International Monetary Fund

Republic of Armenia
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Press Release:
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June 28, 2010

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Republic of Armenia: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

June 10, 2010

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ARMENIA: LETTER OF INTENT

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

Yerevan, June 10, 2010

Dear Mr. Strauss-Kahn:

1. Armenia's economy performed strongly in the years prior to the world financial and economic crisis of 2008–09. Sound macroeconomic policies and structural reforms delivered buoyant economic growth, low and stable inflation, sound public finances, and a sharp reduction in poverty. However, the global slowdown caused by the world financial crisis severely affected Armenia's economy. The Government of Armenia, with the support of the International Monetary Fund (IMF) and other partners, has aimed to mitigate the impact of the crisis on the domestic economy—especially the most vulnerable segments of the population—through the implementation of countercyclical policies, while preserving macroeconomic and financial stability.

2. While economic conditions remain difficult, the Armenian economy is gradually recovering, and the financial sector remains sound. The Stand-By Arrangement (SBA) approved on March 6, 2009 has helped us achieve our objectives of maintaining macroeconomic and financial stability, and program performance has been very strong. Nevertheless, while the crisis has passed, its effects persist: a decline in potential output, a sharp rise in public debt, and an increase in poverty. And despite our efforts to address the crisis and continue our reform efforts, the medium-term balance of payments remains vulnerable. Therefore, the focus of our post-crisis medium-term agenda will shift to restoring fiscal and debt sustainability, addressing our external imbalances, boosting growth and reducing poverty, as well as strengthening the financial system.

3. Recognizing that important medium-term challenges have emerged, we would like to request the cancellation of the SBA and the approval of two three-year IMF arrangements—the Extended Fund Facility (EFF) and the Extended Credit Facility (ECF), totaling SDR 266.80 million (290 percent of quota), covering the period through June 2013. We believe that a blend EFF/ECF arrangement would be the most appropriate vehicle to support our program, as detailed in the attached Memorandum of Economic and Financial Policies (MEFP) that lays out our economic and financial policies for 2010−13. We believe that these policies are adequate to help us achieve the objectives of our program. We understand that our macroeconomic policies will bear fruit only if facilitated by renewed efforts on structural

reforms to enhance revenue management, rationalize spending, develop a medium-term expenditure framework and a debt management strategy, strengthen the financial system, and improve the business environment. The program will also allow us to advance our poverty reduction strategy through a higher and sustained level of growth.

4. We will consult with the Fund in advance of any revisions to the policies described in the MEFP, as well as for the adoption of additional measures, in accordance with IMF policies on such consultations. In addition, we stand ready to take any additional measures that may be needed to achieve the program objectives. We will also continue providing the IMF with the necessary information for program and post-program monitoring.

5. 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/
Tigran Davtyan
Minister of Finance
Republic of Armenia

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

ARMENIA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2010–13

JUNE 10, 2010

I. RECENT DEVELOPMENTS

1. The global economic crisis had a deep impact on Armenia, and signaled the end of a long period of double-digit growth fueled by remittances. Real GDP declined by more than 14 percent in 2009, while inflation picked up. The current account deficit widened to more than 15½ percent of GDP in 2009 on account of sharp declines in exports and remittances, despite a large drop in imports induced by a contraction in domestic demand. And public finances deteriorated on account of increases in discretionary spending and automatic stabilizers.

2. We responded forcefully to mitigate the impact of the crisis on the economy and the Armenian population. The fiscal deficit widened to 7½ percent of GDP, supported by large public borrowing, which was crucial to protect domestic demand. Monetary policy was loosened and exceptional measures were implemented to sustain credit and support economic activity. Throughout this period, we maintained vigilant financial sector supervision, and preserved financial stability. And while poverty levels increased, our targeted efforts were successful in maintaining social safety nets and protecting basic social services.

3. Recent developments have signaled the beginning of the economic recovery. Real GDP growth has turned positive, reflecting in part the lagged effects of last year's stimulus package and a pickup in external trade and remittances. Fiscal performance was strong in the first 4 months of 2010, benefiting from higher tax collections, including VAT and social contributions, and restrained spending. Inflation, however, remained high at 6.8 percent in April, outside the CBA band.

4. Looking forward, it is clear that the period of double-digit growth registered in the past is unlikely to return in the near future, and that important medium-term challenges have emerged. We intend to adjust our economic program to focus on these vulnerabilities: achieving sustainable growth while reducing poverty, ensuring fiscal and debt sustainability, reducing the very large external imbalances, and preserving financial stability. Sound macroeconomic policies and forceful structural reforms, particularly in tax administration, debt management, and competitiveness, will be crucial to achieve these objectives.

