© 2008 International Monetary Fund

June 2008
IMF Country Report No. 08/176

Republic of Armenia: Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Republic of Armenia

In the context of the sixth review under the three-year arrangement under the Poverty Reduction and Growth Facility with the Republic of Armenia, the following documents have been released and are included in this package:

- The staff report for Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on March 17, 2008, with the officials of the Republic of Armenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 5, 2008. 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.

- A Press Release summarizing the views of the Executive Board as expressed during its May 19, 2008 discussion of the staff report that completed the review.

- A statement by the Executive Director for Republic of Armenia.

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

Letter of Intent sent to the IMF by the authorities of Republic of Armenia*
*Also in the Staff Report

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility

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

Approved by Lorenzo Pérez and Martin Fetherston

May 5, 2008

Executive Summary

- **Armenia has made significant headway under its third PRGF-supported program**, achieving double-digit growth, declining poverty rates, moderate inflation, low fiscal deficits, and a comfortable international reserves position. The current policy mix has appropriately combined sound fiscal and monetary policies with exchange rate flexibility. The short-term outlook remains positive, but there are uncertainties related to the post-election turmoil and the global outlook, while inflation risks remain on the upside. The PRGF-supported program is on track**.** All end-December 2007 quantitative and structural performance criteria were observed. The authorities have expressed strong interest in a new Fund arrangement, after the current PRGF expires in May 2008.
- **Policy discussions focused on the key policy challenges ahead.** There was agreement that rising inflationary pressures, medium-term fiscal risks, and the need to preserve external competitiveness call for tighter-than-envisaged monetary and fiscal policies in the short run. Going forward, reform efforts should focus on strengthening the fiscal and monetary policy frameworks, while accelerating productivity-enhancing reforms.
- The authorities are considering the mission's advice on the need to tighten **fiscal policy** compared to the budget. A lower fiscal deficit would limit the fiscal impulse and help contain real exchange rate appreciation pressures. Looking ahead, a consistent medium-term fiscal framework should be developed to help maintain fiscal discipline, anchor expectations, and improve policy coordination.
- The gradual tightening of **monetary policy** has been appropriate, and the authorities concurred that it will have to continue in light of heightened inflationary risks and to limit second-round effects of higher food prices. Increasingly, monetary policy has to deal with inflationary pressures coming not only from the supply side, but also from the demand side. It will be important to contain a possible rise in inflation expectations. The authorities should closely monitor rapid credit growth.
- The authorities remain committed to a **flexible exchange rate regime**. With staff analysis showing no evidence of exchange rate misalignment so far, the authorities were advised against excessive foreign exchange interventions. The mission and staff agreed that intervention should be limited to liquidity management and limiting exchange rate volatility. Policies to spur domestic competition and productivity would limit the adverse impact of dram appreciation on external competitiveness.
- Implementing "**second-generation**" **reforms** will help remove remaining bottlenecks to growth, diversify the economy, and reduce the size of the shadow economy. Further efforts are needed to strengthen tax/customs administration and the fiscal framework, deepen financial intermediation, improve the business environment, promote domestic competition, and boost external competitiveness.

Contents Page

Executive Summary 1
I. Introduction 3
II. Background 4
III. Report on the Discussions 7
A. Macroeconomic Outlook and Risks 7
B. The Policy Mix 7
C. Structural Reforms 10
IV. Staff Appraisal 12

Boxes
1. Armenia's Third PRGF-supported Program—Objectives and Achievements 3
2. Asymmetric Exchange Rate Pass-Through 9
3. Informality and Financial Deepening 11

Text Tables
1. Fiscal Indicators, 2006–07 4
2. Monetary Indicators, 2007–08 5
3. Fiscal Stance in 2008 8

Tables
1. Selected Economic and Financial Indicators, 2003–08 14
2. Central Government Operations, 2006–08 15
3. Monetary Accounts, 2006–08 17
4. Balance of Payments, 2005–11 18
5. Status of Measures Under the Sixth Review 19
6. Quantitative Targets, September 2006–December 2007 20
7. Indicators of Fund Credit, 2003–11 21
8. Medium-Term Macroeconomic Framework, 2006–11 22
9. Financial Soundness Indicators for the Banking Sector, 2003–07 23
10. Poverty Indicators and Millennium Development Goals, 1990–2015 24

Attachment
Letter of Intent 25

I. INTRODUCTION

1. Armenia's performance under its third PRGF arrangement has been commendable. A marked reduction in poverty has been achieved in a high-growth and low-inflation macroeconomic environment. Structural reforms, largely focused on the fiscal and financial sectors, have progressed steadily (Box 1). But important reforms are still needed to sustain and broaden growth, and the country—land-locked and facing two closed borders—remains vulnerable to external shocks and regional instability.

Box 1: Armenia's Third PRGF-supported Program—Objectives and Achievements

The program focused primarily on achieving three objectives:

- maintaining macroeconomic stability through prudent monetary and fiscal policies;
- generating additional domestic resources to finance poverty-reducing and growth-enhancing expenditures, in particular by strengthening tax and customs administration;
- boosting private sector activities by fostering financial sector development, and improving public and corporate governance.

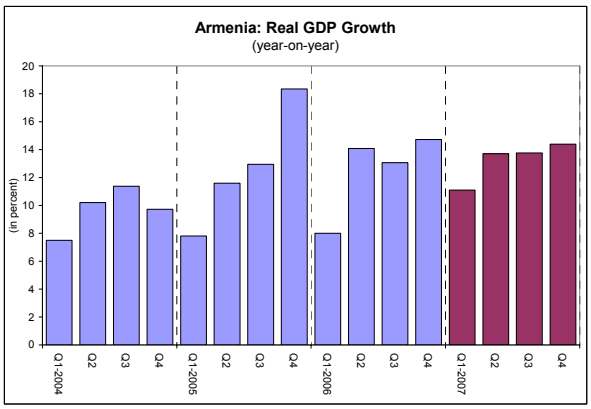
To a large measure, these objectives have been achieved. Program conditionality helped the authorities to implement prudent monetary and fiscal policies and accomplish far-reaching structural reforms in an environment of strong growth, low inflation, rising real incomes, and declining poverty rates. While much remains to be done to strengthen governance and tax/customs administration, revenue targets were consistently exceeded, and the tax/GDP ratio was raised by two percentage points amid double-digit GDP growth during the program period. At the same time, substantial financial sector reforms have been implemented, promoting private sector activity and financial deepening.

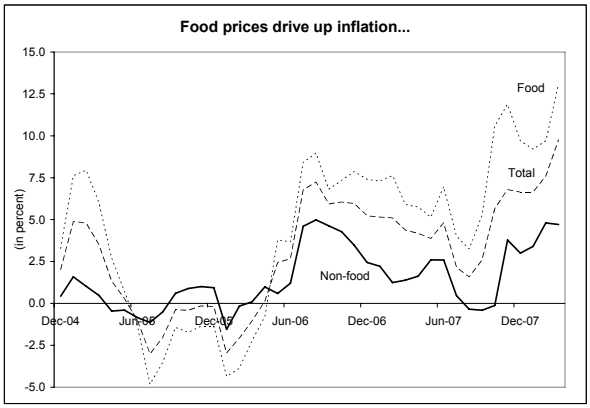
2. Against this background, the authorities have expressed strong interest in a new Fund arrangement, after the current PRGF expires in May 2008. To this end, they are updating their Poverty Reduction Strategy Paper (PRSP), and have committed to policy continuity during the post-program period (Attachment).

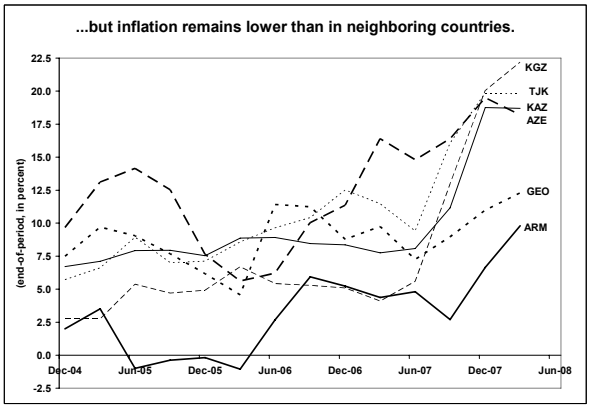
3. Controversial presidential elections in February were followed by a violent crackdown on opposition protests, and a twenty-day state of emergency. In early April, the previous prime minister was sworn in as president, and appointed the reform-minded central bank governor as prime minister. The economic impact of the political crisis is expected to remain limited if the new government takes concrete steps to recover its legitimacy by pressing ahead with economic reforms and fighting corruption.

II. BACKGROUND

4. Macroeconomic performance in 2007 was very strong, with double-digit growth and single-digit inflation for the sixth consecutive year (Table 1). Real GDP grew by 13.7 percent, driven by nontradables, while remittance and FDI inflows buoyed domestic demand. Surging commodity import prices pushed inflation to 6.6 percent in December, above the end-year inflation target (4 ±1.5 percent). Following further hikes in food prices, 12-month inflation jumped to 9.6 percent in March 2008.







5. Fiscal policy in 2007 remained prudent, with the central government deficit limited to the programmed level of 1.8 percent of GDP (Table 2). While capital expenditures surged in the last quarter due to a larger-than-expected loan disbursement from Japan to finance a power plant, high tax revenues and under-execution of current government spending helped contain inflationary pressures. Tax revenues exceeded expectations, largely on account of a 50 percent increase in VAT collections. However, the reported use of *ad hoc* measures, such as advance tax payments requests and unprocessed VAT refunds, raise concerns about revenue sustainability.

Armenia: Fiscal Indicators, 2006-07

	2006 Act.	2007 Prog.	2007 Act.
	(In billions of AMD)		
Tax revenue	383.8	479.3	504.3
Total expenditures (exc. gas subsidy)	469.9	595.7	624.8
Overall balance (commitment basis)	-50.2	-56.5	-58.5
Overall balance (cash basis) 1/	-50.4	-56.5	-56.1
	(In percent of GDP)		
Tax revenue	14.4	15.6	16.1
Total expenditures (exc. gas subsidy)	17.7	19.4	19.9
Overall balance (commitment basis)	-1.9	-1.8	-1.9
Overall balance (cash basis) 1/	-1.9	-1.8	-1.8
Memorandum item:			
GDP (annual, in billions of AMD)	2,657	3,076	3,139
Unprocessed VAT refunds (percent of GDP)	...	...	0.18

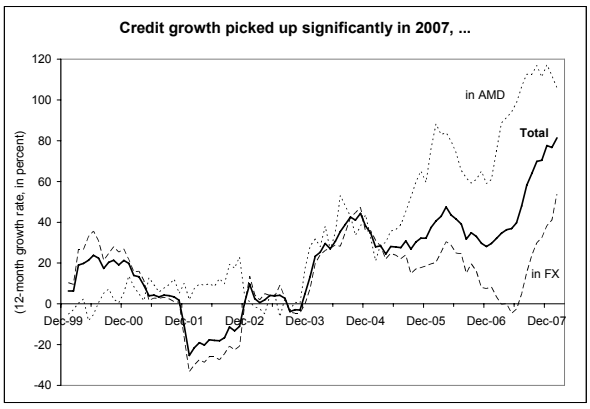
1/ Overall balance according to program definitions.

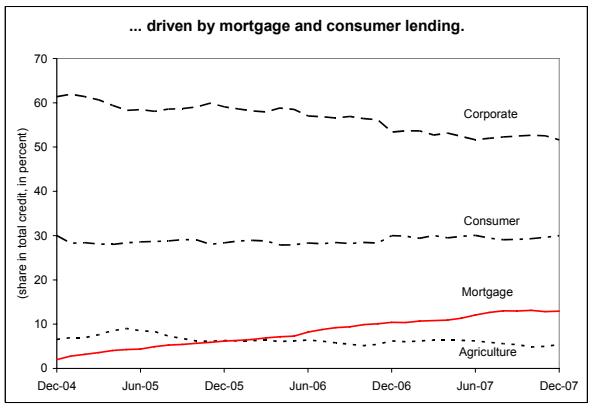
6. Monetary growth accelerated in 2007, fueled by unsterilized foreign exchange intervention, cash dedollarization, and a surge in private sector credit (Table 3). Credit growth, driven by mortgage and consumer loans, picked up sharply on the back of buoyant domestic demand, changes in prudential requirements freeing up resources for additional lending (Country Report No. 07/377), and expanded bank funding. In line with the implicit inflation targeting regime adopted in 2006, the Central Bank of Armenia (CBA) gradually raised its refinancing rate from 4.5 percent in June 2007 to 6.5 percent in April 2008 in order to rein in demand-related inflationary pressures and second-round effects of higher food import prices. To promote dedollarization, reserve requirements on foreign currency deposits were increased from 8 to 12 percent.

