May 2009
IMF Country Report No. 09/140

Republic of Armenia: Request for Stand-By Arrangement—Staff Report; Staff Supplements and Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Armenia.

In the context of the request for a stand-by arrangement for the Republic of Armenia, the following documents have been released and are included in this package:

- The staff report for the Request for Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on February 18, 2009, 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 March 3, 2009. 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 staff supplement on the debt sustainability analysis.

- A staff supplement of March 4, 2009, on the assessment of the risks to the Fund and the Fund's liquidity position.

- A staff statement of March 6, 2009, updating information on recent developments.

- A Press Release summarizing the views of the Executive Board as expressed during its March 6, 2009, discussion of the staff report that approved the request.

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

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

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

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

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International Monetary Fund
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INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

Request for Stand-By Arrangement

Prepared by the Middle East and Central Asia Department

(In consultation with other departments)

Approved by Lorenzo Pérez and Alan MacArthur

March 3, 2009

- **Background:** Since the approval of a low-access PRGF arrangement on November 17, 2008 (Country Report No. 09/29), Armenia has been confronted by a set of external shocks and now faces fading confidence in the currency and financial system.
- **Request for a stand-by arrangement:** In light of the large increase in Armenia's financing needs, the authorities have requested a stand-by arrangement with exceptional access of 400 percent of quota (equivalent to SDR 368 million or about $544 million). Given the urgency of the situation, the request is being considered under the Emergency Financing Mechanism. The new program aims to achieve the necessary external adjustment, restore confidence in the domestic currency and the banking sector, and protect the poor. The authorities have committed to a set of policies in the exchange rate, monetary and financial, and fiscal areas as well as on maintaining its ongoing structural reform program. The authorities have requested that the low-access PRGF arrangement be canceled.
- **Mission:** A staff team visited Yerevan on February 4–18. The team comprised Mr. Bonato, Ms. Hijazi, and Mr. Lewis (head) (all MCD), Mr. Darius (SPR), Ms. ElGanainy and Mr. Gracia (both FAD), and Mr. Saker (MCM). Ms. Oomes, resident representative, assisted the mission. Mr. Pérez (MCD) and Mr. Bakker (OED) joined the discussions in the last few days.
- **Exchange rate regime:** The de jure arrangement is a "managed float". The de facto arrangement was reclassified to "stabilized (peg-like) arrangement" as of July 1, 2008 from a "managed float".
- **Statistics:** Economic data are adequate for surveillance and program monitoring. Armenia subscribed to the SDDS.

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I. Background

1. **Until recently, Armenia had enjoyed a long period of strong economic performance.** Positive regional spillovers and prudent policies underpinned rapid GDP growth and large capital inflows in a context of macroeconomic stability. Prudent fiscal policies led to a reduction of government debt as a share of GDP, while a flexible exchange rate and a well-designed monetary framework helped maintain low inflation. On the basis of Armenia's impressive track record of successful implementation of Fund-supported programs, the Fund's Executive Board approved on November 17, 2008 the authorities' request for a new low-access PRGF arrangement. Directors endorsed this request, but noted that the deteriorating global conditions could have implications for Armenia's economic outlook and financing requirements.

2. **Amidst political uncertainty and regional instability, the Armenian economy was showing signs of overheating in the first part of 2008.** The new coalition government installed in April 2008 following controversial presidential elections pressed ahead with an ambitious reform agenda, but unresolved tensions with the opposition weakened its political support. The war between neighboring Georgia and Russia in August 2008 led to severe, although temporary, disruptions in trade flows and fuel shortages. Nevertheless, real GDP increased by some 10½ percent through September, supported by remittances and FDI, with brisk activity in construction and services. High import prices and strong domestic demand pushed inflation to 11½ percent in August.

II. The Impact of the Global Crisis

3. **The global crisis has confronted Armenia with a number of strong external shocks.** Although sheltered from direct contagion effects by the limited international integration of its financial system, Armenia has been hit by a set of adverse shocks to the current and capital accounts, particularly emanating from Russia. Remittances and capital inflows, which sustained the construction boom in recent years, have decelerated markedly. Falling international commodity prices adversely affected mining, a key export sector, and several mines have ceased operations. GDP growth came to a halt in the fourth quarter, and fell to 6.8 percent for the year as a whole (Table 1, Figure 1). Following the rapid unwinding of international prices and domestic demand, annual CPI inflation fell to 1 percent in February 2009. With exports being hit by the global downturn and imports growing strongly through October, the external current account deficit rose to an estimated 12½ percent of GDP in 2008 (Table 2).

Armenia: Shortfall in Foreign Exchange Earnings
(millions of US dollars)

	2008	2009			2010			2011		
	Est.	Country Report 1/	Staff Proj.	diff.	Country Report 1/	Staff Proj.	diff.	Country Report 1/	Staff Proj.	diff.
Exports	1,078	1,403	756	-647	1,613	861	-752	1,839	982	-857
Private Transfers	1,138	1,410	750	-660	1,551	765	-786	1,660	845	-814
FDI	936	962	488	-474	1,106	507	-599	1,272	568	-704
Other Capital	-121	332	-262	-594	256	-60	-316	195	-70	-265
Total	3,030	4,107	1,732	-2,375	4,526	2,073	-2,453	4,966	2,325	-2,641

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

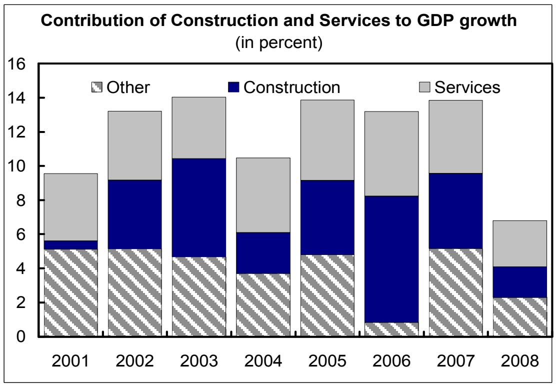
1/ See Country Report No. 09/29.

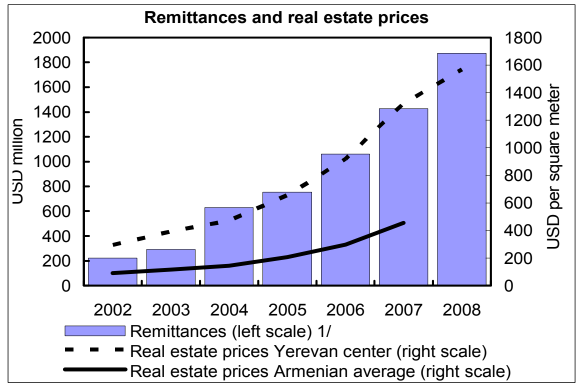
4. **The de facto fixed exchange rate policy has contributed to an emerging confidence problem in the exchange rate and financial system.** Depreciation pressures on the dram have increased, as depositors started converting local currency deposits into foreign currency deposits, and dram cash holdings into foreign currency cash. The Central Bank of Armenia (CBA) has been selling about $50 million a week (now about 5 percent of gross reserves) in recent months, with net international reserves (according to the program definition, which excludes foreign currency deposits of commercial banks at the central bank) falling from $1,084 million at end-December to $627 million as of February 27, 2009. The authorities have resisted depreciation pressures, out of concerns that a devaluation would precipitate a rapid and destabilizing shift in local to foreign currency deposits and trigger substantial deposit withdrawals from the banking system.

5. **As a result of the de facto peg, the exchange rate has become increasingly misaligned.** Staff's current assessment indicates that the real exchange rate is about 20-30 percent above its equilibrium value (Figure 2). This assessment contrasts with that made at the time of Armenia's 2008 Article IV consultation, which found that the exchange rate was only slightly above its equilibrium value. The External Sustainability (ES) approach now suggests an overvaluation of about 20 percent at end-2008. Based on the purchasing power parity (PPP) approach, the real exchange rate is currently around 30 percent above equilibrium, while the behavioral equilibrium exchange rate (BEER) approach suggests that the dram was overvalued by 21 percent at end-2008. These results are in line with those obtained by the CBA using a similar approach.

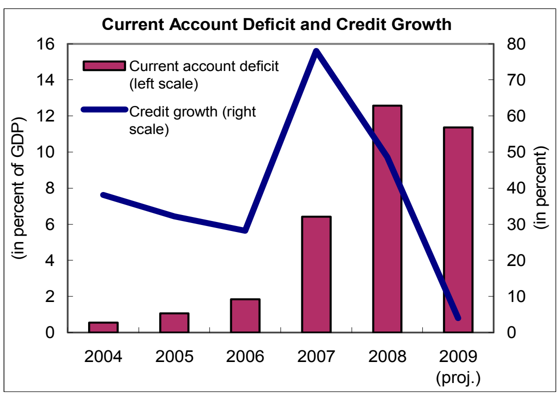
Figure 1. Armenia: Recent Economic Developments

GDP growth will be affected by the expected decline in remittances and construction activity.

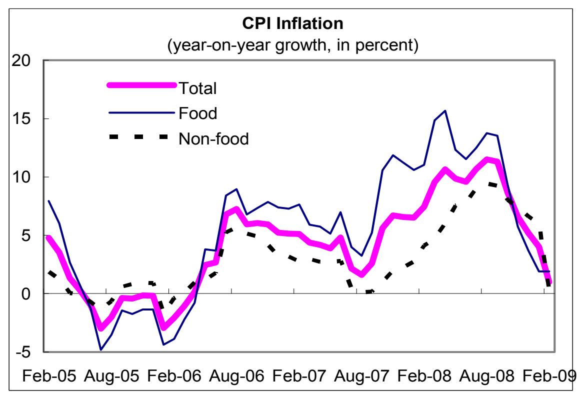




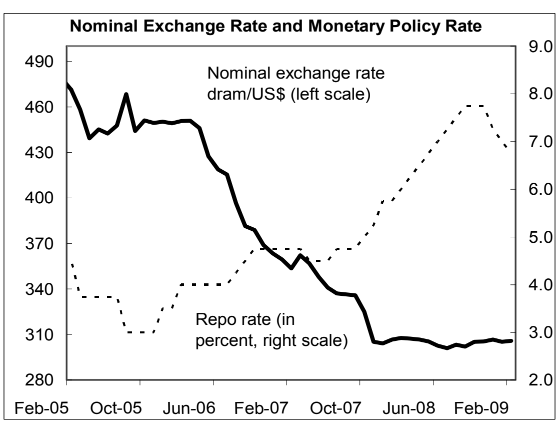
The current account deficit widened, but is expected to adjust as credit growth is slowing down.

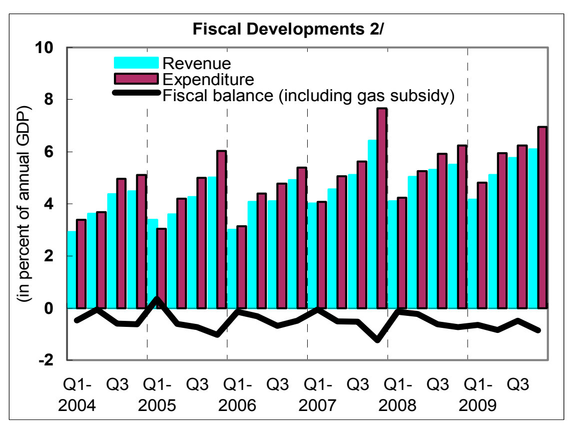


Inflation has responded promptly to falling international prices and weaker domestic demand.



Fiscal policy continues to be prudent, but the exchange rate has become less flexible.

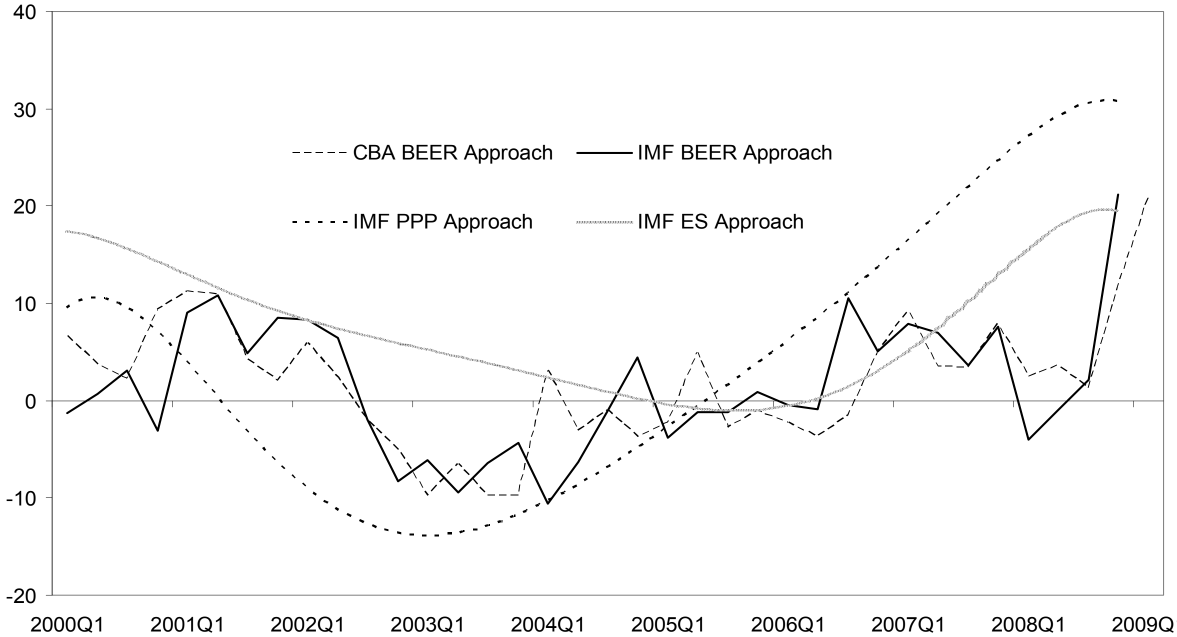




Sources: Armenian authorities; and Fund staff estimates.

1/ Remittances are defined as the sum of compensation of employees, workers' remittances, and other non-government current transfers. 2008 figures are estimated.
2/ 2009:Q1 to 2009:Q4 data are projections.

Figure 2. Armenia: Estimated Real Exchange Rate Misalignment
(In percent)



Sources: CBA and Fund staff estimates.

6. **Despite the depreciation pressures, the CBA cut the repo rate to 6.75 percent in three steps from December to February,** in line with the more benign inflation developments. The growth in monetary aggregates has slowed considerably, and broad money fell in the first part of 2009 (Table 3, Figure 3).

7. **In the face of redollarization and disintermediation, the financial sector has come under mounting stress as the dram became increasingly overvalued.** Despite high capital adequacy ratios (CAR)(Table 4), more than double the minimum 12 percent, and low levels of non performing loans, banks could be vulnerable to liquidity problems, reflecting the fragile confidence of the public in the banking system due to previous episodes of devaluations and bank runs in Armenia.

8. **In these circumstances, banks are restructuring their balance sheets to avoid large currency and liquidity mismatches.** Given the local currency shortage, banks have reduced their lending activities in drams, particularly by not rolling over such loans as they fall due and are trying to pass the exchange rate risk to borrowers by switching to dollar loans. Dram lending is now largely funded by a number of initiatives by multilateral and bilateral donors to promote local currency lending to the SME sector. The result is an unfolding credit crunch in dram lending, which notably finances consumer loans and mortgages, with a risk of increased dollar lending to borrowers without dollar incomes. At the same time, however, banks have also accumulated high levels of dollar liquidity (placed both at the CBA or overseas with correspondent banks) (Box 1).

Box 1. Armenia: Financial Sector Stability Issues

The banking system, comprising 22 banks, has been strengthened in recent years with the entry of foreign banks from the European Union as well as Russia, which are amongst the largest banks in Armenia. Based on latest data from the CBA, the system's CAR of 27.9 percent is well above the minimum 12 percent requirement and non-performing loans are low at around 5 percent of total loans. Encouragingly, the banks have limited external borrowing or debt issuance and most liabilities to nonresidents are long term to multilateral and bilateral donors. The CBA has also put in place aspects of a modern risk-based prudential framework and a Deposit Guarantee Fund (DGF) was established in 2004.

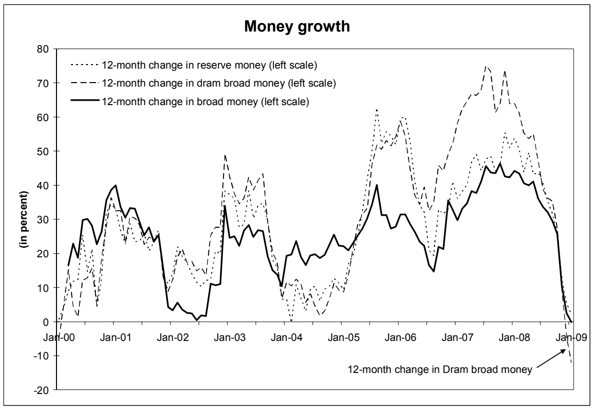
However, despite these positives, there are serious structural weaknesses in the system which the effects of the on-going exogenous shocks have exposed. The system remains very small, with deposits equivalent to about 15 percent of GDP. This compares to the CBA's estimate of dollar cash-in-circulation of about 35 percent of GDP. The system was unable to fully mobilize the local deposit base during the recent years of strong economic growth, despite a positive trend of dedollarization, due to lingering fears related to the historical experience in the initial chaotic years after independence. Now that economic conditions have deteriorated, such fears have again come to the fore and depositors are switching at a rapid rate from dram to dollar accounts, and are accelerating their withdrawals of cash dollars to add to the high stock of "mattress money."

Although stress testing by the CBA indicates that solvency is not at risk, for prudential reasons the CBA is putting in place measures for long-term support for weak banks. This is especially important as their shareholders may be unable to fund the resources to do so in the context of a global crisis. International experience has shown that banks can be stabilized through the placements of long-term deposits, which can be backed by the issuance of subordinated debt with an option to convert into equity if necessary. Forward planning should also assess what would happen if a large bank were to become insolvent. The creation of the DGF was a positive step in 2004. Staff suggested that a broadening of the guarantee would be positive in boosting confidence in the banking system and preventing deposit runs.

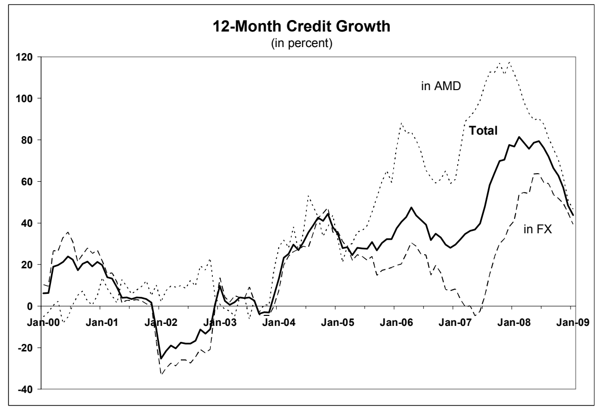
9. **Fiscal policy remained prudent throughout 2008.** The overall deficit was contained at 1.7 percent of GDP, well below its budgeted level, with an improvement of 0.6 percent of GDP compared to the 2007 budget outturn (Table 5, Figure 4). The improved fiscal position reflected both revenue-enhancing and expenditure-reducing measures. On the revenue side, tax collection was well above expectations, in particular for VAT, reflecting some progress in tax administration and the continued accumulation of tax credits. On the expenditure side, the elimination of the gas subsidy in May 2008 and the slowdown in the implementation of capital projects contributed to a lower-than-budgeted outturn. Government debt remained at a comfortable level.

Figure 3. Armenia: Recent Monetary and Financial Sector Developments

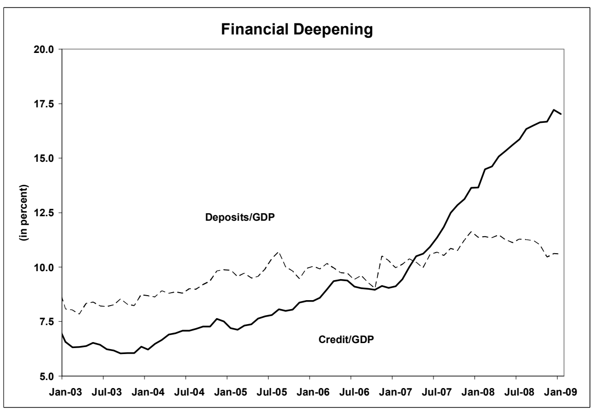
Growth of monetary aggregates has decelerated significantly…



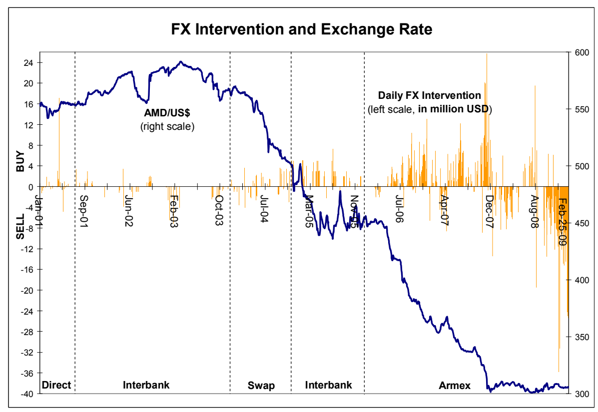
…reflecting the rapid fall off in credit…



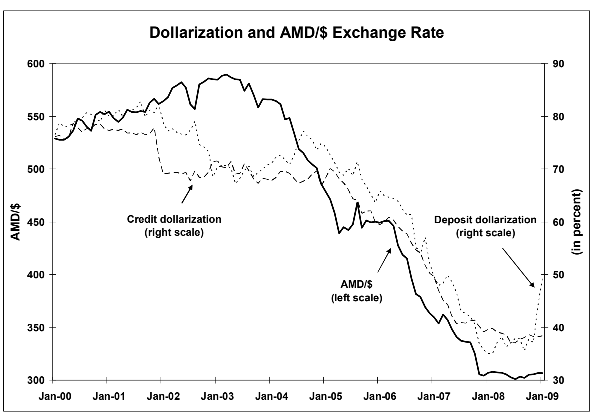
…and signs of disintermediation.



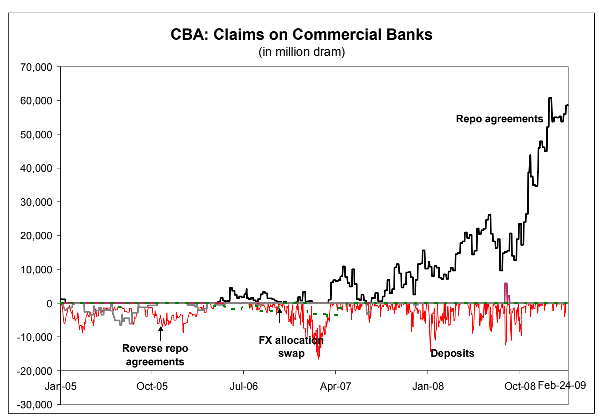
Resistance to dram depreciation pressures led to unsustainable foreign exchange sales by the CBA...



… accompanied by substantial re-dollarization



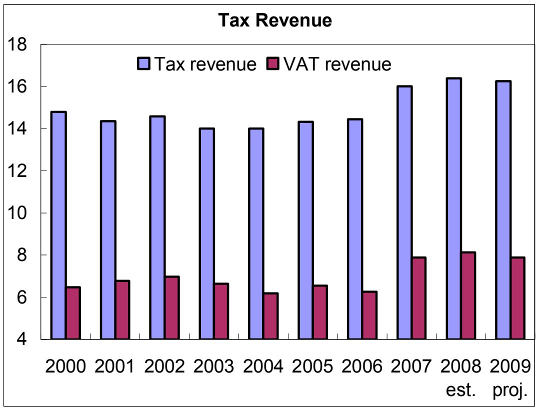
…and strong demand for liquidity by commercial banks.



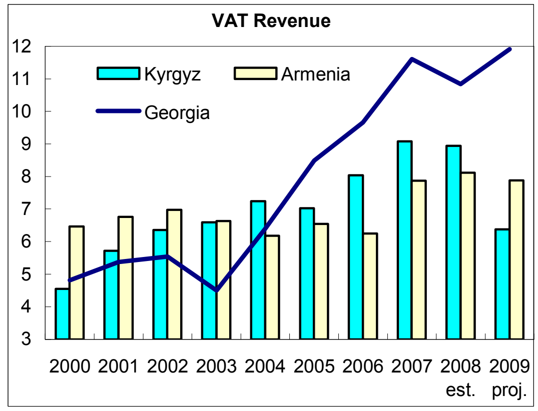
Sources: Armenian authorities; and Fund staff estimates.

Figure 4. Armenia: Recent Fiscal Developments 1/

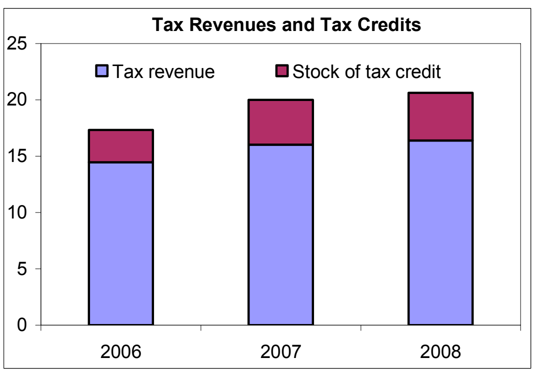
Tax revenues have shown some buoyancy lately...



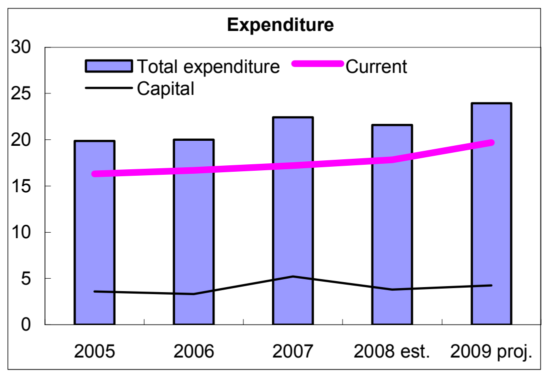
...but they are still low relative to other countries in the region.



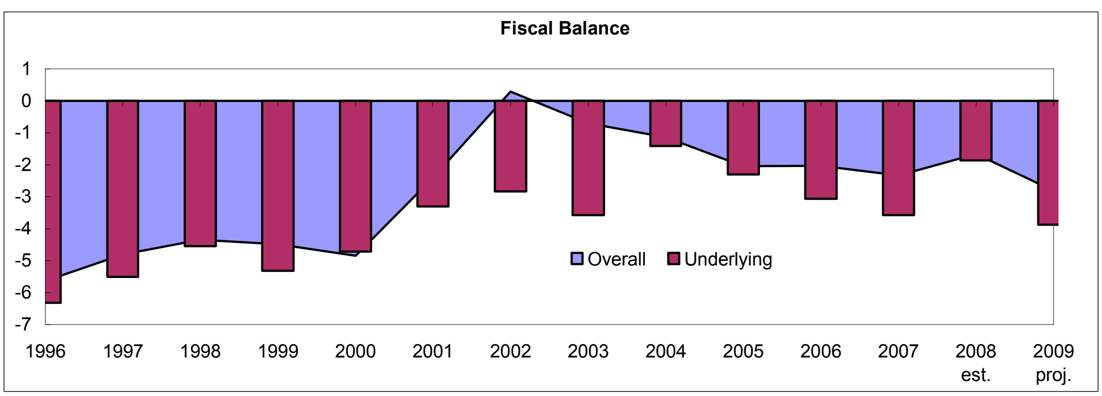
At the same time, the accumulation of tax credits continued.



Overall expenditure increases have been moderate, resulting in a prudent fiscal stance.



The overall and underlying fiscal balances improved in 2008.



Sources: Armenian authorities; and Fund staff estimates.

1/ All figures are in percent of GDP.

10. **Nonetheless, the rapid and unexpected deterioration of the economic situation had a strong impact on program performance under the PRGF arrangement.** Most of the end-December 2008 quantitative performance criteria were missed. Due to the large foreign currency sales and the need to provide liquidity to banks, both the end-2008 targets for international reserves and net domestic assets of the CBA were missed. In addition, the target on net banking system credit to the government, as well as that on the underlying fiscal balance, were missed (Table 6). The authorities, recognizing the changed circumstances and the large increase in their financing needs, have requested the Stand-By arrangement and also requested the cancellation of the PRGF arrangement.

III. The Authorities' Program

11. **The new program aims to achieve the necessary external adjustment, restore confidence in the domestic currency and the banking sector, and protect the poor.** The authorities recognize that postponing the necessary adjustment in the exchange rate has deepened the external imbalances and the lack of confidence in the currency. Therefore, they feel that it is desirable to return to a floating regime and address the confidence crisis with a strong program backed by the Fund. Their program is based on a consistent set of policies in the exchange rate, monetary, financial, and fiscal areas as well continued structural reforms.