II. OUTLOOK FOR 2010 AND THE MEDIUM TERM

5. We expect GDP growth to reach 4−5 percent in 2010, supported by a pickup in domestic demand and an increase in international trade. Inflation is expected to ease to about 6 percent by year-end, and will revert to the CBA's inflation band during the first half of 2011. The gradual recovery of exports and remittances should allow for a small narrowing of the current account deficit to 14 percent of GDP, but protracted balance of payments needs

will remain. Financial sector intermediation is picking up, and will help support growth and stimulate domestic demand.

6. The medium-term outlook is guardedly encouraging, although external demand and remittances are not likely to recover quickly to pre-crisis levels and private investment and FDI are only expected to strengthen gradually. As a result, growth will average about 4−4½ percent over 2011−13. Inflation will be contained within the CBA's band. Fiscal consolidation will bear fruit, by bringing the deficit to about 2 percent of GDP by 2013. And the current account deficit is expected to narrow to single digits. The new program will help us smooth the debt profile and ease the debt service dynamics.

III. The Program for 2010−13

A. Fiscal Policy

7. Fiscal policy will continue to support economic activity and improved social services, but, as the recovery takes hold, a gradual unwinding of the fiscal stimulus will be necessary to set our public finances on a sustainable path. To this end, we are committed to reducing our deficit to 4.8 percent of GDP in 2010. With the rebound in economic activity and improving tax administration, the tax-to-GDP ratio should increase by about ½ percent of GDP this year, while spending will continue at budgeted amounts. We intend to implement contingency measures if revenues diverge from projections under the program, including adjusting spending as needed in order to achieve the deficit target. We also intend to save at least half of any revenue over-performance above the projections reflected in our EFF/ECF program.

8. Gradual fiscal consolidation will proceed over the medium term. Given the sharp increase in public debt during the recent crisis, a prudent tightening of about 1 percent of GDP annually during 2011−13 will help ensure fiscal sustainability, gradually lower our public debt, and contribute to reducing the external imbalances. The fiscal consolidation will rely on both implementing revenue measures and maintaining prudent spending. With a strong tax administration reform program (see below), tax revenue is projected to increase by 1.7 percent of GDP during 2010−13. If these gains do not materialize, we will consider needed expenditure measures to attain our deficit targets. On the expenditure side, we will maintain a prudent stance, continuing to improve the targeting and efficiency of spending, while ensuring sufficient allocations for social and capital spending. We intend to consult with our international partners on how to optimize budget allocations and reduce the rigidity of our current spending. With the economic crisis receding, we intend to wind down our net lending program financed by the Russia loan.

9. In collaboration with the World Bank and other international partners we are taking further steps to protect the poor by enhancing the social safety net, better targeting pro-poor spending, and increasing the coverage under our social programs. Social spending will be maintained at the budgeted level in 2010, while additional measures to boost benefits to

mitigate the poverty impact of higher gas tariffs are being sought within the current spending envelope. Over the medium-term, ensuring adequate spending on education and health, as well as advancing the pension reform agenda is high on our priority list.

B. Monetary and Exchange Rate Policy

10. Price stability continues to be the main objective of our monetary policy underpinned by our inflation targeting framework, and remains essential to preserving macroeconomic stability. With the economy showing signs of recovery, and with some concerns about possible inflationary pressure emerging, we have gradually tightened our interest rate policy since the beginning of the year through five successive rate increases totaling 225 basis points. We have been concerned about any excess dram liquidity that may destabilize the foreign currency market and fuel inflationary expectations. Thus, we have tightened liquidity conditions significantly, pushing the effective repo rates well above the policy rate. Recognizing that the wedge between the effective repo and policy rates increases short-term interest rate volatility and affects the credibility of our monetary framework, we will reduce the Lombard margin by end-June, and will adjust liquidity conditions to ensure that the wedge henceforth remains low. These measures will increase the relevance and effectiveness of our policy rate as the main instrument to achieve our target. We will continue monitoring price developments and adjust our monetary stance as needed.

