INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/246

REPUBLIC OF ARMENIA

July 2016

THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT, AND REQUEST FOR WAIVER AND MODIFICATION OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF ARMENIA

In the context of the Third Review Under the Extended Arrangement, And Request for Waiver and Modification of Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 15, 2016, following discussions that ended on April 7, 2016, with the officials of Republic of Armenia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on May 31, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for 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 Republic of Armenia*
Memorandum of Economic and Financial Policies by the authorities of Republic of Armenia*
Technical Memorandum of Understanding*
*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Press Release No. 16/284
FOR IMMEDIATE RELEASE
June 15, 2016

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third Review of Armenia's Extended Arrangement

The Executive Board of the International Monetary Fund (IMF) completed today the third review of Armenia's performance under a three-year arrangement under the Extended Fund Facility (EFF). The completion enables the release of SDR 15.65 million (about US$22.01 million), bringing total disbursements under the arrangement to SDR 50.87 million (about US$71.53 million). The extended arrangement for SDR 82.21 million (about US$115.60 million) was approved on March 7, 2014 (see Press Release No. 14/88).

In completing the review, the Executive Board also approved the authorities' request for waiver of non-observance of the end of December 2015 fiscal deficit performance criterion (PC), modification of the end-June 2016 fiscal deficit and budgetary domestic lending PCs, as well as shift from a net domestic assets (NDA) PC to monetary policy consultation clause (as of end-June 2016).

Following the Executive Board's discussion on Armenia, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, said:

"Despite difficult external conditions, program performance has been broadly satisfactory, with most targets met. The weak global and regional conditions have, through lower commodity prices and remittances, contributed to declining domestic demand. Moreover, bank credit growth and inflation have been negative. Nevertheless, real GDP growth has held up moderately, primarily due to export-related supply-side factors in mining and agriculture. Monetary conditions have stabilized and pressures in the FX market have diminished.

"The authorities remain committed to fiscal consolidation and debt sustainability, along with a greater focus on revenue gains to protect and increase capital and social spending. The new tax code (recently submitted to the national assembly) provides a major opportunity to broaden the tax base by reducing exemptions and addressing gaps and thereby supporting both consolidation and increases in growth-enhancing spending.

"The central bank's actions have helped ensure orderly market conditions and financial stability. Going forward, exchange rate policy will continue to limit intervention and sustain buffers. Further normalization of the monetary conditions will help bring inflation closer to the target and support a resumption of bank lending, while the use of macro- and micro-prudential regulations and further strengthening of the crisis preparedness framework will help maintain orderly financial markets conditions.

"Pursuing further structural reforms to enhance competition, competitiveness, and regional and global integration remains critical to reduce vulnerabilities and support medium-term growth. Ensuring that the state budget does not absorb losses or liabilities or make payments on behalf of utilities or other companies will be needed to safeguard the prudent use of the limited budgetary resources.

"The outlook remains challenging, but the risks to the program are manageable. Steadfast implementation of the agreed set of measures going forward will keep the program on track, rebuild buffers and policy space, and accelerate achieving key reform agenda objectives."

Armenia: Selected Economic and Financial Indicators, 2013–17

	2013	2014	2015		2016		2017
	Act.	Act.	CR No. 15/320 1/	Prel.	CR No. 15/320 1/	Proj.	Proj.
National income and prices:							
Real GDP (percent change)	3.3	3.5	2.5	3.0	2.2	2.2	2.5
Gross domestic product (in billions of drams)	4,556	4,843	5,122	5,047	5,443	5,297	5,646
Gross domestic product (in millions of U.S. dollars)	11,121	11,644	10,607	10,561	10,672	10,735	11,112
CPI (period average; percent change)	5.8	3.0	4.3	3.7	3.4	-0.4	4.0
CPI (end of period; percent change)	5.6	4.6	3.4	-0.1	4.0	1.0	4.0
GDP deflator (percent change) 2/	3.4	2.7	3.2	1.2	4.0	2.7	4.0
Investment and saving (in percent of GDP)							
Investment	22.3	21.1	18.9	19.5	19.5	19.6	20.0
National savings	14.7	13.8	14.0	16.9	13.7	16.6	16.6
Money and credit (end of period)							
Reserve money (percent change)	29.9	-0.1	4.9	3.9	4.8	5.8	6.7
Broad money (percent change)	15.2	8.9	6.8	10.7	6.3	5.5	6.7
Central government operations (in percent of GDP)							
Revenue and grants	22.2	22.0	21.5	21.5	21.2	21.5	21.6
Of which: tax revenue	21.0	21.0	20.1	20.0	20.0	20.0	20.5
Expenditure	23.8	23.9	25.4	26.3	24.7	25.6	24.4
Overall balance on a cash basis	-1.0	-2.1	-3.9	-4.8	-3.5	-4.1	-2.8
Public and publicly-guaranteed debt (in percent of GDP)	40.8	43.5	48.2	48.7	50.6	52.4	54.0
Share of foreign currency debt (in percent)	85.2	86.2	88.5	86.9	87.7	87.0	86.2
External sector							
Exports of goods and services (in millions of U.S. dollars)	3,156	3,319	3,226	3,140	3,215	3,059	3,137
Imports of goods and services (in millions of U.S. dollars)	-5,365	-5,468	-4,634	-4,357	-4,693	-4,041	-4,202
Exports of goods and services (percent change)	8.2	5.2	-2.8	-5.4	-0.3	-2.6	2.5
Imports of goods and services (percent change)	4.6	1.9	-15.3	-20.3	1.3	-7.3	4.0
Current account balance (in percent of GDP)	-7.6	-7.3	-4.9	-2.6	-5.8	-3.0	-3.4
Debt service ratio (in % of exp. of goods and serv.)	27.9	8.6	5.8	12.5	6.6	8.0	9.2
Gross international reserves (in millions of U.S. dollars)	2,253	1,489	1,712	1,771	1,779	1,858	1,959
Import cover (months of import)	4.9	4.1	4.4	5.3	4.5	5.3	5.4
End-of-period exchange rate (dram per U.S. dollar)	406	475	…	484	…	…	…
Average exchange rate (dram per U.S. dollar)	410	416	…	478	…	…	…

Sources: Armenian authorities; and Fund staff estimates and projections.
1/ Staff Report for the Second Review

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

May 31, 2016

THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT, AND REQUEST FOR WAIVER AND MODIFICATION OF PERFORMANCE CRITERIA

KEY ISSUES

Background. External conditions have remained difficult since the Second Review. Remittances have fallen and copper prices remain repressed. As a result, domestic demand has weakened further, with both private consumption and investment falling. The decline in imports has continued, and bank credit growth and inflation have turned negative. Nevertheless, real GDP growth has held up moderately, primarily due to export-related supply-side factors in agriculture and mining, although nominal GDP growth is lower than expected earlier. Owing to developments beyond the authorities' control, the fiscal deficit for 2015 was marginally higher than programmed. Monetary conditions have stabilized and pressures in the FX market have diminished. Banking sector profitability and loan performance have weakened but bank capitalization remains high due to efforts by banks to comply with the increase in minimum capital requirements. On the geopolitical front, there was a temporary but intense increase in regional tensions in April along the Line of Contact in the Nagorno-Karabakh conflict zone (see UN statement http://www.un.org/sg/statements/index.asp?nid=9584).

Outlook and risks. The outlook remains challenging. Growth is expected to remain subdued as recession in Russia continues and as the base effects of the 2015 one-off factors dissipate. Despite falling by about 0.7 percent of GDP, the fiscal deficit is expected to remain high in 2016 as the weak economic environment continues to translate into low fiscal revenues. On the other hand, the current account deficit will remain relatively low as the value of imports decline further, reflecting weak domestic demand and lower import prices. Uncertainty regarding prospects for economic activity in Russia, copper prices, and global financial conditions are significant downside risks in the near term. Over the medium term, growth is expected to recover gradually, along with recovery in Russia and in the global economy. Fiscal consolidation is planned to continue, supported by measures to structurally increase tax revenues.

Program performance. Program performance has been broadly satisfactory. All end-December 2015 Performance Criteria (PCs), except for the fiscal deficit PC, and all the continuous PCs were met. The fiscal deficit PC was missed by 0.3 percent of GDP on account of higher VAT refunds and the non-completion of an asset sale. The end-December indicative target on inflation was missed, as inflation fell rapidly in the fourth quarter, while the end-December indicative target on external debt concessionality was missed due to the issuance of a Eurobond. Other end-December indicative targets were met and most end-March 2016 indicative targets appear to have been met, with the exception of the inflation target which remained below the Second Review projections. Progress has been made in meeting the program structural reform conditionality: publication of regular consolidated statements across all budget domestic lending programs has commenced; the financial recovery plan for the energy sector has been adopted; and the new Tax Code has been submitted to the National Assembly.

Policy discussions. Discussions focused on the macro policy response to the challenging external environment in the near term: maintaining buffers while supporting activity, and stepping up reforms needed to strengthen medium-term inclusive growth and fiscal sustainability. The strategy involves: (i) strengthening the tax system and introducing new tax policy measures in the context of a new Tax Code, with a view to expanding the tax net and supporting essential expenditures and debt sustainability; (ii) further unwinding the tight monetary policy measures introduced in late-2014, supported by greater two-way exchange rate (ER) flexibility; (iii) strengthening the resilience of the financial sector; and (iv) implementing structural reforms to ensure the financial viability of the energy sector, improve the business environment, and enhance the regional and global integration.

Program issues. The authorities are requesting a waiver of nonobservance for the missed end-December 2015 fiscal deficit PC, modification in the end-June 2016 fiscal deficit and budgetary domestic lending PCs, as well as the shift from an NDA PC to a monetary policy consultation clause (as of end-June 2016). Staff supports the authorities' requests. The measures embedded in the recently submitted Tax Code provide assurances regarding appropriate fiscal discipline and debt sustainability in spite of the somewhat weaker fiscal performance in 2015 and revised fiscal targets for 2016. The adoption of a monetary policy consultation clause as of end-June (2016) would better align the program's monetary policy conditionality with the authorities' inflation targeting policy framework.

Approved By:
Juha Kähkönen and Steven Barnett

Discussions were held between March 23 and April 6 with Prime Minister Abrahamyan, Deputy Prime Minister Gabrielyan, CBA Chairman Javadyan, Finance Minister Khachatryan, Economy Minister Minasyan, Energy and Natural Resources Minister Yolyan, other senior officials, and representatives of the private sector, civil society, and the diplomatic community. The team comprised H. Samiei (head), P. Rodriguez and Y. Sobolev (MCD), M. Perks (SPR), R. Rozenov (FAD), and M. Souto (MCM). T. Daban (Resident Representative) and M. Aleksanyan, A. Manookian, and V. Janvelyan (IMF Office) assisted. A. Hubic (OED) joined most of the meetings. N. Aivazova and S. Davis provided assistance.