12. **The short-term macroeconomic outlook is very challenging.** The significant slowdown experienced by Russia and other countries will cause remittances to fall, with a negative impact on domestic demand. Activity in the construction sector is expected to decelerate dramatically, and difficulties in mining are bound to persist. Against this backdrop, real GDP is projected to decline by 1½ percent in 2009, and significant job losses are expected. Reflecting a combination of exchange rate depreciation, a decline in international prices, and a drop in domestic demand, imports are expected to fall. Despite weak exports and remittances, the current account deficit will narrow by more than 1 percent of GDP to 11½ percent of GDP. Depending on global developments, a gradual recovery may be possible starting in 2010 (Table 7), but downside risks are prevalent. Although price pressures continue to dissipate, this will be offset in part by pass-through as the exchange rate moves in line with its fundamentals.

Armenia: Macroeconomic Outlook, 2008-12

(In percent of GDP, unless otherwise indicated)

	Est.	Projections			
	2008	2009	2010	2011	2012
Real GDP growth (percent change)	6.8	-1.5	3.0	6.0	6.0
Inflation (percent change, end of period)	5.2	8.0	4.0	4.0	4.0
Investment	38.1	33.0	33.2	34.3	34.7
Fiscal balance	-1.7	-2.8	-2.7	-2.4	-2.1
Underlying fiscal balance 1/	-1.9	-3.9	-3.1	-2.6	-2.5
Current account balance	-12.6	-11.4	-10.4	-8.9	-8.1

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

1/ Excluding grants and external interest payments.

Monetary and exchange rate policies

13. **As part of the program, the authorities are returning to a flexible exchange rate regime.** In particular, the authorities will indicate that they will no longer intervene in the market, except to smooth extreme volatility. At the outset, it is expected that the dram will adjust downward in line with the exchange rate's equilibrium rate, but some overshooting is possible. The depreciation will be accompanied by a 100-basis points increase in the policy rate and a coordinated and transparent communication campaign involving the CBA, the government, and the Fund. The authorities are ready to raise interest rates by at least a further 100 basis points shortly thereafter should market conditions prove unstable. This will help support demand for dram-denominated assets, fight capital outflows, mitigate potential inflationary pressures stemming from depreciation, and restore confidence in the financial sector. When normal market functioning is restored, the exchange rate policy will be a managed float with no predetermined path. The authorities will only intervene to smooth excessive market volatility and to increase international reserves as a secondary objective.

14. **Under a managed float, the authorities would gradually return to their inflation-targeting framework.** In the short term, increased dollarization will hamper the implementation of monetary policy. The quantitative targets under the program will guide the formulation of monetary policy until conditions for a return to inflation targeting are fulfilled. To this purpose, the authorities will further strengthen the monetary transmission mechanism by pursuing more active liquidity management and fostering the development of the money market, which will require closer coordination between the Ministry of Finance and the CBA (MEFP ¶12).

Financial sector policy

15. **Strengthening financial stability will be a key part of the authorities' program.** The immediate priority will be to restore stability and confidence and to support banks while they adjust to the new situation. The authorities clearly recognize that the banking system will be adversely affected by the depreciation of the dram and they are committed to take all appropriate measures to ensure that banks remain able to meet all liabilities as they fall due. This will be done through short-term emergency measures to stabilize the system, while at the same time enacting more structural measures to ensure the soundness of the system going forward (MEFP ¶11).

16. **The authorities' principal immediate concern is liquidity.** Demand for dollar and dram liquidity may surge following the return to the floating exchange rate, and the authorities intend to ensure that this demand is adequately addressed. One particular source of risk is that all deposits held by individuals are immediately callable, including term deposits, but the banks are short of liquid dram assets with which to repay the depositors. Another issue is the adequate provision of dollar cash to accommodate dollar deposit withdrawals. This will be mitigated to the extent banks are facilitating the opening of foreign exchange accounts, so that individuals can change the currency denomination of their deposits without having to move into cash.

17. **While the banking system as a whole is resilient, solvency concerns may emerge over time for some banks**. The first round impact of a sharp depreciation on banks' balance sheets, in terms of valuation effects, is likely to be mild. Taking into account the current net open foreign exchange position of the banking system of about 7 percent of capital (with dram assets now exceeding dram liabilities, and the inverse for dollars), this would lead to a decline in the capital adequacy ratio (CAR) of just under 1 percent to 27.1 percent. According to the CBA's stress tests even under a scenario that includes conservative estimates of the second round effects of a substantial deterioration in credit quality, the CAR for the system as a whole would remain comfortable. However, several banks would fall below the 12 percent CAR minimum, requiring remedial action including recapitalization.

18. **The CBA is formulating a comprehensive and actionable contingency plan to ensure a timely and consistent policy response.** The plan will include plans for dealing with banks' illiquidity as well as solvency problems if necessary. The CBA will consult with the government as needed on the preparation of this contingency plan and the roles of the relevant agencies will be clearly specified. Key aspects that will be addressed in this plan are:

- **Liquidity support operations:** The CBA is committed to providing sufficient liquidity to banks on a temporary basis, after depreciation, in exchange for adequate collateral. In consultation with the recommendations of IMF technical assistance, the CBA will accept a wider range of collateral.

- **Addressing bank restructuring issues:** If financial conditions in any bank appear to be deteriorating, the CBA will agree with bank management and shareholders on a restructuring plan to resolve the difficulties and the existing shareholders will be required to inject new capital. If a bank is judged to be viable, the authorities would consider providing long-term funding and/or taking an equity stake. Otherwise, bank mergers will be encouraged where appropriate with closures the final option. Should circumstances warrant it, the coverage of the DGF will be increased. To this end, the authorities will approve a plan to increase the resources of the DGF by end-June 2009.

- **Enhanced banking supervision:** Bank supervision will be strengthened with more intensive on-site and off-site surveillance and monitoring. The CBA will also tighten prudential standards, particularly regarding foreign currency exposures, and will progressively work to reduce banks' net open positions.

Fiscal policy

19. **Fiscal policy will contribute to macroeconomic stability, while protecting social outlays and public investment.** For 2009, revenue in nominal terms is projected to be significantly lower than in the budget, reflecting the downturn in revenue-generating sectors such as mining. To partly offset the anticipated revenue shortfall, the authorities intend to cut back on non-priority spending and introduce some tax policy measures. On spending cuts, key measures include cuts in areas where execution has been slow, and other non-priority spending such as representation and other administrative costs. These measures are expected to yield savings of about 0.8 percent of GDP. Accordingly, the program aims at limiting the deficit, excluding non-programmed externally financed investment projects, to 2.8 percent of GDP compared to a deficit target of 1 percent of GDP in the announced budget. The program accommodates an increase in social spending of 0.3 percent of GDP, relative to the budget, to protect the poor through well-targeted social safety nets.

20. **The program also provides room for additional infrastructure and investment spending as foreign financing materializes.** The authorities expect additional resources to be available from external donors and partners, notably from Russia, on top of what is currently projected. While much of these resources are only partially concessional, they would provide scope to finance additional public investment in 2009, and potentially expand credit lines for small and medium enterprises. The program envisages a cap on spending out of these resources of $200 million in 2009 on top of what is included in the program. The program, therefore, includes an upward adjuster on the fiscal deficit target up to this amount.

21. **The authorities have decided to raise customs tariffs, against staff recommendations.** Custom tariffs on a wide range of consumer goods are being increased from 10 to 15 percent, mainly to soothe domestic political pressure for protectionist measures, and to enhance revenues (about 0.3 percent of GDP in 2009); average effective

tariffs are expected to increase from 3 to 5 percent. In their discussions with staff, the authorities argued that these tariff increases are within Armenia's bindings with the WTO, and will be limited to a certain number of goods for which Armenian substitutes exist (MEFP ¶16). They have signaled their intention to revert to the original levels of tariffs within a few years.

22. **The authorities plan other tax policy changes,** including an increase in presumptive taxes on tobacco products and in excise taxes on imported alcoholic beverages. Going forward, the authorities indicated their readiness to abolish presumptive taxation for tobacco and fuel and bring these sectors within the regular tax regimes (excise tax, customs duties, profit tax, and VAT) by January 2011 (MEFP ¶16).

Structural policies

23. **The authorities will continue their wide-ranging structural reform agenda outlined in their Sustainable Development Program.** This agenda is aimed at deepening productivity-enhancing structural reforms, and improving governance. A key area will be continued efforts to strengthen the business environment, with a focus on tax administration reforms and the fight against corruption.

24. **The authorities are planning to advance the reform agenda in tax policy and tax administration.** They have made progress towards modernizing tax administration, and remain committed to their comprehensive reform agenda in this area (MEFP ¶18). More importantly, they intend to address two long-standing problems in the tax administration area, namely the large amount of outstanding tax credits, and the long delays in VAT refund processing to exporters. Both issues are included in the program's conditionality because resolving these concerns would have a positive impact on public finances, the business environment, and economic growth (Box 2)(MEFP ¶17).

25. **Staff and the authorities agreed on the importance of establishing a comprehensive approach to analyzing fiscal risks**, as this would strengthen budget process and enhance fiscal policy credibility. This would be all the more important in view of the authorities' plan to introduce a funded pension pillar by January 2010. To this end, the authorities intend to strengthen the fiscal framework by publishing an annual report on medium-term fiscal risks and contingency plans in the context of the Medium-Term Expenditure Framework (MEFP ¶19).

26. **The authorities will expedite their financial sector reforms.** In parallel with the above-mentioned urgent measures aimed at ensuring financial stability, the authorities will continue improving the financial soundness of commercial banks, including by enhancing their risk management capacity and strengthening supervision. They will also enhance credit availability and financial intermediation, and launch a campaign to educate consumers about financial products and services. In order to develop the securities market,

Box 2. Armenia: Structural Conditionality, 2009–10	
Structural Measure	**Rationale for Macro-Criticality**
1. Approve a plan to increase the resources of the Deposit Guarantee Fund (Structural Performance Criterion, June 2009)	***Higher resources would boost the credibility of the DGF, which is crucial in assuring depositors that there is no need to withdraw deposits from banks.*** In case of bank closures, the Deposit Guarantee Fund is likely to need further resources to meet existing commitments to depositors.
2. Submit to parliament an amendment to Article 11 of the "Law on the Central Bank of the Republic of Armenia" to allow a **gradual recapitalization of the CBA with marketable interest bearing securities**. (Structural Benchmark, September 2009)	***Current modalities (non-marketable, non-interest bearing promissory notes) lack transparency, hinder monetary policy implementation, and discourage debt market development.***
3. Introduce best practices in VAT refund processing to exporters by: (Structural Benchmark, December 2009) (i) meeting the statutory 90-day processing deadline for all VAT refund claims filed in 2009, (ii) clearing the stock of late refund claims, (iii) implementing risk management approaches (i.e. taxpayers with good compliance histories to get fast-track refunds, while risky cases face pre-refund audits); (iv) implementing a forecasting system to anticipate refund levels so that funds are available to pay legitimate refund claims as they occur; and (v) submitting legislation to parliament to strengthen penalties for false refund claims and pay interest on legitimate late refunds arising from claims filed after December 2009, with interest to be paid out of VAT revenues.	***Denied refunds are a tax on exports, and more broadly, undermine the integrity of the VAT and discourage tax compliance. This step is a key element of improving revenue performance.*** Reduce the stock of refund claims, which has been increasing since late 2006 because of pressure to meet collection targets and concerns about VAT fraud. Introduce best practice in modern tax administration in Armenia, which should be feasible given small number of claims. Ensure that funds are available to pay legitimate refund claims as they occur. Enhance the integrity of VAT system by strengthening incentives for both tax payers and tax administration.

the authorities will submit to parliament an amendment to Article 11 of the "Law on the Central Bank of the Republic of Armenia" to allow a gradual recapitalization of the CBA with marketable interest bearing securities (MEFP ¶20

IV. Program Modalities

Program access and financing

27. **Armenia faces high financing needs from 2009 through 2011.** Gross external financing requirements are projected at about $1.6 billion for 2009, and will remain elevated through 2011, albeit with a slight downward trend. Capital outflows are projected to contribute significantly to the financing gap in 2009, with a turnaround projected in 2010. Import coverage would decline to well below 3 months of imports but recover gradually over the program period.

Armenia: External Financing Requirements and Sources, 2008–2011
(In millions of U.S. dollars, unless otherwise indicated)

	2008	2009	2010	2011
Total Requirements	**2,364**	**1,617**	**2,149**	**2,337**
External current account deficit (exc. transfers)	2,578	2,104	1,982	2,057
Debt amortization	14	22	24	27
Gross international reserve accumulation	-254	-532	121	231
IMF repurchases and repayments	26	23	22	22
Available financing	**2,364**	**1,617**	**2,098**	**2,327**
Capital Account and Current Transfers	2,360	1,266	1,957	2,270
Capital transfers (net)	146	103	73	74
Foreign Direct Investment	784	488	670	715
Public Sector Disbursements	172	262	265	305
Other Capital 1/	179	-462	48	118
Current transfers	1,079	875	901	1,057
Private	1,023	820	869	1,030
Official	55	55	32	27
Exceptional Financing	4	351	141	57
IMF	3	349	139	56
Change in Arrears (+ increase)	0	0	0	0
Debt Relief 2/	1	2	2	2
Financing gap	**0**	**0**	**51**	**10**

Sources: Armenian authorities; and Fund staff estimates.

1/ Includes portfolio investment and net errors and omissions.
2/ Includes debt deferal from the Lincy Foundation in 2003, and debt relief from Turkmenistan in 2003 and from the United Kingdom from 2006 to 2008.

28. **These financing requirements are unlikely to be met from traditional sources (FDI and bank flows) given the deteriorating global economic environment.** Foreign direct investment will contract, reflecting the decline in economic activity in Russia, from

where most FDI flows originate. The financing pressures could actually worsen with continued deposit outflows given the uncertain policy environment. The World Bank has already signaled an increase in financing with a $525 million dollar package to be disbursed over the period 2009-2012 with some front-loading. The authorities are in negotiations with the Russian government for a $500 million dollar loan to boost investment spending and credit programs to small and medium-sized enterprises. Other agencies such as the Asian Development Bank are considering increasing their financing envelope, while a Fund-supported program could trigger additional financing by the European Union. Financing of existing external debt obligations is minimal and does not exert a strong effect on the current financing requirement.

29. **The remainder of the financing gap can only be closed by significant domestic adjustment and funding from other sources.** The current account position is expected to adjust by 1.2 percent of GDP under the program, improving by $288 million relative to the baseline in 2009. The adjustment in the current account is predicated on the implementation of the policy measures under a Fund program, which is expected to curtail import growth. However, in the absence of Fund financing, reserves coverage would fall below 3 months of imports.

30. **The proposed Stand-By Arrangement would involve frontloaded and exceptional access from the Fund of 400 percent of quota (SDR 368 million or about $544 million).** The objective of providing sufficient liquidity buffer to the banking system, preserve import coverage at a desirable level, while sending a powerful signal to depositors would not be achieved within the current access limits. This level of access would allow for a first purchase of 175.6 percent of quota (SDR 161.5 million, or about $239 million) to be made available upon approval. The remaining 224.4 percent of quota would be disbursed between May 2009 and June 2011 (Table 8). The arrangement is subject to the exceptional access framework. Armenia is experiencing large shocks to both the current and capital account, with the relative weight of the shocks suggesting this case is more of a capital account crisis. Box 3 presents an assessment relative to the four substantive criteria, and on this basis, staff considers that all four criteria are met.[2]

[2]The staff proposes that this exceptional access be on credit tranche terms. Normally, there is a presumption that exceptional access in capital account crises will be provided using resources of the Supplemental Reserve Facility (SRF) where SRF conditions apply. However, the SRF is geared towards "a large short-term financing need resulting from a sudden and disruptive loss of confidence reflected in pressure on the capital account and the member's reserves" and given the seriousness of Armenia's problems and uncertain global financial markets, the balance of payments difficulties will likely have a longer duration than envisaged by the SRF.

Box 3. Armenia: Exceptional Access Criteria

1. **Armenia's exceptional financing need is a result of the large shocks it is experiencing to both the current and capital accounts**. Under the Fund's policy on exceptional access, Armenia would need to satisfy four substantive criteria:

- **Criterion 1—exceptional balance of payments pressure in the capital account.** In addition to large current account pressures, Armenia is currently experiencing a sharp contraction in prospective FDI financing paired with capital outflows. A disorderly response to policy adjustments could precipitate a substantial withdrawal of deposits from the banking system. The corresponding capital outflow would generate exceptional balance of payments pressures.

- **Criterion 2—sustainable debt position.** An assessment by staff indicates that debt will remain sustainable according to the calculations of both external and public debt. Armenia's total external and domestic debt is relatively low at about 18 percent of GDP as of end 2008. Drawdown of the full amount of the proposed SBA and nonconcessional borrowing from IBRD would increase the public debt-to-GDP ratio over the medium term to about 22 percent of GDP—all debt indicators would remain well below prudential levels. Standard stress tests indicate that Armenia's debt outlook would remain favorable in the context of a one-time 30 percent real depreciation of the exchange rate.

- **Criterion 3—access to private capital markets.** Armenia private sector firms have undertaken limited borrowing on international capital markets to date, although the government has not. Successful implementation of a Fund program is expected to allow Armenia to regain access to private capital markets by the time repurchase obligations to the Fund become due. By that time, the substantial adjustment of the current account and anticipated recoveries in Armenia's main trading partners should significantly strengthen the economy.

- **Criterion 4—strong economic policy program.** Armenia has a long track record of sound macroeconomic management—notwithstanding the recent difficulties on exchange rate policy—and has a strong commitment to the policies that underpin this program. The authorities would have to implement robust policy measures, which would demonstrate the authorities' commitment and institutional and political capacity to deliver. On this basis, staff consider that the program has a strong likelihood of success.

31. **Fund financing would cover Armenia's projected unfinanced balance of payments needs during the first 12 months of the program.** After the Fund resources, an unfinanced gap of about $51 million remains in 2010, and $10 million in 2011, but this could be covered by as yet unidentified resources from other external sources, or from measures to be implemented during 2010-2011. Fund financing would be utilized to buffer against liquidity strains and increase reserve coverage to about 3 months of imports of goods and services, a necessary level given the degree of uncertainty.

Capacity to Repay the Fund

32. **While Fund financing of this amount presents some risks, Armenia's capacity to repay is expected to be good.** The capacity to repay is based on the government's strong commitment to macroeconomic stability, reflected in sound fiscal policy, which has kept public debt relatively low (about 18 percent of GDP). By the end of the arrangement, Fund exposure is expected to remain at 5.4 percent of GDP, and about 49.7 percent of gross reserves. There is a marginal increase in public debt ratios over the duration of the program, partially on account of a slowing economy, but debt service will remain low and manageable (Table 9). However, there are some risks associated with the relatively high Fund exposure in relation to peak debt service as a percent of export of goods and services. Armenia's strong commitment to the program, likely improvement in external conditions over the medium term, and excellent repayment history provide strong assurances that Armenia will be in a position to discharge its Fund obligations.

Program Monitoring and Conditionality

33. **The SBA would run over 28 months from March 2009 to July 2011.** The size and timing of the disbursements were chosen to help anchor expectations in advance of a major policy shift, buffer against a liquidity crisis in the early stages of adjustment while shoring up import reserve coverage. The authorities will be in frequent consultation with staff for the duration of the program and will constantly update staff of any emerging risk, and decide on necessary policy changes to achieve the goals of the program.

34. **Program performance will be monitored through quarterly reviews.** The first review under the program will be set for mid-May 2009, based on end-March 2009 performance criteria, the second review is proposed for mid-August 2009, based on end-June 2009 targets, while the third review is proposed for mid-November 2009 based on end-September targets. Conditionality focuses on measures critical to address macroeconomic vulnerabilities. The importance of continued reforms in the financial sector and public finance areas to underpin macroeconomic adjustment implies that some structural conditionality is appropriate. The quantitative and structural performance criteria and benchmarks are indicated in Tables 1 and 2 of the Memorandum of Economic and Financial Policies.

Risks to the program

35. **There are several risks to the program.** Global growth may turn out to be slower than expected and a more severe regional downturn, led by a deterioration of economic conditions in Russia, is quite possible. A sharper economic slowdown in Armenia would pose substantial downside risks to revenues and to the fiscal program. Armenia is vulnerable to changes in external conditions owing to its dependence on remittances and capital inflows. A shortfall in these inflows would imply a larger adjustment in the exchange rate. The return to a flexible exchange rate may destabilize the financial system in the short

run, which could in turn impact economic activity. Lack of political support could hamper progress on structural reforms.

V. Staff Appraisal

36. **Armenia's external outlook has changed dramatically in recent months, and there are growing pressures on the financial system.** The deterioration in the balance of payments due to the shocks to the current and capital accounts will require a significant adjustment in the context of a deep growth slowdown. At the same time, the already fragile confidence in the banking system is weakening, risking rapid redollarization and deposit withdrawals, which could be destabilizing.

37. **The proposed Stand-by Arrangement is a strong and credible package that can help maintain macroeconomic, financial, and social stability.** The proposed program is based on exchange rate flexibility, with supportive fiscal, financial sector, and structural policies.

38. **Central to this strategy is the return to a flexible exchange rate regime.** Given the nature of its economy and potential shocks, Armenia is well-served by a flexible regime, which will help narrow external imbalances and support economic recovery. Effectively pegging the exchange rate has proved both costly to maintain and a source of growing risk to the economy and the financial sector. Accompanying policies—including on interest rates, intervention policy, fiscal restraint, and communication with the public—will be crucial to ensure that the return to a floating regime is a success. The authorities should stand ready to adjust policies as needed should the exchange rate overshoot.

39. **Strengthening financial stability will be crucial.** The program is designed to ensure sufficient liquidity to the banking sector—recognizing that such needs may surge in the immediate future—and thus serve to underpin confidence in the banking system. Appropriate contingency plans for the liquidity and capital needs of banks, enhanced bank supervision, and possible modifications to the deposit guarantee system, should help address specific problems and boost confidence in the system.

40. **Sound fiscal policy, with room for public investment and social spending, is a key pillar of the strategy.** Despite a sharp drop in revenue linked to the global slowdown and the recession in Armenia, the authorities will appropriately restrain the fiscal deficit in support of a flexible exchange rate regime. At the same time, externally-financed public investment will be maintained, which will be important both to offset the economic downturn and lay the basis for strong growth over the medium term. In addition, sufficient allocations will be made to maintain social services and increased targeted support for the poor as necessary, which will be essential to mitigating the impact of the economic crisis on the poor.

41. **The structural reforms in the program will likewise be important for buttressing the objectives of the program.** The authorities have made good progress on

their tax administration reform program, although work remains to be done to ensure that Armenia has a broad-based, equitable, and efficient tax system that serves as a stable source of revenue. Continued financial sector reforms will also be important to steadily deepen financial intermediation and reduce risks emanating from the banking system. In addition, the authorities are encouraged to continue their broader reform efforts. While not covered by this program, sectoral reforms and efforts to reduce corruption will be essential to boosting productivity and making the economy more resilient to shocks.

42. **The decision to raise customs tariffs is regrettable.** This measure only increases distortions in the economy and, from a competitiveness standpoint, is less effective than correcting the exchange rate misalignment. While the new tariff rates are within the WTO bindings, the authorities are encouraged to retract the increases as soon as possible.

43. **The exceptional access proposed under the program is consistent with the shocks faced by Armenia and the need to preserve financial stability.** The proposed access would ensure that reserves coverage remains over three months of imports over the program period, a prudent target given the immense uncertainties and downside risks to the outlook, while policies would allow the necessary external adjustment to take place. The potential liquidity needs of the financial system are large, and Fund resources would also help ensure that a surge in liquidity pressures could be met. Equally important, the signaling effect of such a commitment from the Fund would provide a large boost of confidence and help stabilize the foreign exchange market and financial system.

44. **The risks to the program are manageable.** There are significant risks to the outlook, particularly regarding a deeper impact from the downturn in Russia. In addition, escalated political tensions in the region could prove a hindrance to economic activity in Armenia. Nonetheless, Armenia has a long track record of sound macroeconomic management—notwithstanding the recent missteps on exchange rate policy—and has a strong commitment to the policies that underpin this program. Moreover, with a low debt and debt service burden, and a strong repayment record to the Fund, Armenia is very unlikely to experience payment difficulties with regard to its Fund obligations.

45. **In light of Armenia's balance of payments needs and concerns for financial stability, and the strong policy package being implemented by the authorities, staff support the authorities' request for a stand-by arrangement.**

Table 1. Armenia: Selected Economic and Financial Indicators, 2006–10

	2006	2007	2008	2009	2010
			Prel.	Proj.	
National income and prices					
Real GDP growth	13.2	13.8	6.8	-1.5	3.0
Gross domestic product (in billions of drams)	2,656	3,149	3,650	3,757	4,111
Gross domestic product (in millions of U.S. dollars)	6,386	9,228	11,929	10,823	10,419
Gross domestic product per capita (in U.S. dollars)	1,981	2,857	3,685	3,327	3,187
CPI (period average; annual percent change)	2.9	4.4	9.0	4.5	6.2
CPI (end of period; annual percent change)	5.2	6.6	5.2	8.0	4.0
Unemployment rate (in percent)	7.2	7.1	…	…	…
Poverty rate (in percent)	26.5	25.0	...	...	...
Investment and saving					
Investment	35.9	37.2	38.1	33.0	33.2
National savings	34.1	30.8	25.6	21.6	22.8
Money and credit (end of period)					
Reserve money (percent change)	41.1	50.9	5.3	3.2	10.0
Broad money (percent change)	32.9	42.3	2.4	2.9	11.4
Commercial banks' 3-month lending rate (in percent)	17.1	18.6	17.9	...	...
Central government operations					
Revenue and grants	18.0	20.1	19.9	21.1	21.3
Of which : tax revenue	14.5	16.0	16.4	16.2	16.6
Expenditure 1/	20.0	22.4	21.7	23.9	23.9
Overall balance on a cash basis	-2.1	-2.2	-1.7	-2.8	-2.7
Underlying balance 2/	-3.1	-3.6	-1.9	-3.9	-3.1
Government and government-guaranteed debt	18.7	17.5	17.9	26.7	28.3
Share of foreign currency debt (in percent)	88.2	88.1	92.0	91.6	86.8
External sector					
Exports of goods and services (in millions of U.S. dollars)	1,510	1,777	1,759	1,385	1,646
Imports of goods and services (in millions of U.S. dollars)	-2,536	-3,589	-4,726	-3,785	-3,933
Exports of goods and services (percent change)	6.7	17.6	-1.0	-21.3	18.8
Imports of goods and services (percent change)	19.4	41.5	31.7	-19.9	3.9
Current account balance	-1.8	-6.4	-12.6	-11.4	-10.4
FDI (net, in millions of U.S. dollars)	450	701	784	488	670
External debt-to-exports ratio (NPV, in percent)	72.1	67.4	46.3	89.8	92.7
Debt service ratio (in percent of exports of goods and services)	3.9	2.9	3.1	4.2	3.7
Gross international reserves (in millions of U.S. dollars) 3/	1,072	1,659	1,405	873	994
Import cover 4/	3.6	4.2	4.5	2.7	2.8
Nominal effective exchange rate (percent change) 5/	10.0	15.1	7.7	…	…
Real effective exchange rate (percent change) 5/	9.0	15.4	18.6	…	…
End-of-period exchange rate (dram per dollar)	364	304	307	…	…
Average exchange rate (dram per dollar)	416	342	306	…	…
Memorandum item:					
Population (in millions)	3.223	3.230	3.237	…	…

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

1/ Including the gas subsidy in 2006-2008.

2/ Overall balance excluding grants and external interest payments.

3/ Excluding the special privatization account (SPA).

4/ Gross international reserves in months of next year's imports of goods and services, without the use of Fund resources.