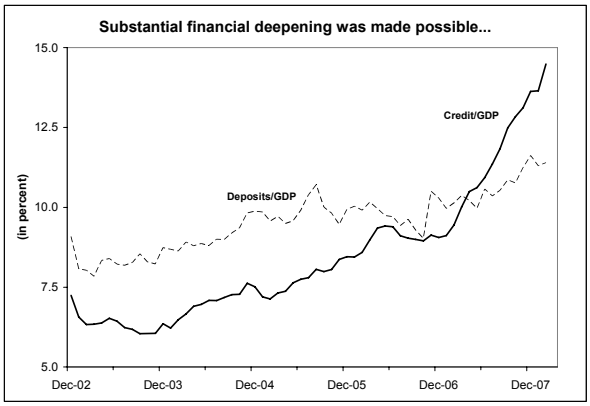
Armenia: Monetary Indicators, 2007-08

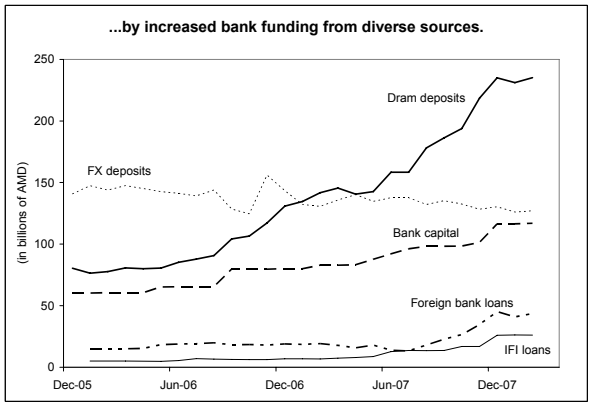
	Dec. 07 Prog.	Dec. 07 Act.	Mar. 08 Prel.
	(In percent)		
12-month change in reserve money	31.7	50.9	51.7
12-month change in broad money	34.4	42.3	42.0
12-month change in credit to the economy	49.3	78.0	80.8
	(In millions of USD)		
Net international reserves 1/	1,157.7	1,403.7	1,371.7

1/ At program exchange rates.

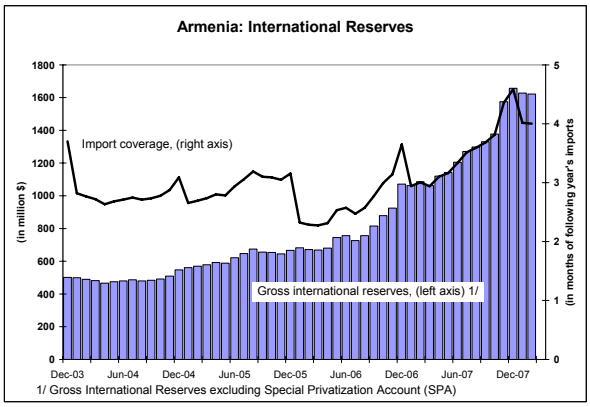


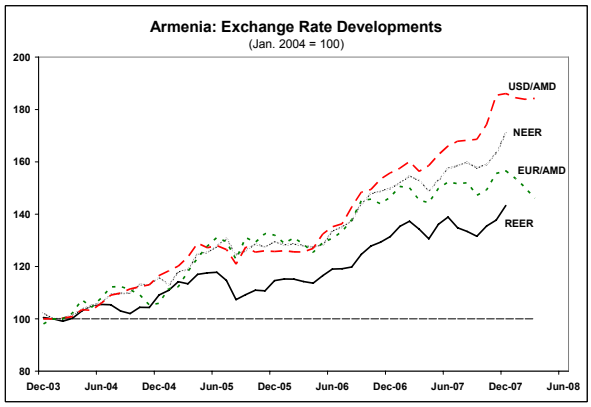






7. External developments in 2007 were shaped by large-scale inflows, high food prices, and buoyant domestic demand, amid continued dram appreciation (Table 4). Notwithstanding robust export growth and substantial remittance inflows, surging imports resulted in a sizeable widening of the current account deficit, while international reserves increased markedly. The dram rose by 16.3 percent against the dollar in 2007, but has stabilized so far in 2008. The debt sustainability analysis indicates that Armenia is at low risk of debt distress, but is sensitive to a long-lasting terms of trade deterioration (Country Report No. 07/377).





8. The PRGF program remains on track, with all reviews completed on time (Tables 5–7). All December 2007 quantitative targets, structural performance criteria, and benchmarks were met (except the indicative target on reserve money), and important fiscal and financial sector reforms were implemented:

- Legislation was approved limiting access to the simplified tax regime to the retail and household sectors, and the authorities submitted to parliament the general part of the unified tax code, and legislation moving tobacco products toward the regular tax regime.

- A risk-based audit selection system is being implemented to reduce discretion by tax officials, and an order was issued by the State Tax Service (STS) to eliminate recording commissions from September 2008, to limit direct interactions between tax officials and taxpayers.

- The authorities introduced a consumer credit law to increase market transparency and consumer protection; approved the purchase of shares of several existing banks by foreign investors; finalized the takeover of the Armenian stock exchange by the Scandinavian stock market operator OMX; and initiated legislative measures according to program conditionality.

III. Report on the Discussions

Policy discussions highlighted the key challenges currently faced by Armenia: heightened inflationary pressures; medium-term fiscal risks; and the need to preserve external competitiveness against the backdrop of large-scale foreign exchange inflows, continued real appreciation pressures, and a more challenging external and domestic environment.

A. Macroeconomic Outlook and Risks

9. The short-term picture remains positive, but this assessment is clouded by uncertainties related to the post-election turmoil, and the global outlook for commodity prices. Real GDP growth is projected to reach 10 percent in 2008, fueled by continued strong activity in services and construction. But there are downside risks if recent developments result in a slowdown in investment, and a suspension of donor programs. Buoyant domestic demand, together with the announced increase in end-user tariffs after the current gas subsidy expires on May 1, are projected to result in an end-year inflation of close to 7 percent. But inflation risks remain on the upside, given the potential for further hikes in food prices, pressure for wage and pension increases, and larger-than-expected foreign exchange inflows.

10. The medium-term outlook remains favorable, assuming continuity of macroeconomic policies. Robust growth is projected (6–8 percent annually) in view of good prospects for investment and external grants (Table 8). Inflation is expected to moderate to around 5 percent in 2009, notwithstanding a potential hike in gas import prices, and to 4 percent in the medium term, as restrained monetary and fiscal policies help contain second-round effects of higher gas prices.

B. The Policy Mix

Fiscal policy

11. Given the 2007 outcome and the more challenging internal and external environment, staff argued for a lower fiscal deficit than the 2.6 percent of GDP envisaged in the 2008 budget. The deficit of 1.8 percent of GDP proposed by staff would limit the fiscal impulse

and help contain real exchange rate appreciation pressures. Data for the first quarter of 2008 suggest that most of the proposed reduction in the deficit could be achieved by saving any revenue overperformance. There is only limited scope for expenditure cuts, given the budgeted 60 percent increase in average pensions and the forthcoming removal of the gas subsidy, which will be partially compensated by increasing social benefits to the poor. The authorities agreed that fiscal policy needs to remain prudent, but noted that achieving a lower deficit will be politically difficult this year, given expenditure commitments and increased political and economic uncertainty.

Armenia: Fiscal Stance in 2008 1/

	2006 Act.	2007 Prel.	2008 Budg.	2008 Proj.
	(In billions of AMD)			
Tax revenue	384	504	575	591
Total expenditure (exc. gas subsidy)	470	625	719	709
Of which: capital	104	183	183	183
Overall balance	-50	-58	-92	-66
	(In percent of GDP)			
Tax revenue	14.4	16.1	16.3	16.3
Total expenditure (exc. gas subsidy)	17.7	19.9	20.4	19.6
Of which: capital	3.9	5.8	5.2	5.0
Overal balance 2/	-1.9	-1.9	-2.6	-1.8
Memorandum item:				
Underlying primary balance 3/	-2.5	-3.2	-4.0	-3.2
GDP (annual)	2,657	3,139	3,520	3,623

1/ Program definition that excludes the gas subsidy and the State Fund for Social Insurance (SFSI).
2/ Including the SFSI, the fiscal deficit for the 2008 budget is 2.9 percent of GDP.
3/ Including the SFSI and the gas subsidy.

12. Looking ahead, a consistent medium-term fiscal framework should be developed to help maintain fiscal discipline, anchor expectations, and improve policy coordination. The authorities believe that their current framework already addresses these issues. But staff argued that a more analytical approach, including estimates of the fiscal impulse, was necessary for an adequate assessment of the stabilization role of fiscal policy and of medium-term risks (such as pension reform and higher gas import prices in 2009), and to improve policy effectiveness and transparency.

Monetary and exchange rate policies

13. The gradual tightening of monetary policy has been appropriate and will have to continue in light of heightened inflationary risks. Increasingly, monetary policy has to deal with inflationary pressures coming not only from the supply side, but also from the demand side, highlighting the need for effective demand management policies.

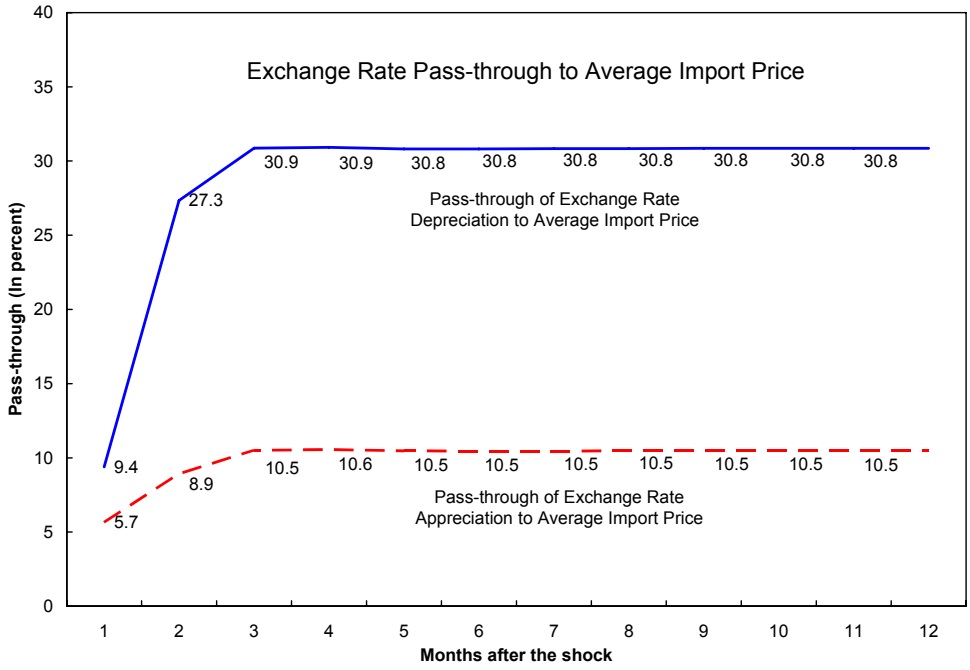
14. Monetary growth is expected to remain high in 2008, given continued remonetization, capital inflows, and cash dedollarization. Credit growth is projected to moderate slightly by end-2008, as one-time effects from the 2007 regulatory changes taper off. The CBA may need to refrain from large-scale foreign exchange intervention and step up the issuance of its securities, since the higher issuance of treasury securities planned for the year may not be enough to slow down the pace of base money growth.

15. The CBA is moving steadily toward full-fledged inflation targeting. An important step in this direction was its recent commitment to a preannounced three-year inflation target (4 ±1.5 percent). The CBA agreed that money market development will remain key to improving the transmission mechanism and increasing the effectiveness of monetary policy.

Analysis of the exchange rate pass-through to domestic prices will be useful in determining the appropriate monetary policy response to exchange rate movements (Box 2).

Box 2: Asymmetric Exchange Rate Pass-through

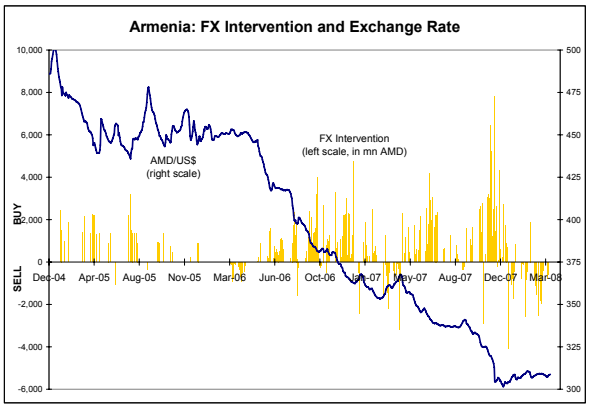
Dram appreciation can help contain inflation if exchange rate changes are translated into adjustments in domestic import prices. Preliminary estimates show a significantly higher pass-through for exchange rate depreciations (about 31 percent) than for appreciations (10 percent). This suggests that there is significant downward rigidity in import prices in response to exchange rate movements, limiting the impact of exchange rate appreciation on inflation.



Source: Fund staff estimates.

16. The recent sharp pickup in credit growth has not yet raised supervisors' concerns about financial institutions' ability to maintain high prudential standards in a higher risk environment (Table 9). The authorities based their views on the still low level of credit and high regulation/supervision standards. In addition, more efficient bank procedures (loan origination, risk assessment) and an improved financial infrastructure (credit bureau) would help mitigate emerging risks. While acknowledging the positive impact of credit growth on financial deepening, staff noted that the related potential risks warrant close monitoring, as incipient problems with loan quality may be more difficult to detect with rapidly expanding credit. Therefore, staff urged the CBA to take a conservative approach regarding prudential standards and the implementation of Basel II, as well as to pursue its efforts to improve financial institutions' risk management capacity.