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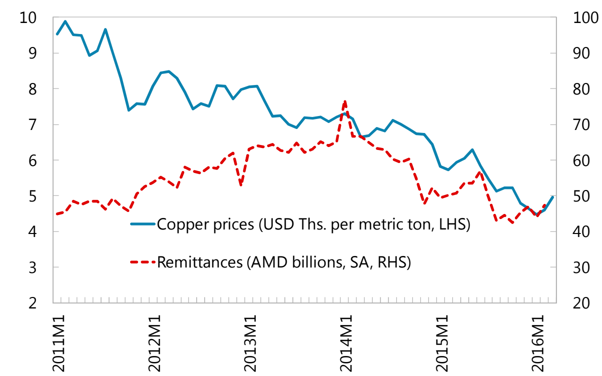
CONTEXT AND RECENT DEVELOPMENTS

1. **External conditions have remained difficult since the Second Review.** Economic activity in Russia—Armenia's main trading partner and source of remittances—has continued to decline since the last quarter of 2015. Remittances have fallen by around 40 percent (in drams) from their highs in early 2014, although they have flattened more recently. Weaknesses in global activity have remained a source of pressure on the price of copper—one of Armenia's key exports—which has fallen to levels not seen since the 2008-09 global crisis. As a result, Armenia's external receipts have fallen significantly.

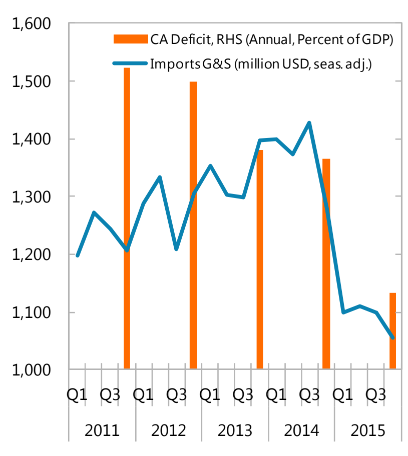
Copper Prices and Remittances



Sources: National authorities and IMF databases.

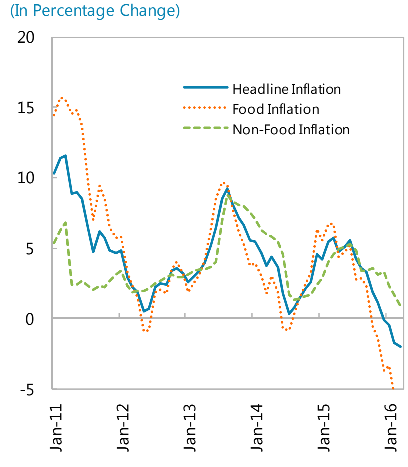
2. **Domestic demand weakened further in 2015Q4, largely reflecting lower purchasing power and continued external uncertainty.** For 2015 as a whole, aggregate demand fell by 5½ percent in 2015, driven by weaker private consumption and investment. This, together with low import prices (notably food), resulted in a continued decline in the value of imports and brought the current account deficit down to 2½ percent of GDP (Annex I). The same factors, together with tight monetary conditions, also contributed to inflation turning negative.

Imports and the Current Account Deficit



Source: National Authorities; and IMF staff calculations.

Consumer Price Inflation
(In Percentage Change)



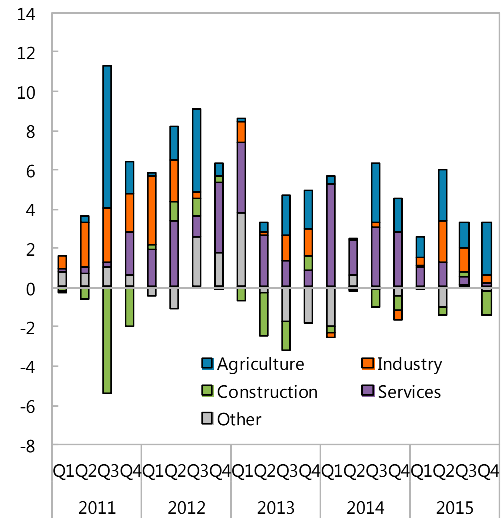
3. **Nevertheless, real GDP growth has held up moderately, primarily due to export-related supply-side factors.** Growth closed the year at 3 percent, about ½ percent above the projection at the time of the Second Review, but nominal GDP growth was almost 1½ percentage points lower than projected at that time due to the decline in the GDP deflator.

Agricultural and mining exports continued to support real growth in the last quarter of the year, while trade and construction exhibited negative or no growth. The stronger agricultural and mining activity reflected a continuation of trends seen earlier in 2015, namely: the coming on line of a new copper mine; favorable weather conditions for agriculture; and expanding sales to nontraditional export destinations (especially the Middle East and China). High frequency indicators of economic activity suggest that this growth pattern has continued in early 2016.

4. The 2015 fiscal deficit, at 4.8 percent of GDP, was higher than at the time of the Second Review. This was due to higher-than-expected VAT refunds in the last quarter of 2015 (reflecting higher exports) and the non-completion of an asset sale (for reasons beyond the authorities' control). The deviation from the program deficit, however, was marginal after accounting for the adjusters in the program. Revenues in early 2016 have been close to the 2016 budget projections.

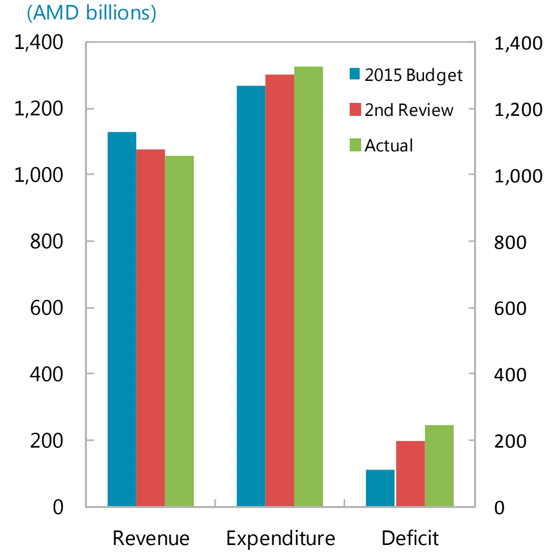
5. Monetary conditions have stabilized. Pressures in the FX market have diminished, and the CBA reduced its net FX sales in the market ($95 million in 2016Q1 compared with $167 million in 2015Q1), in part supported by Gazprom Armenia's improved phasing of its FX purchases to pay for gas imports from Russia and a milder winter. Domestic credit has started to pick up after a period of negative growth. With inflation below the 4 percent target the CBA has lowered the policy rate by a cumulative 2.5 percentage points since August 2015.

Sectoral Contributions to Growth
(In Percent, Production Approach)



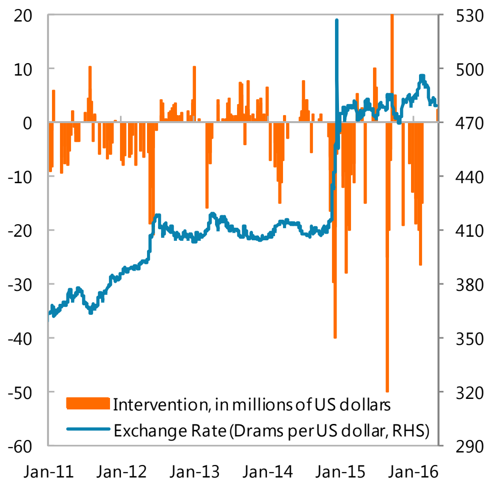
Source: National Authorities; and IMF staff calculations.

Fiscal Revenue, Expenditure, and Deficit
(AMD billions)

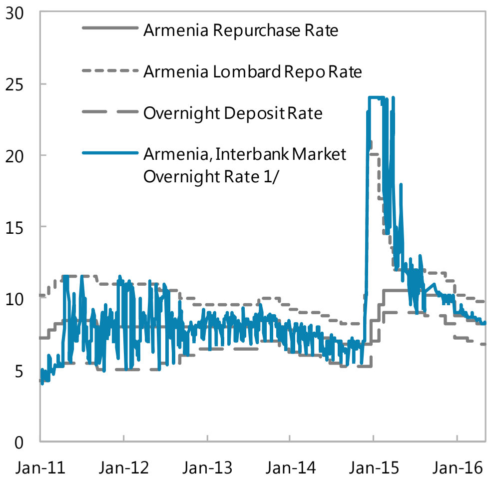


Source: National Authorities; and IMF staff calculations.

FX Intervention and Exchange Rate



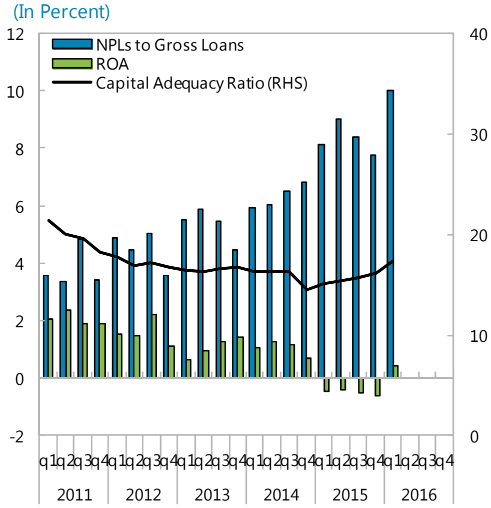
Interest Rate Corridor
(In Percent)



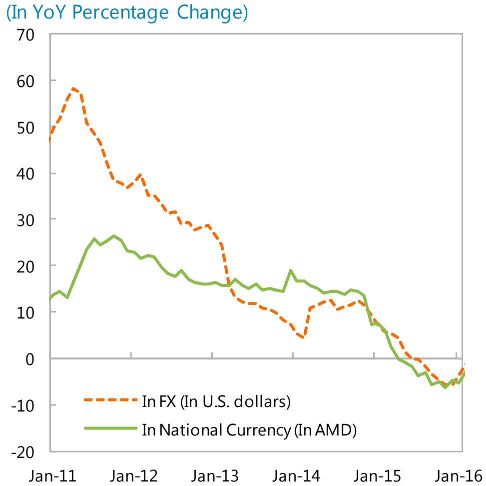
Source: National authorities.

6. Banking sector performance has weakened, but capital adequacy remains high and deposits continue to grow. Profitability continues to be low (although turning slightly positive in the first quarter of 2016), with loan performance deteriorating further. Bank capitalization, however, remains high, in part due to efforts by banks to comply with the central bank increase in minimum capital requirements. In addition, banking sector deposits continued to grow (albeit mostly in foreign currency) in the last quarter of 2015 and in the first quarter of 2016.

Financial Soundness Indicators
(In Percent)



Credit Growth
(In YoY Percentage Change)



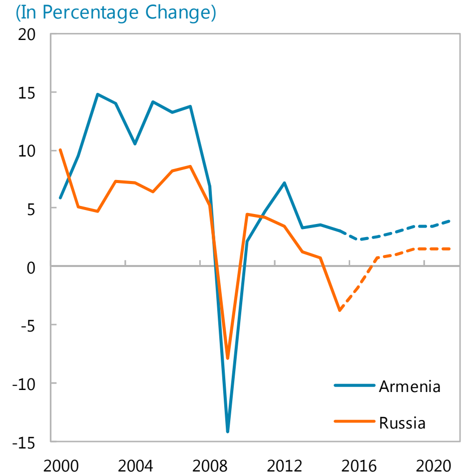
Sources: National Authorities; and IMF staff calculations.

7. Political developments have been dominated by a constitutional referendum and renewed regional tensions. A referendum on constitutional reform in December 2015 changed the country's governance structure by shifting powers from the President to the National Assembly and introducing other institutional changes. On the economic front, the constitutional reform added financial stability to price stability as a primary objective of the CBA, and modified the selection process of the CBA Board, which will now be appointed by the parliament. The next parliamentary elections are expected in April 2017. The surge in regional tensions in April was among the worst since the ceasefire agreement of 1994, but a ceasefire has broadly held up so far.