11. We will continue to strengthen the monetary transmission mechanism. Recognizing that changes in our policy rates have limited impact on the economy and inflation given the high dollarization of our economy, we have taken steps to encourage the dedollarization process by enhancing the attractiveness of the dram relative to foreign currency. In addition to higher reserve requirements already in place on foreign currency deposits (FCD), we now require a quarter of banks' reserves on FCD to be maintained in drams and intend to increase the proportion further in the coming months. This measure has prompted some banks to widen the interest rate differential in an attempt to attract more dram deposits. We also use prudential measures to discourage banks from extending unhedged foreign exchange (FX) loans and ensure proper management of foreign exchange risk (see below).

12. Moreover, we are taking steps to further develop our financial markets, especially for dram instruments. Building on the success of the overnight interbank deposit trading platform, we plan to introduce longer maturities to enhance the functioning of our money market. Parliament is also currently considering draft laws, expected to be in place by early next year that will pave the way for third-party liability insurance and private investment funds. These should stimulate demand and supply of local currency debt instruments. We are fostering a secondary market of government securities, including by requiring primary dealers to provide quotes for benchmark issues.

13. We remain committed to allowing increased flexibility in the exchange rate to maintain competitiveness and support the needed external adjustment. We will not seek to

intervene in the foreign exchange market against fundamental trends, but only to smooth extreme volatility. We also aim to continue building reserves. In our interventions, we will continue to hew closely to our intervention strategy and avoid sending misleading signals to the market that we have an exchange rate target.

C. Financial Sector Stability and Development

14. The Armenian banking system has proven its resilience during the crisis, but we continue to monitor closely the health of banks. Banks have remained liquid and well-capitalized, and their balance sheets are improving. Non-performing loans have been falling, but remain high compared to pre-crisis levels. Profitability has turned positive since September. Stress test results revealed that almost all banks are able to withstand multiple shocks. We expect lending to continue to grow moderately in 2010. Dram lending will likely be limited by the high dollarization of deposits, but our dedollarization measures are expected to help banks rebalance their liabilities and yield the financing necessary to support dram credit.

15. We have taken steps to limit vulnerabilities and enhance risk management in the financial sector. The high level of dollarization inflicts considerable financial stability risks, particularly since foreign exchange exposures are mostly unhedged. Prudential measures aim to discourage banks from extending unhedged FX loans and ensuring proper management of FX risks. We have issued, in March, the regulation imposing higher risk weights (by 50 percent) in capital requirements for FX loans, and we will issue, by June 2010, the regulation requiring increased loan-loss provisioning for FX loans (Structural benchmark, June 2010). The limit on open FX position is expected to become symmetric at 7 percent of capital on both the long and short positions by August 2010.

16. We continue to improve our crisis preparedness and contingency planning. We plan to implement the key recommendations provided by the Fund technical assistance in this area, and will enhance our supervisory framework by focusing more on a forward-looking assessment of potential risks. We are deepening our financial stability analysis and early warning system to enhance monitoring of macro-prudential risks and to enable early detections of emerging vulnerabilities and prompt reactions. We aim to conduct crisis simulation exercises with stakeholders, as part of contingency arrangements, to enhance the preparedness for managing potential crisis situations. In addition, we plan to formalize the Committee for Financial Stability (Structural benchmark, September 2010) 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. We will also issue a prudential regulation requiring banks to prepare their contingency plans for liquidity and solvency support (Structural benchmark, December 2010).

17. All of these efforts will help ensure the stability of the financial system, support macroeconomic stability, and promote financial intermediation to support economic activity.

Nonetheless, we realize more can be done. To this end, we intend to request an FSAP update to get a fuller picture of the systemic issues and vulnerabilities in the financial system and identify key development issues.

IV. Structural Reforms

A. Fiscal Reforms

18. A strong revenue base is critical to maintaining sound public finances while providing the resources for the public spending necessary to achieve our growth and social objectives. This goal in turn will hinge on reversing the less than satisfactory results from our tax administration reform efforts in the past. Accordingly, we intend to implement a strong program of tax administration reforms aimed at improving the integrity of the system, achieving important efficiency gains, and ultimately casting a tax net as wide as possible, while providing incentives for taxpayers to comply.

19. We have taken concrete measures to modernize tax administration. We made progress in introducing best practice in VAT refund processing, including by (i) significantly reducing the stock of unprocessed late VAT refund claims; (ii) ensuring that all VAT refunds are processed within the statutory 90-day period; and (iii) submitting legislation to parliament that allows only high-risk VAT refunds to be subject to review. Furthermore, we have slightly reduced the stock of tax credits.

