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Republic of Armenia: 2012 Article IV Consultation and Fifth Reviews Under the Extended Fund Facility and Under the Extended Credit Facility, and Request for Waiver and Modification of Performance Criterion—Staff Report; Press Release; Public Information Notice; and Statement by the Executive Director for Republic of Armenia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2012 Article IV consultation with Republic of Armenia and the Fifth Reviews Under The Extended Fund Facility and Under The Extended Credit Facility, and Request for Waiver and Modification of Performance Criterion, the following documents have been released and are included in this package:

- The staff report for the combined 2012 Article IV consultation fifth reviews under the Extended Fund Facility and under the Extended Credit Facility, and request for waiver and modification of performance criterion, prepared by a staff team of the IMF, following discussions that ended on September 19, 2012, 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 November 20, 2012. 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 Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its December 7, 2012, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- 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

REPUBLIC OF ARMENIA

November 20, 2012

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION, FIFTH REVIEWS UNDER THE EXTENDED FUND FACILITY AND UNDER THE EXTENDED CREDIT FACILITY, AND REQUEST FOR WAIVER AND MODIFICATION OF PERFORMANCE CRITERION

KEY ISSUES

Context, outlook, and risks. Growth has accelerated to over 6 percent in 2012, led by mining, agriculture, agroprocessing, and services. Inflation remains subdued. Growth will likely moderate to trend in 2013 (4–4½ percent), reflecting weaknesses globally and in FDI. Key risks include geopolitical developments in the region (Nagorno-Karabakh, Iran).

Fiscal policy. The authorities are committed to an adjustment path that would stabilize debt. In 2012, consolidation will again be larger than expected, reflecting spending restraint and project delays. Gradual revenue gains are taking place, but more is needed.

Monetary and financial sector. The financial sector is sound, and credit has continued to expand at a healthy pace. The authorities are taking measures to address risks from dollarization and are implementing FSAP Update recommendations.

External stability. External consolidation has continued, supported by the fiscal adjustment, but the external current account deficit remains large. Reserves are adequate, but will come under pressure with repayment of crisis support. Greater exchange rate (ER) flexibility would help preserve buffers and contribute to external adjustment.

Structural reforms. Important actions are underway in regulatory streamlining and anti-monopoly enforcement. More ambitious structural reforms are needed, however, to further improve the business environment and enhance competitiveness.

Program. The program is broadly on track, with all but one of the performance criteria (PC) and indicative targets (IT) met. All structural benchmarks were observed or are on track with brief delays. The June PC on reserves (NIR) of the central bank (CBA) was missed because of intensified efforts to defend the dram in the face of unexpectedly strong market pressures. The September NIR IT was also missed. The authorities are requesting a waiver of nonobservance of the June NIR PC, based on corrective actions being taken, and modification of the December NIR target. They are also requesting that SDR 33.5 million become available with completion of the reviews.

Article IV. Discussions focused on ensuring medium-term stability and sustainable and inclusive growth via: (i) greater revenue mobilization to strengthen the fiscal outlook; (ii) continuing monetary and financial sector reforms; (iii) greater ER flexibility to underpin external consolidation and sustainability; and (iv) improvements to the business climate and competitiveness. The last consultation took place in 2010. Directors supported the swift response to the crisis, but highlighted many of the same challenges: a more flexible ER, enhanced revenue collections, and an ambitious structural reform agenda.

Approved By:
Juha Kähkönen and Peter Allum

Discussions were held September 5–18 in Yerevan with Prime Minister Sargsyan, CBA Chairman Javadyan, Finance Minister Gabrielyan, Economy Minister Davtyan, Energy Minister Movsisyan, Transport Minister Beglaryan, other senior officials, and representatives of the private sector, civil society, and the diplomatic community. The team comprised M. Horton (head), J. Gijon, and P. Rodriguez (all MCD), J. Thornton (SPR), T. Komatsuzaki (FAD), and C. Caceres and H. Tanimoto (MCM). G. Tolosa (IMF Resident Representative) and A. Manookian and A. Ghazaryan (IMF Office) assisted. R. Mosch (OED) joined the discussions.

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CONTEXT

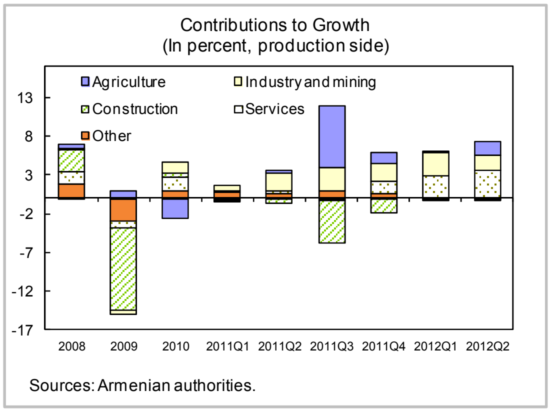
1. **The post-crisis recovery has accelerated, but challenges remain.** Robust growth in 2012 has reflected strong performance across a range of sectors and industries. Risks are mainly on the downside, however, given global and euro area weaknesses. Inflation has remained subdued, as fiscal consolidation has continued. Public spending has remained restrained, and pressures are growing (infrastructure, health and education, pension reforms). Public debt is sustainable, with low risk of distress, and reserves are adequate. However, the end-June NIR target was missed, reflecting unexpected pressures. Reserves could come under further strain as debt repayments come due in 2013–15. Substantial external adjustment has taken place, but further consolidation is needed, supported by ER flexibility and an acceleration of structural reforms.

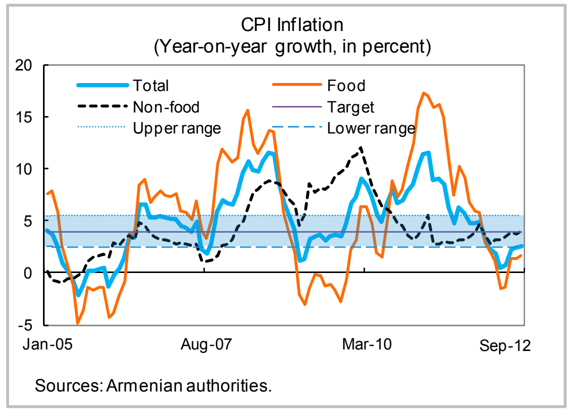
2. **Armenia is between parliamentary elections in May 2012 and presidential elections next February.** The May elections gave a boost to President Sargsyan and the Republican Party, which gained a majority of seats in parliament. Political uncertainties remain ahead of the presidential elections, however, and pre- and post-election developments could pose risks of delayed or indecisive fiscal and structural reforms. The geopolitical environment remains complex, with continuing tensions over Nagorno-Karabakh and Iran.

3. **Economic policies have been broadly consistent with Fund advice**. As described in the accompanying Ex Post Assessment, Armenia has had a long program relationship, and programs have generally remained on track. Overall, the authorities and staff have agreed on the need to implement policies to attain stability and foster growth. Past Article IV consultations have emphasized a more flexible ER, enhanced tax revenue collections, and an ambitious structural reform agenda. The authorities have implemented measures in these areas, but the results have been mixed. Tax revenues have not increased markedly, ER flexibility remains a challenge, and structural reforms have not yet led to a decisive breakthrough in the business climate.

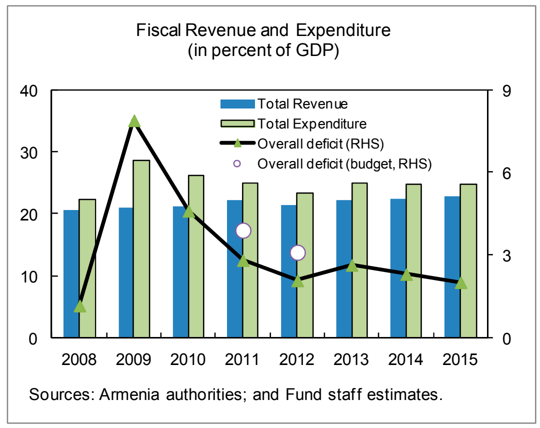
RECENT ECONOMIC DEVELOPMENTS

4. **Performance has strengthened in 2012.** Growth has accelerated to over 6 percent, led by agriculture, agro-processing, mining, and services. Construction, a key pre-crisis growth driver, is finally stabilizing. Credit has continued to expand at a healthy pace, and the financial sector remains well capitalized. However, private investment has remained weak. Inflation has been subdued, reflecting low agricultural prices and supportive policies. The CBA has kept the policy rate at 8 percent since September 2011. Significant spillovers from the euro area have not materialized, although there have been weaknesses in some financial flows, particularly FDI.

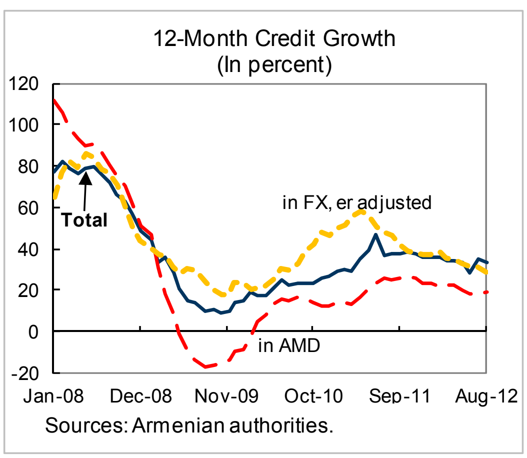


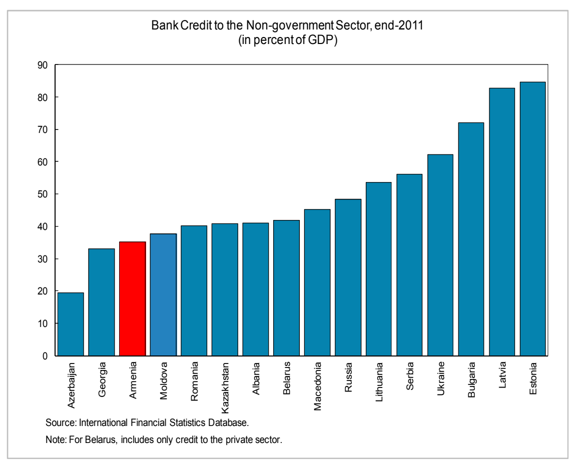


5. As in 2011, fiscal consolidation will be larger than budgeted in 2012. The headline deficit is expected to reach 2.1 percent of GDP, compared with a target of 3.1 percent and last year's outturn of 2.8 percent. The lower deficit reflects spending restraint, mainly due to delays in large, foreign-financed infrastructure projects. Tax revenues were below projections in the first half, but have picked up and are likely to meet nominal budget targets.

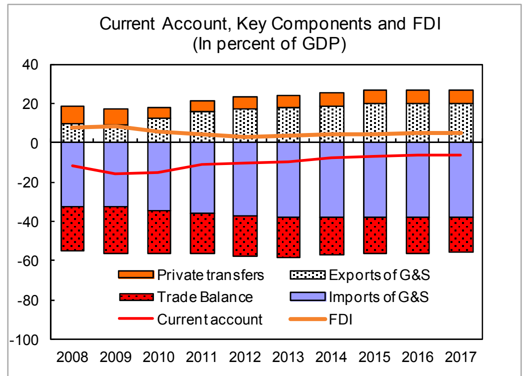


6. Credit growth has been strong, especially in foreign currency (FX), but the banking sector remains robust. Credit grew by 24 percent yoy through August, with FX loans growing by 27 percent. Banks remain well capitalized, with a capital ratio of almost 17 percent, and no bank below 12 percent. Despite the strong growth, the credit-to-GDP ratio remains relatively low.





7. External adjustment is proceeding, although financial flows have been weaker than expected. Exports and remittances have continued to expand at a healthy pace, although strong growth of export volumes has been partly offset by lower metals prices. FDI has fallen sharply, however, putting pressure on the balance of payments and the dram. In addition to global and regional concerns, FDI in Armenia has been dominated by large energy and communications projects, which are winding down.



Sources: Armenian authorities; and Fund staff estimates.

OUTLOOK AND RISKS

8. **Growth is likely to moderate in 2013 and beyond**, returning to trend (4–4½ percent), as the effect of favorable weather dissipates and credit expansion slows. Weakening FDI and low domestic private investment also suggest slower growth. The output gap is small and negative and should close over the course of 2013. Staff's inflation projections are in line with the CBA's target range (4 ± 1.5 percent). During the discussions, the authorities recognized the weaker environment globally and in Europe, but also pointed to high growth rates in the region and suggested that implementation of new export diversification and industrialization policies would keep growth at 6–7 percent. They viewed FDI weaknesses as temporary, noting planned projects in mining, manufacturing, and energy. They also suggested that pension reforms would help mobilize domestic savings and foster financial sector development. Staff observed that business environment reforms had not so far proved sufficient to sustain private investment growth and reduce unemployment, but agreed that accelerated reforms could help strengthen and diversify domestic investment and FDI to sectors such as pharmaceuticals, agriculture, and IT.

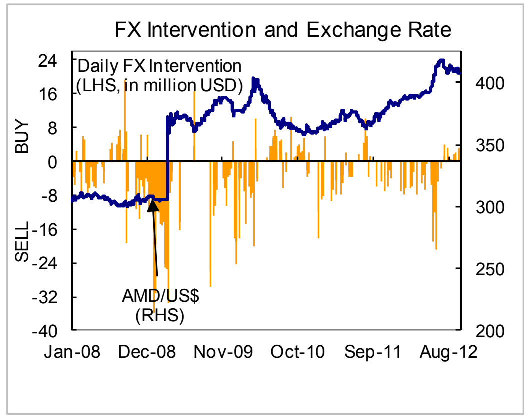
9. **Risks are mainly on the down side and come from potential external shocks, political uncertainties, and regional conflicts** (Box 1). A stagnation of global growth, possibly emanating from Europe, is the main risk, with spillovers through trade, finance, and investment channels, particularly if Russia is strongly affected (Box 2). A disorderly external adjustment remains a risk, given the still-large external current account deficit and the likely need for a medium-term adjustment of the real exchange rate (Annex I). A disorderly adjustment, however, is likely to come about in the event of a low-risk event, such as another global shock. The authorities' sound policy framework and official support are likely to mitigate impacts. Geopolitical risks are rising, both with respect to Azerbaijan and spillovers from a possible confrontation of the West or Israel with Iran. Finally, there are risks in the run-up or after the February 2013 presidential elections. The authorities broadly agreed with the staff's assessment of risks and reaffirmed their commitment to strengthening buffers and reducing vulnerabilities through continued consolidation and greater ER flexibility.

FIFTH REVIEWS UNDER THE EFF/ECF

The program is broadly on track, although the June NIR PC was missed in the context of unexpected pressures. The authorities are requesting a waiver of nonobservance of the June PC based on corrective actions being taken, and modification of the December target. New benchmarks were agreed in bank reporting, and pension and regulatory reforms.

A. Monetary and Exchange Policy and the Financial Sector

10. The June NIR PC was missed due to heavy intervention to defend the dram in a weaker-than-expected external environment. The dram had been stable for several months, but came under pressure in May-June. While allowing depreciation from AMD 385 to AMD 420 per dollar (a maximum since 2006), the CBA also intervened significantly to calm the market, resulting in an end-June NIR shortfall of $50 million. The developments reflected a strengthening of the dollar amidst euro area concerns, a significant fall in FDI, and lower tourism receipts from Iran.



11. In light of the missed NIR target, the authorities are taking corrective actions and requesting adjustments to the program (LOI ¶9). The CBA has revised its intervention approach to allow more sizable daily fluctuations, aiming to strictly limit net FX sales, while intervening only to smooth excessive volatility and avoid market instability. To bolster reserves, the authorities are purchasing FX in the market where possible and have stepped up communications with the public and market participants on factors that are affecting the FX market and the ER. The dram has appreciated since mid-June, and the CBA has purchased $40 million. However, additional large-scale reserve accumulation to meet the original end-year targets, which had built in extensive third quarter purchases, would have placed excessive pressures on a thin market. Staff and the authorities saw little scope to tighten other policies. Fiscal policy is already tight, and with inflation low and growth expected to slow, raising interest rates would be undesirable. Against this background, the authorities are requesting a waiver of nonobservance of the June PC based on corrective actions being taken and downward revision of the December NIR target by $60 million, $10 million larger than the end-June breach amount. Gross reserves would remain above 3.5 months of prospective imports. Staff supports this request.[1]

12. Monetary conditions have otherwise remained stable. The June PC and September IT on CBA net domestic assets (NDA) were met, along with the June and September ITs on reserve money (RM). In connection with reduction of the NIR target, the authorities request a downward revision of the December RM IT, leaving the NDA target unchanged. Achieving these targets should not require significant monetary operations that would send mixed signals about policies, given the corrective actions being taken. Staff supports this request.

[1] A FIN staffer joined the mission for a safeguards visit and recommended full provisioning of illiquid CBA deposits in the 2012 financial statements, amending the CBA's reserve guidelines by limiting holdings in the region, and appointing external experts to the CBA audit committee.

Box 1. Armenia: Risk Assessment Matrix

Nature/source of risk	Likelihood of realization in the next three years	Expected impact on the economy if risk is realized
Stagnation of world growth (through 2013) Stagnation of euro area growth could lead to global stagnation, with Russia likely affected.	**Staff assessment: Medium** EU growth is expected to remain restrained in 2013, before picking up from 2014. Growth in Russia is expected to remain at around 4 percent.	**Staff assessment: Low-medium** Armenia would be affected through trade, remittance, finance, and investment channels, particularly via Russia. The euro area and Russia are key trading partners, and Russia is the main source for remittances and FDI.
Disorderly external adjustment The external current account deficit remains a source of vulnerability, and staff's assessment is that a medium-term adjustment of the real exchange rate is needed.	**Staff assessment: Low** A reversal of bank flows could take place, although a sound policy framework, continued fiscal adjustment, and international and bilateral support help mitigate risks.	**Staff assessment: Medium** The FSAP Update found that the financial sector is resilient to a shock, but some vulnerabilities remain. CBA efforts to enhance monitoring of unhedged borrowers and ensure sufficient FX liquidity coverage will mitigate risks.
World oil price shock A deterioration of security in the Middle East could lead to a spike of oil prices.	**Staff assessment: Low** A spike of oil prices is unlikely to be prolonged, as demand conditions are not robust.	**Staff assessment: Medium** Reserves are sufficient to address an immediate shock, but a prolonged shock would require adjustment. Armenia benefits from higher remittances from Russia and correlation of copper and oil prices.
Regional conflict Risks arise from renewed conflict with Azerbaijan over Nagorno-Karabakh or from spillovers from a possible confrontation of the West or Israel with Iran.	**Staff assessment: Low-medium** Tensions with Azerbaijan remain high. Lack of a clear path for resolution of issues with Iran is a source of concern.	**Staff assessment: High** Conflict with Azerbaijan would involve severe impacts and possibly other countries in the region. Links with Iran are limited, but spillovers could include refugees or a wider regional conflict.
Political uncertainty, in connection with elections Political tensions have arisen in the past (1998, 2008). The election outcome could involve a less reform-minded government.	**Staff assessment: Low** Parliamentary elections in 2012 took place largely without incident.	**Staff assessment: Low to medium** Prolonged demonstrations would have an impact. More broadly, political factors may delay much-needed fiscal and structural reforms.

Policy response in most cases would involve ER flexibility, acceleration of structural reforms, and possibly monetary easing, along with assessing the scope for a moderate counter-cyclical fiscal response. In the case of an oil price shock, the CBA would need to be vigilant to possible second round effects.

Box 2. Output Linkages of Armenia, the CCA and Russia

Spillovers from the euro area have so far been moderate. Lower FDI appears to reflect, at least in part, the end of a cycle of large privatizations and investments in telecommunications, energy, and transportation, along with continuing caution on the domestic business environment, Armenia's small market size and relative isolation, and geopolitical risks. Staff analysis for the Fall 2012 MCD Regional Economic Outlook suggests that spillovers from the euro area to Armenia are channeled (and amplified) via Russia, given strong trade, remittance, FDI, and bank linkages. Russia continues to benefit from high oil prices and its own strong links to the "core" euro area (especially Germany), which has performed better than the euro area "periphery."

Business cycles of the eight Caucasus and Central Asia (CCA) countries exhibit a substantial degree of synchronicity among themselves and with Russia. Like Armenia, this reflects trade, financial, and remittance linkages. At the country level, output changes are driven by both domestic and common developments that affect the region as a whole. Common shocks could be due to global developments (e.g., slower global demand, global financial market tensions, falling commodity prices). Co-movement of commodity prices, such as oil and copper, are an important factor. For some CCA countries, domestic factors may be more important; the common factor may dominate for others. This distinction is important, as different responses might be warranted, depending on whether "internal" or "external" shocks dominate.

A state-space model was used to extract the "common factor" from GDP series of the CCA countries. This common factor can be analyzed relative to country-specific CCA GDP series and to Russia's real GDP. We find that the common factor has a strong correlation with Russian (0.89) and Armenian (0.86) output, suggesting that output dynamics in Armenia (also Azerbaijan, Georgia, and Kazakhstan) are driven by external factors closely related to developments in Russia. This underscores the need for close monitoring in Armenia of Russian leading indicators and assessment of consequences for flows to Armenia. Efforts should also be made to build greater resilience by diversifying exports, while allowing for greater ER flexibility.

Figure 2.1. Russia's and Armenia's real GDP growth and the "common factor

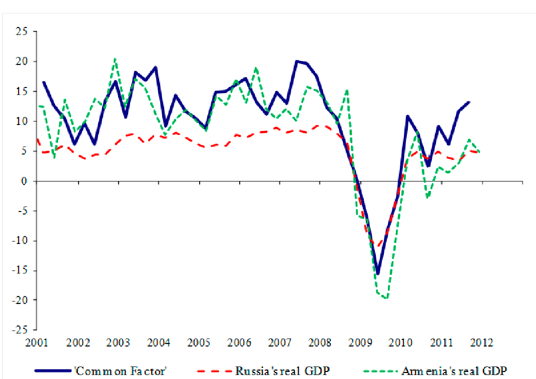
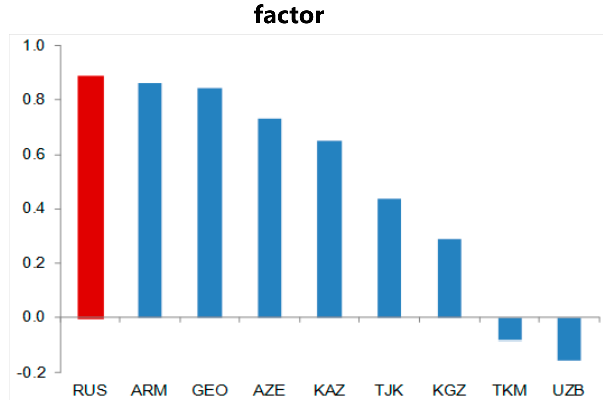
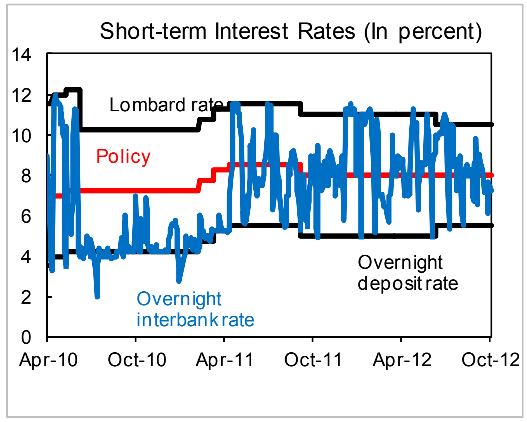


Figure 2.2. Correlation of Russia and CCA countries' real GDP growth and the common factor



13. The CBA is continuing efforts to strengthen the interest rate channel (LOI ¶11)**.** Interbank interest rates continued to exhibit significant volatility in mid-2012, and staff urged the CBA to further strengthen operations to increase the relevance of the policy rate. The CBA noted that the width of the interest rate corridor had been reduced from 600 to 400 basis points to reinforce the transmission mechanism; the corridor was further narrowed to 300 bps in early November. The CBA also pledged to step up fine-tuning operations while strengthening communications to better anchor expectations.



14. The banking system is sound, although it remains heavily dollarized. With high capital adequacy and dram liquidity ratios and moderate rates of NPLs and profitability, banks remain sound. Nonetheless, since the 2009 crisis, credit has become increasingly dollarized, and almost two-thirds of loans are denominated in FX (up nine percentage points from a year ago).[2] Staff advised the CBA to assess possible policy actions, including expanding the difference between reserve requirements for FX and dram liabilities and further adjusting capital ratios for FX-denominated loans.

15. The CBA is improving the regulatory and supervisory framework in line with FSAP recommendations (LOI ¶12–13).[3] The CBA introduced a new prudential norm for bank FX liquidity ratios, effective in January 2013, and is committed to gradually increasing these ratios. The CBA also required banks to report on potential currency mismatches of large borrowers. Staff suggested using this new information to strengthen the assessment of sectoral risks and tailor stress-testing guidance to banks. In line with FSAP recommendations, the CBA will require banks to immediately report changes that have a material adverse impact and will review calculation of large exposures to determine whether treatment is in line with best practice. The CBA and government will assess whether changes are needed to streamline the execution of collateral, following recent reforms to the system of property registration.

B. Fiscal Policy

16. Strong adjustment is continuing in 2012, with the deficit again expected to be lower than budgeted. While the consolidation is supported by the authorities' tax package (0.6 percent of

[2] The increase in credit dollarization has occurred even as the CBA increased loan-loss provisioning requirements and capital risk weights for FX loans in 2010. The loan dollarization rise may have been due in part to bank efforts to limit currency mismatches, particularly as a significant share of funding attracted by banks has been in foreign currency and after the CBA's shift of the currency of denomination of reserve requirements for FX liabilities to dram. As banks converted these required reserves to dram, they may have rebalanced the currency match on their balance sheets by increasing FX loans.

[3] The FSAP Update was considered by the IMF Executive Board in June 2012.

GDP), the smaller deficit relative to the budget reflects lower spending, mainly due to delays in initiating infrastructure projects, in particular the North-South highway. The authorities also highlighted efficiency gains and spending restraint in other areas, and staff commended strong budgetary management during successive election years.

17. Tax collections are on track to meet the targeted gain, with higher tax revenues compensating for lower social contributions. While revenue targets for the second half of the year are ambitious, collections picked up in the third quarter. However, staff observed that increases may be posing a strain on the business environment and SMEs, which have complained of a substantial tightening of the tax net (e.g., stepped-up presumptive approaches, more frequent inspector visits, requests for tax advances) and an increasingly uneven playing field. This threatens to undermine gains in e-filing and taxpayer services. Both sides look forward to a major new USAID-World Bank tax administration project on strategic planning, revenue analysis, internal control, and IT. New transfer pricing legislation should also help, although implementation may begin only in 2014, once guidelines and regulations are in place.

18. The 2013 budget targets a headline deficit of 2.6 percent of GDP, as project delays should be overcome. Current spending items will remain restrained. For example, most public sector wages and pensions will remain constant in nominal terms, implying a substantial cut in real terms.

19. While staff and the authorities agreed on the headline deficit target for 2013, there were differences of view on revenues. Staff urged the authorities to raise revenues by 0.4 percent of GDP to ease spending constraints, focusing on excise taxes (including covering pressurized gas) and elimination of exemptions. The authorities noted strong opposition to tax hikes and warned that tax proposals might lead some parliamentarians to propose tax cuts. In the end, they proposed 0.2 percent of GDP, reflecting both tax policy changes and revenue administration improvements (LOI ¶5), as well as elimination of PIT exemptions for the military and police amounting to a further 0.7 percent of GDP, offset by targeted wage increases. Staff agreed, noting that the PIT measure sends an important signal on exemptions.

20. Pension reform implementation is on track. To ensure that progress continues, the authorities agreed on a new benchmark on key two pension regulations. Under the pension reform, PIT and social contributions will be integrated in 2013, and the authorities are preparing to launch an electronic system for individual accounting and recording under the new unified PIT.

C. Structural Issues

21. The authorities continue to implement structural reforms focused on business environment improvements and deregulation (LOI ¶14–16).

- The centerpiece "Regulatory Guillotine" program, with strong support from the President, Prime Minister, and donors, was launched with preparation of comprehensive legislative packages to streamline regulation and red-tape in three areas, from a total of 17 areas. Further guillotine areas will be initiated in the first half of 2013.

- The competition committee has continued to step up enforcement efforts, and further legal changes in the competition area are expected to be proposed to parliament with a short delay. Staff welcomed these actions, but observed that distortions to competition also arise from selective application of laws and regulations.

- No actions have been taken with respect to Nairit, the troubled synthetic rubber producer and Armenia's largest industrial complex. There is investor interest from a Russian energy firm, and the authorities again stressed they would only assume liabilities (including guarantees) in consultation with the Fund and the World Bank.

ARTICLE IV DISCUSSIONS: SECURING SUSTAINABLE AND INCLUSIVE GROWTH

Discussions focused on ensuring medium-term stability and fostering sustainable and inclusive growth through: (i) greater revenue mobilization to strengthen the fiscal outlook; (ii) continuing monetary and financial reforms; (iii) greater ER flexibility to underpin external consolidation and sustainability; and (iv) further improvements to the business climate and competitiveness.