OUTLOOK AND RISKS

8. The outlook remains challenging. Growth is expected to reach about 2.2 percent in 2016, as recession in Russia continues and as the effects of the 2015 one-off factors dissipate. Domestic prices are projected to remain subdued, with inflation averaging about 1.0 percent driven by weak domestic demand and tight monetary conditions. Fiscal consolidation is projected to resume in 2016, with the deficit declining to 4.1 percent of GDP. The current account deficit will remain low at 3 percent of GDP, as the value of imports decline further due to modest growth and lower import prices. Over the medium term, growth is expected to recover gradually, along with recovery in Russia and in the global economy. Fiscal consolidation is planned to continue, supported by measures to increase tax revenues, while the current account deficit will widen somewhat.

Growth Correlation with Russia
(In Percentage Change)



Sources: National authorities.; and IMF WEO.

9. Near-term risks remain high (Annex II). Uncertainty regarding prospects for economic activity in Russia, copper prices, and global financial conditions are significant downside risks to GDP growth. Geopolitical conditions pose additional risks, particularly following the recent regional hostilities. Continued softness in food and other prices and a switch to (cheaper) imports from Russia due to weaker ruble generate additional risks to nominal GDP (and thus fiscal revenues). Nonetheless, there is also upside potential if exports prove to be a higher than expected, or if removal of sanctions provides positive spillover from Iran via higher tourism and increased investment opportunities.

THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT

A. Program Performance

10. Program performance was broadly satisfactory, with most performance criteria (PCs), indicative targets (ITs), and structural benchmarks (SBs) being met. More specifically,

- *PCs*: All end-December 2015 and continuous PCs were met**,** except for the fiscal deficit PC which was missed by 0.3 percent of GDP (as noted) on account of higher-than-budgeted VAT refunds and the non-completion of an asset sale. In spite of higher-than-projected interventions in 2015Q4, the NIR PC was met owing to overperformance in CBA's other operations. The NDA PC was also met, as improved liquidity conditions in the banking sector allowed the central bank to withdraw part of the liquidity support provided in late 2014. The three continuous PCs (budget lending, public debt arrears, and absorption by the government of losses or liabilities of companies) were also met.

- *ITs*: The end-December IT on inflation was missed as inflation fell rapidly in the fourth quarter, while the end-December IT on external debt concessionality was missed due to the issuance of a Eurobond. Other ITs (floor on social spending floor and ceiling on government guaranteed external debt) were met. While data are still preliminary, most end-March 2016 ITs appear to have been met, with the exception of the inflation IT—which remained below the Second Review projections—and (by a very small margin) the NIR target.

- *SBs*: The end-December 2015 SBs on publication of domestic lending programs and the adoption of a financial recovery plan for the energy sector were met. The submission of the Tax Code to the General Assembly (end-March 2016 SB) took place with a delay in April 2016, reflecting the need to complete the consultation process with domestic and international stakeholders, including the IMF.

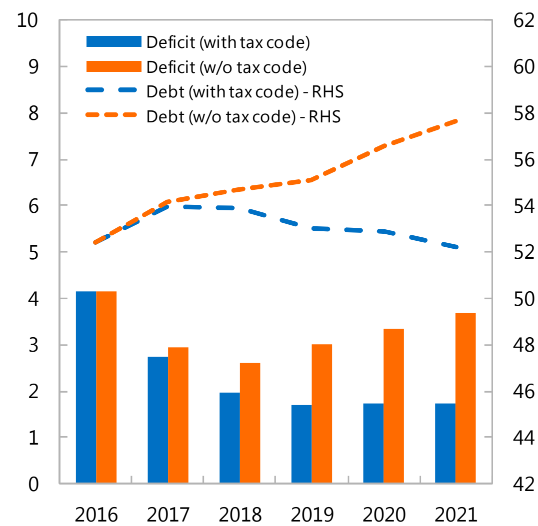
B. Policy Discussions

Fiscal Policy

11. Against the background of continuing economic difficulties and faltering revenue, the mission agreed to modify the fiscal targets for 2016. Nominal GDP in 2016 is now projected to be lower by about 2.7 percent than the budget projection, resulting in weaker tax revenues by about 0.5 percent of GDP. The shortfall could be larger if 2016Q1's negative trends (especially regarding VAT on imports) continue or imports within the EEU (and thus Armenia's receipts from the EEU pool of customs duties) decline more than anticipated. Limited fiscal space significantly constrains the options for pursuing additional countercyclical measures in 2016. Accordingly, on the expenditure side, staff and authorities agreed only on a modest increase in capital expenditure in 2016. The headline budget deficit in 2016 is now projected at 4.1 percent of GDP, compared to 3.5 percent of GDP in the budget. As noted above, this increase is almost entirely driven by letting the automatic stabilizers operate. Still, fiscal policy in 2016 would be contractionary, with the overall deficit decreasing by over 1 percent of GDP in cyclically-adjusted terms relative to 2015. An understanding was also reached to increase domestic budgetary lending by about 0.2 percent of GDP to accommodate a development project in central Yerevan with important social implications. Recognizing the pressures on the budget, the authorities further strengthened the proposed Tax Code by including additional measures to increase collections in 2017 and beyond (see below).

12. Medium-term consolidation remains on track, largely underpinned by the new Tax Code. With public debt approaching 50 percent of GDP, maintaining fiscal discipline is key. Consolidation will continue in 2017 and beyond with a view to reducing the primary deficit below the debt-stabilizing level of 0.8 percent of GDP (a medium-term fiscal anchor) and putting the debt ratio on a declining path from 2018 (Annex III). Current expenditure is projected to increase only moderately in nominal terms (and to decline as percent of GDP), with efforts focused on increasing the efficiency and quality of spending, especially in critical areas such as healthcare and education. A significant part of medium-term consolidation will result from the new Tax Code (Chart and Box 1). In the final version of the Code submitted to the NA, the authorities agreed to further close loopholes by: (i) introducing a 5 percent tax on dividends for residents; (ii) ensuring that agricultural businesses with turnover above the AMD 40 million threshold will be subject to VAT; (iii) bringing diesel fuel under the VAT regime; and (iv) bringing forward excise increases for alcohol and tobacco to 2017. The inclusion of additional measures to strengthen the Tax Code and frontloading of some of the tax increases contribute to achieving fiscal sustainability and attests to the authorities' commitment to the program objectives. Adoption of the new Tax Code is an end-September SB.

Fiscal Position With and Without the Tax Code
(Percent GDP)



Source: National Authorities; and IMF staff calculations.

Box 1. The Proposed New Tax Code

The planned Tax Code will overhaul the existing tax legislation and will introduce a more stable and predictable tax environment.

The Code consolidates tax provisions currently scattered in numerous legal acts into a single coherent and internally consistent document. It comprises 4 parts: (i) *general part,* which establishes the main principles of taxation, provides key definitions, and defines the rights and responsibilities of the different parties; (ii) *special part,* which contains regulations on the various types of taxes; (iii) *tax administration part* which covers issues such as registration, oversight, sanctions for non-compliance, etc. and (iv) *transitional part*.

The general approach to the design of tax reforms in Armenia has been based on the understanding that the new tax system should enhance growth and equity, and generate revenue to support fiscal consolidation and higher social and capital expenditure. The increase in tax revenue is expected to come almost exclusively from indirect and property taxes which relatively less distortionary and harmful for growth. Specifically:

- Excise rates for alcohol and tobacco are to increase by 15 percent per year in the period 2017-21 and in addition, an ad valorem excise tax is proposed for tobacco products. The excise rates on fuels, including compressed natural gas, will be increased in 2018.

- The VAT threshold will be decreased from 2019 to AMD 40 million from the current high level of AMD 115 million.

- Some important VAT exemptions, including on diesel fuel, will be abolished to strengthen the system, help close loopholes, and potentially increase collections.

- The cadastral value of buildings and land will be updated with a view to gradually aligning it with market value.

- The progressivity of the personal income tax will be improved with a lower tax rate for the bottom income bracket and a lower cut-off income for the top marginal rate.

- Introducing a 5 percent tax on dividends for residents will improve equity and close loopholes in the reporting and taxation of income.

Overall, the proposed tax policy package, if approved by the National Assembly, is expected to raise the tax-to-GDP ratio by about 2 percentage points by 2021. A number of tax administration measures aimed at improving compliance could make the gain even larger.

13. With support from the new Tax Code and increased spending efficiency, social and capital expenditure will be protected despite the fiscal consolidation. Given limited fiscal space, expenditure policy will focus largely on improving efficiency, with capital and social spending remaining a priority owing to their implications for growth and equity. Capital project implementation improved markedly last year, with a number of foreign-financed projects reporting overexecution. This was due in part to strengthening the framework for monitoring and accountability of project implementation units and removing bottlenecks to implementing some large projects. The trend is expected to continue this year, including as a result of stepping up the work under past projects related to roads infrastructure and schools rehabilitation. In social policy, efforts are targeted mainly at improving coverage and the quality of services provided through the integrated social service centers.

14. The full implementation of the pension reform will be delayed by one year. Following the Constitutional Court ruling and ensuing amendments to the pension law in 2014, individual contributions to Pillar II were made mandatory for public sector employees and new entrants in the labor market. Private sector employees were allowed to postpone participation until July 2017. The public's perception of the pension reform seems to have improved in the last two years, including as a result of the government's awareness campaign. Nevertheless, the authorities have decided to postpone full implementation to July 2018, citing the technical challenges and pressures on the budget resulting from the increase in matching contributions (about 0.4 percent of GDP). Staff urged stronger efforts to complete this important reform and noted that further delays would risk losing the interest of the current foreign asset managers with sizeable potential reputational costs for Armenia.

15. Assessment of fiscal risks has become more important given increased budget lending. The outstanding stock of budget loans and sub-loans to the private sector stood at almost 9 percent of GDP in 2016Q1, and is set to increase further during the year. Staff pointed to the significant risks associated with this practice, especially in an environment of adverse shocks and rapidly decreasing buffers, and called for strengthening the lending framework. In this regard, the authorities and staff agreed that the newly established Fiscal Risk Assessment Division (FRAD) at the Ministry of Finance would undertake a comprehensive review of budgetary lending, including beneficiaries, borrowing terms, collateral and guarantees to identify risks and areas for management improvements (September 2016 SB).

Exchange Rate and Monetary Policies

16. The CBA is limiting its FX intervention to episodes of excessive market volatility, to allow greater two-way exchange rate flexibility and maintain buffers. FX sales in 2016Q1 targeted at avoiding a repeat of the periods of excessive pressure and fluctuation seen in late 2014 and 2015. Pressures on the dram have mitigated in recent months, and staff estimates suggest that the real exchange rate remains close to equilibrium. The current account is projected to gradually widen again over the medium term but should stabilize at a sustainable level of around 5 percent of GDP. The authorities agreed that limited intervention and increased two-way exchange rate flexibility will support the needed adjustments to external pressures and help strengthen the FX reserve buffers. Reserve coverage is projected to be adequate under most standard metrics, including the Fund's reserve adequacy (ARA) metric for floating regimes, but remains below the ARA metric for non-floating regimes, highlighting the importance of increasing exchange rate flexibility and limited intervention (Annex IV).

