	Prog. 3/ Prog.	Prog. 2/ Prog.	Prog. 3/ Prog.
Net domestic assets of the CBA 4/	-32.0	-49.4	-19.8	-115.4	-52.2	-50.5	-35.5	-27.1
Net banking system credit to the government	7.1	-3.8	-3.9	-31.8	-30.6	-36.3	-32.7	-29.6
Domestic arrears of the central government	0	0	0	0	0	0	0	0
Tax revenues of the central government (floor) 5/ 6/	259.1	268.8	378.1	383.8	93.4	204.2	326.4	458.8
Balance of the central government on a cash basis (floor) 5/ 7/	-48.5	-31.8	-60.2	-50.4	-14.0	-32.8	-43.0	-68.5
Reserve money (band/level) 2/	(216-225)	231.1	(246-256)	283.0	(265-276)	(276-288)	(311-324)	(347-361)
Contributions to the State Fund for Social Insurance 2/ 5/	52.4	52.6	74.0	73.3	17.1	37.7	59.0	82.1
Contracting or guaranteeing of new nonconcessional external debt 5/ 8/	0	0	0	0	0	0	0	0
External arrears (continuous criterion)	0	0	0	0	0	0	0	0
Net official international reserves (floor)	543.9	528.0	577.2	812.2	877.6	910.6	967.8	1050.8

1/ All items as defined in the technical memorandum of understanding.

2/ Indicative target.

3/ Performance criterion.

4/ At program exchange rate of 500 dram per U.S. dollar for 2005 and program exchange rate of 450 dram per U.S. dollar for 2006 and 357 dram per dollar for 2007.

5/ Cumulative flow from the beginning of the calendar year until the end of the month indicated.

6/ Tax revenues of the central government is an indicative target starting from June 2007.

7/ AMD 8 billion from the privatization of Zangezur is classified as financing (below-the-line) from June 2006 onwards.

8/ Includes debt with maturity of more than a year, as well as obligations with maturity of one year or less, excluding normal import-related credit and sales of treasury bills to nonresidents.

Table 2. Armenia: Matrix of Proposed Measures for the Fifth and Sixth Reviews

Item	Measure	Proposed Time Frame (End of Period)	Type of Conditionality	Status
<u>General</u>				
1	Government to approve a medium-term modernization program for the State Tax Service (STS) in line with IMF recommendations.	May 2007	Structural Benchmark	
<u>Tax policy</u>				
2*	Submit to parliament legislation to change the calculation of the income tax bases from cash to accrual so as to unify the calculation period of income tax and social contributions.	March 2007	Structural Performance Criterion	Observed
3*	Finalize the general part of the unified tax code:			
	(i) Complete the general part of the unified tax code in consultation with stakeholders.	June 2007	Structural Benchmark	
	(ii) Submit to parliament.	December 2007	Structural Benchmark	
4*	Submit to parliament amendments to all presumptive tax laws to index the rates to the CPI	June 2007	Structural Benchmark	
5	Submit legislation to parliament limiting access to the simplified tax regime to the retail and household services sectors.	December 2007	Structural Performance Criterion	
6	Submit legislation to parliament to help increase tax revenues from imported and domestically produced tobacco products preferably by moving these products from the presumptive to the regular VAT and excise regime; alternatively raise the current tax rates on these products by at least 10 percent.	December 2007	Structural Benchmark	
<u>Tax administration</u>				
7*	Submit legislation to parliament to require the recording of taxpayers at the location of their main economic activity.	March 2007	Structural Performance Criterion	Observed
8	Submit to parliament legislation to change the filing process by (a) conducting camera audits as part of the audit (not filing) program; and (b) eliminating recording commissions effective September 2008.	December 2007	Structural Performance Criterion	
9	Strengthen the IT capacity of the State Tax Service (STS):			
*	(i) Introduce a unified computer network linking all inspectorates of the STS.	June 2007	Structural Benchmark	
	(ii) Start the pilot testing of automated risk-based audit selection system.	June 2007	Structural Benchmark	
	(iii) Start the pilot testing of risk-based software for VAT refunds.	October 2007	Structural Benchmark	
	(iv) Implement the automated risk-based audit selection system.	December 2007	Structural Benchmark	
<u>Financial sector</u>				
10*	Submit to parliament a new Securities Market Regulation Law that corresponds to the standards of the International Organization of Securities Commissions.	March 2007	Structural Benchmark	Not observed. Expected to be submitted in April.
11	Submit to parliament legislation allowing asset securitization and issuance of mortgage-backed securities.	December 2007	Structural Benchmark	
12	Submit to parliament an amendment to the law on Anti-Money Laundering and Combating the Financing of Terrorism in line with FATF 40+9 recommendations.	December 2007	Structural Benchmark	

\* As agreed to in the memorandum of economic and financial policies dated November 1, 2006.

**Attachment III. Republic of Armenia: Amendments to the Technical Memorandum of Understanding (TMU)**

The TMU dated October 26, 2005 and its amendments dated April 27, 2006 and November 1, 2006, will remain valid for the remainder of 2007, with the revised baseline assumptions for (program) exchange rates of the Central Bank of Armenia (CBA), foreign-financed project loan disbursements, World Bank lending, and *Kreditanstalt für Wiederaufbau* (KfW) loan disbursements as indicated in Tables 1 to 5 below, and the following amendment to apply from June 1, 2007.