D. Fiscal Policy: Consolidation While Creating Space to Support Growth

22. Armenia's fiscal policy faces a number of important challenges:

- **Further consolidation is needed to ensure debt sustainability.** Staff estimates indicate that a headline deficit of 2 percent of GDP or lower is needed to stabilize debt, albeit at a relatively high level (39 percent of GDP in 2032), leaving little room to respond to shocks.[4] Moreover, historical shocks to output, interest rates, and the ER imply a high probability that debt would follow an upward trend with a deficit of 2 percent of GDP. Accordingly, the deficit should ideally be reduced below 2 percent of GDP.

- **Revenue performance, while increasing gradually since 2009, remains a constraint**. The authorities have taken steps to strengthen and modernize tax policy and revenue administration, including enactment of a new mining royalty, adoption of risk-based approaches in tax and customs administration, initiation of e-filing and taxpayer service centers, and formation of a high-level tax appeals committee. Still, these actions have not translated into significantly higher revenues collected in a business-friendly manner. Collections remain 4–6 percentage points of GDP below regional and international comparators.

- **Fiscal consolidation and low revenues have limited growth- and welfare-enhancing spending**. Education and health outlays have decreased by 1.1 percentage points of GDP

[4] See the updated debt sustainability analysis in Annex III. The debt-stabilizing deficit level is estimated at 3 percent of GDP (see IMF Report 11/366). A headline deficit of 2 percent would be consistent with this level, in light of recurrent external net lending of 1 percent of GDP recorded below the line.

since 2009 and are below many other countries in Central and Eastern Europe. The Family Benefits Program (FBP), Armenia's flagship poverty-reduction initiative, is well-targeted and cost effective. FBP spending has remained stable at 0.9 percent of GDP, but coverage is relatively narrow and has fallen with the crisis. Investment spending has also declined in recent years. The authorities have utilized extensive net lending operations in recent years to mitigate the crisis and ease spending pressures, but exposing the government to risk (Box 3).

- **Spending pressures are expected in priority areas**. The World Bank and other partners have called for higher outlays in areas such as road maintenance and modernization of health and education facilities. The implementation of pension reform in 2014 is expected to add costs of 0.4–0.7 percent of GDP annually, and possibly significantly more if minimum pensions are increased. Graduation from concessional financing is expected to increase borrowing costs.

Box 3. Armenia: Net Lending Operations

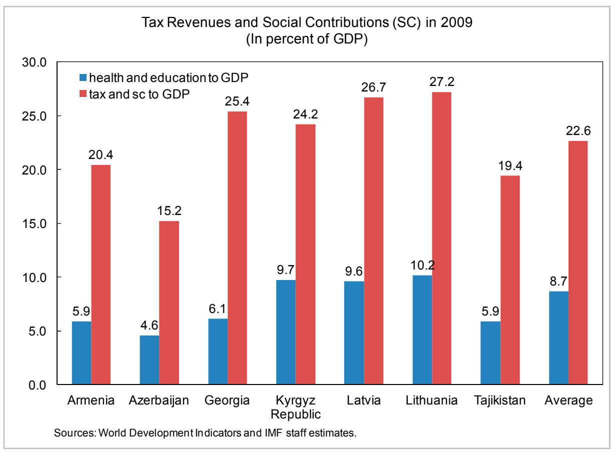
Public sector lending to the domestic economy amounts to nearly US$1 billion or 10 percent of GDP. The modalities are complex, with a variety of programs depending on the source and targets of lending. A significant expansion took place in 2009 as a response to the crisis, with financing from Russia, the World Bank and KfW. In 2010–11, there was a modest net repayment. Funding was directed to SMEs, renewable energy and housing finance, and gas and mining companies. Most of the Russian loan has maturity of 5–10 years and floating interest rates linked to LIBOR. Loans from KfW and the World Bank have longer maturity and lower interest rates.

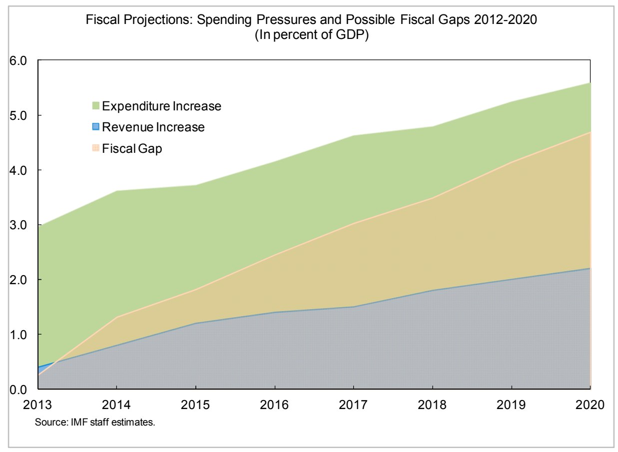
Domestic lending entails fiscal risks. Credit risk may materialize as repayments commence. Sizable loans to the energy sector fall due soon. There are also FX and interest risks, due to currency denomination and floating rates. It will be critical to closely monitor borrowers to ensure that repayments are made on a timely basis and external financing is repaid accordingly. Lending operations also need to be managed consistently with broader macroeconomic management and limiting distortions for private lenders. In the discussions, the authorities noted that they are monitoring borrowers carefully while including these assets improves Armenia's (net) debt profile.

23. Staff noted that continued difficulties in raising revenues would compel a medium-term path of restrained spending, with negative consequences for growth and socio-economic development. Staff commended the authorities' tight expenditure control and efficiency gains but noted that an annual fiscal gap will emerge from 2014, which could rise to as much as 4½ percentage points of GDP by 2020 if spending pressures fully materialize and revenues do not rise.[5] This called for more aggressive reforms to raise revenues, including further improvements in tax policy (exemptions) and administration (strengthened coverage of large, well-connected taxpayers). It would be particularly important to avoid an erosion of social spending.

[5] In the energy sector, supply adequacy will be an issue with the future decommissioning of Metsamor nuclear power plant by 2020. Estimates for replacing Metsamor are not included in the projections; these run to $4.5–5 billion.

24. The authorities agreed that the path is challenging, but argued that growth should be higher, while recent gains show that they can ensure sufficient medium–term revenue mobilization. Higher medium-term growth, including through higher domestic savings connected with pension reforms, would ease pressures. Moreover, recent tax policy measures had already contributed to an improving tax ratio, including the expected 0.6 percentage point increase in 2012, while significant progress had been made in the use of IT in tax administration. These should lead to further revenue gains, together with improved approaches in areas like transfer pricing. Staff noted that tax buoyancy remained low and that tax administration practices were flagged in surveys as the most significant business climate constraint. Further measures such as the establishment of an independent tax ombudsman, would help.





E. Monetary and Financial Sector: Underpinning a Robust Monetary Framework and a Sound Financial Sector

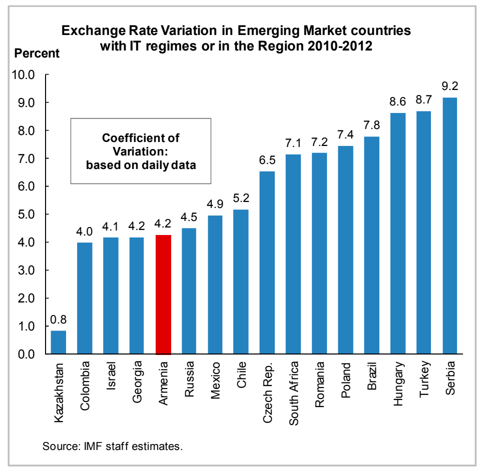
25. Staff supported the CBA's continued strengthening of the inflation-targeting framework, which has contributed to low inflation and well-anchored expectations. Efforts include significant modeling development (with support from MCM and RES) and improved liquidity management through weekly forecasts and fine-tuning operations (LOI ¶10). Based on Fund TA, staff suggested further strengthening, including enhancing communications, augmenting the survey of private forecasters, and developing term money-market instruments. Staff added that further ER flexibility would enhance the independence of monetary policy and the transmission mechanism. The authorities agreed in principle, but also noted that it was important to continue to smooth unusually large movements or policies could lose hard-fought credibility gains.

26. The regulatory and supervisory framework is sound, and the CBA is paying further attention to key vulnerabilities and financial deepening. Staff observed that there is a concentration of exposure at some banks, along with high dollarization of deposits and lending, and a decline in capital ratios (due in part to risk weights on FX assets). The CBA will further improve the framework by using Basel II Pillar II powers to assess and mitigate individual, institution-specific risks and indirect FX risks. On financial deepening, staff stressed the importance of a sound framework for investment policy and asset managers under the pension reform. The authorities agreed, noting that they would be guided by FSAP recommendations and their medium-term debt strategy in their efforts to further improve domestic financial markets and instruments.

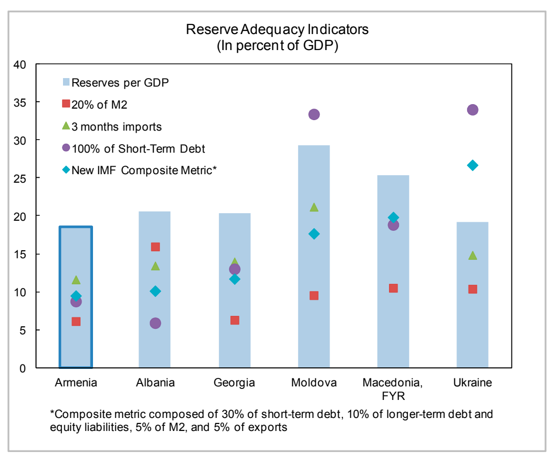
F. External Sector: Greater Dram Flexibility to Support Consolidation

27. Despite significant consolidation since 2009, the external current account deficit remains high, underscoring the need to strengthen competitiveness. The current account continues to be characterized by a significant gap between the actual and sustainable deficits, and further narrowing the current account deficit is critical, as FDI has not recovered to pre-crisis levels and the terms of external financing will harden over the medium term. So far, the consolidation has been driven by fiscal consolidation; going forward, the private sector will have to lead the adjustment.

28. A greater commitment to ER flexibility will be an important component of the external adjustment and increasing resilience to shocks. In recent years, Armenia has tended to allow less ER movement than other emerging markets that have adopted inflation-targeting regimes, suggesting that the role of the ER in absorbing external shocks is underutilized. In addition, while the real depreciation in 2012 has brought the ER closer in line with its equilibrium level, staff's estimates suggest that a further adjustment of the dram in real effective terms is needed over the medium term. This would help ensure that the export sector, which halved in percent of GDP during a period of real ER appreciation in the mid-2000s, faces appropriate price signals. ER flexibility will also be essential to ensure a comfortable level of reserves. While appearing adequate by most traditional metrics, reserves are expected to come under pressure over the medium term as crisis support unwinds. The FSAP update found that the financial system would be resilient to greater exchange rate flexibility, including a depreciation on the scale of the 2009 adjustment, which would be significantly greater than the estimated amount needed to bring the exchange rate into line with the fundamentals.



29. The authorities concurred on the need for further external consolidation, and reiterated their commitment to a flexible ER, as demonstrated by the movement in 2012. However, they disagreed with staff's assessment of the extent of overvaluation of the dram and placed less emphasis on the role of ER adjustment and more on structural measures to improve export performance and import competition. To this end, the authorities launched an export diversification and industrialization strategy in 2011 that identified 11 sectors with significant potential.



Sector-specific strategies are being developed to identify and remove obstacles to growth. They also noted that assessing the appropriate value for the ER was a difficult task, and that a strong resumption of FDI or remittance growth could lead to a resumption of appreciation pressures.

G. Structural Reforms: Achieving Inclusive Growth

30. Armenia faces important barriers to ensuring sustainable and inclusive growth. These include a difficult geopolitical situation and relative isolation (risks and high costs), a small economy with limited diversification, and a perception of dominance by well-connected businessmen ("oligarchs"). Armenia has made advances in global competitiveness surveys, for example, ranking 55th out of 183 countries in the World Bank's 2012 Doing Business (DB) indicators and jumping significantly further—to 32nd place—in the 2013 DB rankings. However, staff observed a disparity in Armenia's performance: good scores in areas related to *opening* a business (registering a business or property), but weaker scores in areas related to *running* a business (paying taxes, receiving electricity, trading across borders, protecting investors), although scores for protecting investors, paying taxes, and obtaining electricity improved dramatically (from low levels) in the 2013 DB rankings. Moreover, Armenia has underperformed other countries in Europe and Central Asia (Annex II). In areas where scores had improved sharply, it was essential to ensure that higher rankings—often based on new legislation—translated into durable changes on the ground and that further progress was recorded. The authorities agreed, noting that initiatives such as the export diversification and industrialization strategy, continued customer-oriented tax and customs reforms, the regulatory guillotine, and actions against market dominance would bring results. Staff agreed that improvements in growth prospects will rest on ambitious business climate reforms.

31. High unemployment remains a challenge. While Armenia is regarded as having a flexible labor market (the World Economic Forum recently ranked Armenia 30th out of 144 countries in labor market efficiency), a lack of employment opportunities has continued to push Armenians abroad (60 thousand annually). Moreover, high levels of skilled emigration seem inconsistent with a flexible labor market. Once again, staff and the authorities agreed that improvements would depend on business environment improvements to support private investment and SME creation and operations. Budgetary resources for reintegration of returning migrants and targeted skill-building programs might also be helpful.

32. The crisis has had a negative impact on meeting the Millennium Development Goals (MDGs). With worse socioeconomic conditions and higher poverty rates, Armenia faces greater challenges in meeting the MDGs by 2015. The authorities considered that efforts to protect key social spending since the onset of the crisis (e.g., the FBP) had prevented a more dramatic deterioration in poverty. Continued donor support was essential to their efforts.

PROGRAM ISSUES

33. The authorities indicated their intention to seek a successor arrangement next year. They noted that a new program would provide policy continuity and support to the continuing external and fiscal adjustment through a period of debt repayments. A key objective would be to further establish buffers and policy space, especially strong reserves and higher tax revenues. Structural reforms should target further financial sector development and decisive improvements in the business environment and competitiveness.[6]

34. Program design and monitoring remain broadly unchanged. The authorities are requesting a waiver for nonobservance of the June PC on NIR based on corrective actions being taken and modification of the December target. The NIR adjustor would be modified to lock in any CBA deposits received from the CIS Interstate Bank. New structural benchmarks focus on key pension reform decrees, bank reporting to the CBA, and further regulatory guillotine areas. The program is fully financed through the end of the period covered by the EFF/ECF arrangements (June 2013). However, staff estimates indicate additional financing needs of around 2.1 percent of GDP in the balance of payments and 1.4 percent of GDP in the fiscal accounts in the latter half of 2013. Talks are underway with partners who have provided significant recent financing, including the EU and the Asian Development Bank, and staff sees good prospects for these gaps to be filled in the near future.

STAFF APPRAISAL

35. Performance has strengthened in 2012, and is expected to remain sound in 2013. Growth has accelerated to over 6 percent in 2012, inflation has remained subdued, the fiscal deficit declined, credit growth remained robust, and adverse spillovers from the euro area slowdown have not materialized beyond weaknesses in some financial flows. Economic activity has benefitted from especially strong outcomes in agriculture, agroprocessing, mining, and services. Credit growth has been particularly strong in FX. Performance in 2013 is expected to be broadly similar, although GDP growth is expected to moderate back to potential—i.e., 4 to 4½ percent—as positive, weather-related factors dissipate and credit growth moderates.

36. Still, vulnerabilities remain. While Armenia's reserves appear broadly adequate by most metrics, the external current account deficit remains high, leaving Armenia significantly exposed to shocks—such as a decline in exports and remittances connected with a severe slowdown in the euro area and Russia. The moderate depreciation of the dram so far this year should contribute to reduce the current account deficit going forward, but staff estimates that an adjustment of the dram in real effective terms is needed over the medium term. In addition, the banking system continues to exhibit high rates of deposit and credit dollarization, which could cause pressures on bank balance sheets if a disorderly external adjustment takes place.

37. Monetary and financial policies remain appropriate, but reforms to strengthen the banking system should continue. The authorities' objective of strengthening the CBA's monetary

[6] An EPA Update has been prepared for consideration with the Fifth Reviews and the 2012 Article IV Consultation.

policy framework and of allowing greater ER flexibility should help enhance the transmission mechanism and reduce external imbalances, while better absorbing shocks. At the same time, recent financial regulations regarding currency mismatches of large borrowers and FX liquidity ratios are a step forward in strengthening the soundness and supervision of the banking system. These regulations should be complemented with other policies to reduce dollarization, and consideration should be given to expanding the difference between reserve requirements for FX liabilities and dram liabilities, and increasing FX liquidity ratios beyond their current levels. The CBA is urged to implement the findings of the safeguards visit.

38. Fiscal policy also remains appropriate, although increasing revenue collection to allow for higher social and investment spending while reducing the deficit and debt is gaining urgency. The fiscal deficit is expected to close 2012 at 2.1 percent of GDP, almost 6 percentage points below the 2009 deficit. The strong consolidation has not only arrested the rise in debt, but has also contributed to the reduction of the current account deficit. Nonetheless, the consolidation needs to further emphasize revenues to provide space for much needed investment and social outlays. Increasing excise taxes (which have eroded sharply over the past decade), eliminating exemptions, and significantly improving tax and customs administration to raise greater revenues in an even-handed, business-friendly manner should be emphasized.

39. Ongoing structural reforms are welcome, and they should be complemented by a better business environment and periodically assessed to ensure that they are achieving objectives. Determined implementation of the regulatory guillotine program should help streamline red-tape in key areas. The strengthening of competition policies and launching of an export diversification strategy are also important steps. The challenge going forward is to follow up and complement these measures, ensuring that they are indeed attaining the objectives set. In this context, measures to improve the business environment in areas such as tax administration, investment, education, dispute resolution, and fair competition should be implemented to bring Armenia closer to a business climate consistent with its peers and its per-capita income. Staff continues to urge against large-scale public involvement in Nairit.

40. Policies under the program remain broadly on track. All but one PC and most ITs were met. All structural benchmarks were observed or are on track with brief delays possible. On the basis of the corrective actions being taken by the authorities and difficulties in meeting the targets set at the time of the Fourth Review without placing excessive pressures on the FX market, staff recommends completion of the Fifth Review, a waiver for the missed end-June NIR PC, and modification of the end-December NIR PC. Staff also supports the authorities' request for SDR 33.5 million to become available with completion of the reviews.

41. The staff recommends that the next Article IV consultation with Armenia be held in accordance with the September 28, 2010 Decision on Article IV Consultation Cycles.

Table 1. Armenia: Selected Economic and Financial Indicators, 2009–15

	2009	2010	2011	2012		2013	2014	2015
	Act.	Act.	Act.	Country Report No. 12/153	Proj.	Proj.	Proj.	Proj.
National income and prices								
Real GDP (percent change)	-14.1	2.2	4.7	3.8	6.2	4.3	4.1	4.3
Gross domestic product (in billions of drams)	3,142	3,460	3,776	4,172	4,167	4,535	4,910	5,326
Gross domestic product (in millions of U.S. dollars)	8,648	9,260	10,138	10,553	10,216	10,497	10,767	11,084
Gross domestic product per capita (in U.S. dollars)	2,647	2,807	3,042	3,135	3,036	3,088	3,136	3,196
CPI (period average; percent change)	3.5	7.3	7.7	3.9	2.4	4.2	4.0	4.0
CPI (end of period; percent change)	6.7	8.5	4.7	4.2	4.0	4.0	4.0	4.0
GDP deflator (percent change)	2.6	7.8	4.2	5.3	4.0	4.3	4.0	4.0
Poverty rate (in percent) 1/	34.1	35.8	...	...	...	...	...	...
Investment and saving (in percent of GDP)								
Investment	33.8	29.4	28.8	30.7	28.1	30.1	30.3	30.6
National savings	18.0	14.6	17.9	20.7	17.7	20.5	22.4	24.0
Money and credit (end of period)								
Reserve money (percent change)	13.8	-0.8	32.3	6.2	-7.2	11.5	...	...
Broad money (percent change)	16.4	10.6	23.6	15.5	14.5	11.5	...	...
Velocity of broad money (end of period)	3.8	3.8	3.4	3.2	3.2	3.7	...	...
Commercial banks' 3-month lending rate (in percent)	19.1	17.7	20.7	...	...	...	...	...
Central government operations (in percent of GDP)								
Revenue and grants	20.9	21.2	22.1	21.3	21.3	22.2	22.4	22.8
Of which tax revenue	16.1	16.4	16.7	17.1	17.3	18.2	18.6	19.0
Expenditure 2/	28.6	26.2	25.0	24.5	23.4	24.8	24.7	24.8
Overall balance on a cash basis	-7.9	-4.6	-2.8	-3.1	-2.1	-2.6	-2.3	-2.0
Public and publicly-guaranteed debt (in percent of GDP)	40.2	39.7	41.8	42.3	44.9	43.5	45.1	44.0
Share of foreign currency debt (in percent)	88.9	87.4	87.1	87.1	88.1	86.4	86.3	85.4
External sector								
Exports of goods and services (in millions of U.S. dollars)	1,336	1,937	2,407	2,527	2,588	2,793	3,033	3,267
Imports of goods and services (in millions of U.S. dollars)	-3,683	-4,212	-4,797	-4,920	-4,975	-5,192	-5,341	-5,548
Exports of goods and services (percent change)	-24.0	45.0	24.3	5.1	7.5	7.9	8.6	7.7
Imports of goods and services (percent change)	-22.4	14.4	13.9	2.7	3.7	4.4	2.9	3.9
Current account balance (in percent of GDP)	-15.8	-14.8	-10.9	-10.0	-10.4	-9.6	-7.8	-6.6
FDI (net, in millions of U.S. dollars)	725	562	447	498	320	361	465	512
External debt (in percent of GDP)	57.8	65.4	72.8	67.5	77.7	76.0	78.0	77.3
o.w. public debt (in percent of GDP) 3/	35.7	34.7	36.4	36.9	39.5	37.6	38.9	37.6
Debt service ratio (in percent of exports of goods and services) 3/	5.4	4.7	4.2	10.2	9.8	15.1	9.7	5.8
Gross international reserves (in millions of U.S. dollars) 4/	2,004	1,866	1,869	1,759	1,614	1,536	1,598	1,830
Import cover 5/	5.7	4.7	4.5	4.1	3.7	3.5	3.5	3.7
Nominal effective exchange rate (percent change) 6/	-8.4	-2.6	0.3	...	...	...	...	...
Real effective exchange rate (percent change) 6/	-7.5	1.3	6.9	...	...	...	...	...
End-of-period exchange rate (dram per U.S. dollar)	378	363	385.8	...	...	...	...	...
Average exchange rate (dram per U.S. dollar)	363	374	372.5	...	...	...	...	...
Memorandum item:								
Population (in millions)	3.3	3.3	3.3	...	...	...	...	...

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

1/ From 2008, the poverty rate is computed using a different methodology based on the new household survey.
2/ Including the gas subsidy in 2006–08.
3/ Based on public and publicly-guaranteed debt.
4/ Excluding the special privatization account (SPA), but including the Russian project loan.
5/ Gross international reserves in months of next year's imports of goods and services, including the SDR holdings.
6/ A positive sign denotes appreciation.

Table 2. Armenia: Balance of Payments, 2009–17
(In millions of U.S. dollars, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016	2017
	Act.	Act.	Act.			Projections			
Current account	-1,367	-1,373	-1,108	-1,061	-1,004	-844	-730	-758	-797
Trade balance	-2,081	-2,033	-2,078	-2,093	-2,133	-2,064	-2,044	-2,150	-2,272
Exports, fob	749	1,175	1,580	1,724	1,842	2,007	2,169	2,336	2,532
Imports, fob	-2,830	-3,208	-3,658	-3,817	-3,975	-4,070	-4,213	-4,485	-4,804
Services (net)	-266	-242	-312	-294	-266	-244	-237	-228	-222
Credits	587	762	827	864	951	1,027	1,097	1,173	1,249
Debits	-853	-1,004	-1,139	-1,158	-1,216	-1,271	-1,335	-1,401	-1,471
Income (net)	167	339	559	629	659	729	769	795	838
Transfers (net)	814	563	723	697	735	735	782	825	859
Private	733	477	563	636	668	708	757	810	859
Official	81	86	160	62	68	27	25	15	0
Capital and financial account	1,560	1,058	1,050	858	895	980	986	1,055	1,094
Capital transfers (net)	89	108	96	67	54	81	95	95	96
Foreign direct investment (net)	725	562	447	320	361	465	512	563	619
Portfolio investment (net)	-4	11	-10	5	0	30	38	41	45
Public sector borrowing (net)	886	194	152	251	344	224	152	166	140
Disbursements	907	219	180	300	421	306	275	309	312
Amortization	-21	-25	-28	-49	-78	-82	-123	-143	-172
Other capital (net)	-136	184	365	214	136	180	189	191	193
Errors and omissions	-39	18	-29	0	0	0	0	0	0
Overall balance	155	-298	-88	-203	-109	136	256	298	297
Financing	-155	298	88	153	-194	-211	-256	-298	-297
Gross international reserves (increase: -) 1/	-597	138	-4	255	78	-62	-231	-259	-241
Use of Fund credit, net	442	160	92	-103	-272	-148	-25	-38	-56
Purchases/disbursements	466	181	114	51	...	...	...	...	...
Repurchases/repayments	-23	-22	-23	-154	-272	-148	-25	-38	-56
Financing gap	0	0	0	51	303	75	0	0	0
Identified financing									
IMF ECF/EFF	0	0	0	51	83	0	...	...	...
Other	0	0	0	0	220	...	...	...	...
Memorandum items:									
Financing gap (Country Report No. 11/366)	0	0	57	106	239	0	0	0	0
Current account (in percent of GDP)	-15.8	-14.8	-10.9	-10.4	-9.6	-7.8	-6.6	-6.4	-6.3
Trade balance (in percent of GDP)	-24.1	-21.9	-20.5	-20.5	-20.3	-19.2	-18.4	-18.2	-17.9
Gross international reserves (end of period)	2,004	1,866	1,869	1,614	1,536	1,598	1,830	2,089	2,330
In months of next year's imports	5.7	4.7	4.5	3.7	3.5	3.5	3.7	4.0	4.2
Merchandise export growth, percent change	-32.7	57.0	34.4	9.1	6.9	8.9	8.1	7.7	8.4
Merchandise import growth, percent change	-25.0	13.4	14.0	4.3	4.2	2.4	3.5	6.5	7.1
Nominal external debt	4,878	6,145	7,252	7,729	7,962	8,207	8,548	8,905	9,238
o.w. public external debt	2,967	3,299	3,568	3,831	3,929	3,993	4,146	4,311	4,452
Nominal external debt stock (in percent of GDP)	57.8	65.4	72.8	77.7	76.0	78.0	77.3	76.1	72.8
External public debt-to-exports ratio (in percent)	222.1	170.3	148.2	148.0	140.7	131.7	126.9	122.9	117.7
External public debt service (in percent of exports)	5.4	4.7	4.2	9.8	15.1	9.7	5.8	6.0	6.5

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

1/ Gross international reserves include the SDR holdings.