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

Table 2. Armenia: Balance of Payments, 2007–12
(in millions of U.S. dollars, unless otherwise indicated)

	2007	2008	2009	2010	2011	2012
		Est.	Projections			
Current account	-589	-1,499	-1,229	-1,081	-1,000	-1,001
Trade balance	-1,600	-2,650	-2,160	-2,118	-2,235	-2,420
Exports, fob	1,197	1,118	815	962	1,106	1,272
Imports, fob	-2,797	-3,767	-2,975	-3,079	-3,341	-3,692
Services (net)	-213	-318	-240	-169	-145	-120
Credits	580	641	570	684	793	912
Debits	-793	-959	-810	-853	-938	-1,032
Income (net)	279	389	296	305	323	343
Transfers (net)	945	1,079	875	901	1,057	1,196
Private	850	1,023	820	869	1,030	1,169
Official	94	55	55	32	27	27
Capital and financial account	1,191	1,274	369	1,032	1,186	1,192
Capital transfers (net)	143	146	103	73	74	72
Foreign direct investment (net)	701	784	488	670	715	794
Portfolio investment (net)	-9	8	8	8	8	8
Public sector (net)	133	158	240	241	278	238
Disbursements	149	172	262	265	305	265
Amortization	-17	-14	-22	-24	-27	-27
Other capital (net)	224	178	-470	40	110	80
Errors and omissions	-2	-7	0	0	0	0
Overall balance	600	-233	-860	-49	186	191
Financing	-600	233	510	-141	-252	-191
Gross international reserves (increase: -)	-587	254	532	-121	-231	-170
Use of Fund credit, net	-14	-23	-23	-22	-22	-23
Disbursements	10	3	...	...	...	...
Repurchases/repayments	-24	-26	-23	-22	-22	-23
Exceptional financing 1/	1	1	2	2	2	2
Financing gap	0	0	349	190	66	0
Identified financing						
IMF	0	0	349	139	56	0
Other	0	0	0	51	10	0
Memorandum items:						
Current account (in percent of GDP)	-6.4	-12.6	-11.4	-10.4	-8.9	-8.1
Trade balance (in percent of GDP)	-17.4	-22.2	-20.0	-20.3	-19.8	-19.6
Gross international reserves (end of period)	1,659	1,405	873	994	1,226	1,396
In months of next year's imports	4.2	4.5	2.7	2.8	3.1	3.2
Net international reserves (program definition)	1,350	1,085	568	647	798	909
Merchandise export growth, percent change	16.7	-6.6	-27.1	18.0	15.0	15.0
Merchandise import growth, percent change	45.6	34.7	-21.0	3.5	8.5	10.5
Nominal external debt 2/	1,591	1,830	2,283	2,500	2,805	2,862
Nominal external debt stock (in percent of GDP) 2/	17.3	15.3	21.1	24.0	24.9	23.2
NPV of external debt in percent of exports 3/	67.4	46.3	89.8	92.7	94.6	90.4
External debt service in percent of exports 2/	2.9	3.1	4.2	3.7	3.6	7.9

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

1/ Debt relief from the United Kingdom through 2015 (in respect of IDA credits).
2/ Based on government and government-guaranteed debt.
3/ Based on low-income country debt sustainability analysis.

Table 3. Armenia: Monetary Accounts, 2006–09

(in billions of AMD, unless otherwise indicated)

	2006	2007				2008				2009			
	Dec.	Mar.	June	Sep.	Dec.	Mar.	June	Sep.	Dec.	Mar.	June	Sep.	Dec.
	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Proj. 1/	Proj. 1/	Proj. 1/	Proj. 1/
Central Bank of Armenia													
Net foreign assets	321.8	317.8	352.8	385.2	516.1	423.1	417.1	430.6	383.2	232.4	228.5	243.9	268.0
Net international reserves	329.9	326.1	361.0	395.2	526.4	434.8	429.0	442.4	395.6	252.5	252.5	271.8	295.8
Medium and long-term	-8.0	-8.3	-8.2	-10.0	-10.3	-11.6	-12.0	-11.9	-12.4	-20.1	-24.0	-27.8	-27.8
Net domestic assets	-38.8	-53.0	-65.5	-52.2	-89.0	-42.3	-4.4	7.8	66.6	148.9	191.3	195.5	196.1
Claims on general government (net)	-57.7	-66.6	-93.8	-87.9	-89.8	-124.7	-121.6	-108.7	-96.5	-101.7	-84.2	-86.0	-77.7
of which: central government (net)	-16.2	-30.2	-39.9	-32.6	-51.5	-90.7	-82.3	-72.5	-79.6	-84.8	-67.3	-69.2	-60.9
Claims on banks	7.9	15.4	13.3	23.8	24.6	30.4	41.9	37.0	80.6	205.8	230.0	235.6	236.0
KfW	11.9	12.0	12.6	13.2	14.4	16.0	17.3	18.1	19.9	27.6	31.5	35.3	35.3
Monetary instruments (net) excluding CBA bills	-4.0	3.4	0.7	10.5	10.2	14.4	24.7	19.0	60.7	178.2	198.5	200.3	200.7
CBA bills 2/	-39.0	-52.1	-45.3	-49.9	-49.0	-36.0	-17.7	-9.4	-1.4	0.0	0.0	0.0	0.0
Other items (net)	50.0	50.4	60.3	61.7	25.1	87.9	93.0	88.8	83.8	44.8	45.4	45.9	37.8
Reserve money	283.0	264.8	287.3	333.0	427.1	380.8	412.7	438.3	449.7	381.3	419.8	439.5	464.1
Currency issue	226.8	216.1	241.9	278.6	350.3	325.8	343.3	361.7	344.5	257.0	286.3	306.1	329.8
Deposits	56.2	48.7	45.5	54.4	76.8	55.1	69.4	76.6	105.2	124.3	133.5	133.3	134.3
Banking system													
Net foreign assets	332.5	322.9	353.4	353.3	369.6	347.7	344.0	290.2	229.2	198.5	204.6	220.0	234.1
Net domestic assets	153.2	160.0	169.7	228.6	321.8	331.0	368.1	463.0	479.0	402.0	454.8	470.3	494.9
Claims on government (net)	-31.8	-42.3	-70.1	-64.0	-54.0	-80.4	-78.2	-61.0	-36.3	-23.4	-2.8	-1.8	9.4
of which: claims on central government (net)	9.7	-5.8	-16.3	-8.8	-15.7	-46.4	-38.9	-24.8	-19.5	-6.6	14.0	15.1	26.3
Claims on rest of the economy	241.5	271.6	306.3	371.2	429.8	485.7	550.6	618.5	638.6	590.3	621.8	640.0	664.0
Other items (net)	-56.4	-69.3	-66.5	-78.6	-54.0	-74.3	-104.3	-94.6	-123.3	-164.8	-164.2	-168.0	-178.5
Broad money	485.7	482.9	523.0	581.9	691.3	678.7	712.1	753.2	708.2	600.4	659.4	690.3	729.0
Currency in circulation	211.5	201.7	227.0	260.3	326.0	302.5	320.5	334.1	316.1	227.5	255.8	274.7	297.4
Deposits	274.3	281.3	296.0	321.6	365.3	376.1	391.6	419.1	392.2	372.9	403.6	415.6	431.6
Domestic currency	130.9	145.4	158.4	186.3	235.0	236.4	246.4	270.2	219.5	66.1	72.6	87.1	100.0
Foreign currency	143.4	135.8	137.6	135.3	130.3	139.8	145.2	148.9	172.6	306.8	331.0	328.5	331.6
Memorandum items													
Exchange rate (in drams per U.S. dollar, end of period)	363.5	362.1	341.0	335.8	304.2	307.3	302.7	302.1	306.7	...	...	...	...
NIR (in millions of U.S. dollars) 3/	842.5	833.3	998.8	1,081.1	1,350.1	1,328.0	1,279.6	1,320.0	1,084.7	455.9	455.9	505.9	568.4
NDA of the CBA (in billions of drams) 4/	0.0	0.0	0.0	0.0	0.0	-42.3	-4.4	7.8	66.6	148.9	191.3	195.5	196.1
12-month change in reserve money (in percent)	41.1	40.0	44.3	44.1	50.9	43.8	43.6	31.6	5.3	0.1	1.7	0.3	3.2
12-month change in broad money (in percent)	32.9	34.7	41.1	43.5	42.3	40.5	36.2	29.4	2.4	-11.5	-7.4	-8.4	2.9
12-month change in private sector credit (in percent)	28.2	34.7	39.8	64.6	78.0	78.8	79.8	66.6	48.6	21.5	12.9	3.5	4.0
Velocity of broad money (end of period)	5.5	5.6	5.4	5.1	4.6	4.7	4.7	4.8	5.2	6.1	5.5	5.3	5.2
Money multiplier	1.7	1.8	1.8	1.7	1.6	1.8	1.7	1.7	1.6	1.6	1.6	1.6	1.6
Dollarization in bank deposits 5/	52.3	48.3	46.5	42.1	35.7	37.2	37.1	35.5	44.0	82.3	82.0	79.0	76.8
Dollarization in broad money 6/	29.5	28.1	26.3	23.3	18.9	20.6	20.4	19.8	24.4	51.1	50.2	47.6	45.5
Currency in circulation in percent of deposits	77.1	71.7	76.7	80.9	89.2	80.4	81.8	79.7	80.6	61.0	63.4	66.1	68.9
Stock of foreign currency deposits (in millions of USD)	394.5	375.1	403.6	403.0	428.4	459.4	477.4	489.4	567.4	796.8	859.7	853.3	861.4
Banking system financing of the central government (cumulative)	-19.4	-15.6	-26.0	-18.5	-25.5	-30.7	-23.1	-9.0	-3.7	12.9	33.5	34.5	45.7

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

1/ At the program exchange rate.

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

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: Financial Soundness Indicators for the Banking Sector, 2004–08

(In percent, unless otherwise indicated)

	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Mar. 2008	Jun. 2008	Sep. 2008	Dec. 2008
Capital adequacy								
Total regulatory capital to risk-weighted assets	32.3	33.7	34.9	30.1	27.0	26.0	27.2	27.5
Tier I regulatory capital to risk-weighted assets	30.2	31.7	32.7	29.0	26.1	...	...	...
Capital (net worth) to assets	17.8	21.5	22.9	22.5	22.7	22.1	22.5	23.0
Asset composition								
Sectoral distribution of loans (billions of drams)								
Industry (excluding energy sector)	29.0	30.4	34.3	49.1	57.4	59.9	65.7	66.2
Energy sector	6.6	8.7	5.0	7.2	7.4	8.3	18.5	19.7
Agriculture	8.6	11.3	14.2	22.4	24.1	30.3	31.7	36.5
Construction	5.3	7.9	11.5	22.0	25.6	31.7	37.4	39.5
Transport and communication	1.2	3.7	3.9	5.8	7.1	10.6	9.8	10.2
Trade/commerce	31.1	42.2	49.6	86.8	97.6	109.6	126.0	132.0
Consumer loans	49.2	75.0	93.2	218.8	244.2	277.7	305.8	313.8
Sectoral distribution of loans to total loans (percent of total)								
Industry (excluding energy sector)	22.2	17.0	16.2	11.9	12.4	11.3	11.1	10.7
Energy sector	5.0	4.8	2.3	1.7	1.6	1.6	3.1	3.2
Agriculture	6.6	6.3	6.7	5.4	5.2	5.7	5.3	5.9
Construction	4.0	4.4	5.5	5.3	5.5	6.0	6.3	6.4
Transport and communication	0.9	2.0	1.9	1.4	1.5	2.0	1.6	1.7
Trade/commerce	23.8	23.5	23.4	21.1	21.1	20.8	21.2	21.4
Consumer loans	37.5	41.9	44.0	53.1	52.7	52.6	51.4	50.8
Foreign exchange loans to total loans	70.4	63.7	52.8	40.7	39.0	37.5	38.2	38.7
Asset quality								
Nonperforming loans (billions of drams)	3.1	3.8	6.0	10.3	18.7	19.2	23.3	27.9
Watch (up to 90 days past due)	1.5	2.9	3.6	5.8	13.3	11.9	13.3	21.8
Substandard (91-180 days past due)	0.4	0.5	1.0	1.3	2.0	4.8	2.8	3.4
Doubtful (181-270 days past due)	1.1	0.5	1.4	3.1	3.3	2.6	7.2	2.7
Nonperforming loans to gross loans	2.1	1.9	2.5	2.4	4.0	3.6	3.9	4.4
Provisions to nonperforming loans	77.0	70.7	64.3	66.6	43.9	46.4	50.1	38.2
Spread between highest and lowest rates of interbank borrowing in AMD	2.0	3.7	3.0	0.5	5.0	7.0	8.0	3.0
Spread between highest and lowest rates of interbank borrowing in foreign currency	1.0	1.0	2.3	0.0	0.0	0.0	0.0	1.0
Earnings and profitability								
ROA (profits to period average assets)	3.2	3.1	3.6	3.4	3.0	2.8	2.9	3.1
ROE (profits to period average equity)	18.4	15.5	15.9	15.0	13.0	12.4	13.1	13.6
Interest margin to gross income	44.2	41.1	47.1	47.9	48.8	48.2	47.7	45.9
Interest income to gross income	63.7	59.8	66.3	68.6	74.4	74.0	73.4	72.7
Noninterest expenses to gross income	46.5	49.7	45.1	44.5	42.1	43.5	41.0	42.0
Liquidity								
Liquid assets to total assets	47.1	44.2	41.2	33.7	30.5	27.1	25.5	23.8
Liquid assets to total short-term liabilities	98.7	110.5	106.1	98.2	101.0	95.6	92.4	103.1
Customer deposits to total (non-interbank) loans	177.3	140.5	130.8	106.2	96.4	91.4	87.5	81.4
Foreign exchange liabilities to total liabilities	73.3	66.8	56.0	48.3	48.7	50.0	50.2	55.1
Sensitivity to market risk								
Gross open positions in foreign exchange to capital	7.4	4.9	4.4	8.8	6.9	4.8	4.1	11.5

Source: Central Bank of Armenia.

Table 5. Armenia: Central Government Operations, 2006–09
(in billions of drams)

	2006	2007	2008	2009		2009			
	Jan.-Dec.	Jan.-Dec.	Jan.-Dec.	Jan.-Dec.		Q1	Q2	Q3	Q4
	Act.	Act.	Prelim.	IMF Proj.	Budget	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	**477.2**	**632.5**	**728.2**	**793.7**	**879.4**	**156.4**	**191.9**	**216.3**	**229.0**
Total revenue	465.1	609.1	715.7	749.6	**844.7**	149.3	183.3	202.1	215.0
Tax revenues	383.8	504.3	598.0	610.5	701.5	120.8	149.4	167.1	173.2
VAT	165.9	248.0	296.3	296.1	...	59.2	72.3	79.1	85.6
Profits, simplified and presumptive	88.1	103.4	113.2	117.3	...	26.9	33.5	27.8	29.1
Personal income tax	35.5	46.8	53.7	54.3	...	10.9	13.2	14.9	15.3
Customs duties	18.3	24.0	37.3	47.6	...	8.1	11.6	13.9	14.1
Other	76.1	82.1	97.5	95.2	...	15.8	18.9	31.4	29.1
Social contributions	73.3	85.1	104.1	124.3	128.4	25.4	30.3	31.0	37.6
Other revenue	7.9	19.6	13.6	14.8	14.8	3.1	3.6	3.9	4.2
Grants	12.1	23.5	12.4	44.0	34.7	7.1	8.7	14.3	14.0
Total expenditure	**531.2**	**706.1**	**790.6**	**899.4**	**919.4**	**180.5**	**223.3**	**234.4**	**261.2**
Expense	**442.9**	**541.6**	**650.5**	**739.8**	**744.8**	**162.7**	**184.6**	**186.2**	**206.3**
Wages 1/	49.8	61.3	72.4	88.9	61.6	17.8	23.8	21.5	25.8
Pensions	20.1	21.1	4.1	4.9	4.9	0.9	1.2	1.2	1.6
Subsidies	39.1	58.9	38.4	20.5	20.5	9.6	4.6	3.6	2.6
Of which : gas subsidy	22.7	37.4	16.4	0.0	0.0	0.0	0.0	0.0	0.0
Interest	9.0	10.0	10.4	15.9	15.9	4.4	3.1	5.0	3.5
Social allowances and pensions	152.5	183.7	206.2	253.1	243.1	61.0	62.8	62.6	66.8
Of which : social insurance	71.0	85.8	153.5	178.8	178.8	44.9	44.8	44.6	44.5
Goods and services	172.4	206.7	131.9	164.0	168.9	31.8	40.7	40.4	51.1
Grants	...	...	52.9	66.2	66.2	15.2	15.6	16.9	18.6
Other expenditure	...	...	134.1	126.2	163.6	22.0	32.9	34.9	36.4
Transactions in non-financial assets	**88.4**	**164.5**	**140.1**	**159.7**	**174.7**	**17.8**	**38.7**	**48.3**	**55.0**
Acquisition of non-financial assets	104.2	183.3	161.2	173.0	188.0	20.6	43.3	52.8	56.3
Disposals of non-financial assets	15.9	18.9	21.1	13.3	13.3	2.9	4.6	4.5	1.4
Overall balance (above-the-line)	**-54.0**	**-73.5**	**-62.4**	**-105.8**	**-40.0**	**-24.1**	**-31.4**	**-18.1**	**-32.2**
Statistical discrepancy	-2.6	4.1	1.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	**-56.7**	**-69.4**	**-61.1**	**-105.8**	**-40.0**	**-24.1**	**-31.4**	**-18.1**	**-32.2**
Deficit/Financing	**56.7**	**69.4**	**61.1**	**105.8**	**40.0**	**24.1**	**31.4**	**18.1**	**32.2**
Domestic financing	**44.8**	**30.6**	**29.6**	**45.0**	**30.7**	**13.9**	**20.0**	**0.4**	**10.6**
Banking system	-9.3	-6.4	-3.7	45.7	9.5	12.9	20.6	1.0	11.2
CBA	-12.7	-16.2	-28.1	18.7	9.5	-5.2	17.5	-1.9	8.3
Commercial Banks	3.4	9.9	24.4	27.0	0.0	18.1	3.1	2.9	2.9
Nonbanks	54.1	37.0	33.4	-0.8	21.2	1.1	-0.6	-0.6	-0.6
Privatization proceeds	50.0	44.2	31.6	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills	4.8	-2.8	3.5	3.0	25.0	2.0	0.3	0.3	0.3
Promissory note/other	-0.1	-1.0	-1.2	-0.1	-0.1	0.0	0.0	0.0	0.0
Net lending	-0.5	-3.4	-0.5	-3.7	-3.7	-0.9	-0.9	-0.9	-0.9
External financing	**11.8**	**38.8**	**31.4**	**60.8**	**9.3**	**10.2**	**11.4**	**17.7**	**21.6**
Gross inflow	34.9	64.5	52.6	100.8	49.2	19.8	21.2	30.1	29.6
Amortization due	-7.1	-6.0	4.9	-6.6	-6.6	-2.8	-0.7	-2.6	-0.6
Net lending	-16.0	-19.7	-26.0	-33.3	-33.3	-6.9	-9.1	-9.8	-7.5
Memorandum items									
Nominal GDP (billion of drams)	2,656	3,149	3,650	3,757	4,169	3,757	3,757	3,757	3,757
Underlying balance 2/	-81.4	-112.6	-69.9	-145.7	-70.7	-30.4	-38.9	-31.5	-45.0
Program balance 3/	-73.1	-92.5	-87.6	-142.8	...	-31.9	-41.4	-28.9	-40.6

Table 5. Armenia: Central Government Operations, 2006–09 (concluded)

(in percent of GDP, unless otherwise specified)

	2006	2007	2008	2009		2009			
	Jan.-Dec.	Jan.-Dec.	Jan.-Dec.	Jan.-Dec.		Q1	Q2	Q3	Q4
	Act.	Act.	Prelim.	IMF Proj.	Budget	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	**18.0**	**20.1**	**19.9**	**21.1**	**21.1**	**4.2**	**5.1**	**5.8**	**6.1**
Total revenue	17.5	19.3	19.6	20.0	20.3	4.0	4.9	5.4	5.7
Tax revenues	14.5	16.0	16.4	16.2	16.8	3.2	4.0	4.4	4.6
VAT	6.2	7.9	8.1	7.9	...	1.6	1.9	2.1	2.3
Profits, simplified and presumptive	3.3	3.3	3.1	3.1	...	0.7	0.9	0.7	0.8
Personal income tax	1.3	1.5	1.5	1.4	...	0.3	0.4	0.4	0.4
Customs duties	0.7	0.8	1.0	1.3	...	0.2	0.3	0.4	0.4
Other	2.9	2.6	2.7	2.5	...	0.4	0.5	0.8	0.8
Social contributions	2.8	2.7	2.9	3.3	3.1	0.7	0.8	0.8	1.0
Other revenue	0.3	0.6	0.4	0.4	0.4	0.1	0.1	0.1	0.1
Grants	0.5	0.7	0.3	1.2	0.8	0.2	0.2	0.4	0.4
Total expenditure	**20.0**	**22.4**	**21.7**	**23.9**	**22.1**	**4.8**	**5.9**	**6.2**	**7.0**
Expense	**16.7**	**17.2**	**17.8**	**19.7**	**17.9**	**4.3**	**4.9**	**5.0**	**5.5**
Wages 1/	1.9	1.9	2.0	2.4	1.5	0.5	0.6	0.6	0.7
Pensions	0.8	0.7	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Subsidies	1.5	1.9	1.1	0.5	0.5	0.3	0.1	0.1	0.1
Of which : gas subsidy	0.9	1.2	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Interest	0.3	0.3	0.3	0.4	0.4	0.1	0.1	0.1	0.1
Social allowances and pensions	5.7	5.8	5.6	6.7	5.8	1.6	1.7	1.7	1.8
Of which : social insurance	2.7	2.7	4.2	4.8	4.3	1.2	1.2	1.2	1.2
Goods and services	6.5	6.6	3.6	4.4	4.1	0.8	1.1	1.1	1.4
Grants	...	...	1.4	1.8	1.6	0.4	0.4	0.4	0.5
Other expenditure	...	...	3.7	3.4	3.9	0.6	0.9	0.9	1.0
Transactions in non-financial assets	**3.3**	**5.2**	**3.8**	**4.2**	**4.2**	**0.5**	**1.0**	**1.3**	**1.5**
Acquisition of non-financial assets	3.9	5.8	4.4	4.6	4.5	0.5	1.2	1.4	1.5
Disposals of non-financial assets	0.6	0.6	0.6	0.4	0.3	0.1	0.1	0.1	0.0
Overall balance (above-the-line)	**-2.0**	**-2.3**	**-1.7**	**-2.8**	**-1.0**	**-0.6**	**-0.8**	**-0.5**	**-0.9**
Statistical discrepancy	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	**-2.1**	**-2.2**	**-1.7**	**-2.8**	**-1.0**	**-0.6**	**-0.8**	**-0.5**	**-0.9**
Deficit/Financing	**2.1**	**2.2**	**1.7**	**2.8**	**1.0**	**0.6**	**0.8**	**0.5**	**0.9**
Domestic financing	**1.7**	**1.0**	**0.8**	**1.2**	**0.7**	**0.4**	**0.5**	**0.0**	**0.3**
Banking system	-0.4	-0.2	-0.1	1.2	0.2	0.3	0.5	0.0	0.3
CBA	-0.5	-0.5	-0.8	0.5	...	-0.1	0.5	0.0	0.2
Commercial Banks	0.1	0.3	0.7	0.7	...	0.5	0.1	0.1	0.1
Nonbanks	2.0	1.2	0.9	0.0	0.5	0.0	0.0	0.0	0.0
Privatization proceeds	1.9	1.4	0.9	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills	0.2	-0.1	0.1	0.1	0.6	0.1	0.0	0.0	0.0
Promissory note/other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	0.0	-0.1	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0
External financing	**0.4**	**1.2**	**0.9**	**1.6**	**0.2**	**0.3**	**0.3**	**0.5**	**0.6**
Gross inflow	1.3	2.0	1.4	2.7	1.2	0.5	0.6	0.8	0.8
Amortization due	-0.3	-0.2	0.1	-0.2	-0.2	-0.1	0.0	-0.1	0.0
Net lending	-0.6	-0.6	-0.7	-0.9	-0.8	-0.2	-0.2	-0.3	-0.2
Memorandum items									
Nominal GDP (billion of drams)	2,656	3,149	3,650	3,757	4,169	3,757	3,757	3,757	3,757
Underlying balance 2/	-3.1	-3.6	-1.9	-3.9	-1.7	-0.8	-1.0	-0.8	-1.2
Program balance 3/	-2.8	-2.9	-2.4	-3.8	...	-0.8	-1.1	-0.8	-1.1

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 and other expenditure to wages.
2/ Underlying balance is defined as overall balance before grants, and excluding external interest payments.
3/ Overall balance excluding net lending.

Table 6. Armenia: Quantitative Targets under the PRGF Program, 2008 1/
(End of period ceilings on stocks, unless otherwise specified)

	2007	2008		
	Dec.	Jun.	Dec.	
	Act.	Act.	Prog. /2	Prel.
	(in billions of dram)			
Net domestic assets of the CBA 3/	-96.2	-8.1	19.9	75.9
Net banking system credit to the government	-54.0	-78.2	-50.8	-36.3
Underlying fiscal balance on a cash basis (floor) 4/	-93.6	-18.0	-68.6	-69.9
Reserve money 5/	427.1	412.7	506.4	449.7
	(in millions of dollars)			
Contracting or guaranteeing of new nonconcessional external debt 5/ 6/	0	0	0	0
External arrears (continuous criterion)	0	0	0	0
Net official international reserves (floor) 3/	1,350.1	1,279.6	1,517.9	1,084.7

1/ All items as defined in Country Report No. 09/29.
2/ Performance criterion.
3/ At program exchange rates (357 dram per dollar in 2007 and 304.2 dram per dollar in 2008).
4/ Overall balance before grants, and excluding external interest payments. Cumulative flow from the beginning of the calendar year until the end of the month indicated.
5/ Indicative target.
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: Medium-Term Macroeconomic Framework, 2007–12

	2007	2008	2009	2010	2011	2012
		Projections				
	(In percent of GDP, unless otherwise specified)					
National income and prices						
Real GDP growth (percent change)	13.8	6.8	-1.5	3.0	6.0	6.0
Gross domestic product (in millions of U.S. dollars)	9,228	11,929	10,823	10,419	11,276	12,324
Gross national income per capita (in U.S. dollars)	2,943	3,806	3,418	3,280	3,530	3,836
CPI inflation, end-of-period (annual percent change)	6.6	5.2	8.0	4.0	4.0	4.0
Investment and saving						
Investment	37.2	38.1	33.0	33.2	34.3	34.7
Government	5.2	3.8	4.2	4.2	4.4	4.6
Other	32.0	34.3	28.7	29.0	29.8	30.0
National savings	30.8	25.6	21.6	22.8	25.4	26.5
Government	2.9	2.1	1.4	1.6	2.1	2.5
Other	27.9	23.4	20.2	21.2	23.3	24.0
Government operations						
Revenue and grants	20.1	19.9	21.1	21.3	21.6	22.0
of which: tax revenue	16.0	16.4	16.2	16.6	17.0	17.4
grants 1/	0.7	0.3	1.2	0.6	0.4	0.4
Expenditure	22.4	21.7	23.9	23.9	24.0	24.1
Current expenditure	17.2	17.8	19.7	19.7	19.6	19.5
Capital expenditure	5.2	3.8	4.2	4.2	4.4	4.6
Overall balance (including grants)	-2.3	-1.7	-2.7	-2.7	-2.4	-2.1
Underlying balance 2/	-3.6	-1.9	-3.9	-3.1	-2.6	-2.5
Domestic financing	1.1	0.8	1.2	1.1	1.0	1.1
External financing	1.2	0.8	1.5	1.5	1.3	1.1
Government and government-guaranteed debt	17.5	17.9	26.7	28.3	29.3	28.7
External sector						
Exports of goods and services	19.3	14.7	12.8	15.8	16.8	17.7
Imports of goods and services	39.0	39.6	35.0	37.7	38.0	38.3
Current account (in percent of GDP)	-6.4	-12.6	-11.4	-10.4	-8.9	-8.1
Current account (in millions of U.S. dollars)	-589	-1,499	-1,229	-1,081	-1,000	-1,001
Capital and financial account (in millions of U.S. dollars)	1,191	1,274	369	1,032	1,186	1,192
of which: direct foreign investment	701	784	488	670	715	794
public sector disbursements	149	172	262	265	305	265
Change in gross international reserves (in millions of U.S. dollars) 3/	-587	254	532	-121	-231	-170
Arrears and debt relief (in millions of U.S. dollars)	1	1	2	2	2	2
Financing/gap (in millions of U.S. dollars)	0	0	349	190	66	0
of which: IMF	0	0	349	139	56	0
Other	0	0	0	51	10	0
Gross international reserves in months of imports	4.2	4.5	2.7	2.8	3.1	3.2

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/ Underlying balance is defined as overall balance before grants and excluding external interest payments.
3/ A negative figure indicates an increase.

Table 8. Armenia: Fund Disbursements and Timing of Reviews Under the Twenty-Eight Month Stand-By Arrangement, 2009-11

Date of Availability	Conditions	Amount (In millions of SDR)
6 March, 2009	Board approval of the Stand -By arrangement	161.552
15 May, 2009	Observance of end -March 2009 performance criteria and completion of first review	36.800
15 August, 2009	Observance of end -June 2009 performance criteria and completion of second review	18.860
15 November, 2009	Observance of end -September 2009 performance criteria and completion of third review	18.860
15 February, 2010	Observance of end -December 2009 performance criteria and completion of fourth review	23.552
15 May, 2010	Observance of end -March 2010 performance criteria and completion of fifth review	23.552
15 August, 2010	Observance of end -June 2010 performance criteria and completion of sixth review	23.552
15 November, 2010	Observance of end -September 2010 performance criteria and completion of seventh review	23.552
15 February, 2011	Observance of end -December 2010 performance criteria and completion of eighth review	18.860
15 May, 2011	Observance of end -March 2011 performance criteria and completion of ninth review	18.860

Source: Fund staff estimates and projections.