17. Monetary policy remains focused on managing inflation expectations, aiming at further gradual easing of monetary conditions. Staff noted that despite the policy rate cuts since mid-2015, monetary conditions remain tight as illustrated by negative inflation and the decline in private sector credit. The CBA argued that, in the context of an increased risk premium, the strong initial tightening and a cautious approach to easing the monetary conditions were needed to maintain credibility and minimize cumulative output loss over the medium term. Staff and the CBA agreed on the need to monitor and evaluate the situation continuously—particularly in the context of the new monetary policy conditionality (see below)—with the aim of gradually reducing the policy rate further to bring inflation back to the target at an appropriate pace. In line with this understanding, the CBA has reduced the policy rate by a further 75 basis point since the discussion during the mission. Headline inflation, nevertheless, is projected to remain slightly negative for a significant part of the year as food and energy prices continue to decline. With the envisaged path of gradual monetary easing, inflation is projected to return to positive territory by the end of 2016, and to the confidence band around the CBA target in 2017. Monetary easing will be supported by greater two-way flexibility of the exchange rate and further limiting FX interventions.

18. The CBA is working on building a policy framework to integrate the objective of financial stability into its operational framework. Staff stressed the need to ensure consistency of operations and designation of appropriate instruments in integrating the two objectives to mitigate the impact of greater exchange rate flexibility on financial stability. To this end, the CBA is taking action to develop an operational financial stability index, introduce a financial sector module into the CBA's macroeconomic model, and enhance coordination between the Monetary Policy and Financial Stability Departments of the CBA. The CBA should complement these efforts with the use of the macro and micro-prudential measures to minimize the risks of financial instability and further strengthen its crisis preparedness and regulatory and supervisory frameworks. The CBA also intends to seek further TA from the IMF.

19. To align program conditionality more closely with the CBA's policy-making framework, staff and the authorities agreed to replace the NDA PC by a monetary policy consultation clause (MPCC). The authorities argued that the correlation between meeting the NDA targets and the inflation outcome has weakened and that targeting money under the EFF in the inflation targeting context may be sending conflicting signals. In line with the policy adopted by the IMF in 2014 on review-based conditionality in countries with evolving monetary policy frameworks (EBS/14/24), the CBA requested that the NDA PC be replaced with an MPCC. Staff agreed that the CBA meets the criteria set for the review-based approach to monetary policy conditionality—namely, progress made in achieving central bank autonomy, minimal fiscal dominance, a quantitative understanding of the inflation process, and a focus on achieving an inflation objective, although communication needs to be strengthened. In addition, the MPCC can be a more effective means to control monetary conditions since, unlike the NDA, it is a two-sided instrument. Thus, for example, in the current circumstances, although the NDA PC has been met, MPCC conditionality would have been triggered because inflation is below the target. It was agreed, however, to retain the NDA as an indicative target to monitor domestic liquidity operations of the CBA and to safeguard against excessive expansion of the CBA balance sheet.

20. Progress has been made in implementing the recommendations of the 2014 Safeguards Assessment. The CBA has adopted a charter for its board members that clarifies their roles and responsibilities, and also strengthened its oversight and control of entities engaged in financial sector development and infrastructure in which the CBA holds equity investments. In addition, starting from 2016, the CBA will include in its annual report the objectives, risks, and risk-mitigation efforts associated with these investments. Further legislative changes to the Central Bank Law to strengthen the CBA's autonomy are pending.

Financial Sector Policy

21. The CBA is addressing the challenges associated with the new higher minimum capital requirements. The new AMD 30 billion minimum capital requirement intended to consolidate and strengthen the banking sector and due to enter into force on January 1, 2017, has brought challenges both to the banking industry and the supervisor. Some consolidation has been achieved so far, but absent more mergers and acquisitions, about AMD 175 billion ($360 million) will need to be injected as capital by January 1, 2017, to ensure all banks are in compliance with the new prudential requirement. The mission urged the CBA to develop a strategy (end-September 2016 SB) to deal with potential risks, including contingency plans for non-compliant banks. Staff advises against resorting to the option of allowing them to become non-deposit taking credit institutions with less stringent prudential requirements. Weak and unviable banks should be resolved and have their assets and liabilities absorbed by the banking industry in an orderly manner. Proper communication will be important to maintain public confidence in the stability of the financial sector.

22. The CBA has in place a number of macroprudential measures to mitigate risks faced by the banks and is seeking to introduce countercyclical capital buffers. However, micro-prudential intervention may still be needed. For instance, in an effort to encourage banks to carry less FX risk on their balance sheet, the CBA has imposed 50 percent higher risk weights to FX assets and 20 percent higher provisioning for FX loans. There are also limits on FX net open position and liquidity ratios. Furthermore, the CBA has prepared a draft law that will enable it to introduce, if necessary, counter-cyclical capital buffers requirements and charges for systemically important banks, in line with Basel III. In addition to these measures, the CBA should, without overburdening banks, consider performing targeted asset quality review of banks considered to have a weaker credit risk management framework and banks with higher NPLs.

23. The CBA is seeking to fully divest its shares in PanArmenian Bank (PAB). As of end-2015, the PAB, a development bank established in 2009 and fully owned by the CBA, had a loan portfolio in the amount of AMD 4.7 billion (net of impairments) and overdue/impaired loans standing at AMD 1.3 billion compared to AMD 0.2 billion as of end-2014. Given the conflict of interest in supervision and the bank's limited success, staff strongly advised the CBA to develop a plan (end-December 2016 SB) to divest its shares in the PAB within a specified period of time and ensure that the PAB operates under prudential guidelines at par with international best practices.

Structural Reforms

24. After experiencing significant challenges in 2015, the energy sector is undergoing major reforms. Following last year's financial difficulties, the Electricity Networks of Armenia (ENA)—the privately-owned major electricity distributor—was purchased by a new investor who is bringing the company's management to international standards. In addition, a review by an international audit company of last year's tariff increase supported the existing pricing mechanism. The government is now moving forward with a recovery plan for the electricity sector, implemented with financial and technical support from the World Bank. The plan includes refinancing expensive short-term commercial debt of the publicly-owned generators with lower-interest and longer-term borrowing from the World Bank, as well as eliminating expenditures of state companies outside their core areas. New tariffs will be set by the Public Sector Regulatory Commission (PSRC) by early summer, following the expected reduction in the price of natural gas, and the government will stop its temporary electricity subsidy by August. In parallel, work on extending the operating life of the Armenian Nuclear Power Plant is continuing, and the bankruptcy process of Nairit, the synthetic rubber plant that in recent years accumulated significant debts with electricity companies, is proceeding.

25. Reforms to improve the business environment are also advancing. The authorities are mindful of the need to implement structural reforms that can support growth in a context of adverse external conditions. As a result, they are introducing legislative changes to support domestic competition and improved bankruptcy procedures, while at the same time continue to support streamlining of business procedures via the Regulatory Guillotine initiative and regulatory impact assessments. Furthermore, the authorities continue to move forward in improving Armenia's connectivity via the "Open Skies" policy, and expect to conclude a Common Aviation Agreement with the EU by the end of the year.

C. Other Program Issues

26. The authorities are requesting waivers of nonobservance for the missed end-December 2015 fiscal deficit PC, higher end-June 2016 fiscal deficit and budgetary domestic lending PCs, as well as the shift from an NDA PC to a monetary policy consultation clause. The submission of a strengthened Tax Code , along with bringing forward some of the planned excise rate increases, provide tangible assurances regarding fiscal discipline and constitute corrective measures for the weaker fiscal performance in 2015 and revised fiscal targets for 2016. The adoption of a monetary policy consultation clause as of end-June (2016) would help to better align the program's monetary policy conditionality with the authorities' inflation targeting (IT) policy framework, as the correlation between meeting the NDA targets and the inflation outcome has weakened, and targeting money in the IT context may be sending conflicting signals. The program will continue monitoring NDA in the form of an indicative target to complement the assessment of monetary conditions.

STAFF APPRAISAL

27. Notwithstanding the difficult external conditions and the challenging outlook, performance under the program has been broadly satisfactory. All end-2015 PCs were met except for the fiscal deficit PC, which was missed by a small margin largely due to the unexpected non-completion of a large public asset sale and higher-than-budgeted VAT refunds.

28. The authorities' commitment to fiscal consolidation and debt sustainability, supported by a greater focus on a stronger tax system, is welcome. The stimulus in 2015 helped address the initial impact of the shock but risks to the fiscal position have increased and the fiscal policy options to further mitigate the impact of external shocks are limited. There is little room to further adjust expenditures, and it will be critical to ensure adoption of the new Tax Code that would bring revenue gains over the medium term to support fiscal consolidation and create space for capital and social spending. The authorities should also ensure that the various budgetary lending channels are well coordinated and monitored while at the same time undertaking an assessment of the fiscal risks of the ongoing and future lending operations.

29. Monetary policy should remain focused on managing inflation expectations with the aim of further gradual easing, supported by greater ER flexibility and limited FX interventions. The strong response by the CBA to the December 2014 external shock has ensured orderly market conditions and financial sector stability. However, given the negative inflation and output gap, the CBA should continue to cautiously ease monetary conditions within its inflation targeting framework with the objective of returning inflation to the target while maintaining orderly financial markets conditions through the use of macro and micro-prudential regulations. With the exchange rate currently estimated close to its equilibrium level, limited interventions and two-way flexibility will support monetary policy, allow adjustments to external pressures, and help maintain strong reserve buffers.

30. The CBA should continue improving its regulatory and policy frameworks to mitigate risks to bank balance sheets and to integrate the objectives of price and financial stability. With the deadline for the banks to meet the new capital requirement approaching, the CBA needs to put in place a sound strategy to deal with banks that may fail to comply with the prudential requirement by the stated deadline. Measures being taken by the CBA to introduce macroprudential requirements in line with Basel III and to further develop domestic capital markets are welcome. The CBA should proceed expeditiously to ensure consistency of financial stability considerations with its inflation targeting operational framework by introducing a financial sector module in the CBA's macroeconomic model, enhancing coordination between the CBA's Monetary Policy and Financial Stability Departments, and further strengthening its crisis preparedness and regulatory and supervisory frameworks. The CBA should also accelerate its efforts to divest its equity investments with entities engaged in financial sector activities, including a full divestment of its shares in PanArmenian Bank, to reduce the CBA's involvement in non-core activities.

31. Structural reforms remain critical to reduce vulnerabilities to adverse external developments and support medium-term growth. The authorities have made progress in moving forward with a financial recovery plan for the state-owned electricity generators, including a significant restructuring of their debt and the streamlining of their non-core expenditures. However significant challenges remain and the authorities should take further steps to improve the regulatory environment to support broad-based growth, including through introducing legislative changes to support domestic competition and improving the bankruptcy resolution procedures. Decommissioning the defunct Nairit chemical plant and ensuring that the state budget does not absorb losses or liabilities or make payments on behalf of utilities or other companies will be critical to safeguarding the prudent use of the limited budgetary resources.

32. Staff supports completion of the review and the authorities' request for a purchase in an amount equivalent to SDR 15.65 million. Risks to the program remain elevated but are manageable as the authorities are committed to sound macroeconomic policies and strengthened implementation of structural reforms. Armenia's repayment capacity and track record remain satisfactory. Staff supports the request for waiver of nonobservance for the missed December 2015 fiscal deficit PC on the basis of the corrective actions taken as well as the modification of the end-June fiscal deficit and budget lending PCs, and introducing MPCC conditionality.