Table 3. Armenia: Monetary Accounts, 2009–13
(In billions of drams, unless otherwise indicated)

	2009	2010	2011	2012				2013			
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
	Act.	Act.	Act.	Prel. 1/	Prel. 1/	Proj. 1/	Proj. 1/	Proj. 1/	Proj. 1/	Proj. 1/	Proj. 1/
Central Bank of Armenia											
Net foreign assets	571.6	422.4	465.0	404.0	424.1	432.6	400.9	373.9	365.7	351.6	372.4
Net international reserves 2/	595.8	500.6	521.2	465.3	490.5	501.1	471.8	444.8	436.6	422.5	443.3
Other	-80.5	-76.9	-56.3	-61.3	-66.4	-68.5	-70.9	-70.9	-70.9	-70.9	-70.9
Net domestic assets	-59.9	85.2	206.3	149.7	139.6	171.5	222.3	227.2	266.8	309.1	322.1
Claims on general government (net)	-152.5	-95.6	-66.7	-82.1	-94.1	-101.8	-93.8	-97.6	-108.0	-143.7	-169.8
Of which: central government (net)	-138.8	-76.7	-54.2	-64.3	-78.1	-85.8	-77.8	-81.6	-91.9	-127.6	-153.8
Claims on banks	66.2	57.4	137.0	98.0	108.6	160.0	182.4	182.4	181.8	181.8	190.1
KfW & IBRD	39.1	61.5	90.7	93.4	97.9	100.0	102.4	102.4	101.8	101.8	110.1
Monetary instruments (net) excluding CBA bills	27.1	-4.1	46.3	4.5	10.7	60.0	80.0	80.0	80.0	80.0	80.0
CBA bills 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other items (net)	26.4	123.4	136.0	133.9	125.0	113.3	133.7	142.3	193.0	271.0	301.8
Reserve money	511.7	507.6	671.3	553.8	563.6	604.1	623.2	601.0	632.4	660.7	694.5
Currency issue	320.7	348.2	398.8	361.6	384.0	394.2	415.1	416.7	436.8	440.0	460.9
Deposits	191.0	159.4	272.5	192.2	179.6	210.0	208.1	184.3	195.6	220.6	233.7
Deposits in drams	42.3	61.4	169.9	160.2	140.4	146.5	177.1	177.3	182.3	182.7	187.6
Deposits in foreign currency	148.7	98.0	102.6	32.0	39.1	63.4	31.0	7.1	13.3	38.0	46.0
Banking system											
Net foreign assets	379.1	193.8	31.9	-43.1	-97.1	-136.4	-198.1	-255.1	-293.4	-312.4	-296.6
Net domestic assets	444.9	717.4	1,094.7	1,175.2	1,295.6	1,352.5	1,488.1	1,547.4	1,653.1	1,680.0	1,734.3
Claims on government (net)	-125.3	-50.9	-1.8	-14.0	-33.5	-29.3	-7.4	-0.8	-0.8	-26.1	-41.8
Of which: claims on central government (net)	-111.6	-32.0	10.7	3.9	-17.4	-13.2	8.7	15.2	15.3	-10.0	-25.8
Claims on rest of the economy	728.3	922.9	1251.2	1339.6	1479.2	1531.8	1640.5	1678.2	1773.9	1841.1	1886.1
Other items (net)	-158.0	-154.5	-154.7	-150.5	-150.1	-150.0	-145.0	-130.0	-120.0	-135.0	-110.0
Broad money	824.0	911.2	1,126.6	1,132.1	1,198.5	1,216.1	1,290.0	1,292.2	1,359.7	1,367.5	1,437.7
Currency in circulation	282.7	304.5	349.6	321.5	339.2	344.2	365.1	365.7	384.8	387.0	406.9
Deposits	541.3	606.7	777.0	810.6	859.4	872.0	924.9	926.5	974.9	980.5	1030.8
Domestic currency	170.7	216.7	306.5	323.9	315.7	326.4	346.2	346.8	365.0	373.9	400.3
Foreign currency	370.6	389.9	470.5	486.6	543.7	545.6	578.7	579.7	610.0	606.6	630.6
Memorandum items:											
Exchange rate (in drams per U.S. dollar, end of period)	377.9	363.4	385.8	390.6	418.0	406.3	...	...	...	...	...
NIR, program definition, at program exchange rates (in millions of U.S. dollars)	1,019	892	794	810	778	810	771	720	722	710	810
12-month change in reserve money (in percent)	13.8	-0.8	32.3	9.4	8.3	5.9	-7.2	8.5	12.2	9.4	11.5
12-month change in broad money (in percent)	16.4	10.6	23.6	21.7	23.9	19.0	14.5	14.2	13.5	12.5	11.5
12-month change in private sector credit (in percent)	14.0	26.7	35.6	34.2	28.3	33.0	31.1	25.3	19.9	20.2	15.0
Velocity of broad money (end of period)	3.8	3.8	3.4	3.4	3.2	3.3	3.2	3.7	3.9	3.9	3.7
Money multiplier	1.6	1.8	1.7	2.0	2.1	2.0	2.1	2.2	2.2	2.1	2.1
Dollarization in bank deposits 4/	68.5	64.3	60.6	60.0	63.3	62.6	62.6	62.6	62.6	61.9	61.2
Dollarization in broad money 5/	45.0	42.8	41.8	43.0	45.4	44.9	44.9	44.9	44.9	44.4	43.9
Currency in circulation in percent of deposits	52.2	50.2	45.0	39.7	39.5	39.5	39.5	39.5	39.5	39.5	39.5
Stock of foreign currency deposits (in millions of U.S. dollars) 1/	980.8	1,012.9	1,222.2	1,264.0	1,412.1	1,417.0	1,503.1	1,505.7	1,584.4	1,575.7	1,637.8
Banking system financing of the central government (cumulative) 6/	-86.4	79.6	42.7	-6.8	-28.1	-23.9	-2.1	6.6	6.6	-18.7	-34.4

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

1/ At the program exchange rate.
2/ Starting Dec-2011, some foreign assets previously in NIR were reclassified as other foreign assets.
3/ Following the agreement between the CBA and the Ministry of Finance, the issue of new CBA bills was terminated in 2008.
4/ Ratio of foreign currency deposits to total deposits (in percent).
5/ Ratio of foreign currency deposits to broad money (in percent).
6/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is exp lained by government lending to the economy through commercial banks.

Table 4. Armenia: Financial Soundness Indicators for the Banking Sector, 2010–12
(In percent, unless otherwise indicated)

	2010				2011				2012			
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep	Dec.	Mar.	Jun.	Sep	Dec.
Capital adequacy												
Total regulatory capital to risk-weighted assets	28.6	28.9	26.9	22.2	21.3	20.0	19.6	18.3	17.8	16.8		
Capital (net worth) to assets	20.6	22.1	21.6	20.4	20.2	19.3	18.5	17.2	17.8	16.5		
Asset composition												
Sectoral distribution of loans (in billions of drams)												
Industry (excluding energy sector)	121.2	127.7	136.7	156.7	164.9	165.6	172.3	178.6	205.5	231.8		
Energy sector	32.0	24.3	37.0	47.2	56.3	65.4	72.7	77.5	79.5	62.6		
Agriculture	48.1	48.7	50.0	52.4	57.3	66.4	75.6	80.7	87.9	102.6		
Construction	57.5	58.8	65.3	74.8	78.8	87.3	85.8	96.0	97.6	108.6		
Transport and communication	17.8	22.2	26.0	25.7	30.2	38.2	47.8	50.9	52.2	42.2		
Trade/commerce	161.0	164.7	174.1	184.8	200.1	222.1	248.0	275.7	298.0	327.3		
Sectoral distribution of loans to total loans (percent of total)												
Industry (excluding energy sector)	16.2	16.9	17.0	17.7	17.1	15.9	14.8	14.0	15.2	14.3		
Energy sector	4.3	3.2	4.6	5.3	5.9	6.3	6.2	6.1	5.9	3.9		
Agriculture	6.4	6.4	6.2	5.9	6.0	6.4	6.5	6.3	6.5	6.3		
Construction	7.7	7.8	8.1	8.4	8.2	8.4	7.4	7.5	7.2	6.7		
Transport and communication	2.4	2.9	3.2	2.9	3.1	3.7	4.1	4.0	3.8	2.6		
Trade/commerce	21.6	21.8	21.6	20.9	20.8	21.3	21.3	21.6	22.0	20.3		
Foreign exchange loans to total loans	54.3	55.4	56.4	58.0	59.6	59.6	60.2	61.2	62.7	64.6		
Asset quality												
Nonperforming loans (in billions of drams)	43.9	38.5	37.9	28.6	35.7	37.4	56.0	43.7	66.4	66.1		
Watch (up to 90 days past due)	23.2	18.3	18.9	11.3	20.7	19.3	35.0	18.8	43.1	32.0		
Substandard (91-180 days past due)	16.0	13.8	13.8	11.3	8.5	13.9	13.6	15.6	12.2	23.1		
Doubtful (181-270 days past due)	4.7	6.4	5.2	6.1	6.5	4.2	7.4	9.3	11.1	11.0		
Loss (>270 days past due)	32.3	32.0	34.0	34.6	36.4	36.6	42.3	45.2	65.8	75.5		
Nonperforming loans to gross loans	5.6	4.8	4.5	3.1	3.5	3.4	4.8	3.4	4.9	4.1		
Provisions to nonperforming loans	36.2	41.4	41.9	56.7	51.0	50.9	41.3	55.4	43.2	47.9		
Spread between highest and lowest rates of interbank borrowing in AMD	3.0	2.8	4.3	4.0	4.0	3.0	2.3	1.5	3.0	3.0		
Spread between highest and lowest rates of interbank borrowing in foreign currency	4.0	7.6	2.8	5.0	2.0	5.0	4.1	5.3	2.5	5.0		
Earnings and profitability												
ROA (profits to period average assets)	1.3	1.8	2.0	2.2	2.0	2.3	1.9	1.9	1.5	1.5		
ROE (profits to period average equity)	6.1	8.5	9.5	10.2	10.0	11.7	9.8	9.8	8.7	8.6		
Interest margin to gross income	43.5	44.1	44.3	43.8	43.6	43.4	42.4	42.0	45.5	43.1		
Interest income to gross income	79.0	78.9	78.2	77.0	78.9	78.9	78.5	78.3	82.7	81.6		
Noninterest expenses to gross income	39.4	39.6	38.9	39.2	36.9	36.6	35.6	36.4	33.5	34.1		
Liquidity												
Liquid assets to total assets	33.9	30.1	30.1	29.5	28.9	26.8	28.3	27.9	26.6	24.4		
Liquid assets to total short-term liabilities	140.4	128.8	129.3	131.5	137.2	132.0	125.0	120.8	126.4	118.1		
Customer deposits to total (non-interbank) loans	96.5	86.8	86.5	87.2	87.1	85.3	89.3	91.5	85.5	85.0		
Foreign exchange liabilities to total liabilities	70.3	67.4	66.2	64.9	65.3	65.5	66.0	63.3	63.4	65.6		
Sensitivity to market risk												
Gross open positions in foreign exchange to capital	3.1	3.8	3.6	2.9	3.0	3.2	3.4	3.0	3.1	2.9		
Net open position in FX to capital	0.4	-0.1	0.2	-0.2	0.5	0.4	-1.1	-0.9	-0.9	-0.2		

Source: Central Bank of Armenia.

Table 5. Armenia: Central Government Operations, 2009–15
(In billions of drams)

	2009	2010	2011	2012	2012	2012	2012	2012	2012	2013	2014	2015
						Q1	Q2	Q3	Q4			
	Act.	Act.	Act.	Country Report No. 12/153	Proj.	Prel.	Prel.	Prog.	Prog.	Proj.	Proj.	Proj.
Total revenue and grants	655.6	734.3	834.8	890.0	887.7	178.1	222.2	227.2	260.2	1006.5	1100.1	1213.9
Total revenue	634.4	706.1	776.6	874.7	872.5	177.1	220.3	225.6	249.5	990.0	1087.7	1201.5
Tax revenues	505.9	568.9	629.6	711.7	721.5	142.7	182.0	188.0	208.8	826.2	910.9	1009.7
VAT	239.2	278.1	301.5	338.8	328.9	64.6	80.7	91.0	92.6	358.0	387.6	425.7
Profits, simplified and presumptive	104.9	99.7	143.8	163.9	176.2	34.2	49.0	39.5	53.5	193.1	210.8	234.2
Personal income tax	60.2	73.9	81.2	102.2	93.1	20.1	22.1	24.7	26.2	132.2	148.0	165.9
Customs duties	25.1	29.4	34.7	38.8	39.7	6.2	10.5	10.5	12.5	43.2	51.7	56.0
Other	76.5	87.8	68.4	68.0	83.7	17.6	19.8	22.3	24.0	99.8	112.9	127.8
Social contributions	102.9	105.3	123.4	142.1	130.1	30.0	31.2	33.4	35.4	141.5	153.2	166.2
Other revenue	25.6	31.8	23.6	20.9	20.9	4.4	7.1	4.1	5.3	22.3	23.6	25.6
Grants	21.2	28.2	58.2	15.3	15.3	1.0	1.8	1.6	10.8	16.5	12.4	12.4
Budget support	10.3	5.4	28.6	9.5	9.3	0.0	0.0	0.0	9.3	5.9		
Project grants	9.0	22.8	29.6	5.8	6.0	1.0	1.8	1.6	1.5	10.6		
Total expenditure	897.1	906.6	943.1	1021.4	974.3	186.3	233.3	241.5	313.2	1126.1	1213.3	1321.2
Expense	712.0	727.9	788.7	874.9	856.8	174.6	211.7	214.6	255.9	931.0	1016.9	1117.8
Wages	83.5	82.5	86.5	95.6	93.4	18.8	23.2	23.9	27.5	109.7	118.8	128.9
Social Contributions	4.6	4.5	4.7	5.4	5.4	0.9	1.2	1.2	2.1	0.0	0.0	0.0
Pension Co-payment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.0	25.0
Subsidies	18.4	17.4	18.3	24.5	22.5	4.1	4.6	6.9	6.9	19.5	32.0	34.0
Interest	16.2	30.2	35.2	47.7	44.7	8.1	11.7	9.7	15.3	52.5	59.3	66.7
Social allowances and pensions	239.9	241.7	255.1	294.7	287.6	66.9	73.3	74.3	73.0	302.0	336.8	376.0
Pensions/social security benefits	176.0	176.8	186.6	199.1	196.8	48.5	49.3	49.7	49.2	197.6	218.8	237.4
Social assistance benefits	64.0	64.9	68.5	83.6	78.8	18.4	24.0	18.6	17.8	84.9	106.0	126.6
Employer social benefits	0.0	0.0	0.0	12.0	12.0	3.0	3.0	3.0	3.0	19.5	12.0	12.0
Goods and services	150.7	155.6	166.7	171.2	169.4	37.1	48.6	37.3	46.4	170.0	180.1	191.2
Grants	62.0	66.6	69.2	76.1	76.1	15.9	19.7	20.4	20.0	75.8	75.8	75.8
Other expenditure	136.6	129.5	152.9	159.8	157.8	22.8	29.4	40.7	64.8	201.4	213.9	245.3
Transactions in nonfinancial assets	185.1	178.7	154.4	146.5	117.5	11.7	21.6	26.9	57.3	195.1	196.4	203.4
Acquisition of nonfinancial assets	195.7	179.2	157.7	148.3	119.3	11.9	21.9	27.6	57.9	195.1	196.4	203.4
Disposals of nonfinancial assets	10.6	0.5	3.3	1.8	1.8	0.1	0.3	0.7	0.6	0.0	0.0	0.0
			0.0									
Overall balance (above-the-line)	-241.5	-172.3	-108.3	-131.4	-86.6	-8.2	-11.1	-14.3	-53.0	-119.6	-113.2	-107.3
Of which: Unidentified Revenue Measures 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-18.0	-25.0
Statistical discrepancy	-6.2	13.2	2.1	0.0	0.0	0.2	2.1	-3.0	-3.5	0.0	0.0	0.0
Overall balance (below-the-line)	-247.7	-159.1	-106.2	-131.4	-86.6	-8.0	-9.0	-17.2	-56.4	-119.6	-113.2	-107.3
Financing	247.7	159.1	106.2	131.4	86.6	8.0	9.0	17.2	56.4	119.6	113.2	107.3
Domestic financing	-108.5	96.5	62.7	31.5	0.9	-4.1	-30.0	4.7	34.4	-10.8	78.0	84.7
Banking system 2/	-40.0	95.6	55.1	22.5	-1.1	-5.9	-21.3	4.2	21.9	-34.4	65.4	71.0
CBA	-54.4	62.1	22.4	2.5	-23.5	-10.0	-13.8	-7.7	8.0	-76.0	32.0	35.6
Commercial Banks	14.4	33.5	32.7	20.0	22.4	4.2	-7.5	11.9	13.8	41.6	33.3	35.4
Nonbanks	-68.5	0.9	7.6	6.0	6.1	1.8	-8.7	0.5	12.5	20.5	12.6	13.7
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills	8.7	5.5	4.3	6.0	-2.5	-2.7	-6.3	3.0	3.5	2.6	2.8	3.1
Promissory note/other	-3.2	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-74.0	-2.6	3.4	0.0	8.6	4.5	-2.5	-2.5	9.0	17.9	9.8	10.7
External financing	356.2	62.5	43.5	99.8	85.7	12.1	39.0	12.5	22.0	67.8	35.2	22.6
Gross inflow 3/	395.6	105.3	89.4	163.6	141.6	25.3	51.0	28.8	36.4	182.1	139.4	132.1
Amortization due	-6.3	-9.7	-10.9	-28.1	-20.2	-3.4	-2.3	-7.2	-7.2	-75.0	-65.0	-66.8
Net lending	-33.1	-33.1	-35.1	-35.7	-35.7	-9.8	-9.7	-9.1	-7.1	-39.3	-39.3	-42.6
Unidentified financing	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0	62.6	0.0	0.0
Memorandum items:												
Nominal GDP (in billion of drams)	3,142	3,460	3,776	4,172	4,167	4,167	4,167	4,167	4,167	4,535	4,910	5,326
Program balance 4/	-354.8	-124.4	-137.9	-164.0	-111.3	-13.4	-21.1	-25.8	-51.0	...	...	...
Debt-creating fiscal balance 5/	-274.6	-205.4	-143.4	-167.1	-122.2	-18.0	-20.8	-23.3	-60.0	-158.9	-152.5	-149.9
Overall balance excl. spending financed with the Russian loan	-215.0	-149.3	-108.3		-86.6	-8.2	-11.1	-14.3	-53.0	-119.6	-113.2	-107.3
Budget support loans	290.9	35.0	45.2	0.0	70.8	20.8	42.9	0.0	7.1	31.1	0.0	0.0
T-bill issuance	45.4	30.2	30.3	30.0	30.8	2.0	-3.4	14.9	17.3	52.0	2.8	3.1

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

1/ Needed to offset pension reform costs.
2/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.
3/ Includes IMF budget support.
4/ The program balance is measured as below-the-line overall balance minus net lending, except from 2010 to 2011Q1, where project financing is also subtracted.
5/ Sum of overall balance (above-the-line) and external net lending.

Table 6. Armenia: Central Government Operations, 2009–15
(In percent of GDP, unless otherwise specified)

	2009	2010	2011	2012						2013	2014	2015
				Country Report		Q1	Q2	Q3	Q4			
	Act.	Act.	Act.	No. 12/153	Proj.	Prel.	Prel.	Prog.	Prog.	Prog.	Proj.	Proj.
Total revenue and grants	20.9	21.2	22.1	21.3	21.3	4.3	5.3	5.5	6.2	22.2	22.4	22.8
Total revenue	20.2	20.4	20.6	21.0	20.9	4.3	5.3	5.4	6.0	21.8	22.2	22.6
Tax revenues	16.1	16.4	16.7	17.1	17.3	3.4	4.4	4.5	5.0	18.2	18.6	19.0
VAT	7.6	8.0	8.0	8.1	7.9	1.6	1.9	2.2	2.2	7.9	7.9	8.0
Profits, simplified and presumptive	3.3	2.9	3.8	3.9	4.2	0.8	1.2	0.9	1.3	4.3	4.3	4.4
Personal income tax	1.9	2.1	2.2	2.5	2.2	0.5	0.5	0.6	0.6	2.9	3.0	3.1
Customs duties	0.8	0.8	0.9	0.9	1.0	0.1	0.3	0.3	0.3	1.0	1.1	1.1
Other	2.4	2.5	1.8	1.6	2.0	0.4	0.5	0.5	0.6	2.2	2.3	2.4
Social contributions	3.3	3.0	3.3	3.4	3.1	0.7	0.7	0.8	0.8	3.1	3.1	3.1
Other revenue	0.8	0.9	0.6	0.5	0.5	0.1	0.2	0.1	0.1	0.5	0.5	0.5
Grants	0.7	0.8	1.5	0.4	0.4	0.0	0.0	0.0	0.3	0.4	0.3	0.2
Budget support	0.3	0.2	0.8	0.2	0.2	0.0	0.0	0.0	0.2	0.1		
Project grants	0.3	0.7	0.8	0.1	0.1	0.0	0.0	0.0	0.0	0.2		
Total expenditure	28.6	26.2	25.0	24.5	23.4	4.5	5.6	5.8	7.5	24.8	24.7	24.8
Expense	22.7	21.0	20.9	21.0	20.6	4.2	5.1	5.1	6.1	20.5	20.7	21.0
Wages	2.7	2.4	2.3	2.3	2.2	0.5	0.6	0.6	0.7	2.4	2.4	2.4
Social Contributions	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Pension Co-payment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.5
Subsidies	0.6	0.5	0.5	0.6	0.5	0.1	0.1	0.2	0.2	0.4	0.7	0.6
Interest	0.5	0.9	0.9	1.1	1.1	0.2	0.3	0.2	0.4	1.2	1.2	1.3
Social allowances and pensions	7.6	7.0	6.8	7.1	6.9	1.6	1.8	1.8	1.8	6.7	6.9	7.1
Pensions/social security benefits	5.6	5.1	4.9	4.8	4.7	1.2	1.2	1.2	1.2	4.4	4.5	4.5
Social assistance benefits	2.0	1.9	1.8	2.0	1.9	0.4	0.6	0.4	0.4	1.9	2.2	2.4
Employer social benefits	0.0	0.0	0.0	0.3	0.3	0.1	0.1	0.1	0.1	0.4	0.2	0.2
Goods and services	4.8	4.5	4.4	4.1	4.1	0.9	1.2	0.9	1.1	3.7	3.7	3.6
Grants	2.0	1.9	1.8	1.8	1.8	0.4	0.5	0.5	0.5	1.7	1.5	1.4
Other expenditure	4.3	3.7	4.0	3.8	3.8	0.5	0.7	1.0	1.6	4.4	4.4	4.6
Transactions in nonfinancial assets	5.9	5.2	4.1	3.5	2.8	0.3	0.5	0.6	1.4	4.3	4.0	3.8
Acquisition of nonfinancial assets	6.2	5.2	4.2	3.6	2.9	0.3	0.5	0.7	1.4	4.3	4.0	3.8
Disposals of nonfinancial assets	0.3	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-7.7	-5.0	-2.9	-3.1	-2.1	-0.2	-0.3	-0.3	-1.3	-2.6	-2.3	-2.0
Of which: Unidentified Revenue Measures 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.4	-0.5
Statistical discrepancy	-0.2	0.4	0.1	0.0	0.0	0.0	0.1	-0.1	-0.1	0.0	0.0	0.0
Overall balance (below-the-line)	-7.9	-4.6	-2.8	-3.1	-2.1	-0.2	-0.2	-0.4	-1.4	-2.6	-2.3	-2.0
Financing	7.9	4.6	2.8	3.1	2.1	0.2	0.2	0.4	1.4	2.6	2.3	2.0
Domestic financing	-3.5	2.8	1.7	0.8	0.0	-0.1	-0.7	0.1	0.8	-0.2	1.6	1.6
Banking system 2/	-1.3	2.8	1.5	0.5	0.0	-0.1	-0.5	0.1	0.5	-0.8	1.3	1.3
CBA	-1.7	1.8	0.6	0.1	-0.6	-0.2	-0.3	-0.2	0.2	-1.7	0.7	0.7
Commercial Banks	0.5	1.0	0.9	0.5	0.5	0.1	-0.2	0.3	0.3	0.9	0.7	0.7
Nonbanks	-2.2	0.0	0.2	0.1	0.1	0.0	-0.2	0.0	0.3	0.5	0.3	0.3
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
T-Bills	0.3	0.2	0.1	0.1	-0.1	-0.1	-0.2	0.1	0.1	0.1	0.1	0.1
Promissory note/other	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-2.4	-0.1	0.1	0.0	0.2	0.1	-0.1	-0.1	0.2	0.4	0.2	0.2
Of which: financed with the Russian loan	-2.5	0.1	0.1	0.0	0.1	0.1	-0.1	0.0	0.0	0.0	0.0	0.0
External financing	11.3	1.8	1.2	2.4	2.1	0.3	0.9	0.3	0.5	1.5	0.7	0.4
Gross inflow 3/	12.6	3.0	2.4	3.9	3.4	0.6	1.2	0.7	0.9	4.0	2.8	2.5
Of which: Russian project loan	5.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Amortization due	-0.2	-0.3	-0.3	-0.7	-0.5	-0.1	-0.1	-0.2	-0.2	-1.7	-1.3	-1.3
Net lending	-1.1	-1.0	-0.9	-0.9	-0.9	-0.2	-0.2	-0.2	-0.2	-0.9	-0.8	-0.8
Unidentified financing	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0	1.4	0.0	0.0
Memorandum items:												
Nominal GDP (in billion of drams)	3,142	3,460	3,776	4,172	4,167	4,167	4,167	4,167	4,167	4,535	4,910	5,326
Program balance 4/	-11.3	-3.6	-3.7	-3.9	-2.7	-0.3	-0.5	-0.6	-1.2	...	...	...
Debt-creating fiscal balance 5/	-8.7	-5.9	-3.8	-4.0	-2.9	-0.4	-0.5	-0.5	-1.4	-3.5	-3.1	-2.8
Overall balance excl. spending financed with the Russian loan	-6.8	-4.3	-2.9		-2.1	-0.2	-0.3	-0.3	-1.3	-2.9	-2.7	-2.6
Budget support loans	9.3	1.0	1.2	0.0	1.7	0.5	1.0	0.0	0.2	0.7	0.0	0.0
T-bill issuance	1.4	0.9	0.8	0.7	0.7	0.0	-0.1	0.4	0.4	1.1	0.1	0.1

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

1/ Needed to offset pension reform costs.
2/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.
3/ Includes IMF budget support.
4/ The program balance is measured as below-the-line overall balance minus net lending, except from 2010 to 2011Q1, where project financing is also subtracted.
5/ Sum of overall balance (above-the-line) and external net lending.

Table 7. Armenia: Medium-Term Macroeconomic Framework, 2009–17
(In percent of GDP, unless otherwise specified)

	2009	2010	2011	2012	2013	2014	2015	2016	2017
	Act.	Act.	Act.			Projections			
National income and prices									
Real GDP (percent change)	-14.1	2.2	4.7	6.2	4.3	4.1	4.3	4.3	4.3
Gross domestic product (in millions of U.S. dollars)	8,648	9,260	10,138	10,216	10,497	10,767	11,084	11,789	12,659
Gross national income per capita (in U.S. dollars)	2,698	2,909	3,210	3,222	3,282	3,348	3,418	3,593	3,816
CPI inflation, period average (percent change)	3.5	7.3	7.7	2.4	4.2	4.0	4.0	4.0	4.0
Investment and saving									
Investment	33.8	29.4	28.8	28.1	30.1	30.3	30.6	31.3	31.7
Private	27.9	24.3	24.8	25.3	25.8	26.3	26.8	27.3	27.8
Public	5.9	5.2	4.1	2.8	4.3	4.0	3.8	4.1	3.9
National savings	18.0	14.6	17.9	17.7	20.5	22.4	24.0	24.9	25.4
Private	19.8	14.4	16.7	16.9	18.8	20.7	22.2	22.8	23.5
Public	-1.8	0.2	1.2	0.7	1.7	1.7	1.8	2.1	1.9
Central government operations									
Revenue and grants	20.9	21.2	22.1	21.3	22.2	22.4	22.8	23.1	23.4
Of which: tax revenue	16.1	16.4	16.7	17.3	18.2	18.6	19.0	19.3	19.6
grants	0.7	0.8	1.5	0.4	0.4	0.3	0.2	0.2	0.2
Expenditure	28.6	26.2	25.0	23.4	24.8	24.7	24.8	25.1	25.4
Current expenditure	22.7	21.0	20.9	20.6	20.5	20.7	21.0	21.0	21.5
Capital expenditure	5.9	5.2	4.1	2.8	4.3	4.0	3.8	4.1	3.9
Overall balance on a cash basis	-7.9	-4.6	-2.8	-2.1	-2.6	-2.3	-2.0	-2.0	-2.0
Domestic financing	-3.5	2.8	1.7	0.0	-0.2	1.6	1.6	1.2	1.5
External financing	11.3	1.8	1.2	2.1	1.5	0.7	0.4	0.8	0.5
Unidentified financing	…	…	0.0	0.0	1.4	0.0	0.0	0.0	0.0
Public and publicly-guaranteed debt	40.2	39.7	41.8	44.9	43.5	45.1	44.0	44.2	43.1
External sector									
Exports of goods and services	15.4	20.9	23.7	25.3	26.6	28.2	29.5	29.8	29.9
Imports of goods and services	42.6	45.5	47.3	48.7	49.5	49.6	50.1	49.9	49.6
Current account (in percent of GDP)	-15.8	-14.8	-10.9	-10.4	-9.6	-7.8	-6.6	-6.4	-6.3
Current account (in millions of U.S. dollars)	-1,367	-1,373	-1,108	-1,061	-1,004	-844	-730	-758	-797
Capital and financial account (in millions of U.S. dollars)	1,560	1,058	1,050	858	895	980	986	1,055	1,094
Of which: direct foreign investment	725	562	447	320	361	465	512	563	619
public sector disbursements	907	219	180	300	421	306	275	309	312
Change in gross international reserves (in millions of U.S. dollars) 1/	-597	138	-4	255	78	-62	-231	-259	-241
Arrears and debt relief (in millions of U.S. dollars)	0	0	0	0	0	0	0	0	0
Financing gap (in millions of U.S. dollars)	0	0	0	51	303	75	0	0	0
Of which: IMF	0	0	0	51	83	0	0	0	0
Other	0	0	0	0	220	75	0	0	0
Gross international reserves in months of imports	5.7	4.7	4.5	3.7	3.5	3.5	3.7	4.0	4.2

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

1/ A negative figure indicates an increase.

