

## Armenia—Program Note

**Current IMF-Supported Program:** A 38-month, SDR 82.21 (approximately US\$128 million) arrangement under the Extended Fund (EFF) was approved by the IMF Executive Board in March 2014. The Second Review was completed with a delay in November 2015, and the Third Review is planned for June 2016.

### Background

Performance under the program has faced challenges, as spillovers from Russia are taking a toll. Growth has been lower than envisaged at the outset of the program—in line with lower growth in Russia—and the dram depreciated in late 2014 in a context of lower remittances and weaker regional currencies but has been broadly stable since then. Financial dollarization continues to be high, keeping the economy vulnerable to shocks, but recently the current account deficit has narrowed substantially and is working as a mitigating factor. Poverty and unemployment also remain high. The main risks stem from a further deterioration in Russia and protracted slow growth in Emerging Markets. Weaker growth prospects and greater vulnerability call for decisive implementation of policy actions and reforms.

### Role of the IMF

The EFF-supported program aims to maintain macroeconomic stability, reduce external vulnerabilities, and support growth. Key policies include:

- Following a fiscal impulse in 2015 to support demand, moving to a gradual reduction of the fiscal deficit in 2016–17 and beyond, with the aim of maintaining public debt on a sustainable path;
- Implementing reforms to improve the tax system through a new Tax Code to be considered by the National Assembly within 2016 that would aim to harmonize the system, reduce loopholes, expand the tax net, and achieve gains in revenue administration;
- Creating fiscal space through higher tax revenues to expand growth-supporting capital expenditure and address social needs;
- Ensuring greater exchange rate flexibility to support the reduction in the external current account deficit over the medium term;
- Strengthening of the monetary framework;
- Further strengthening financial sector supervision to maintain robust confidence in the banking system and improve its resilience to shocks; and
- Improving the business environment, enhancing competitiveness, and reducing poverty.

In addition to financial support, the IMF has provided a wide-ranging program of technical assistance with Armenia, focused in particular on tax policy and revenue administration, management of public finances, macroeconomic modeling and the inflation targeting framework, contingency planning in the banking sector, and statistics. A full update under the Financial Sector Assessment Program took place in 2012. The IMF has coordinated its efforts with other agencies, including the World Bank, the European Bank for Reconstruction and Development, the Asian Development Bank, the Eurasian Development Bank, the European Union, and other bilateral partners.

### **Challenges Ahead**

Key challenges are implementing appropriate policy responses to the external shock stemming from the sharp deterioration in Russia, while stepping up fiscal and structural reforms.

- There is a need to balance the fiscal stimulus to support growth in 2015, with fiscal consolidation in 2016-17. Revenue reforms are moving forward, and it is essential that a strong Tax Code is approved by the National Assembly with the objective of improving the efficiency of the tax system and increasing revenue collection.
- The banking sector remains well-capitalized, but also heavily dollarized. Profitability has declined due to weaker economic activity and the depreciation of the dram. The Central Bank of Armenia monitors developments closely, and it has been working with banks to ensure an increase in minimum capital requirements in order to achieve higher buffers and foster economies of scale.
- While Armenia has adequate levels of international reserves, balance of payments pressures remain given the difficult external context. Continued fiscal discipline, together with exchange rate flexibility and structural reforms, will be needed to mitigate pressures, along with continued support from external partners.
- Armenia's economic growth is highly dependent on Russia, which in turn is influenced by Europe, global oil prices, and geopolitical developments. With membership in the Eurasian Economic Union starting in January 2015, clarity and ambition on the structural reform agenda are now even more important than before in order to diversify the sources of growth and expand integration with trading partners both inside and outside the Union.
- Protecting the poor during the program period will continue to be critical. To this end, the authorities have committed to improving the efficiency and widening the coverage of social spending.

Armenia is capable of weathering these challenges. The policy package being implemented by the authorities, combined with financial support from the IMF and other partners, should enable Armenia to weather the external shock, foster medium-term growth prospect with rising incomes and employment, and help reduce poverty.