Table 9. Armenia: Indicators of Capacity to Repay the Fund, 2008–15

	2008	2009	2010	2011	2012	2013	2014	2015
				Projections				
Fund obligations based on existing credit (in millions of SDRs)								
Principal	17.1	15.2	14.1	14.4	14.8	11.1	7.7	4.5
Charges and interest	0.5	0.4	0.3	0.3	0.2	0.1	0.1	0.0
Fund obligations based on existing and prospective credit (in millions of SDRs)								
Principal	17.1	15.2	14.1	14.4	86.9	146.8	112.5	52.8
Charges and interest	0.5	3.7	6.1	8.5	8.5	5.1	2.0	0.6
Total obligations based on existing and prospective credit								
In millions of SDRs	17.6	18.9	20.2	23.0	95.3	151.9	114.4	53.4
In millions of US$	26.4	27.9	29.9	34.0	141.1	224.8	169.4	79.1
In percent of Gross International Reserves	1.9	3.2	3.0	2.8	11.5	19.8	16.0	6.9
In percent of exports of goods and services	1.4	2.1	2.0	2.0	7.4	10.5	7.0	2.9
In percent of debt service 1/	48.3	44.8	43.4	42.7	76.1	81.4	71.0	48.6
In percent of GDP	0.2	0.3	0.3	0.3	1.1	1.7	1.1	0.5
In percent of quota	19.1	20.5	22.0	25.0	103.6	165.1	124.4	58.1
Outstanding Fund credit 1/								
In millions of SDRs	87.5	308.4	388.5	411.7	324.9	178.1	65.6	12.8
In billions of US$	0.13	0.46	0.57	0.61	0.48	0.26	0.10	0.02
In percent of Gross International Reserves	9.4	52.3	57.8	49.7	34.4	17.7	6.2	1.1
In percent of exports of goods and services	7.5	33.0	34.9	32.1	22.0	10.6	3.4	0.6
In percent of debt service 1/	240.5	732.8	833.9	764.8	259.1	95.4	40.7	11.6
In percent of GDP	1.1	4.2	5.5	5.4	3.9	1.9	0.6	0.1
In percent of quota	95.1	335.2	422.2	447.5	353.1	193.6	71.3	13.9
Net use of Fund credit (millions of SDRs)	-12.5	220.9	80.1	23.3	-86.9	-146.8	-112.5	-52.8
Disbursements	4.6	236.1	94.2	37.7	0.0	0.0	0.0	0.0
Repayments and Repurchases	17.1	15.2	14.1	14.4	86.9	146.8	112.5	52.8
Memorandum items:								
Nominal GDP (in millions of US$)	11,929.5	10,822.7	10,419.1	11,275.9	12,324.0	13,602.7	15,018.2	16,420.1
Exports of goods and services (in millions of US$)	1,758.9	1,385.1	1,645.8	1,899.5	2,184.5	2,479.2	2,815.7	3,188.9
Gross International Reserves (in millions of US$)	1,405.0	873.0	994.4	1,225.7	1,396.1	1,491.6	1,576.3	1,744.7
Debt service (in millions of US$) 1/	54.7	62.3	68.9	79.7	185.5	276.1	238.4	162.8
Quota (millions of SDRs)	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0

Sources: IMF staff estimates and projections.

1/ Includes prospective SBA purchase of SDR 368 million (400 percent of quota).

Table 10. Armenia: Proposed Access, 2009-2011

		High Access Cases 1/				Normal Access Cases			
	Proposed Arrangement	Proposed Arrangement (Percentile)	20th Percentile (Ratio)	80th Percentile (Ratio)	Average (Ratio)	Proposed Arrangement (Percentile)	20th Percentile (Ratio)	80th Percentile (Ratio)	Average (Ratio)
Access									
In millions of SDRs	368	3	1,726	12,862	7,985	74	36	408	353
Average annual access (percent of quota)	171	34	119	457	284	100	21	51	39
Total access in percent of: 2/									
Quota	400	31	300	900	635	100	30	75	63
Gross domestic product	5.0	47	3	10	10	97	1	3	2
Gross international reserves	62.9	62	27	90	86	88	5	41	41
Exports of goods and nonfactor services	39.3	80	12	40	24	100	2	7	6
Imports of goods and nonfactor services	14.4	26	11	53	32	94	2	6	5
Total debt stock									
Of which: Public 3/	26.1	71	7	34	23	…	…	…	…
External	29.9	97	7	17	13	100	2	6	4
Short-term	…		20	107	93	…	…	…	…
M2	28.8	84	5	24	25	95	1	12	101

Source: Executive Board documents, MONA database, and Fund staff estimates and projections.

1/ High access cases include all available data at approval and on augmentation for the 35 requests to the Board since 1994 which involved the use of the exceptional circumstances clause or SRF resources. Exceptional access augmentations are counted as separate observations. For the purpose of measuring access as a ratio of different metrics, access includes augmentations and previously approved and drawn amounts.

2/ The data used to calculate ratios is the actual value for the year prior to approval for public and short-term debt, and the projection at the time of program approval for the year in which the program was approved for all other variables.

3/ Defined as debt of the central government and debt guaranteed by the central government

ATTACHMENT I. ARMENIA: LETTER OF INTENT

March 2, 2009

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

Dear Mr. Strauss-Kahn:

The Government of the Republic of Armenia has made significant progress on economic and structural reforms in recent years, with impressive gains in growth and poverty reduction in a context of low inflation. The IMF has accompanied these efforts, and we have successfully implemented a sequence of arrangements under the Poverty Reduction and Growth Facility (PRGF). A new low-access PRGF arrangement was approved by the IMF's Executive Board on November 17, 2008 to support Armenia's macroeconomic and reform objectives for the 2008-11 period.

Since last fall, the global outlook has deteriorated substantially, with sharp downturns experienced by Armenia's key trade partners. As a result, Armenia's balance of payments inflows have contracted dramatically and capital outflows have picked up, putting significant pressure on the exchange rate and significantly reducing our international reserves. This situation has placed the financial sector in a vulnerable position.

To help address this situation, the Government of Armenia requests a Stand-By Arrangement in the amount of SDR 368 million (400 percent of quota or $544 million) for the period March 2009 through June 2011. These resources should help us to ensure economic and financial stability by stabilizing the international reserves position and the banking system, and allowing for a sound implementation of our budget while protecting the poor. In support of these objectives, we have committed to a set of policies outlined in the attached Memorandum of Economic and Financial Policies. We will continue to implement the structural reforms that underpinned our PRGF-supported program and will be crucial to strengthening our medium-term public finance position. However, given the changed outlook and financing needs, we request cancellation of the PRGF arrangement.

The Government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, but it will take other measures that may become necessary for this purpose. The Government will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. Moreover, after the period of the arrangement, and while Armenia has outstanding financial obligations to the Fund from purchases and loans on earlier arrangements, the Government will consult with the Fund on Armenia's economic and financial policies from time to time, at the initiative of the Government or at the request of the Managing Director. We expect to complete the first quarterly review under the proposed arrangement by June 2009. Finally, we grant our permission for the publication on the IMF's website of the staff report and this letter.

Very truly yours,

/s/
Tigran Sargsyan
Prime Minister
Republic of Armenia

/s/
Tigran Davtyan
Minister of Finance
Republic of Armenia

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

ATTACHMENT II. ARMENIA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

(March 2, 2009)

I. RECENT MACROECONOMIC PERFORMANCE AND OUTLOOK FOR 2009-10

1. **Armenia is now facing significant challenges following a long period of macroeconomic success and stability.** Under the PRGF arrangement that covered the period 2005–08, prudent macroeconomic policies and structural reforms contributed to double digit GDP growth, low inflation, and a significant reduction in poverty rates. Despite a widening external current account deficit, international reserves continued to increase, owing to large foreign exchange inflows and dedollarization, and external debt remained low. The overall fiscal deficit was contained, and additional revenues arising from improvements in tax administration could be used to finance poverty-reducing expenditures. Government debt remained stable. The monetary framework was strengthened, contributing, with a flexible exchange rate, to maintaining low inflation.

2. **In the first three quarters of 2008,** growth remained strong, with GDP increasing by 10.4 percent through September. Driven by international prices and strong domestic demand, inflation rose to a high of 11.5 percent in August, and the current account deficit continued to worsen. In response to these signs of overheating, monetary policy was progressively tightened.

3. **The economic outlook changed abruptly as the global financial crisis deepened in October.** Owing to its relative international isolation, the financial sector was not directly affected. However, the mining sector and exports were severely hit by the sharp drop in international commodity prices, with many mines stopping operations. In addition, remittances and capital inflows slowed considerably, which had a major impact on the construction sector. As a consequence, growth came to a halt, with annual GDP growth falling to 6.8 percent for the year as a whole, and the external current account deficit rising to an estimated 12.6 percent of GDP. In the wake of falling international prices and rapidly slowing domestic demand, inflation fell to 4 percent in January 2009.

4. **Out of concerns for the impact of a crisis in confidence on financial stability, the Central Bank of Armenia (CBA) intervened repeatedly to stabilize the exchange rate in the last part of 2008 and in early 2009.** With expectations for a depreciation of the dram gaining strength, the CBA faced strong pressures, leading to a rapid decline in international reserves. With a significant amount of deposits being converted to foreign currency, and overall deposits declining slightly, banks came under pressure to reduce lending. In this context, and in line with the changed inflation outlook, the CBA eased monetary policy, cutting the policy rate from 7.75 in November 2008 to 6.75 percent in February 2009.

5. **As a result of the commodity price shock and our attempt to preserve financial stability, we missed most of the end-December targets under the PRGF arrangement.** Due to unexpectedly large foreign currency sales, both the end-2008 targets for international reserves and net domestic assets of the CBA were missed. In addition, the target on net banking system credit to the government, as well as that on the underlying fiscal balance, were also missed. Other targets under the program were respected.

6. **The short-term economic outlook presents enormous challenges.** Difficulties in many sectors, including mining and construction, are affecting growth prospects and weakening the labor market. GDP growth in 2009 is projected to fall considerably with respect to 2008, and unemployment is expected to increase. Depressed international commodity prices, falling remittances, and weaker capital inflows are putting pressure on the balance of payments, despite falling domestic demand. The redollarization of the financial system presents risks for financial stability and challenges for monetary policy. We are expecting a gradual recovery in 2010, but this is highly dependent on global economic developments, and downside risks are prevalent. A strong policy response is needed to restore confidence, stop the loss of international reserves, and maintain macroeconomic stability.

II. The Program for 2009

7. **The policies outlined below are designed to tackle the economic and financial challenges now confronting Armenia.** These policies, which would form the basis for a new 28-month stand-by arrangement from the Fund, are aimed at preserving economic and financial stability, while mitigating the impact of the global crisis and economic downturn on the poor. Central to this strategy is the return to a flexible exchange rate regime supported by appropriate monetary policies. We are also vigilant to possible distress in the financial sector, and will respond rapidly should more targeted measures be needed. A sound fiscal policy will underpin our commitment to macroeconomic stability, while ensuring that growth-promoting public investment moves forward. In addition, we want to preserve the impressive gains Armenia has made in reducing poverty in recent years. To this end, we will ensure that the level of social services is maintained, and that programs to protect the poor are expanded as needed. We will continue our ambitious structural reform program aimed at strengthening public finances, boosting productivity, and increasing the resilience of the economy.

8. **We will establish a high-level committee to monitor developments in the economy and coordinate the policy response of the authorities to the ongoing economic challenges.** This committee will be chaired by the Prime Minister, and will include representatives from the Ministry of Finance, Ministry of Economy, the CBA, and the State Revenue Committee.

A. Monetary, Exchange Rate, and Financial Sector Policies

9. **We are committed to return to a flexible exchange rate regime in the immediate future.** Since the deepening of the global financial crisis in October 2008, intervention has been necessary to prevent a crisis of confidence that was threatening the stability of the financial system. However, we recognize that the maintenance of a soft peg has led to a large loss of international reserves and significant redollarization without stemming expectations of a dram depreciation. This, in turn, has undermined the credibility of our inflation-targeting framework and the effectiveness of monetary policy, which we are committed to restoring. Since October 2008, our exchange rate misalignment has increased significantly, owing to the worsening economic outlook and the currency depreciation experienced by many of our trade partners. We expect the exchange rate to move to a value in line with its fundamentals when we return to a floating regime. When normal market functioning is restored, our exchange rate policy will be a managed float with no predetermined path. We are committed to intervening only to smooth excessive market volatility and to increase international reserves.

10. **Monetary policy will be geared towards supporting the return to a flexible exchange rate regime.** As outlined below, we will take any emergency measures necessary to address banks' liquidity shortages in order to avoid any risks of bank runs. The CBA will raise policy interest rates at the time we return to a flexible regime. This will support demand for dram-denominated assets, fight capital outflows, mitigate any inflationary pressures stemming from depreciation, and restore confidence in the financial sector. Throughout this transition period, we will conduct an open and transparent communication campaign to explain to the public the reasons behind the depreciation and any additional measures needed to preserve financial stability.

11. **Strengthening financial stability will be a critical part of the program:**

- To ensure a timely and consistent policy response, the CBA will prepare a comprehensive and actionable contingency plan for the financial sector. This plan will contain the explicit policy responses to all likely developments, including liquidity shortages in the banking sector, with responsibilities of various parties clearly defined. The CBA will consult with the government as needed on the preparation of this contingency plan.

- We recognize that the banking system will be adversely affected by the depreciation of the dram and will take all appropriate measures to ensure that banks remain able to meet all liabilities as they fall due. The CBA stands ready to provide liquidity to banks on a temporary basis in exchange for adequate collateral. The CBA will on a temporary basis accept a wider range of collateral, including pledged fixed assets, bank shares, and high quality bank loans if necessary.

- Should circumstances warrant it, the coverage of the Deposit Guarantee Fund will be increased. In addition, the authorities will approve a plan to increase the resources of the Deposit Guarantee Fund (performance criterion for end-June 2009).

- Bank supervision will be enhanced with more intensive on-site and off-site surveillance and monitoring. If financial conditions in any banks appear to be deteriorating, we will agree with bank management and shareholders on a restructuring plan to resolve the difficulties. In the first instance, we would expect the banks' shareholders to recapitalize the bank to adequate levels. However, we will also set out a framework for using public resources if this approach proves to be inadequate. In exceptional cases, we will provide banks with long-term funds. In order to protect taxpayers' interests, the banks will issue subordinated debt, with an option to convert such debt into bank equity. We will also tighten prudential standards, particularly regarding foreign currency exposures, and will progressively work to reduce banks' net open positions.

12. **As market conditions stabilize, we will return to our inflation-targeting framework.** In the short term, increased dollarization will hamper the implementation of monetary policy. Therefore, it will be particularly important to further strengthen the monetary transmission mechanism, pursue more active liquidity management, and foster the development of the money market. To enhance monetary operations and debt management, the Ministry of Finance (MoF) and CBA will closely coordinate their liquidity forecasting and MoF debt issuance to take account of both budget financing and liquidity management needs. Furthermore, the CBA will continue to conduct repo operations, and will not go back to issuing its own securities. At the same time, the treasury will maintain its issuance of short-term T- bills, including three-month and six-month T-bills, consistent with the recent memorandum of understanding between the CBA and the MoF. The CBA also plans to increase its holdings of treasury securities over the medium term in order to strengthen its capacity to conduct reverse repo operations.

B. Fiscal Policy

13. **Fiscal policy will support macroeconomic stability, while allowing for continued public investment and protection of social services.** To this end, we intend to limit the overall fiscal deficit in 2009 to around 3 percent of GDP, excluding nonprogrammed externally-financed investment projects (see below). The deterioration in the deficit target relative to the 1 percent of GDP budget objective is due to the fact that revenue is projected to be significantly lower than the projection in the budget, reflecting the contraction in economic activity, particularly the downturn in revenue-generating sectors such as mining. As discussed below, the revenue shortfall will be offset in part by restrained spending and some tax policy measures.

14. **On spending, we plan to restrict non-priority expenditure, while protecting social outlays and allowing for higher investment as foreign financing materializes.** To this end, we expect substantial savings on nonessential spending and areas where execution has been slow. At the same time, we intend to boost spending on social protection programs, and are in discussions with partners, notably the World Bank, on how to strengthen these programs.

15. **Our aim is to restrict spending financed by domestic resources and instead rely on external financing to fund the increase in capital spending.** We expect additional resources to become available from external donors and partners on top of what is currently projected by the IMF. While much of these resources are only partially concessional, they would allow us to finance more public investment projects, and potentially set up credit lines for small and medium enterprises. To this end, we propose to spend up to $200 million from those additional resources on public investment in 2009, with which would allow us to increase our deficit target accordingly. We are committed to maintaining transparency in the use of such resources by channeling any additional spending through the budget. We will also limit the use of government cash deposits to finance the budget, as we recognize the need to have a cushion for cash-flow management purposes, and possibly for future needs.

16. **We are implementing some changes to tax policy.** Given the weak revenue outlook and the difficult conditions facing Armenian firms with respect to trading partners, we plan to raise temporarily customs tariffs for some goods. We recognize the distortionary impact of such a policy, and the negative impact on the poor. However, the changes in tariff rates are within our commitments to the WTO, and will be limited to a certain number of goods for which Armenian substitutes exist. In terms of revenue impact, we expect this measure to generate an additional AMD 10 billion in receipts in 2009. In addition, we have recently raised presumptive taxes on tobacco products, we plan to raise excise taxes on imported alcoholic beverages, and are considering raising presumptive taxes on petroleum products. Looking forward, we maintain our objective of abolishing presumptive taxation for tobacco and fuel, and to this end, we will submit legislation to parliament by December 2009 to bring petroleum and tobacco products within the regular tax regimes (excise tax, customs duties, profit tax, and VAT), effective January 1, 2011.

17. **In 2009, we intend to address two long-standing problems in the tax area:**

- The large amount of outstanding tax credits (AMD 154.4 billion at end-December 2008) is associated with ad-hoc collection practices in earlier periods, including requests for advance tax payments. Halting these practices and offsetting advance payments against future tax liabilities will provide an important stimulus during the recession. Therefore, we will not accumulate additional tax credits during 2009, and, more generally, we are committed to analyzing and fixing the systemic problems underlying these tax credits in the context of our comprehensive tax administration reform. We have included in the program a quantitative indicative target on the stock of tax credits.

- We remain committed to introducing best practices in VAT refund processing to exporters by: (i) meeting the statutory 90-day processing deadline for all VAT refund claims filed in 2009, (ii) clearing the stock of late refund claims, (iii) implementing risk management approaches (i.e. taxpayers with good compliance histories to get fast-track refunds, while risky cases face pre-refund audits); (iv) implementing a forecasting system to anticipate refund levels so that funds are available to pay legitimate refund claims as they occur; and (v) submitting legislation to parliament to strengthen penalties for false refund claims and pay interest on legitimate late refunds arising from claims filed after December 2009, with interest to be paid out of VAT revenues (structural benchmark for December 2009). We have already significantly reduced the stock of refund claims and plan to completely eliminate it over the next few months.

C. Structural Reforms

Public finances

18. **We remain committed to our ambitious tax administration reform agenda.** To this end, we restructured the tax administration organization by adopting a function-based organizational structure, merging the four specialist inspectorates into a single large taxpayer inspectorate, and closing 11 tax inspectorates, all of which became effective in February 2009. We expect these changes to generate savings and enhance cost-effectiveness, while securing a sustainable revenue base. Going forward, we intend to continue consolidating the regional tax inspectorates. We have also completed the merger of the State Customs Service with the State Tax Service into a new organization named State Revenue Committee (SRC). The merger is expected to generate efficiency gains through information sharing and administrative support functions, such as human resources and IT, while the core functions of customs and tax administration will not be integrated.

19. **On other fiscal reforms,** we plan to introduce a funded pension pillar on January 1, 2010. We intend to revise our estimates of the costs of this reform, as well as those associated with the planned increase in basic pensions, taking into consideration the weakening economic environment. Legislation on the new pension system, including on the unification of income tax and social contributions, will be submitted to parliament by mid-2009. The SRC will assume the task of collecting and reconciling individual contributions. In the context of the Medium Term Expenditure Framework (MTEF), we intend to produce an analytical report on medium-term fiscal risks, including those arising from the introduction of the funded pillar and the costs associated with the planned increase in basic and average pensions over the next few years. To further improve our fiscal framework, we intend to improve the MTEF by including a section on debt management, which will help align policy

decisions over the medium term, with their long-term fiscal implications. Finally, we plan to complete the specific part of the unified tax code by June 2009.

Financial sector

20. We remain committed to the financial sector reforms outlined in the Memorandum of Economic and Financial Policies underpinning our November 2008 PRGF request. In the current crisis, our focus is on ensuring financial stability, including through the adoption of the measures discussed above. Nonetheless, we will continue to implement our reform agenda, including:

- Foster the development of commercial banks' risk management capacity, and integrate an assessment of banks' risk management systems into the CBA's regular supervisory activity.
- Enhance credit availability and improve financial intermediation;
- Launch our campaign to educate consumers about financial terms, products, and services; and
- Further develop the securities market as laid out in our capital market development action plan. To increase the stock of government securities available for open market operations, we will amend Article 11 of the "Law on the Central Bank of the Republic of Armenia" to allow a gradual recapitalization of the CBA with marketable interest-bearing securities (structural benchmark for end-September 2009).

Other structural reforms

21. **Despite the difficult economic climate, we will continue our wide-ranging structural reform agenda outlined in our Sustainable Development Program.** This agenda is aimed at deepening productivity-enhancing structural reforms, and improving governance. A key area will be continued efforts to strengthen the business environment. The tax administration reforms outlined above will help in this regard, and we will continue our fight against corruption.

III. PROGRAM FINANCING

22. **Armenia faces significant financing needs during the program period.** Our estimates suggest that a large financing gap in 2009 is likely, due to a significant reduction in export earnings, private transfers, and private capital inflows. The decline in export earnings reflects the sharp drop in base metals prices and weakening external demand, while the steep drop in private transfers and capital inflows is particularly associated with the sharp contraction of the Russian economy, from which the majority of both remittances and FDI originate.

23. **In the current global climate there are limited available sources of financing.** Foreign direct investment is projected to slow considerably in line with the expected weakening of the Russian economy, the main source of such inflows. The bulk of official external financing included in the program will be provided by the World Bank.

24. **The resulting financing gap can only be partially financed from domestic adjustment.** The current account position is expected to adjust significantly under the program scenario, declining by close to $300 million relative to the program concluded with the Fund in November 2008. Nevertheless, absent Fund financing, official foreign exchange reserves would fall below the desirable minimum level, and cover less than 3 months of imports.

IV. PROGRAM MONITORING

25. **In the context of significant external financing needs associated with severe external shocks, we would like to request a 28-month Stand-By Arrangement in the amount of SDR 368 million.** The funding requested would cover the remaining projected balance of payments needs during 2009 and part of the projected financing gaps in 2010-11. The IMF financing would be utilized to assure financial stability and to maintain Armenia's gross international reserves at a level sufficient to cover about 3 months of imports of goods and services at the end of the program.

26. **The program will be monitored via quarterly performance criteria and structural benchmarks.** Progress in implementing the program will be monitored through quantitative criteria and indicative targets outlined in Table 1 as well as structural performance criteria and benchmarks as listed in Table 2. The structural measures discussed above that are not mentioned in Table 2 are part of the authorities' overall reform effort, but are not part of conditionality under this program. The first review of the program is expected to be completed on or after May 15, 2009, the second review on or after August 15, 2009, the third review on or after November 15, 2009, and the fourth review on or after February 15, 2010.

Table 1. Armenia: Quantitative Targets, 2009 1/
(End of period ceilings on stocks, unless otherwise specified)

	2007	2008		2009		
	Dec.	Jun.	Dec.	Mar.	Jun.	Sep.
	Act.	Act.	Prel.	Prog. 2/	Prog. 2/	Prog. 2/
	(in billions of dram)					
Net domestic assets of the CBA 3/	-96.2	-8.1	75.9	131.8	174.2	178.4
Net banking system credit to the government	-54.0	-78.2	-36.3	-23.6	-2.7	-1.8
Overall fiscal balance on a cash basis (floor) 4/	-69.4	15.9	-46.1	-24.0	-55.7	-73.6
Reserve money 5/	427.1	412.7	449.7	381.3	419.8	439.5
Stock of tax credits 5/	125.3	129.8	145.0	145.0	145.0	145.0
	(in millions of dollars)					
External arrears (continuous criterion)	0	0	0	0	0	0
Net official international reserves (floor)	1,350.1	1,279.6	1,084.7	0.0	0.0	0.0

1/ All items as defined in .
2/ Performance criterion.
3/ At program exchange rates.
4/ Overall balance before grants, and excluding external interest payments. Cumulative flow from the beginning of the calendar year until the end of the month indicated.
5/ Indicative target.

Table 2. Proposed Structural Conditionality for 2009

Measure	Proposed Time Frame (End of Period)	Type of Conditionality
Approve a plan to increase the resources of the Deposit Guarantee Fund (see MEFP ¶11).	June 2009	Performance Criterion
Submit to parliament an amendment to Article 11 of the "Law on the Central Bank of the Republic of Armenia" to allow a gradual recapitalization of the CBA with marketable interest bearing securities (see MEFP ¶20).	September 2009	Benchmark
Introduce best practices in VAT refund processing to exporters (see MEFP ¶17).	December 2009	Benchmark

ATTACHMENT III. ARMENIA: TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum defines the benchmarks, performance criteria, indicative targets, adjustors, and reporting modalities referred to in the Memorandum of Economic and Financial Policies (MEFP).

I. QUANTITATIVE TARGETS

1. The program targets a minimum level of **net official international reserves (NIR)** of the Central Bank of Armenia (CBA). The stock of such reserves will be calculated as the difference between total official gross international reserves (excluding reserve money denominated in foreign currencies) and official gross reserve liabilities. Total gross official international reserves are defined as the CBA's holdings of monetary gold (excluding amounts pledged as collateral or in swaps), holdings of Special Drawing Rights (SDRs), any reserve position in the IMF, and holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments). Gross reserves held in the form of securities and other financial instruments are marked to market. Gross reserves are reported separate from the balance on the government's Special Privatization Account (SPA) and the Millennium Challenge Account (MCA) and exclude capital subscriptions in foreign financial institutions and illiquid foreign assets. Official reserve liabilities shall be defined as outstanding liabilities to the IMF, and convertible currency liabilities of the CBA to nonresidents with an original maturity of up to and including one year. NIR is monitored in U.S. dollars, and, for program monitoring purposes, assets and liabilities in currencies other than the U.S. dollar shall be converted into dollar-equivalent values using the exchange rates as specified in Table 1.

2. The program targets a maximum level of **net domestic assets (NDA)** of the CBA. For program purposes, NDA is defined as reserve money minus NIR, minus reserve money denominated in foreign currencies, and plus medium- and long-term liabilities (i.e. liabilities with a maturity of one year or more) of the CBA. To evaluate program targets, the dram-equivalent values of NIR, medium- and long-term liabilities, and reserve money in U.S. dollar are calculated at the program exchange rate of dram 385 per U.S. dollar. The dram-equivalent value of reserve money in euro is calculated at the program exchange rate specified in Table 1. NDA is composed of net CBA credit to the general government; outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money (exclusive of accrued interest), and other items net.

1. The program's ceiling on **reserve money** is an indicative target. Reserve money is defined as the sum of currency issued, required and excess reserves, and current and time deposit accounts of certain resident agents.[1]

2. The program targets a maximum level of **net credit of the banking system to the government, which is** the sum of net credit from the CBA and net credit from commercial banks to the central government.

3. **The stock of net credit from the CBA to the government** includes the CBA's holdings of treasury bills and treasury bonds less all types of government deposits with the CBA (including the deposits in the Treasury Single Account, deposits of donor-financed project implementation units, the Lincy foundation, and balances of proceeds from the sale of humanitarian assistance). Treasury bonds are valued at the purchase price and excluding accrued interest and treasury bills are valued at the purchase price plus the implicit accrued interest.

4. **Net credit from commercial banks to the government** includes: (1) gross commercial bank credit to the central government less government deposits with commercial banks (including the counterpart funds of certain government on lending to the economy financed by the Lincy Foundation and the World Bank); and (2) bank holdings of treasury bonds (valued at the purchase price and excluding accrued interest) and treasury bills (valued at the purchase price plus the implicit accrued interest).

5. **External payment arrears** will consist of all unpaid debt-service obligations (i.e., payments of principal and interest) arising in respect of public sector loans contracted or guaranteed including unpaid penalties or interest charges associated with these obligations that are overdue beyond 30 days after the due date.[2]

6. **The program fiscal balance** is defined as the negative of the sum of domestic banking system net financing, domestic nonbank net financing, and external net financing to the government. Should a general subsidy be introduced off-budget, the overall balance will be measured including the subsidy as part of government spending. **Net banking system credit to the government** equals the change during the period of net credit to the government. **Nonbank net financing** equals the sum of: (1) the change during the period of

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[1] Liquidity absorbing transactions under reverse repurchase agreements, the CBA's deposit facility, foreign currency swaps, and securities issued by the CBA are netted out from claims on banks, i.e., they are excluded from the reserve money definition.