Table 1. Armenia: Selected Economic and Financial Indicators, 2011–17

	2011	2012	2013	2014	2015		2016		2017
	Act.	Act.	Act.	Act.	EBS/15/119 1/	Prel.	EBS/15/119 1/	Proj.	Proj.
National income and prices:									
Real GDP (percent change)	4.7	7.1	3.3	3.5	2.5	3.0	2.2	2.2	2.5
Gross domestic product (in billions of drams) 2/	3,778	4,266	4,556	4,843	5,122	5,047	5,443	5,297	5,646
Gross domestic product (in millions of U.S. dollars)	10,142	10,619	11,121	11,644	10,607	10,561	10,672	10,735	11,112
Gross domestic product per capita (in U.S. dollars)	3,426	3,576	3,732	3,901	3,547	3,532	3,568	3,589	3,715
CPI (period average; percent change)	7.7	2.5	5.8	3.0	4.3	3.7	3.4	-0.4	4.0
CPI (end of period; percent change)	4.7	3.2	5.6	4.6	3.4	-0.1	4.0	1.0	4.0
GDP deflator (percent change) 2/	4.3	5.4	3.4	2.7	3.2	1.2	4.0	2.7	4.0
Poverty rate (in percent)	35.0	32.4	32.0	30.0	...	...	...	...	...
Investment and saving (in percent of GDP)									
Investment	27.0	22.8	22.3	21.1	18.9	19.5	19.5	19.6	20.0
National savings	16.6	12.8	14.7	13.8	14.0	16.9	13.7	16.6	16.6
Money and credit (end of period)									
Reserve money (percent change)	32.3	1.9	29.9	-0.1	4.9	3.9	4.8	5.8	6.7
Broad money (percent change)	23.6	19.6	15.2	8.9	6.8	10.7	6.3	5.5	6.7
Velocity of broad money (end of period)	3.4	3.2	2.9	2.9	2.8	2.7	2.8	2.7	2.7
Commercial banks' 3-month lending rate (in percent)	20.7	18.5	18.3	19.4	...	15.7	...	...	...
Central government operations (in percent of GDP)									
Revenue and grants	22.1	20.9	22.2	22.0	21.5	21.5	21.2	21.5	21.6
Of which: tax revenue 3/	16.7	17.0	21.0	21.0	20.1	20.0	20.0	20.0	20.5
Expenditure 4/	25.0	22.4	23.8	23.9	25.4	26.3	24.7	25.6	24.4
Overall balance on a cash basis	-2.8	-1.4	-1.0	-2.1	-3.9	-4.8	-3.5	-4.1	-2.8
Public and publicly-guaranteed debt (in percent of GDP)	42.0	41.2	40.8	43.5	48.2	48.7	50.6	52.4	54.0
Share of foreign currency debt (in percent)	86.8	85.8	85.2	86.2	88.5	86.9	87.7	87.0	86.2
External sector									
Exports of goods and services (in millions of U.S. dollars)	2,742	2,918	3,156	3,319	3,226	3,140	3,215	3,059	3,137
Imports of goods and services (in millions of U.S. dollars)	-4,918	-5,131	-5,365	-5,468	-4,634	-4,357	-4,693	-4,041	-4,202
Exports of goods and services (percent change)	24.0	6.4	8.2	5.2	-2.8	-5.4	-0.3	-2.6	2.5
Imports of goods and services (percent change)	8.4	4.3	4.6	1.9	-15.3	-20.3	1.3	-7.3	4.0
Current account balance (in percent of GDP)	-10.4	-10.0	-7.6	-7.3	-4.9	-2.6	-5.8	-3.0	-3.4
FDI (net, in millions of U.S. dollars) 5/	437	481	508	388	334	170	438	274	278
Debt service ratio (in percent of exp. of goods and serv.) 6/	3.7	8.2	27.9	8.6	5.8	12.5	6.6	8.0	9.2
Gross international reserves (in millions of U.S. dollars)	1,869	1,799	2,253	1,489	1,712	1,771	1,779	1,858	1,959
Import cover 7/	4.4	4.0	4.9	4.1	4.4	5.3	4.5	5.3	5.4
Nominal effective exchange rate (percent change) 8/	-2.8	-2.4	-0.9	3.9	...	2.8	...	...	...
Real effective exchange rate (percent change) 8/	0.1	-3.3	1.2	4.0	...	2.9	...	...	...
End-of-period exchange rate (dram per U.S. dollar)	386	404	406	475	...	484	...	...	...
Average exchange rate (dram per U.S. dollar)	373	402	410	416	...	478	...	...	...
Memorandum item:									
Population (in millions)	3.0	3.0	3.0	3.0	...	...	...	...	...

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

1/ Staff Report for the Second Review.
2/ In the first quarter of 2015 the authorities started calculating GDP using the SNA 2008 methodology. They have revised GDP series from 2012 on, but pre-2012 series remain calculated using the SNA 1993 methodology. The Staff Report for the First Review and 2014 Consultation was calculated using the pre-revision series. The increase in the GDP deflator in 2012 is due to this methodological change. Without this methodological change, the GDP deflator in 2012 is -1.2 percent.
3/ In 2013, tax revenue includes social contribution.
4/ In 2013 includes 1.5 percent of GDP related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom, and the transfer (expenditure) of the same amount from the government to ArmRusGazprom to liquidate liabilities. A surplus of 0.6 percent of GDP is obtained when this transaction is excluded.
5/ In 2013, a credit for $155 million is registered in FDI to reflect the acquisition by Gazprom of 20 percent of the shares of ArmRusGazprom, while an offseting debit is registered in other capital (net) to reflect the corresponding reduction in liabilities of the latter with the former.
6/ Based on public and publicly-guaranteed debt.
7/ Gross international reserves in months of next year's imports of goods and services, including the SDR holdings.
8/ A positive sign denotes appreciation.

Table 2. Armenia: Balance of Payments, 2011–21

(In millions of U.S. dollars, unless otherwise indicated)

	2011	2012	2013	2014	2015		2016	2017	2018	2019	2020	2021
	Act.	Act.	Act.	Prel.	EBS/15/119	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	-1,059	-1,058	-845	-849	-520	-279	-326	-381	-441	-507	-588	-715
Trade balance	-2,110	-2,112	-2,092	-2,055	-1,384	-1,154	-921	-989	-1,057	-1,135	-1,229	-1,363
Exports, fob	1,432	1,516	1,636	1,698	1,622	1,626	1,622	1,670	1,735	1,794	1,856	1,850
Imports, fob 1/	-3,541	-3,628	-3,728	-3,754	-3,005	-2,780	-2,543	-2,659	-2,792	-2,928	-3,085	-3,212
Services (net)	-66	-102	-117	-93	-24	-64	-61	-77	-94	-112	-130	-151
Credits	1,311	1,402	1,520	1,621	1,605	1,513	1,438	1,466	1,496	1,526	1,556	1,603
Debits	-1,376	-1,504	-1,637	-1,714	-1,628	-1,577	-1,498	-1,543	-1,590	-1,637	-1,686	-1,754
Income (net) 2/	360	423	539	556	307	414	155	163	171	180	189	198
Transfers (net)	757	733	825	744	581	524	501	521	538	560	582	600
Private	584	625	704	641	461	419	386	401	413	430	447	460
Official	172	108	121	103	120	105	115	120	125	130	135	140
Capital and financial account	1,007	848	1,789	260	649	745	302	412	605	678	637	821
Capital transfers (net)	95	108	84	70	66	39	78	66	88	89	91	93
Foreign direct investment (net) 2/	437	481	508	388	334	170	274	278	287	297	307	319
Portfolio investment (net)	-8	1	-9	-43	-26	-29	-36	-33	-35	-34	-34	-34
Public sector borrowing (net)	151	225	376	216	479	535	276	221	186	226	144	274
Disbursements	180	255	914	257	740	798	354	327	314	373	803	440
Amortization	-28	-30	-537	-41	-260	-262	-79	-107	-128	-147	-660	-167
Other capital (net)	332	34	830	-371	-204	30	-290	-120	80	100	130	170
Errors and omissions	-37	191	0	-66	0	-275	0	0	0	0	0	0
Overall balance	-88	-18	644	-650	129	190	-24	31	164	171	48	107
Financing	88	18	-644	650	-246	-290	-120	-153	-164	-171	-48	-107
Gross international reserves (increase: -)	-4	70	-454	764	-222	-282	-87	-102	-101	-97	29	-35
Use of Fund credit, net	92	-52	-190	-113	-24	-9	-33	-52	-63	-74	-77	-71
Purchases/disbursements	114	103	84	36	...	16	...	...	...	...	...	...
Repurchases/repayments	-23	-155	-274	-149	-24	-25	-33	-52	-63	-74	-77	-71
Financing gap	0	0	0	0	117	100	144	122	0	0	0	0
IMF EFF	0	0	0	0	17	0	44	22	...	...	...	...
Other 3/	0	0	0	0	100	100	100	100	...	...	...	...
Memorandum items:												
Current account (in percent of GDP)	-10.4	-10.0	-7.6	-7.3	-4.9	-2.6	-3.0	-3.4	-3.8	-4.1	-4.5	-5.2
Trade balance (in percent of GDP)	-20.8	-19.9	-18.8	-17.7	-13.0	-10.9	-8.6	-8.9	-9.1	-9.2	-9.5	-9.9
Gross international reserves (end of period)	1,869	1,799	2,253	1,489	1,712	1,771	1,858	1,959	2,060	2,158	2,129	2,164
In months of next year's imports	4.4	4.0	4.9	4.1	4.4	5.3	5.3	5.4	5.4	5.4	5.4	5.0
Merchandise export growth, percent change	19.5	5.9	7.9	3.8	-4.5	-4.2	-0.3	3.0	3.8	3.4	3.5	-0.3
Merchandise import growth, percent change	8.5	2.4	2.8	0.7	-19.9	-25.9	-8.5	4.6	5.0	4.9	5.3	4.1
Non-gas merchandise imports growth, percent cha	7.3	0.5	5.7	1.0	-18.2	-26.9	-8.4	4.9	5.2	5.1	5.3	4.1
Nominal external debt	7,252	7,456	8,682	8,274	8,539	8,902	9,284	9,607	9,839	10,119	10,347	10,750
o.w. public external debt	3,568	3,738	3,902	3,825	4,266	4,414	4,766	5,058	5,210	5,390	5,488	5,721
Nominal external debt stock (in percent of GDP)	71.5	70.2	78.1	71.1	80.5	84.3	86.5	86.5	84.3	82.2	79.7	78.1
External public debt-to-exports ratio (in percent)	130.1	128.1	123.6	115.3	132.2	140.6	155.8	161.3	161.3	162.4	160.8	165.7
External public debt service (in percent of exports)	3.7	8.2	27.9	8.6	5.8	12.5	8.0	9.2	9.9	10.5	25.2	9.5

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

1/ From 2014 on, imports of gas are calculated at the (lower) price of $189 per thousand cubic meter. In addition to reducing projected gas imports in 2014, this change also implies lower FDI (lower intercompany lending between parent and subsidiary)

2/ In 2013, a credit for $155 million is registered in FDI to reflect the acquisition by Gazprom of 20 percent of the shares of ArmRusGazprom, while an offseting debit is registered in other capital (net) to reflect the corresponding reduction in liabilities of the latter with the former.

3/ Financing from the Eurasian Fund for Stability and Development. First disbursement occurred in December 2015.