20. Looking ahead, we will continue to implement concrete measures to modernize tax administration based on a self-assessment model to enhance revenue collection and secure a sustainable revenue base. We will aim to fight corruption and increase transparency and demonstrate impartiality to taxpayers, which should increase taxpayers' confidence and improve tax compliance. To this end, we will:

- Set up an Appeals Committee under the Ministry of Finance to deal with legal and procedural disputes of taxpayers (Structural benchmark, September 2010). This committee will include members from the government and independent members with expertise in tax issues. Decisions from this committee will be published.
- Issue a government decree stipulating that clarifications and interpretations of laws, legislative provisions, and bylaws on taxes, duties, and mandatory fees should be agreed in advance with the Ministry of Finance (Structural benchmark, July 2010). These clarifications and interpretations will be published, put in the information base opened in the SRC's website and applied consistently across all taxpayers starting September 1, 2010.

21. Furthermore, we are committed to a wide range of actions in 2010−11 to modernize tax administration and customs, boost collection, and broaden the tax base:

- Adopting a government decree establishing a mechanism for implementing a fully functional risk management approach in VAT refund processing (Structural benchmark, December 2010) and ensure this approach is fully operational by June 2011.
- Increasing the number of large taxpayers (LTPs) in the large tax inspectorate by about 100 by December 2010 with a view to ensuring that LTPs contribution in terms of total domestic revenues is continuously increasing compared to the previous year by end-2011.
- Implement a risk-based approach in customs procedures.
- Extending e-filing to all taxpayers with a turnover of more than 100 million drams by July 2010 and to all LTPs by end-2010.
- Developing manuals in tourism, mining, real estate, transport and sectors using cash register machines for tax audits for usage starting in January 2011 (Structural benchmark, December 2010).
- Developing the State Revenue Committee's (SRC) Tax Service Training Program.
- In collaboration with the Central Bank, tightening control by the SRC over implementation of currency regulation legislation by September 2010.

22. Improvements in tax administration will be essential to boosting tax compliance and strengthening the business environment. To enhance tax compliance, we will simplify the reporting system by reducing the frequency of reporting to tax authorities and considerably streamlining tax forms for VAT, profits tax, and personal income tax (Structural benchmark, December 2010). In addition, we are improving the quality of taxpayer services, and, on the difficult issue of tax credits, are analyzing the systemic problems underlying this problem, and will implement measures to reduce tax credits by December 2010.

23. In the area of tax policy, we have submitted legislation to parliament to abolish the presumptive taxation regime for tobacco and petroleum products and bring these sectors within the regular tax regimes effective January 2011. Moreover, we will submit legislation to allow transfer of certain activities identified in the Law on Presumptive Taxes to the general taxation system by September 2010. Furthermore, and in order to meet our obligations with the World Trade Organization and Free Trade Agreements, we will also submit legislation to parliament by September 2010 to ensure that excise tax rates for domestic and imported tobacco are harmonized effective January 2011. Over time, we intend to move to a system of full deductability of VAT credits, provided that any offset against outstanding tax liabilities other than VAT has been made, with any remaining balances being fully refunded. This would make the VAT system less burdensome for businesses, ease cash flows for taxpayers, and minimize the risk of requiring advance tax payments not warranted by legislation.

24. We remain firmly committed to medium-term fiscal sustainability and are in the process of strengthening our fiscal framework. A medium-term expenditure framework (MTEF) for 2011–13, which includes our medium-term debt strategy, has been drafted and will be approved by the government (Structural benchmark, August 2010). The MTEF outlines our revenue projections, spending priorities, financing sources, risk factors, mitigating measures, as well as debt dynamics.

25. We intend to strengthen our debt monitoring and planning capacity. We recently adopted a time-bound action plan to develop and implement a comprehensive medium-term debt management strategy. Under this plan, we will acquire a new debt management information system which will gradually be implemented over the next two years. We will improve our legal framework governing public debt management by enacting the necessary amendments. Finally, to consolidate public resources under the treasury, we intend to move the accounts of the Project Implementation Units (PIUs) from commercial banks to the treasury by June 2011.

B. Other Reforms

26. We are in the process of updating our Sustainable Development Plan (SDP) to serve as the basis for our macroeconomic policy aimed at achieving prosperity through sustained growth. The measures outlined in the updated SDP will be fully consistent with the commitments stipulated in the present MEFP, and will support our objectives by providing an analytical background for the growth strategy and ensuring a high participatory process in civil society.

27. We strongly believe that substantial progress on structural reforms is necessary to secure sustained growth over the longer term. We will continue our efforts to deepen structural reforms to sustain the economic recovery, enhance productivity and resilience of the economy, and promote long-term economic growth. These reforms include substantial investments in transportation infrastructure and information technology and are expected to be supported by the multilateral donors. We continue to be committed to maintaining an open trade regime while improving customs procedures.