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

outstanding treasury bills and bonds to nonbanks (including accrued interest for treasury bills and excluding accrued interest for treasury bonds);[3] (2) any other disbursement or transaction that increases nonbanks' claims on the central government plus withdrawals from the special privatization account or the treasury sub-account containing privatization proceeds in dram, less amortizations made by the central government to private resident nonbank agents. **External net financing** equals total debt-increasing disbursements from non-residents to the central government less total amortizations from the central government to non-residents. All foreign-currency denominated transactions are recorded in drams using the prevailing exchange rate at the time of the transaction.

7. The project implementation units, which carry out projects financed by the US-based Lincy Foundation, maintain accounts at the CBA. These grants are recorded in the fiscal accounts as external grants on the revenue side and as foreign-financed capital expenditure on the expenditure side. In addition, any loans extended by the US-based Lincy foundation to finance investments and that are intermediated through the banking system are recorded in the financial accounts as a financing item below the line and are thus excluded from net lending.

8. Foreign currency proceeds from selling enterprises are deposited into the Special Privatization Account (SPA). The account is held at the CBA and the proceeds are invested abroad together with the CBA's international reserves. These proceeds are included in the definition of the monetary accounts of the CBA as part of net foreign assets with a counter entry in other items net. Any budgeted withdrawal from the SPA will be accounted for as privatization proceeds used to finance the budget and will be recorded below the line. Any unanticipated withdrawal from the SPA will be recorded below the line as privatization receipts; these withdrawals, however, will be replenished during the same fiscal year. Domestic currency proceeds from selling enterprises to residents are deposited in a sub-account of the treasury single account.

9. **The stock of tax credits** is defined as the sum of outstanding accumulated credit by the State Revenue Committee (SRC) of all types of tax revenues (VAT, profit tax, excises, income tax, presumptive payments, and others) resulting from advanced tax payments to be offset against future tax liabilities.

II. Adjusters

10. The quantitative performance criteria and benchmarks under the program are subject to the following adjusters:

[3] Domestic nonbank holdings of treasury bills and treasury bonds are defined as total outstanding treasury bills and bonds less holdings by the banking system and the SFSI.

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

- **KfW loan disbursements**: the target on the NDA of the CBA will be adjusted upward by the full amount of any non-programmed disbursement from KfW. The adjustment will be made at program exchange rates. The programmed amount is shown in Table 2 below.

- **Other external financing**: The floor on the overall fiscal balance on a cash basis is subject to an automatic adjuster, based on deviations of external financing (defined as disbursements of loans from bilateral and multilateral agencies not explicitly mentioned above to government for budget or project support) from program projections (shown in Table 3 below). If external financing exceeds the program projections, the floor on the fiscal balance will be adjusted downward by the amount of the cumulative positive difference between actual and programmed external financing up to a maximum of $200 million (as in Table 4 below).

- **Recapitalization of the CBA**: the target on the net credit of the banking system to the government will be adjusted upward by the full amount of the recapitalization of the CBA.

III. Structural Performance Criteria and Benchmarks

11. Approve a plan to increase the resources of the Deposit Guarantee Fund (DGF) (performance criterion, end-June 2009).

12. Submit to parliament an amendment to Article 11 of the "Law on the Central Bank of the Republic of Armenia" to allow a gradual recapitalization of the CBA with marketable interest bearing securities (structural benchmark, end-September 2009). See paragraph 20 of the MEFP.

13. Introduce best practices in VAT refund processing to exporters by (i) clearing the stock of late refund claims, while meeting the statutory 90-day processing deadline for all

claims filed in 2009; (ii) implementing risk-management approaches;[4] (iii) implementing a forecasting system to anticipate refund levels so that funds are available to pay legitimate refund claims as they occur; and (iv) submitting legislation to parliament to strengthen penalties for false refund claims and pay interest on legitimate refunds not paid on time (interest will apply only to new claims filed after December 31, 2009), (structural benchmark, end December 2009). See paragraph 17 of the MEFP.

[4] The implementation by the tax administration of a risk-management approach to administering VAT refunds will be evidenced by: (i) a documented risk-based audit strategy, plan, and methodology; (ii) regular risk assessments and maintenance of risk profiles for all exporters making VAT refund claims, using information in tax and customs databases and from third parties; (iii) payment of refunds within 14 days to exporters assessed as low-risk (i.e. those with sound compliance histories in relation to VAT and other taxes), supported by selective post-refund audits; and (iv) pre-refund audits within the statutory 90-day processing period to verify claims of exporters categorized as high-risk (i.e. those with a poor compliance history).

IV. Data Reporting

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA[5]	CBA balance sheet	Summary	Weekly	Last working day of the week
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within seven days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks by chart of accounts at actual official exchange rates	Monthly	Within 25 days of the end of each month
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Weekly	Last working day of the week
		By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Monthly	Within 25 days of the end of each month
	Foreign exchange market	Official exchange rates (buying and selling) and volume of CBA interventions, including foreign exchange swaps; daily trade volume, number of trades, and weighted average exchange rate of Nasdaq-OMX	Weekly	Last working day of the week
	Foreign exchange market	CBA intervention	Daily	Within 1 day
	Interest rates	Repo rate	Monthly	Within 7 days of the end of each month
	Interbank money market	Daily interbank repo volume and interest rate	Weekly	Last working day of the week
	CBA operations	Repo (reverse repo) operations; Lombard credits; and deposit facility	Monthly	Within 7 days of the end of each month
	Bank liquidity	Reserves and excess reserves	Monthly	Within 15 days of the end of each reference period

[5] As defined in CBA resolution No. 201 (December 6, 1999).

	Banking data	Sectoral distribution of loans and deposits; dollarization of loans and deposits; loan maturities; interbank rate, by volume and maturity; T-bill rate, bond yield; deposit and lending rates, by maturity; monthly weighted average interest rate on government bonds	Monthly	Within 25 days of the end of each month
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Quarterly	Within 30 days of the end of each quarter
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Transfers	Non-commercial transfers of individuals	Monthly	Within 30 of the end of each month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
Ministry of Finance (MOF)	T-bill and coupon bond financing	By holders, i.e., CBA, resident banks, resident nonbanks, and nonresidents	Monthly	Within 7 days of each month
	T-bill and coupon bond financing	Auction data: date, original and remaining maturities, issuance volume, demand, allocation, minimum yield, cut-off yield, average yield	Weekly	Each Friday
	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the CBA, and state-owned companies (by company); any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears	Monthly	Within 21 days of the end of each month (preliminary data) and within 45 days of the end of each month (final data)
	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions	Monthly	Within 7 days of the end of each month
	Expenditure arrears	Government	Monthly	Within 45 days of the end of each month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month
	Treasury single account	Detailed breakdown of central treasury	Monthly	Within 7 days of

	(TSA)	account, including deposits at the central treasury, community budgets, off budget account, monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.		the end of each month
	Consolidated central government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Central and local governments, and Non-Commercial Enterprises that belong within the general government (NCEs)	Quarterly	Within 60 days of the end of each quarter
	Consolidated general government	Central and local governments, and NCEs that belong within the general government	Annual	Within 180 days of the end of each year
	Budget execution	All cash receipts, cash expenditures, including domestic and external debt-service payments, external and domestic borrowing operations, and inflow of grants to the central government; expenditure data will be provided according to both economic and functional classifications, consistent with the GFSM2001 methodology	Monthly	Within one month following the end of each quarter.
NSS	Balance of payments	Detailed export and import data	Monthly	Within 28 days of the end of each month
		Detailed export and import data	Quarterly	Within 45 days of the end of each quarter
	GDP	Estimates	Monthly	Within 30 days of the end of each month
	CPI	By category	Monthly	Within 5 days of the end of each month
State Revenue Committee	Tax arrears	By type of tax	Monthly	Within 30 days of the end of each month
		For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	Tax credits	Detailed data, by type of tax, of outstanding tax credits for all types of	Monthly	Within 45 days of the end of each

		tax revenues		month
	VAT refund claims in arrears	Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90 day statutory processing period. Number of refund applications processed per month.	Monthly	Within 30 days of the end of each month
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty free recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving non-duty free recorded imports 5. Value of recorded imports where customs value was assessed using transaction prices, breaking out raw diamond imports; 6. Value of non-duty free recorded imports where customs value was assessed using transaction prices; 7. Number of transactions involving recorded imports where customs value was assessed using transaction prices; 8. Number of transactions involving non duty free recorded imports where customs value was assessed using transaction prices	Quarterly	Within 30 days of the end of each quarter

Table 1. Armenia: (Program) Exchange Rates of the CBA
(As of December 31, 2008 for dollars per currency rates)

Country	Drams Per Currency	Dollars Per Currency
Australian dollar	266.57	0.6924
Canadian dollar	313.39	0.8140
Swiss franc	365.58	0.9496
Danish krone	73.26	0.1903
Euro	546.00	1.4182
Pound sterling	558.68	1.4511
Japanese yen	4.27	0.0111
Norwegian krone	55.20	0.1434
Russian ruble	13.13	0.0341
Swedish krone	18.21	0.0473
U.S. dollar	[...]	1.0000
SDR	593.00	1.5403

Table 2. Armenia: KfW Loan Disbursements 1/
(In billions of dram)

2009			
March	June	September	December
7.70	11.55	15.40	15.40

1/ Cumulative from December 2008, at program exchange rates.

Table 3. Armenia: Other External Financing (Program) 1/
(in billions of drams)

2009			
March	June	September	December
19.83	41.00	71.10	100.80

1/ Cumulative from December 2008, at program exchange rates.

Table 4. Armenia: Other External Financing (Additional) 1/ (in billions of drams)			
2009			
March	June	September	December
13.3	53.3	66.6	77.0

1/ Cumulative from December 2008, at program exchange rates.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

Request for Stand-By Arrangement

Informational Annex

Prepared by the Middle East and Central Asia Department

March 3, 2009

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ANNEX I. ARMENIA: RELATIONS WITH THE FUND
(As of January 31, 2009)

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	100.00

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Holdings	1.89	n.a.

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
PRGF arrangements	87.50	95.10

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	11/17/2008	11/16/2011	9.20	1.31
PRGF	05/25/2005	05/24/2008	23.00	23.00
PRGF	05/23/2001	12/31/2004	69.00	69.00

VI. **Projected Payments to Fund** [1/]
(SDR Million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2009	2010	2011	2012	2013
Principal	15.19	14.13	14.44	14.75	11.07
Charges/interest	0.41	0.33	0.26	0.19	0.12
Total	15.59	14.46	14.70	14.94	11.19

[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 Assessments policy, an update safeguards assessment of the Central Bank of Armenia (CBA) is currently being finalized with respect to the PRGF approved on November 18, 2008. An earlier update assessment completed on November 7, 2005 found that the CBA's safeguards framework has been strengthened since the initial assessment completed in 2002.

VIII. **Exchange Rate Arrangement**

(a) The de jure arrangement is a “managed float.” The de facto arrangement was reclassified to “stabilized (peg-like) arrangement” as of July 1, 2008 from a “managed float.” 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 2008 Article IV consultation with Armenia was concluded on November 17, 2008. Armenia is subject to a 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	Published	09/50

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, 2002–09

Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Tax policy and administration	Short-term	September 17–October 2, 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	Short-term	October 5–18, 2006	MFE, STS
Public financial management reform	Short-term	November 27 – December 8, 2006	MFE
Tax administration	Short-term	October 31 – November 13, 2007	MFE, STS
Tax administration	Short-term	January 5 – 22, 2008	MFE, STS
Tax administration	Short-term	April 1-12, 2008	MFE, STS
Tax administration	Short-term	June 11-17, 2008	MFE, STS
Tax administration	Short-term	February 2-27, 2009	MFE, STS

Legal Department			
Tax legislation		September 1, 2004–December 31, 2005	
Legislation Development & FIU	Short-term	July 31–August 7, 2006	
Unified Tax Code	Short-term	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
Exchange rate and collateral	Short-term	February 23—27, 2009	CBA
Statistics Department			
Data dissemination standards	Short-term	September 18–25, 2003	National Statistical Service
Balance of payments: remittances	Short-term	August 22–September 5, 2006	CBA
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	CBA

ANNEX II. ARMENIA: RELATIONS WITH THE WORLD BANK
(January 15, 2009)

Country Director: Donna Dowsett-Coirolo Telephone: (202) 473-0121

I. IMPLEMENTATION OF STRUCTURAL REFORM MEASURES

A. Legal and Judicial Reform

1. The World Bank has supported the Armenian government to establish the core legal framework necessary for private sector operations, including the civil procedures 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 procedures code, and strengthens the enforcement mechanisms for bankruptcy procedures. The concessions 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. With support from the Second Judicial Reform Project (JRP2), the judiciary and the government formulated a long term strategy for the system, which is reflected in the judicial code and consequent establishment of the Judicial Department responsible for judicial administration and a career judicial service (excluding judges). With the support of JRP1 all the normative legal acts were made available electronically through the ARLIS legal database with free on-line access. Special automated case management information systems were developed and piloted for courts (CAST) and the Enforcement Service Department. Under JRP2 CAST now has been rolled-out across the entire judicial system. The World Bank has also supported the rehabilitation of 13 courthouses housing 15 courts and the installation of digital case recording audio systems in all renovated or new courtrooms. Additional courthouses throughout Armenia are under construction as part of JRP2.

B. Business Environment

2. The World Bank has supported the government in making some progress in removing administrative barriers for business and investment and has strengthened the consultative mechanisms with the business community, though overall there is still much work remaining to improve Armenia's competitiveness. Recent steps taken include: 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 improved and the private sector's awareness of its activities has been enhanced.

3. 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. FDI increased by almost 3-fold in 2007 compared with 2005.

4. The government recently commenced policy work to widen participation in the provision of international civil aviation services, raise efficiency, and reduce costs. Despite these improvements, there is still considerable scope for further reforms in the areas of competition, and deregulation and strengthening of business and investment climate (especially in commercial debt recovery procedures).

5. The IFC is active in Armenia and has a committed portfolio of US$ 43.5 million ($40.5 million outstanding), as of January 2009. IFC's portfolio is concentrated primarily in the banking sector, with additional commitments in the retail, mining, and hotel sectors. IFC will continue to seek opportunities for investments in the real sector, including in retail, mining, transportation logistics, and telecoms. In the financial markets sector IFC will continue providing term funds to selected Armenian banks for SME on-lending and housing finance, and will increase existing trade lines and extend new lines to new clients. IFC is also working toward introducing new products (e.g., energy efficiency financing for SMEs and households). Furthermore, since autumn 2008 IFC Advisory Services has started work on four new areas: an energy efficiency survey, housing finance development, and corporate governance and Business Enabling Environment projects.

C. Public Sector Reform

6. Further strengthening of tax and customs administration was at the core of the PRSC series, as much work remains to reduce the burden imposed on firms and to raise revenue as a share of GDP. The shortcomings of the tax and customs administrations remain acute: recent survey data show tax and customs as one of the main constraints affecting the operations and growth of Armenian companies. One of the major reforms was the adoption of a self-declaration system. A separate division for taxpayer service has been established within the SRC headquarters designated for: (i) defining the policies and procedures of taxpayer education and assistance for tax inspectorates; (ii) overseeing the performance of taxpayer

service divisions of tax inspectorates; and (iii) managing the taxpayer education and assistance operations through out the SRC. A work plan for improving the enforcement of the Law on Declaring Individuals' Property and Income was also developed. Recording commissions were abolished as of July 1st 2008.

7. Under PRSC-supported reforms the government merged the large taxpayers, banking and financial, excise, and mining inspectorates into one department - the Large Taxpayers Unit (LTU). The administrative and audit capacity of the LTP was also strengthened under the PRSC-supported program. Reforms focused on legislative initiatives to facilitate effective tax audits and on development of personnel, institutional, and administrative infrastructure to support the LTU. An annual audit plan based on risk classification, priorities and targets was introduced. Further measures are needed to strengthen the LTU in order to reduce the stock of VAT arrears owed to exporters and ensure that no additional arrears are incurred.

8. Over the PRSC program, some significant structural improvements were achieved in customs administration, such as the introduction of modern software and improved personnel practices. The central reform was the institution of *direct trader input* (DTI) that currently covers about 70 percent of imports. DTI has initiated a systemic change away from the intimate involvement of customs officials at the declaration validation stage, where opportunities for discretionary behavior are rife. The system has the capability to provide for immediate validation and assessment of acceptable declarations. Under PRSC-IV**,** the working of DTI was made increasingly effective through the implementation of a comprehensive post-release review program for imports. The post-release reviews are becoming increasingly effective in ensuring proper customs administration whilst reducing the opportunities for poor governance.

9. The PRSC program also supported the detailed preparatory technical work for the introduction of a bank guarantee mechanism for approved importers to facilitate the smooth flow of imports, strengthen the rules-based regime, reduce risks, and minimize the interface between importers and customs officials. Moreover, customs introduced a self declaration system and reduced the role of reference prices. It has also provided public access to customs values through the official customs website (www.customs.am). Legislative amendments for the implementation of guarantees were approved by the government at end-September 2007. Progress has also been made in selectivity of customs control. A risk-based system was introduced under the PRSC program. Reforms in this area have led to greater regularization and predictability in clearance of goods, reduced discretion, and lowered business costs. However, these efforts are still too fragmented to meet the challenges of a modern customs administration. There does not seem to be a vision as to what customs could and should do in the Armenian environment. Critical next steps include: (i) developing a strategic approach to a government-supported cross-border control policy (extending beyond the purely customs domain); and (ii) consolidating recent progress under an objective-driven action plan.

10. The World Bank has also been supporting the government in a wide range of public administration reforms, in particular in developing the Anti-Corruption Strategy and Action Plan 2003-2007 (adopted in November 2003), improving policy formulation, and strengthening the civil service. Ongoing support from the Bank has already assisted the Government in advancing merit based recruitment and performance management in the civil and municipal services, capacity building for certification, and external audit reforms. Information management systems have been delivered for central and municipal administration. The electronic document management system, piloted in the government staff and two pilot ministries, is already being rolled-out across the entire government. Development of e-tendering modules for planned electronic public procurement system is also underway.

11. The Bank has also supported Armenia's public financial management (PFM) reform agenda by strengthening external audit through the Chamber of Control, assisting development of a modern internal audit capacity, and building capacity in local government. Since 2003 there has been continuous support to capacity building for treasury reforms, which in particular produced technical and functional specifications for a Government Financial Management Information System. Further, the Bank supported the government in preparation of its Public Expenditure and Financial Accountability (PEFA) Performance Assessment Report, which was published in October 2008. The conducted and ongoing analytical and capacity building work will shape the PFM system as Armenia prepares its PFM reform strategy.

D. Energy and Infrastructure

12. 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 its investment plan to the regulator. Supported by the World Bank, the government and the regulator have 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. The market rules in the energy sector have improved. The Electricity Distribution Company is allowed to enter into direct contracts with the electricity generators and service providers, which has enhanced sector transparency. The regulator has adopted and enforced service quality standards for electricity supply. 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.

13. 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 also 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.

14. As part of the PRSC-supported program, the Government also developed and is now considering a step-by-step civil aviation liberalization action plan. A railway restructuring plan and telecommunication regulations are also under preparation.

E. Rural Development, Agriculture, and Environment

15. Recent World Bank support for the rural development and agriculture sector has largely been through the Rural Enterprise and Small-scale Commercial Agriculture Development Project (RESCAD), effective since December 2005. The objective of this project is o support the development of Armenia's small and medium-scale rural businesses by: (a) improving the ability of farmers and rural entrepreneurs to access markets; and (b) stimulating market-oriented private and public investments in rural areas. It helped provide long term credit resources (more than US$4.75 million) for rural agri-business, rural enterprises, and farmers. It also helped introduce, test, and demonstrate technical innovations, and focused on processing and marketing of agricultural production through a series of competitive small grant. It helped strengthen extension services to deliver technical advice to farmers and rural businesses, with 15,000 farmers served on a regular basis. The project also supported a modern legal and regulatory framework for production of high generation seed in support of private seed production activities.

16. The Bank has also supported analytical work on the rural sector, including on marketing and value chains for various products, and sector-specific development challenges, including in-depth analysis of food safety and agricultural health issues. Considerable support has also been mobilized for the forestry sector through investment lending and the PRSC series, which promoted substantial legal and institutional reforms, including sustainable forest management through enhanced control of illegal logging and community forest management.

F. Education and Health

17. The World Bank has provided significant support for 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, under the auspices of the staff optimization and social assistance program, approximately 3,200 newly redundant teachers were registered and provided with social assistance. The ratio of pupils to full-time equivalent teachers increased to over 14, and teacher salaries increased by 65 percent in 2005, 16.1 percent in 2006, and 27.0 percent in 2007. In addition, the government approved a strategy on preschool education and prepared a pilot project for its implementation in two marzes. The government has also made progress carrying out the three year reform plan for higher education.

18. Progress was also made with regard to sector financing and management. The medium-term action plan for improving the financial management, accounting, and financial reporting for higher education institutions was adopted by the government in January 2003. Accountants at the higher institutions have been trained and special software has been prepared. The government also 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 put in place measures to prevent further arrears).

19. Despite these important improvements, there is scope for further reforms, including: (i) further refining the curriculum to enhance relevance and reduce the overload, particularly in upper secondary education; (ii) strengthening the teacher education and ongoing professional development strategy to make it more demand-driven and school-based; (iii) enhancing capacities for ICT use and integration in teaching and learning, (iv) addressing governance and transparency issues in higher education; (v) enhancing standards for higher education in response to market demands; (vi) developing a student loan system; (vii) promoting school readiness and equal opportunities through an improved preschool education system and increasing the enrollment rate; and (viii) strengthening monitoring and financial reporting of the noncommercial organizations (NCOs) in the education sector.

20. The Bank also supported the government's reform program in the health sector, focusing in particular on public hospitals. 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 a smaller number of hospital networks while being restructured. The government adopted a decree in November 2003 identifying the configuration of ten hospital networks through consolidation of twenty-four public hospitals and thirteen outpatient health care institutions. A Bank-financed project supported upgrading hospitals' physical condition and equipment, while also improving internal management and governance of the three hospital mergers in Yerevan, which demonstrated the biggest efficiency gains. While the hospital merger process in Yerevan resulted in notable improvements in productivity and efficiency indicators in selected hospital networks, further measures are required to improve cost

accounting, personnel management and governance of hospitals. In addition, in 2006 the government adopted a regional hospital optimization/modernization plan aimed at improving the efficiency and productivity of outpatient services in the regions. The consolidation of regional hospitals in smaller networks is underway.

21. The medium-term financial management action plan for public hospitals was adopted by the government to prepare new reporting and accounting procedures, including cost accounting manuals. All public hospitals use updated financial management and accounting procedures. The government plans to conduct independent financial audits of all public hospitals over the next three years. Implementation progress has been satisfactory and about 200 hospital accountants have been trained in the new accounting procedures.

22. The level of public financing in the health sector has been continuously increasing as projected in the MTEF. The government also adopted a decision to introduce further reforms in the Basic Benefits Package. The government strategy for increasing revenues in the short term is to keep the existing benefits package but raise reimbursement rates to reduce the gap with the cost of services. The government undertook measures to increase financing of 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 to improve the population's overall health status, reduce child and maternal mortality, increase the use of the healthcare system by rural and low-income groups, monitor public health and promote better health behavior, and strengthen monitoring and financial reporting of NCOs. 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.

G. Social Protection and Insurance

23. 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 existing benefits; and (iii) establishment of a central database for poverty benefit recipients. Data from recent household surveys suggest that the system of benefits and transfers to the poor has become an efficient instrument for reducing extreme poverty. 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.

24. The Government of Armenia approved a new pension strategy in November 2008 along with an action plan for implementation. The strategy includes the mandatory introduction of a second pillar for those born after January 1, 1970 (financed by an additional contribution), a flat-benefit budget-financed first pillar, and a universal zero pillar for those who did not contribute to the system. A task force has been established to monitor the implementation of the pension reforms, and the Government has requested the Bank's support for implementation going forward.

II. LENDING

25. World Bank lending to Armenia as of August 1, 2008 totals US$ 1,056.1 million, (including 2 GEF operations) of which US$953.3 million has been disbursed. The current Bank portfolio consists of 17 IDA credits and 2 GEF projects, for a total commitment of $291.7 million, of which $187.5 million is disbursed. The Armenia portfolio continues to be low risk with all projects rated in the satisfactory range. In FY08, one development policy operation—PRSC-IV for $18.5 million—was approved in November 2007. In FY09, one investment operation—Additional Financing for Municipal Water Project—was approved in October 2008 for $20 million.

26. Building on the Armenia's 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. A CAS Progress Report, considered by the Board on March 8, 2007, reconfirmed this focus. IDA country resource envelopes are determined annually using the Performance Based Allocation (PBA) methodology common to all IDA countries. The PBA draws on the Country Policy and Institutional Assessments and performance of the ongoing portfolio. Armenia has a very strong PBA rating and as a consequence is eligible for about US$50-60 million equivalent per year. In addition, Armenia has now become a blend country and is eligible to begin IBRD borrowing in FY09.

27. A new World Bank CPS will be prepared in late FY09, which will lay out expected lending and analytic work for the next four years. This will be based on Armenia's development priorities contained in the recent update of its Poverty Reduction Strategy Program (PRSP), renamed the Sustainable Development Program (SDP). The Bank and the Fund presented the Joint Staff Advisory Note (JSAN) for the SDP to their respective Boards in November 2008.

List of World Bank Lending to Armenia, January 2009
(In millions of U.S. dollars)

	Active Projects	Credit Amount as of 01/15/09	Disbursement as of 01/15/09	Approval Date	Closing Date
Active Projects		***311.7***	***225***		
1.	Irrigation Dam Safety	26.6	27.1	06/24/99	12/31/08
2.	Irrigation Development	29.9	34.5	08/30/01	03/31/09
3.	Social Protection Admin.	5.15	4.8	06/10/04	06/30/09
4.	Natural Resource Management	8.3	9.4	06/04/02	01/31/09
	Natural Resource Management (GEF)	5.1	4.0	06/04/02	01/31/09
5.	Educ. Qual. & Relevance (APL #1)	19.0	16.5	01/20/04	11/30/09
6.	Municipal Water and WW	43.0	23.3	05/04/04	12/31/11
7.	Health System Modernization	19.0	16.7	06/10/04	06/30/09
8.	Irrigation Dam Safety 2	6.75	4.9	06/10/04	03/31/09
9.	Public Sector Modernization	10.15	8.2	05/04/04	06/30/10
10	Rural Enterprise & Small Scale Agric.	20.0	17.2	07/07/05	05/31/10
11.	Urban Heating	15.0	12.3	07/12/05	06/30/10
12.	Yerevan Water/Wastewater	20.0	7.9	02/24/05	02/28/11
13.	Renewable Energy	5.0	4.2	03/29/06	12/31/10
	Renewable Energy (GEF)	3.0	1.5	03/29/06	12/31/10
14.	Avian Influenza Preparedness	6.25	3.4	06/02/06	07/31/09
15.	Armenia SIF III	25.0	18.6	10/26/06	30/06/11
16.	Health Systems Modernization (APL-II)	22.0	2.9	03/08/07	12/31/12
17.	Judicial Reform II	22.5	7.6	03/08/07	12/31/12
Closed Projects		***764.5***	***797.9***		
18.	Economic Rehabilitation	60.0	57.6	02/28/95	06/30/96
19.	SAC	60.0	56.9	02/29/96	12/31/97
20.	Institution Building	12.0	10.6	03/30/93	11/30/97
21.	Earthquake Rehabilitation	28.0	29.7	02/01/94	06/30/97
22.	Power Maintenance	13.7	12.8	12/08/94	06/30/99
23.	SAC II	60.0	63.1	08/26/97	06/30/99
24.	SATAC I	3.8	2.9	02/29/96	06/30/00
25.	Highway	31.0	29.9	09/14/95	12/31/00
26.	Social Investment Fund	12.0	11.4	11/09/95	12/31/00
27.	Irrigation Rehabilitation	43.0	40.9	12/08/94	05/31/01
28.	SAC III	65.0	70.3	12/22/98	06/30/01
29.	Enterprise Development	16.8	16.4	12/24/96	07/01/02
30.	SATAC II	5.0	4.9	08/26/97	12/31/02
31.	Education	15.0	16.2	11/20/97	10/31/02
32.	SAC IV	50.0	58.4	05/22/01	03/31/03
33.	Health	10.0	10.4	07/29/97	12/30/03
34.	SAC V	40.0	45.9	03/13/03	06/30/04
35.	Title Registration	8.0	8.9	10/13/98	09/30/04
36.	Transport	40.0	45.5	06/08/00	12/31/04
37.	PRSC I	20.0	20.8	18/11/04	12/31/05
38.	Agric. Reform Support	16.3	17.6	01/27/98	06/30/05

39.	Social Investment Fund II	20.0	22.7	05/11/00	12/31/05
40.	Investment and Export Facilitation	1.0	1.2	04/16/02	12/31/05
41.	Municipal Development	30.0	33.1	06/11/98	01/31/06
42.	PRSC II	20.0	21.5	01/19/06	06/30/07
43.	Enterprise Incubator	5.0	5.7	11/30/01	12/31/06
44.	Judicial Reform	11.4	13.0	09/14/00	12/31/06
45.	Electricity Transmission & Distribution	21.0	22.8	03/04/99	06/30/07
46.	PRSC III	28.0	28.5	03/08/07	06/30/08
47.	PRSC IV	18.5	18.3	11/27/07	06/30/08
	Total	**1,076.2**	**1,022.9**		

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

(As of December, 2008)

1. As of December 19, 2008, the EBRD approved 63 projects in the power, transport, agribusiness, municipal and infrastructure, property, construction and financial sectors. Total commitments amounted to around EUR 289 million.