Table 8. Armenia: Fund Disbursements and Timing of Reviews Under a Three-year EFF/ECF Blend

Date of Availability	Conditions	Amount (millions of SDRs)			Percent of Quota		
		ECF	EFF	Total	ECF	EFF	Total
June 28, 2010	Board approval of the arrangement	18.70	17.50	36.20	20.33	19.02	39.35
September 30, 2010	Observance of end-June 2010 performance criteria and completion of first review	18.70	17.50	36.20	20.33	19.02	39.35
March 30, 2011	Observance of end-December 2010 performance criteria and completion of second review	18.70	17.50	36.20	20.33	19.02	39.35
September 30, 2011	Observance of end-June 2011 performance criteria and completion of third review	18.70	17.50	36.20	20.33	19.02	39.35
March 30, 2012	Observance of end-December 2011 performance criteria and completion of fourth review	16.00	17.50	33.50	17.39	19.02	36.41
September 30, 2012	Observance of end-June 2012 performance criteria and completion of fifth review	16.00	17.50	33.50	17.39	19.02	36.41
March 30, 2013	Observance of end-December 2012 performance criteria and completion of sixth review	26.60	28.40	55.00	28.91	30.87	59.78
	Total	133.40	133.40	266.80	145.00	145.00	290.00

Source: Fund staff estimates and projections.

Table 9. Armenia: Indicators of Capacity to Repay the Fund, 2011–19 1/

				Projections					
	2011	2012	2013	2014	2015	2016	2017	2018	2019
Fund obligations based on existing credit									
(in millions of SDRs)									
Principal	14.4	101.0	180.2	98.1	16.4	25.3	31.6	33.3	32.7
Charges and interest	7.9	5.4	3.4	1.9	1.3	1.1	1.0	0.8	0.5
Fund obligations based on existing and prospective credit									
(in millions of SDRs)									
Principal	14.4	101.0	180.2	98.1	16.4	25.3	36.9	46.9	48.9
Charges and interest	7.9	7.9	5.9	2.5	1.9	1.7	1.5	1.3	1.0
Total obligations based on existing and prospective credit									
In millions of SDRs	22.4	108.9	186.1	100.6	18.3	27.0	38.4	48.1	49.9
In millions of U.S. dollars	35.3	165.8	281.3	152.0	27.6	40.7	57.9	72.6	75.2
In percent of gross international reserves	1.9	10.3	18.3	9.5	1.5	2.0	2.5	2.8	2.7
In percent of exports of goods and services	1.5	6.4	10.1	5.0	0.8	1.2	1.5	1.8	1.7
In percent of debt service 2/	33.6	65.6	68.3	54.5	15.7	23.6	32.3	39.7	40.8
In percent of GDP	0.3	1.6	2.7	1.4	0.2	0.3	0.5	0.5	0.5
In percent of quota	24.3	118.3	202.3	109.4	19.9	29.4	41.8	52.3	54.2
Outstanding Fund credit 2/									
In millions of SDRs	539.0	505.0	379.7	281.7	265.2	240.0	203.1	156.2	107.3
In billions of U.S. dollars	0.9	0.8	0.6	0.4	0.4	0.4	0.3	0.2	0.2
In percent of gross international reserves	45.5	47.6	37.4	26.6	21.9	17.3	13.1	9.2	5.9
In percent of exports of goods and services	35.4	29.7	20.6	14.0	12.3	10.3	8.1	5.8	3.7
In percent of debt service 2/	810.6	304.3	139.3	152.7	227.2	209.7	170.5	128.8	87.8
In percent of GDP	8.4	7.5	5.5	4.0	3.6	3.1	2.4	1.7	1.1
In percent of quota	585.8	548.9	412.8	306.2	288.3	260.8	220.7	169.8	116.6
Net use of Fund credit (in millions of SDRs)	58.0	-34.0	-125.2	-98.1	-16.4	-25.3	-36.9	-46.9	-48.9
Disbursements	72.4	67.0	55.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	14.4	101.0	180.2	98.1	16.4	25.3	36.9	46.9	48.9
Memorandum items:									
Nominal GDP (in millions of U.S. dollars)	10,138.1	10,216.4	10,497.5	10,766.8	11,083.5	11,789.4	12,659.0	13,720.6	14,739.9
Exports of goods and services (in millions of U.S. dollars)	2,406.9	2,587.9	2,793.0	3,033.2	3,266.9	3,508.8	3,781.3	4,081.7	4,407.6
Gross international reserves (in millions of U.S. dollars)	1,869.5	1,614.3	1,536.0	1,598.5	1,829.7	2,089.1	2,330.3	2,555.4	2,756.4
Debt service (in millions of U.S. dollars) 2/	105.0	252.8	412.2	278.7	176.2	172.6	179.6	182.9	184.3
Quota (in millions of SDRs)	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0

Source: Fund staff estimates and projections.

1/ Indicators cover both GRA and ECF credit.

2/ Total debt service includes IMF obligations.

Table 10. Armenia: Structural Benchmarks for Future Implementation Under the EFF/ECF

Item	Measure	Desired Outcome
Financial sector		
1	Amend and issue by CBA regulations to require banks to immediately report to the CBA changes to operations that have a material adverse impact on the bank (e.g., any substantial change in activities, structure, financial situation or overall condition, or as soon as banks become aware of any material adverse developments, including breaches of legal or prudential requirements) (December 2012).	Managing financial risk
Pension reform		
2	Submit by government to Cabinet two pension reform decrees to establish: (i) procedures for managing the guarantee fund for mandatory, funded contributions; and (ii) quantitative and currency restrictions on investing mandatory funded pension assets in financial instruments (December 2012).	Ensuring feasbility of pension reforms
Regulatory reform		
3	Submit by government to parliament a regulatory guillotine legislative packet in a fourth area (i.e., following completion of three packets in 2012. This could cover, e.g., construction permits or education) (March 2013).	Reducing regulatory burden and the cost of doing business

Table 11. Armenia: Poverty Indicators and Millennium Development Goals, 1993–2012

	1993	1996	2000	2005	2006	2007	2008	2009	2010	2011	2012
Goal 1: Eradicate extreme poverty and hunger											
Population below $1 (PPP) per day, percentage		17.5		4	3	3.5	1.3				
Poverty gap ratio at $1 a day (PPP), percentage		4.7		0.9	0.7	0.7	0.3				
Employment-to-population ratio, both sexes, percentage					42.5		45				
Children under 5 moderately or severely underweight, percentage				4.2					1.2		
Goal 2: Achieve universal primary education											
Total net enrolment ratio in primary education, both sexes				88.2	91.7	96.2					
Primary completion rate, both sexes				91.8	93	101.3					
Literacy rates of 15-24 years old, both sexes, percentage									99.8		
Goal 3: Promote gender equality and enpower women											
Gender Parity Index in primary level enrolment				1.03	1.03	1.02	1.02	1.03	1.02		
Share of women in wage employment in the non-agricultural sector				41.2	41.5	41.4	40.4	43.1			
Seats held by women in national parliament, percentage			3.1	5.3	5.3	5.3	9.2	8.4	9.2	9.2	8.4
Goal 4: Reduce child mortality											
Children under five mortality rate per 1,000 live births	48	41	33	26	24	23	22	21	20		
Infant mortality rate (0-1 year) per 1,000 live births	41	36	29	23	22	20	19	18	18		
Children 1 year old immunized against measles, percentage	95	89	92	94	92	92	94	96	97		
Goal 5: Improve maternal health											
Maternal mortality ratio per 100,000 live births			38	34					30		
Births attended by skilled health personnel, percentage			96.8	97.8		99.9			99.5		
Adolescent birth rate, per 1,000 women	89.4	63.2	32.8	26.8	25.7	26.4	27.2	29.4	28.3		
Goal 6: Combat HIV/AIDS, malaria and other diseases											
People living with HIV, 15-49 years old, percentage	0	0	0.1	0.1	0.1	0.1	0.1	0.1			
Antiretroviral therapy coverage among people with advanced HIV infection, percentage								23	30		
Tuberculosis prevalence rate per 100,000 population (mid-point)	69	86	112	93	93	102	106	111	114		
Tuberculosis detection rate under DOTS, percentage (mid-point)	48	55	61	100	80	76	74	69	62		
Tuberculosis treatment success rate under DOTS, percentage		77	87	72	69	70	73	73			
Goal 7: Ensure environmental sustainability											
Proportion of land area covered by forest, percentage			10.8	10					9.3		
Carbon dioxide emissions (CO2), metric tons of CO2 per capita (CDIAC)	0.86	0.82	1.13	1.42	1.43	1.65	1.80	1.46			
Carbon dioxide emissions (CO2), kg CO2 per $1 GDP (PPP) (CDIAC)	0.52	0.49	0.42	0.28	0.28	0.29	0.27				
Energy use (kg oil equivalent) per $1,000 GDP (Constant 2005 PPP $)	446	304	284	199	179	176	173	175			
Terrestrial and marine areas protected to total territorial area, percentage	6.9	6.9	6.9	8.0	8.0	8.0	8.0	8.0	8.0		
Proportion of the population using improved drinking water sources, total	90	90	92	95	96	96	97	98	98		
Proportion of the population using improved sanitation facilities, total	88	88	89	89	89	90	90	90	90		
Goal 8: Develop a Global Partnership for Development											
Debt service as percentage of exports of goods and services and net income	1.1	9.6	7.9	3.2	2.7	2.0	1.9	3.5	3.1		
Fixed telephone lines per 100 inhabitants	17.3	18.3	17.3	19.4	19.7	20.3	20.4	19.5	19.2	18.6	
Mobile cellular subscriptions per 100 inhabitants	0.0	0.0	0.6	10.4	41.0	61.0	46.8	71.0	125.0	103.6	
Internet users per 100 population		0.1	1.3	5.3	5.6	6.0	6.2	15.3			
ODA received in landlocked developing countries as percentage of their GNI	9.9	17.8	11.0	3.4	3.3	3.7	2.5	6.0	3.6		

Sources: http://mdgs.un.org/unsd/mdg/Data.aspx?cr=51 database on MDGs

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

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

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

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

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

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

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

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

ANNEX I. EXTERNAL SUSTAINABILITY AND EXCHANGE RATE ASSESSMENT

External consolidation is proceeding, driven by fiscal adjustment, strong growth in mining exports, and a recovery of remittances. However, with a relatively narrow export base and concentrated remittances, Armenia remains vulnerable to shocks, and its pre-crisis buffers of low debt and high reserves have not been rebuilt. Staff assess that a depreciation of the dram in real terms would be needed over the medium term to bring the current account into equilibrium. Stepped-up structural reforms and further ER flexibility should facilitate an orderly adjustment.

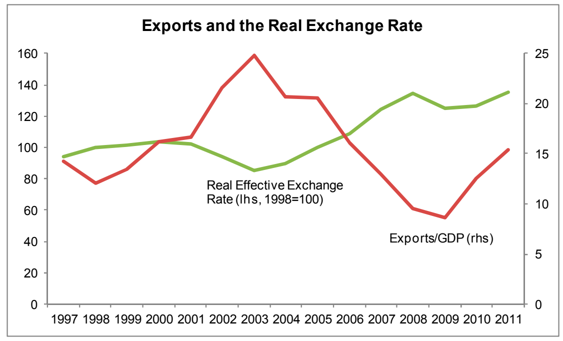
Armenia's reserves appear broadly adequate. They are equivalent to over 3½ months of prospective imports, more than twice short-term debt, and around 195 percent of the Fund's new composite metric. However, these measures do not take account of dollarization, which for Armenia (60–70 percent of liabilities and loans) suggests holding higher reserves, given potential banking sector FX liquidity needs.[1] Furthermore, the concentrated nature of some financing flows (remittances) suggests the need for a relatively high buffer. Armenia's reserves will also come under pressure over the medium term as support provided during the crisis is repaid. Repayments to the IMF peak next year at around $270 milllion, and remain significant in 2014–15. Repayment of the large Russian crisis support also begins in 2013.

Armenia's public and external debt remains sustainable.[2] Public debt increased from 16 percent of GDP in 2008 to 41 percent at end 2011, but has now stabilized. Assuming that the planned medium-term fiscal consolidation is implemented, Armenia should remain at low risk of debt distress. However, the large pre-crisis buffer will not be rebuilt unless growth is stronger or the headline deficit is reduced to well below 2 percent of GDP. Private external debt also increased rapidly from $0.7 billion at end-2003 to $3.7 billion at end 2011, but much of it has come as longer-term and inter-company lending, as well as lending by IFIs to support private sector development.

Current account consolidation is underway but has further to go. The current account defict peaked in 2009 at around 16 percent of GDP, before falling to 11 percent in 2011. The strong fiscal consolidation (5 percent of GDP during 2009–11) has been the primary driver. Looking forward, the private sector will have to drive much of the remaining adjustment. Structural reforms will be key to reducing impediments to export and import-competing sectors, while continued movement of the real ER to its equilibrium value over the medium term will also be important to ensure that price signals support adjustment and that the economy recovers competitiveness lost in the mid-2000s.

[1] If the new metric is extended to cover 30 percent of FX deposits, Armenia's gross reserves would amount to around 140 percent of the revised metric. See WP/07/265 for a discussion of the optimum level of reserves in a dollarized economy. Goncalves' model assumed coverage of foreign currency deposits by official reserves and banks' liquid foreign assets at 100 percent for non-residents and 30 percent for residents.

[2] See the accompanying Debt Sustainability Analysis (DSA) for more details.



Staff assess that a depreciation of the dram in real terms would be needed over the medium term to bring the current account into equilibrium:

- The **Macrobalance approach** suggests a current account norm of -4.6 percent of GDP, about 4 percentage points less than the underlying current account (calculated as the medium-term current account correcting for changes in real ERs). Based on an elasticity of the current account to the real effective ER of -0.30 percent, this would imply that a real effective depreciation over the medium term would be necessary to bring the underlying current account into line with the norm.

- Based on the assumptions in the DSA, the **External Stability** approach suggests that a non-interest current account deficit of 4.7 percent of GDP would stabilize debt at its current level. This compares with an underlying non-interest current account of -6.9 percent of GDP, suggesting that a real effective ER depreciation over the medium term would be needed to bring the underlying current account to its NFA-stabilizing level.

- Finally, the **Equilibrium Real ER** approach suggests overvaluation.

Exchange Rate Assessment

	Macro-economic Balance	Equilibrium Real Exchange Rate	External sustainability 1/
Current account norm	-4.6		-4.7
Underlying current account	-8.8		-6.9
CA gap	-4.2		-2.2
Elasticity	-0.3		-0.3
Real exchange rate gap 2/	14.3	9.5	7.5

1/ The current account reported are non-interest portions only.

2/ Movement in real exchange rate needed to close the gap between norm and projection.

These methodologies are subject to limitations and are sensitive to assumptions; they should therefore be viewed with some caution. For example, this MB approach does not take into account FDI flows, which in the case of Armenia have been supported by investments from the large diaspora (not always solely for purely economic purposes), and may result in a larger sustainable current account deficit than would otherwise be the case. The ES and ERER approaches may therefore provide a better indication of the degree of overvaluation for Armenia, although the objective of stabilizing debt at its current level would leave Armenia with little or no room to accommodate future shocks. And while the exact magnitude of overvaluation is difficult to determine with certainty, the results do tend to confirm the view suggested by the evolution of the balance of payments, that the real ER remains moderately overvalued, despite developments in 2012.

Further current account adjustment of 4 percent of GDP is likely necessary over the medium term. This would still allow for a sizable deficit as Armenia uses external finance to support development. Net official financing of the public sector is expected to fall as fiscal consolidation continues and crisis support unwinds, but may nevertheless continue at just under 2 percent of GDP. Net bank flows may diminish as credit/GDP ratios approach their equilibrium, and private investment comes increasingly from FDI.

During 2012, depreciation has brought the dram closer in line with its equilibrium value. However, CBA sales of FX have been larger than purchases, and further flexibility would be an important part of the adjustment process, particularly in the event of shocks. Potential sources of shocks include trade links with the EU and Russia, a fall of remittances, and fuel price fluctuations:

- **Exports to the EU account for roughly 50 percent of total exports over the last five years, around three times higher than exports to Russia.** However, almost two-thirds of EU exports consist of ores and metals, compared to only around 15 percent of exports to Russia. This would suggest that the impact of a downturn in Europe might be relatively contained if the global economy grows at or near potential. Exports to Russia, however, tend to be higher value-added and aimed more specifically at the Russian market, suggesting less transferability.

- **Remittances averaged 16 percent of GDP over the last five years (down from 19 percent in 2004).**[3] They are a critical FX source**,** averaging 38 percent higher than total exports, twice higher than FDI, eight times higher than bank flows, and four times higher than official government inflows. Remittances finance around 40 percent of imports. Russia accounts for 80–90 percent of remittances, and statistical analysis shows that lagged Russian GDP has the largest impact on remittances**.** While remittances have been seen as a relatively stable source of finance, they have exhibited significant volatility in Armenia, notably with the global downturn in 2009.

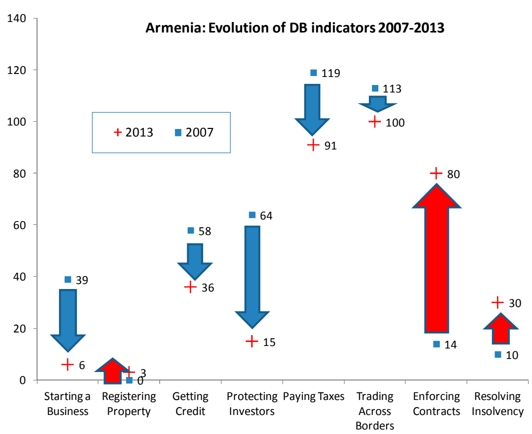
- **Armenia has no significant reserves of oil or gas, and fuel is largely imported from Russia.** While the ageing Metsamor nuclear power plant provides a significant component of domestic electricity production, an increase in fuel prices could have an adverse impact. However, this may be mitigated by the large role remittances from Russia have on the Armenian economy: to the extent that high fuel prices support economic activity in Russia, the flow of remittances from Russia would increase. The positive effect on Armenia's economy from increased remittances may outweigh the direct, negative impact of an increased fuel bill.

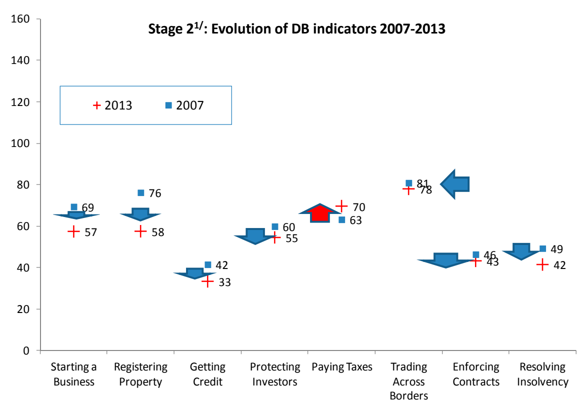
[3] This analysis is based on "Remittances in Armenia: Dynamic Patterns and Drivers", Ghazaryan and Tolosa, *www.imf.org/external/country/arm/rr/2012/062012.pdf*

ANNEX II. BUSINESS ENVIRONMENT AND COMPETITIVENESS

The evolution of Armenia's business environment indicators presents a mixed picture. Advances have been made, for example, in the World Bank's Doing Business Indicators (WBDBI), where Armenia ranked 55th out of 183 countries in 2012 and 32nd out of 185 countries in 2013. However, there is an important disparity in performance: Armenia performs well in areas related to *opening* a business (e.g. registering a business or property), but performs relatively poorly in areas related to *running* a business (e.g. paying taxes, receiving electricity, trade, protecting investors). WBDBI gains through 2012 were due only to first group of indicators. Scores for protecting investors, paying taxes, and obtaining electricity improved dramatically (from low levels) in the 2013 rankings, helping to boost Armenia's overall ranking. These higher scores, based in large part on new legislation, need to be translated into durable changes on the ground, while further progress from still-low levels should be made.

WBDBI rankings indicate that Armenia has underperformed relative to its peers in Europe and Central Asia (ECA). Comparing the evolution of WBDBI in Armenia with the average WBDBI for two groups of ECA countries between 2007 and 2013 shows that for Armenia, three of the eight indicators worsened (left chart), while for ECA middle-income countries, seven of eight indicators *improved*, on average (right chart).[1] In ECA low-income countries (Kyrgyz Republic, Moldova, Tajikistan), half of the indicators improved. For Armenia, the deterioration took place in key areas for operating a business (enforcing contracts, resolving insolvency). In other important areas, such as paying taxes or trading across borders, there has been an improvement but Armenia remains significantly behind ECA middle-income countries.





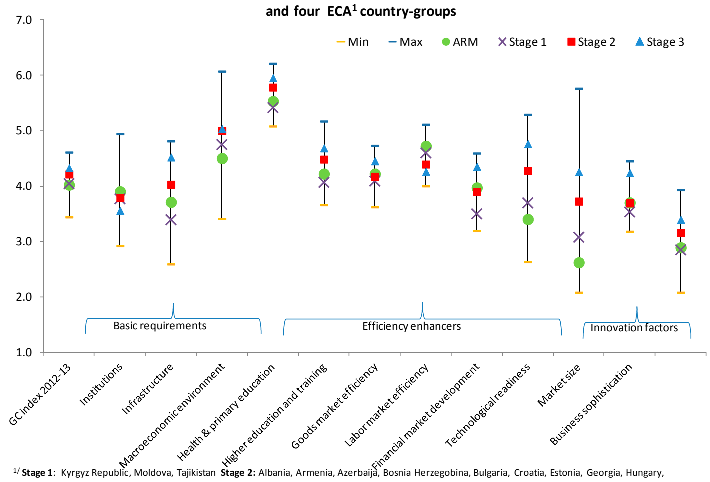
1/ Albania, Azerbaijan, Bulgaria, Estonia, Georgia, Hungary, Kazakhstan, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Russia, Serbia, Ukraine

[1] The panel compares the distance in ranking between each country and the best performer among ECA countries covered by the WBDBI. A fall in this distance is a positive development. ECA middle-income countries are: Albania, Azerbaijan, Bulgaria, Estonia, Georgia, Hungary, Kazakhstan, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Russia, Serbia, and Ukraine.

Business climate challenges appear to have undermined gains in competitiveness. The 2013 World Economy Forum (WEF) Global Competitiveness Index (GGI) ranked Armenia 82nd out of 144 countries, a significant improvement from 2012, but more moderate progress compared with 2005, when Armenia was first included. Armenia is in "Stage 2" of WEF's levels of development meaning that "basic requirements" pillars (institutions, infrastructure, macroeconomic environment, health and primary education) account for 50 percent of its assessment of Armenia's competitiveness.[2] If Armenia is to reach higher growth and income levels, it must increase productivity while ensuring sufficient physical factor accumulation. To do so, the basic requirement pillars must support productivity gains. This calls for structural reforms in such areas as tax administration, investment, education, and fair competition in domestic markets.

Compared with other WEF Stage 2 ECA countries, Armenia lags in three of four "basic requirements" and three of six "efficiency enhancers." Armenia does not score markedly better than the ECA Stage 1 countries: it is higher in two of four "basic requirements," in four of six "efficiency enhancers," and in one of two "innovation factors." Armenia outperforms the ECA Stage 2 countries in just one efficiency-enhancer: labor market efficiency.

2012-13 Scores in the WEF's GCI and pillars in Armenia and four ECA[1] country-groups



1/ **Stage 1**: Kyrgyz Republic, Moldova, Tajikistan **Stage 2:** Albania, Armenia, Azerbaija, Bosnia Herzegobina, Bulgaria, Croatia, Estonia, Georgia, Hungary, Kazakhstan, Latvia, Lithuania, Macedonia, , Montenegro, Poland, Romania, Russia, Serbia and Ukraine **Stage 3:** Czech Republic, Slovak Republic,

Source: Staff estimates and World Economic Forum database.

A key challenge is to improve the efficiency of markets for goods and services. Armenia ranks just 130th of 144 countries in the intensity of local competition, and 118th in effectiveness and trust in anti-monopoly policies. That said, the 2013 GCI survey shows gains in the extent of market dominance (133rd in 2012; 90th in 2013). The authorities should continue efforts of the competition committee to improve domestic competition and markets, and of the regulatory guillotine initiative to reduce red-tape, inefficiency, and room for corrupt practices. Two other pillars with key challenges are financial market development (78th) and technological readiness (92nd).

[2] The GCI assesses the competitiveness based on twelve pillars grouped three main sub categories: (1) *basic requirements* (which includes four pillars, institutions, infrastructure, macroeconomic environment, and health and primary education), (2) *efficiency enhancers* (which includes six pillars higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, and market size) and (3) *innovation and sophistication factors* (which includes two pillars, business sophistication and innovation).

To improve medium-term growth prospects, Armenia needs productivity increases in the tradable sector to support export-oriented growth. Over the past decade, it is noteworthy that productivity fell, despite high levels of investment. A large share of this investment, however, took place in the non-tradable sector (real estate). Implementation of the export-led industrial policy focusing on agribusiness, pharmaceuticals and IT is an important step toward ensuring high and sustainable medium-term growth. Countries with successful export diversification strategies have built strong export-promotion frameworks, underpinned by greater trade openness.[3]

[3]See, for example, Gijon, J. (2011), "Will the New Foreign Direct Investment Regime Promote Export Diversification in Algeria? A Perspective from Chile's and Malaysia's Successes," Maghreb Center Journal. Issue 1, 2010 (www.themaghrebcenter.org).

ANNEX III. DEBT SUSTAINABILITY ANALYSIS

Bank and Fund staff have undertaken an updated debt sustainability analysis (DSA) for Armenia using the debt sustainability framework for low-income countries (LICs).[1] Based on the external LIC DSA, Armenia is assessed to be at a low risk of debt distress, with all indicators below the revised country-specific thresholds under the baseline scenario. One flow indicator briefly exceeds the threshold under the stress tests.[2] The public sector DSA also suggests that following the post-crisis consolidation underway, public debt is likely to remain sustainable. In a post-crisis context of lower growth, weaker buffers, and less concessional financing, continued fiscal discipline will be essential to preserve sustainability. The DSA suggests that a headline deficit significantly in excess of 2 percent of GDP would likely lead to an unsustainable increase in debt levels.

Background

Armenia's total nominal external debt stood at $7.3 billion as of end-2011, the equivalent of 73 percent of GDP, up from $6.1 billion (65 percent of GDP) at end-2010. Public debt increased by US$270 million, while private external debt increased by $840 million. Half of the debt stock at end-2011 consisted of public and publicly-guaranteed (PPG) debt, of which over two-thirds was owed to multilateral creditors, and the balance to official bilateral creditors. The PV of the external PPG debt stood at $2.9 billion, or 29.1 percent of GDP. Including domestic debt, Armenia's total nominal public debt increased from 16.1 to 41.8 percent of GDP during 2008–11. Most of this increase stemmed from external borrowing, with the IMF and Russia providing almost two-thirds of the additional financing during the crisis period.[3]

Armenia's external private sector borrowing has increased rapidly in recent years (Figure 1). The stock of private debt increased from $0.7 billion at end-2003 to $3.7 billion at the end of last year. Borrowing by the banking sector accounted for 44 percent of the total, of which 62 percent consisted of long-term borrowing, mostly from parent banks and the official sector. Inter-company lending and other long-term lending accounted for 49 percent of total external borrowing. Solvency stress tests conducted as part of the recent FSAP suggested that the banking system is robust enough to withstand significant shocks, although rapid FX credit growth is a key risk.

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[1] The debt data underlying this analysis were provided by the Armenian authorities. Data beyond end-2011 are staffs' and authorities' projections.

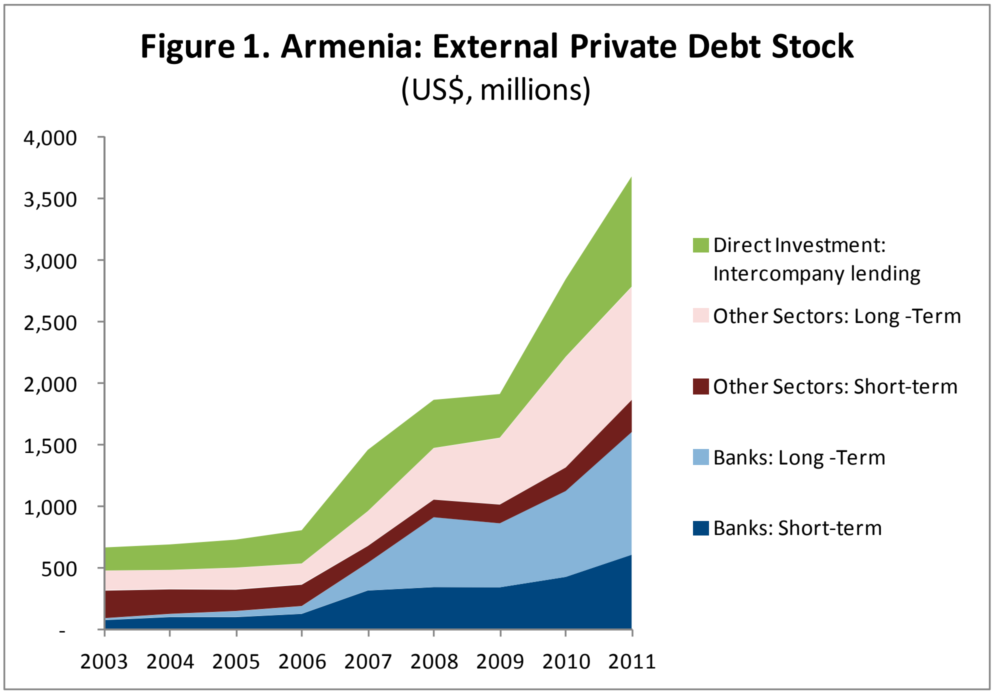
[2] Armenia is classified as a strong performer, based on its three-year average score of 4.24 on the Bank's Country Policy and Institutional Assessment (CPIA), which measures the strength of a country's policies and institutions. For a strong performer (three-year CPIA rating above 3.75), the indicative thresholds for external debt sustainability for a country where remittances are high are: PV of debt-to-GDP+remittances of 45 percent, PV of debt-to-exports+remittances of 160 percent, PV of debt-to-revenues of 300 percent, debt service-to-exports+remittances of 20 percent, and debt service-to-revenues of 22 percent.