17. FDI, remittances, and donor assistance will likely remain strong in 2008, maintaining upward pressure on the dram. The authorities remain committed to a flexible exchange rate regime, but noted the adverse impact of dram appreciation on remittance recipients and export competitiveness. With staff analysis showing no evidence of exchange rate misalignment so far, the authorities were advised to refrain from excessive unsterilized foreign exchange interventions to limit exchange rate appreciation. Such interventions are not only costly, but will fuel reserve money growth and inflation if they go beyond the (hard to estimate) need to accommodate remonetization and dedollarization.



C. Structural Reforms

18. Implementing "second-generation" reforms will help remove remaining bottlenecks to growth, diversify the economy, and reduce the size of the shadow economy. Consistent with PRSP objectives, further efforts are needed to strengthen the fiscal framework, deepen financial intermediation, improve the business environment, promote domestic competition, and boost external competitiveness. Obstacles related to tax administration are listed among the top constraints to the operations and growth of businesses in recent World Bank surveys (the 2005 *Business Environment Enterprise Performance Survey* (BEEPS), and the 2008 *Doing Business*). Improving tax policy and administration will be crucial for discouraging informality and encouraging financial deepening (Box 3).

19. Tax administration reforms should advance expeditiously to ensure that recent improvements in tax collection are sustainable, and tax collection is transparent and fair. Key measures include adopting a function-based organization structure at the STS and consolidating the large taxpayer's inspectorates. Staff also recommended introducing a VAT threshold, and eliminating tax holidays and other preferential regimes. While provision of resources in the 2008 budget to clear accumulated and projected unprocessed VAT claims and the ongoing development of risk-based criteria for VAT refunds at the STS are welcome initiatives, paying interest on late refunds would be the most effective way to improve the VAT refunds system. The authorities are still resisting any commitment in that direction.

20. The conversion of many budgetary institutions into noncommercial organizations (NCOs) outside the treasury system—with little emphasis on financial management, supervision, and monitoring—has created macro-fiscal risks and partially undone earlier treasury reforms. In this context, staff welcomes the authorities' efforts to address the challenges for public financial management that the NCO reform has presented. The

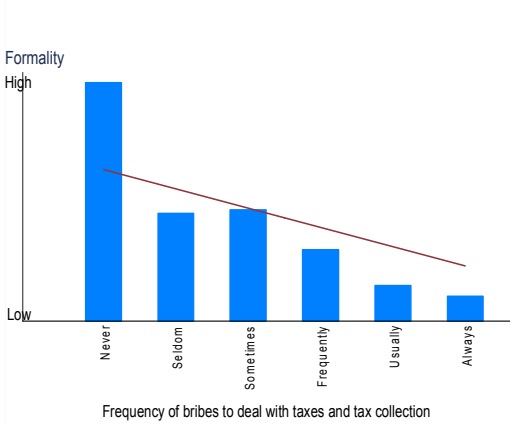
amendment recently submitted to parliament aimed at reestablishing treasury controls will help partially address some of these risks.

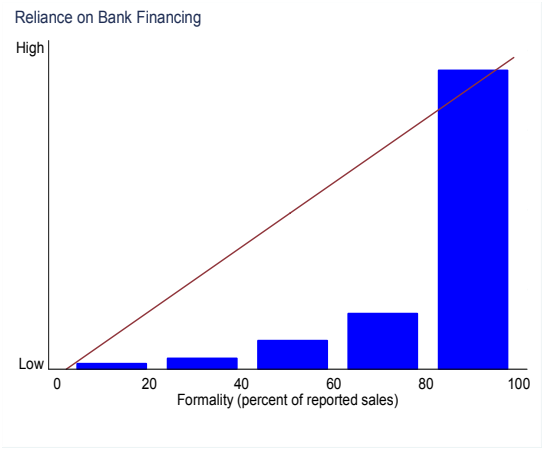
Box 3: Informality and Financial Deepening

Despite the recent surge in credit growth, the ratio of private credit to GDP in Armenia (13.6 percent in 2007) is still low relative to other transition countries. The presence of a large informal economy—avoiding the banking sector to evade taxes—is an obstacle to financial sector development. High tax compliance costs, unclear audit rules, political interference, and weak tax administration, all create incentives for tax evasion and informality.

An analysis of firm-level data for 27 transition countries finds a robust ***negative association between informality and firms' reliance on bank credit,*** even after controlling for reverse causality. This highlights the importance of strengthening tax policy and administration in order to reduce the size of the informal economy *and* encourage financial deepening.

Weaknesses in the tax system lead to informality, limiting reliance on bank financing.





Source: BEEPS, 2005 Database

Note: Relationships are significant at the 1 percent level. Formality is proxied by the percentage of sales reported by firms for tax purposes. Bank financing is measured by the percentage of firms' working capital financed through the banking system. See Dabla-Norris and Koeda, "Informality and Bank Credit: Evidence from Firm-Level Data." IMF Working Paper (forthcoming).

21. Regarding the financial sector, the government approved a law on cash transaction limits and electronic payment of salaries, targeting the shadow economy and supporting tax administration. The CBA is implementing several technical improvements to the functioning of the money market, and the authorities adopted a package of capital market development

measures, including controversial tax incentives for companies that list in the stock exchange. The CBA is on track with implementing the first stage of Basel II, but plans to establish an independent Financial Supervision Agency will be revised against the backdrop of recent international experience.

IV. Staff Appraisal

22. Armenia has experienced a prolonged period of high economic growth and moderate inflation. Sound macroeconomic policies, a favorable global environment, lower gas import prices than in other CIS countries, and large-scale foreign exchange inflows have all contributed to this strong performance. Going forward, however, Armenia will face a more challenging external and domestic environment. Rising energy and food import prices, recent and planned pension increases, and rapid credit growth will likely keep inflationary pressures high and lead to larger current account deficits.

23. While the current policy mix has been appropriate so far, these new developments will require additional tightening. With monetary policy effectiveness constrained by large-scale foreign exchange inflows and a weak monetary transmission mechanism, fiscal policy will need to play a crucial role in maintaining macroeconomic stability. In this light, and given the upside inflationary risks, the government should save any revenue overperformance and aim for a lower fiscal deficit than envisaged in the 2008 budget. At the same time, targeted support for vulnerable groups to cushion the impact of the gas subsidy's removal would be appropriate.

24. The capacity for fiscal policy analysis should be strengthened to improve the effectiveness of fiscal policy and help maintain fiscal discipline. In particular, the authorities should consider the impact of government spending on inflation and growth to assess the appropriateness of the fiscal stance. This will become increasingly important because inflationary pressures are likely to arise more from demand-side factors as incomes grow.

25. Monetary policy was appropriately tightened during the past year. The gradual increases in the refinance rate helped contain second-round effects from higher food import prices. But inflation may well turn out to be higher than currently projected, given the potential for further supply shocks and increasing demand pressure. Against this background, the CBA should tighten its stance as needed to anchor inflation expectations. Given the sharp pick-up in credit growth, the CBA should take a conservative approach on prudential standards, while pressing for upgrades in banks' risk-management capacity.

26. Widening trade deficits and the dram appreciation have raised concerns about external competitiveness. Thus far, however, staff analysis has found no evidence of exchange rate misalignment. The flexible exchange regime remains the best choice for Armenia, as attempts to limit nominal appreciation would simply create additional inflation,

rather than improve competitiveness. Safeguarding competitiveness in the context of dram appreciation calls for a more determined approach to structural reforms.

27. Weaknesses in tax administration remain a major constraint to private sector growth. They discourage financial intermediation, since enterprises operate in the shadow economy to evade taxes. Sustaining the recent increase in tax collection requires major tax administration reforms, aimed at improving tax collections in a more transparent and fair way to encourage compliance and ensure a level playing field for all businesses. The provision of tax incentives to foster capital market development would undermine efforts to improve tax administration and would dent policy credibility.

28. Prospects for a successor program are favorable on account of the authorities' good track record and strong commitment to reform. Reform efforts should focus on strengthening the fiscal and monetary policy frameworks, while deepening productivity-enhancing structural reforms, notably by reducing the cost of doing business, increasing domestic competition, diversifying the economy, and discouraging participation in the shadow economy.

29. On the basis of Armenia's strong performance under the PRGF arrangement, staff supports the authorities' request for completing the sixth and final review.

Table 1. Armenia: Selected Economic and Financial Indicators, 2003–08

	2003	2004	2005	2006	2007		2008
					Prog.	Act.	Proj.
	(In percent of GDP, unless otherwise specified)						
National income and prices							
Real GDP growth	14.0	10.5	14.0	13.3	11.1	13.7	10.0
Gross domestic product (in billions of drams)	1,625	1,908	2,243	2,657	3,076	3,139	3,623
Gross domestic product (in millions of U.S. dollars)	2,807	3,578	4,909	6,388	8,618	9,177	11,908
Gross domestic product per capita (in U.S. dollars)	874	1,113	1,523	1,983	2,654	2,826	3,649
CPI (period average)	4.7	7.0	0.6	2.9	4.3	4.4	8.9
CPI (end of period)	8.6	2.0	-0.2	5.2	6.0	6.6	6.8
Unemployment rate (in percent)	10.1	9.6	8.1	7.2	...	6.7	…
Poverty rate (in percent)	42.9	34.6	29.8	26.5	...	...	...
Investment and saving (in percent of GDP) 1/							
Investment	24.3	24.9	30.5	33.6	29.7	34.8	34.4
National savings	17.5	24.3	29.4	31.7	25.8	28.6	27.7
Money and credit (end of period)							
Reserve money	6.6	11.3	51.9	41.1	31.7	50.9	32.3
Broad money	10.4	22.3	27.8	32.9	34.4	42.3	32.0
Commercial banks' 3-month lending rate (in percent)	22.5	17.5	18.3	17.1	...	18.6	...
Central government operations (in percent of GDP)							
Revenue and grants	17.8	15.4	15.7	15.8	17.5	18.0	17.7
Of which : tax revenue 2/	14.0	14.0	14.3	14.4	15.6	16.1	16.3
Expenditure and net lending 3/	18.9	17.1	18.3	17.7	19.4	19.9	19.6
Overall balance on a commitment basis	-1.1	-1.7	-2.6	-1.9	-1.8	-1.9	-1.8
Overall balance on a cash basis	-1.5	-1.6	-2.6	-1.9	-1.8	-1.8	-1.8
Government and government-guaranteed debt (in percent of GDP)	40.9	32.4	24.3	18.7	17.7	17.6	16.5
Share of foreign currency debt (in percent)	93.5	93.0	90.8	88.2	87.9	87.1	83.9
External sector							
Exports of goods and services (in millions of U.S. dollars)	903	1,071	1,416	1,510	1,650	1,727	2,005
Imports of goods and services (in millions of U.S. dollars)	-1,406	-1,628	-2,124	-2,536	-3,129	-3,525	-4,335
Exports of goods and services (in percent)	29.5	18.5	32.2	6.7	18.8	14.3	16.1
Imports of goods and services (in percent)	27.0	15.8	30.5	19.4	30.4	39.0	23.0
Current account (in percent of GDP) 1/	-6.8	-0.5	-1.0	-1.8	-4.0	-6.2	-6.7
FDI (net, in millions of U.S. dollars)	121	246	233	450	455	664	690
External debt-to-exports ratio (NPV, in percent)	60	59	60	72	61	67	62
Debt service ratio (in percent of exports of goods and services) 4/	15.6	8.9	5.7	9.2	8.1	8.0	7.1
Gross international reserves (in millions of U.S. dollars) 5/	502	547	667	1072	1389	1657	2018
Import cover 6/	3.7	3.1	3.2	3.6	4.5	4.6	5.0
Nominal effective exchange rate 7/	-4.6	11.5	13.6	15.6	…	14.1	…
Real effective exchange rate 7/	-2.6	6.5	7.4	14.2	…	9.0	…
End-of-period exchange rate (dram per dollar)	566	486	450	364	…	304.2	
Average exchange rate (dram per dollar)	579	533	458	416	…	342.1	…
Memorandum item:							
Population (in millions)	3.212	3.214	3.223	3.221	…	…	…

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

1/ The 2004-2006 external current account figures were revised following changes in methodology (see footnote 1 of table 4)

2/ Tax revenues in 2007 include 0.2 percent of GDP in tax arrears paid by Armentel, which were not part of the official target.

3/ Not including the gas subsidy.

4/ Private external debt included since 2006.

5/ Excluding the special privatization account (SPA).