Table 3. Armenia: Monetary Accounts, 2011–16
(in billions of drams, unless otherwise indicated)

	2011	2012	2013	2014	2015				2016			
	Act.	Act.	Act.	Act.	Act.	Act.	Proj.		Proj.			
				Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Central Bank of Armenia												
Net foreign assets	465.0	467.2	655.8	437.4	441.8	468.2	484.4	566.2	486.8	521.3	529.2	552.3
Net international reserves	521.2	538.7	768.7	569.2	573.7	602.6	641.8	723.8	648.1	683.8	699.0	724.0
Other	-56.3	-71.5	-112.9	-131.8	-131.9	-134.4	-157.4	-157.6	-161.3	-162.6	-169.7	-171.7
Net domestic assets	206.3	216.6	232.2	449.4	350.2	349.8	393.2	355.1	363.0	366.9	382.4	422.6
Claims on general government (net)	-66.7	-93.3	-175.9	-102.1	-203.2	-161.0	-115.0	-120.2	-98.7	-73.0	-99.0	-59.1
Of which: central government (net)	-54.2	-80.5	-160.1	-83.9	-180.2	-138.9	-94.6	-105.6	-98.7	-73.0	-99.0	-59.1
Claims on banks	137.0	152.9	174.0	312.5	281.3	252.5	247.8	225.0	194.0	200.3	207.4	209.4
CBA bills 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other items (net)	136.0	157.0	234.1	239.0	272.0	258.3	260.4	250.3	267.7	239.7	274.0	272.3
Reserve money	671.3	683.8	888.1	886.8	792.0	818.0	877.6	921.3	849.8	888.2	911.6	974.9
Currency issue	398.8	440.1	446.8	412.3	345.9	375.1	375.8	413.6	349.2	385.4	389.6	433.4
Deposits	272.5	243.7	441.2	474.4	446.1	442.9	501.8	507.7	500.6	502.7	522.0	541.5
Deposits in drams	169.9	157.7	202.4	337.7	335.0	317.8	315.6	324.6	337.3	323.1	322.8	341.0
Deposits in foreign currency	102.6	86.0	238.8	136.7	111.0	125.1	186.2	183.1	163.3	179.7	199.2	200.5
Banking system												
Net foreign assets	31.9	-124.2	-58.8	-373.1	-297.8	-240.3	-270.1	-160.6	-203.9	-174.5	-181.4	-155.1
Net domestic assets	1,094.7	1,471.2	1,610.9	2,062.8	1,935.9	1,962.9	2,020.1	2,030.4	2,094.0	2,032.3	2,039.5	2,128.4
Claims on government (net)	-1.8	17.0	-9.6	79.5	-9.8	23.9	72.7	85.1	115.7	149.7	132.1	180.4
Of which: claims on central government (net)	10.7	29.8	6.1	97.8	13.1	45.9	93.1	99.8	115.7	149.7	132.1	180.4
Claims on rest of the economy	1,251.2	1,587.9	1,781.7	2,147.3	2,072.2	2,057.1	2,038.2	2,069.9	2,107.2	2,011.4	2,041.3	2,081.8
Other items (net)	-154.7	-133.7	-161.2	-163.9	-126.5	-118.1	-90.8	-124.6	-128.9	-128.9	-133.9	-133.9
Broad money	1,126.6	1,347.0	1,552.1	1,689.8	1,638.1	1,722.7	1,750.0	1,869.8	1,890.0	1,857.8	1,858.1	1,973.3
Currency in circulation	349.6	384.3	384.9	349.2	297.8	325.7	323.8	346.9	298.4	333.4	335.0	364.0
Deposits	777.0	962.7	1,167.2	1,340.6	1,340.3	1,397.0	1,426.2	1,522.8	1,591.7	1,524.4	1,523.1	1,609.2
Domestic currency	306.5	355.9	470.2	483.8	495.2	515.6	506.4	547.2	583.3	527.7	523.9	574.2
Foreign currency	470.5	606.8	697.0	856.7	845.1	881.4	919.8	975.7	1,008.4	996.7	999.2	1,035.0
Memorandum items:												
Exchange rate (in drams per U.S. dollar, end of period)	385.8	403.6	405.6	475.0	471.1	472.5	473.7	483.8	480.8	...	...	...
NIR, program definition, at program exchange rates (USD millions)	794	830	1,068	796	902	912	855	1,013	896	977	998	1,074
12-month change in reserve money (in percent)	32.3	1.9	29.9	-0.1	1.6	14.7	22.1	3.9	7.3	8.6	3.9	5.8
12-month change in broad money (in percent)	23.6	19.6	15.2	8.9	6.1	7.7	8.6	10.7	15.4	7.8	6.2	5.5
12-month change in dram broad money (in percent)	25.9	12.8	15.5	-2.6	-1.0	-1.0	-5.9	7.3	11.2	2.4	3.5	4.9
12-month change in private sector credit (in percent)	35.6	26.9	12.2	20.5	14.0	9.6	6.2	-3.6	1.7	-2.2	0.2	0.6
Velocity of broad money (end of period)	3.4	3.2	2.9	2.9	3.0	2.9	2.9	2.7	2.7	2.8	2.8	2.7
Money multiplier	1.7	2.0	1.7	1.9	2.1	2.1	2.0	2.0	2.2	2.1	2.0	2.0
Dollarization in bank deposits 2/	60.6	63.0	59.7	63.9	63.1	63.1	64.5	64.1	63.4	65.4	65.6	64.3
Dollarization in broad money 3/	41.8	45.0	44.9	50.7	51.6	51.2	52.6	52.2	53.4	53.6	53.8	52.5
Currency in circulation in percent of deposits	45.0	39.9	33.0	26.0	22.2	23.3	22.7	22.8	18.7	21.9	22.0	22.6
Stock of foreign currency deposits (in millions of U.S. dollars) 4/	1,222	1,576	1,700	2,090	2,061	2,150	2,244	2,380	2,459	2,431	2,437	2,524
Banking system financing of the central government (cumulative) 5/	42.7	19.1	-23.7	91.6	-84.6	-51.8	-4.7	2.0	15.9	49.9	32.3	80.7
Banks' deposits at CBA to deposits in banking system (in percent)	35.1	25.3	37.8	35.4	33.3	31.7	35.2	33.3	31.5	33.0	34.3	33.6

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

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

Table 4. Armenia: Financial Soundness Indicators for the Banking Sector, 2011–16
(in percent, unless otherwise indicated)

	2011	2012	2013	2014	2015				2016
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep	Dec	Mar.
Capital adequacy									
Total regulatory capital to risk-weighted assets	18.3	16.8	16.7	14.5	15.1	15.4	15.7	16.2	17.3
Capital (net worth) to assets	17.2	15.9	15.3	14.0	14.4	14.6	14.2	14.7	15.0
Asset composition									
Sectoral distribution of loans (in billions of drams)									
Industry (excluding energy sector)	179	250	223	266	246	245	236	226	220
Energy sector	78	75	95	112	104	94	108	111	101
Agriculture	81	101	118	150	161	163	154	149	150
Construction	96	100	109	124	115	115	113	107	123
Transport and communication	51	48	54	52	53	55	81	77	77
Trade/commerce	276	321	352	386	363	352	334	345	373
Consumer credits			366	452	436	423	414	423	429
Mortgage loans			143	172	169	171	174	179	177
Sectoral distribution of loans to total loans (percent of total)									
Industry (excluding energy sector)	14.0	15.5	12.2	12.0	11.6	11.8	11.4	10.5	9.9
Energy sector	6.1	4.6	5.2	5.1	4.9	4.5	5.2	5.2	4.6
Agriculture	6.3	6.3	6.5	6.8	7.6	7.8	7.5	6.9	6.8
Construction	7.5	6.2	6.0	5.6	5.4	5.5	5.5	4.9	5.1
Transport and communication	4.0	3.0	3.0	2.3	2.5	2.6	3.9	3.6	3.5
Trade/commerce	21.6	19.9	19.3	17.4	17.2	16.9	16.2	16.0	16.8
Consumer credits			20.1	20.3	20.7	20.3	20.0	19.6	19.4
Mortgage loans			7.9	7.8	8.0	8.2	8.4	8.3	8.0
Foreign exchange loans to total loans	61.2	64.7	63.8	64.7	67.7	67.1	66.7	66.7	67.9
Asset quality									
Nonperforming loans (in billions of drams)	44	58	80	150	171	188	173	166	218
Watch (up to 90 days past due)	19	27	41	73	78	85	72	75	97
Substandard (91-180 days past due)	16	19	20	44	56	61	54	48	57
Doubtful (181-270 days past due)	9	13	19	33	37	41	47	43	63
Loss (>270 days past due)	45	77	108	173	195	218	249	288	293
Nonperforming loans to gross loans	3.4	3.6	4.5	6.8	8.1	9.0	8.4	7.8	10.0
Provisions to nonperforming loans	55.4	55.1	49.5	41.3	39.1	38.1	40.7	42.9	40.6
Spread between highest and lowest rates of interbank borrowing in AMD	1.5	1.0	2.2	4.0	10.5	3.0	1.0	1.8	0.4
Spread between highest and lowest rates of interbank borrowing in FX	5.3	9.5	6.3	3.5	0.8	0.0	0.0	5.0	1.0
Earnings and profitability									
ROA (profits to period average assets)	1.9	1.1	1.4	0.7	-0.5	-0.4	-0.5	-0.6	0.4
ROE (profits to period average equity)	9.8	11.5	9.2	4.6	-3.4	-3.1	-3.5	-4.4	3.0
Interest margin to gross income	42.0	40.6	37.1	35.7	28.2	29.2	29.2	28.9	28.8
Interest income to gross income	78.3	80.0	79.1	77.3	78.2	77.9	77.2	76.5	78.4
Noninterest expenses to gross income	36.4	34.2	33.0	31.7	28.9	29.0	29.0	29.4	28.6
Liquidity									
Liquid assets to total assets	27.9	25.6	29.1	25.1	24.1	25.2	27.2	28.0	29.2
Liquid assets to total short-term liabilities	121	126	142	129	137	138	147	142	158
Customer deposits to total (non-interbank) loans	92	93	106	98	100	103	108	112	113
Foreign exchange liabilities to total liabilities	63.3	64.9	64.1	63.5	64.1	64.4	65.6	65.7	65.6
Sensitivity to market risk									
Gross open positions in foreign exchange to capital	3.0	3.8	3.7	14.6	8.6	7.5	5.8	6.5	5.2
Net open position in FX to capital	-0.9	1.6	0.1	-11.1	-4.6	-3.3	-2.2	-2.8	-2.3

Source: Central Bank of Armenia.