1. In Section I of the TMU dated October 26, 2005, the performance criterion on tax revenues of the central government will be changed to an indicative target.

Table 1. Armenia: (Program) Exchange Rates of the CBA  
(As of December 31, 2006 for dollars per currency rates. Dram per currency rates are calculated using the 357 dram per U.S. dollar rate)

Country	Dram Per Currency	Dollars Per Currency
Australian dollar	281.53	1.268070
Canadian dollar	306.20	1.165900
Swiss franc	292.86	1.219000
Danish krone	63.18	5.650100
Euro	470.51	1.317962
Pound sterling	699.33	0.510491
Japanese yen	3.00	119.070000
Norwegian krone	57.25	6.236000
Russian ruble	13.56	26.325500
Swedish krone	52.12	6.849700
U.S. dollar	357.00	1.000000
SDR	537.07	0.664717
Gold 1/	7,307.93	20.470378

1/ Per gram.

Table 2. Armenia: Cumulative Foreign-Financed Project Loan Disbursements 1/ 2/  
(In billions of dram)

2007			
<u>March</u>	<u>June</u>	<u>September</u>	<u>December</u>
4.3	9.6	15.8	36.7

1/ Cumulative from December 2006, at program exchange rates.

2/ Excludes World Bank PRSC lending and KfW loan disbursements.

Table 3. Armenia: World Bank PRSC Lending 1/  
(In billions of dram)

2007			
<u>March</u>	<u>June</u>	<u>September</u>	<u>December</u>
0.0	10.0	0.0	0.0

1/ Cumulative from December 2006, at program exchange rates.

Table 4. Armenia: KfW Loan Disbursements 1/  
(In billions of dram)

2007			
<u>March</u>	<u>June</u>	<u>September</u>	<u>December</u>
1.2	2.7	5.4	8.4

1/ Cumulative from December 2006, at program exchange rates.

Table 5. Armenia: Total Grant Disbursements  
(In billions of dram)

2007 1/			
<u>March</u>	<u>June</u>	<u>September</u>	<u>December</u>
1.7	3.8	8.3	15.1

1/ Cumulative from December 2006, at program exchange rates.



INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

**Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction  
and Growth Facility and Request for Waiver of Performance Criterion**

**Informational Annex**

Prepared by Middle East and Central Asia Department

April 30, 2007

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## ANNEX I. RELATIONS WITH THE FUND

(As of March 31, 2007)

**Mission:** Program discussions were held in Yerevan, February 28–March 13, 2007.

**Country interlocutors:** The mission met with President Kocharyan, Mr. Khachatryan (Minister of Finance and Economy), Mr. Chshmarityan (Minister of Trade and Economic Development), Mr. Movsisyan (Minister of Energy), Mr. Sargsyan (Chairman of the Central Bank), other senior officials, and representatives of the donor community and civil society.

**Staff team:** Mr. Al-Atrash (head), Ms. Dabla-Norris, Mr. Floerkemeier (all MCD), Mr. Atoyán (PDR), and Mr. Gracia (FAD). Ms. Castello-Branco (next mission chief) participated in the mission. Ms. Oomes, resident representative, and Ms. Minasyan and Ms. Manookyan (economists in the local office) assisted the mission.

**Fund relations:** Armenia has accepted the obligations under Article VIII Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions, except for exchange restrictions maintained for security reasons that have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

**Data:** Armenia's data are adequate for surveillance and program monitoring. Armenia subscribes to the Special Data Dissemination Standard (SDDS).

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

II.	<b>General Resources Account:</b>	<b>SDR Million</b>	<b>Percent of Quota</b>
	Quota	92.00	100.00
	Fund holdings of currency	92.00	100.01
III.	<b>SDR Department:</b>	<b>SDR Million</b>	<b>Percent of Allocation</b>
	Holdings	7.70	n.a.
IV.	<b>Outstanding Purchases and Loans:</b>	<b>SDR Million</b>	<b>Percent of Quota</b>
	PRGF arrangements	107.11	116.42

V. **Latest Financial Arrangements:**

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
PRGF	05/25/2005	05/24/2008	23.00	13.12
PRGF	05/23/2001	12/31/2004	69.00	69.00
PRGF	02/14/1996	12/20/1999	109.35	109.35

**VI. Projected Payments to Fund <sup>1/</sup>**

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

	Forthcoming				
	2007	2008	2009	2010	2011
Principal	13.75	17.06	15.19	14.13	14.44
Charges/interest	<u>0.51</u>	<u>0.43</u>	<u>0.35</u>	<u>0.28</u>	<u>0.21</u>
Total	14.26	17.49	15.54	14.41	14.65

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

**VII. Safeguards Assessment**

Under the Fund's safeguards assessment policy, the Central Bank of Armenia (CBA) is subject to a safeguards assessment update in the context of the current arrangement. A safeguards update of the CBA was completed on November 7, 2005. The update found that the CBA's safeguards framework has been strengthened since the previous assessment completed in 2002. In particular, measures have been put in place to improve data reported to the Fund, to strengthen controls and reporting on externally managed foreign exchange investments, and to address weaknesses in the legal framework. Furthermore, the appointment term of the external audit firm has been lengthened and new regulations and procedures have been put in place to better define the actions and scope of the internal audit function. A number of areas were identified where further steps could be taken. This includes strengthening controls over reporting of monetary program data to the Fund, improving oversight of the audit processes and the internal control systems by establishing an audit committee, and enhancing the CBA's internal audit function. The CBA agreed with the specific recommendations and their implementation schedule.