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

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

Table 2. Armenia: Central Government Operations, 2006–08
(In billions of drams)

	2006	2007						2008					
	Jan.-Dec.	Q1	Q2	Q3	Q4	Jan.-Dec.		Q1	Q2	Q3	Q4	Jan.-Dec.	
	Act.	Act.	Act.	Act.	Act.	Prog. 1/	Act.	Proj.	Proj.	Proj.	Proj.	Budget	Proj.
Total revenue and grants	**419.8**	**111.9**	**127.9**	**142.8**	**183.8**	**539.2**	**566.3**	**120.9**	**150.7**	**176.4**	**194.9**	**627.1**	**642.9**
Total revenue	407.7	108.1	123.6	137.6	173.5	512.4	542.8	115.3	144.3	168.7	179.7	592.2	608.0
Tax revenue	383.8	94.2	115.8	132.3	162.1	479.3	504.3	110.4	138.7	164.0	177.9	575.1	590.9
Value-added tax	165.9	44.6	52.3	66.1	85.0	…	248.0	…	…	…	…	…	…
Excises	39.9	8.5	9.3	18.5	19.6	…	41.5	…	…	…	…	…	…
Profits, simplified, and presumptive taxes	88.1	21.5	28.8	12.4	15.2	…	75.5	…	…	…	…	…	…
Personal income tax	35.5	8.4	10.8	0.0	0.0	…	46.8	…	…	…	…	…	…
Customs duties	18.3	4.5	5.2	5.6	8.8	…	24.0	…	…	…	…	…	…
Other taxes	36.2	6.7	9.5	10.8	13.6	…	40.5	…	…	…	…	…	…
Nontax revenue	7.9	9.6	2.2	1.8	6.0	13.3	19.6	3.1	3.3	3.2	-0.6	9.0	9.0
Capital revenue	15.9	4.3	5.6	3.6	5.4	19.8	18.9	1.8	2.4	1.5	2.3	8.0	8.0
Grants	12.1	3.8	4.3	5.2	10.2	26.8	23.5	5.6	6.4	7.7	15.2	34.9	34.9
Total expenditure	**492.6**	**115.6**	**149.1**	**165.5**	**231.9**	**632.4**	**662.3**	**142.4**	**164.6**	**194.0**	**222.5**	**733.6**	**723.5**
Current expenditure	371.9	91.8	110.2	106.3	147.4	464.2	455.9	114.2	118.3	123.6	158.3	524.5	514.4
Wages	49.8	11.5	15.1	16.7	18.0	59.6	61.3	14.2	18.7	20.7	22.3	75.8	75.8
Subsidies	16.4	3.5	5.0	6.9	6.1	21.4	21.5	3.3	4.7	6.4	5.6	20.9	20.0
Interest	9.0	2.1	2.1	3.2	2.6	11.2	10.0	2.3	2.3	3.5	2.9	11.0	11.0
Transfers	124.3	36.1	36.9	25.3	58.1	153.5	156.4	34.2	32.2	28.7	53.4	167.0	163.0
Of which: pensions	19.5	4.5	4.4	4.3	4.3	18.3	18.3	…	…	…	…	52.6	52.6
gas subsidy 2/	22.7	13.5	6.3	5.4	12.1	36.7	37.5	14.5	0.0	0.0	0.0	14.5	14.5
Goods and services	172.4	38.6	51.1	54.3	62.7	218.4	206.7	45.7	60.5	64.2	74.2	249.7	244.6
Capital expenditure and net lending	120.7	23.8	39.0	59.2	84.4	168.2	206.4	28.2	46.3	70.4	64.1	209.1	209.1
Capital expenditure	104.2	19.1	33.2	52.9	78.2	146.1	183.3	22.8	39.5	63.1	57.5	182.9	182.9
Overall balance with gas subsidy	**-72.8**	**-3.8**	**-21.3**	**-22.7**	**-48.1**	**-93.1**	**-96.0**	**-21.5**	**-13.9**	**-17.6**	**-27.6**	**-106.5**	**-80.6**
Overall balance without gas subsidy	**-50.2**	**9.7**	**-15.0**	**-17.3**	**-36.0**	**-56.5**	**-58.5**	**-7.0**	**-13.9**	**-17.6**	**-27.6**	**-92.0**	**-66.1**
Total revenues of State Fund for Social Insurance (SFSI)	99.7	…	…	…	…	116.0	116.0	…	…	…	…	160.8	160.8
Of which: social contributions	80.2	…	…	…	…	94.3	94.3	…	…	…	…	105.0	105.0
Total expenditure of SFSI	91.1	…	…	…	…	105.7	105.7	…	…	…	…	171.1	171.1
Balance of SFSI	**8.6**	**…**	**…**	**…**	**…**	**10.3**	**10.3**	**…**	**…**	**…**	**…**	**-10.3**	**-10.3**
Overall balance without gas subsidy incl. SFSI	**-41.6**	**…**	**…**	**…**	**…**	**-46.2**	**-48.2**	**…**	**…**	**…**	**…**	**-102.3**	**-76.4**
Overall balance without gas subsidy and SFSI 3/	**-50.4**	**9.8**	**-11.6**	**-12.8**	**-41.6**	**-56.5**	**-56.1**	**-7.0**	**-13.9**	**-17.6**	**-27.6**	**-92.0**	**-66.1**
Deficit/financing (excluding the SFSI)	**73.1**	**3.7**	**17.9**	**18.2**	**53.7**	**93.1**	**93.5**	**21.5**	**13.9**	**17.6**	**27.6**	**106.5**	**80.6**
Domestic financing	**45.3**	**-1.4**	**2.4**	**12.6**	**21.4**	**45.1**	**35.0**	**9.9**	**-0.8**	**4.3**	**13.2**	**52.5**	**26.6**
Bank financing	-9.3	-15.6	-10.4	7.5	12.1	2.5	-6.4	-6.2	-1.1	4.0	12.9	-0.4	9.6
Central Bank of Armenia (net)	-12.7	-14.0	-9.7	7.3	0.2	0.2	-16.2	-21.3	-3.7	1.6	10.5	...	-12.9
Commercial Banks (net)	3.4	-1.5	-0.7	0.2	11.9	2.4	9.9	15.1	2.6	2.4	2.4	...	22.5
Nonbank financing (net)	4.7	0.7	-0.3	-0.4	-2.9	-1.0	-2.8	1.7	0.3	0.3	0.3	25.0	2.5
Privatization proceeds	30.7	13.5	13.1	5.4	12.1	43.5	44.2	14.5	0.0	0.0	0.0	27.8	14.5
Of which: gas subsidy 2/	22.7	13.5	6.3	5.4	12.1	36.7	37.4	14.5	0.0	0.0	0.0	14.5	14.5
External financing 4/	**27.8**	**5.1**	**15.5**	**5.6**	**32.3**	**48.1**	**58.5**	**11.6**	**14.7**	**13.3**	**14.4**	**54.0**	**54.0**
Gross inflow	34.9	7.2	16.6	7.3	33.5	54.1	64.5	13.6	15.1	15.2	14.8	58.8	58.8
Amortization due	-7.1	-2.1	-1.1	-1.6	-1.2	-6.0	-6.0	-2.0	-0.4	-1.9	-0.4	-4.8	-4.8

Table 2. Armenia: Central Government Operations, 2006–08 (concluded)
(In percent of GDP, unless otherwise specified)

	2006	2007						2008					
	Jan.-Dec.	Q1	Q2	Q3	Q4	Jan.-Dec.		Q1	Q2	Q3	Q4	Jan.-Dec.	
	Act.	Act.	Act.	Act.	Act.	Prog. 1/	Act.	Proj.	Proj.	Proj.	Proj.	Budget	Proj.
Total revenue and grants	**15.8**	**3.6**	**4.1**	**4.5**	**5.9**	**17.5**	**18.0**	**3.3**	**4.2**	**4.9**	**5.4**	**17.8**	**17.7**
Total revenue	15.3	3.4	3.9	4.4	5.5	16.7	17.3	3.2	4.0	4.7	5.0	16.8	16.8
Tax revenue	14.4	3.0	3.7	4.2	5.2	15.6	16.1	3.0	3.8	4.5	4.9	16.3	16.3
Value-added tax	6.2	1.4	1.7	2.1	2.7	…	7.9	…	…	…	…	…	…
Excises	1.5	0.3	0.3	0.6	0.6	…	1.3	…	…	…	…	…	…
Profits, simplified, and presumptive taxes	3.3	0.7	0.9	0.4	0.5	…	2.4	…	…	…	…	…	…
Personal income tax	1.3	0.3	0.3	0.0	0.0	…	1.5	…	…	…	…	…	…
Customs duties	0.7	0.1	0.2	0.2	0.3	…	0.8	…	…	…	…	…	…
Other taxes	1.4	0.2	0.3	0.3	0.4	…	1.3	…	…	…	…	…	…
Nontax revenue	0.3	0.3	0.1	0.1	0.2	0.4	0.6	0.1	0.1	0.1	0.0	0.3	0.2
Capital revenue	0.6	0.1	0.2	0.1	0.2	0.6	0.6	0.1	0.1	0.0	0.1	0.2	0.2
Grants	0.5	0.1	0.1	0.2	0.3	0.9	0.7	0.2	0.2	0.2	0.4	1.0	1.0
Total expenditure	**18.5**	**3.7**	**4.8**	**5.3**	**7.4**	**20.6**	**21.1**	**3.9**	**4.5**	**5.4**	**6.1**	**20.8**	**20.0**
Current expenditure	14.0	2.9	3.5	3.4	4.7	15.1	14.5	3.2	3.3	3.4	4.4	14.9	14.2
Wages	1.9	0.4	0.5	0.5	0.6	1.9	2.0	0.4	0.5	0.6	0.6	2.2	2.1
Subsidies	0.6	0.1	0.2	0.2	0.2	0.7	0.7	0.1	0.1	0.2	0.2	0.6	0.6
Interest	0.3	0.1	0.1	0.1	0.1	0.4	0.3	0.1	0.1	0.1	0.1	0.3	0.3
Transfers	4.7	1.1	1.2	0.8	1.8	5.0	5.0	0.9	0.9	0.8	1.5	4.7	4.5
Of which: pensions	0.7	0.1	0.1	0.1	0.1	0.6	0.6	…	…	…	…	1.5	1.5
gas subsidy 2/	0.9	0.4	0.2	0.2	0.4	1.2	1.2	0.4	0.0	0.0	0.0	0.4	0.4
Goods and services	6.5	1.2	1.6	1.7	2.0	7.1	6.6	1.3	1.7	1.8	2.0	7.1	6.8
Capital expenditure and net lending	4.5	0.8	1.2	1.9	2.7	5.5	6.6	0.8	1.3	1.9	1.8	5.9	5.8
Capital expenditure	3.9	0.6	1.1	1.7	2.5	4.7	5.8	0.6	1.1	1.7	1.6	5.2	5.0
Overall balance with gas subsidy	**-2.7**	**-0.1**	**-0.7**	**-0.7**	**-1.5**	**-3.0**	**-3.1**	**-0.6**	**-0.4**	**-0.5**	**-0.8**	**-3.0**	**-2.2**
Overall balance without gas subsidy	**-1.9**	**0.3**	**-0.5**	**-0.6**	**-1.1**	**-1.8**	**-1.9**	**-0.2**	**-0.4**	**-0.5**	**-0.8**	**-2.6**	**-1.8**
Total revenues of State Fund for Social Insurance (SFSI)	3.8	…	…	…	…	3.8	3.7	…	…	…	…	4.6	4.4
Of which: social contributions	3.0	…	…	…	…	3.1	3.0	…	…	…	…	3.0	2.9
Total expenditure of SFSI	3.4	…	…	…	…	3.4	3.4	…	…	…	…	4.9	4.7
Balance of SFSI	**0.3**	**…**	**…**	**…**	**…**	**0.3**	**0.3**	**…**	**…**	**…**	**…**	**-0.3**	**-0.3**
Overall balance without gas subsidy incl. SFSI	**-1.6**	**…**	**…**	**…**	**…**	**-1.5**	**-1.5**	**…**	**…**	**…**	**…**	**-2.9**	**-2.1**
Overall balance without gas subsidy and SFSI 3/	**-1.9**	**0.3**	**-0.4**	**-0.4**	**-1.3**	**-1.8**	**-1.8**	**-0.2**	**-0.4**	**-0.5**	**-0.8**	**-2.6**	**-1.8**
Deficit/financing (excluding the SFSI)	**2.8**	**0.1**	**0.6**	**0.6**	**1.7**	**3.0**	**3.0**	**0.6**	**0.4**	**0.5**	**0.8**	**3.0**	**2.2**
Domestic financing	1.7	0.0	0.1	0.4	0.7	1.5	1.1	0.3	0.0	0.1	0.4	1.5	0.7
Bank financing	-0.4	-0.5	-0.3	0.2	0.4	0.1	-0.2	-0.2	0.0	0.1	0.4	0.0	0.3
Central Bank of Armenia (net)	-0.5	-0.4	-0.3	0.2	0.0	0.0	-0.5	-0.6	-0.1	0.0	0.3	…	-0.4
Commercial Banks (net)	0.1	0.0	0.0	0.0	0.4	0.1	0.3	0.4	0.1	0.1	0.1	…	0.6
Nonbank financing (net)	0.2	0.0	0.0	0.0	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.7	0.1
Privatization proceeds	1.2	0.4	0.4	0.2	0.4	1.4	1.4	0.4	0.0	0.0	0.0	0.8	0.4
Of which: gas subsidy 2/	0.9	0.4	0.2	0.2	0.4	1.2	1.2	0.4	0.0	0.0	0.0	0.4	0.4
External financing 4/	1.0	0.2	0.5	0.2	1.0	1.6	1.9	0.3	0.4	0.4	0.4	1.5	1.5
Gross inflow	1.3	0.2	0.5	0.2	1.1	1.8	2.1	0.4	0.4	0.4	0.4	1.7	1.6
Amortization due	-0.3	-0.1	0.0	-0.1	0.0	-0.2	-0.2	-0.1	0.0	-0.1	0.0	-0.1	-0.1
Memorandum items													
Underlying primary balance (excl. grants, incl. gas subsidy and SFSI)	-2.5	…	…	…	…	-3.2	-3.2	…	…	…	…	-4.0	-3.2
Primary balance (excl. interest)	-2.4	-0.1	-0.6	…	…	-2.7	-2.7	…	…	…	…	-2.7	-1.9
Government and government-guaranteed debt	18.7	…	…	…	…	17.7	17.6	…	…	…	…	…	16.5
Of which: domestic debt	2.2	…	…	…	…	2.1	2.3	…	…	…	…	…	2.7
Nominal GDP (annual, in billions of drams)	2,657	3,139	3,139	3,139	3,139	3,076	3,139	3,623	3,623	3,623	3,623	3,520	3,623

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

1/ Relative to the budget, the staff presentation reclassifies estimated military wages from Other goods and services to Wages.