2. 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 was contemplating the privatization of Hrazdan Unit 5 as the completion of this plant was constrained by limited budgetary resources. The EBRD had funded technical assistance for the Hrazdan privatization prospectus and followed the privatization process. The Hrazdan Thermal Power Complex excluding the unfinished Unit 5 was 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 million 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.

3. Most of the Bank's projects in Armenia are in the private sector. Amongst other corporate clients the EBRD has provided a loan to the Yerevan Brandy Company owned by Pernod Ricard of France (EUR 16.5 million). In 2007 the Bank provided a USD 20 million loan to the private concessionaire of Zvartnots International Airport, Armenia's principal gateway. The loan was a commercial facility with no sovereign support. Other private sector finance includes relatively smaller loans to private companies and equity participation in a number of companies in various sectors of the industry. 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. The EBRD expanded its relationship with the partner banks in Armenia from four to nine. Seven banks were provided with new credit facilities under the MBFF, including through historic (for Armenia) commercially-syndicated loans to ACBA Credit Agricole Bank and Armeconombank. Co-financing facility with local banks was also expanded through three MCFF facilities with twelve MCFF sub-loans. By

means of MCFF the Bank has entered such new sectors as healthcare and telecom, in addition to significantly expanding its portfolio of agribusiness loans. The Bank acquired new equity stakes in three including with foreign strategic co-investors (ProCredit and ITB-Byblos) and Ararat Bank. One institution (Armeconombank) was provided with a mortgage facility, and the first leasing facility in Armenia was signed. A Trade Facilitation Program with the purpose to facilitate access of Armenian banks to trade financing was also made available to four Armenian banks. The EBRD has launched the Turn Around Management (TAM) and Business Advisory Service programs 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. Since 2006 BAS has completed 263 projects in the amount of €1.1 million in TC, while TAM delivered 7 projects for €0.5 million in TC.

4. Supporting development of renewable energy was another core activity of the Bank. To that end, the EBRD joined forces with the WB, USAID, and Cascade Credit (a financing arm of the Armenian-American Cafesdjian Foundation) to launch the Armenian Renewable Energy Programme (AREP). The Bank's participation took the form of a loan to Cascade Credit. The Bank also continued to finance renewable energy projects on its own through Direct Lending Facility, with two such projects signed. In addition to renewable energy, the Bank returned to the mainstream segment of the sector, seeking to support post-privatisation development of the sector with a loan to the Armenian privately-owned power distribution company.

5. Projects identified by the Bank for future development are well-diversified across sectors, and includes several relatively large transactions, thus reflecting economic growth in Armenia and the country's increasing attractiveness to foreign investors. Additional business opportunities are offered by the country's infrastructure sector, including projects in the public sector (municipal and sovereign). Equity transactions through Direct Investment Facility represent one of the fastest growing portfolio segments in Armenia, which has emerged as the leading DIF country in the Caucasus.

6. 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 and a new one is presently in the review process.

ANNEX IV. ARMENIA: STATISTICAL ISSUES

1. Data provision has some shortcomings, but is broadly adequate for surveillance. Further improvements in real, fiscal, and external sector statistics would be desirable 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 prepared a detailed evaluation of the quality of the macroeconomic statistics.

Real sector statistics

2. The National Statistics Service (NSS) has made significant changes to the national accounts methodology to bring it in line with best international practices although some shortcomings on data sources and methods remain. Progress has been made in developing estimates of monthly and (constant price) quarterly GDP that are now published. Basic data collection procedures have also partially improved. The national accounts statistics are compiled following the conceptual frameworks of the *1993 SNA* and *ESA 95.* The classification of value added by economic activity follows the *ESA 95* directions and data are published grouped accordingly to the A3, A6, A17 and A60 codes of the EU nomenclature of economic activities.

3. Annual and quarterly GDP estimates are compiled at current prices, at comparable previous year's prices, and at average annual prices of the base year (1998) for the series up to the year 2006. Since 2007, GDP at constant prices is computed at average annual 2005 prices. The April 2008 ROSC mission found that compilation techniques for the estimates of GDP by production at constant prices are sound, however there is still need for improvements in the corresponding estimates of GDP by expenditure, particularly regarding the deflators of imports and exports. The mission also found that government expenditures and some transactions with the rest of the world are recorded on a cash basis rather than the required accrual method. Moreover, quarterly data are still collected on a cumulative basis, which are likely to undermine their accuracy. Additionally, statistical techniques need improvements regarding the estimates of the imputed rental services for owner-occupied dwellings, consumption of fixed assets, and work in progress in agriculture.

4. The CPI covers 11 large population centers and the capital city. Since January 2006 the CPI has been computed using 2005 weights. Concepts and definitions used in the compilation of the CPI are broadly in line with international standards; source data and

compilation techniques are generally adequate. The NSS compiles a ten-day and a monthly CPI. The ten-day index and the monthly index are disseminated jointly.

Government finance statistics

5. The budget execution reporting system compiles data on a cash basis supplemented with monthly reports on arrears and quarterly reports on receivables and payables. Daily revenue and cash expenditure data for the central government are available with a lag of one to two days. 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 *Government Finance Statistics Manual 2001 (GFSM 2001)*. 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 *GFSM 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.

Monetary and financial statistics

8. Monetary and financial 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. The balance sheets of the CBA and of the deposit money banks follow IAS methodology. Monthly interest rate data are provided with an one-week lag.

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* and are used to update IFS. An Integrated Monetary Database (IMD) has also been established by STA to share the SRF data with MCD.

External sector statistics

10. The coverage of external sector data has improved in recent years. Trade statistics are provided on a timely basis, and trade data by origin, destination, and commodity are generally available within a month. Price data for exports and imports are less readily available. Quarterly balance of payments statistics are generally available with a three-month lag. However, 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 nonbank sector.

11. Quarterly data on international investment position are published by the NSS within one quarter after the reference period, and the annual data within two quarters; and are also provided for publication in IFS.

Armenia: Table of Common Indicators Required for Surveillance

(As of March 2, 2009)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	March. 2009	3/2/2009	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Feb. 2009	3/2/2009	D	W	M
Reserve/Base Money	Feb. 2009	3/2/2009	D	W	D
Broad Money	Jan. 2009	2/23/2009	M	M	M
Central Bank Balance Sheet	Jan. 2009	2/13/2009	D	M	M
Consolidated Balance Sheet of the Banking System	Jan. 2009	2/23/2009	M	M	M
Interest Rates[2]	Feb. 2009	2/23/2009	W	W	M
Consumer Price Index	Feb. 2009	2/27/2009	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Q3 2008	1/30/2009	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Jan. 2009	2/24/2009	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q4 2008	1/30/2009	Q	Q	Q
External Current Account Balance	Q3 08	12/30/2008	Q	Q	Q
Exports and Imports of Goods and Services	Q3 08	12/30/2008	Q	Q	Q
GDP/GNP	Q3 08	12/30/2008	Q	Q	Q
Gross External Debt	Q3 08	12/30/2008	Q	Q	Q
International Investment Position[6]	Q3 08	12/30/2008	Q	Q	Q

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

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

IMF Debt Sustainability Analysis

Prepared by the Staff of the International Monetary Fund

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The updated IMF staffs' debt sustainability analysis (DSA) suggests that Armenia is at a low risk of debt distress, with all external debt indicators well below the relevant country-specific debt-burden thresholds. Despite the inclusion of higher short term borrowing from the Fund, the debt outlook remains similar to that which was presented in Country Report No. 09/29. An alternative scenario examines the impact of additional new borrowing from Russia. The analysis highlights the importance of continued sound macroeconomic policies and reforms for safeguarding the favorable debt outlook.

1. The DSA was prepared by Fund staff, using the joint Bank-Fund Low-Income Country Debt Sustainability Framework.[1] The macroeconomic assumptions underlying the baseline scenario are consistent with the medium term framework presented in the staff report and include new Fund lending in the baseline. The external debt data used for this exercise is broadly consistent with the authorities' medium term borrowing plans.

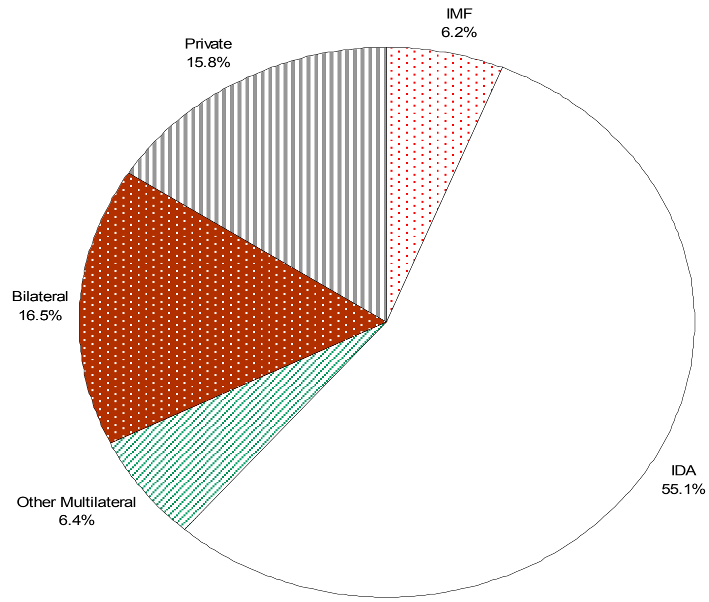
Structure of debt

2. Armenia's external debt stock as of end-2008 is estimated at $2,174 million (18 percent of GDP), mostly representing public and publicly guaranteed (PPG) debt owed to multilateral international organizations (Figure 1).[2] The outstanding debts of the government to the World Bank and to the Fund account for 55 percent and 6 percent of total external debt stock, respectively. Armenia's estimated private sector external debt outstanding accounts for about 15 percent of total external debt.

[1] The most recent assessment of Armenia's debt sustainability was conducted in November 2008 in the context of the new PRGF (Country Report No. 09/29).

[2] The DSA covers the central government only, since other public sector debt is believed to be negligible.

Figure 1. Armenia: External Debt Stock, end 2008



3. The share of domestic debt in the stock of public and publicly guaranteed debt is small, reflecting the limited development of the domestic debt markets. In 2008, the PPG debt owed to domestic creditors accounted for only 2.3 percent of GDP, virtually unchanged from the previous year.

The baseline scenario

4. The baseline scenario shows a sustainable fiscal position (Table 1, Figure 3). The net present value of public sector debt would gradually increase over the projection period from 9.8 percent of GDP in 2008 up to 23.6 percent of GDP in 2028, reflecting the increasing issuance of domestic debt securities on the one hand, and a declining share of concessional public external debt on the other hand. The net present value of debt-to-revenue ratio would increase from 49 percent in 2008 and climbing steadily to 97 percent in 2012 and declining thereafter to 80 percent in 2028. The debt service–to-revenue ratio would also edge up to 12 percent in 2013 and declining to below 10 percent at the end of the projection period. Despite the temporary spike in 2009-2012, these indicators for public debt would remain at comfortable levels and below the indicative indicators for external debt.

Box 1. Macroeconomic Assumptions for the DSA Baseline Scenario, 2009–28

Annual real GDP growth is projected to average around about 6 percent between 2011-2016, thereafter declining to its long-run rate of 4 percent. Medium term growth is supported by a relatively strong recovery in private transfers and FDI inflows. The average inflation rate is assumed to be around 4 percent in the long-run.

The external current account deficit is projected to average around 7.5 percent of GDP over the DSA projection period. Somewhat higher deficits are envisaged in the near-term, against the background of weakening export demand and private transfers. Exports are projected to recover steadily over the medium term, owing to increased exchange rate competitiveness and as new investments in base metal, minerals, and food processing sectors become operational. Private transfers are projected to rebound over the medium term, financing a significant share of the trade deficit, but will gradually moderate thereafter.

In 2010-15, net FDI is expected to average about 6.0 percent of GDP, gradually moderating from the high levels experienced in the pre crisis period, which was driven by the privatization in base metal and mineral sectors. In the near term, the level of FDI will be constrained by developments in the global economy and in particular Russia. Improvements in business climate, however, should yield a more diversified FDI structure, with new investment going into new industries (e.g., tourism and the IT sector). The long-run net FDI is projected to average around 5 percent of GDP.

Central government revenues (excluding grants) are projected to gradually increase from 20.0 percent of GDP in 2009 to 22.7 percent of GDP in 2014, and will continue to improve over the long-run, in line with government revenue targets. The overall fiscal deficit is projected to decrease from 2.8 percent of GDP in 2009 to 2.4 percent of GDP in 2011, and in the long term, remain at around 1.4 percent of GDP.

The level of concessionality of new external borrowing is envisaged to decline in the future, given recent increases in Armenia's relative income. The projected disbursements from the World Bank—Armenia's largest creditor, accounting for about 55 percent of the country's total external debt stock as of end-2008—assume that starting from 2009 Armenia will begin receiving IBRD loans in addition to IDA credits, gradually shifting to exclusively IBRD borrowing over the medium term. In addition, the degree of concessionality of borrowing is likely to be further reduced given significant level of borrowing from the Fund over the next three years. Unidentified residual lending for 2011 and beyond is assumed to be on non-concessional terms.

Consistent with the authorities' intention, over the medium term the deficit is assumed to be increasingly financed by domestic borrowing. The stock of domestic debt would thus increase from 2.6 percent of GDP in 2008 to 12.3 percent of GDP in 2022, and to 16.9 percent by 2028.

The private sector external debt stock in 2008 is estimated as the difference between Armenia's long-term total external debt and government's external debt. The new external borrowing by the private sector is estimated as a proportion of commercial banks' projected inflows. The terms of private sector borrowing are unknown, and assumed to be similar to those in other comparable countries. Specifically, the maturity period is assumed to be 6 years (with a 1-year grace period) and the interest rate is set at 8 percent—a compromise between the interest rate on U.S. dollar-denominated sovereign bonds of similar maturity in Russia and Ukraine (about 6.5 percent), and the ongoing lending rate in U.S. dollars charged by Armenian banks on long-term loans (about 15-17 percent). To the extent that most of this lending is likely to be from foreign banks to their Armenian subsidiaries, this relatively low interest rate assumption is justified.

5. The external debt outlook remains benign, notwithstanding a notable increase in non-concessional financing over the medium term (Table 3a, Figure 2). The net present value of external debt is expected to increase from 7 percent of GDP in 2008 to 16 percent of GDP in 2013 and declining thereafter to about 7 percent in 2028. The increase reliance on non-concessional external borrowing over the medium term will result in a steep but temporary increase in the external debt service ratio. External debt service in percent of exports increases from 3 percent to 11 percent over the medium term, but declines relatively quickly to a long term average of about 3 percent. The net present value of public external debt in percent of exports rises rapidly from 50 percent in 2008 to 90 percent in 2012, on account of increased IMF lending and weaker export performance. However, with a projected gradual recovery in exports earnings, and moderated debt accumulation over the medium term, the NPV of debt to export ratio declines steadily to reach 20 percent in 2028.

Stress testing and alternative scenario

6. The standard menu of alternative scenarios and bound tests indicate that Armenia's public debt outlook would be most adversely affected by a lasting shock to economic growth (Figure 2).[3] Under the extreme adverse growth scenario, the stress tests indicate that public debt ratios would follow a persistent upward trend through the projection horizon. Under permanently lower real GDP growth, the net present value of public debt-to-GDP would exceed 30 percent from about 2020 onward, even though other debt indicators would remain at comfortable levels. Debt indicators are less prone to unfavorable debt dynamics under other stress tests. This result reinforces the importance of maintaining prudent financial policies and preserving macroeconomic stability in order to safeguard the debt outlook.

7. Armenia's external debt outlook is robust to a variety of shocks (Table 3b). Under all standard alternative scenarios and bound tests, the external debt ratios remain well below the relevant thresholds.

8. In addition to the standard stress test an alternative scenario, which included higher external debt financing for government investment spending was also considered. The investment is expected to be financed by a $500 million loan from Russia. The exact terms of the loan are unknown . The following is assumed: (i) an interest rate will be charged at a rate of LIBOR plus three percent, with a grace period of 5 years and maturity of 15 years; and (ii) the loan is assumed to be fully disbursed in 2009-2010.

9. The increase in external borrowing associated with the Russian loan is projected to have minimal impact on Armenia's long term debt sustainability. Over the near term this additional borrowing will result in a steep increase in all debt indicators. The NPV of debt to export ratio would jump to 120 percent and the debt service to revenue ratio would increase to 108 percent by 2010. These results suggest that the capacity to contract additional non-

[3] The framework for low-income country DSA incorporates alternative scenarios and bound tests aimed at identifying the sensitivities of the baseline projection to a range of potential shocks.

concessional borrowing over the near term is relatively restricted. However, thanks to the relatively favorable starting position, all indicators would remain well below the country specific debt-burden thresholds.

10. The results from this DSA suggest that Armenia's debt outlook is relatively stable. However given increasing external vulnerabilities and the sensitivity of the debt outlook to long-term growth assumptions, it is important that the authorities follow a prudent borrowing strategy over the medium term.

Table 1. Armenia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2005-2028
(In percent of GDP, unless otherwise indicated)

	Actual					Estimate						Projections							
	2005	2006	2007	Average	Standard Deviation	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-13 Average	2018	2028	2014-28 Average
Public sector debt 1/	24.3	18.7	17.5			17.9	26.7	28.3	29.3	28.7	26.3	25.3	24.6	25.0	25.2	27.8	25.7	26.1	
o/w foreign-currency denominated	22.1	16.5	15.4			15.4	23.4	24.6	24.8	23.5	20.3	18.6	17.3	17.0	16.5	23.3	16.3	9.2	
Change in public sector debt	-8.3	-5.6	-1.2			0.4	8.7	1.6	0.9	-0.6	-2.4	-1.0	-0.7	0.4	0.2		0.5	0.2	
Identified debt-creating flows	-5.5	-5.6	-2.3			0.0	5.7	2.7	1.3	2.7	-0.1	-0.4	-1.0	-0.3	-0.5		0.1	0.0	
Primary deficit	1.8	1.7	2.0	2.1	1.8	1.4	2.7	2.2	1.8	1.3	1.2	1.0	0.7	0.6	0.6	1.8	0.6	0.7	0.8
Revenue and grants	17.8	18.0	20.1			19.9	21.1	21.3	21.6	22.0	22.5	23.0	23.4	23.9	24.4		24.9	29.7	
of which: grants	0.4	0.5	0.7			0.3	0.9	0.9	0.2	0.2	0.3	0.2	0.6	0.6	0.6		0.5	0.2	
Primary (noninterest) expenditure	19.7	19.6	22.1			21.4	23.8	23.4	23.5	23.3	23.7	24.0	24.1	24.5	25.0		25.5	30.4	
Automatic debt dynamics	-6.7	-5.9	-3.8			-1.7	3.0	0.6	-0.5	1.3	-1.3	-1.4	-1.7	-0.9	-1.1		-0.6	-0.7	
Contribution from interest rate/growth differential	-4.8	-1.7	-1.1			-0.9	-0.4	0.4	0.2	1.2	-0.1	-1.2	-1.1	-1.1	-0.9		-0.7	-0.8	
of which: contribution from average real interest rate	-0.7	1.2	1.2			0.2	-0.6	1.2	1.8	2.8	1.5	0.1	0.1	0.1	0.1		0.3	0.2	
of which: contribution from real GDP growth	-4.1	-2.8	-2.3			-1.1	0.3	-0.8	-1.6	-1.7	-1.6	-1.3	-1.2	-1.2	-1.0		-1.0	-1.0	
Contribution from real exchange rate depreciation	-1.9	-4.2	-2.7			-0.9	3.4	0.2	-0.8	0.2	-1.2	-0.2	-0.5	0.1	-0.2		...	...	
Other identified debt-creating flows	-0.6	-1.4	-0.5			0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.6	-1.9	-1.4			-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.5	0.9			1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-2.8	0.0	1.1			0.4	3.1	-1.1	-0.3	-3.3	-2.3	-0.6	0.3	0.7	0.7		0.4	0.2	
Other Sustainability Indicators																			
PV of public sector debt	2.2	2.2	10.2			9.9	16.0	18.7	20.4	21.4	21.5	22.2	22.0	22.2	22.1		22.2	23.7	
o/w foreign-currency denominated	0.0	0.0	8.1			7.4	12.7	15.0	15.9	16.2	15.5	15.5	14.7	14.2	13.4		12.8	6.8	
o/w external	...	...	8.1			7.4	12.7	15.0	15.9	16.2	15.5	15.5	14.7	14.2	13.4		12.8	6.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...	...	...	...	...		...	...	
Gross financing need 2/	5.1	4.4	4.4			4.4	2.2	3.0	3.2	3.0	3.5	4.0	3.4	2.5	2.1		2.1	3.0	
PV of public sector debt-to-revenue and grants ratio (in percent)	12.6	12.2	50.6			49.8	75.9	88.2	94.2	97.1	95.6	96.8	93.9	92.8	90.5		89.3	79.7	
PV of public sector debt-to-revenue ratio (in percent)	12.9	12.6	52.6			50.6	79.4	91.8	94.9	97.8	96.7	97.8	96.2	95.2	92.7		91.2	80.4	
o/w external 3/	…	…	41.8			37.6	63.1	73.5	73.8	74.3	69.7	68.2	64.2	61.0	56.3		52.5	23.0	
Debt service-to-revenue and grants ratio (in percent) 4/	1.4	2.0	1.6			1.5	0.7	2.4	2.6	3.6	3.0	2.9	2.9	2.8	2.8		2.6	2.7	
Debt service-to-revenue ratio (in percent) 4/	1.4	2.0	1.7			1.5	0.7	2.5	2.6	3.7	3.0	2.9	2.9	2.9	2.9		2.6	2.7	
Primary deficit that stabilizes the debt-to-GDP ratio	10.1	7.3	3.2			1.0	-6.1	0.5	0.9	1.9	3.6	2.0	1.4	0.2	0.4		0.1	0.5	
Key macroeconomic and fiscal assumptions																			
Real GDP growth (in percent)	14.5	13.2	13.8	10.5	3.9	6.8	-1.5	3.0	6.0	6.0	6.0	5.0	5.0	5.0	4.0	4.4	4.0	4.0	4.2
Average nominal interest rate on forex debt (in percent)	1.0	0.9	0.9	1.6	0.8	0.8	0.8	0.8	0.8	0.9	1.0	1.2	1.3	1.4	1.5	0.8	1.6	2.1	1.8
Average real interest rate on domestic debt (in percent)	...	-4.0	-12.2	16.1	24.2	-9.0	...	19.0	8.9	11.2	5.4	2.9	3.0	3.4	3.8	7.1	3.0	2.4	1.8
Real exchange rate depreciation (in percent, + indicates depreciation)	-20.6	-27.6	-32.3	-11.0	16.8	-15.6	...	...	...	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	20.5	15.1	26.7	8.1	10.8	21.4	-7.9	-6.5	2.1	3.1	4.1	5.1	4.1	3.1	2.1	2.7	2.1	1.5	2.4
Growth of real primary spending (deflated by GDP deflator, in percent)	0.3	0.1	0.3	0.1	0.1	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	53.9	31.5	31.1	25.5	18.9	15.8	15.8	15.8	15.8	15.8	29.4	15.8	15.8	...

Sources: Armenian authorities; and Fund staff estimates and projections.
1/ Gross debt of the central government.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2. Armenia: Sensitivity Analysis for Key Indicators of Public Debt, 2008-2028

	Projections							
	2008	2009	2010	2011	2012	2013	2018	2028
PV of Debt-to-GDP Ratio								
Baseline	10	16	19	20	21	21	22	24
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	10	13	13	13	13	13	19	32
A2. Primary balance is unchanged from 2008	10	13	14	13	12	12	19	54
A3. Permanently lower GDP growth 1/	10	14	16	17	16	17	28	70
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	10	12	10	8	5	3	-5	-25
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	10	16	19	19	17	16	19	24
B3. Combination of B1-B2 using one half standard deviation shocks	10	14	15	12	8	5	-6	-32
B4. One-time 30 percent real depreciation in 2009	10	19	21	20	20	19	22	29
B5. 10 percent of GDP increase in other debt-creating flows in 2009	10	24	25	25	23	22	24	28
PV of Debt-to-Revenue Ratio 2/								
Baseline	49	75	88	94	97	95	89	80
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	49	60	63	62	59	58	76	108
A2. Primary balance is unchanged from 2008	49	62	65	62	57	53	75	184
A3. Permanently lower GDP growth 1/	49	68	77	78	75	74	113	236
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	49	55	49	38	23	11	-21	-84
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	49	74	88	86	79	73	78	81
B3. Combination of B1-B2 using one half standard deviation shocks	49	65	72	58	38	23	-25	-110
B4. One-time 30 percent real depreciation in 2009	49	90	99	94	89	86	90	97
B5. 10 percent of GDP increase in other debt-creating flows in 2009	49	112	118	114	106	98	98	96
Debt Service-to-Revenue Ratio 2/								
Baseline	4	5	5	6	10	12	7	8
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	4	4	4	5	9	11	11	18
A2. Primary balance is unchanged from 2008	4	5	5	3	8	9	8	29
A3. Permanently lower GDP growth 1/	4	5	5	6	12	15	15	37
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	4	4	4	0	2	2	-10	-20
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	4	5	6	10	15	15	8	10
B3. Combination of B1-B2 using one half standard deviation shocks	4	4	5	7	11	4	-12	-24
B4. One-time 30 percent real depreciation in 2009	4	6	7	8	15	19	12	16
B5. 10 percent of GDP increase in other debt-creating flows in 2009	4	5	9	32	15	27	10	13

Sources: Armenian authorities; and Fund staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the length of the projection period.
2/ Revenues are defined inclusive of grants.