**VIII. Exchange Rate Arrangement**

- (a) The exchange rate system can be classified as a managed float without a predetermined path. In 2005–06, the CBA intervened heavily in the foreign exchange market to smooth out volatility in the exchange rate, but also for liquidity management. The official exchange rate is quoted daily as a weighted average of the previous day's interbank exchange rates.
- (b) Armenia maintains no exchange restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons, and notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

**IX. Article IV Consultations**

The 2004 Article IV consultation with Armenia was concluded on November 22, 2006. Armenia is subject to the 24-month consultation cycle.

## X. FSAP Participation and ROSCs

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

### ROSC Modules

Standard	Timing	Publication	Document Number
		Status	
Basel Core Principles for Effective Banking Supervision (BCP)	April 2001	Unpublished	...
Core Principles for Systemically Important Payments Systems (CPSS)	April 2001	Unpublished	...
Insurance Principles set by the International Association of Insurance Supervisors (IAIS)	2001	Unpublished	...
Principles set by the International Organization of Securities Commissions (IOSCO)	2001	Unpublished	...
Code of Good Practices in Monetary and Financial Policy Transparency (MFPT)	April 2001	Unpublished	...
Code of Good Practices on Fiscal Transparency	March 2001	Published	02/37
Data ROSC module	September 2000	Published	02/06
AML-CFT assessment by MONEYVAL	July 2004	Unpublished	...
Basel Core Principles for Effective Banking Supervision (BCP) update	May 2005	Unpublished	...
Corporate Governance	May 2005	Unpublished	...

## XI. Resident Representatives

Ms. Nienke Oomes, since August 2006.

## XII. Technical Assistance

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

### Armenia: Technical Assistance from the Fund, 2002–06

Subject	Type of Mission	Timing	Counterpart
<b>Fiscal Affairs Department (FAD)</b>			
Tax policy and administration	Short-term	September 17– October 3, 2003	MFE, State Tax Service (STS), and Customs Committee
Tax policy	Short-term	April 22–May 6, 2004	MFE, STS, and Customs Committee
Tax administration	Short-term	July 13–July 27, 2004	MFE, STS, and Customs Committee
Public expenditure management advisor		November 7, 2003– November 6, 2004	
Tax administration reform	Short-term	October 5–18, 2006	MFE, STS
Public financial management reform	Short-term	November 27 – December 8, 2006	MFE
<b>Legal Department</b>			
Tax legislation		September 1, 2004– December 31, 2005	
Legislation Development & FIU		July 31–August 7, 2006	
<b>Monetary and Capital Markets Department (MCM)</b>			
Banking system issues	Short-term	April 15–19, 2002	CBA
Banking system, deposit insurance, foreign exchange market development, and CBA monetary operations.	Short-term	June 24–July 4, 2002	CBA
Unified financial supervision, mortgage financing markets and inflation targeting	Short-term	January 26– February 6, 2004	CBA
Financial sector assessment program update	Short-term	February 16– March 4, 2005	CBA
Recapitalization of the Central Bank of Armenia	Short-term	December 8–14, 2005	CBA
Monetary policy and markets		December 4, 2005– December 31, 2006	
Strengthening the implementation of monetary policy	Short-term	March 8–21, 2006	CBA
Monetary policy implementation and money market development	Short-term	October 5–17, 2006	CBA
AML/CFT preventive measures		April 1, 2006–April 30, 2007	

**Statistics Department**

Data dissemination standards	Short-term	September 18–25, 2003	National Statistical Service
Balance of payments: remittances		August 22– September 5, 2006	

**International Capital Market Department**

Sovereign credit quality	Short-term	September 6–10, 2005	CBA
Sovereign credit risk	Short-term	August 20, 2005– August 20, 2006	

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**ANNEX II. REPUBLIC OF ARMENIA: RELATIONS WITH THE WORLD BANK**

(March 31, 2007)

Country Director: Donna Dowsett-Coirolo

Telephone: (202) 473-0121

**I. IMPLEMENTATION OF STRUCTURAL REFORM MEASURES****A. Legal Framework**

1. The World Bank has supported the Armenian government to establish the core legal framework necessary for private sector operations, including the Civil Procedure Code, the Procurement law, the Business Registration law and the Public Auction law. The fully restructured and enacted Bankruptcy law is now harmonized with the Civil Code and the Civil Procedure Code, and strengthens the enforcement mechanisms for bankruptcy procedures. The Concession law has been enacted and the National Assembly has adopted a new Labor Code, which is compatible with the requirements of a market economy and is an important instrument of flexible job-creation. The government also has made significant progress in drafting the necessary legislation to improve the lending environment through strengthening the procedures for collateral registration and for foreclosure and enhancing the knowledge of the judiciary concerning commercial contracts. Specifically, the government has adopted amendments to civil code, criminal code, civil procedure law, law on compulsory enforcement, and public auction law.