2/ Projections based on consumption growth for small and large consumers of 20 and 10 percent respectively in 2007.

3/ Overall balance according to program definitions.

4/ As described in the government decree of 6th April, 2006, N449-N, part of privatization proceeds could include a grant element. Assumed to be disbursed evenly throughout the year.

Table 3. Armenia: Monetary Accounts, 2006–08
(In billions of AMD, unless otherwise indicated)

	2006	2007					2008			
	Dec.	Mar.			Dec.		Mar.	June	Sep.	Dec.
	Act.	Act.	Act.	Act.	Prog. 1/	Act.	Est. 1/	Proj. 1/	Proj. 1/	Proj. 1/
Central Bank of Armenia										
Net foreign assets	321.8	317.8	349.1	383.3	423.4	515.4	423.0	445.6	480.6	560.8
Net international reserves	329.9	326.1	357.3	393.3	433.8	525.6	434.0	457.3	492.8	573.7
Medium and long-term	-8.0	-8.2	-8.2	-10.0	-10.4	-10.3	-11.0	-11.6	-12.3	-12.9
Net domestic assets	-38.8	-53.0	-61.8	-50.3	-50.7	-88.2	-21.2	-19.9	-9.5	4.2
Claims on general government (net)	-57.7	-66.6	-93.8	-87.9	-68.8	-89.8	-111.1	-114.8	-113.2	-102.7
Of which: central government (net)	-16.2	-30.2	-39.9	-32.6	-16.0	-51.5	-72.8	-76.5	-74.9	-64.4
Claims on banks	7.9	15.4	13.3	23.8	24.6	24.6	30.2	30.8	31.4	32.0
KfW	11.9	12.0	12.6	13.2	24.6	14.4	15.2	15.8	16.4	17.0
Monetary instruments (net) excluding CBA bills	-4.0	3.4	0.7	10.5	0.0	10.2	15.0	15.0	15.0	15.0
CBA bills	-39.0	-52.1	-45.3	-49.9	-50.3	-49.0	-34.9	-38.2	-31.5	-31.5
Other items (net)	50.0	50.4	64.0	63.7	43.8	25.9	94.6	102.3	103.8	106.4
Reserve money	283.0	264.8	287.3	333.0	372.6	427.1	401.7	425.7	471.1	565.1
Currency issue	226.8	216.1	241.9	278.6	326.8	350.3	330.2	354.5	392.0	471.5
Deposits	56.2	48.7	45.5	54.4	45.8	76.8	71.6	71.2	79.1	93.6
Banking system										
Net foreign assets	332.5	322.9	353.4	353.3	415.5	369.6	334.6	339.9	352.6	405.6
Net domestic assets	153.2	160.0	169.7	228.6	237.3	321.8	351.1	392.4	438.7	507.0
Claims on government (net)	-31.8	-42.3	-70.1	-64.0	-40.5	-54.0	-60.2	-61.3	-57.4	-44.4
Of which: claims on central government (net)	9.7	-5.8	-16.3	-8.8	12.2	-15.7	-22.0	-23.1	-19.1	-6.2
Claims on rest of the economy	241.5	271.6	306.3	371.2	360.5	429.8	490.9	533.8	612.1	688.3
Other items (net)	-56.4	-69.3	-66.5	-78.6	-82.6	-54.0	-79.6	-80.0	-116.0	-136.9
Broad money	485.7	482.9	523.0	581.9	652.8	691.3	685.8	732.3	791.4	912.6
Currency in circulation	211.5	201.7	227.0	260.3	306.8	326.0	305.2	329.5	368.0	433.5
Deposits	274.3	281.3	296.0	321.6	346.0	365.3	380.6	402.7	423.4	479.1
Domestic currency	130.9	145.4	158.4	186.3	208.9	235.0	248.9	273.1	293.6	349.5
Foreign currency	143.4	135.8	137.6	135.3	137.1	130.3	131.7	129.6	129.8	129.6
Memorandum items										
Exchange rate (in drams per U.S. dollar, end of period)	363.5	362.1	341.0	335.8	...	304.2	...	...	...	...
Program e-rate	...	...	...	...	357.0	...	304.2	304.2	304.2	304.2
NIR (in millions of U.S. dollars) 2/	837.4	821.9	997.2	1,113.3	...	1,426.4	...	...	...	...
NIR (in millions of U.S. dollars) 3/	812.2	819.7	990.5	1,096.2	1,157.7	1,403.7	1,371.7	1,444.8	1,560.5	1,825.1
NDA of the CBA (in billions of drams) 4/	-115.6	-48.5	-78.2	-74.5	-50.7	-95.5	-21.2	-19.9	-9.5	4.2
12-month change in reserve money (in percent)	41.1	40.0	44.3	37.3	31.7	50.9	51.7	48.2	41.5	32.3
12-month change in broad money (in percent)	32.9	34.7	41.1	33.0	34.4	42.3	42.0	40.0	36.0	32.0
12-month change in private sector credit (in percent)	28.2	34.7	39.8	30.1	49.3	78.0	80.8	74.3	64.9	60.2
Velocity of broad money (end of period)	5.5	5.6	5.3	5.1	4.7	4.5	4.6	4.5	4.3	4.0
Money multiplier	1.7	1.8	1.8	1.7	1.8	1.6	1.7	1.7	1.7	1.6
Dollarization in bank deposits 5/	52.3	48.3	46.5	42.1	39.6	35.7	34.6	32.2	30.7	27.0
Dollarization in broad money 6/	29.5	28.1	26.3	23.3	21.0	18.9	19.2	17.7	16.4	14.2
Currency in circulation in percent of deposits	77.1	71.7	76.7	80.9	88.7	89.2	80.2	81.8	86.9	90.5
Stock of FCD (in millions of USD)	394.5	375.1	403.6	401.4	421.8	428.4	432.8	426.0	426.6	426.0
Banking system financing of the central government (cumulative)	-19.4	-15.6	-26.0	-18.5	2.5	-25.5	-6.2	-7.3	-3.3	9.6

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

1/ At program exchange rate of 357 dram per U.S. dollar for 2007 and 304.22 dram per U.S. dollar for 2008.

2/ At actual exchange rates, excluding the Special Privatization Account and foreign currency reserve money.

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

4/ Defined as reserve money minus NIR plus medium- and long-term liabilities.

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

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

Table 4. Armenia: Balance of Payments, 2005–11
(In millions of U.S. dollars, unless otherwise indicated)

	2005 1/	2006 1/	2007	2008	2009	2010	2011
			Projections				
Current account	-51	-117	-571	-799	-884	-974	-1,093
Trade balance	-588	-896	-1,607	-2,125	-2,404	-2,614	-2,814
Exports, fob	1,005	1,025	1,200	1,384	1,550	1,736	1,927
Imports, fob	-1,593	-1,921	-2,807	-3,509	-3,954	-4,349	-4,741
Services (net)	-120	-130	-192	-205	-213	-252	-272
Credits	411	485	526	621	696	779	873
Debits	-531	-615	-718	-826	-909	-1,031	-1,145
Income (net)	133	215	299	354	378	405	429
Transfers (net)	524	694	929	1,177	1,355	1,487	1,564
Private	458	614	834	1,135	1,327	1,460	1,562
Official	66	80	94	43	28	27	2
Capital and financial account	190	558	1,172	1,161	1,263	1,327	1,392
Capital transfers (net)	73	86	139	125	138	122	141
Foreign direct investment (net)	233	450	664	690	766	842	918
Of which : Privatization/debt swap	57	75	0	0	0	0	0
Retained earnings/new investment	175	375	664	690	766	842	918
Portfolio investment (net)	-2	9	9	0	0	0	0
Public sector (net)	36	68	133	166	170	167	135
Disbursements	50	83	149	181	191	191	162
Of which : World Bank program support	...	20	...	...	...	...	...
Amortization	-14	-16	-17	-14	-21	-24	-27
Other capital (net)	-151	-55	227	180	189	196	198
Errors and omissions	4	-16	-41	0	0	0	0
Overall balance	142	426	559	362	380	353	299
Financing	-141	-426	-597	-386	-380	-353	-299
Gross international reserves (increase: -)	-120	-405	-585	-361	-358	-333	-279
Use of Fund credit, net	-24	-21	-14	-26	-23	-22	-22
Disbursements	10	10	10	...	...	...	...
Repurchases/repayments	-33	-31	-24	-26	-23	-22	-22
Exceptional financing 2/	1	1	1	1	2	2	2
Financing gap	...	...	38	24	0	0	0
IMF	...	...	10	5	0	0	0
World Bank	...	...	28	19	0	0	0
Memorandum items:							
Current account (in percent of GDP)	-1.0	-1.8	-6.2	-6.7	-6.5	-6.3	-6.2
Trade balance (in percent of GDP)	-12.0	-14.0	-17.5	-17.8	-17.6	-16.8	-16.0
Gross international reserves (end of period)	667	1072	1657	2018	2376	2709	2988
In months of next year's imports	3.2	3.6	4.6	5.0	5.3	5.5	5.6
Merchandise export growth, percent change	36.1	2.0	17.0	15.3	12.0	12.0	11.0
Merchandise import growth, percent change	33.1	20.6	46.1	25.0	12.7	10.0	9.0
Nominal external debt 3/	1,099	1,206	1,582	1,652	1,718	1,780	1,852
Nominal external debt stock (in percent of GDP) 3/	22	19	17	14	13	11	11
NPV of external debt in percent of exports 4/	60	72	67	62	58	55	53
External debt service in percent of exports 3/	5.7	9.2	8.0	7.1	6.7	6.3	6.1

Sources: Armenian authorities; and Fund staff estimates.

1/ Starting from 2004, BOP figures were revised to reflect non-bank private transfers in the current account. In 2005 and previous years, nonbank private transfers are reported in the financial account.

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

3/ Starting from 2006, based on government, government-guaranteed, and private sector medium- and long-term debt.

Table 5. Armenia: Status of Measures Under the Sixth Review

Item	Measure	Proposed Time Frame (End of Period)	Type of Conditionality	Status
	Tax policy			
1	Submit to parliament the general part of the unified tax code.	December 2007	Structural Benchmark	Observed
2	Submit legislation to parliament limiting access to the simplified tax regime to the retail and household services sectors.	December 2007	Structural Performance Criterion	Observed
3	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 rate on these products by at least 10 percent.	December 2007	Structural Benchmark	Observed
	Tax administration			
4	Submit to parliament legislation to change the filing process by conducting cameral audits as part of the audit (not filing) program	December 2007	Structural Performance Criterion	Observed
5	Issue an order to eliminate recording commissions effective September 2008.	December 2007	Structural Performance Criterion	Observed
6	Strengthen the IT capacity of the State Tax Service (STS):			
	(i) Start the pilot testing of risk-based software for VAT refunds.	October 2007	Structural Benchmark	Observed
	(ii) Implement the automated risk-based audit selection system.	December 2007	Structural Benchmark	Observed
	Financial sector			
7	Submit to parliament legislation allowing asset securitization and issuance of mortgage-backed securities.	December 2007	Structural Benchmark	Observed
8	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	Observed

Table 6. 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.	
	Prog.	Actual 2/	Prog.	Actual 3/	Prog. 2/	Actual 2/	Prog. 3/	Actual 3/	Prog. 2/	Actual 2/	Prog. 3/	Prel. 3/
Net domestic assets of the CBA 4/	-32.0	-55.4	-19.8	-115.6	-52.2	-48.5	-50.5	-78.2	-35.5	-74.5	-50.7	-95.5
Net banking system credit to the government	7.1	-3.8	-3.9	-31.8	-30.6	-42.3	-36.3	-70.1	-32.7	-64.0	-40.5	-54.0
Domestic arrears of the central government	0	0	0	0	0	0	0	0	0	0	0	0
Tax revenues of the central government (floor) 2/ 5/	259.1	268.8	378.1	383.8	93.4	94.2	204.2	210.0	326.4	342.3	479.3	504.3
Balance of the central government on a cash basis (floor) 5/	-48.5	-31.8	-60.2	-50.4	-14.0	9.8	-32.8	-1.8	-43.0	-14.5	-56.5	-56.1
Reserve money (band/level) 2/	(216-225)	231.1	(246-256)	283.0	(265-276)	264.8	(276-288)	287.3	(311-324)	333.0	(366-381)	427.1
Contributions to the State Fund for Social Insurance 2/ 5/	52.4	52.6	74.0	73.3	17.1	18.7	37.7	39.7	59.0	61.0	82.1	85.1
Contracting or guaranteeing of new nonconcessional external debt 5/ 6/	0	0	0	0	0	0	0	0	0	0	0	0
External arrears (continuous criterion)	0	0	0	0	0	0	0	0	0	0	0	0
Net official international reserves (floor)	543.9	528.0	577.2	812.2	877.6	819.7	910.6	990.5	967.8	1096.2	1157.7	1403.7