Table 3a.: External Debt Sustainability Framework, Baseline Scenario, 2005-2028 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical 0 Average	0 Standard Deviation	Projections									
	2005	2006	2007			2008	2009	2010	2011	2012	2013	2008-2013 Average	2018	2028	2014-202 Average
External debt (nominal) 1/	27.3	22.7	20.2			18.2	19.0	22.4	25.4	25.4	24.0		21.2	14.0	
o/w public and publicly guaranteed (PPG)	22.4	18.9	17.3			15.3	21.1	24.0	24.9	23.2	20.6		16.1	9.1	
Change in external debt	-6.0	-4.6	-2.5			-1.9	0.7	3.4	3.1	0.0	-1.4		-0.4	-0.7	
Identified net debt-creating flows	-12.9	-11.6	-8.2			4.9	7.1	3.3	1.3	0.3	0.5		0.6	2.3	
Non-interest current account deficit	0.3	1.3	6.0	6.6	5.2	12.2	11.3	10.3	8.7	7.8	7.6		5.9	6.5	6.2
Deficit in balance of goods and services	14.4	16.1	19.7			24.9	22.2	22.0	21.1	20.6	20.0		17.5	15.9	
Exports	28.9	23.7	19.3			14.7	12.8	15.8	16.8	17.7	18.2		23.1	34.1	
Imports	43.3	39.7	39.0			39.6	35.0	37.7	38.0	38.3	38.2		40.6	50.0	
Net current transfers (negative = inflow)	-10.7	-10.9	-10.3	-9.3	1.2	-9.0	-8.1	-8.6	-9.4	-9.7	-9.2		-8.6	-6.9	-8.1
o/w official	-1.3	-1.3	-1.0			-0.5	-0.5	-0.3	-0.2	-0.2	0.0		-0.5	-0.3	
Other current account flows (negative = net inflow)	-3.5	-4.0	-3.5			-3.6	-2.8	-3.0	-3.1	-3.2	-3.2		-3.0	-2.5	
Net FDI (negative = inflow)	-4.7	-7.0	-7.6	-6.1	2.4	-6.6	-4.5	-6.4	-6.3	-6.4	-6.2		-5.3	-4.3	-5.0
Endogenous debt dynamics 2/	-8.4	-5.8	-6.5			-0.7	0.3	-0.5	-1.0	-1.0	-0.9		-0.1	0.1	
Contribution from nominal interest rate	0.8	0.6	0.4			0.4	0.0	0.1	0.2	0.4	0.5		0.7	0.6	
Contribution from real GDP growth	-3.5	-2.8	-2.2			-1.1	0.3	-0.6	-1.2	-1.4	-1.4		-0.8	-0.6	
Contribution from price and exchange rate changes	-5.7	-3.6	-4.8			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	6.9	6.9	5.6			-6.9	-6.4	0.0	1.8	-0.3	-2.0		-0.9	-3.0	
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	12.0			10.2	9.4	13.0	16.5	18.2	19.2		17.8	11.6	
In percent of exports	...	...	62.0			69.4	73.2	82.3	97.9	102.7	105.1		77.0	34.1	
PV of PPG external debt	...	...	9.1			7.4	11.5	14.6	15.9	16.0	15.7		12.6	6.7	
In percent of exports	...	...	47.1			49.9	89.8	92.7	94.6	90.4	86.3		54.6	19.6	
In percent of government revenues	...	...	46.9			37.5	56.9	71.8	74.2	73.3	70.7		51.8	22.8	
Debt service-to-exports ratio (in percent)	2.7	2.5	2.2			8.4	7.9	8.1	2.1	8.1	12.8		10.0	7.3	
PPG debt service-to-exports ratio (in percent)	-2.1	-2.9	-2.6			3.1	4.2	3.7	3.6	7.9	10.8		3.2	2.7	
PPG debt service-to-revenue ratio (in percent)	-3.5	-3.9	-2.6			2.3	2.6	2.9	2.8	6.4	8.9		3.0	3.2	
Total gross financing need (Billions of U.S. dollars)	-0.2	-0.3	-0.1			0.8	0.8	0.5	0.3	0.3	0.5		0.6	1.7	
Non-interest current account deficit that stabilizes debt ratio	6.3	5.9	8.5			14.1	10.6	6.9	5.6	7.8	9.0		6.3	7.2	
Key macroeconomic assumptions															
Real GDP growth (in percent)	14.5	13.2	13.8	10.5	3.9	6.8	-1.5	3.0	6.0	6.0	6.0	4.4	4.0	4.0	4.2
GDP deflator in US dollar terms (change in percent)	20.5	15.1	26.7	8.1	10.8	21.4	-7.9	-6.5	2.1	3.1	4.1	2.7	2.1	1.5	2.4
Effective interest rate (percent) 5/	3.2	2.8	2.7	2.9	0.6	2.5	0.1	0.4	1.0	1.6	2.1	1.3	3.5	4.6	3.8
Growth of exports of G&S (US dollar terms, in percent)	43.8	6.7	17.6	19.0	12.8	-1.0	-21.3	18.8	15.4	15.0	13.5	6.7	13.2	8.9	11.3
Growth of imports of G&S (US dollar terms, in percent)	40.3	19.4	41.5	15.2	16.6	31.7	-19.9	3.9	8.8	10.4	10.0	7.5	9.0	8.3	8.7
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	53.9	31.5	31.1	25.5	18.9	15.8	29.4	15.8	15.8	15.8
Government revenues (excluding grants, in percent of GDP)	17.4	17.5	19.4			19.6	20.2	20.4	21.5	21.8	22.2		24.4	29.4	25.9
Aid flows (in Billions of US dollars) 7/	0.3	0.2	0.3			0.2	0.8	1.2	1.4	1.7	1.8		2.3	2.5	
o/w Grants	0.0	0.0	0.1			0.0	0.1	0.1	0.0	0.0	0.0		0.1	0.1	
o/w Concessional loans	0.3	0.2	0.2			0.1	0.7	1.1	1.4	1.6	1.8		2.2	2.4	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			0.8	2.5	2.1	1.0	0.5	0.5		0.7	0.3	0.5
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			66.3	42.1	43.4	29.0	26.5	29.9		43.9	40.7	41.7
Memorandum items:															
Nominal GDP (Billions of US dollars)	4.9	6.4	9.2			11.9	10.8	10.4	11.3	12.3	13.6		20.0	36.2	
Nominal dollar GDP growth	38.0	30.3	44.2			29.6	-9.3	-3.7	8.2	9.3	10.4	**7.4**	6.2	5.6	6.8
PV of PPG external debt (in Billions of US dollars)			0.8			0.9	1.2	1.5	1.8	2.0	2.1		2.5	2.4	
(PVt-PVt-1)/GDPt-1 (in percent)						0.4	3.1	2.6	2.6	1.6	1.3	1.9	0.0	-0.1	0.2

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that PV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 3b.Armenia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2008-2028
(In percent)

	Projections										
	2008	2009	2010	2011	2012	2013	**2018**	2019	2020	2027	2028
PV of debt-to GDP ratio											
Baseline	7	11	15	16	16	16	**13**	12	11	7	7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2008-2028 1/	7	4	4	6	7	6	**7**	7	7	1	0
A2. New public sector loans on less favorable terms in 2008-2028 2	7	11	13	14	14	14	**12**	11	11	7	7
B. Bound Tests											
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	7	11	13	14	14	14	**11**	11	10	6	6
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	7	8	8	10	10	10	**9**	9	9	7	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	7	11	13	14	15	14	**11**	11	10	7	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	7	12	18	19	19	19	**14**	13	12	7	7
B5. Combination of B1-B4 using one-half standard deviation shocks	7	3	-1	0	1	1	**3**	3	3	4	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	7	17	22	24	24	23	**19**	17	17	11	10
PV of debt-to-exports ratio											
Baseline	50	90	93	95	90	86	**55**	49	45	22	20
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2008-2028 1/	50	34	27	35	37	36	**32**	29	26	3	0
A2. New public sector loans on less favorable terms in 2008-2028 2	50	84	84	84	80	77	**51**	46	42	22	20
B. Bound Tests											
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	50	90	93	95	90	86	**55**	49	45	22	20
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	50	46	43	47	47	46	**33**	31	29	17	15
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	50	90	93	95	90	86	**55**	49	45	22	20
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	50	94	113	113	107	102	**62**	55	50	22	20
B5. Combination of B1-B4 using one-half standard deviation shocks	50	20	-9	0	3	5	**13**	13	14	14	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	50	90	93	95	90	86	**55**	49	45	22	20
PV of debt-to-revenue ratio											
Baseline	37	57	72	74	73	71	**52**	47	44	25	23
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2008-2028 1/	37	22	21	27	30	29	**30**	28	26	4	0
A2. New public sector loans on less favorable terms in 2008-2028 2	37	54	65	66	65	63	**48**	44	42	25	23
B. Bound Tests											
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	37	53	64	66	65	63	**46**	42	39	22	20
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	37	39	40	45	46	45	**38**	36	34	23	22
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	37	54	65	67	67	64	**47**	43	40	23	21
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	37	60	87	89	87	83	**59**	53	49	26	23
B5. Combination of B1-B4 using one-half standard deviation shocks	37	15	-7	0	2	4	**12**	12	13	15	14
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	37	84	106	110	109	105	**77**	70	65	37	34

Table 3b.Armenia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2008-2028 (continued)
(In percent)

Debt service-to-exports ratio

Baseline	3	4	4	4	8	11	**3**	3	3	3	3
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2008-2028 1/	3	3	2	1	1	1	**2**	2	2	1	1
A2. New public sector loans on less favorable terms in 2008-2028 2	3	4	4	5	5	4	**3**	3	3	2	1
B. Bound Tests											
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	3	4	4	4	4	3	**6**	6	5	3	3
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	3	3	2	2	2	2	**3**	4	3	2	2
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	3	4	4	4	4	3	**6**	6	5	3	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	3	4	4	4	4	4	**7**	7	6	3	3
B5. Combination of B1-B4 using one-half standard deviation shocks	3	3	1	1	1	1	**1**	1	0	2	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	3	4	4	4	4	3	**6**	6	5	3	3

Debt service-to-revenue ratio

Baseline	2	3	3	3	6	9	**3**	3	3	3	3
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2008-2028 1/	2	2	1	1	1	1	**2**	2	2	1	1
A2. New public sector loans on less favorable terms in 2008-2028 2	2	3	3	4	4	4	**3**	3	3	2	2
B. Bound Tests											
B1. Real GDP growth at historical average minus one standard deviation in 2009-2010	2	2	3	3	3	2	**5**	5	4	3	3
B2. Export value growth at historical average minus one standard deviation in 2009-2010 3/	2	3	2	2	2	2	**4**	4	3	3	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-2010	2	2	3	3	3	2	**5**	6	4	3	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-2010 4/	2	3	3	3	3	3	**7**	7	6	4	3
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	1	0	1	0	**1**	1	0	2	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	2	4	4	4	4	4	**9**	9	7	5	5
Memorandum item:											
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	19	19	19	19	19	19	**19**	19	19	19	19

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 2. Armenia: Indicators of Public and Publicly Guranteed External Debt Under Alternative Scenarios, 2008-2028

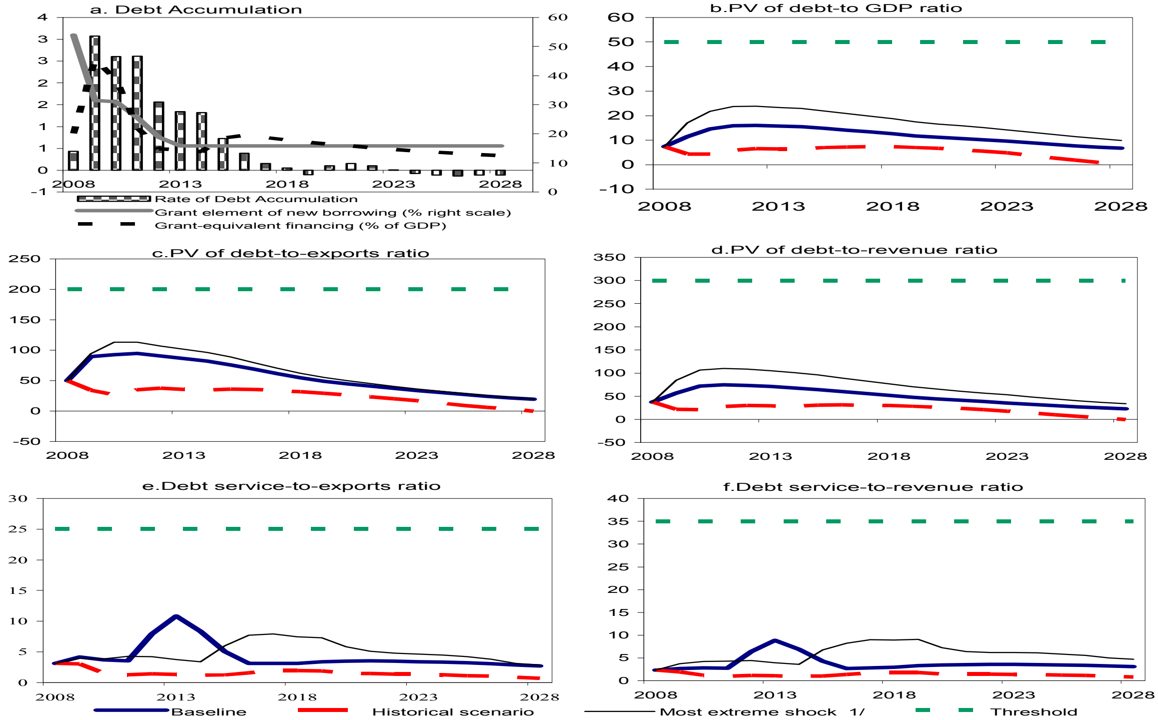
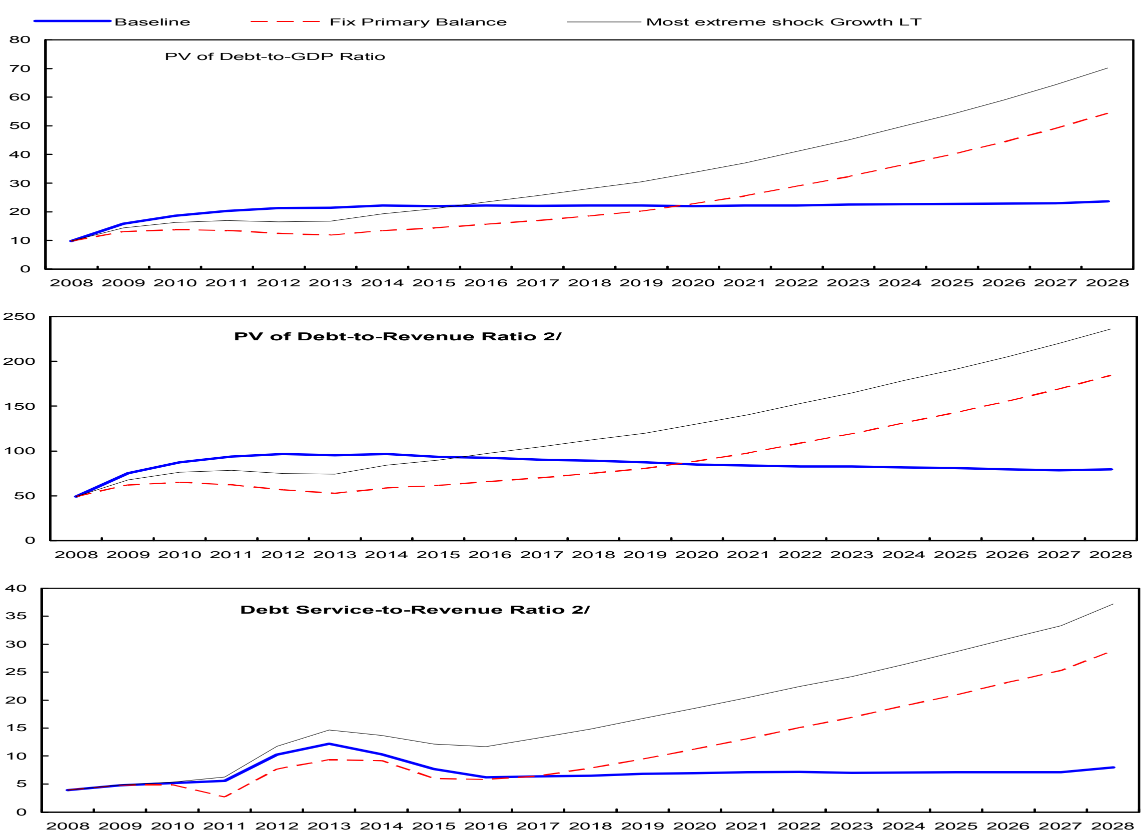


Figure 3. Armenia: Indicators of Public Debt Under Alternative Scenarios, 2008-2028



INTERNATIONAL MONETARY FUND

Republic of Armenia—Assessment of the Risks to the Fund and the Fund's Liquidity Position

Prepared by the Finance and Strategy, Policy, and Review Departments

In consultation with other Departments

Approved by Andrew Tweedie and Alan MacArthur

March 4, 2009

1. **This note assesses the risks to the Fund arising from the proposed Stand-By Arrangement (SBA) for Armenia and its effects on the Fund's liquidity, in accordance with the policy on exceptional access.**[1] The authorities are requesting a 28-month SBA with access of SDR 368 million (400 percent of quota). The arrangement would be front-loaded with a first purchase of SDR 161.6 million (175.6 percent of quota) upon approval and a purchase of SDR 36.8 million (40.0 percent of quota) in May 2009. The remaining resources would be phased in eight quarterly purchases, with the last purchase of SDR 18.9 million (20.5 percent of quota) scheduled to take place in May 2011 (Table 1).

Table 1. Armenia: Proposed SBA—Access and Phasing

			Percent of quota	
Availability	Date 1/	SDR mn.	Purchase	Cumulative
2009	March (approval)	161.552	175.6	175.6
	May	36.800	40.0	215.6
	August	18.860	20.5	236.1
	November	18.860	20.5	256.6
2010	February	23.552	25.6	282.2
	May	23.552	25.6	307.8
	August	23.552	25.6	333.4
	November	23.552	25.6	359.0
2011	February	18.860	20.5	379.5
	May	18.860	20.5	400.0
	Total	368.000	400.0	400.0

Source: Finance Department.

1/ Starting in May 2009, purchases will depend on the completion of a review.

[1] See *The Acting Chair's Summing Up of the Review of Access Policy Under the Credit Tranches and the Extended Fund Facility, and Access Policy in Capital Account Crises—Modifications to the Supplemental Reserve Facility and Follow-Up Issues Related to Exceptional Access Policy* (3/5/03).

I. BACKGROUND

2. **Armenia has had several programs supported by the Fund since becoming a member in May 1992 (Table 2 and Figure 1).** Armenia made purchases under the Systemic Transformation Facility (STF) in 1994 and 1995 totaling SDR 33.8 million. An SBA was approved in June 1995 in an amount of SDR 43.9 million, of which SDR 13.5 million was purchased. From 1996 to 2008, Armenia had first an ESAF arrangement and then two PRGF arrangements under which it made all available purchases, reflecting its generally successful implementation of the programs. In November 2008, the Executive Board approved Armenia's current low-access PRGF arrangement in an amount of SDR 9.2 million. Only the initial purchase of SDR 1.3 million has been made under this arrangement, with most end-December 2008 quantitative performance criteria not observed. The authorities have requested that this arrangement be canceled. Armenia has made repurchases and repayments in a timely fashion, and its outstanding obligations to the Fund have been on a declining path since 2004. As of end-February 2009, Armenia's outstanding obligations, all to the PRGF Trust, were SDR 87.5 million.

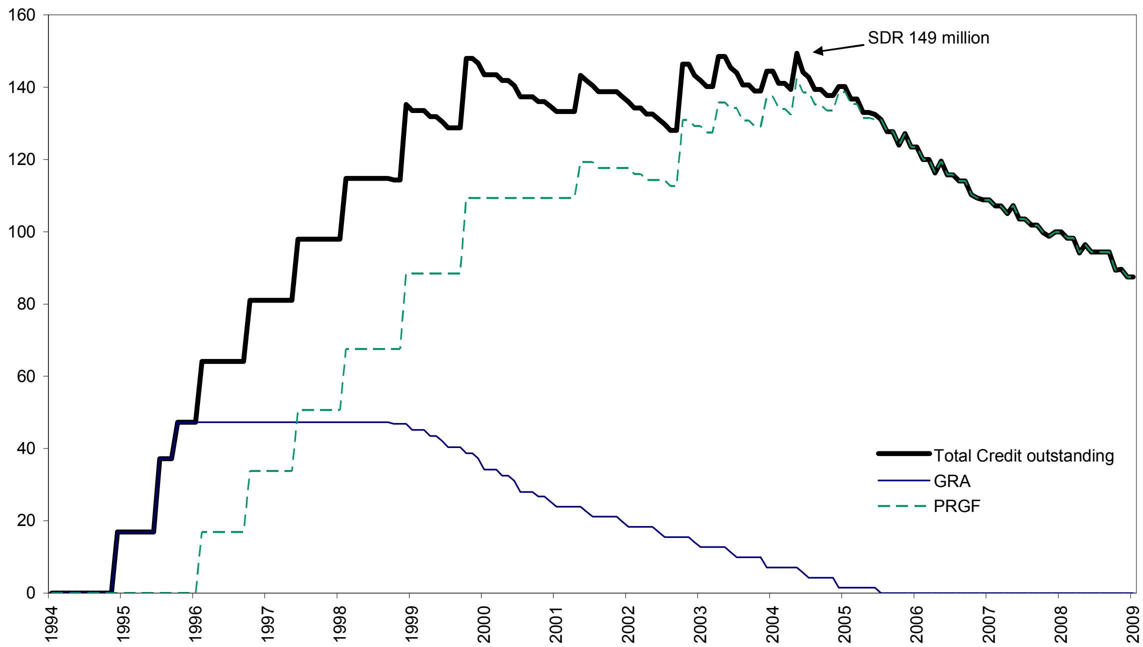
Table 2. Armenia: IMF Financial Arrangements, 1994–2018
(In millions of SDRs)

Year	Type of Arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount of New Arrangement	Amount Drawn	Purchases/ Disbursements	Repurchases/ Repayments	Fund Exposure 1/ GRA	PRGF	Total
1994	STF 2/					16.9	--	16.9	--	16.9
1995	SBA	28-Jun-95	14-Feb-96	43.9	13.5	30.4 3/	--	47.3	--	47.3
1996	ESAF	14-Feb-96	20-Dec-99	109.4	109.4	33.8	--	47.3	33.8	81.0
1997						16.9	--	47.3	50.6	97.9
1998						37.8	0.4	46.8	88.4	135.3
1999						20.9	9.6	37.3	109.4	146.6
2000						--	12.0	25.3	109.4	134.7
2001	PRGF	23-May-01	31-Dec-04	69.0	69.0	10.0	7.3	19.7	117.7	137.4
2002						20.0	14.1	14.1	129.2	143.3
2003						20.0	18.8	7.0	137.4	144.4
2004						19.0	23.3	1.4	138.7	140.1
2005	PRGF	25-May-05	24-May-08	23.0	23.0	6.6	23.3	--	123.4	123.4
2006						6.6	21.2	--	108.8	108.8
2007						6.6	15.4	--	99.9	99.9
2008	PRGF	17-Nov-08	16-Nov-11	9.2	1.3	4.6	17.1	--	87.5	87.5
2009 4/	*SBA*	*06-Mar-09*		*368.0*		*236.07*	*15.19*	*236.07*	*72.31*	*308.38*
2010 4/						*94.21*	*14.13*	*330.28*	*58.18*	*388.46*
2011 4/						*37.72*	*14.44*	*368.00*	*43.74*	*411.74*
2012 4/						--	*86.89*	*295.86*	*28.99*	*324.85*
2013 4/						--	*146.77*	*160.16*	*17.92*	*178.08*
2014 4/						--	*112.45*	*55.37*	*10.26*	*65.63*
2015 4/						--	*52.83*	*7.07*	*5.73*	*12.80*
2016 4/						--	*10.29*	--	*2.50*	*2.50*
2017 4/						--	*1.91*	--	*0.59*	*0.59*
2018 4/						--	*0.59*	--	--	--

Source: Finance Department.

1/ As of end-December, unless otherwise stated.
2/ The Systemic Transformation Facility (STF) was created in April 1993 and allowed to lapse in April 1995.
3/ Includes a second drawing under the 1995 STF of SDR 16.9 million.
4/ Figures under the proposed program in italics. Assumes repurchases on an obligations basis.

Figure 1. Armenia: IMF Credit Outstanding, 1994–2009
(In millions of SDRs)



Source: Finance Department.

3. **Armenia's external debt is relatively low and consists mainly of public sector debt to multilateral creditors.** (Table 3 and Figure 2). At end-2008, Armenia's total external debt was estimated at slightly over 18 percent of GDP, i.e., below the corresponding ratios for all exceptional access cases since the exceptional access framework was put in place in 2003.[2] At end-2008, Armenia's public external debt, most of which is due to multilateral creditors, was estimated at slightly over 15 percent of GDP although this ratio is expected to rise somewhat in the near-term as the real exchange rate adjusts. As such, Armenia's external public debt ratio was below the corresponding ratios for all except three of the previous exceptional access cases (Figure 3, Panel B).[3] Armenia's external debt

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[2] No comprehensive data of Armenia's private external debt are available, but the amount is generally thought to be relatively low, partly reflecting Armenia's limited borrowing on international capital markets. The authorities are currently in the process of increasing their monitoring of private external debt and expect to produce estimates shortly.

[3] The previous exceptional access cases used as comparators in this paper are four of the five arrangements approved since the exceptional access framework was put in place (Argentina, Brazil, Turkey, and Uruguay), while the recent cases are those approved in 2008-09. The 2008 extended arrangement for Liberia also involved exceptional access. However, this arrangement was different from other exceptional access cases since, in this case, exceptional access was granted in the context of Liberia's clearance of arrears to the Fund.

service is also comparatively low relative to exports of goods and services in 2008 owing to the low level of debt and the high share of multilateral debt.

4. **This external public debt accounts for the bulk of Armenia's total public debt** (Figure 3, Panel C)**.** At end-2008, total government and government-guaranteed debt was estimated at about 18 percent of GDP, which is below the corresponding ratios for all except three of the previous exceptional access cases.

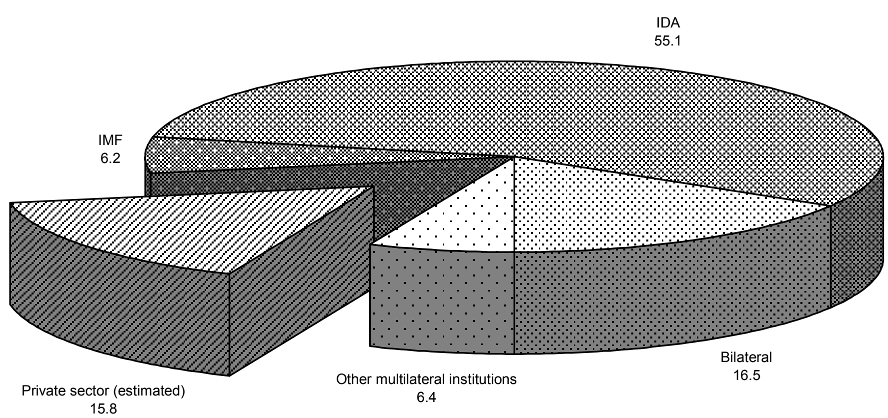
Table 3. Armenia: Public External Debt, 2004-2008 1/

Public External Debt	2004	2005	2006	2007	2008
In Millions of U.S. Dollars	1,183	1,099	1,206	1,591	1,830
In Percent of GDP	33	22	19	17	15

Source: Armenian authorities and IMF staff estimates.

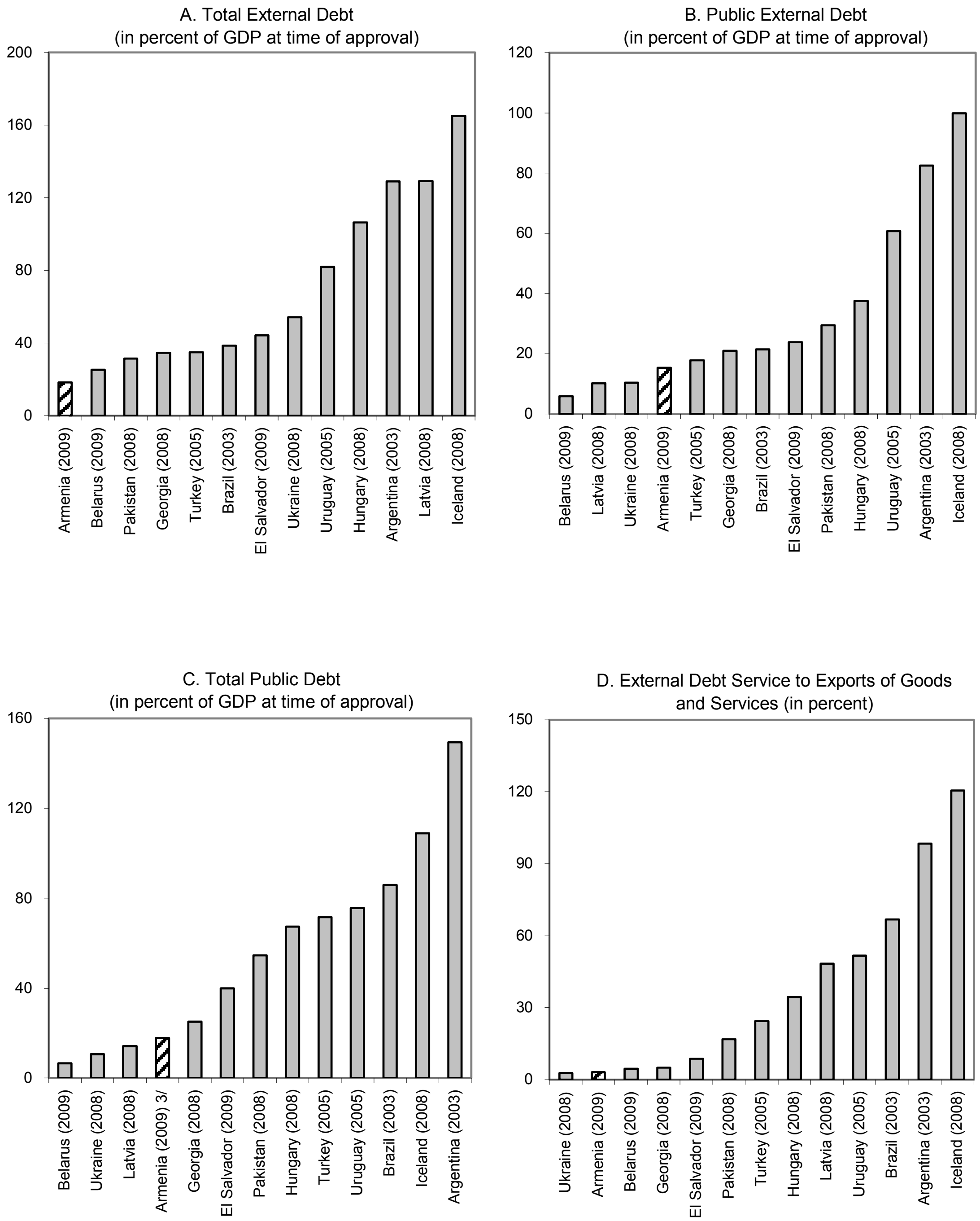
1/ End of year unless otherwise indicated.

Figure 2. Armenia: Composition of Total External Debt, end-2008
(in percent)



Source: Armenian authorities and IMF staff estimates.

Figure 3. Debt Ratios for Recent Exceptional Access Arrangements 1/ 2/



Source: Armenian authorities and IMF staff estimates, and World Economic Outlook.

1/ Year in parenthesis corresponds to the year of approval. Ratios are for the year indicated in parenthesis, with the exception of Belarus, El Salvador and Armenia, for which 2008 ratios are shown.
2/ For arrangements approved since September 2008, estimates as reported in each staff report on the request of the Stand-By Arrangement.
3/ Government and government-guaranteed debt.

