

## **ARMENIA—PROGRAM NOTE**

**Current IMF-Supported Program:** 28-month US\$544 million Stand-By Arrangement (SBA), approved by the IMF's Executive Board on March 6, 2009, and augmented to US\$830 million on June 22, 2009, at the time of the first review of the program. The program is on track, and the Board completed the combined second and third review of the program on October 30, 2009.

### **Background**

Armenia has been hit hard by the global economic crisis, which has put an end to the strong economic performance the country had enjoyed since 2000. The global financial meltdown and the ensuing downturn in Russia drained Armenia of capital inflows and resulted in a sharp slowdown in its exports and inward remittances. Real GDP growth fell from double-digit levels well into negative territory, unemployment rose, and distress in the corporate sector picked up considerably. The resulting downward pressure on the exchange rate was initially resisted by the authorities, with a rapid and unsustainable loss of international reserves in late 2008 and early 2009.

### **Role of the Fund**

In response to these events, the Armenian authorities introduced a strong set of policies, supported by the current SBA with exceptional access of 400 percent of quota. But in light of continued deterioration of economic conditions—with fiscal revenues falling sharply and the external gap widening—the authorities strengthened the program at the time of the first review and the IMF's Board approved their request for an augmentation of Fund resources in the amount of 180 percent, bringing total access to 580 percent of quota. This level of support aims to ensure that the country will have sufficient resources to achieve the necessary external adjustment, maintain confidence in the domestic currency and the banking sector, and protect the poor. The program focuses on:

- the return to a floating exchange rate regime on March 3, 2009;
- continued strengthening of financial sector supervision to maintain robust confidence in the banking system and improve its resilience to the crisis;
- an easing of monetary policy, consistent with the inflation-targeting framework;
- a further easing of fiscal policy, focused on protecting key social and development expenditure; and
- a structural reform plan to help strengthen public finances and continue boosting the resilience of the economy.

In addition, the IMF has a wide-ranging program of technical assistance with Armenia focused, in particular, on tax administration, central bank operations, contingency planning, and crisis preparedness.

## **Progress to Date**

Developments since the program went into effect are encouraging, despite the deterioration in economic conditions following the deepening of the global crisis. With the return to the floating exchange rate, the dram depreciated by some 20 percent, but has since been broadly stable, with limited intervention by the authorities in the foreign exchange market. Financial stability has been maintained and no banks are reported to be facing major difficulties. Inflation has remained contained, with the pressures from the depreciation of the dram so far counteracted by the global deflationary environment and the weakness of domestic activity.

## **The Challenges Ahead**

Despite recent achievements, the short-term macroeconomic outlook continues to be difficult and important challenges remain. The significant slowdown in Russia and other trading partners, in particular, is having a deep impact on Armenia:

- Real GDP growth in Armenia is expected to contract in 2009 by over 15 percent, as the drop in remittances and foreign direct investment leads to lower domestic demand, and exports fall in response to weaker foreign demand.
- The banking sector is sound and well-capitalized, but the economic contraction will affect credit risk, as already reflected by the increase in non-performing loans. The authorities are taking steps to ensure that these risks are well-managed.
- While Armenia now has ample international reserves, balance of payments pressures will remain. Continued support from Armenia's external donors and partners will be important for mitigating these pressures, and more broadly, for softening the impact of the economic downturn.
- Protecting the poor during this difficult period will be critical, and will require targeted actions by the authorities, coupled with support from donors.

Armenia is well-placed to weather these challenges. The policy package being implemented by the authorities, combined with financial support from the IMF and other partners in the international community, should enable the country to get through this difficult period and emerge with renewed strong economic growth, rising incomes and employment, and falling poverty.