**B. Business Environment**

2. The World Bank has supported the government to make satisfactory progress in removing administrative barriers for business and investment and has strengthened the consultative mechanisms with the business community. The steps taken include, inter alia, consolidating, downsizing, and clarifying mandates of various government inspections; enacting the new law on business registration; streamlining licensing procedures; issuing new accounting recommendations for small and medium-sized enterprises; establishing a regulatory framework that allows privatization of urban land by business entities; and adopting simplified procedures for obtaining site development and construction permits. The capacity of the Armenian Development Agency as a focal point for government's efforts to promote investment and exports as well as for identifying the remaining bottlenecks in the business environment has been strengthened. The functioning of the Business Council has been improved and the private sector's awareness of its activities has been enhanced.

3. The recent business surveys of Armenian entrepreneurs suggest that these efforts have already resulted in a more positive private sector perception of the business and investment environment. For example, the average time necessary to get construction and building renovation permits was reduced from 310 days in 2001 to 112 days in 2006. The FDI increased by almost 20 percent in 2005 compared with 2003. The State Customs Committee's websites became operational and during 2003, on average 467 references per

month were made to it. As part of the PRSC I, II and III the Customs introduced a self declaration system and reduced the role of reference prices.

4. On tax administration, the government strengthened the operation of Large Tax Payers Unit (LTPU), placed a high priority on reducing the stock of VAT refunds owed to exporters and ensured that no additional VAT arrears were incurred to exporters. The government adopted decision announcing its intention to widen participation in the provision of international civil aviation services, raise efficiency and cut costs and initiated policy work. Despite these improvements, there is still considerable scope for further reforms in the areas of competition, deregulation and strengthening of business and investment climate, especially in commercial debt recovery procedures, improvements in the transparency and efficiency of the judicial system, tax and customs administrations, improvements in governance and implementing the anti-corruption strategy. In addition to the above-stated, further strengthening of both tax and customs administration are at the core of the PRSC III, in particular implementation of self-assessment systems; adherence to reforms for the Large Taxpayer Unit and good practices on VAT refund and tax arrears; completion, implementation and expansion of DTI facilities in major customs and implementation of intelligence-based system based on risk assessment.

### **C. Energy and Infrastructure**

5. Since its privatization in the second half of 2002, the Electricity Distribution Company has remained in compliance with its licenses agreement as confirmed by making full payments to the generation and service providers, reporting to the regulator on a timely basis, and submitting investment plan to the regulator. Supported by the World Bank, the government has also made satisfactory efforts to improve the legal and regulatory framework in the energy sector in order to establish a supportive environment for the new private operator. Budget allocations have been increased to ensure full payments to the energy sector by the budgetary organizations and public utilities. The government implemented the Integrated Rehabilitation Plan for state-owned utilities (including energy, irrigation, drinking water companies and Yerevan metro) with strengthened corporate governance, creation of electricity market, and cessation of operations of the state electricity wholesale company. In addition, the Public Sector Regulatory Commission (PSRC) has made considerable progress in improving utilities regulatory framework and adopted several measures including, monitoring indicators for electricity service quality and standard. Despite this satisfactory performance, continued efforts are crucial for improvements in the energy sector through restructuring the midstream companies and strengthening the regulatory framework to ensure adequate functioning, transparency, and reliability of this sector.

6. There has been progress in improving fiscal discipline and reducing losses in the irrigation and water sectors. The World Bank has been working with the government to: (i) upgrade the management capacity of public companies in these sectors; (ii) ensure a gradual increase in tariffs to cost recovery; (iii) provide additional investments to improve technical efficiency; and (iv) ensure that the budget provides adequate financing for water consumed by public sector entities. To provide full cost recovery, the government has adopted a schedule for irrigation tariff increase in 2002–07 in order to achieve full cost



recovery in the irrigation system by 2007. As part of the PRSC III reforms, the government has also developed and now considering a step-by-step civil aviation liberalization action plan. Railway restructuring plan and development of telecommunication regulations are also underway.

#### **D. Education and Health**

7. The World Bank has supported reforms in education and health. The government implemented a major rationalization program during the 2003 school year. As a result, 37 schools were merged or closed and about 9,000 teachers were made redundant. The medium-term action plan for improving the financial management, accounting, and financial reporting for higher education institutions was adopted by the government on January 26, 2003. Accountants at the higher institutions have been trained and special software has been prepared for use. Since the second quarter of 2003, the new accounting procedures are being used. The government increased the state budget allocation for primary and secondary education and improved teachers' salaries. The government also developed an action plan and cleared arrears in the education sector and prevented further arrears in this sector. The ratio of pupils to full-time equivalent teachers increased to over 14 and teacher salaries increased by 65 percent in 2005. In addition, the government developed a strategy on early childhood education and options for its piloting in two marzes. The government has also made initiatives to carry out the three year implementation plan for higher education reforms. Despite these improvements, there is scope for further reforms in education, including adoption of new curricula for secondary education, enhancement of standards for higher education to make it more responsive to employers' needs, improving preschool systems, and strengthening monitoring and financial reporting of the noncommercial organizations (NCOs) in the education sector.