Table 5. Armenia: Central Government Operations, 2011–17

(In billions of dram)

	2011	2012	2013	2014	2015		2016		2017
	Act.	Act.	Act. 2/	Prel.	EBS/15/119	Proj.	EBS/15/119	Proj.	Proj.
Total revenue and grants	834.5	892.6	1011.5	1064.6	1103.8	1084.1	1156.0	1136.2	1222.1
Total revenue	776.6	875.7	1000.7	1050.1	1074.5	1056.3	1124.3	1103.4	1200.3
Tax revenues	629.6	723.4	956.6	1018.4	1031.1	1011.3	1087.0	1061.8	1156.0
VAT	301.5	340.4	371.7	401.0	392.3	380.1	407.8	409.9	436.9
Profits, simplified and presumptive	143.8	164.5	167.6	120.9	105.5	106.8	106.6	112.0	122.3
Personal income tax	81.2	91.7	256.9	301.1	313.3	311.7	332.9	327.1	348.7
Customs duties	34.7	41.3	44.3	48.4	58.1	61.5	64.9	54.2	59.4
Other	68.4	85.6	116.1	147.0	162.0	151.2	174.6	158.6	188.8
Social contributions 1/	123.4	129.1	17.9	4.8	9.8	10.5	13.4	13.4	14.3
Other revenue	23.6	23.2	26.2	26.9	33.6	34.4	24.0	28.2	30.0
Grants	57.9	16.9	10.8	14.5	29.3	27.8	31.7	32.8	21.8
Total expenditure	943.1	956.3	1084.1	1158.4	1303.4	1328.0	1346.8	1355.6	1377.8
Expenses 2/	788.7	852.4	980.6	1048.7	1186.3	1179.6	1216.6	1221.1	1240.8
Wages	190.5	194.3	215.6	253.4	299.3	296.2	306.6	309.5	310.8
Social Contributions	4.7	4.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments to individual pension accts.	0.0	0.0	0.0	9.5	18.6	20.8	26.8	26.8	28.5
Subsidies 3/	4.3	4.6	4.9	8.4	24.6	19.8	15.9	18.9	8.2
Interest	35.2	40.2	46.7	61.6	76.3	74.1	99.4	100.2	98.1
Social allowances and pensions	255.1	287.4	294.0	335.0	380.2	368.5	386.6	386.6	399.8
Pensions/social security benefits	186.6	197.5	198.4	218.1	249.6	246.8	250.3	250.3	258.1
Social assistance benefits	68.5	89.9	95.6	117.0	130.6	121.7	136.3	136.3	141.7
Employer social benefits	0.0	12.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Goods and services	95.4	132.6	140.9	112.2	112.7	125.3	72.1	71.0	74.2
Grants	69.2	71.4	78.2	82.9	104.7	102.2	102.5	105.6	108.0
Other expenditure 4/	134.3	117.1	200.3	185.6	169.9	172.8	206.7	202.5	213.2
Transactions in nonfinancial assets	154.4	103.9	103.5	109.7	117.1	148.4	130.1	134.5	137.0
Acquisition of nonfinancial assets 5/	157.7	106.6	105.0	111.2	133.1	150.5	130.1	134.5	137.0
Disposals of nonfinancial assets	3.3	2.7	1.6	1.6	16.0	2.1	0.0	0.0	0.0
Overall balance (above-the-line)	-108.7	-63.8	-72.6	-93.8	-199.6	-244.0	-190.7	-219.4	-155.7
Statistical discrepancy	2.9	2.1	28.6	-7.6	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-105.8	-61.6	-43.9	-101.4	-199.6	-244.0	-190.7	-219.4	-155.7
Financing	105.8	61.6	43.9	101.4	199.6	244.0	190.7	219.4	155.7
Domestic financing	62.7	6.8	-43.9	75.7	-21.6	33.6	84.3	74.9	36.4
Banking system 6/	55.1	20.1	-23.7	91.6	-14.2	2.0	51.5	89.0	31.7
CBA	22.4	-26.3	-79.6	76.3	-31.4	-21.7	17.9	54.9	-0.5
Commercial Banks	32.7	46.4	55.9	15.4	17.2	23.7	33.6	34.2	32.1
Nonbanks	7.6	-13.2	-20.2	-16.0	-4.0	8.6	32.8	-14.1	4.8
Privatization proceeds	0.0	0.0	0.0	0.0	12.6	7.7	0.0	0.0	0.0
T-Bills/other	4.3	-24.6	-62.7	7.3	-7.3	-5.1	8.4	8.4	7.9
Promissory note/other	0.0	0.0	63.3	-6.5	0.0	0.0	0.0	0.0	0.0
Net lending	3.4	11.4	-20.9	-16.7	-9.2	6.0	24.4	-22.5	-3.1
External financing	43.0	54.8	87.8	25.8	172.9	162.5	55.5	95.2	68.4
Gross inflow 4/ 7/	88.9	118.4	373.1	106.8	346.3	345.6	138.5	175.2	166.3
Amortization due	-10.8	-27.9	-246.4	-38.6	-118.7	-118.7	-36.2	-33.3	-48.2
Net lending	-35.1	-35.6	-38.9	-42.4	-54.7	-64.3	-46.8	-46.8	-49.6
Other financing 8/	...	...	0.0	0.0	48.3	47.8	51.0	49.3	50.8
Memorandum items:									
Nominal GDP (in billion of drams)	3,778	4,266	4,556	4,843	5,122	5,047	5,443	5,297	5,646
Program balance 9/	-137.4	-85.9	-40.4	-160.5	-263.5	-298.6	-213.2	-261.6	-180.5
Primary balance 10/	-105.1	-47.8	-85.6	-91.2	-187.2	-228.2	-113.7	-188.5	-110.3
Debt-creating fiscal balance 11/	-143.7	-99.4	-48.2	-136.2	-254.3	-308.3	-237.5	-266.2	-205.3
Government securities issuance	30.3	30.8	20.4	16.7	10.0	15.6	42.0	42.0	40.0

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

1/ From 2014, social contributions include contributions to the second pillar of the pension system.

2/ Composition of expense reclassified in November 2013 to account for wage bill more accurately. A further reclassification of expenses was made in 2015 whereby some spending on goods and services was classified in other categories.

3/ In 2015 reflects the payment of wage arrears for Nairit and the electricity subsidy to households and SMEs. In 2016, an additional subsidy of AMD 2 billion is assumed to cover the electricity tariff differential for households and SMEs.

4/ In 2013 includes AMD 63 billion related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom (gross inflow), and the transfer (other expenditure) of the same amount from the government to ArmRusGazprom to liquidate liabilities. Excluding this transaction, the deficit would amount to AMD 43.6 billion, or 1 percent of GDP.

5/ Includes acquisition of military equipment.

6/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.

7/ Includes IMF budget support in 2011-12.

8/ EFSD financing ($100 million in 2015-17). First disbursement occurred in December 2015.

9/ 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.

10/ Sum of overall balance (above the line), interest expense, and domestic and external net lending.

11/ Sum of overall balance (above-the-line) and external net lending. In 2013, it excludes the transfer associated to the acquisition of ArmRusGazprom by Gazprom, since it was financed with the sale of the government's shares in the company.

Table 6. Armenia: Central Government Operations, 2011–17

(In percent of GDP)

	2011	2012	2013	2014	2015		2016		2017
	Act.	Act.	Act.	Prel.	EBS/15/119	Proj.	EBS/15/119	Proj.	Proj.
Total revenue and grants	22.1	20.9	22.2	22.0	21.5	21.5	21.2	21.5	21.6
Total revenue	20.6	20.5	22.0	21.7	21.0	20.9	20.7	20.8	21.3
Tax revenues	16.7	17.0	21.0	21.0	20.1	20.0	20.0	20.0	20.5
VAT	8.0	8.0	8.2	8.3	7.7	7.5	7.5	7.7	7.7
Profits, simplified and presumptive	3.8	3.9	3.7	2.5	2.1	2.1	2.0	2.1	2.2
Personal income tax	2.1	2.1	5.6	6.2	6.1	6.2	6.1	6.2	6.2
Customs duties	0.9	1.0	1.0	1.0	1.1	1.2	1.2	1.0	1.1
Other	1.8	2.0	2.5	3.0	3.2	3.0	3.2	3.0	3.3
Social contributions 1/	3.3	3.0	0.4	0.1	0.2	0.2	0.2	0.3	0.3
Other revenue	0.6	0.5	0.6	0.6	0.7	0.7	0.4	0.5	0.5
Grants	1.5	0.4	0.2	0.3	0.6	0.6	0.6	0.6	0.4
Total expenditure	25.0	22.4	23.8	23.9	25.4	26.3	24.7	25.6	24.4
Expense 2/	20.9	20.0	21.5	21.7	23.2	23.4	22.4	23.1	22.0
Wages	5.0	4.6	4.7	5.2	5.8	5.9	5.6	5.8	5.5
Social Contributions	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments to individual pension accts.	0.0	0.0	0.0	0.2	0.4	0.4	0.5	0.5	0.5
Subsidies 3/	0.1	0.1	0.1	0.2	0.5	0.4	0.3	0.4	0.1
Interest	0.9	0.9	1.0	1.3	1.5	1.5	1.8	1.9	1.7
Social allowances and pensions	6.8	6.7	6.5	6.9	7.4	7.3	7.1	7.3	7.1
Pensions/social security benefits	4.9	4.6	4.4	4.5	4.9	4.9	4.6	4.7	4.6
Social assistance benefits	1.8	2.1	2.1	2.4	2.5	2.4	2.5	2.6	2.5
Employer social benefits	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Goods and services	2.5	3.1	3.1	2.3	2.2	2.5	1.3	1.3	1.3
Grants	1.8	1.7	1.7	1.7	2.0	2.0	1.9	2.0	1.9
Other expenditure 4/	3.6	2.7	4.4	3.8	3.3	3.4	3.8	3.8	3.8
Transactions in nonfinancial assets	4.1	2.4	2.3	2.3	2.3	2.9	2.4	2.5	2.4
Acquisition of nonfinancial assets 5/	4.2	2.5	2.3	2.3	2.6	3.0	2.4	2.5	2.4
Disposals of nonfinancial assets	0.1	0.1	0.0	0.0	0.3	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-2.9	-1.5	-1.6	-1.9	-3.9	-4.8	-3.5	-4.1	-2.8
Statistical discrepancy	0.1	0.0	0.6	-0.2	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-2.8	-1.4	-1.0	-2.1	-3.9	-4.8	-3.5	-4.1	-2.8
Financing	2.8	1.4	1.0	2.1	3.9	4.8	3.5	4.1	2.8
Domestic financing	1.7	0.2	-1.0	1.6	-0.4	0.7	1.5	1.4	0.6
Banking system 6/	1.5	0.5	-0.5	1.9	-0.3	0.0	0.9	1.7	0.6
CBA	0.6	-0.6	-1.7	1.6	-0.6	-0.4	0.3	1.0	0.0
Commercial Banks	0.9	1.1	1.2	0.3	0.3	0.5	0.6	0.6	0.6
Nonbanks	0.2	-0.3	-0.4	-0.3	-0.1	0.2	0.6	-0.3	0.1
Privatization proceeds	0.0	0.0	0.0	0.0	0.2	0.2	0.0	0.0	0.0
T-Bills/other	0.1	-0.6	-1.4	0.1	-0.1	-0.1	0.2	0.2	0.1
Promissory note/other	0.0	0.0	1.4	-0.1	0.0	0.0	0.0	0.0	0.0
Net lending	0.1	0.3	-0.5	-0.3	-0.2	0.1	0.4	-0.4	-0.1
External financing	1.1	1.3	1.9	0.5	3.4	3.2	1.0	1.8	1.2
Gross inflow 4/ 7/	2.4	2.8	8.2	2.2	6.8	6.8	2.5	3.3	2.9
Amortization due	-0.3	-0.7	-5.4	-0.8	-2.3	-2.4	-0.7	-0.6	-0.9
Net lending	-0.9	-0.8	-0.9	-0.9	-1.1	-1.3	-0.9	-0.9	-0.9
Other financing 8/	…	…	0.0	0.0	0.9	0.9	0.9	0.9	0.9
Memorandum items:									
Nominal GDP (in billion of drams)	3,778	4,266	4,556	4,843	5,122	5,047	5,443	5,297	5,646
Program balance 9/	-3.6	-2.0	-0.9	-3.3	-5.1	-5.9	-3.9	-4.9	-3.2
Primary balance 10/	-2.8	-1.1	-1.9	-1.9	-3.7	-4.5	-2.1	-3.6	-2.0
Debt-creating fiscal balance 11/	-3.8	-2.3	-1.1	-2.8	-5.0	-6.1	-4.4	-5.0	-3.6
Government securities issuance	0.8	0.7	0.4	0.3	0.2	0.3	0.8	0.8	0.7

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

1/ From 2014, social contributions include contributions to the second pillar of the pension system.