[3] ER changes and the decline of GDP in 2009 also contributed to the rise in the debt-to-GDP ratio.

Armenia: External Public Debt Stock
(U.S. Dollars, millions)

General Government	2008	2009	2010	2011
Multilateral	**1,100**	**1,563**	**1,737**	**1,919**
IBRD	5	28	75	110
IDA	1,015	1,161	1,160	1,186
EBRD	-	1	10	14
EIB	-	-	-	4
IFAD	58	60	62	66
OPEC	15	25	29	28
ADB	8	127	147	165
EU	-	-	-	34
IMF	-	161	254	311
Bilateral (Paris Club)	**301**	**903**	**999**	**1,027**
Russia	-	500	500	500
Germany-KfW	84	93	87	95
France	5	5	4	4
USA	37	35	33	31
Japan - JICA	175	271	374	397
Bilateral (Non Paris Club)	**-**	**0**	**1**	**5**
Total government external debt stock	**1,401**	**2,466**	**2,736**	**2,946**
Monetary Authority				
Multilateral	**135**	**451**	**517**	**557**
IBRD	-	25	30	40
IMF	135	426	487	517
Bilateral	**41**	**50**	**46**	**60**
Germany-KfW	41	50	46	60
Total monetary authority external debt stock	**176**	**501**	**563**	**617**
Total Public Debt	**1,577**	**2,967**	**3,298**	**3,563**

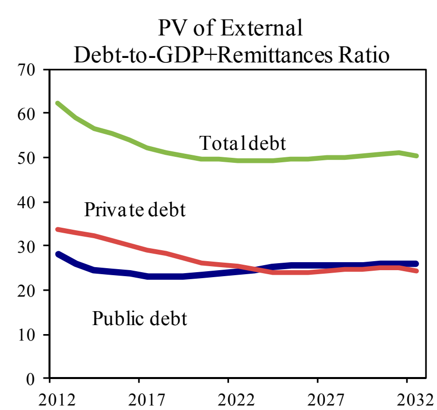
Source: Armenian authorities



The macroeconomic assumptions for the DSA have not changed significantly (Box 1.1). A key difference from the 2010 exercise is a somewhat lower-than-projected PPG debt-to-GDP ratio reflecting a faster fiscal consolidation as well as a stronger dram.[4] However, private borrowing was higher than anticipated, leading to a higher overall external debt-to-GDP ratio. While the current global uncertainties represent a downside risk, medium and long-term growth rates have been retained from the previous DSA, given that there is little sign of any impact on Armenia's remittances or exports. Exposure to the euro area is also largely limited to commodity exports, which may be well placed to find alternative markets, unless there is a decline in global growth.

External DSA

Baseline Scenario



Under the baseline scenario, the public debt burden is expected to remain sustainable, with all indicators remaining under the policy-dependent thresholds (Tables 1 and 3). The PV of PPG external debt would peak at around 32 percent of GDP this year, before falling to 28 percent in 2017 and remain around that level for the rest of the projection period. As a percentage of exports plus remittances, the PV of public debt is also expected to peak this year at

[4] The previous DSA was completed in November 2011.

100 percent, declining to around 75 percent at the end of the projection period. The PPG debt burden currently stands at 142 percent of government revenues, and is expected to fall to around 120 percent over the next five years and 108 percent at the end of the projection period.

Box I.1. Armenia: Key Macroeconomic Assumptions for Baseline Scenario (2010–30)

Real GDP growth is projected at around its estimated potential of 4.3 percent per year during 2013–16.

Inflation is expected to average just under 3 percent this year, reflecting favorable base effects and positive developments in the agricultural and the energy sectors. Consistent with the target range, inflation over the long term is assumed to be around 4 percent.

The overall fiscal deficit is projected to remain at around 2 percent of GDP over the long term, or the equivalent of around 2.8 – 2.9 percent of GDP after including external lending. Net domestic financing is assumed to cover just under half of the deficit, with external financing covering the balance.

Gross external financing is assumed to average just under 3 percent of GDP over the forecast period, in line with the average in the decade prior to the crisis, and implying net external financing of around 2 percent of GDP after amortization (or 1 percent after amortization and Armenian external lending). No successor Fund program is assumed. New lending terms are projected to harden as Armenia graduates from IFI concessional financing into the non-concessional lending windows over the medium term, and then further harden as Armenia begins to access the commercial bond markets. The DSA assumes that the government gradually begins to access loans on fully commercial terms from 2018 onwards, although official non-concessional financing is expected to make up the bulk of the borrowing until the late 2020s.

The current account deficit is projected to narrow from 14.7 percent of GDP in 2010 to under 9 percent in 2013. Over the long term, the deficit is expected to average around 7 percent of GDP, as consolidation continues and crisis financing unwinds. Exports are projected to grow at around 8 percent per year in dollar terms, reflecting efforts to unlock potential in minerals, agriculture, and IT.

Remittances will continue to play an important role in financing Armenia's trade deficit, but will continue the declining trend as a percentage of GDP they have manifested since the peak in 2004, and are projected to fall gradually from around 7 percent of GDP in the near term to around 4 percent at the end of the projection period.

FDI is expected to average just under 5 percent of GDP. In the near term, FDI is likely to be concentrated in mining. Over the longer term, business climate improvements should yield a more diversified FDI structure.

The PPG debt service ratios also remain sustainable throughout the projection period. The debt service-to-revenue ratio peaks next year at 18 percent, but declines rapidly thereafter. The debt service of PPG external debt in percent of exports and remittances also peaks in 2013 at 12 percent, but will fall to 5 percent by 2017, increasing slowly thereafter but remaining under 10 percent.

The total external debt-to-GDP ratio (public and private) is also expected to decline over the medium term. Unlike most PRGT-eligible countries, private sector external debt in Armenia is larger than the public debt stock. While the debt stock has increased rapidly in recent years, much of it consists of long-term lending to the banking sector from parent banks or official lending, intra-company lending, and long-term loans to other sectors of the economy. It is anticipated that the pace of external private sector borrowing will moderate with the current account consolidation projected over the medium term, and as dedollarization efforts and the development of domestic debt markets reduce the demand for FX loans. Nevertheless, the significant private external debt stock constitutes a source of vulnerability, particularly in light of the limited ability of the CBA to provide emergency liquidity assistance in foreign currency.

Alternative Scenarios and Stress Tests

While Armenia's debt stock remains sustainable under alternative scenarios and bound tests, the results point to debt flows exerting significant pressure in the short term. The PV of PPG debt remains under the relevant thresholds as a percentage of GDP plus remittances, exports plus remittances, and revenues under the standard menu of alternative scenarios and bound tests. The PV debt-to-GDP ratio reaches its highest level, 39 percent, under a scenario that projects a one-time 30 percent nominal depreciation relative to the baseline in 2013. Such a depreciation would see the PPG debt service-to-revenue ratio reaching 26 percent of revenue in 2013, exceeding the 22 percent indicative threshold. However, in view of the fact that Armenia's CPIA rating makes it a very strong performer, and that the threshold is exceeded only for one year and under just one of the bound tests, Armenia should continue to be regarded as being at low risk of external debt distress.

The impact of accelerated IDA repayments in the event of IDA graduation is likely to be relatively muted (Table 3).[5] The acceleration of repayments would increase the PV of debt-to-GDP+remittances by around 1 percent, and the PV of debt-to-exports+remittances by around 4 percent. The PV debt-to-revenue ratio would increase by around 6 percent. The debt service ratios would only be marginally affected, since the principal repayments would continue to be spread out over more than a decade. In all cases under this scenario, the ratios would stay below the relevant thresholds.

In addition to the factors analyzed under the alternative scenarios, remittances are a further source of vulnerability in Armenia. Remittances averaged around 16 percent of GDP over the last five years, with 80–90 percent coming from one country (Russia). Staff projections suggest that a one-off 40 percent fall in private transfers in 2013 would increase the PV of debt-to-exports+remittances by 8 percent, while the debt service-to-exports+remittances ratio would increase from 12 to 13 percent.

[5] The scenario assumes accelerated repayment on the pre-FY07 IDA debt commencing in FY15.

Public Sector DSA

Baseline Scenario

The baseline scenario indicates that Armenia's debt is sustainable (Table 2). The PV of public sector debt would peak this year at 37 percent of GDP and remain broadly stable thereafter. The NPV of debt-to-revenue ratio also peaks this year at 177 percent, before dropping gradually to under 135 percent at the end of the projection period. The indicators for public debt would remain at reasonable levels throughout the projection period, below their indicative thresholds. However, taking into consideration the legal requirement in Armenia to keep public debt lower than 50 percent of the previous year's GDP, the public debt ratios leave limited space in the event of a significant exogenous shock such as that which Armenia experienced in 2009.

Alternative Scenarios and Stress Tests

The standard menu of alternative scenarios and bound tests indicates that Armenia's public debt outlook would be most adversely affected by a permanent fall in the rate of economic growth (Table 4). Under an extreme adverse growth scenario, stress tests indicate that public debt ratios would follow a persistent upward trend through the projection horizon. The most extreme adverse scenario in the medium term is a 30 percent depreciation in 2013, which would push the NPV of debt to 49 percent in 2013, and would remain at this elevated level over the long term. This adverse scenario also worsens Armenia's liquidity situation, implying a debt service-to-revenue ratio of 30 percent in 2013.

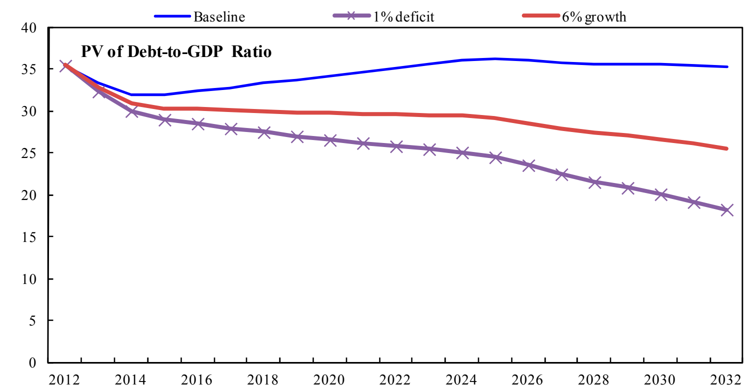
A customized alternative scenario shows the impact of averaging an overall deficit of 3 percent of GDP over the medium and long term rather than 2 percent (Table 4). Under this scenario, the debt would increase throughout the projection period, resulting in an end-2032 PV debt to GDP ratio of 52 rather than 35 percent in the baseline. This result reinforces the importance of maintaining a medium-term overall deficit target of two percent or less of GDP if the debt is to be kept on a stable or declining path.

Conclusion

In the staffs' view, Armenia should be considered at low level of debt distress, based on external debt burden indicators, and even after taking account of the significant private sector debt burden. The public sector DSA suggests that Armenia's overall public sector debt dynamics are sustainable in light of the current size of the debt stock.

Nevertheless, the rapid accumulation of public debt since the onset of the global crisis calls for continuing the pursuit of fiscal consolidation over the medium term. Public external debt was only about 14 percent of GDP at end-2008, but reached 36 percent of GDP at end-2011, and is expected to remain at similar levels over the medium term. While the projected debt-to-GDP levels do not breach the indicative thresholds, the ratios remain at much higher levels than prior to the crisis, pointing to a permanently lower resilience of the Armenian economy to exogenous shocks.

By targeting a deficit of less than 2 percent over the long term, the authorities could rebuild the macroeconomic buffers used during the crisis and increase the resilience of the economy. A one percent deficit, for example would reduce the PV debt-to-GDP ratio by half compared to the baseline scenario by the end of the projection period in 2032. However, this would come at the cost of either compressing expenditures further, or making more strenuous efforts to increase the revenue-to-GDP ratio. Alternatively, if Armenia were able to attain a higher growth trajectory, a two percent deficit target would allow for an increase in fiscal space and a more rapid increase in buffers. If real GDP growth were to average 6 percent rather than the 4–4½ percent assumed in the baseline, the PV debt-to-GDP ratio would fall steadily from over 35 percent of GDP in 2012 to 28 percent at the end of the projection period, instead of remaining broadly constant as under the baseline.



The authorities agreed with the broad thrust of the DSA. However, they stressed that the 4.3 percent long-term growth rate was conservative. In their view, the economy's growth potential is somewhat higher. Secondly, they emphasized that when viewed from a net rather than gross perspective, their debt situation is more favorable: the total outstanding stock of loans by public sector agencies to the domestic economy is AMD 379 billion, equivalent to $913 million, or about 10 percent of GDP. Assuming that these amounts are to be repaid as scheduled, the public debt burden could be reduced by around one-quarter.

Table 1. External Debt Sustainability Framework, Baseline Scenario, 2009-2032 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-2017 Average	2022	2032	2018-2032 Average
External debt (nominal) 1/	**57.8**	**65.4**	**72.8**			**77.7**	**76.0**	**78.0**	**77.3**	**76.1**	**72.8**		**62.2**	**47.9**	
o/w public and publicly guaranteed (PPG)	35.7	34.7	36.4			39.5	37.6	38.9	37.6	37.1	35.0		32.2	29.1	
Change in external debt	28.2	7.6	7.4			4.9	-1.7	2.0	-0.7	-1.3	-3.2		-2.2	-1.7	
Identified net debt-creating flows	17.7	5.0	0.8			2.9	2.9	0.5	-1.2	-1.5	-1.6		-0.2	-2.2	
Non-interest current account deficit	**14.5**	**13.2**	**9.0**	**6.6**	**5.5**	**8.1**	**7.2**	**5.4**	**4.1**	**3.9**	**3.8**		**4.1**	**0.6**	3.2
Deficit in balance of goods and services	27.1	24.6	23.6			23.4	22.9	21.4	20.6	20.2	19.7		17.1	9.9	
Exports	15.4	20.9	23.7			25.3	26.6	28.2	29.5	29.8	29.9		30.6	34.2	
Imports	42.6	45.5	47.3			48.7	49.5	49.6	50.1	49.9	49.6		47.7	44.2	
Net current transfers (negative = inflow)	-9.4	-6.1	-7.1	-9.1	1.9	-6.8	-7.0	-6.8	-7.1	-7.0	-6.8		-5.4	-3.5	-4.8
o/w official	-0.9	-0.9	-1.6			-0.6	-0.6	-0.3	-0.2	-0.1	0.0		0.0	0.0	
Other current account flows (negative = net inflow)	-3.2	-5.3	-7.5			-8.4	-8.6	-9.2	-9.4	-9.2	-9.1		-7.5	-5.9	
Net FDI (negative = inflow)	**-8.4**	**-6.1**	**-4.4**	**-6.2**	**1.6**	**-3.1**	**-3.4**	**-4.3**	**-4.6**	**-4.8**	**-4.9**		**-4.2**	**-3.4**	-4.0
Endogenous debt dynamics 2/	**11.6**	**-2.2**	**-3.7**			**-2.1**	**-0.9**	**-0.6**	**-0.7**	**-0.6**	**-0.6**		**-0.1**	**0.5**	
Contribution from nominal interest rate	1.3	1.7	1.9			2.3	2.4	2.4	2.5	2.5	2.5		2.5	2.5	
Contribution from real GDP growth	5.6	-1.2	-2.8			-4.4	-3.3	-3.0	-3.3	-3.1	-3.0		-2.6	-2.0	
Contribution from price and exchange rate changes	4.7	-2.6	-2.9			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**10.5**	**2.6**	**6.6**			**2.0**	**-4.6**	**1.5**	**0.5**	**0.2**	**-1.6**		**-2.0**	**0.5**	
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/	...	...	65.5			69.8	68.2	69.9	69.7	68.7	66.0		58.3	47.1	
In percent of exports	...	...	275.8			275.7	256.1	248.1	236.4	230.8	221.0		190.7	137.8	
PV of PPG external debt	**...**	**...**	**29.1**			**31.7**	**29.7**	**30.7**	**30.0**	**29.7**	**28.2**		**28.3**	**28.4**	
In percent of exports	**...**	**...**	**122.7**			**125.1**	**111.7**	**109.2**	**101.7**	**99.8**	**94.4**		**92.6**	**83.0**	
In percent of government revenues	**...**	**...**	**141.7**			**151.3**	**136.2**	**138.8**	**132.8**	**130.0**	**121.4**		**115.2**	**108.1**	
Debt service-to-exports ratio (in percent)	**22.3**	**21.6**	**22.1**			**27.5**	**32.1**	**26.2**	**21.9**	**21.8**	**21.7**		**18.8**	**15.2**	
PPG debt service-to-exports ratio (in percent)	**5.4**	**4.7**	**4.2**			**9.8**	**15.1**	**9.7**	**5.8**	**6.0**	**6.5**		**6.8**	**8.4**	
PPG debt service-to-revenue ratio (in percent)	**4.1**	**5.0**	**4.9**			**11.8**	**18.4**	**12.3**	**7.6**	**7.9**	**8.3**		**8.5**	**10.9**	
Total gross financing need (millions of U.S. dollars)	1319	1580	1614			2087	2271	1959	1792	1893	2010		2781	3463	
Non-interest current account deficit that stabilizes debt ratio	-13.7	5.6	1.6			3.2	8.9	3.4	4.8	5.2	7.0		6.3	2.3	
Key macroeconomic assumptions															
Real GDP growth (in percent)	-14.1	2.2	4.7	8.0	9.0	6.2	4.3	4.1	4.3	4.3	4.3	4.6	4.3	4.3	4.3
GDP deflator in US dollar terms (change in percent)	-13.6	4.8	4.6	9.3	12.1	-5.1	-1.5	-1.5	-1.3	2.0	2.9	-0.7	3.0	3.0	3.1
Effective interest rate (percent) 5/	3.3	3.1	3.2	2.7	1.5	3.2	3.2	3.2	3.4	3.4	3.5	3.3	4.1	5.4	4.6
Growth of exports of G&S (US dollar terms, in percent)	-24.0	45.0	24.3	17.8	19.7	7.5	7.9	8.6	7.7	7.4	7.8	7.8	8.3	9.1	8.5
Growth of imports of G&S (US dollar terms, in percent)	-22.4	14.4	13.9	18.6	17.3	3.7	4.4	2.9	3.9	6.1	6.6	4.6	6.7	5.3	6.7
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	22.5	27.9	24.7	23.7	23.2	23.1	24.2	-0.8	-11.9	-4.4
Government revenues (excluding grants, in percent of GDP)	20.2	19.7	20.6			20.9	21.8	22.2	22.6	22.9	23.2		24.6	26.3	25.2
Aid flows (in millions of US dollars) 7/	965	333	336			338	460	333	301	334	333		618	1071	
o/w Grants	58.3	114.1	156.2			37.4	38.2	27.1	25.9	25.5	20.2		16.7	11.2	
o/w Concessional loans	907	219	180			300	421	306	275	309	312		602	1059	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.4	1.6	0.9	0.8	0.8	0.7		0.1	-0.4	-0.1
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			28.5	33.5	31.1	30.3	29.1	27.7		1.9	-10.9	-2.1
Memorandum items:															
Nominal GDP (millions of US dollars)	8648	9260	10138			10216	10497	10767	11084	11789	12659		18275	37418	
Nominal dollar GDP growth	-25.8	7.1	9.5			0.8	2.8	2.6	2.9	6.4	7.4	3.8	7.4	7.4	7.5
PV of PPG external debt (in millions of US dollars)			2852			3071	3106	3158	3304	3454	3584		5147	10573	
(PVt-PVt-1)/GDPt-1 (in percent)						2.2	0.3	0.5	1.4	1.3	1.1	1.1	2.4	2.0	2.1
Gross workers' remittances (millions of US dollars)	733.2	477.1	562.7			635.9	667.7	707.7	757.3	810.3	858.9		995.7	1293.3	
PV of PPG external debt (in percent of GDP + remittances)	...	...	27.6			29.8	27.9	28.9	28.1	27.8	26.4		26.8	27.4	
PV of PPG external debt (in percent of exports + remittances)	...	...	99.5			100.4	90.2	88.5	82.5	81.1	76.9		78.6	75.4	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	3.4			7.8	12.2	7.9	4.7	4.9	5.3		5.8	7.6	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = 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 2.Armenia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2009-2032

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2009	2010	2011	Average 5/	Standard Deviation 5/	2012	2013	2014	2015	2016	2017	2012-17 Average	2022	2032	2018-32 Average
Public sector debt 1/	40.2	39.6	41.8			44.9	43.5	45.1	44.0	44.2	43.1		40.9	35.8	
o/w foreign-currency denominated	35.7	34.7	36.4			39.5	37.6	38.9	37.6	37.1	35.0		32.2	29.1	
Change in public sector debt	24.0	-0.5	2.2			3.1	-1.4	1.6	-1.0	0.2	-1.1		-0.2	-0.4	
Identified debt-creating flows	13.5	0.6	1.5			2.0	-0.7	2.5	-1.1	-0.4	-1.7		-0.9	-0.5	
Primary deficit	7.1	4.7	1.8	2.3	2.0	0.9	1.3	1.0	0.7	0.6	0.7	0.9	0.5	0.4	0.5
Revenue and grants	20.9	20.9	22.1			21.3	22.2	22.4	22.8	23.1	23.4		24.7	26.3	
of which: grants	0.7	1.2	1.5			0.4	0.4	0.3	0.2	0.2	0.2		0.1	0.0	
Primary (noninterest) expenditure	28.0	25.6	23.9			22.2	23.5	23.4	23.5	23.7	24.0		25.2	26.7	
Automatic debt dynamics	6.4	-4.0	-0.3			1.1	-2.0	1.6	-1.9	-1.1	-2.3		-1.4	-0.9	
Contribution from interest rate/growth differential	2.7	-0.8	-1.6			-2.5	-1.9	-1.7	-1.9	-1.8	-1.7		-1.4	-0.9	
of which: contribution from average real interest rate	0.1	0.1	0.2			-0.1	0.0	0.0	0.0	0.0	0.1		0.3	0.6	
of which: contribution from real GDP growth	2.7	-0.9	-1.8			-2.4	-1.9	-1.7	-1.9	-1.8	-1.8		-1.7	-1.5	
Contribution from real exchange rate depreciation	3.6	-3.3	1.2			3.5	-0.1	3.2	0.0	0.7	-0.6		...	...	
Other identified debt-creating flows	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)	0.0	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	
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	
Other (specify, e.g. bank recapitalization)	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	10.6	-1.2	0.7			1.1	-0.7	-1.0	0.1	0.6	0.6		0.7	0.1	
Other Sustainability Indicators															
PV of public sector debt	...	...	34.5			37.0	35.6	36.9	36.4	36.8	36.3		37.0	35.1	
o/w foreign-currency denominated	...	...	29.1			31.7	29.7	30.7	30.0	29.7	28.2		28.3	28.4	
o/w external	...	...	29.1			31.7	29.7	30.7	30.0	29.7	28.2		28.3	28.4	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	11.2	10.0	5.5			6.6	8.8	7.4	6.2	6.4	6.9		7.1	6.5	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	156.1			173.9	160.5	164.8	159.6	159.6	155.1		150.1	133.4	
PV of public sector debt-to-revenue ratio (in percent)	…	…	167.8			176.9	163.2	166.7	161.3	161.1	156.2		150.7	133.6	
o/w external 3/	…	…	141.7			151.3	136.2	138.8	132.8	130.0	121.4		115.2	108.1	
Debt service-to-revenue and grants ratio (in percent) 4/	15.2	19.6	10.6			19.2	26.4	20.8	15.8	16.7	17.8		16.1	15.5	
Debt service-to-revenue ratio (in percent) 4/	15.7	20.8	11.4			19.5	26.9	21.1	15.9	16.8	18.0		16.2	15.5	
Primary deficit that stabilizes the debt-to-GDP ratio	-16.9	5.2	-0.4			-2.1	2.7	-0.6	1.8	0.4	1.8		0.7	0.8	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	-14.1	2.2	4.7	8.0	9.0	6.2	4.3	4.1	4.3	4.3	4.3	4.6	4.3	4.3	4.3
Average nominal interest rate on forex debt (in percent)	1.7	1.5	1.5	0.9	0.6	1.9	1.8	1.7	1.7	1.7	1.7	1.7	2.8	5.0	3.5
Average real interest rate on domestic debt (in percent)	6.9	3.3	7.1	5.6	1.6	5.8	8.6	8.9	7.5	8.4	8.2	7.9	4.1	0.7	3.0
Real exchange rate depreciation (in percent, + indicates depreciation)	23.2	-9.3	3.8	-4.8	13.2	10.4	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.6	7.8	4.2	4.4	2.0	4.0	4.3	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	-0.1	0.0	0.1	0.1	0.0	0.1	0.0	0.1	0.1	0.1	0.0	0.1	0.0	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	22.5	27.9	24.7	23.7	23.2	23.1	24.2	-0.8	-11.9	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

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 3.Armenia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012-2032
(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	**2022**	2032
PV of debt-to-GDP+remittances ratio								
Baseline	30	28	29	28	28	26	**27**	27
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	30	21	18	16	16	15	**13**	13
A2. New public sector loans on less favorable terms in 2012-2032 2	30	29	29	30	30	29	**32**	39
A3. Alternative Scenario: IDA Graduation	31	29	30	29	28	27	26	27
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	30	29	30	31	30	29	**29**	30
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	30	30	35	35	34	33	**32**	29
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	30	28	28	28	28	27	**27**	28
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	30	26	25	26	25	25	**25**	27
B5. Combination of B1-B4 using one-half standard deviation shocks	30	23	19	20	19	19	**20**	24
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	30	39	38	39	38	37	**37**	39
PV of debt-to-exports+remittances ratio								
Baseline	100	90	89	83	81	77	**79**	75
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	100	68	56	50	49	47	**39**	39
A2. New public sector loans on less favorable terms in 2012-2032 2	100	93	89	88	87	86	**94**	107
A3. Alternative Scenario: IDA Graduation	104	93	92	85	83	78	77	75
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	100	90	84	82	80	77	**78**	75
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	100	105	124	120	117	113	**109**	94
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	100	90	84	82	80	77	**78**	75
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	100	85	77	76	74	71	**74**	74
B5. Combination of B1-B4 using one-half standard deviation shocks	100	76	61	63	61	59	**65**	72
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	100	90	84	82	80	77	**78**	75
PV of debt-to-revenue ratio								
Baseline	151	136	139	133	130	121	**115**	108
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	151	101	83	75	72	68	**52**	51
A2. New public sector loans on less favorable terms in 2012-2032 2	151	141	140	142	140	136	**138**	154
A3. Alternative Scenario: IDA Graduation	157	141	144	137	133	123	112	108
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	151	142	146	146	141	134	**126**	119
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	151	146	166	165	160	152	**136**	113
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	151	137	136	135	131	125	**117**	110
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	151	129	123	122	119	113	**108**	106
B5. Combination of B1-B4 using one-half standard deviation shocks	151	114	92	91	89	84	**86**	94
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	151	194	190	189	183	174	**164**	154

Table 3.Armenia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012-2032 (continued)
(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
Debt service-to-exports+remittances ratio								
Baseline	8	12	8	5	5	5	**6**	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	8	11	6	3	3	3	**2**	2
A2. New public sector loans on less favorable terms in 2012-2032 2	8	12	8	5	5	6	**6**	9
A3. Alternative Scenario: IDA Graduation	8	12	8	5	5	6	6	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	8	12	8	5	5	5	**6**	8
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	8	13	9	6	7	7	**9**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	8	12	8	5	5	5	**6**	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	8	12	8	4	5	5	**5**	7
B5. Combination of B1-B4 using one-half standard deviation shocks	8	12	7	4	4	5	**4**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	8	12	8	5	5	5	**6**	8
Debt service-to-revenue ratio								
Baseline	12	18	12	8	8	8	**8**	11
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	12	16	9	4	4	4	**3**	3
A2. New public sector loans on less favorable terms in 2012-2032 2	12	18	12	8	8	9	**9**	14
A3. Alternative Scenario: IDA Graduation	12	18	13	8	9	9	9	11
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	12	19	14	8	9	9	**9**	12
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	12	18	13	9	9	10	**11**	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	12	18	13	8	8	9	**9**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	12	18	12	7	8	8	**8**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	12	17	11	6	6	7	**6**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	12	26	18	11	12	12	**12**	16
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	-1	-1	-1	-1	-1	-1	**-1**	-1

Sources: Country authorities; and staff estimates and projections.