II. THE NEW STAND-BY ARRANGEMENT—RISKS AND IMPACT ON FUND'S FINANCES

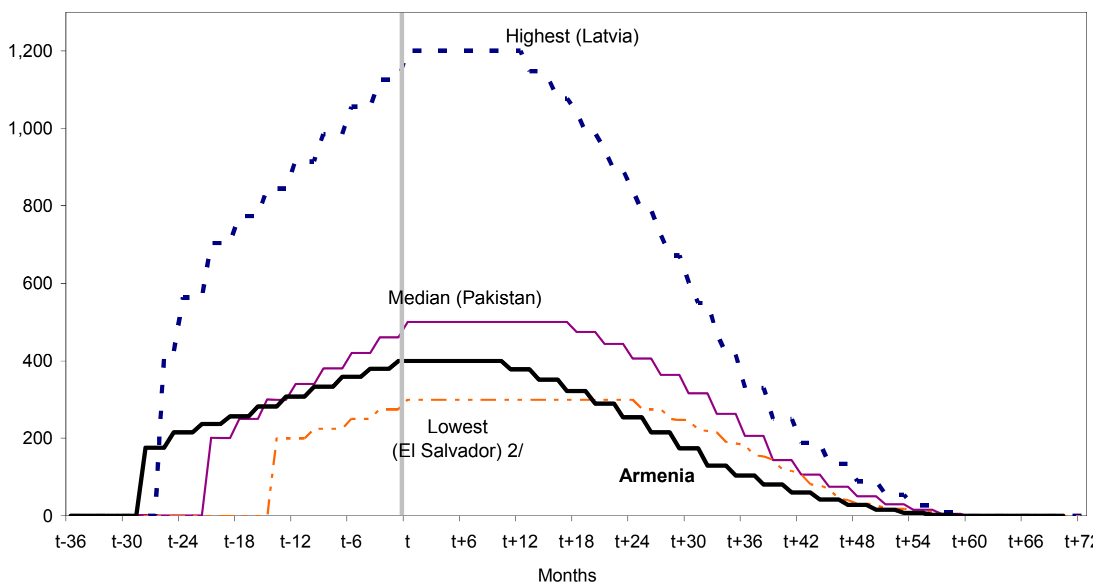
A. Risks to the Fund

5. **Access under the proposed arrangement would greatly exceed that in previous arrangements for Armenia, and would exceed both the annual and cumulative limits:**

- If all purchases are made as scheduled, Armenia's outstanding use of GRA resources would rise to over 200 percent of quota with the first two drawings, and then to 400 percent of quota in May 2011—well above the historic peak in Armenia's outstanding credit—and remain above 300 percent of quota through January 2013.[4] In terms of quota, this projected peak exposure would be below the median peak for recent exceptional access cases (Figure 4). Including outstanding PRGF loans, the peak exposure, at 457 percent of quota (SDR 421 million) occurs in May 2011.

Figure 4. Fund Credit Outstanding in the GRA around Peak Borrowing 1/
(in percent of quota)

Approved and Forthcoming Exceptional Access Cases since September 2008



Source: IFS, Finance Department, and IMF staff estimates.
1/ Peak borrowing 't' is defined as the highest level of credit outstanding for a member. Repurchases are assumed to be under obligation basis.
2/ The authorities have expressed their intention to treat the arrangements as precautionary, as balance of payments pressures have not materialized.

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[4] Debt service to the Fund is calculated on an obligations basis, in line with the guidelines stipulated in *Review of Fund Facilities—Proposed Decisions and Implementation Guidelines* (11/3/00). Under the obligations schedule, the first repurchase is scheduled to take place in June 2012, 3¼ years after the first purchase under the arrangement.

- In SDR terms the peak exposure of SDR 368 million would be the lowest of the recent exceptional access cases (Figure 5, Panel A).

- Under the proposed SBA, Armenia's total outstanding use of GRA resources will be 2.2 percent of GDP following the first purchase, and 4.8 percent of GDP after the final disbursement (Table 4). This peak relative to GDP would be close to the median of the exceptional access cases approved since September 2008.

6. **If all purchases under the SBA were made as scheduled, Fund credit would soon represent a substantial share of reserves, and debt service to the Fund would substantially increase Armenia's external debt service burden** (see Table 4):

- By end-2009, Armenia's outstanding use of GRA resources would account for about 15 percent of Armenia's projected public external debt and 40 percent of international reserves. Use of GRA resources would peak at close to 20 percent of projected public external debt, and 49 percent of reserves by end-2010.

- Armenia's projected debt service to the GRA would peak in 2013 at about SDR 141 million (and would exceed SDR 150 million when debt service to the PRGF Trust is included), at which time it would account over 75 percent of total external debt service.[5]

- In terms of exports of goods and services, external debt service to the Fund on GRA credit would peak at 8.4 percent in 2013, exceeding the peak in all but one of the recent exceptional access cases (Iceland), although incorporating remittances into the denominator would reduce this ratio to about 6 percent.

[5] Currency holdings resulting from scheduled purchases under the proposed SBA would be subject to level-based surcharges of 100 basis points over the basic rate of charge (adjusted for burden sharing) on credit outstanding exceeding 200 percent of quota from May 2009 through October 2013, and surcharges of 200 basis points on credit outstanding exceeding 300 percent of quota from May 2010 through January 2013.

Table 4. Armenia—Impact on GRA Finances

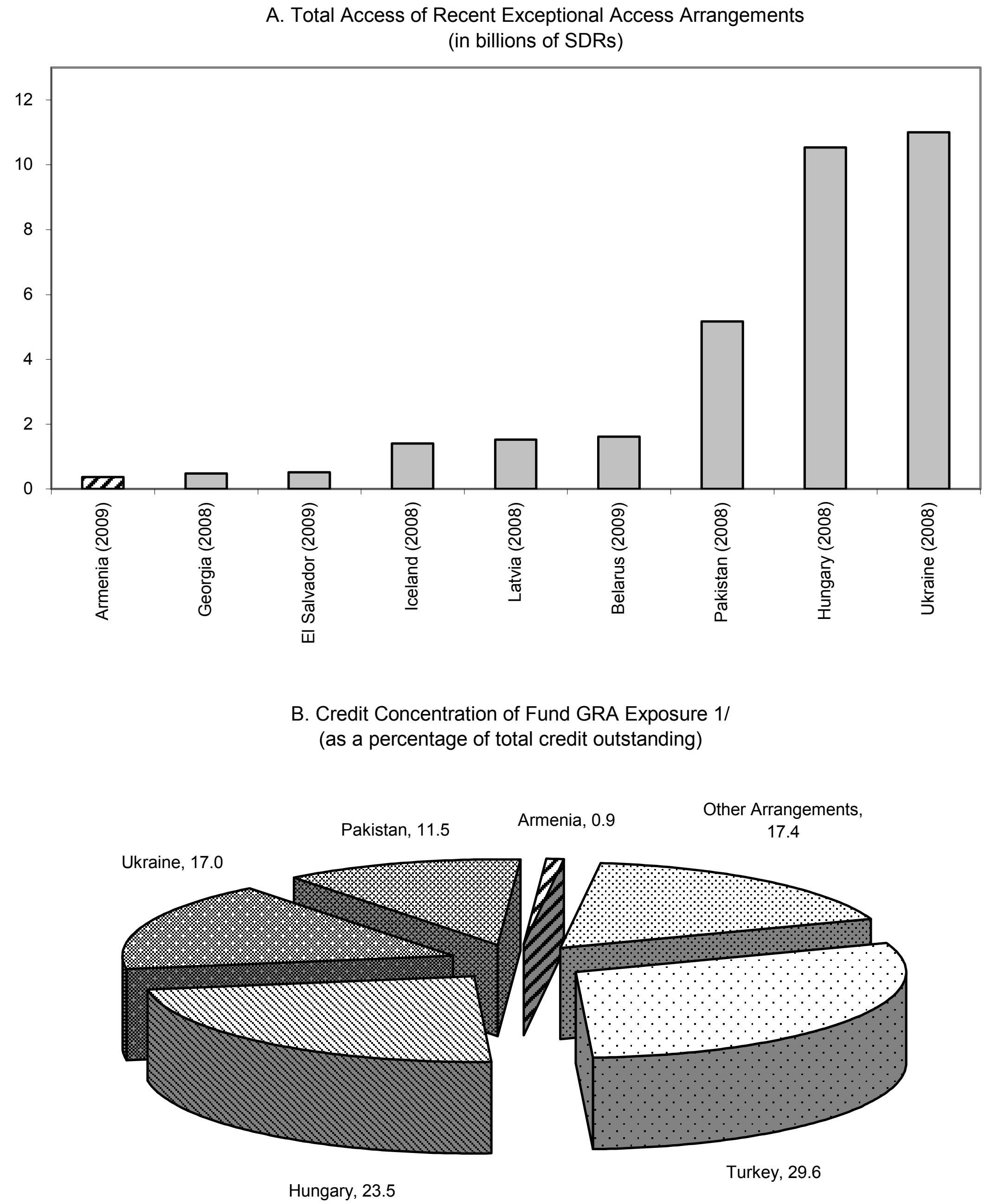
(In millions of SDRs, at end of period unless otherwise noted)

	Mar-09	2009	2010	2011	2012	2013	2014	2015
Exposure and Repayments								
Fund GRA credit outstanding to Armenia 1/	161.6	236.1	330.3	368.0	295.9	160.2	55.4	7.1
Fund GRA credit outstanding to Armenia (percent of quota)	175.6	256.6	359.0	400.0	321.6	174.1	60.2	7.7
Projected payment of charges to the Fund on GRA credit outstanding 2/		3.3	5.7	8.2	8.2	5.0	1.9	0.6
Projected debt service payments to the Fund on GRA credit outstanding 2/		3.3	5.7	8.2	80.4	140.7	106.7	48.9
Debt and Debt Service Ratios 3/								
Armenia's GRA credit outstanding (percent of total public external debt)	13.1	15.3	19.5	19.4	15.3	8.5	2.9	0.4
Armenia's GRA credit outstanding (percent of GDP)	2.2	3.2	4.7	4.8	3.6	1.7	0.5	0.1
Armenia's GRA credit outstanding (percent of gross international reserves)	17.0	40.0	49.1	44.4	31.4	15.9	5.2	0.6
Armenia's GRA debt service to the Fund (percent of exports of goods and services)		0.4	0.5	0.6	5.4	8.4	5.6	2.3
Armenia's GRA debt service to the Fund (percent of total public external debt service)		7.9	12.2	15.3	64.1	75.4	66.2	44.4
Armenia's total debt to the Fund (percent of total public external debt) 4/	20.1	20.0	23.0	21.7	16.8	9.4	3.5	0.7
Armenia's total debt service to the Fund (percent of total public external debt service) 4/		44.9	43.2	42.6	76.0	81.4	71.0	48.6
Liquidity and Prudential Measures								
One-year Forward Commitment Capacity (FCC) 5/	95,561.0	…	…	…	…	…	…	…
Armenia's impact on FCC 6/	(368.0)	…	…	…	…	…	…	…
Fund GRA credit outstanding to Armenia (percent of current precautionary balances) 7/	2.3	…	…	…	…	…	…	…
Memorandum items								
Fund's precautionary balances 7/	6,938.6							
Fund's residual burden sharing capacity 8/	30.0							
Fund GRA credit outstanding to Armenia (percent of total GRA credit outstanding) 9/	0.9	…	…	…	…	…	…	…
Fund GRA credit outstanding to five largest debtors (percent of total GRA credit outstanding) 9/	85.3	…	…	…	…	…	…	…

Sources: Armenia authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Repurchases follow the obligations schedule.
2/ Includes surcharges and service fees.
3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed SBA. For March 2009, projections for external debt, GDP, gross international reserves, and exports of goods and services are as of end-December 2008.
4/ Total debt to the Fund comprises balances outstanding on GRA credit and PRGF loans.
5/ As of February 26, 2009. The Forward Commitment Capacity is a measure of the resources available for new financial commitments in the coming year, equal to usable resources plus repurchases one-year forward minus the prudential balance. FCC determined on basis of available quota resources only; in addition, the Fund has access to SDR 34 billion under the NAB/GAB borrowing arrangements and $US 100 billion under the borrowing arrangement with Japan.
6/ A single country's negative impact on the FCC is defined as the country's sum of Fund credit and undrawn commitments minus repurchases one-year forward.
7/ As of end-April 2008.
8/ Estimated based on February 26, 2009 data. Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.
9/ Reflects total Fund credit outstanding as of February 26, 2009, plus the first purchase of Armenia.

Figure 5. Exceptional Access Levels and Credit Concentration



Source: Finance Department.

1/ Credit outstanding as of February 26, 2009 plus the first purchase under the proposed arrangement with Armenia.

B. Impact on the Fund's Liquidity Position and Risk Exposure

7. **Given the comparatively low scale of access under the arrangement in SDR terms, the impact on the Fund's liquidity and credit risk exposure is relatively small:**

- **The proposed arrangement would reduce Fund liquidity by less than 0.4 percent.** Commitments under the proposed arrangement would reduce the one-year forward commitment capacity (FCC) of SDR 95.6 billion by SDR 368 million (see Table 4).[6] [7]

- **Fund credit to Armenia as a share of total current Fund credit from the GRA would increase to 0.9 percent with the first purchase (Figure 5, Panel B)**. The share of the top five borrowers of total outstanding credit would decrease slightly to just over 85 percent (see Table 4).[8]

- **Were Armenia to accrue arrears on charges under the proposed arrangement, the Fund's remaining burden sharing capacity would be reduced significantly**.[9] Projected charges on the GRA obligations will peak at about SDR 8 million in 2011-12 or about one-quarter of the Fund's current estimated residual burden-sharing capacity (see Table 4).[10] However, the impact on the Fund's burden sharing capacity of potential arrears from this arrangement would decline if the Fund's loan portfolio were to expand further.

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[6] The FCC is the principal measure of Fund liquidity. The (one-year) FCC indicates the amount of GRA resources available for new financing over the next 12 months. See *The Fund's Liquidity Position—Review and Outlook* (10/14/02), Following the creation of the Short-Term Liquidity Facility (SLF), the calculation of the FCC will exclude repurchases falling due under the SLF—see *A New Facility for Market Access Countries—The Short-Term Liquidity Facility—Proposed Decision* (Supplement 1, 10/27/08).

[7] Data as of February 26, 2009. This FCC is determined on the basis of available quota resources only; in addition, the Fund has access to SDR 34 billion under the NAB/GAB borrowing arrangements and US$100 billion under the borrowing agreement with Japan.

[8] Given the possibility of new financing operations, including some that will involve exceptional access, the concentration of the Fund's lending portfolio is likely to change in coming months.

[9] Under the burden-sharing mechanism, the financial consequences for the Fund that stem from the existence of overdue financial obligations are shared between creditors and debtors through a decrease in the rate of remuneration and an increase in the rate of charge, respectively. The mechanism is used to accumulate precautionary balances in the special contingent account (SCA-1) and to compensate the Fund for a loss in income when debtors do not pay charges. The Executive Board has set a floor for remuneration at 85 percent of the SDR interest rate. No corresponding ceiling applies to the rate of charge.

[10] Burden sharing capacity has declined recently, despite the increase in credit outstanding, reflecting the steep decline in the SDR interest rate.

- **Potential GRA exposure to Armenia would be modest in relation to the Fund's current level of precautionary balances**. After the first purchase, Fund credit to Armenia would be about 2.3 percent of the Fund's current precautionary balances (see Table 4), and the total access amounts to somewhat over 5 percent of current precautionary balances.

III. ASSESSMENT

8. **The proposed program, and the substantial and front-loaded financing it makes available, aim to strengthen Armenia's ability to address the effects of external shocks.** The specific objectives are to provide a sufficient liquidity buffer to the banking system, preserve import coverage of international reserves at a desirable level, and send a powerful signal to depositors in order to restore confidence in the currency and the banking system. A return to a managed floating exchange rate should help to stabilize the balance of payments, support growth, and cushion shocks.

9. **There are number of risks to the proposed arrangement for Armenia.** There are significant downside risks to the baseline scenario and many of these risks are beyond the authorities' control. These include a slower than expected global growth and a more severe regional downturn, led by a deterioration of economic conditions in Russia. An escalation of political tensions in the region could also prove a hindrance to economic activity in Armenia. A sharper economic slowdown in Armenia would pose substantial downside risks to revenues and to the fiscal program. Armenia is vulnerable to changes in external conditions owing to its dependence on remittances and capital inflows. A shortfall in these inflows could imply a larger adjustment in the exchange rate, and the potential destabilizing effects on the financial system could impact on economic activity. Domestically, lack of political support could hamper the successful implementation of structural reforms important to buttressing the program's objectives.

10. **These risks may adversely affect Armenia's capacity to repay the Fund, although the impact on the Fund's finances would be contained by the comparatively small scale of access in absolute terms**. Debt to the Fund will become a large share of Armenia's international reserves and external obligations, although the latter mainly reflects Armenia's low external indebtedness. Similarly, debt service to the Fund is expected to become relatively large compared with the country's exports of goods and services, although remittances also provide a significant source of current account inflows. In these conditions, the authorities' commitment to firm implementation of the program, including adherence to the new exchange rate regime, prompt response to changes in underlying conditions, and continued structural reform are key to mitigating downside risks and safeguarding Fund resources. Armenia's track record of sound macroeconomic management and successful implementation of Fund-supported programs provides confidence in this regard.

Statement by the IMF Staff Representative on the Republic of Armenia
March 6, 2009

1. This statement reports on economic and policy developments in Armenia in the last three days. These developments do not change the thrust of the staff appraisal.

2. On March 3, the Central Bank of Armenia (CBA) announced a return to the floating exchange rate regime, and noted that they expected the rate to depreciate from 305 dram per US dollar to around 360–380 dram per US dollar. They also announced an increase in the policy interest rate of 100 basis points. This was accompanied by a coordinated communication campaign, including statements from the Fund and the World Bank.

3. Since March 3, the foreign exchange market has been generally calm. The rate quickly jumped to around 372 dram per US dollar, a depreciation of about 22 percent, where it remained for two days. There was limited intervention from the CBA. On March 5, dollar sales picked up, and the rate appreciated to 363 dram per US dollar, with the central bank buying dollars. Bid/ask spreads of the banks were initially very wide, but have since narrowed.

4. The CBA has indicated that most banks had a limited net open position just prior to the devaluation, so that bank losses on foreign currency exposures have to date been relatively small. There are no reports of banks being in difficulties, and thus far, there is no evidence of significant deposit outflows from the banking system.

5. On March 3, there was initially some erratic pricing behavior by retailers, and hoarding by consumers. Some stores closed to reset prices, and announced very sharp increases in retail prices, beyond what pass-through from the exchange rate would imply. Since then, and following public statements by the authorities on price hikes by retail outlets, the situation has settled and most prices—with the exception of petroleum products—have returned close to earlier levels.

6. On a separate issue, the authorities recently withdrew the proposed legislation to increase customs tariffs, and they have indicated that they do not intend to reintroduce it for the foreseeable future. The depreciation of the exchange rate has removed the competitiveness reasons for the tariff increase, and in the current context, the authorities are reluctant to add further pressure to import prices. They are examining the potential revenue impact of not introducing this measure, and are considering other measures that would enhance revenue.

Press Release No. 09/68
FOR IMMEDIATE RELEASE
March 6, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves US$540 Million Stand-By Arrangement for Armenia

The Executive Board of the International Monetary Fund (IMF) today approved a 28-month SDR 368 million (about US$540 million) Stand-By Arrangement for Armenia to support the country's program to adjust to the deteriorated global outlook, restore confidence in the currency and financial system, and protect the poor. The approval makes the amount equivalent to SDR 161.5 million (about US$237 million) immediately available and the remainder in nine installments subject to quarterly reviews. The Stand-By Arrangement entails exceptional access to IMF resources, amounting to about 400 percent of Armenia's quota. It was approved under the Fund's fast-track Emergency Financing Mechanism procedures.

The authorities' program is based on a consistent set of measures regarding exchange rate, monetary, financial, and fiscal policies, as well as continued structural reforms. Key elements include:

- **Return to a flexible exchange rate regime**. The Central Bank of Armenia (CBA) announced on March 3 that it will no longer intervene in the market, except to smooth extreme volatility, and raised its policy interest rate by 100 basis points. Following the announcement, the dram depreciated about 20 percent, and since then, has broadly remained in that range.
- **Strengthening of the financial sector to maintain stability and confidence**. Key aspects of the CBA's policy response include liquidity support operations, as needed, and enhanced banking supervision.
- **A revision of fiscal priorities to maintain macroeconomic stability, while protecting social outlays and public investment,** in light of the expected revenue shortfall. The authorities intend to cut back on non-priority spending while providing an increase in social spending of 0.3 percent of GDP, relative to the budget, to protect the poor through well-targeted social safety nets. Additional external financing will be used to boost public investment.

Armenia's gross external financing requirements are projected at about US$1.6 billion for 2009, and will remain elevated through 2011, albeit with a slight downward trend. The Stand-By Arrangement will cover a large share of the country's 2009-2011 financing gap. Additional financing will be provided by Armenia's donors and international partners, including the World Bank.

Following the Executive Board discussion on Armenia, Mr. Murillo Portugal, Deputy Managing Director and Acting Chair, said:

"Since the approval of a low-access PRGF arrangement in November 2008, Armenia has been confronted by a variety of major external shocks. Reflecting the sharp deterioration in global economic conditions, private transfers and capital inflows slowed considerably and international commodity prices have dropped severely, affecting mining exports and production. In light of a rapid decline in international reserves and growing financing needs, the authorities have requested additional financial assistance from the Fund.

"With the adverse global developments, real growth is expected to contract in 2009, reflecting the downturn in Russia and other countries in the region. Falling international prices, lower growth, and exchange rate depreciation will help reduce the external current account deficit. Medium-term prospects remain good.

"Sound policies are essential to maintain macroeconomic stability. The recent return to a flexible exchange rate will help cushion the impact of the global downturn and eventual further regional deterioration. An appropriately tight monetary policy is necessary to contain the inflationary pressures stemming from the depreciation and support demand for dram-denominated assets. While potential negative impact of the depreciation on the financial sector seems unlikely, contingency plans are available to help address any such effects. In light of the expected revenue shortfall, fiscal policy will remain prudent, protecting social outlays and public investment by reducing non-priority spending.

"Maintaining the structural reform agenda will contribute to macroeconomic stability and a strengthened business environment. Key elements include the completion of the unfinished tax policy and tax administration reform agenda, and progress on financial sector reforms.

"The Fund is confident that the policy package put in place by the authorities is appropriate and strong," Mr. Portugal said.

ANNEX

Recent Economic Developments

The global crisis has confronted Armenia with a number of large external shocks. Remittances and capital inflows, which sustained rapid economic growth in recent years, have decelerated markedly. Falling international commodity prices adversely affected mining, a key export sector. GDP growth came to a halt in the fourth quarter, and fell to 6.8 percent for the year as a whole, from over 13 percent in 2007. Following the rapid unwinding of international prices and domestic demand, annual CPI inflation fell to 1 percent in February 2009. With exports being hit by the global downturn and imports growing strongly through October, the external current account deficit rose to an estimated 12½ percent of GDP in 2008.

The rapid and unexpected deterioration of the economic situation had a strong impact on program performance under the PRGF arrangement. Most of the end-December 2008 quantitative performance criteria were missed. The authorities, recognizing the changed circumstances and the large increase in their financing needs, have requested the Stand-By arrangement and also requested the cancellation of the PRGF arrangement.

Program Summary

The authorities' program aims to achieve the necessary external adjustment, restore confidence in the domestic currency and the banking sector, and protect the poor. Their program is based on a consistent set of policies in the exchange rate, monetary, financial, and fiscal areas as well continued structural reforms.

As part of the program, **the authorities are returning to a flexible exchange rate regime**. In particular, the authorities have indicated that they will no longer intervene in the market, except to smooth extreme volatility. Under a managed float, the authorities would gradually return to their inflation-targeting framework.

Strengthening financial stability will be a key part of the authorities' program. The authorities will implement short-term emergency measures to stabilize the system, while at the same time enacting more structural measures to ensure the soundness of the system going forward. Key aspects to be addressed are liquidity support operations and enhancing banking supervision.

Fiscal priorities will be revised. To partly offset the anticipated revenue shortfall for 2008, the authorities intend to cut back on non-priority spending and introduce some tax policy measures, yielding savings of about 0.8 percent of GDP. Accordingly, the program aims at limiting the deficit, excluding non-programmed externally financed investment projects, to 2.8 percent of GDP compared to a deficit target of 1 percent of GDP in the announced budget.

The IMF supports the protection of social spending embedded in the program. The program accommodates an increase in social spending of 0.3 percent of GDP, relative to the budget, to protect the poor through well-targeted social safety nets. The program also provides room for additional infrastructure and investment spending as foreign financing materializes.

The authorities will continue their wide-ranging structural reform agenda outlined in their Sustainable Development Program. This agenda is aimed at deepening productivity-enhancing structural reforms, and improving governance. A key area will be continued efforts to strengthen the business environment, with a focus on tax administration reforms and the fight against corruption.

Armenia joined the IMF on May 28, 1992; its quota is SDR 92 million (about US$135.2 million) and its outstanding credit to the IMF (as of end-January 2009) is SDR 87.495 million (US$128.6 million).

Statement by Age Bakker, Executive Director for the Republic of Armenia
March 6, 2009

The economic outlook for Armenia has changed abruptly since last November and the authorities are grateful for the prompt response from the IMF. They would like to express their appreciation to the MCD team for their hard work and especially to Mr.Perez.

First, the mining sector was affected by the sharp drop in commodity prices and in external demand. Then, construction activities have started to slow down, responding to lower inflows of investment, capital, and remittances. The country is now facing a severe shock to growth that was running at over 10 percent last September, and now, a year later, it is expected to be in negative territory. Negative expectations were also strengthened by the growing difficulties among economic partners in the region.

Challenges from the short-term outlook affect the overall confidence and threaten financial stability. Depressed commodity prices and weaker inflows have put pressure on the balance of payments, despite lower domestic demand, and capital outflows picked up. With negative expectations gaining strength, the Central Bank faced unexpectedly high demand for foreign exchange, while credit growth slowed down, responding to declining deposits and uncertain prospects of some borrowers. Inflation also slowed remarkably, but the new trend of re-dollarization presents risks for financial stability and challenges for monetary policy implementation. Finally, fiscal revenues will likely be affected by the economic slowdown; however, the authorities remain committed not only to fiscal prudence, but also to preserving achievements of the recent years in reducing poverty.

The long-term horizon of the proposed arrangement should give sufficient room for completing the authorities' structural reform agenda, notably in the areas of tax policy and tax administration. Resolving long standing problems of tax credits and delayed tax refunds will also provide additional stimulus during the recession. Thus, structural reforms of the new arrangement demonstrate continuity with the previous PRGF. In addition, the proposed reforms in the financial sector are needed and timely.

The important new element is the urgent need to address the sizeable financing gap that emerged due to a contagion from the global crisis. The exceptional access is consistent with the size of the gap and the need to preserve financial stability. Large assistance packages by the World Bank, the Russian Federation, as well as possible support from the Asian Development Bank and the European Union are very helpful in this respect. Armenia needs a large boost of confidence, but it will also have to undertake a more substantial upfront adjustment than was expected under the previous program. A projected increase in external debt, including from the Fund, is manageable, given that the NPV of external debt to exports is projected to reach the levels of about five years ago (not to mention the levels of 10 years ago, which were twice as high, when Armenia was considered a relatively indebted country). Armenia's public debt at under 18 percent is now one of the lowest among its peers, and we consider that repayment risks to the Fund are low.

A return to the flexible exchange rate arrangement presents the most viable adjustment option under the current circumstances, especially in light of sizeable depreciations of exchange rates among other emerging market economies of the region. Staff share the authorities' concerns about possible distress in the financial sector, especially in the case of initial exchange rate overshooting, which could not be excluded. The small size of the financial sector, with deposits at only 15 percent of GDP, and the uncommonly high capitalization levels, at 28 percent, should mitigate financial sector risks from the depreciation. The authorities, in consultation with staff, are also preparing targeted contingency measures to respond to the banking sector problems – should they materialize.

Unfortunately, memories of violent economic and political crises of the first few years of Armenian independence and the political tensions in the region magnify risks to confidence and may require quick reaction from the authorities. To this end, the authorities established a high-level committee to monitor the developments in the economy and to coordinate the policy response to the ongoing economic challenges.

So far, the first few days since the exchange rate was allowed to float are generally encouraging, while the upside potential of further exchange rate movements should address the risks associated with one-way bets by market participants. The authorities are committed to ensure that the exchange rate is flexible in both directions.

The Armenian economy proved resilient to the shocks of the past, is flexible, and there remains a likelihood of upside risks to the outlook this time as well, especially if regional trade restrictions are lifted. Armenia has a long history of successful implementation of Fund programs, and we expect that implementation of the proposed stand-by arrangement will likewise be successful.