8. The government adopted the hospital master plan for Yerevan in late 2002. As a result, the remaining public hospitals in Yerevan were to be merged into smaller number of hospital networks with necessary steps to be taken to restructure them. The government adopted a decree on November 21, 2003, identifying the configuration of ten hospital networks through consolidation of twenty-four public hospitals and thirteen outpatient health care institutions. Directors for nine of these hospital networks have been appointed. While the hospital merger process is being implemented, introduction of further appropriate adjustments may be required. The medium-term action plan for improving financial management accounting and reporting for the public hospitals was adopted by the government to prepare new reporting and accounting procedures and cost accounting manuals.

9. Implementation progress has been satisfactory and about 200 hospital accountants have been trained in new accounting procedures. The government developed an action plan for clearing the accumulated arrears in the health sector and prevented further arrears in this sector. The government also adopted a decision to introduce further reforms in the Basic Benefit Package in the health sector. The government undertook measures for financing and management of the Primary Health Care departments of polyclinic that are included in the hospital networks. Further reforms are needed in increasing the population overall health

status, reducing child and maternal mortality, increasing use of healthcare system by rural and low-income groups, monitoring public health and promoting better health behavior, and strengthening monitoring and financial reporting of the noncommercial organizations (NCOs) in the health sector. The government developed the national strategy on combating non-communicable diseases and plans to take necessary steps to address the public health threats from non-communicable diseases through development and implementation of specific priority programs on non-communicable diseases and through allocation of adequate public resources in the health care budget.

### **E. Social Protection and Insurance**

10. Since 1999, the government has been replacing a range of fragmented cash and non-cash benefits and privileges with better-targeted transfers to families. The government has been supported by the World Bank to complete several important steps to enhance its capacity for administration of transfers to families, including: (i) re-registration of poverty benefit recipients; (ii) beneficiary assessment of the existing benefits; and (iii) establishment of a central database for poverty benefit recipients. Data from the recent household survey suggest that the system of benefits and transfers to the poor has become an efficient instrument for reducing extreme poverty. The government introduced differentiation of benefits within the family poverty benefits. Continued efforts are needed to ensure the adequacy of the level and administrative capacity of the social protection systems to guarantee coverage of transfers to people with special needs. Based on the 2004 household survey results the government plans to evaluate effectiveness of the family poverty benefits.

11. The law on Public Pension focuses on strengthening and streamlining the pension system. It provides significant improvements in the pension systems, including: (i) introduction of an equal retirement age for men and women at age 63; (ii) separation of social insurance benefits from social pensions; (iii) elimination of most early retirement provisions; (iv) indexation of pension to inflation; and (v) establishment of more direct links between benefits and contributions, with adequate provision for a minimum benefit. Following adoption of the law, the government has made satisfactory progress in its implementation. The government Decree No. 309 of July 2003, established an inter agency working group to monitor introduction of the Personal Identification Numbers (PINs) into the pension system. Additionally, a range of necessary implementation regulations, based on the Public Pension Law, was developed, including: (i) the documents required for award of pensions; (ii) rules for awarding and making payments for partial pensions to those with less than the minimum required length of insurance history; (iii) procedures for making payments of the survivors' pensions to children under full state custody; and (iv) procedures for awarding, computing and making payments of the privileged pensions. While the fiscal performance of the State Pension Fund has improved and as a result, the average pension has increased, the level, coverage and sustainability of pensions are issues for further elaboration. Overall, within the PRSC and Social Protection Project, the Bank supported the analytic work enabling the Government to develop a new Social Protection and Pension package, with improvements in the family poverty benefit formula.

## II. LENDING

12. World Bank lending to Armenia as of March 31, 2007 totals slightly over US\$1 billion, of which US\$827.5 million has been disbursed. The current Bank portfolio consists of 20 IDA credits with a total commitment of \$302.7 million, of which US\$121.1 million is disbursed.

13. Building on the major Poverty Reduction Strategy Paper's (PRSP) themes, the fourth Country Assistance Strategy (CAS) for Armenia was discussed in the World Bank Board of Executive Directors on June 10, 2004 and focuses on three main objectives of: (i) promoting private sector led economic growth; (ii) making growth more pro-poor; and (iii) reducing non-income poverty. CAS PR (Progress Report) was approved by the Board on March 8, 2007 and reconfirmed this focus. Pursuant to agreements reached in the context of IDA-14, country resource envelopes are determined annually based on the Country Policy and Institutional Assessments and performance of the ongoing portfolio. Armenia has a very strong IDA performance rating and as a consequence was eligible for about \$58 million in FY06 and \$61 million in FY07. Based on a 2006 review of Armenia's creditworthiness, Armenia will now be eligible to receive a small amount of IBRD lending beginning in FY08, although it is not yet decided whether to do so.