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.

Table 4. Armenia: Sensitivity Analysis for Key Indicators of Public Debt 2012-2032

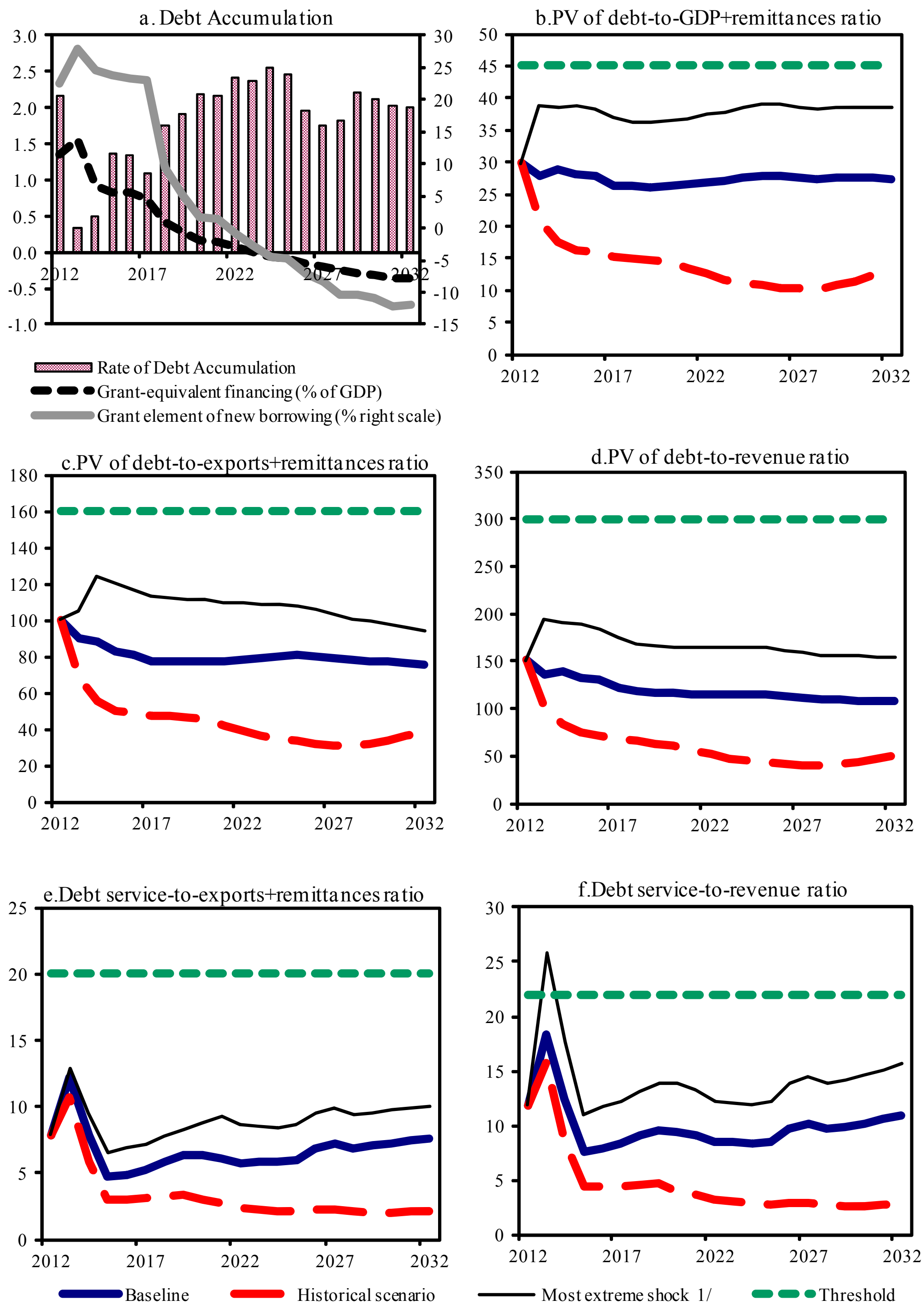
	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
PV of Debt-to-GDP Ratio								
Baseline	37	36	37	36	37	36	37	35
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	37	35	37	37	38	37	40	41
A2. Primary balance is unchanged from 2012	37	35	36	36	37	37	39	41
A3. Permanently lower GDP growth 1/	37	37	40	41	44	47	71	161
A4. Three percent deficit	37	37	39	39	41	41	46	52
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	37	39	45	46	49	51	62	79
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	37	39	43	43	43	42	42	39
B3. Combination of B1-B2 using one half standard deviation shocks	37	38	42	42	42	42	43	43
B4. One-time 30 percent real depreciation in 2013	37	49	51	49	50	48	49	49
B5. 10 percent of GDP increase in other debt-creating flows in 2013	37	46	48	47	47	46	45	41
PV of Debt-to-Revenue Ratio 2/								
Baseline	174	160	165	160	160	155	150	133
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	174	160	165	161	163	160	161	155
A2. Primary balance is unchanged from 2012	174	159	163	158	160	156	158	157
A3. Permanently lower GDP growth 1/	174	165	177	180	191	199	287	611
A4. Three percent deficit	174	165	174	173	177	176	187	196
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	174	174	199	203	213	217	253	301
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	174	174	194	188	187	181	171	148
B3. Combination of B1-B2 using one half standard deviation shocks	174	171	187	182	183	179	176	163
B4. One-time 30 percent real depreciation in 2013	174	219	225	217	215	206	197	188
B5. 10 percent of GDP increase in other debt-creating flows in 2013	174	206	212	205	204	197	184	157
Debt Service-to-Revenue Ratio 2/								
Baseline	19	26	21	16	17	18	16	16
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	19	26	20	15	16	17	15	14
A2. Primary balance is unchanged from 2012	19	26	21	16	17	18	17	17
A3. Permanently lower GDP growth 1/	19	27	22	17	19	21	25	50
A4. Three percent deficit	19	26	21	17	18	20	21	25
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	19	28	23	19	21	22	23	29
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	19	26	21	18	19	19	18	17
B3. Combination of B1-B2 using one half standard deviation shocks	19	27	22	18	19	19	18	18
B4. One-time 30 percent real depreciation in 2013	19	30	26	20	21	22	22	25
B5. 10 percent of GDP increase in other debt-creating flows in 2013	19	26	23	21	19	20	19	18

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

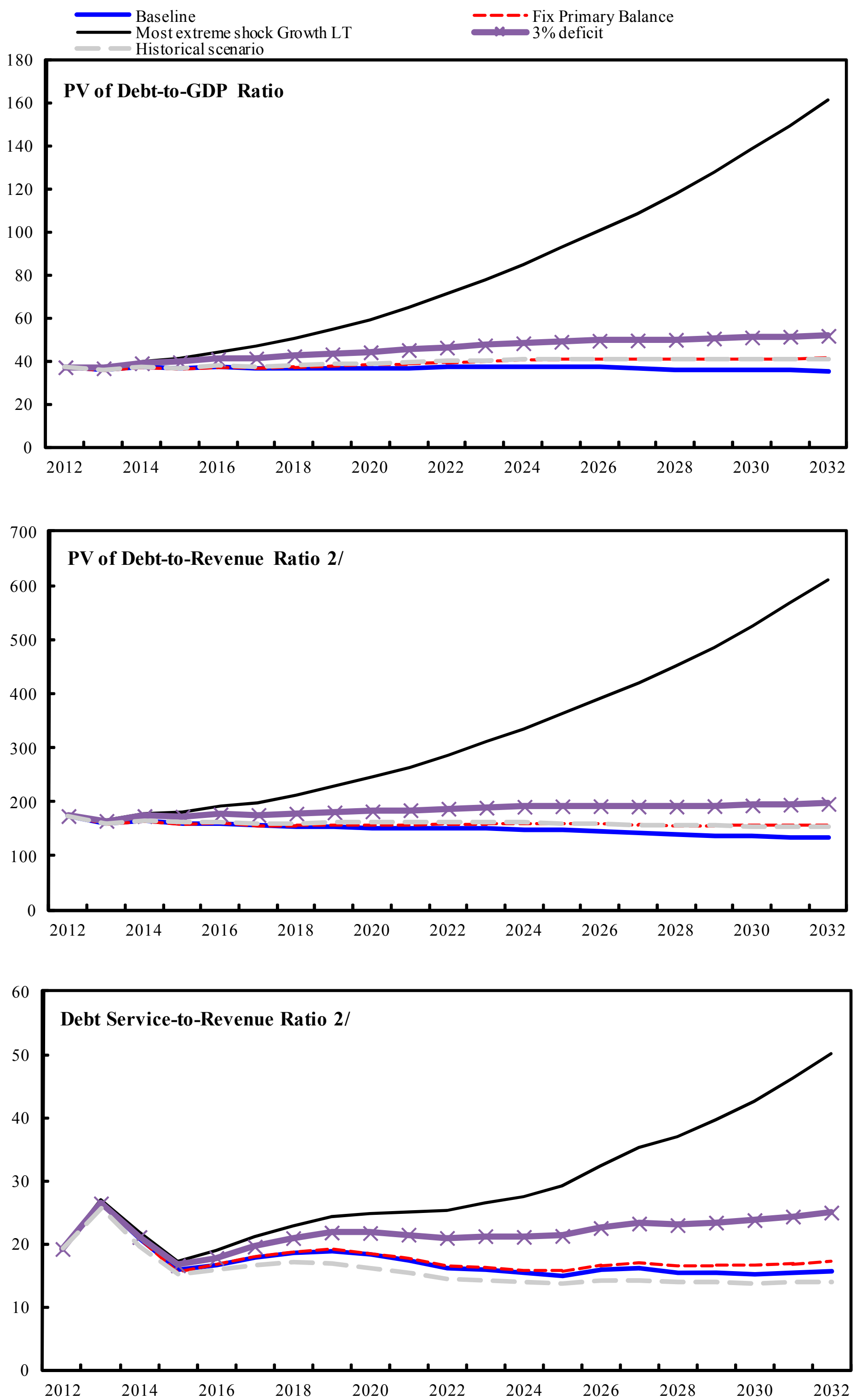
Figure 1. Armenia: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2012-2032 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2.Armenia: Indicators of Public Debt Under Alternative Scenarios, 2012-2032 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022.

2/ Revenues are defined inclusive of grants.

APPENDIX I. LETTER OF INTENT FOR THE FIFTH REVIEWS UNDER THE EXTENDED FUND AND EXTENDED CREDIT FACILITIES

Yerevan, November 20, 2012

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

Dear Madam Lagarde:

1. **Armenia's economic performance has strengthened in 2012.** Growth has accelerated to over 6 percent, with particularly strong performance in agriculture, agro-processing, mining, and services. Construction is showing signs of recovery. Credit has continued to expand at a healthy pace. The financial sector remains strong and well capitalized, and inflation is subdued with low agricultural prices, benign global price developments, and supportive policies. Fiscal consolidation in 2012 will be stronger than expected, reflecting efficiency gains, spending restraint, and delays in large capital projects. Despite a fall in metals prices, export volumes grew rapidly, and the external current account consolidation continues, albeit at a somewhat slower pace than expected. In addition, while significant spillovers from the euro area have not materialized, there have been weaknesses in some financial flows, particularly FDI and banking sector inflows.

2. **In 2013, further deterioration in Europe and in the global environment are downside risks.** We expect growth to moderate. Inflation should remain within the target range (4 ± 1.5 percent). Over the medium-term, we are committed to strengthen buffers and reduce vulnerabilities through continued fiscal and external consolidation. Structural reforms to improve the business environment and competitiveness will support private investment growth and boost productivity. These reforms and prudent macroeconomic management should support growth over the medium-term, as financial flows recover.

3. **Our program, supported by Extended Fund and Extended Credit (EFF/ECF) arrangements, remains broadly on track**. All but one continuous and quantitative performance criteria (PC) and most indicative targets (IT) for end-June 2012 [and September 2012] were met. The end-June PC and end-September IT on net international reserves (NIR) of the Central Bank of Armenia (CBA) was missed, however, due to unexpected pressures in the foreign exchange market. All structural benchmarks were observed or are on track with brief delays possible. This letter of intent (LOI) describes policies for the remainder of 2012 and the first half of 2013. These continue to aim at containing pressures, limiting disruptions to the recovery, enhancing growth and poverty reduction, strengthening fiscal and debt sustainability, and further developing a sound financial system. We anticipate policy continuity following presidential elections in February.

I. THE PROGRAM FOR 2012–13

A. Fiscal Policy and Debt Sustainability

4. **We have continued our strict fiscal management.** We expect the deficit for 2012 to be around 2 percent of GDP, 1 percentage point lower than budgeted. Revenue is on track to achieve the envisaged 0.6 percent of GDP gain over 2011. Expenditure will be lower, most notably by delayed implementation of a few large, externally-financed capital projects. The 2013 budget will aim at a headline deficit of 2.6 percent of GDP with a further 0.9 percentage point increase in the tax-to-GDP ratio. The headline deficit is in line with our 2013–15 medium-term framework, which aims to reach the debt stabilizing deficit level by 2015. In recent years, including in connection with mitigating the effects of the crisis, the government and CBA have undertaken extensive lending operations (e.g., energy, mining, SMEs). As repayments to external lenders commence soon, we will closely monitor borrowers to ensure timely debt service.

5. **We are continuing our efforts to improve tax policy and revenue administration to support higher revenues.** We are on track to submit legislative proposals to adopt OECD guidelines for transfer pricing regulation (Structural Benchmark, November 2012), with support from the IFC. Implementation will depend on preparation and issuance of guidelines and regulations, which we expect will take place during the course of 2013. We will propose a range of tax policy measures to support the envisaged revenue increase in 2013, including removal of personal income tax exemptions for all occupations, including the military and the police (0.7 percent of GDP), and an additional 0.2 percent of GDP from introduction of a turnover tax for small businesses and expansion of the range of application of the patent law. The revenue gains will also reflect scheduled increases in tobacco taxes, as well as further improvements in revenue administration. We will begin to receive the new mining royalty, based on 2012 results. Key tax administration reform efforts planned for 2013, including launching an electronic system for individual accounting and recording under the new unified personal income tax, which will bring together the income tax with social security contributions. The reforms are far-reaching, complex, and critical to the launch of the new pension system. The work is being undertaken on an ambitious time schedule and will be supported by World Bank financing and USAID TA on strategic planning, revenue analysis, internal control processes, and IT infrastructure.

6. **We are augmenting growth-enhancing expenditures and strengthening social protection.** After delays in 2011–12, we have now launched the major North-South highway project and will accelerate implementation of urban infrastructure projects. We will also begin to reverse the erosion in education spending. We have made progress in our efforts to integrate the wide range of social services to improve efficiency and service quality. We adopted a list and timetable of legal amendments needed for integration in July (Structural benchmark, October 2012) and have begun a pilot program to test and refine the functioning of one-stop service centers. We will integrate the results of the pilot and submit the legal changes to parliament in the second half of 2013.

7. **We are on track in our preparation for pension reforms.** Preparation of government decrees and regulations and legislative changes has proceeded as planned, and an on-line system of individual accounts will be launched and managed by NASDAQ-OMX Armenia to running in parallel with the unified income tax IT system. Two key decrees are to be submitted to Cabinet by end-December 2012. These would establish procedures for managing the guarantee fund for mandatory, funded contributions and quantitative and currency restrictions on investing mandatory funded pension assets in financial instruments (New structural benchmark, December 2012). We have stepped up our awareness campaign with involvement of high-ranking officials and expanded access to the Internet, in light of the integration of personal income tax and social contributions that will start in 2013. We are also making progress toward producing updated estimates of the fiscal costs of the reform (including the contingency costs of state guarantees), with the first set of comprehensive estimates to be completed by year end (Structural benchmark, December 2012).

B. Monetary and Exchange Rate Policy

8. **Monetary policy will continue to aim at maintaining price stability**. Activity has expanded faster than expected, but this has reflected largely supply side developments (agriculture, mining), and inflation has remained subdued. We have kept the policy rate steady at 8 percent since September 2011. Under the baseline scenario, the output gap is expected to close gradually while growth moderates, and headline inflation is likely to stay in the target range over the policy-relevant horizon. Thus, further interest rate policy action is unlikely to be needed. We will, however, remain vigilant to both upside and downside risks and stand ready to adjust policies using the full range of tools.

9. **Balance of payments pressures caused us to miss the end-June reserves target.** To mitigate market pressures, we sold reserves in May and June to contain what we perceived as temporary turbulence. Over the course of the summer, however, it became clear that the pressures reflected more persistent, weaker-than-expected external flows, and we were unable to rebuild NIR as planned. We therefore request an adjustment of the end-December NIR target, supported by corrective actions that we are taking. Since the start of the year we have allowed the dram to adjust by 5 percent in real terms. We have strictly limited foreign exchange sales, and will confine our interventions to smoothing unusually large movements, while maintaining a strong NIR buffer against shocks. We will continue to communicate frequently with the markets and the public on developments. More broadly, we are confident that continued structural reforms, fiscal consolidation, and a flexible exchange rate will support the continued reduction of the external current account deficit. In support of these efforts, we have updated our reserve management guidelines in consultation with the Fund staff.

10. **We will further improve our inflation-targeting framework.** We are improving our policy framework by making organizational changes and enhancing our capacity for model building and forecasting with support from IMF TA. Two key recommendations under implementation are: augmenting the current survey of private forecasters by requiring banks to regularly submit macroeconomic forecasts (output, inflation, interest and exchange rates,

external current account) to the CBA; and devising a communications strategy on the monetary policy framework, covering the objectives and operations of exchange rate and inflation-forecast-targeting policies (by end-2012).

11. **We are also strengthening monetary operations to increase the relevance of the policy rate to market rates**. We are closely communicating with market participants and providing enhanced information on liquidity conditions. We will continue to conduct timely and sufficient fine-tuning operations aiming to further reduce the volatility of interbank rates. To reinforce this aim, we have narrowed the width of the interest rate corridor around the policy rate from 600 to 400 basis points. We will further reduce the corridor to 300 basis points by end-2012. For the enhancement of the monetary transmission mechanism, we are also supporting efforts of NASDAQ-OMX Armenia to develop a term interbank trading platform, which is expected to start during the fourth quarter of 2012 and to introduce longer-term money market instruments.

C. Financial Sector Stability and Development

12. **We will continue to safeguard the stability of the banking system, especially in light of rapid growth of loan portfolios.** In line with the program's structural benchmarks and FSAP recommendations, we have introduced a new prudential norm for bank foreign currency liquidity ratios, which will become effective in January 2013 and increase gradually thereafter. In addition, we issued a regulation requiring banks to initiate transmission to the CBA of information on potential currency mismatches of large borrowers. We will consider standardizing reporting of this information, and use it to assess risks and tailor our stress-testing guidance to the banks. We will continue efforts to reduce the high levels of dollarization of the banking system, primarily by fostering a stable macroeconomic environment anchored on our inflation targeting framework. In light of continued strong growth of FX deposits and lending, we are assessing possible policy actions, including expanding the differential between reserve requirements for foreign currency liabilities and dram liabilities. Finally, in line with FSAP recommendations and in light of changes to the system of property registration in 2012, the government and CBA will assess whether further changes are needed to streamline the execution of collateral.

13. **We are strengthening our regulatory and supervisory framework in line with FSAP recommendations.** We will continue our effort to integrate the use of Basel II Pillar II powers in the supervisory toolkit to mitigate individual, institution-specific risks, including application of additional capital and other prudential requirements in case banks are not following appropriate risk-management practices. From this perspective, we will further strengthen our structured dialogue with bank boards or senior management on their capital adequacy assessments. We will amend and issue new regulations to require banks to immediately report changes to operations that have a material adverse impact on the bank by end-2012 (New structural benchmark, December 2012). Also in line with FSAP recommendations, we are reviewing the calculation of large exposures to determine whether changes are needed to bring treatment fully in line with international good practice. Finally, we will take further steps to clarify the division of

responsibilities between the CBA and the government in crisis management, including setting out in CBA rules that the Finance Ministry and the Deposit Guarantee Fund should participate in the Financial Stability Committee when financial institutions become insolvent and state budget allocation and deposit payouts are needed.

D. Structural Reforms

14. **We continue to pursue a structural reform agenda aimed at improving the business environment**. We are implementing a government action plan comprising more than 50 measures to improve the business environment in 2012. Key milestones include approval of legal changes to streamline customs operations and electronic systems for notary services and construction permits. We expect to adopt a similar action plan for 2013 by end-December 2012. We have also initiated full operation of the Regulatory Guillotine program, with preparation in 2012 of comprehensive legislative packages to significantly streamline regulation and red-tape in three areas—transportation, utilities, and healthcare—from a total of 17 areas. These will be submitted to parliament by end-year (Structural benchmark—one area). Further guillotine reforms areas will be initiated in the first half of 2013, possibly covering education and tax and customs (New structural benchmark—one area, March 2013). Reform of inspection and safety agencies is another key area, with a focus on merging and rationalizing functions, limiting administrative influence, and risk-based approaches.

15. **The State Committee for the Protection of Economic Competition (SCPEC) has continued to step up enforcement efforts against abuse of market dominance**. Armenia's ranking in the 2013 World Economic Forum competitiveness index improved significantly owing to improvements in competition policies and SCPEC actions. These actions have focused on the fuel sector and pharmaceuticals. Further legal changes to strengthen the definition and assessment of anticompetitive practices, increase fines, and introduce sanctions were returned by the Cabinet and are now expected to be proposed to parliament by end-December rather than end-October (Structural benchmark). In 2013, the SCPEC will focus on new actions within public procurement, state aid, and agro-processing.

16. **We continue to explore options for Nairit that strictly minimize government exposure and use of public funds.** We are assessing a new feasibility study commissioned by a potential investor from the region and covering the state of Nairit's plant and equipment, the market for its products, possible modernization plans (including environmental impacts), and other options (including closure). We would only assume liabilities (including guarantees) in consultation with the Fund and the World Bank, and we expect no participation in the company in the future. In the event that we are unable to find a relevant private-party solution, we look forward to IFI assistance in handling Nairit's wide range of concerns (including workforce, environmental clean-up, and safety issues).

E. Successor Program

17. **We intend to seek a successor arrangement with the IMF, after the current program concludes in mid-2013**. The new program would provide significant policy support to the continuing external and fiscal adjustment throughout a period of elevated repayment of crisis-related assistance. Key objectives would be to further establish policy buffers, especially strong CBA reserves supported by a flexible exchange rate–as a result of an improved policy framework and further development of the policy toolkit—and higher tax revenues to create fiscal space for growth-enhancing and poverty reducing outlays, while helping further reduce the fiscal deficit and public debt. Continued structural reforms would target sustained and accelerated growth by supporting further financial sector development, business environment improvements, and competitiveness.

F. Conclusion

18. **In support of its policies, we request that the IMF Executive Board complete the Fifth Reviews of the EFF/ECF-supported program and approve the associated disbursements.** We also request that the Board grant a waiver of nonobservance of the PC on NIR at end-June 2012 and modification of the end-December PCs on NIR of the CBA and of the end-December indicative target on reserve money. Finally, we request that SDR 33.5 million be made available upon completion of the reviews.

19. **We will maintain a close policy dialogue with the Fund and stand ready to take additional measures, as appropriate, to ensure the achievement of our social and economic objectives under the EFF/ECF program.** We will continue to consult with the Fund on the adoption of measures, and in advance of revisions of the policies contained in the LOI, in accordance with the Fund's policies on such consultation. We will also provide the Fund with information it requests for monitoring program implementation. The program's quantitative PCs and ITs, as described in the attached Technical Memorandum of Understanding, and structural benchmarks are set out in Tables 1 and 2. The Sixth Review is expected to be completed on or after March 30, 2013.

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

Very truly yours,

/S/
Tigran Sargsyan
Prime Minister
Republic of Armenia

/S/
Vache Gabrielyan
Minister of Finance
Republic of Armenia

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

Table 1. Armenia: Quantitative Targets for 2011–13 [1/]

(in billion drams, at program exchange rates, unless otherwise specified)

	2011	2012													2013	
	Dec.	Mar. 2/			Jun.			Sep. 2/			Dec.				Mar. 2/	Jun. 2/
	Act.	3rd. Review	Adj. Prog.	Act.	3rd. Review	Adj. Prog.	Act.	4th Review	Adj. Prog.	Proj.	4th Review	Adj. 4th Review.	Proj.	New Target.	Prog.	Proj.
Performance Criteria																
Net official international reserves (floor, in millions of U.S. dollars)	794	785	782	810	802	828	778	812	842	810	764	821	771	761	710	712
Net domestic assets of the CBA (ceiling)	201	187	195	152	186	189	163	197	202	195	248	252	244	252	248	288
Program fiscal balance (floor) 3/	-187	-22	-27	-13	-37	-37	-34	-64	[…]	[…]	-167	-167	-111	-167	-30	-53
External public debt arrears (continuous criterion)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Indicative Targets																
Reserve money (ceiling)	671	578	583	554	594	599	564	614	619	604	658	663	623	651	629	660
Average concessionality of newly contracted debt (floor, in percent) 4/	34										30		30	30		
Social spending of the government (floor) 5/	36	8	8	8	15	15	15	28	28	[…]	37	37	37	37	8	16
Memorandum items:																
Budget support grants	28	33	28	28	39	28	28	39	[…]	28	43	37	37	37	37	37
o.w. EU MFA grant	19	19	19	19	19	19	19	19	[…]	19	19	19	19	19	19	19
Budget support loans	46	67	67	67	93	108	108	93	[…]	108	100	114	114	114	114	142
o.w. non-IMF loans	24	45	45	45	62	76	76	62	[…]	76	62	76	76	76	76	104
Project financing	44	23	23	4	46	12	12	70	[…]	38	93	64	64	64	34	67
KFW and IBRD loan disbursements	11	10	14	14	11	14	17	11	[…]	19	12	25	25	25	25	25

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU.

2/ Indicative target.

3/ Below-the-line overall balance excluding net lending and project financing until March 2011. Below-the-line overall balance excluding net lending from June 2011.

4/ Assessed on a calendar year basis.

5/ Defined as 100 percent of the budgeted amount of the family benefit program and lump-sum financial aid.

Table 2. Armenia: Structural Benchmarks Under the EFF/ECF Arrangement

Item	Measure	Time Frame (End of Period)	Outcome	Comment /Status
Tax administration				
1	Issue a government decree stipulating that clarifications and interpretations of laws, regulations, and procedures on taxes, duties, and mandatory fees should be approved by the Ministry of Finance. These clarifications and interpretations will become normative acts to be published and applied consistently across all taxpayers effective September 1, 2010.	July 2010	Met	
2	Set up a Tax Appeals Council under the Government to deal with legal and procedural disputes of taxpayers.	September 2010	Met with delay	
3	Develop manuals in tourism, real estate, transport, and sectors using cash register machines for tax audits for usage starting January 2011.	December 2010	Met	
4	Simplify the reporting system by reducing the frequency of reporting to tax authorities and considerably streamline tax forms for VAT, profits tax, and personal income tax.	December 2010	Met	
5	Adopt a government decree establishing a mechanism for implementing a fully functional risk management approach in VAT refund processing.	December 2010	Met	
6	Implement a fully functional risk-based management approach in VAT refund processing.	June 2011	Met with delay	
7	Establish the capacity to identify whether the taxpayer has VAT liability by adding a VAT payer identification number to the tax identification number.	December 2011	Met	
8	Issue a White Paper detailing the measures and costs to address of addressing mixed cash and accrual accounting and refunding or setting off against future VAT liability excess VAT credits.	March 2012	Met	
Tax policy				
9	Introduce legislative changes that provide for annual automatic indexation of excises for inflation.	August 2011	Not met	Annual automatic adjustment mechanism proposal in 2011 not supported by the National Assembly, although excises increased for 2012.
10	Increase the tax rate structure for up-market luxury vehicles and SUVs for 2012 and adjust the specific tax on cars annually for inflation.	December 2011	Not met	Tax rates for luxury vehicles increased for 2012, but no annual adjustment mechanism. Authorities will propose new excise regime for imported vehicles for 2013.
11	Approve a Tax Strategy paper that lays out the tax reform objectives and implementation plan for 2012–15.	December 2011	Met	
12	Overhaul fiscal regime for the mining sector	December 2011	Met	
	a. Strictly limit the fiscal stability clause in the new mining code to tax rates and to a set period of 5 years.		Met	
	b. Introduce and collect resource rents in terms of a variable royalty regime with the sliding rate depending on the EBIT to sales value.		Met	
	c. Clarification of deductibility of contributions for mine rehabilitation and mine site clean-up.		Met	
13	Submit to Parliament legislative proposals to adopt OECD guidelines for transfer pricing for implementation in 2013.	November 2012		Legislative proposals expected to be submitted by end-year; drafting and adoption of guidelines and regulations may mean that implementation will begin only from 2014.
Social policy				
14	Submit amendments to existing laws to parliament to enable the full functioning of an integrated system for the provision of social protection services.	December 2011	Not met (rephasing to 2013)	Successful pilot project for integrated system in 6 regions revealed need for additional work on legislative and regulatory package.
15	Approval by Cabinet of list and timetable of required legal and regulatory amendments to enable the full functioning of the integrated system of social protection services	October 2012	Met	Action taken in July 2012.