1/ All items as defined in the Technical Memorandum of Understanding.
2/ Indicative target.
3/ Performance criterion.
4/ At program exchange rates (500 dram per U.S. dollar in 2005, 450 dram per U.S. dollar in 2006, and 357 dram per dollar in 2007).
5/ Cumulative flow from the beginning of the calendar year until the end of the month indicated.
6/ 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 7. Armenia: Indicators of Fund Credit, 2003–11
(In units indicated)

	2003	2004	2005	2006	2007	2008	2009	2010	2011
					Projections				
Existing and prospective Fund oustanding 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	19.4	12.9	10.6	8.9	6.6	4.8	3.5	2.3
In percent of external debt	18.4	17.6	16.6	13.3	9.7	8.0	6.3	4.9	3.5
In percent of gross reserves	40.3	38.0	27.3	14.9	9.2	6.5	4.6	3.2	2.2
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	144.4	140.1	123.4	108.8	99.9	82.9	67.7	53.6	39.1
In percent of exports 2/	22.4	19.4	12.9	10.6	8.9	6.3	4.6	3.3	2.1
In percent of external debt	18.4	17.6	16.6	13.3	9.7	7.7	6.0	4.6	3.2
In percent of gross reserves	40.3	38.0	27.3	14.9	9.2	6.3	4.4	3.0	2.0
In percent of quota	157.0	152.3	134.2	118.3	108.6	90.1	73.6	58.2	42.5
Prospective Fund outstanding credit 1/									
In millions of SDRs	…	…	…	…	…	3.3	3.3	3.3	3.3
In percent of exports 2/	…	…	…	…	…	0.3	0.2	0.2	0.2
In percent of external debt	…	…	…	…	…	0.3	0.3	0.3	0.3
In percent of gross reserves	…	…	…	…	…	0.3	0.2	0.2	0.2
In percent of quota	…	…	…	…	…	3.6	3.6	3.6	3.6
Repurchases, repayments, and charges due from existing and prospective drawings									
In millions of SDRs	…	…	…	…	…	17.5	15.6	14.5	14.7
In percent of exports 2/	…	…	…	…	…	1.3	1.1	0.9	0.8
In percent of external debt	…	…	…	…	…	1.6	1.4	1.2	1.2
In percent of gross reserves	…	…	…	…	…	1.3	1.0	0.8	0.8
In percent of quota	…	…	…	…	…	19.1	16.9	15.7	16.0
Repurchases and charges due from existing drawings									
In millions of SDRs	…	…	…	…	…	17.5	15.6	14.4	14.7
In percent of exports 2/	…	…	…	…	…	1.3	1.1	0.9	0.8
In percent of external debt	…	…	…	…	…	1.6	1.4	1.2	1.2
In percent of gross reserves	…	…	…	…	…	1.3	1.0	0.8	0.8
In percent of quota	…	…	…	…	…	19.0	16.9	15.7	15.9
Repurchases and charges due from prospective drawings									
In millions of SDRs	…	…	…	…	…	0.0	0.0	0.0	0.0
In percent of exports 2/	…	…	…	…	…	0.0	0.0	0.0	0.0
In percent of external debt	…	…	…	…	…	0.0	0.0	0.0	0.0
In percent of gross reserves	…	…	…	…	…	0.0	0.0	0.0	0.0
In percent of quota	…	…	…	…	…	0.0	0.0	0.0	0.0

Sources: Armenian authorities; and Fund staff estimates.

1/ End of period stocks.
2/ Exports of goods and services.

Table 8. Armenia: Medium-Term Macroeconomic Framework, 2006–11

	2006	2007	2008	2009	2010	2011
			Projections			
	(In percent of GDP, unless otherwise specified)					
National income and prices						
Real GDP growth (percent change)	13.3	13.7	10.0	8.0	7.0	6.0
Gross domestic product (in millions of U.S. dollars)	6,388	9,177	11,908	13,678	15,576	17,570
Gross national income per capita (in U.S. dollars)	2,050	2,918	3,757	4,286	4,848	5,433
CPI inflation, end-of-period (annual percent change)	5.2	6.6	6.8	5.0	4.0	4.0
Investment and saving						
Investment	33.6	34.8	34.4	34.8	35.3	35.3
Government	3.9	5.8	5.0	5.0	5.0	5.0
Other	29.6	29.0	29.4	29.8	30.3	30.3
National savings	31.7	28.6	27.7	28.3	29.0	29.1
Government	2.0	4.0	3.2	2.8	2.8	3.0
Other	29.7	24.6	24.5	25.6	26.2	26.1
Government operations						
Revenue and grants	15.8	18.0	17.7	18.1	18.1	18.3
Of which: tax revenue	14.4	16.1	16.3	16.7	17.2	17.6
grants 1/	0.5	0.7	1.0	0.8	0.5	0.3
Expenditure 2/	17.7	19.9	19.6	20.3	20.3	20.4
Of which: social expenditure 3/	6.0	6.3	7.0	7.0	7.0	7.0
Current expenditure	13.1	13.3	13.8	14.7	14.7	14.7
Capital expenditure	3.9	5.8	5.0	5.0	5.0	5.0
Net lending	0.6	0.7	0.7	0.7	0.7	0.7
Overall balance (including grants)	-1.9	-1.9	-1.8	-2.2	-2.1	-2.0
Domestic financing	0.9	-0.1	0.3	0.7	0.7	1.0
External financing	1.0	1.9	1.5	1.6	1.4	1.1
Government and government-guaranteed debt	18.7	17.6	16.5	14.6	13.6	12.2
External sector						
Exports of goods and services	23.6	18.8	16.8	16.4	16.1	15.9
Imports of goods and services	39.7	38.4	36.4	35.5	34.5	33.5
Current account (in percent of GDP)	-1.8	-6.2	-6.7	-6.5	-6.3	-6.2
Current account (in millions of U.S. dollars)	-117	-571	-799	-884	-974	-1,093
Capital and financial account (in millions of U.S. dollars)	558	1172	1161	1263	1327	1392
Of which: direct foreign investment	450	664	690	766	842	918
public sector disbursements	83	149	181	191	191	162
Change in gross international reserves (in millions of U.S. dollars) 4/	-405	-585	-361	-358	-333	-279
Arrears and debt relief (in millions of U.S. dollars)	1	1	1	2	2	2
Financing/gap (in millions of U.S. dollars)	0	38	24	0	0	0
Of which: IMF	0	10	5	0	0	0
World Bank	0	28	19	0	0	0
Gross international reserves in months of imports	3.6	4.6	5.0	5.3	5.5	5.6

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

1/ For 2007–09, the figures include projections for disbursements under the U.S. Millennium Challenge Account.

2/ Not including the gas subsidy.

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

4/ A negative figure indicates an increase.

Table 9. Armenia: Financial Soundness Indicators for the Banking Sector, 2003–07
(In percent, unless otherwise indicated)

	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
	2003	2004	2005	2006				2007			
Capital adequacy											
Total regulatory capital to risk-weighted assets	33.8	32.3	33.7	33.8	33.7	35.3	34.9	35.3	32.7	31.4	30.1
Tier I regulatory capital to risk-weighted assets	32.2	30.2	31.7	31.6	30.0	31.4	32.7	33.4	31.4	30.2	29.0
Capital (net worth) to assets	18.1	17.8	21.5	21.3	22.0	24.3	22.9	23.2	23.9	22.3	22.5
Asset composition											
Sectoral distribution of loans (billions of drams)											
Industry (excluding energy sector)	19.0	29.0	30.4	33.5	34.6	34.0	34.3	39.4	43.0	47.8	49.1
Energy sector	10.7	6.6	8.7	6.3	8.3	7.2	5.0	5.4	6.4	10.1	7.2
Agriculture	8.2	8.6	11.3	12.1	13.3	11.6	14.2	16.4	18.1	19.0	22.4
Construction	4.8	5.3	7.9	8.5	8.2	9.8	11.5	13.1	14.8	17.4	22.0
Transport and communication	0.7	1.2	3.7	4.1	4.9	3.7	3.9	4.2	4.5	4.4	5.8
Trade/commerce	21.5	31.1	42.2	44.0	47.1	49.7	49.6	55.4	60.3	75.5	86.8
Sectoral distribution of loans to total loans (percent of total)											
Industry (excluding energy sector)	20.1	22.2	17.0	17.5	16.6	16.1	16.2	15.4	14.8	13.5	11.9
Energy sector	11.4	5.0	4.8	3.3	4.0	3.4	2.3	2.1	2.2	2.9	1.7
Agriculture	8.6	6.6	6.3	6.3	6.4	5.5	6.7	6.4	6.2	5.4	5.4
Construction	5.1	4.0	4.4	4.5	3.9	4.6	5.5	5.1	5.1	4.9	5.3
Transport and communication	0.7	0.9	2.0	2.1	2.4	1.8	1.9	1.6	1.5	1.2	1.4
Trade/commerce	22.7	23.8	23.5	23.0	22.7	23.5	23.4	21.7	20.7	21.4	21.1
Foreign exchange loans to total loans	72.7	70.4	63.7	64.6	59.8	57.5	52.8	46.3	42.5	42.3	40.7
Asset quality											
Nonperforming loans (billions of drams)	6.7	3.1	3.8	6.5	6.6	9.1	6.0	7.3	8.6	10.6	10.3
Watch (up to 90 days past due)	4.9	1.5	2.9	4.9	4.6	5.6	3.6	5.4	5.5	7.0	5.8
Substandard (91-180 days past due)	0.9	0.4	0.5	1.2	1.4	2.5	1.0	1.1	2.1	2.2	1.3
Doubtful (181-270 days past due)	0.9	1.1	0.5	0.5	0.6	1.0	1.4	0.9	0.9	1.4	3.1
Loss (>270 days past due)	11.6		0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Nonperforming loans to gross loans	5.4	2.1	1.9	3.1	3.0	4.0	2.5	2.8	2.8	2.9	2.4
Provisions to nonperforming loans	34.3	77.0	70.7	48.7	51.5	43.7	64.3	54.7	54.4	53.8	66.6
Spread between highest and lowest rates of interbank borrowing in AMD	2.6	2.0	3.7	1.5	2.0	0.5	3.0	1.4	1.3	1.3	0.5
Spread between highest and lowest rates of interbank borrowing in foreign currency	3.7	1.0	1.0	0.0	1.3	0.5	2.3	0.0	N/A	0.0	0.0
Earnings and profitability											
ROA (profits to period average assets)	2.7	3.2	3.1	3.6	3.6	3.8	3.6	3.5	3.6	3.8	3.4
ROE (profits to period average equity)	14.4	18.4	15.5	16.6	16.6	17.2	15.9	15.2	15.6	16.7	15.0
Interest margin to gross income	42.0	44.2	41.1	48.8	49.6	46.9	47.1	48.6	49.1	48.6	47.9
Interest income to gross income	62.7	63.7	59.8	70.0	70.2	66.3	66.3	69.9	69.6	69.0	68.6
Noninterest expenses to gross income	48.5	46.5	49.7	45.3	45.9	43.3	45.1	45.5	44.3	43.2	44.5
Liquidity											
Liquid assets to total assets	47.5	47.1	44.2	44.7	40.8	42.3	41.2	41.0	36.7	34.7	33.7
Liquid assets to total short-term liabilities	101.3	98.7	110.5	110.3	105.9	104.5	106.1	109.9	98.6	93.7	98.2
Customer deposits to total (non-interbank) loans	177.1	177.3	140.5	142.5	121.2	121.1	130.8	119.3	118.3	105.9	106.2
Foreign exchange liabilities to total liabilities	73.2	73.3	66.8	68.2	64.5	59.3	56.0	52.4	51.0	48.7	48.3
Sensitivity to market risk											
Gross open positions in foreign exchange to capital	13.8	7.4	4.9	4.3	3.9	11.9	4.4	4.3	4.8	5.5	8.8

Source: Central Bank of Armenia.