28. A number of initiatives to improve Armenia's business environment are being undertaken, with a focus on improving the capacity of the regulatory bodies and the ease of doing business. Considerable simplification and streamlining of regulations is needed to stimulate domestic and foreign investors. In addition, strengthening standardization and certification procedures will be crucial to boosting the competitiveness of Armenian products and opening up new markets. Finally, we are proceeding with simplifying and streamlining the tax regime for small and medium enterprises that will also improve the competitiveness of the economy over a longer term.

29. Corruption remains a major challenge, and we are committed to reversing the recent deterioration noted by several international indicators. To this end, we intend to address conflict of interest issues by enforcing the constitutional provisions restricting public officials from engaging in commercial activities. Finally, we are considering measures to increase competition and provide a level playing field, in order to eliminate monopolistic behavior in key sectors.

30. In the social sectors, we aim to continue our efforts to improve access to social services. Our reform efforts to improve the quality of education and health spending are

expected to bear fruit through greater efficiency of spending. Also, health expenditures in particular remain low for Armenia's income level, and thus we aim to gradually increase allocations. In addition, we will continue our efforts to better target our anti-poverty programs. In collaboration with the World Bank, we will adopt a decree on introducing an integrated system for the provision of social protection services (Structural benchmark, March 2011). This would strengthen the efficiency and targeting of social services delivery, while improving their quality and affordability. In addition, the IMF program will include a social indicator which sets a floor on priority social spending.

V. PROGRAM MONITORING

31. The program will be monitored through semi-annual reviews, and will contain quantitative performance criteria, indicative targets, and structural benchmarks, as stipulated in the attached Technical Memorandum of Understanding (TMU). The program's quantitative performance criteria and indicative targets for 2010 and structural benchmarks are set out in Tables 1 and 2 attached to this memorandum. The first review under the EFF/ECF is expected to be completed on or after September 30, 2010 and will assess performance as of end-June 2010. The first review will focus on the 2011 budget, tax administration, and monetary policy effectiveness. The second program review is expected to be completed on or after March 30, 2011.

Table 1. Armenia: Quantitative Targets for 2010-11 1/

(In billions of drams, at program exchange rates, unless otherwise specified)

	2009	2010 2/							2011 2/	
	Dec.	Mar.	Jun.		Sep.		Dec.		Mar.	Jun.
	Act.	Prel.	Country Report No. 10/97	Prog.	Country Report No. 10/97	Prog.	Country Report No. 10/97	Prog.	Prog.	Prog.
Performance Criteria										
Net official international reserves (floor, in millions of U.S. dollars)	1,019	897	875	824	833	855	889	829	856	793
Net domestic assets of the CBA (ceiling)	-12	-28	15	38	38	46	30	85	51	95
Program fiscal balance (floor) 3/	-355	3	-93	-75	-121	-92	-149	-133	-36	-88
External public debt arrears (continuous criterion)	0	0	0	0	0	0	0	0	0	0
Indicative Targets										
Reserve money (ceiling)	…	465	513	503	534	534	563	575	541	570
Average concessionality of newly disbursed debt (floor, in percent)			…	30	…	30	…	30	30	30
Social spending of the government (floor) 4/	…	7	…	15	…	23	…	31	9	18

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU.
2/ Indicative target for September 2010, March 2011, and June 2011.
3/ Below-the-line overall balance excluding net lending until 2009. Below-the-line overall balance excluding net lending and project financing from 2010.
4/ Defined as 100 percent of the budgeted amount of the family benefit program and lump-sum financial aid.

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

Item	Measure	Proposed Time Frame (End of Period)	Outcome
Tax administration			
1	Issue a government decree stipulating that clarifications and interpretations of laws and legislative provisions on taxes, duties, and mandatory fees should be agreed in advance by the Ministry of Finance. These clarifications and interpretations will be published and applied consistently across all taxpayers effective September 1, 2010.	July 2010	
2	Set up a Tax Appeals Committee under the Ministry of Finance to deal with legal and procedural disputes of taxpayers.	September 2010	
3	Develop manuals in tourism, mining, real estate, transport, and sectors using cash register machines for tax audits for usage starting in January 2011.	December 2010	
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	
5	Adopt a government decree establishing a mechanism for implementing a fully functional risk management approach in VAT refund processing.	December 2010	
Social policy			
6	Adopt a decree on introducing an integrated system for the provision of social protection services.	March 2011	
Fiscal and debt sustainability			
7	Approve a medium-term expenditure framework (2011–13), including a medium-term debt management strategy.	August 2010	
Financial sector			
8	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	
9	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	
10	Issue prudential regulation requiring banks to prepare their contingency plans for liquidity and solvency support.	December 2010	