Table 2. Armenia: Structural Benchmarks Under the EFF/ECF Arrangement (concluded)

Item	Measure	Time Frame (End of Period)	Outcome	Comment / Status
Fiscal and debt sustainability				
16	Approve a medium-term expenditure framework (2011–13), including a medium-term debt management strategy.	August 2010	Met	Subsequent MTEFs have been approved in 2011 and 2012.
17	Complete first set of estimates of the fiscal cost of the pension reform.	December 2012		On track.
18	Submit by government to Cabinet two pension reform decrees to establish: (i) procedures for managing the guarantee fund for mandatory, funded contributions; and (ii) quantitative and currency restrictions on investing mandatory funded pension assets in financial instruments.	December 2012		New
Monetary sector				
19	Approve terms and conditions for deposit auction to enable the CBA to absorb liquidity with greater flexibility.	September 2011	Met	
20	Publish the CBA's liquidity forecast that provides projected amount of dram liquidity before CBA's actions with indication of separate components such as currency outside the CBA, net foreign assets, government transactions excluding treasury bill issuances, and treasury bill issuances for liquidity management purposes.	December 2011	Met	
Financial sector				
21	Issue prudential regulations to specifically address currency-induced credit risk, including increased loan-loss provisioning requirements and higher risk weights in capital requirements for foreign currency loans.	June 2010	Met	
22	Formalize the Committee for Financial Stability in an MOU to set the modalities for main policy makers to coordinate their policies and responses in case of an imminent critical situation in the banking sector.	September 2010	Met	
23	Issue prudential regulation requiring banks to prepare their contingency plans for liquidity and solvency support.	December 2010	Met	
24	Issue a regulation initiating collection and transmission by banks to the CBA of information on the currency mismatch of large borrowers.	June 2012	Met	
25	Issue a regulation introducing low-level liquidity coverage ratios by major currencies, effective January 2013.	June 2012	Met	
26	Amend and issue by CBA regulations to require banks to immediately report to the CBA changes to operations that have a material adverse impact on the bank (e.g., any substantial change in activities, structure, financial situation or overall condition, or as soon as banks become aware of any material adverse developments, including breaches of legal or prudential requirements) (December 2012).	December 2012		New
Regulatory and competition policy and enforcement				
27	Submit to Parliament further changes to the legal framework for competition (fines and sanctions, definitions).	October 2012	Not met	Likely to be delayed to December 2012 to incorporate comments from ministries and agencies.
28	Submit to Cabinet a packet of legislative and regulatory changes in at least one area under the Regulatory Guillotine initiative (from among construction permitting, inspections, health and social regulations, or another major regulatory reform area).	December 2012	Met	Two packets have been submitted to the government.
29	Submit by government to parliament a regulatory guillotine legislative packet in a fourth area (i.e., following completion of three packets in 2012. This could cover, e.g., construction permits or education).	March 2013		New

ATTACHMENT I. UPDATED TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum sets out the understandings between the Armenian authorities and the IMF staff regarding the definition of performance criteria and indicative targets, their adjusters, and data reporting requirements for the three-year EFF/ECF Arrangement as per the Letter of Intent dated November 20, 2012 (LOI).

2. For program monitoring purposes, all foreign currency-related assets, liabilities, and flows in the monetary accounts will be evaluated at program exchange rates. The program exchange rate of the Armenian dram to the U.S. dollar is set at 385 dram per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

I. Quantitative Targets

3. The program sets performance criteria and indicative targets for defined test dates (see Table 1 in the LOI). The program sets the following performance criteria:

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

The program sets the following indicative targets:

- Ceiling on reserve money;
- Floor on average concessionality of new debt; and
- Floor on social spending of the government.

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

- Gross official international reserves are defined as the CBA's holdings of monetary gold (excluding amounts pledged as collateral), holdings of Special Drawing Rights (SDRs), including the August 28, 2009 General Allocation and the September 9, 2009 Special Allocation, the country's reserve position at the IMF, and holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments). Gross reserves held in the form of securities and other financial instruments are marked to market. Excluded from gross reserves are the balance on the government's Special Privatization Account (SPA), capital subscriptions in foreign financial institutions and illiquid foreign assets, any assets that are pledged, collateralized, or otherwise encumbered, claims on residents, claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options), precious metals other than gold, assets in nonconvertible currencies, and illiquid assets.

- Official reserve liabilities shall be defined as the total outstanding liabilities of the government and the CBA to the IMF and convertible currency liabilities of the CBA to nonresidents with an original maturity of up to and including one year, as well as commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options).

NIR is monitored in U.S. dollars, and, for program monitoring purposes, assets and liabilities in currencies other than the U.S. dollar shall be converted into dollar-equivalent values using the exchange rates as specified in Table 1.

5. **Reserve money** is defined as the sum of currency issued, required and excess reserves, and current and time deposit accounts of certain resident agents. Liquidity absorbing transactions under reverse repurchase agreements, foreign currency swaps, and securities issued by the CBA are excluded from the reserve money definition. The ceiling will be considered as met if the outcome is within AMD 5 billion of the indicative target sets in Table 1 attached to the LOI.

6. **Net domestic assets** are defined as reserve money minus NIR, minus other assets not included in gross official international reserves, minus commercial bank required and excess reserves at CBA in FX, plus medium and long-term foreign liabilities (i.e., liabilities with a maturity of one year or more) of the CBA, plus other foreign liabilities not included in official reserve liabilities, minus the balance of outstanding Fund purchases credited to the government account at the CBA. NDA is composed of net CBA credit to the general government plus outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money and other items net.

7. **External public debt arrears** are defined as all unpaid debt-service obligations (i.e., payments of principal and interest) arising in respect of public sector loans contracted or guaranteed, including unpaid penalties or interest charges associated with these obligations that are overdue beyond 30 days after the due date.[1] The ceiling on external payment arrears is set at zero.

[1] The public sector is here defined following the *Government Financial Statistics Manual* (GFS 2001) and *System of National Accounts* (1993 SNA). It includes the general government and nonfinancial public enterprises (as defined in paragraph 12).

8. **The program fiscal balance** is cumulative from the beginning of the fiscal year and is measured from the financing side as the negative of the sum of net domestic banking system credit to the central government, net domestic nonbank financing, and net external financing to the central government. Should a general subsidy or any other fiscal transaction be introduced off-budget, the overall balance will be measured including the subsidy and other fiscal transactions as part of government spending

- **Net banking system credit to the central government** equals the change during the period of net credit to the central government.

- **Net nonbank financing** equals the sum of: (1) the change during the period of outstanding treasury bills and bonds to nonbanks (including accrued interest for treasury bills and excluding accrued interest for treasury bonds);[2] (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 drams, less amortization paid by the central government to private resident nonbank agents.

- **Net external financing** equals total debt-increasing disbursements from non-residents to the central government (including Fund net purchases credited directly to the government accounts at the CBA) less total amortization from the central government to non-residents. All foreign currency-denominated transactions are recorded in drams using the prevailing exchange rate at the time of the transaction.

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

10. Some project implementation units maintain accounts at the CBA. Grants received by these units are recorded in the fiscal accounts as external grants on the revenue side and as foreign-financed expenditure on the expenditure side. In addition, any loans to finance investments that are intermediated through the banking system are recorded in the financial accounts as a financing item below the line and are thus excluded from net lending. Under previous Technical Memoranda of Understanding, these activities were excluded from the calculation of the program fiscal balance. This treatment reflected lags in receiving information from project implementation units and on project loans intermediated through the banking system. With the shift to semi-annual program reviews with the EFF/ECF arrangement and consolidation of the accounts of these units in the Treasury, there is no longer a need for such exclusion, and these activities are now fully accounted for in the program fiscal balance.

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

11. Foreign currency proceeds from selling enterprises are deposited into the Special Privatization Account (SPA). The SPA is held at the CBA and the proceeds are invested abroad together with the CBA's international reserves. These proceeds are included in the definition of the monetary accounts of the CBA as part of net foreign assets with a counter entry in other items net. Any 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 and are also treated as a financing item and recorded below the line.

12. The program sets an annual indicative floor of 30 percent on average concessionality of new debt on a contraction basis on debt with nonresidents with original maturities of one year or more contracted and guaranteed by the public sector.

- The grant element is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose for 2011 onwards are the currency specific commercial interest reference rates (CIRRs), published by OECD. For debt with a maturity of at least 15 years, the ten-year-average CIRR is used to calculate the PV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR is used. The margins for differing repayment periods (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more) are added to the ten-year and six-month CIRR averages.

- The public sector here comprises the general government, the central bank, and nonfinancial public enterprises (enterprises and agencies in which the government holds a controlling stake—typically owns more than 50 percent of the shares, but which are not consolidated in the budget).

- For program purposes, the guarantee of a debt arises from any explicit legal obligation of the public sector to service a debt in the event of nonpayment by the debtor (involving payments in cash or in kind), or from any implicit legal or contractual obligation of the public sector to finance partially or in full any shortfall incurred by the debtor.

13. The program sets a floor on **social spending of the government**. For the purposes of the program, social spending of the government is defined as 100 percent of the budgeted amount of the family benefit program and lump-sum financial aid.

II. Adjustors

14. The quantitative performance criteria and indicative targets under the program are subject to the following adjusters, calculated, where relevant, using program exchange rates:

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

- **KfW and World Bank loan disbursements**: the ceiling on the NDA of the CBA will be adjusted upward (downward) by the full amount of any excess (shortfall) of disbursements from the KfW and World Bank loans directed at SME financing compared to programmed amounts (Table 2). The floor on NIR will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of these disbursements compared to program amounts.

- **Budget support grants to the public sector** are defined as grants received by the general government for direct budget support from external donors and not related to project financing.

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

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

- **The floor on NIR** will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants (excluding Fund disbursements to the government) compared to program amounts (Table 3). The floor on NIR will be adjusted downward for any external public debt amortization amounts in excess of program amounts. The floor on NIR will be adjusted upwards by the amount of any funds received in respect of deposits held at the Inter State Bank.

- **The ceiling on NDA** will be adjusted downward (upward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants compared to program amounts (Table 3).

- **The floor on the program fiscal balance on a cash basis** will be adjusted upward (downward) by the cumulative total amount of the budget support grants received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $50 million in either direction. The floor on the program fiscal balance on a cash basis will also be adjusted downward (upward) by the cumulative total amount of the project financing received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $100 million in either direction.

III. Data Reporting

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA	CBA balance sheet	Summary	Daily	The following working day
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within seven days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks by chart of accounts at actual official exchange rates	Monthly	Within 25 days of the end of each month
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Daily	The following working day
	Foreign exchange market	Official exchange rates (buying and selling); daily trade volume, and weighted average exchange rate of the interbank, intrabank and Nasdaq-OMX	Daily	Within 1 day
	Foreign exchange market	CBA foreign exchange operations, (exchange rate, volume, counterpart)	Daily	Within 1 day
	Foreign exchange market	Exchange rate (buying and selling)	Daily	Within 1 day
	Interest rates	Refinance rate	At least monthly	Within 1 days of the CBA Board decision
	Interbank money market	Daily interbank repo volume and interest rate and number of trades	Daily	Within 1 day
	CBA operations	Repo (reverse repo) operations, open market operations, Lombard credits, deposit facility, and foreign exchange swaps (volumes, maturity,	Daily	Within 1 day

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		yields, exchange rates)		
	Bank liquidity	Reserves and excess reserves, by currency	Monthly	Within 15 days of the end of each reference period
	Interest rates and flows of the funds attracted and allocated by commercial banks	By currency and maturity	Weekly	Last working day of the week
	T-bill and coupon bond financing, CBA securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Weekly	Last working day of the week
	Banking data	Sectoral distribution of loans and deposits; dollarization of loans and deposits; loan maturities; interbank rate, by volume and maturity; T-bill rate, bond yield; deposit and lending rates, by maturity; monthly weighted average interest rate on government bonds	Monthly	Within 25 days of the end of each month
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Monthly	Within 30 days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Monthly	Within 30 days of the end of each month
	On-lending via commercial banks	On lending via the CBA and government (from the Russian loan, KfW, WB, ADB, etc.) by type of on-lending projects (including loan disbursements and repayments)	Monthly	Within 10 days of the end of each month.
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Transfers	Non-commercial transfers of individuals	Monthly	Within 30 of the end of each month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
Ministry of	T-bill and coupon	By holders, i.e., CBA, resident banks,	Monthly	Within 7 days of

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
Finance (MOF)	bond financing	resident nonbanks, and nonresidents		each month
	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the CBA, and state-owned companies (by company); any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears	Monthly	Within 21 days of the end of each month. For project implementation units, within 21 days of the end of each month (preliminary data) and within 45 days of the end of each month (final data)
	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions	Monthly	Within 7 days of the end of each month
	Domestic expenditure arrears	All unpaid claims outstanding at the end of the month which includes wages, social contributions (including for pensions), family allowances, and amortization and domestic interest payments	Monthly	Within 45 days of the end of each month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month
	Treasury single account (TSA)	Detailed breakdown of central treasury account, including deposits at the central treasury, community budgets, off budget account, monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.	Monthly	Within 7 days of the end of each month
	Consolidated central government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general 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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	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
		Detailed balance of payments data	quarterly	Within 60 days of the end of each quarter
	CPI	By category	Monthly	Within 5 days of the end of each month
State Revenue Committee	Tax arrears	By type of tax	Monthly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)
		For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	Tax credits	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	VAT refund claims in arrears	Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90 day statutory processing period. Number of refund applications	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		processed per month.		
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax inspectorate	Monthly	Within 45days after the end of each month
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty free recorded imports; 3. Number of total transactions 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
	Automated VAT refunds	Number of refunds that were processed automatically (share of total refunds); total value of automated and automatic refunds and offsets; average waiting time (days) to receive refund	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Risk-based selection approach	Percentage of selected companies chosen on the basis of risk-based approach, identified revenue from risk-based audits	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)

Table 1. Armenia: (Program) Exchange Rates of the CBA
(As of December 31, 2008 in U.S. 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
SDR	593.00	1.5403

Table 2. Armenia: KFW and IBRD SME Loan Disbursements [1]
(In millions of U.S. dollars)

Dec-11		Mar-12		Jun-12		Sep-12		Dec-12		Mar-13	Jun-13
Country Report No. 11/366	Act.	Country Report No. 11/366	Act.	Country Report No. 11/366	Act.	Country Report No. 11/366	Proj.	Country Report No. 11/366	Proj.	Proj.	Proj.
23.8	27.7	25.8	35.6	27.8	45.0	29.8	50.4	31.8	65.0	65.0	65.0

[1] Cumulative from end of the previous year.

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

	Dec-11		Mar-12		Jun-12		Sep-12		Dec-12		Mar-13	Jun-13
	Country Report No. 11/366	Act.	Country Report No. 11/366	Act.	Country Report No. 11/366	Act.	Country Report No. 11/366	Proj.	Country Report No. 11/366	Proj.	Prog.	Proj.
Project financing loans	152	116	60	12	121	31	181	99	241	167	87	175
Budget support loan	175	119	175	175	242	279	242	279	259	296	296	368
Budget support grant	86	73	86	73	101	73	101	73	113	96	96	96
of which: EU MFA	50	50	50	50	50	50	50	50	50	50	50	50

[1] Budget support cumulative from the end of the previous year. Project financing loans cumulative during the same year.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION, FIFTH REVIEWS UNDER THE EXTENDED FUND FACILITY AND UNDER THE EXTENDED CREDIT FACILITY, AND REQUEST FOR WAIVER AND MODIFICATION OF PERFORMANCE CRITERION—INFORMATIONAL ANNEX

November 20, 2012

Prepared By

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

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FUND RELATIONS

(As of September 30, 2012)

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

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	92.00	100.00
Fund holdings of currency	476.71	518.16
Reserve Tranche Position	0.00	0.00

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	87.99	100.00
Holdings	4.35	4.94

Outstanding Purchases and Loans:	**SDR Million**	**Percent of Quota**
Stand-By Arrangements	297.20	323.05
ECF Arrangements	127.33	138.40
Extended Arrangements	87.50	95.11

Latest Financial Arrangements:
In millions of SDR (09/30/2012)

Type	**Approval Date**	**Expiration Date**	**Amount Approved**	**Amount Drawn**
Stand-By	03/06/2009	06/27/2010	533.60	350.43
ECF	06/28/2010	06/27/2013	133.40	90.80
EFF	06/28/2010	06/27/2013	133.40	87.50

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

			Forthcoming		
	2012	2013	2014	2015	2016
Principal	40.57	180.22	98.08	16.43	25.29
Charges/interest	1.73	4.59	1.94	1.27	1.13
Total	**42.30**	**184.81**	**100.02**	**17.70**	**26.42**

Safeguards Assessment

Under the Fund's safeguards assessment policy, an update safeguards assessment of the Central Bank of Armenia (CBA) was completed in November 2010 with respect to the current EFF/ECF Arrangements. A safeguards monitoring visit to the CBA was completed in September 2012. The visit made recommendations to strengthen: (i) controls over management of foreign reserves and; (ii) CBA oversight arrangements.

Exchange Rate Arrangement

The de jure arrangement is "free floating." The de facto arrangement was reclassified to "floating" from a "stabilized arrangement" effective March 3, 2009. The official exchange rate is quoted daily as a weighted average of the buying and selling rates in the foreign exchange market.

Armenia maintains no multiple currency practices or exchange restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons, and notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Article IV Consultations

The 2010 Article IV consultation with Armenia was concluded on December 1, 2010. Armenia is subject to a 24-month consultation cycle.

FSAP Participation and ROSCs

A joint World Bank-IMF mission assessed Armenia's financial sector as part of a Financial Sector Assessment Program (FSAP) update during February 1–14, 2012. The Financial Sector Stability Assessment (FSSA) report was approved by the Executive Board in June 2012. The most recent previous FSAP update took place in 2005.

Resident Representatives

Mr. Guillermo Tolosa, since January 2010.

Technical Assistance

The following table summarizes the Fund's technical assistance (TA) to Armenia since 2006.

Armenia: Technical Assistance from the Fund, 2006–12

Subject	Type of	Timing	Counterpart
Fiscal Affairs Department (FAD)			
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	MoF, SRC
Tax administration	Short-term	April 28–May 22, 2009	MoF, SRC
Tax administration	Short-term	September 23–October 6, 2009	MoF, SRC
Tax administration	Short-term	March 1–May 14, 2010	MoF, SRC
Tax administration	Short-term	August 30–November 10, 2010	MoF, SRC
Tax administration	Short-term	September 2010	MoF, SRC
Tax administration	Short-term	November 2010	MoF, SRC
Tax policy	Short-term	February 2011	MoF
Tax administration	Short-term	February–March 2011	MoF, SRC
Tax administration	Short-term	May–June 2011	MoF, SRC
Tax policy (mining)	Short-term	June 14–27, 2011	MoF
Budget process	Short-term	October 11–24, 2011	MoF
Legal Department			
Legislation Development & FIU	Short-term	July 31–August 7, 2006	MoF
Unified Tax Code	Short-term	June 16–23, 2007	MFE
Unified Tax Code	Short-term	April 13–18, 2009	MoF, SRC
AML/CFT	Short-term	Various	MoF

Subject	Type of Mission	Timing	Counterpart
Monetary and Capital Markets Department			
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	Short-term	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
Contingency planning, crisis preparedness	Short-term	October 11–22, 2009	CBA
Contingency planning, crisis preparedness	Short-term	March 28–April 14, 2010	CBA
Workshop on Inflation Targeting (with IMF Research Dept.)	Workshop	April 27–May 6, 2011	CBA
Bank resolution framework	Short-term	June 17–27, 2011	CBA
Medium-term debt management strategy	Short-term	December 12–21, 2011	CBA
FSAP update	Short-term	February 1–14, 2012	CBA
Inflation targeting (with IMF Research Dept.)	Short-term	February 27-March 9, 2012	CBA
Inflation targeting	Short-term	November 19-30, 2012	CBA
Statistics Department			
Balance of payments: remittances	Short-term	August 22–Sept. 5, 2006	CBA
ROSC mission on macroeconomic statistics	Short-term	April 2008	NSS, CBA
Multi-topic mission: national accounts, balance of payments, monetary and financial statistics	Short-term	January 25–February 5, 2010	NSS, CBA
ROSC update mission	Short-term	January 2009	NSS
National accounts	Short-term	September 16–28, 2010	NSS
BOP and external debt statistics	Short-term	October 3–13, 2011	CBA
National accounts	Short-term	April 2012	NSS
Monetary statistics	Short-term	April 2012	CBA
National accounts	Short-term	May 2012	NSS
Monetary statistics	Short-term	October 2012	CBA

WORLD BANK AND IMF COLLABORATION—JMAP IMPLEMENTATION

(AS OF OCTOBER 18, 2012)

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
1. Bank program in the next 12 months	***Selected Ongoing and New Operations***		
	Public Sector Modernization Project II (US$9m)	Semi Annual	Project Implementation started in Sept. 2010 and closing is Dec. 2015
	Tax Administration Modernization Project (US$12 m)	Oct./Nov., 2012, Jan. 2013	WB Board approval July 2012, expected effectiveness Nov. 2012
	New DPO series to support competitiveness and ensure sustainability (US$100m)	Oct., 2012	Targeted Board date – July, 2013
	New Health Project for Disease Prevention and Control (US$30m)		Targeted Board date – March 2013
	Analytic Work		
	Programmatic Poverty work	Continuous	Annual Series, 2012 report due in Nov. 2012
	Programmatic Fiscal work		Irrigation sector PER March 2013
	New Opportunities for Growth		December 2012
	Policy Notes for new government		Policy workshop in Nov. 2012
	Promoting Productive employment in Armenia – a note on labor market conditions		Jan. 2013
	Selected Technical Assistance	Ongoing	
	IDF grant for guillotine exercise		2013
	IDF grant to improve tax audit and macro-modeling/projections		2013
	Macro-monitoring		2012-2013
2. IMF work program in the next 12 months	Sixth EFF/ECF Review	March-May 2013	May-July 2013
	New Program Discussions	March-August 2013	May-October 2013
	Selected Technical Assistance/Training		
	FAD (follow-up on Revenue administration)	TBD	TBD
	MCM (follow-up on FSAP recommendations and Inflation targeting)	TBD	TBD
3. Joint work program	DSA	Oct. 2012	Dec. 2012

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

(AS OF OCTOBER 18, 2012)

1. As of September 30, 2012, the EBRD had approved 109 projects in the power, transport, agribusiness, municipal and infrastructure, manufacturing and services, property, telecommunications, and financial sectors. Total commitments amounted to around EUR 562.3 million. During January-September 2012, the EBRD signed 8 projects with a total volume of EUR 43.0 million.

2. There are five 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. 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 TA for the Hrazdan privatization prospectus and followed the privatization process. 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 (according to a concession agreement). The new management prepared a master plan for the development of the airport, which is expected to generate further cargo traffic for the cargo terminal. In April 2007, the EBRD approved a EUR 7 million loan to the State Committee for Water Systems, owner of the water and wastewater assets located in the small municipalities outside of Yerevan. The proceeds of this loan have been used to improve wastewater treatment in five municipalities located near Lake Sevan. In March 2010, EBRD signed a first EUR 5.0 million sovereign loan with Yerevan Metro Company. This project is providing emergency investments in the Yerevan Metro, covering immediate rehabilitation needs including safety upgrades and energy efficiency. The investment is part of a plan to improve and reform public transport services in the capital of Armenia. In August 2012, EBRD signed its second EUR 5.0 million sovereign loan with Yerevan Metro to primarily address issues related to water ingress into the tunnels.

3. Most of the Bank's projects (93 percent) in Armenia are in the private sector. In addition to the loan to Electric Networks of Armenia (see section 5 below), the Bank approved an additional loan to Zvartnots International Airport in the amount of EUR 29.6 million (supplemented by investments from ADB and DEG). This project followed on from the successful completion, in May 2007, of the first phase of the Passenger Terminal, for which the Bank provided a EUR 14.8 million loan together with DEG (USD 10 million). This project involved the construction and purchase of equipment for the second phase of the Passenger Terminal complex at Zvartnots International Airport and facilitated the completion of Airport Terminal development reallocating all operations (arrivals and departures) from the old Airport building. 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 first three quarters of 2012 the Bank committed EUR 43 million to Armenia through 8 transactions, including 5 projects in the financial institutions sector, 1 in equity funds, 1 sovereign project with Yerevan Metro Company, and 1 in natural resources sector. In early 2012, EBRD together with other international financial institutions supported the creation of the Caucasus Growth Fund. This fund will be managed by the Small Enterprise Assistance Funds (SEAF), a global fund manager, and will be the first institutional quality fund to provide debt and equity to SMEs in the Caucasus region.

4. In the banking sector, a first equity participation in the Commercial Bank of Greece-Armenia (EUR 1.1 million) was approved in late 1999. Now there are four local banks where EBRD participates in equity: Armeconombank, Byblos Bank Armenia, Ararat Bank and Procredit Bank.

The Armenia Multi-Bank Framework Facility II (AMBFF II), established to provide loans and equity to commercial banks and leasing companies in Armenia, was approved by the EBRD Board in March 2006 for an amount of $40 million, and then extended for another $80 million in November 2007. In late 2009, the EBRD has approved a further $100 million extension to AMBFF II in order to support increased financial intermediation and the development of the financial sector in Armenia and to contribute to economic development by providing medium to long-term funding to selected Armenian financial intermediaries. Another extension to this Facility of $100 million was approved in mid-2011. The Facility will seek to develop new products for financial institutions, including provision of local currency loans, agricultural credit lines and mortgage financing. Additional TA will be provided to partner banks.

The EBRD expanded its relationship with partner banks in Armenia from four to twelve (taking into account that two EBRD clients – Ameria Bank and Cascade Bank merged in 2010). Nine banks were provided with new credit facilities under the AMBFF. One institution (Armeconombank) was provided with a mortgage facility, and the first leasing facility in Armenia was signed with ACBA Leasing in 2008 for EUR 5.9 million. A co-financing facility with six local banks was also extended resulting in 14 sub-loans to Armenian corporates. By means of co-financing lines, the Bank has entered such new sectors as healthcare and telecoms, in addition to significantly expanding its portfolio of agribusiness loans. A Trade Facilitation Program with the purpose of facilitating access of Armenian banks to trade financing was also made available to nine Armenian banks.

As of end September 2012, the EBRD has disbursed about EUR 50 million equivalent in local currency financing to Armenian commercial banks and microfinancing institutions. The Currency Exchange (TCX) provides the Armenian dram hedge to the EBRD. In parallel, the EBRD and IMF are assisting the government and the CBA to implement reforms aiming to facilitate financing in dram, reduce the level of dollarization, and foster the development of local capital markets.

5. Supporting development of renewable energy is another core activity of the Bank. To that end, the EBRD joined forces with the WB, USAID, and Cascade Credit (a financing arm of 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 a 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-privatization development with a loan to the Armenian privately-owned power distribution company. In April 2009, the EBRD signed a EUR 42 million loan with Electric Networks of Armenia to upgrade and modernize obsolete low-voltage infrastructure and improve energy efficiency.

6. The EBRD launched the Enterprise Growth Programme (EGP) and Business Advisory Service programs in Armenia in 2003 to support micro, small, and medium-sized enterprises. Since 2003, BAS has completed 916 projects in the amount of EUR 5.9 million, as well as 45 Market Development Activity (MDA) projects. EGP has delivered more than 25 projects. Among the donors are Canada, Taipei China, the United Kingdom, the EU, EU - Eastern Partnership Multi-Beneficiary Technical Assistance, the United States, the Early Transition Countries Fund (ETCF), the EBRD, EBRD Shareholder Special Fund (ESSF).

7. The Bank has launched a USD 25 million program to finance projects for industrial energy efficiency and renewable energy through local banks. In October 2010, the first USD 3.0 million, energy efficiency credit line was signed with Anelik Bank. TA has been put in place financed by the Government of Austria. The Bank has also launched a TA program to review and amend the legal, regulatory, institutional, operational and technical frameworks for energy efficiency in the residential sector. At a later stage, the EBRD will offer financing and capacity building to a selected number of commercial banks to support investments in this sector. The residential sector in Armenia is a large energy consumer with significant potential for energy savings and carbon emission reductions.

8. As part of inspection reform and doing business programs, the EBRD is assisting the government improve the business environment. The EBRD is actively promoting and supporting the preparation of a corporate governance code in cooperation with the Ministry of Economy, the Central Bank, the Stock Exchange and the IFC. The Bank is also providing assistance to the Public Services Regulatory Commission for telecommunications sector regulation. This assistance is being financed by the Government of Finland.