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

(In percent of total population, unless otherwise indicated)

	1990	1998/99	2000	2003	2004	2005	2006 (prel.)	2015 Target
1 Eradicate extreme poverty and hunger								
Population below $2.15 (PPP) a day 1/	...	35.8	...	...	...	...	...	...
Overall poverty rate	...	56.1	50.9	42.9	34.6	29.8	26.5	19.7
Rural poverty	...	48.2	45.7	47.5	31.7	28.3	23.4	...
Extreme poverty	...	21	16.2	7.4	6.4	4.6	4.1	4.1
Prevalence of child malnutrition (in percent of children under 5)	...	3.3	2.6	...	...	...	...	1.4
2 Achieve universal primary education								
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
3 Promote gender equality								
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	...	...	...
4 Reduce child mortality								
Under 5 mortality rate (per 1,000)	60.0	47.0	37.0	35.0	32.0	29.0	...	20.0
Infant mortality rate (per 1,000 live births)	26.0	...	33.0	30.0	29.0	26.0	...	8.7
Immunization, measles (in percent of children under 12 months)	94.8	91.0	92.0	94.0	92.0	94.0	...	...
5 Improve maternal health								
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	...	...	98.0	...	...
6 Combat HIV/AIDS, malaria and other diseases								
Prevalence of HIV, female (in percent of group ages 15-24)	...	0.0	0.2	0.1	0.1	0.1	...	Stabilize
Incidence of tuberculosis (per 100,000 people)	26.3	39.2	63.5	70.1	71.0	71.0	...	and
Tuberculosis cases detected under DOTS (in percent)	...	8.0	51.4	43.3	48.0	60.0	...	reduce
7 Ensure environmental sustainability								
Nationally protected areas (in percent of total land area)	...	7.4	7.6	7.6	...	...	...	...
GDP per unit of energy use (PPP $ per kg oil equivalent)	…	3.5	3.3	4.8	5.0	...	...	...
CO2 emissions (metric tons per capita)	…	1.0	1.1	...	...	...	...	...
Access to an improved water source (% of population)	...	...	...	92.0	...	...	...	...
Access to improved sanitation (% of population)	...	...	...	83.0	...	...	...	...
8 Develop a Global Partnership for Development								
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	...	...	...
General indicators								
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	1.0	...	...
Life expectancy at birth (years)	71.7	73.0	73.6	74.8	75	73	...	...
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. Republic of Armenia: Letter of Intent

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

March 18, 2008

Dear Mr. Strauss-Kahn:

1. In May 2005, the International Monetary Fund approved a three-year Poverty Reduction and Growth Facility (PRGF) arrangement for Armenia. In the subsequent three years, we have achieved a lot: a significant reduction in poverty (from 35 percent in 2004 to 26.5 percent in 2006), along with double-digit growth, single-digit inflation, a prudent fiscal policy, and overall macroeconomic stability. In addition, with the help of the IMF, we have made substantial progress with fiscal and financial sector reforms.

2. Looking forward, a number of challenges remain, and we plan to address them vigorously in the period ahead. First, we need to further reduce poverty, since more than a quarter of Armenia's population is still living below the poverty line. Second, we need to make growth sustainable by diversifying our economy, since recent economic growth has been driven mainly by construction and services. Third, we need to continue to manage large foreign exchange inflows, while preserving external competitiveness and macroeconomic stability. Fourth, we need to strengthen our medium-term fiscal framework to enhance the effectiveness of fiscal policy and improve expenditure management, and at the same time facilitate the coordination of fiscal and monetary policies. Fifth, we need to broaden the tax revenue base, which is still low in spite of notable progress in the past year. Sixth, we need to further develop the financial sector so as to deepen financial intermediation and strengthen the monetary transmission mechanism. Seventh, we need to proceed with "second-generation reforms" to improve governance, accountability, and the business climate, so as to reduce the cost of doing business and raise productivity. These measures will also contribute to reduce our large shadow economy. Finally, we need to increase domestic competition, so as to ensure that consumers will benefit from dram appreciation through lower import prices.

3. Given the prospects for continued real appreciation pressures resulting from large foreign exchange inflows and potential inflationary shocks, we are committed to further tightening both monetary and fiscal policy in 2008, as needed. We will continue to target an inflation rate of 4 percent (+/- 1.5 percent), while maintaining a flexible exchange rate regime. In order to better anchor inflation expectations, we have committed to multi-year target over the 2008-10 period. While our 2008 budget targets a fiscal deficit of 2.6 percent,

we will aim at keeping the actual deficit lower, including by continued efforts to strengthen tax administration. In this connection, we also plan to complete a major organizational restructuring of the State Tax Service by mid-2009.

4. We have met all quantitative targets, structural performance criteria, and benchmarks for end-December 2007, as detailed in our most recent Memorandum of Economic and Financial Policies. Only the indicative target on reserve money was exceeded owing to higher-than-expected foreign exchange intervention in the fourth quarter to offset large-scale foreign inflows related to substantial increases in bank capital.

5. In light of our strong performance and our continued commitment to macroeconomic stability and structural reform, we request hereby the completion of the sixth and final review under the PRGF arrangement and the disbursement of SDR 3.32 million. Further, we grant our permission for the publication on the IMF's website of the staff report and this letter.

6. Finally, we would like to express our interest in negotiating a new Fund arrangement later this year. To this end, we are currently updating our Poverty Reduction Strategy Paper.

Sincerely yours,

/sgd/

Serge Sargsyan
Prime Minister
Republic of Armenia

/sgd/

Vartan Khachatryan
Minister of Finance and Economy
Republic of Armenia

/sgd/

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

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Informational Annex

Prepared by Middle East and Central Asia Department

May 6, 2008

Contents Page

I. Relations with the Fund....2
II. Relations with the World Bank....7
III. Relations with the EBRD....15
IV. Statistical Issues....17

ANNEX I. ARMENIA: RELATIONS WITH THE FUND
(As of March 31, 2008)

Mission: Program discussions were held in Yerevan, March 6–17, 2008.

Country interlocutors: The mission met with president-elect Mr. S. Sargsyan (Prime Minister), Mr. Khachatryan (Minister of Finance and Economy), Mr. Yeritsyan (Minister of Trade and Economic Development), Mr. T. Sargsyan (Chairman of the Central Bank), other senior officials, and representatives of the donor community and civil society.

Staff team: Ms. Castello-Branco (head), Ms. Dabla-Norris, Mr. Floerkemeier (all MCD), Mr. Gonçalves (PDR), and Mr. Gracia (FAD). Ms. Oomes (resident representative), Ms. Manookyan and Mr. Stepanyan (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. **General Resources Account:**	**SDR Million**	**Percent of Quota**
Quota	92.00	100.00
Fund holdings of currency	92.00	100.01

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Holdings	4.55	n.a.

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
PRGF arrangements	98.24	106.78

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	05/25/2005	05/24/2008	23.00	19.68
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 [1/]

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

	Forthcoming				
	2008	2009	2010	2011	2012
Principal	15.37	15.19	14.13	14.44	14.75
Charges/interest	0.46	0.38	0.31	0.24	0.17
Total	15.83	15.57	14.44	14.68	14.92

[1/] 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. 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 Status	Document Number
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	...
Data ROSC module	April 2008	...	...

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
Fiscal Affairs Department (FAD)			
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—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
Tax administration reform	Short-term	October 31 – November 13, 2007	MFE, STS
Revenue Administration	Short-term	January 1 – 22, 2008	MFE, STS
Revenue Administration	Short-term	April 1 -12, 2008	MFE, STS
Legal Department			
Tax legislation		September 1, 2004–December 31, 2005	
Legislation Development & FIU		July 31–August 7, 2006	
Unified Tax Code		June 16—23, 2007	MFE
Monetary and Capital Markets Department			
Banking system issues	Short-term	April 15–19, 2002	CBA
Banking system, deposit insurance, foreign exchange market development, and CBA monetary operations.	Short-term	June 24–July 4, 2002	CBA
Unified financial supervision, mortgage financing markets and inflation targeting	Short-term	January 26–February 6, 2004	CBA
Financial sector assessment program update	Short-term	February 16–March 4, 2005	CBA
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	
Inflation Targeting, Foreign Exchange Market Development and Responding to Dedollarization	Short-term	August 29—September 10, 2007	CBA
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	

ANNEX II. ARMENIA: RELATIONS WITH THE WORLD BANK
(March 31, 2008)

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. The World Bank has also supported the rehabilitation of 12 courthouses and the installation of an automated case management system.

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.

On tax administration, the government strengthened the operation of Large Tax Payers Unit (LTPU), which should help to reduce the stock of VAT refunds owed to exporters and ensure that no additional VAT arrears will be 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 were at the core of the PRSC III, in particular implementation of self-assessment systems; adherence to reforms for the Large Taxpayer Unit; completion, implementation and expansion of DTI facilities in major customs and implementation of intelligence-based system based on risk assessment. **PRSC-IV** supports the next phase of reforms. A series of measures have been adopted aimed at promoting the development of the self-assessment system. A separate division for taxpayer service has been established within the STS headquarters and the capacity built up **PRSC-IV** also supports building institutional capability in specialized audits and a national audit strategy was approved. Under PRSC-IV, annual action plans were developed to improve the performance of tax inspectorates servicing large taxpayers.

C. Energy and Infrastructure

4. 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.

5. 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. The World Bank has supported an innovative public-private partnership in water supply, which has substantially increased reliable water supply throughout the country (70% of Yerevan now has 24 hour service). The government has adopted a schedule for irrigation tariff increases in order to move closer to full cost recovery in the irrigation system. 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

6. 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. Later in 2006, during the second phase of the reforms, in the scope of the staff optimization and social assistance program approximately 3,200 new redundant teachers have been registered and were provided with different type of social assistance. 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, by 16.1 percent in 2006, and by 27.0 percent in 2007. 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 upper secondary education in the framework of the high school consolidation program, strengthening the strategy for teacher education and ongoing professional development,

introduction of new mechanisms of higher education financing and establishment of a national quality assurance framework, enhancement of standards for higher education to make it more responsive to employers' needs, improving preschool systems and increasing enrollment rate, and strengthening monitoring and financial reporting of the noncommercial organizations (NCOs) in the education sector.

7. 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 is required. In addition, in 2006 the Government adopted a regional hospital optimization/modernization plan, aimed at improving efficiency and productivity of outpatient services in regions. The consolidation of regional hospitals in smaller networks is in the process. 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.

8. Implementation progress has been satisfactory and about 200 hospital accountants have been trained in new accounting procedures. All public hospitals use updated financial management and accounting procedures. The government cleared all accumulated arrears in the health sector. Furthermore, the level of public financing in health sector has been continuously increasing as projected under the MTEF The government also adopted a decision to introduce further reforms in the Basic Benefit Package in the health sector. The Government strategy for increasing revenues in the short term is to not expand the benefits package but to raise the reimbursement rates to reduce the gap with the cost of services. The government undertook measures for increasing financing of the Primary Health Care in order to secure access to quality basic health services, in particular for the poor and in rural areas. 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

9. 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.

10. The Government of Armenia is in the process of designing a new pension system. In August 2007 the Government prepared a new Draft Framework Law on Pension Reform in Armenia which defines benefits and beneficiaries of pillars zero and pillar one and the accumulation phase of the mandatory accumulation system. The draft pension reform concept would also involve the mandatory introduction of a second pillar for those above 30 years of age financed by an add-on contribution rate, a flat-benefit budget-financed first pillar and a universal zero-pillar for those that did not contribute to the system. Prior to the Law enactment, the fiscal and social impact of the selected design of the pension system is being assessed and compared to alternative solutions. A Pension Task Force has been established in the Government to analyze these issues.

II. LENDING

11. World Bank lending to Armenia as of March 31, 2008 totals US$ 1,061 million, of which US$1,026 million has been disbursed. The current Bank portfolio consists of 19 IDA credits and 2 GEF projects, for a total commitment of $315,4 million, of which $211,8 million is disbursed. All projects in the Bank's portfolio are rated as satisfactory. In FY08, one investment operation—Irrigation Development: Additional—was approved in July 2007 for $5 million and one development policy operation—PRSC-IV for $18.5 million – was approved in November 2007.

12. 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 $60 million per year in FY06-08. 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.

13. 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 PRSCs' preparation was 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 disbursed in April 2007. The fourth PRSC in the amount of US$18.5 million was presented to the Board presentation November 2007 and fully disbursed in March 2008.

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 03/31/08	Approval Date	Closing Date
Active Projects		***315.4***	***211.8***		
1.	Irrigation dam safety	26.6	28.2	06/24/99	12/31/08
2.	Irrigation development	29.9	33.3	08/30/01	03/31/09
3.	Social protection admin.	5.2	3.9	06/10/04	12/31/07
4.	Natural resource management	8.3	9.0	06/04/02	01/31/09
5.	Natural resource management (GEF)	5.1	3.8	06/04/02	01/31/09
6.	Educ. qual. & relevance (APL #1)	19.0	15.1	01/20/04	11/30/08
7.	Municipal water and WW	23.0	20.9	05/04/04	02/28/09
8.	Health system mod.	19.0	16.5	06/10/04	06/30/09
9.	Irrigation dam safety 2	6.8	4.5	06/10/04	03/31/09
10.	Public sector mod.	10.2	3.7	05/04/04	03/31/09
11.	Rural Enterprise & small scale	20.0	9.7	07/07/05	05/31/10
12.	Urban Heating Project	15.0	11.0	07/12/05	06/30/10
13.	Yerevan water/waste water services	20.0	6.7	02/24/05	02/28/11
14.	Renewable Energy Project	5.0	2.4	03/29/06	12/31/10
15.	Renewable Energy Project (GEF)	3.0	0.7	03/29/06	12/31/10
16.	Avian Influenza Prep. Project	6.3	3.3	06/02/06	07/31/09
17.	SIF III	25.0	13.6	10/26/06	30/06/11
18.	Health system mod (APL-II)	22.0	1.6	03/08/07	12/31/12
19.	Judicial reform II	22.5	4.5	03/08/07	12/31/12
20.	Irrigation Development - Additional	5.0	0.0	07/31/07	3/31/09
21.	PRSC IV	18.5	19.4	11/27/07	06/30/08
Completed Projects		***746.0***	***814.0***		
22.	Economic rehabilitation	60.0	61.1	02/28/95	06/30/96
22.	SAC	60.0	60.3	02/29/96	12/31/97
23.	Institution building	12.0	10.7	03/30/93	11/30/97
24.	Earthquake rehabilitation	28.0	28.4	02/01/94	06/30/97
25.	Power maintenance	13.7	13.6	12/08/94	06/30/99
26.	SAC II	60.0	67.7	08/26/97	06/30/99
27.	SATAC I	3.8	3.0	02/29/96	06/30/00
28.	Highway	31.0	32.0	09/14/95	12/31/00
29.	Social Investment Fund	12.0	12.1	11/09/95	12/31/00
30.	Irrigation rehabilitation	43.0	42.7	12/08/94	05/31/01
31.	SAC III	65.0	72.5	12/22/98	06/30/01
32.	Enterprise development	16.8	17.4	12/24/96	07/01/02
33.	SATAC II	5.0	5.2	08/26/97	12/31/02
34.	Education	15.0	17.4	11/20/97	10/31/02
35.	SAC IV	50.0	60.3	05/22/01	03/31/03
36.	Health	10.0	11.2	07/29/97	12/30/03
37.	SAC V	40.0	47.4	03/13/03	06/30/04
38.	Title registration	8.0	9.3	10/13/98	09/30/04
39.	Transport	40.0	46.9	06/08/00	12/31/04
40.	PRSC I	20.0	21.2	18/11/04	12/31/05
41.	Agric. Reform support	16.3	18.6	01/27/98	06/30/05