ARMENIA: 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 June 10, 2010 (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 dram 385 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 (quarterly on a disbursement basis); 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 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. **The net domestic assets** are defined as reserve money minus NIR, minus reserve money denominated in foreign currencies, plus medium and long-term liabilities (i.e. liabilities with a maturity of one year or more) of the CBA, plus 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; outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money and other items net. 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, the CBA's deposit facility, foreign currency swaps, and securities issued by the CBA are excluded from the reserve money definition.

6. **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.

7. **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 (excluding net project financing). Should a general

[1] The public sector is defined following the *Government Financial Statistics Manual* (GFS 2001) and *System of National Accounts* (1993 SNA). It includes the general government and nonfinancial public enterprises (as defined in paragraph 11).

subsidy be introduced off-budget, the overall balance will be measured including the subsidy as part of government spending.

- **Net banking system credit to the 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.

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

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

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[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.

10. **The reserve money** is defined as the sum of currency issued, required and excess reserves, and current and time deposit accounts of certain resident agents. The ceiling will be considered as met if the outcome is within AMD 5 billion of the indicative target set in Table 1 attached to the LOI.

11. The program sets a floor of 30 percent on average concessionality of new debt on a disbursement basis on debt with nonresidents with original maturities of one year or more contracted and guaranteed by the public sector during the period 2010.

- The monitoring of the average concessionality target is done on a disbursement-by-disbursement basis and consistent with the methodology used in the DSA to calculate the original average concessionality target. In particular, the discount rate and the exchange rates used in the DSA should be used for the monitoring.

- The public sector 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.

12. 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

13. 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 deposits relative to the baseline assumption as per the following formula: $\Delta NDA = \Delta rB$, where B denotes the level of the deposits 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.

- **External financing to the public sector** is 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, with the exception of the KfW and World Bank disbursements mentioned above:

  - The floor on NIR will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of external financing or EU grants in the form of budget support (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 ceiling on NDA will be adjusted downward by the amount of any excess of external financing or EU grants in the form of budget support compared to program amounts.

  - The floor on the program fiscal balance on a cash basis will be adjusted upward by the cumulative total amount of the EU budget grants received in excess of the program amounts (Table 3).

III. Data Reporting

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA[1]	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, yields, exchange rates)	Daily	Within 1 day
	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	By currency and maturity	Weekly	Last working day of the week

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

	and allocated by commercial banks			
	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
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Transfers	Non-commercial transfers of individuals	Monthly	Within 30 of the end of each month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
Ministry of Finance (MOF)	T-bill and coupon bond financing	By holders, i.e., CBA, resident banks, resident nonbanks, and nonresidents	Monthly	Within 7 days of each month
	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	Monthly	Within 45 days of the end of each month for government arrears

		amortization and domestic interest payments		
	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
	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 processed per month.	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	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

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, 2010-11 1/
(In millions of U.S. dollars)

Dec-09		Mar-10		Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
SBA Prog.	Actual	SBA Prog.	Actual	Prog.	Prog.	Prog.	Prog.	Prog.
35.6	33.8	2.0	0.0	0.0	2.0	27.8	2.0	4.0

1/ Cumulative from the end of the previous year.

Table 3. Armenia: External Financing to the Public Sector in 2010-11 1/
(In millions of U.S. dollars)

	Dec-09		Mar-10		Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
	Prog.	Actual	Prog.	Actual	Prog.	Prog.	Prog.	Prog.	Prog.
Project financing	163	261	51	62	95	143	188	4	43
Budget financing	289	304	37	0	38	114	163	57	86
EU grant	…	…	…	…	…	23	…	23	…
Total	952	1,065	89	62	133	280	351	84	129

1/ Cumulative from the end of the previous year, excluding non-EU grants.

IV. Guidelines on the Indicative Benchmark with Respect to the Definition of External Debt

For program purposes, the definition of debt is set out in Executive Board Decision No. 12274, Point 9, as revised on August 31, 2009 (Decision No. 14416-(09/91)).

(a) For the purpose of this guideline, the term “debt” will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, that is, advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers’ credits, that is, contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (for example, payment on delivery) will not give rise to debt.