9. The EBRD's current country strategy was approved in May 2012. The key priorities of the EBRD for the coming three years are: (i) developing the financial sector and improving access to finance; (ii) improving municipal and urban transport infrastructure; (iii) developing agribusiness and high value-added, export-oriented industrial companies; and (iv) improving the regulatory and institutional framework for sustainable energy and increasing value added in the mining sector.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ASDB)

(AS OF OCTOBER 18, 2012)

1. The AsDB's economic report and the interim operational strategy for 2006−09 for Armenia were approved in 2006. The country operational business plan (COBP) for 2012−13 was endorsed by AsDB's Board of Governors in November 2011, and an update of the COBP for 2012−13 is expected to be approved in the fourth quarter of 2012. A new COBP is pending completion of the AsDB's new Country Partnership Strategy for Armenia, expected to be approved in the fourth quarter of 2013. The indicative focus areas of the updated COBP are (i) regional cooperation, (ii) private sector development, and (iii) infrastructure.

2. As of October 15, 2012, the AsDB had approved loans for eight projects in the transport, municipal infrastructure, finance, and general budget support sectors. Total commitments amounted to $482.6 million for sovereign and $108.0 million for non-sovereign loans. One non-sovereign loan was provided to Armenia International Airports for the Zvartnots Airport Expansion Project (Phase 2). The loan financed the construction of a new terminal building and purchase of equipment to supplement the existing concourse building. In November 2012, AsDB approved a non-sovereign lending program totaling $65 million for four commercial banks to expand lending to small and medium-size enterprises (SMEs).

3. The first AsDB sovereign loan ($30.6 million), approved in November 2007, financed rehabilitation of 220 km of rural roads. The second loan ($36 million), approved in December 2007, financed repair and replacement of water supply infrastructure in small towns and villages; in April, 2012, AsDB approved additional financing of $40 million to continue the project. The third was a supplementary loan ($17.3 million) to the rural roads project, approved in November 2008, to finance an increase in project cost from higher construction materials prices, domestic inflation, and appreciation of the dram. The fourth was a crisis recovery support program loan ($80 million), approved in July 2009, to protect budgetary social expenditures. The next two loans were Tranches 1 ($60 million) and 2 ($170 million) of the North-South Road Corridor investment program, approved in October 2009 and December 2010, respectively. Tranche 1 is financing rehabilitation of 18.4 km of the four-lane Yerevan-Ashtarak highway and safety enhancement of a four-lane road between Yerevan and Ararat. Tranche 2 is financing an upgrading of the Ashtarak-Talin road section from two lanes to four lanes. The final loan was the first tranche ($48.6 million) of the Sustainable Urban Development Investment Program approved in April 2011. The loan finances construction of two missing road links of the Yerevan inner bypass and strengthening of institutional and management capacity of the Yerevan municipality and urban transport service providers.

4. With the exception of the North-South Road Corridor Tranche 2 investment program loan, all approved sovereign loans are from the AsDB's concessional window under the Asian

Development Fund (AsDF). The Tranche 2 loan for the North-South road is from the AsDB's non-concessional window under ordinary capital resources (OCR).

5. Two additional sovereign loans are expected to be approved by the AsDF's Board in 2012: (i) the Women's Entrepreneurship Support Sector Development Program (total of $40 million ADF), to support business development services for women, capacity development, and policy reforms through a program loan to the government ($20 million), and to finance the expansion of SME lending to women's businesses by commercial banks in a program administered by the German Armenian Fund of the CBA ($20 million); and (ii) Tranche 3 of the North–South Road Corridor Investment Program, to finance continuing construction of the road to Gyumri (amount of financing still to be determined).

6. In 2011, AsDB signed trade finance agreements under AsDB's Trade Finance Program with six banks in Armenia, a move that is expected to further bolster the country's trade sector and help ensure sustainable economic growth.

7. In addition to financing projects and programs, the AsDB is also involved in advisory services and capacity development. The AsDB provided TA to develop Armenia's Transport Outlook, a transport-sector master plan for 2011−2020; and to assist the government in introducing an online business registry system. Armenia is also included in a number of AsDB's multi-country TA projects, providing assessments and development plans in topics of common interest across countries.

STATISTICAL ISSUES

(As of October 24, 2012)

Background

1. Data provision by Armenia has shortcomings, but is broadly adequate for surveillance. In November 2003, Armenia subscribed to the Special Data Dissemination Standard (SDDS), and the overall quality, timeliness, and coverage of macroeconomic statistics have improved significantly over the past few years. The Fund has supported this process through TA from the Statistics Department (STA), the Fiscal Affairs Department (FAD), and the Monetary and Capital Markets Department (MCM). An April 2008 data ROSC mission prepared a detailed evaluation of the quality of macroeconomic statistics. A multi-topic statistics mission visited Yerevan in February 2010 to review progress with implementation of past recommendations and follow up on outstanding issues in national accounts, balance of payments, and monetary and financial statistics. A follow up STA mission in September 2010 provided further guidance, focusing on improving the accuracy of annual and quarterly GDP estimates. Further improvements in real, fiscal, and external sector statistics would be desirable to facilitate enhanced design and monitoring of economic policies.

Real sector statistics

2. The National Statistics Service (NSS) compiles and disseminates annual and quarterly national accounts. The NSS also compiles and disseminates annually a full set of accounts (up to financial accounts) for the total economy and by institutional sectors. The NSS is developing a plan for implementing the *System of National Accounts 2008 (2008 SNA)*.

3. The accuracy of the annual estimates of the national accounts is undermined by the lack of exhaustive source data for informal activities and of appropriate price and volume indicators, particularly for construction activities. Construction output volume measures are derived by deflating current values with a price index for output, which uses weights and base year prices from a survey in 1984. To improve volume measures of construction, the NSS has started compiling a new construction output price index based on more sound methodology. Until the new construction price index becomes available, the NSS should use other indicators for deriving construction aggregates at constant prices. The NSS should also implement new surveys to derive a proper benchmark for informal activities.

4. The production-side estimates at current prices are derived partially from cumulative source data (from business statistics surveys) and partially from discrete data sources. The NSS validates and reconciles data from different sources, but underlying problems associated with de-cumulating the cumulative output data distort the quarterly pattern. The NSS is currently working to produce GDP data at current and at constant prices to be fully in accordance with the SNA. The NSS received IMF TA on estimating quarterly GDP from discrete data sources only and is using statistical

techniques that conform to international standards. Recent publications of the NSS have reflected this effort. The NSS has discontinued compiling GDP volume measures at the prices of the corresponding quarter of the previous year. The compilation procedures now use only average prices of 2005. The NSS also adopted the recommendation of the IMF STA mission to compile only one set of quarterly GDP estimates—quarterly GDP at previous-year average prices—and derive time series through chain-linking. These estimates would be conceptually consistent with the annual data. They would also allow comparisons between different periods, which are essential for analysis of the business cycle. As of January 2011, the NSS also started compiling a monthly indicator of economic activity (IEA), following international best practices. The monthly GDP compilation was discontinued. The monthly IEA is an implicit volume index compiled by aggregation of monthly volume indices of output using gross output weights. The CPI covers 11 large population centers and Yerevan. Since January 2011, the CPI has been computed using 2010 weights. Concepts and definitions used in the compilation of the CPI are broadly in line with international standards; source data and compilation techniques are generally adequate. The NSS compiles a ten-day and a monthly CPI. The ten-day index and the monthly index are disseminated jointly. A February data 2009 ROSC mission recommended development of an approach to include household expenditure on owner-occupied dwellings in the CPI calculations.

Government finance statistics

5. The budget execution reporting system compiles government finance data on a cash basis, supplemented with monthly reports on arrears and quarterly reports on receivables and payables. Daily revenue and cash expenditure data for the central government are available with a lag of one to two days and monthly data on central government operations are disseminated one month after the reporting period. The 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 respective budgetary institutions. A treasury single account (TSA) was introduced in 1996, and all bank accounts held by budgetary institutions were closed, except for project implementation units (PIU) that are required by donors to operate with commercial bank accounts. These PIU accounts are being moved gradually to the CBA. Starting in 2002, some budgetary institutions have been converted into "noncommercial organizations" (NCOs). These units have been taken out of the treasury system and have their own bank accounts, but since 2003 report data on cash flows and balances to the MoF. The February 2009 ROSC report recommended including NCOs in the government finance statistics data published on national websites. These exceptions notwithstanding, all government receipts and payments are processed through the TSA, although there are still shortcomings on the timeliness and quality of data on the operations of local governments.

6. The budget presentation and the classification of items under the economic and functional classification of expenditures need to be made more transparent; for instance, the data have been subject to frequent reclassification, and wages for military personnel are reported in the category of "other" goods and services rather than as a wage item. The February 2009 ROSC report

recommended using market value rather than face value for financial assets other than loans, and for nonfinancial assets. The reconciliation of central government with general government operations is done by the NSS in cooperation with the MoF.

7. Since 2008, government finance statistics meet the classification requirements of the *Government Finance Statistics Manual 2001* (*GFSM 2001*) for the central government.

Monetary and financial statistics

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

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

External sector statistics

10. In 2009, the Armenian authorities decided to transfer the responsibility for compiling the balance of payments, international investment position (IIP), and external debt statistics from the NSS to the CBA. The February 2010 STA mission provided advice on an action plan aimed at ensuring a smooth institutional transfer of responsibility, as well as consistency and continuity in the production of the external sector statistics. The responsibilities of compiling external sector statistics were *de facto* transferred to the CBA in January 2011, and since then, the CBA has compiled balance of payments, external debt, and IIP data for 2011. The transfer of responsibilities was smooth and during the short period after the transfer, the CBA undertook a number of important actions aimed at improving the compilation system. A follow up IMF STA mission in October 2011 undertook a comprehensive assessment of the institutional arrangements, data sources, methodology, and compilation practices for external sector statistics employed by the CBA, and advised on areas for improvement including further developing data sources and compilation practices.

11. 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, for remittances, there are considerable discrepancies among available source data. Remittance data

obtained from surveys are considerably lower than data obtained through the money transfer system. The absence of a comprehensive, continuously updated business register hampers the coverage of transactions and institutional units; in particular, the coverage of the financial account items for the private nonbank sector. There are also concerns with regard to the collection of data on international trade in services, specifically on import of services. The CBA is currently considering the implementation of an international transactions reporting system that would allow for collecting data on all cross-border payments and receipts going through the banking system.

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

Armenia: Common Indicators Required for Surveillance
(As of October 24, 2012)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	October 2012	10/24/2012	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	October 2012	10/24/2012	D	D	M
Reserve/Base Money	October 2012	10/24/2012	D	D	D
Broad Money	Sept. 2012	10/15/2012	M	M	M
Central Bank Balance Sheet	Sept. 2012	10/15/2012	D	M	M
Consolidated Balance Sheet of the Banking System	August 2012	9/21/2012	M	M	M
Interest Rates[2]	October 2012	10/22/2012	W	W	M
Consumer Price Index	Sept. 2012	10/1/2012	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]— General Government[4]	Q2 2012	8/27/2012	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Sept. 2012	10/22/2012	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Sept. 2012	10/22/2012	M	M	Q
External Current Account Balance	Q 2012	09/05/2012	Q	Q	Q
Exports and Imports of Goods and Services	June 2012	09/05/2012	M	M	Q
GDP/GNP	Q2 2012	8/01/2012	Q	Q	Q
Gross External Debt	Q2 2012	09/05/2012	Q	Q	Q
International Investment Position[6]	Q2 2012	09/05/2012	Q	Q	Q

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

International Monetary Fund
Washington, D.C. 20431 USA

Press Release No. 12/478
FOR IMMEDIATE RELEASE
December 10, 2012

IMF Executive Board Completes Fifth Review Under EFF/ECF Arrangement for Armenia and Approves US$51.4 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed its fifth review of Armenia's economic performance under a program supported by Extended Fund Facility (EFF) and Extended Credit Facility (ECF) arrangements. The completion of the review enables the authorities to draw an additional SDR 33.5 million (about US$51.43 million), bringing total disbursements under the arrangements to SDR 211.8 million (about US$324.4 million). The three-year SDR 266.8 million (about US$408.7 million) EFF and ECF arrangements with Armenia were approved by the IMF's Executive Board on June 28, 2010 (see Press Release No. 10/263).

The Executive Board also approved the authorities' request for a waiver of nonobservance of the end-June 2012 performance criterion on the floor on net official international reserves, which was missed due to unexpected market pressures, and the modification of this same performance criterion for the end-December 2012.

The Executive Board also concluded today the 2012 Article IV Consultations with Armenia, which discusses economic policies from a medium-term perspective, and considered an Ex Post Assessment Update report on Fund relations with Armenia.

Following the Executive Board's discussion, Ms. Nemat Shafik, Deputy Managing Director and Acting Chair, stated:

"Armenia's economy has continued to recover from the deep recession experienced in 2008-09 in the context of the global financial crisis. Growth accelerated in 2012, and is expected to be around potential in 2013. Nonetheless, vulnerabilities remain, particularly due to the large current account deficit and high degree of dollarization in the banking sector.

"Policies under the program remain broadly on track, but net international reserves came under unexpected pressures in May-June when the central bank acted to avoid a destabilization of the market. Since then, the central bank has been able to buy back part of the lost reserves. However, full recovery of reserves would have involved undue pressures on the market.

“Fiscal consolidation has continued to play a key role in the stabilization of the economy, and the authorities’ commitment to continue with that fiscal strategy is welcome. Going forward, fiscal consolidation should rely more on increasing revenues to allow for higher social and investment spending while reducing the deficit and debt.

“The financial sector remains sound, and steps have been taken recently to enhance supervision and the liquidity of the system. For the business environment more generally, structural reforms have continued, but further measures are needed to strengthen the legal framework, improve governance, and enhance competitiveness.”

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 13/09
FOR IMMEDIATE RELEASE
February 5, 2013

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

IMF Executive Board Concludes the 2012 Article IV Consultation with Armenia

On December 7, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the 2012 Article IV Consultation with Armenia.[1] The Board also discussed an Ex Post Assessment of Armenia's long-term involvement with Fund-supported programs.[2] On the same day, the Board also completed the fifth review of Armenia's economic performance under program supported by Extended Fund Facility and Extended Credit Facility arrangements (see Press Release No. 12/478).

Background

The recovery of the Armenian economy has continued for a third consecutive year. After a major decline in activity in 2009 in the context of the global financial crisis, growth resumed in 2010 and 2011, although at a moderate pace. In 2012, growth is projected to accelerate to over 6 percent, led by agriculture, agro-processing, mining, and services. Construction, a key pre-crisis growth driver is finally stabilizing. Inflation remained subdued in 2012, reflecting sound macroeconomic policies and low agricultural prices, and is expected to average about 4 percent, within the authorities' target range (4 ± 1.5 percent).

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

[2] An EPA is required for all members having longer-term program engagement with the Fund. EPAs are intended to provide an opportunity to step back from continuing program relations to consider an analysis of the economic problems facing the country, review progress under Fund-supported programs, and draw forward-looking lessons for future Fund engagement.

Fiscal consolidation has continued, and in 2012, the headline budget deficit is expected to reach 2.1 percent of GDP, lower than the previous years' outturn. The external adjustment has also proceeded, but at a gradual pace—with the current account deficit projected to remain slightly below 10½ percent of GDP in 2012. The financing of the current account deficit has continued to come mainly from foreign direct investment, government external borrowing, and bank flows. Foreign exchange inflows in the first several months of 2012 had been somewhat weaker than expected, contributing to a decline in international reserves of the Central Bank of Armenia (CBA). However, reserves have recovered and are expected to close the year at over 3½ months of imports.

The banking sector remains robust, with the capital adequacy ratio of the system as a whole reaching almost 17 percent, and no bank below the required 12 percent. At about 4 percent of gross loans, nonperforming loans of the banking system continue to be low. Dollarization of both deposits and credit remains high, constituting a source of banking system vulnerability; measures under the Fund-supported program aim to reduce dollarization. Credit to the private sector has been strong, especially in foreign currency. In spite of rapid credit growth in 2012 and in previous years, the ratio of credit to GDP in Armenia remains relatively low compared to more advanced economies.

The authorities' policies remain geared towards maintaining macroeconomic stability and fostering sustainable and inclusive economic growth. The CBA continues to conduct monetary policy under an inflation targeting framework accompanied by exchange rate flexibility and to implement policies aimed at maintaining and strengthening financial sector stability. Fiscal policy remains focused on keeping the deficit and debt at manageable levels, while augmenting growth-enhancing expenditures and strengthening social protection. In addition, the authorities are pursuing an agenda of structural reforms to improve the business environment in Armenia.

An Ex Post Assessment Update (EPA) was conducted to review Armenia's economic performance during its long-term involvement with the Fund. The report covered the country's performance during 2005–12 under four Fund-supported programs: a 2005–08 Poverty Reduction and Growth Facility, a 2008–09 PRGF, a 2009–10 Stand-By Arrangement, and the current Extended Fund Facility and Extended Credit Facility arrangements approved in 2010.

Executive Board Assessment

Executive Directors commended the authorities for implementing economic and financial policies which have contributed to a sustained recovery. Growth has accelerated, inflation has remained subdued, the fiscal deficit has declined, and credit growth has been robust. Directors called for continued commitment to sound macroeconomic policies and ambitious structural reforms to address remaining vulnerabilities, ensure medium-term macroeconomic stability, and foster sustainable and inclusive growth.

Directors recognized the role that fiscal consolidation has played in curbing the rise in debt and reducing the large current account deficit. They welcomed the authorities' commitment to continued consolidation, but underscored the importance of relying on stronger revenue raising measures to create space for higher social and investment spending. Continued improvements in tax policy and administration should be key priorities going forward.

Directors considered the current monetary policy stance to be appropriate as it has kept inflation under control and anchored expectations. They encouraged further strengthening the monetary policy framework, including enhancing communications and developing term money-market instruments to enhance the transmission mechanism. Directors stressed the importance of allowing greater exchange rate flexibility to help narrow the current account deficit, increase resilience to shocks, and ensure a comfortable level of reserves.

Directors noted that the banking system is robust and welcomed the recent financial regulations aimed at strengthening the soundness and supervisory framework of the banking system. They encouraged further efforts to reduce high dollarization, including expanding the differential between reserve requirements for foreign exchange and dram liabilities.

Directors welcomed the advances in the structural reform agenda but underscored that further measures are needed to improve governance and the business environment, enhance competitiveness, and foster export diversification. Full implementation of the regulatory guillotine program will be important to reduce red tape in key areas. Directors also cautioned against large-scale public involvement in Nairit.

Directors broadly agreed with the findings of the ex post assessment. While Fund programs have helped Armenia maintain macroeconomic stability and respond to shocks, results in the areas of tax revenues, exchange rate policy, and structural reforms have been mixed. Directors generally welcomed the authorities' interest in a successor arrangement, stressing that a stronger commitment in these areas should be at the core of any future program.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2012 Article IV Consultation with Armenia is also available.

Armenia: Selected Economic Indicators, 2009–13

	2009	2010	2011	2012 Proj.	2013 Proj.
Output					
Real GDP growth (market price)	-14.1	2.2	4.7	6.2	4.3
GDP (in billions of U.S. dollars)	8.6	9.3	10.1	10.2	10.5
GDP per capita (in U.S. dollars)	2,647	2,807	3,042	3,036	3,088
Prices					
Consumer prices (end of period, percent change)	6.7	8.5	4.7	4.0	4.0
Consumer prices (period average, percent change)	3.5	7.3	7.7	2.4	4.2
Public Finances					
Revenue and grants (percent of GDP)	20.9	21.2	22.1	21.3	22.2
Expenditure (percent of GDP)	28.6	26.2	25.0	23.4	24.8
Budget balance (including grants, percent of GDP)	-7.9	-4.6	-2.8	-2.1	-2.6
Total government debt (percent of GDP)	40.2	39.7	41.8	44.9	43.5
Money and credit					
Credit to the private sector (percent change)	14.0	26.7	35.6	31.1	15.0
Base money (percent change)	13.8	-0.8	32.3	-7.2	11.5
Broad money (percent change)	16.4	10.6	23.6	14.5	11.5
12-month T-bill rate (period average, in percent)	9.4	10.6	9.6	...	...
Balance of Payments					
Exports of goods and services (in U.S. dollars, percent change)	-24.0	45.0	24.3	7.5	7.9
Imports of goods and services (in U.S. dollars, percent change)	-22.4	14.4	13.9	3.7	4.4
Current account balance (percent of GDP)	-15.8	-14.8	-10.9	-10.4	-9.6
Foreign direct investment (percent of GDP)	8.4	6.1	4.4	3.1	3.4
Total external debt (percent of GDP)	57.8	65.4	72.8	77.7	76.0
Gross reserves (in millions of U.S. dollars)	2,004	1,866	1,869	1,614	1,536
International Reserves (in months of imports of goods and services)	5.7	4.7	4.5	3.7	3.5

Sources: Armenian authorities; and IMF staff estimates.

Statement by Mr. Snel, Executive Director for Armenia and
Mr. Hadzi-Vaskov, Advisor to the Executive Director
December 7, 2012

The Armenian authorities would like to thank Executive Directors, Management, and staff for their continued support, valuable advice, and constructive discussions. The authorities also highly appreciate the thorough analysis of the Armenian economy presented in the staff reports.

The authorities' economic program, supported by the Extended Fund and Extended Credit Facilities (EFF/ECF), remains broadly on track. All but one performance criteria (PCs) and most indicative targets (ITs) were met, while all structural benchmarks were observed or are on track with possible brief delays. The end-June PC on net international reserves (NIR) was missed due to unexpected pressures on the foreign exchange market in May and June, largely reflecting external uncertainties. Notwithstanding persistent pressures over the summer, the authorities have managed to rebuild a significant part of the reserves. Based on the commitment to rebuild buffers and carry on corrective actions that include strictly limited foreign exchange sales and the restriction of interventions to smoothing unusually large movements, the authorities are requesting a waiver of nonobservance of the end-June PC on NIR. They also request a modification of the end-December NIR target and a downward revision of the end-December IT on reserve money in line with the reduction in the NIR target.

Macroeconomic developments and outlook

Supported by a set of sound macroeconomic and structural policies, economic growth has accelerated to 9.2 percent yoy in Q3 of 2012, against a backdrop of strong performance in agriculture, agro-processing, mining, and services. Inflation remained subdued, reaching 3.6 percent in November 2012, amid low agricultural prices and supportive policies. Reflecting the authorities' firm commitment to prudent policies, the financial sector remained robust and well-capitalized, while the fiscal consolidation has been stronger than expected. While prices of metals decreased, export volumes continued to grow, contributing to a consolidation of the external current account, albeit at a somewhat slower-than-expected pace. While significant adverse spillovers from the external downturn have not materialized, certain financing flows, particularly FDI and bank inflows, have weakened further.

A further deterioration in the global environment presents a major downside risk for 2013. Recognizing weaker global prospects, the authorities expect growth to moderate and inflation to remain within the target range (4 +/- 1.5 percent) of the Central Bank of Armenia (CBA). Over the medium term, the authorities expect growth to be higher than staff's projections, supported by the implementation of structural reforms, aimed at improving the business environment, diversifying exports, and enhancing competitiveness.

Fiscal policy

Anchored in strict fiscal management, tight expenditure control and efficiency gains, the authorities expect the fiscal deficit in 2012 to be about 2 percent of GDP, 1 percentage point of GDP better than budgeted, and almost 6 percentage points below the 2009 fiscal deficit. Tax revenues are expected to achieve the envisioned increase of 0.6 percent of GDP in line with the authorities' target, while expenditures are expected to be lower by about 1 percentage point of GDP, mainly due to delays in the implementation of a few large capital projects. Ensuring debt sustainability in line with their medium-term framework, which aims at reaching a debt stabilizing level by 2015, remains the authorities' firm goal.

The target for the 2013 headline budget deficit is 2.6 percent of GDP, which encompasses an additional increase in tax revenues of 0.9 percent of GDP. In light of weaker performance compared to regional peers, the authorities are firmly committed to continue increasing tax revenues through tax policy reforms as well as continued improvement of the revenue administration. Envisaged tax policy reforms include legislative proposals to adopt OECD guidelines for transfer pricing regulation, removal of personal income tax exemptions for all occupations, scheduled increases in tobacco taxes, and the start of collection of the new mining royalties. The main tax administration efforts, which include the launch of an electronic system for individual accounting and recording under the new unified personal income tax, will be supported by World Bank financing and USAID technical assistance on strategic planning, revenue analysis, internal control processes, and IT infrastructure.

On the expenditure side, the authorities plan to expand growth-stimulating expenditures, while further strengthening social protection. Following delays in 2011-2012, they have launched the major North-South highway project and plan to accelerate the implementation of additional infrastructure projects. Besides making progress with their efforts to integrate a wide range of social services, and improve efficiency and service quality, the authorities have started reversing the erosion of education spending.

Monetary and exchange rate policies

Maintaining price stability remains the CBA's main objective. The policy rate has been kept at 8 percent since September 2011, while inflation stayed close to 4 percent, the midpoint of the target range. The monetary authorities do not envisage any interest rate policy action in light of expectations of an only gradually closing output gap and inflation likely staying within the target range over the policy-relevant horizon. However, they remain vigilant and stand ready to adjust policies if needed. While recognizing the instrumental role of the stability of the dram in anchoring expectations, the authorities remain committed to a flexible exchange rate policy, and envisage limiting foreign exchange interventions to smoothing excessive volatility. The authorities take note of staff's assessment on the exchange rate, and consider that medium-term structural measures will play a key role in supporting the external adjustment.

Ongoing efforts to enhance the monetary policy framework are being guided by findings from the FSAP and key recommendations from Fund TA. These include: expanding the current survey of private forecasters by requiring banks to regularly submit macroeconomic forecasts to the CBA; devising a communication strategy on the objectives and operations of the monetary policy framework; and continued strengthening of monetary operations to increase the relevance of the policy rate and enhance the policy transmission mechanism. In particular, their efforts focus on enhancing communication with market participants on liquidity conditions and reducing the volatility of interbank rates by narrowing the width of the interest rate corridor. The authorities also support efforts by NASDAQ-OMX Armenia to develop a trading platform for term money market instruments.

Financial sector

The banking system remains robust, with a capital adequacy ratio close to 17 percent, nonperforming loans (NPLs) at about 4 percent of total loans, and liquid assets at about 120 percent of short-term liabilities. In light of the rapid credit growth (24 percent yoy), especially in foreign currency, the authorities continued to strengthen the stability of the banking system in line with recent FSAP recommendations. First, the CBA introduced a new prudential norm for foreign currency liquidity ratios, which will become effective in January 2013 and will gradually increase thereafter. Second, the CBA issued a regulation requiring banks to report to the CBA information on potential currency mismatches of large borrowers. Third, the authorities will continue to improve the sound regulatory and supervisory framework through efforts to integrate the use of Basel II Pillar II powers in the supervisory toolkit to assess and mitigate individual, institution-specific risks, amend and issue new regulation that requires banks to immediately report changes with a material adverse impact, and review the calculation practice of large exposures. Given the continued strong growth in foreign currency deposits and lending, the authorities are assessing possible policy actions, including expanding the differential between reserve requirements for foreign exchange and dram liabilities. Finally, the authorities will continue their efforts to reduce the high level of banking sector dollarization, mainly by further promoting a stable macroeconomic environment.

Structural reforms

Armenia registered progress with several international competitiveness indicators, including a significant improvement in the 2013 World Bank’s Doing Business rankings from the 55th to the 32nd place. Ensuring a more even progress across different indicators remains an important task for the coming period. The authorities continue to implement structural reforms aimed at further improving the business environment. First, they continue realizing more than 50 measures from the government’s action plan, including legal changes to streamline customs operations and electronic systems for notary services and construction permits. Second, they are firmly committed to the continued full operation of the Regulatory Guillotine program, aiming to significantly streamline regulation and red-tape in key business areas. Third, the authorities envisage further reform of inspection and safety agencies, with a focus on merging and rationalizing their functions. On options to revive the chemical plant Nairit, the authorities reiterate their commitment not to assume any liabilities, including guarantees, without consultation with the Fund and the World Bank.

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The Armenian authorities would like to thank staff for useful discussions in the preparations of the ex-post assessment. Given the complex circumstances, the authorities believe that other factors, besides lack of program ownership, may have contributed to the limited success in some areas. In the authorities' view, a reflection on success stories of reforms during the crisis period is also critical for future joint efforts in designing sound macroeconomic policies and structural reforms. For example, significant fiscal consolidation immediately after the crisis reflects the authorities' continued commitment to sound macroeconomic policies and strong program ownership. On monetary and financial sector developments, the authorities believe that two important achievements should be highlighted: the implementation of a modern inflation-targeting framework and the very positive outcome of the recent FSAP report. Finally, the authorities consider worth mentioning that intermediation and credit to GDP ratios increased by factors of 2.7 and 4.5 respectively in less than 5 years, while Armenia remains among few countries that observed increase in the deposit base of the banking system during the crisis years.

Successor program

The authorities intend to seek a successor arrangement with the Fund after completion of the current arrangement in mid-2013, which would support the external and fiscal adjustment through a period of elevated repayment of crisis-related assistance. Key objectives would be to further establish policy buffers and expand policy space, primarily through strong CBA reserves and higher tax revenues, while continuing to implement structural reforms aimed at sustained and accelerated growth through further financial sector development, and business environment improvement.