42.	Social Investment Fund II	20.0	23.4	05/11/00	12/31/05
43.	Investment and export facilitation	1.0	1.3	04/16/02	12/31/05
44.	Municipal development	30.0	35.0	06/11/98	01/31/06
45.	PRSC II	20.0	23.0	01/19/06	06/30/07
46.	Enterprise incubator	5.0	5.9	11/30/01	12/31/06
47.	Judicial reform	11.4	13.4	09/14/00	12/31/06
48.	Electric. Trans. & dist.	21.0	23.6	03/04/99	06/30/07
49.	PRSC III	28.0	29.4	03/08/07	06/30/08
	Total	**1 061.4**	**1025.8**		

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

(As of August 31, 2007)

1. As of August 31, 2007, the EBRD approved 35 projects in the power, transport, agribusiness, textile, mining, construction and financial sectors. Total commitments amounted to EUR 192.9 million.

There are three 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. Third, the EBRD approved a 7 mill EUR loan to the State Committee for Water Systems, owner of the water and wastewater assets located in the small municipalities outside of Yerevan, in April 2007. The proceeds of this loan will be used to improve wastewater treatment in five municipalities located near Lake Sevan.

2. 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.

3. 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. ARMENIA: STATISTICAL ISSUES

1. While data provided for surveillance are adequate overall, further improvements are needed in real, fiscal, and external sector statistics in order to facilitate enhanced 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). The April 2008 data ROSC mission has prepared a detailed evaluation of the quality of the macroeconomic statistics.

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. Presently the NSS is introducing national accounts estimates compatible with the European System of Accounts-95 and the *SNA 1993*. The first step in this direction was to group and publish value added indicators by A3, A6, A17 and A60 codes of the EU nomenclature of economic activities.

3. GDP is compiled at current prices, at comparable previous year prices and at average annual base year (1998). Data are re-estimated in comparable prices of the previous year using the double deflation method. Comparable prices are based on indices of physical volumes, price indices and extrapolation. Indicators used in these cases are the number of employees, or other volume indicators which characterize the activity of the branch. Since 2007, GDP at constant prices is computed at average annual 2005 prices.

4. The CPI covers 11 large population centers and the capital city. Since January 2006 the CPI has been computed using new 2005 weights. The NSS compiles a ten-day and a monthly CPI. The ten-day index and the monthly index are disseminated jointly.

5. **Government finance 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 (MoF) 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 but report data on cash flows and balances to the MoF since 2003. 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 one month after the reporting period.

6. By law, expenditures are classified and presented in the budget in accordance with the *1986 GFSM*, but the MoF is working to implement the *2001 GFSM*. 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 done by the NSS in cooperation with the MoF.

7. The authorities submitted cash data, converted to the framework of the *Government Finance Statistics Manual 2001*, for publication in the *2007 Government Finance Statistics Yearbook*. The authorities began providing data for publication in the *IFS* in July 2007. 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.

8. **Monetary and financial 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.

9. 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 validated the resulting monetary aggregates and the data have been published since the December 2006 issue of *IFS Supplement*.

10. **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. The NSS plans to implement by end-2007 monthly

price indexes for imports and exports. 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.

11. Quarterly data on international investment position is published by the NSS within one quarter after the reporting period, and the annual data within two quarters. These data are also provided by the NSS for publication in IFS, as well as placed in the National Summary Data Page and the official website http://www.armstat.am/arm/Publications.

Armenia: Table of Common Indicators Required for Surveillance

(As of April 16, 2008)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	Mar. 2008	4/7/2008	D	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Feb. 2008	4/2/2008	D	M	M
Reserve/Base Money	Feb. 2008	4/15/2008	D	M	M
Broad Money	Feb. 2008	4/15/2008	M	M	M
Central Bank Balance Sheet	Feb. 2008	4/15/2008	D	M	M
Consolidated Balance Sheet of the Banking System	Feb. 2008	4/15/2008	M	M	M
Interest Rates[2]	Mar. 2008	4/15/2008	W	M	M
Consumer Price Index	Feb. 2008	4/4/2008	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Q2 05	8/28/05	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Q4 06	7/17/07	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q2 05	8/31/05	Q	Q	Q
External Current Account Balance	Q4 07	4/8/2008	Q	Q	Q
Exports and Imports of Goods and Services	Q4 07	4/8/2008	Q	Q	Q
GDP/GNP	Q4 07	4/4/2008	M	Q	Q
Gross External Debt	Q1 05	6/30/05	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA).

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 08/116
FOR IMMEDIATE RELEASE
May 19, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Sixth and Final Review Under the PRGF Arrangement with Armenia and Approves US$5.4 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the sixth and final review of Armenia's economic performance under the Poverty Reduction and Growth Facility (PRGF) arrangement. The completion of the review enables the release of an amount equivalent to SDR 3.32 million (about US$5.4 million), bringing total disbursements to the full amount of SDR 23 million (about US$37.3 million) under the arrangement (see Press Release No. 05/123).

Following the Executive Board's discussion, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, said:

"Armenia's adherence to prudent macroeconomic policies and the progress made in structural reforms have contributed significantly to its strong performance under its third PRGF arrangement. A marked reduction in poverty has been achieved in a high-growth and low inflation macroeconomic environment. Strong remittance and foreign direct investment inflows have dampened the impact of rapidly rising imports on the balance of payments. The medium-term outlook remains positive in view of favorable investment prospects.

"Continued sound fiscal and monetary policies remain key to maintaining macroeconomic stability and external competitiveness, against the background of large-scale foreign exchange inflows and upside inflationary risks. A tighter-than-budgeted fiscal stance is warranted for 2008 as this would deliver welcome support to monetary policy in keeping inflation expectations well anchored. The existing monetary policy framework, based on a flexible exchange rate, remains the best option for Armenia. The authorities' timely monetary policy actions over the past year have demonstrated the authorities' commitment to price stability and helped contain inflationary expectations despite strong headwinds from higher world food and energy prices.

“Strengthening the capacity for fiscal policy analysis will be important for improving the effectiveness of fiscal policy and helping maintain fiscal discipline. Increasing revenue collections in a transparent and nondiscretionary manner will also be crucial, in view of the need to improve the country’s infrastructure, reduce poverty, and improve the business environment.

“The authorities intend to press ahead with their structural reform agenda to remove remaining bottlenecks to broad-based growth and to safeguard competitiveness. Future reform efforts will appropriately focus on deepening productivity-enhancing structural reforms, notably by reducing the cost of doing business, boosting domestic competition, diversifying the economy, and discouraging participation in the shadow economy.

“The IMF welcomes Armenia’s interest in continuing its close cooperation with the Fund after the current PRGF arrangement expires in May 2008,” Mr. Portugal said.

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.

Statement by Yuriy G. Yakusha, Alternate Executive Director
for the Republic of Armenia
May 19, 2008

PRGF Implementation and Challenges Ahead

Armenia has been regularly meeting program performance criteria as well as structural conditions under the current PRGF. All program reviews were completed on time. Strong ownership of the reform program, constant dialogue with and flow of advice from staff, visible public support from management – all have helped the authorities to maintain prudent and well coordinated macroeconomic policies.

As the authorities acknowledge, the Fund-supported program has helped to prioritize tasks and to focus rather limited resources on the key areas of economic transformation – achieving macro-stability and reducing poverty. Under the current PRGF, the authorities have managed to substantially reduce poverty rates – from 34.6 percent at the beginning of the program to 26.5 percent. The PRSP, which is now being updated at the initiative of the authorities, has been already pronounced on April 29 as one of the cornerstones for the reform program of the newly established coalition government, headed by the former Central Bank of Armenia Governor, Mr. Tigran Sargsyan.

Since the beginning of the current PRGF, the growth has remained in double digits. The implicit inflation targeting framework, adopted with the advice and help from the Fund continues to work well despite the recent global and regional increases in inflationary pressures: inflation in Armenia has so far in 2008 been the lowest in the CIS region. The CBA has been gradually increasing interest rates (it has been done in February, March, April, and May). Monetary tightening proved to be helpful for controlling inflationary expectations. Substantial appreciation of the nominal exchange rate, from about 450 drams per dollar at the start of the PRGF to about 306-307 drams today, contributed to substantial de-dollarization of the economy, while it correctly addressed the challenges associated with strong inflows of FDIs and remittances. This steady exchange rate appreciation has also created incentives for productivity-enhancing structural reforms. The World Bank's *Doing Business* report now puts Armenia among the leading reformers in many categories.

Formerly one of the heavily indebted CIS countries, Armenia's debt sustainability is firmly established now. International reserves have more than tripled, though the import cover will now likely decline, with soaring energy and food prices. The current account, as was expected, has deteriorated from about 1 percent deficit to more that 6 percent deficit, reflecting terms of trade changes, and the catching-up efforts. With the global slowdown, soaring import prices, and further improvements in the availability of credit, which is believed to be the necessary precondition for further poverty alleviation, the country's trade

balance may experience additional pressures. The land-locked Armenia continues to face two closed borders, and further external shocks thus cannot be ruled out, while geopolitical situation and the small size of domestic market creates limitations and risks to economic development. Substantial progress in reforms of fiscal and financial sectors has been achieved, though much remains to be done in both of these areas, as financial deepening and capital markets developments as well as second generation fiscal reforms have just begun. Finally, as the authorities stated on numerous occasions after the recent elections, the currently existing divide in the nation can be overcome through successful and mutual hard work in implementing the reform agenda. This agenda, according to the authorities' letter of intent, includes further poverty reduction, diversification of the economy while preserving macroeconomic stability, broadening revenue base, and developing meaningful medium-term budgeting, which will all help with moving towards a full-fledged IT regime, financial deepening, improved governance, accountability, better business climate, and improved competition.

Future Relations with the Fund and the Authorities' Reform Agenda

The authorities expressed their interest in pursuing another program with the Fund, both in the letter of intent and in the letter from the Prime Minister to the Managing Director, sent the day after the new government program was approved by the parliament. A quarter of Armenians still live below poverty line, so the government sees further poverty alleviation as its ultimate goal. This goal can only be achieved now through second generation structural reforms. At the same time, Armenia may face increased risks to the sustainability of its current account, stemming from the new global inflationary trends, as the country is importing all of its fuel and most of its food. In this light, the authorities would like to start a new program already this year. They propose to start preliminary negotiations next month, with the presumed conclusion during the Article IV mission, scheduled for September. The PRGF/EFF blend would reflect challenges the country is facing best, as IDA/IBRD blending is now discussed with the World Bank. Other countries in the region have also used such program arrangements in the past as an exit/graduation mechanism from the program relations with the Fund.

This ambitious general reform agenda, just adopted in Armenia seems to reflect the set of medium-term structural reforms, normally supported by multiyear arrangements with the Fund.

Key Priorities of the New Government

The key priorities of the new government are further efforts in maintaining macroeconomic stability under the floating exchange rate regime and preserving high rates of growth through favorable environment for the private sector development. Some of the proposed measures to achieve these goals include reducing red tape and corruption,

simplifying tax system and reducing the tax burden, and improving competitiveness of the transportation and telecommunications sectors, among many others.

The second bloc of priorities deals with social integration and consolidation through focusing on the significant gap in living standards that still exists from the past years, which resulted from the difference between the average pensions and average wages. In parallel to gradual pension increases, the government will continue to work towards introduction of multilevel retirement schemes, including the introduction of an accrual pension benefits system.

Among other important priorities, there are critical issues, such as development of human capital, particularly, reforms in education system (changes in a broader sense, to create learning opportunities for both public and private sectors); health sector reforms; wider development of the information technology systems in health, education, and government sectors (for example, e-government initiatives); establishment of effective public, local, self-governing, and private sector management systems; meeting numerous environmental challenges; and, better harmonized regional development. Opposition is invited to take part in implementation of the governmental national and regional programs, and it is expected to assume the role of a demanding and fair-minded supervisor. The authorities welcome the initiative of the National Assembly in terms of strengthening the rights of the opposition, which will establish a platform for effective cooperation.