14. The CAS includes four Poverty Reduction Support Credits (PRSCs) for FY05, 06, 07, and 08. These will support the PRSP objectives and focus on four main components: (i) supporting private sector development and governance; (ii) advancing public infrastructure reforms; (iii) improving core public sector functions; and (iv) enhancing human development and improving social safety nets. Macroeconomic stability is a precondition for the PRSC and is vital for facilitating an enabling environment necessary for successful structural reforms implementation. The PRSC's preparation is being closely coordinated with the IMF Poverty Reduction and Growth Facility (PRGF). The first PRSC was approved by the World Bank Board on November 18, 2004, became effective and disbursed in December 2004. The second PRSC in the amount of \$20 million equivalent was approved by the World Bank's Board on January 19, 2006 and fully disbursed in April 2006. The third PRSC in the amount of USD\$28 million was approved by the Board on March 8, 2007 and is scheduled to be disbursed by the end of FY07. The fourth PRSC in the amount of US\$28 millions is currently scheduled for Board presentation during the last quarter of 2007.

List of World Bank Lending to Armenia  
(In millions of U.S. dollars)

Active Projects	Credit Amount as of 03/31/07	Disbursement as of 03/31/07	Approval Date	Closing Date
Active Projects	302.7	121.1		
1. Electric. Trans. & dist.	21.0	22.5	03/04/99	06/30/07
2. Enterprise incubator	5.0	5.5	11/30/01	12/31/06
3. Judicial reform	11.4	12.9	09/14/00	12/31/06
4. Irrigation dam safety	26.6	24.0	06/24/99	09/30/07
5. Social protection admin.	5.2	2.4	06/10/04	12/31/07
6. Natural resource management	8.3	5.3	06/04/02	07/31/08
Natural resource management (GEF)	5.1	2.4		
7. Educ. qual. & relevance (APL #1)	19.0	9.3	01/20/04	11/30/08
8. Municipal water and WW	23.0	12.5	05/04/04	02/28/09
9. Health system mod.	19.0	11.0	06/10/04	06/30/09
10. Irrigation dam safety 2	6.8	1.7	06/10/04	03/31/09
11. Public sector mod.	10.1	2.3	05/04/04	03/31/09
12. Rural Enterprise & small scale	20.0	3.3	07/07/05	05/31/10
13. Urban Heating Project	15.0	5.4	07/12/05	06/30/10
14. Yerevan water/waste water services	20.0	3.1	02/24/05	02/28/11
15. Renewable Energy Project	5.0	0.5	03/29/06	31/12/10
16. Avian Influenza Prep. Project	6.3	1.5	06/02/06	31/07/09
17. Social Investment Fund III	25.5	3.2	10/26/06	30/06/11
18. PRSC III	28.0	0.0	03/08/07	30/06/08
19. Health System Modernization Project	22.4	0.0	03/08/07	12/31/12
20. Judicial Reform 2	23.0	0.0	03/08/07	12/31/12
<b>Completed Projects</b>	<b>705.5</b>	<b>706.4</b>		
21. Economic rehabilitation	60.0	64.3	02/28/95	06/30/96
22. SAC	60.0	58.5	02/29/96	12/31/97
23. Institution building	12.0	10.7	03/30/93	11/30/97
24. Earthquake rehabilitation	28.0	29.7	02/01/94	06/30/97
25. Power maintenance	13.7	13.2	12/08/94	06/30/99
26. SAC II	60.0	58.6	08/26/97	06/30/99
27. SATAC I	3.8	2.8	02/29/96	06/30/00
28. Highway	31.0	29.5	09/14/95	12/31/00
29. Social Investment Fund	12.0	11.1	11/09/95	12/31/00
30. Irrigation rehabilitation	43.0	40.9	12/08/94	05/31/01
31. SAC III	65.0	63.4	12/22/98	06/30/01
32. Enterprise development	16.8	15.3	12/24/96	07/01/02
33. SATAC II	5.0	4.7	08/26/97	12/31/02
34. Education	15.0	14.6	11/20/97	10/31/02
35. SAC IV	50.0	49.4	05/22/01	03/31/03
36. Health	10.0	9.3	07/29/97	12/30/03
37. SAC V	40.0	42.8	03/13/03	06/30/04
38. Title registration	8.0	7.8	10/13/98	09/30/04
39. Transport	40.0	40.4	06/08/00	12/31/04
40. PRSC I	20.0	20.3	18/11/04	12/31/05

41.	Agric. Reform support	16.3	16.0	01/27/98	06/30/05
42.	Social Investment Fund II	20.0	20.0	05/11/00	12/31/05
43.	Investment and export facilitation	1.0	1.0	04/16/02	12/31/05
44.	Municipal development	30.0	33.0	06/11/98	01/31/06
45.	PRSC II	20.0	20.1	01/19/06	06/30/07
46.	Irrigation development	24.9	29.0	08/30/01	03/31/07
	<b>Total</b>	<b>1008.2</b>	<b>827.5</b>		

**ANNEX III. RELATIONS WITH THE EUROPEAN BANK FOR  
RECONSTRUCTION AND DEVELOPMENT (EBRD)**  
(As of December 31, 2006)

1. As of December 31, 2006, the EBRD approved 35 projects in the power, transport, agribusiness, textile, mining, construction and financial sectors. Total commitments amounted to EUR 185.9 million.

2. There are two sovereign projects. First, the EBRD approved a sovereign guaranteed loan of EUR 54.8 million for construction of the Hrazdan Unit 5 thermal power plant in March 1993, partly aimed at the eventual closure of Armenia's nuclear plant in Medzamor. The government is contemplating the privatization of Hrazdan Unit 5 as the completion of this plant is constrained by limited budgetary resources. The EBRD had funded technical assistance for the Hrazdan privatization prospectus and continues to follow the privatization process. The Hrazdan Thermal Power Complex excluding the unfinished Unit 5 has been transferred to the Russian Federation in the context of the debt-for-equity deal. Second, in November 1994, the agreement on a EUR 21.8 million loan to build an air cargo terminal in Zvartnots airport was signed under a guarantee by the Armenian government. The airport was transferred to private management in 2002. The new management has prepared a master plan for the development of the airport, which is expected to generate further cargo traffic for the cargo terminal.

3. Most of the Bank's projects in Armenia are in the private sector. The EBRD has provided a loan to the Yerevan Brandy Company owned by Pernod Ricard of France (EUR 16.5 million). In the banking sector, a first equity participation in the Commercial Bank of Greece-Armenia (EUR 1.1 million) was approved in late 1999 and a second equity participation in Armeconombank was approved in 2004. The Bank also acquired an equity stake in an Armenian non-bank financial intermediary, CIRCO, an insurance subsidiary of Cascade Capital. Moreover, a multi-bank on-lending facility of EUR 10 million was activated in early 2000. Within the framework of multi-bank facility the Bank currently has credit lines for micro and small enterprises with three local banks (a total of EUR 8.0 million). The EBRD is committed to further expanding lending under this facility to other banks. A Trade Facilitation Program with the purpose to facilitate access of Armenian banks to trade financing was also made available to four Armenian banks. In 2002, a loan to finance EUR 2.9 million in working capital expansion was signed with the Armenian Copper Programme (the only copper smelter in the region), and a new loan (EUR 4.3 million), including the refinancing of the existing loan, was signed in August 2004. Moreover, the EBRD has launched the Turn Around Management (TAM) and Business Advisory Service programmes in Armenia in 2003, originally funded by the EU-Tacis program but now funded from the ETC Fund, to support micro, small, and medium-sized enterprises. There were seven new projects completed during 2004 for a total amount of EUR 6.7 million. Two of them are in the banking sector (including equity investment), one in general industry sector (direct investment in equity of a local enterprise), one pre-export finance facility with a local company in the extractive industry and three trade facilitation programmes with local commercial banks. Commitments during 2005 include a trade facilitation project with a local bank, two direct lending facility with a small hydro power plant and gold mining company, three new SME loans, three equity investment

projects with a pharmaceutical company, plastic preform manufacturer (under Direct Investment Facility), an insurance and reinsurance company, and two medium-sized co-financing facility allowing local banks to share the risk of their selected clients with EBRD. During 2006 the EBRD signed 2 projects with the total commitments of Euro 20 million one of them a on-lending long-term loan to support renewable energy projects and the other one to Armenian International Airports CJSC to complete the construction of a new international passenger terminal.

4. The key priorities of the EBRD for the coming years are: (i) financial sector; (ii) enterprise sector, particularly SME and micro-enterprise financing through credit lines to Armenian banks or direct loans and equity investments, (iii) infrastructure investments in the development of alternative energy sources and municipal infrastructure projects and (iv) portfolio monitoring and implementation support. The EBRD's current country strategy was approved in February 2006.

#### ANNEX IV. REPUBLIC OF ARMENIA: STATISTICAL ISSUES

1. While data provision for surveillance is adequate overall, further improvements are needed in real, fiscal, and external sector statistics in order to enhance the design and monitoring of economic policies. The overall quality, timeliness, and coverage of macroeconomic statistics have improved significantly over the past few years. The Fund has substantially facilitated this process, through technical assistance from the Statistics Department, the Fiscal Affairs Department, and the Monetary and Capital Markets Department. On November 7, 2003 Armenia subscribed to the Special Data Dissemination Standard (SDDS).
2. **National accounts and price statistics.** The National Statistics Service (NSS) has made significant changes to the national accounts methodology to bring it in line with best international practices. Progress has been made in developing estimates of monthly and (constant price) quarterly GDP that are now published. Basic data collection procedures have also improved. The national accounts have adopted the concept of gross value added using transaction prices mostly recorded on an accrual basis. However, progress has been slow in improving the compilation of national accounts at constant (1998) prices; annual data are still mainly derived by re-valuing current output and inputs at previous year prices instead of deflating them by the relevant components of the producer price index. Quarterly GDP estimates are published at constant and current prices. The CPI covers eleven large population centers and the capital city, Yerevan. The base year and expenditure weights are for 2005. Data on the consumer price index (CPI) and wages are reported on a timely basis. A ten-day CPI is compiled by the NSS and the Central Bank of Armenia, though its scope, geographical coverage, and dissemination are limited.
3. **Fiscal statistics.** The budget execution reporting system is compiled on a cash basis and supplemented with monthly reports on arrears and quarterly reports on receivables and payables. Daily revenue and cash expenditure data for the central government are available with a lag of one to two days. The Ministry of Finance is undertaking a comprehensive reform of the treasury system, including the introduction of an internal auditing system in line ministries and their budgetary institutions. A single treasury account (TSA) was introduced in 1996, and all bank accounts held by budgetary institutions were closed, except for Project Implementation Units that are required by donors to operate with commercial banks' accounts. Starting in 2002, some budgetary institutions have been converted into "noncommercial organizations" (NCOs). These units have been taken out of the treasury system and have their own bank accounts. They have started reporting data on their operations to the Ministry of Finance. These exceptions notwithstanding, all government receipts and payments are processed through the TSA, although there are still shortcomings on the timeliness and quality of data on the operations of local governments. Classification of government transactions by function and economic category are generally in line with the



*Manual on Government Finance Statistics 1986*, and monthly data on central government operations are disseminated within 40 days of the end of the month.

The budget presentation and the classification of items under the economic and functional classification of expenditures needs to be made more transparent; for instance, the data have been subject to frequent reclassifications, and wages for military personnel are reported in the broader category of “other” goods and services rather than as a wage item. The reconciliation of central government with general government operations is also difficult because of the need to manually identify transactions among central government, local government, and the Social Insurance State Fund.

4. The authorities submitted cash data, converted to the framework of the *Government Finance Statistics Manual 2001*, for publication in the *2006 Government Finance Statistics Yearbook*. Although the authorities expected to begin providing data for publication in the *IFS* in early 2005, such data have yet to be received. The *GFSM 2001* implementation plan is currently limited to bringing the classification of budgetary central government revenue, expense, and transactions in nonfinancial assets in line with international practices.

5. **Money and banking statistics.** Money and banking statistics are provided on a timely basis. Daily data on the accounts of the Central Bank of Armenia (CBA) are provided weekly with a one-day lag, while weekly data on the monetary survey are provided with a one-week lag. Monthly interest rate data are provided with an one-week lag. A new chart of accounts meeting International Accounting Standards (IAS) was introduced in January 1998. Since then, the balance sheets of the CBA and of the deposit money banks follow IAS methodology.

6. Responding to a STA request, the CBA has compiled and submitted a complete set of monetary data beginning from December 2001 using Standardized Report Forms (SRF). STA review validated the resulting monetary aggregates and the data have been published in the December 2006 issue of *IFS Supplement*. Monetary data in the SRF format continue to be reported by the CBA on a regular basis and are used for updates of *IFS*.

7. **External sector statistics.** The coverage of external sector data has improved in recent years. Trade statistics are provided on a timely basis, and trade data by origin, destination, and commodity are generally available within a month. Price data for exports and imports are less readily available. Quarterly balance of payments data are generally available with a three-month lag. However, on remittances, which account for a significant part of the inflows, there are considerable discrepancies among available source data. Survey data are considerably lower than data obtained through the money transfer system. The NSS and CBA are working on establishing a compilation program that would enable proper measurement of remittances. The absence of a comprehensive, continuously updated business register hampers the coverage of transactions and institutional units; in particular, the coverage of the financial account items for the private sector, excluding banks.

**Armenia: Table of Common Indicators Required for Surveillance**  
(As of April 17, 2007)

	Date of latest observation	Date received	Frequency of Data <sup>6</sup>	Frequency of Reporting <sup>6</sup>	Frequency of publication <sup>6</sup>
Exchange Rates	03/30/2007	3/30/2007	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	02/28/2007	02/28/2007	D	W	M
Reserve/Base Money	02/28/2007	04/16/2007	D	W	M
Broad Money	2/28/2007	04/16/2007	M	M	M
Central Bank Balance Sheet	2/28/2007	04/16/2007	D	W	M
Consolidated Balance Sheet of the Banking System	2/28/2007	04/16/2007	M	W	M
Interest Rates <sup>2</sup>	2/28/2007	03/16/2007	W	W	M
Consumer Price Index	February 2007	04/05/2007	M	M	M
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> — General Government <sup>4</sup>	Q2 05	8/28/05	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> — Central Government	Jun 05	7/30/05	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	Q2 05	8/31/05	Q	Q	Q
External Current Account Balance	Q4 06	2/13/2007	Q	Q	Q
Exports and Imports of Goods and Services	Q4 06	04/05/2007	Q	Q	Q
GDP/GNP	Q4 06	04/05/2007	M	M	M
Gross External Debt	Q1 05	6/30/05	Q	Q	Q

<sup>1</sup> Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

<sup>2</sup> Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup> The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup> Including currency and maturity composition.

<sup>6</sup> Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA).



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### **IMF Executive Board Completes Fourth Review Under Armenia's PRGF Arrangement and Approves US\$5 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) has completed the fourth review under the Poverty Reduction and Growth Facility (PRGF) arrangement for Armenia (see [Press Release No. 05/123](#)). The completion of the review, which was undertaken on a lapse of time basis,<sup>1</sup> enables the release of a further SDR 3.28 million (about US\$5 million) under the arrangement. This will bring the total amount drawn under the arrangement to SDR 16.4 million (about US\$24.9 million).

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in the country's Poverty Reduction Strategy Paper. This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½ -year grace period on principal payments.

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<sup>1</sup> The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.