2/ Composition of expense reclassified in November 2013 to account for wage bill more accurately. A further reclassification of expenses was made in 2015 whereby some spending on goods and services was classified in other categories.

3/ In 2015 reflects the payment of wage arrears for Nairit and the electricity subsidy to households and SMEs. In 2016, an additional subsidy of AMD 2 billion (0.04 percent of GDP) is assumed to cover the electricity tariff differential for households and SMEs.

4/ In 2013 includes AMD 63 billion related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom (gross inflow), and the transfer (other expenditure) of the same amount from the government to ArmRusGazprom to liquidate liabilities. Excluding this transaction, the deficit would amount to AMD 43.6 billion, or 1 percent of GDP.

5/ Includes acquisition of military equipment.

6/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.

7/ Includes IMF budget support in 2011-12.

8/ EFSD financing ($100 million in 2015-17). First disbursement occurred in December 2015.

9/ 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.

10/ Sum of overall balance (above the line), interest expense, and domestic and external net lending.

11/ Sum of overall balance (above-the-line) and external net lending. In 2013, it excludes the transfer associated to the acquisition of ArmRusGazprom by Gazprom, since it was financed with the sale of the government's shares in the company.

Table 7. Armenia: Medium-Term Macroeconomic Framework, 2011–21

(in percent of GDP, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	Act.	Act.	Act.	Prel.	Est.	Projections					
National income and prices											
Real GDP (percent change)	4.7	7.1	3.3	3.5	3.0	2.2	2.5	3.0	3.5	3.5	4.0
Gross domestic product (in millions of U.S. dollars)	10,142	10,619	11,121	11,644	10,561	10,735	11,112	11,670	12,315	12,983	13,769
Gross national income per capita (in U.S. dollars)	3,548	3,718	3,913	4,087	3,670	3,641	3,770	3,959	4,177	4,403	4,668
CPI inflation, period average (percent change)	7.7	2.5	5.8	3.0	3.7	-0.4	4.0	4.0	4.0	4.0	4.0
Investment and saving											
Investment	27.0	22.8	22.3	21.1	19.5	19.6	20.0	20.6	21.3	21.4	21.5
Private	22.9	20.3	20.0	18.8	16.6	17.1	17.6	18.1	18.6	18.6	18.6
Public	4.1	2.4	2.3	2.3	2.9	2.5	2.4	2.5	2.7	2.8	2.9
National savings	16.6	12.8	14.7	13.8	16.9	16.6	16.6	16.8	17.2	16.8	16.3
Private	15.3	11.9	14.0	13.4	18.8	18.2	16.9	16.3	16.2	15.8	15.1
Public	1.2	0.9	0.7	0.3	-1.9	-1.6	-0.3	0.5	1.0	1.0	1.2
Central government operations											
Revenue and grants	22.1	20.9	22.2	22.0	21.5	21.5	21.6	22.1	22.6	22.8	23.0
Of which: tax revenue	16.7	17.0	21.0	21.0	20.0	20.0	20.5	20.7	21.2	21.5	21.7
grants	1.5	0.4	0.2	0.3	0.6	0.6	0.4	0.4	0.2	0.1	0.1
Expenditure	25.0	22.4	23.8	23.9	26.3	25.6	24.4	24.1	24.3	24.6	24.7
Current expenditure	20.9	20.0	21.5	21.7	23.4	23.1	22.0	21.6	21.6	21.8	21.8
Capital expenditure	4.1	2.4	2.3	2.3	2.9	2.5	2.4	2.5	2.7	2.8	2.9
Overall balance on a cash basis	-2.8	-1.4	-1.0	-2.1	-4.8	-4.1	-2.8	-2.0	-1.7	-1.7	-1.7
Domestic financing	1.7	0.2	-1.0	1.6	0.7	1.4	0.6	1.2	0.6	1.4	0.5
External financing	1.1	1.3	1.9	0.5	3.2	1.8	1.2	0.8	1.1	0.3	1.2
Other financing	…	…	0.0	0.0	0.9	0.9	0.9	0.0	0.0	0.0	0.0
Public and publicly-guaranteed debt	42.0	41.2	40.8	43.5	48.7	52.4	54.0	53.9	53.0	52.9	52.2
External sector											
Exports of goods and services	27.0	27.5	28.4	28.5	29.7	28.5	28.2	27.7	27.0	26.3	25.1
Imports of goods and services	48.5	48.3	48.2	47.0	41.3	37.6	37.8	37.5	37.1	36.7	36.1
Current account (in percent of GDP)	-10.4	-10.0	-7.6	-7.3	-2.6	-3.0	-3.4	-3.8	-4.1	-4.5	-5.2
Current account (in millions of U.S. dollars)	-1,059	-1,058	-845	-849	-279	-326	-381	-441	-507	-588	-715
Capital and financial account (in millions of U.S. dollars)	1,007	848	1,789	260	745	302	412	605	678	637	821
Of which: direct foreign investment	437	481	508	388	170	274	278	287	297	307	319
public sector disbursements	180	255	914	257	798	354	327	314	373	803	440
Arrears and debt relief (in millions of U.S. dollars)	0	0	0	0	0	0	0	0	0	0	0
Financing gap (in millions of U.S. dollars)	0	0	0	0	100	144	122	0	0	0	0
Of which: IMF	0	0	0	0	0	44	22	…	…	…	…
Other	0	0	0	0	100	100	100	…	…	…	…
Gross international reserves in months of imports	4.4	4.0	4.9	4.1	5.3	5.3	5.4	5.4	5.4	5.4	5.0
Memorandum items:											
Debt-creating fiscal balance 1/	-2.2	-2.3	-1.1	-2.8	-6.1	-5.0	-3.6	-2.8	-2.5	-2.5	-2.5

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

1/ Sum of overall balance (above-the-line) and external net lending.

Table 8. Armenia: Indicators of Capacity to Repay the Fund, 2011–20

	2011	2012	2013	2014	2015	Projections 2016	2017	2018	2019	2020
Fund obligations based on existing credit (in millions of SDRs)										
Principal	14.4	101.0	180.2	98.1	17.9	23.8	36.9	45.2	52.8	53.3
Charges and interest	8.3	7.6	5.5	2.4	1.6	1.7	1.6	1.3	1.3	0.9
Total obligations based on existing and prospective credit										
In millions of SDRs	22.7	108.6	185.7	100.5	19.5	25.7	38.9	47.0	54.6	54.6
In millions of U.S. dollars	35.9	166.3	282.2	152.6	27.3	35.9	54.5	65.8	76.6	76.9
In percent of gross international reserves	1.9	9.2	12.5	10.2	1.5	1.9	2.8	3.2	3.6	3.6
In percent of exports of goods and services	1.3	5.7	8.9	4.6	0.9	1.2	1.7	2.0	2.3	2.3
In percent of debt service 2/	35.3	69.3	32.0	53.5	7.0	14.7	18.9	20.6	22.1	8.9
In percent of GDP	0.4	1.6	2.5	1.3	0.3	0.3	0.5	0.6	0.6	0.6
In percent of quota	24.7	118.0	201.9	109.2	21.2	20.0	30.2	36.5	42.4	42.4
Outstanding Fund credit based on existing credit 2/										
In millions of SDRs	539.0	505.0	379.7	305.1	299.0	275.2	238.3	193.1	140.3	87.0
In millions of U.S. dollars	850.8	773.4	577.0	463.4	418.3	383.7	333.6	270.4	196.9	122.5
In percent of gross international reserves	45.5	43.0	25.6	31.1	23.6	20.7	17.0	13.1	9.1	5.8
In percent of exports of goods and services	31.0	26.5	18.3	14.0	13.3	12.5	10.6	8.4	5.9	3.6
In percent of debt service 2/	837.5	322.2	65.4	162.4	107.0	157.2	115.6	84.6	56.8	14.2
In percent of GDP	8.4	7.3	5.2	4.0	4.0	3.6	3.0	2.3	1.6	0.9
In percent of quota	585.8	548.9	412.8	331.6	325.0	213.6	185.0	149.9	108.9	67.5
Net use of Fund credit based on existing and prospective credit (in millions of SDRs)	58.0	-34.0	-125.2	-74.6	-6.1	7.5	-21.2	-45.2	-52.8	-54.6
Disbursements	72.4	67.0	55.0	23.5	11.7	31.3	15.7	0.0	0.0	0.0
Repayments and repurchases	14.4	101.0	180.2	98.1	17.9	23.8	36.9	45.2	52.8	54.6
Memorandum items:										
Nominal GDP (in millions of U.S. dollars)	10,142	10,619	11,121	11,644	10,561	10,735	11,112	11,670	12,315	12,983
Exports of goods and services (millions of U.S. dollars)	2,742	2,918	3,156	3,319	3,140	3,059	3,137	3,230	3,319	3,412
Gross international reserves (millions of U.S. dollars)	1,869	1,799	2,253	1,489	1,771	1,858	1,959	2,060	2,158	2,129
Debt service (in millions of U.S. dollars) 2/	101.6	240.0	881.7	285.4	391.1	244.0	288.6	319.6	347.0	860.4
Quota (in millions of SDRs)	92.0	92.0	92.0	92.0	92.0	128.8	128.8	128.8	128.8	128.8

Source: Fund staff estimates and projections.

1/ Indicators cover both GRA and ECF credit.

2/ Total debt service includes IMF obligations.

Table 9. Armenia: External Financing Requirements and Sources, 2014–17

(In millions of U.S. dollars, unless otherwise indicated)

	2014	2015	2016	2017
	Prel.	Est.	Proj.	
Gross Financing Requirements	1,020	1,372	1,025	1,162
External current account deficit (excl. transfers)	1,593	804	827	902
Debt amortization and Fund repurchases	190	287	112	158
Gross international reserve accumulation	-764	282	87	102
Available financing	1,019	1,273	882	1,040
Capital Account and Current Transfers	979	1,256	882	1,040
of which: Capital transfers (net)	70	39	78	66
Foreign Direct Investment	388	170	274	278
Public Borrowing	216	535	277	221
Private transfers	641	419	386	401
Commercial banks net flows	-39	-313	-59	20
Financing gap	0	100	144	122
Exceptional Financing	0	100	144	122
Of which: IMF EFF program	0	0	44	22
Other 1/	0	100	100	100
Memorandum item:				
Current Account deficit, percent of GDP	-7.3	-2.6	-3.0	-3.4
Fiscal balance, percent of GDP	-2.1	-4.8	-4.1	-2.8
Net International Reserves	1,215	1,533	1,559	1,695
Gross Reserves	1,489	1,771	1,858	1,959
In months of prospective imports	4.1	5.3	5.3	5.4

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

1/ Financing from EFSD.

Table 10. Armenia: Fund Disbursements and Timing of Review Under the 38-Month Arrangement Under the Extended Fund Facility

Date of Availability	Conditions	Amount (millions of SDRs)	Percent of Quota 1/
		EFF	EFF
March 7, 2014	Board approval of the arrangement	11.74	12.76
September 30, 2014	Observance of end-June 2014 performance criteria and continuous performance criteria, and completion of first review	11.74	12.76
March 30, 2015	Observance of end-December 2014 performance criteria and continuous performance criteria, and completion of second review. 2/	11.74	12.76
March 30, 2016	Observance of end-December 2015 performance criteria and continuous performance criteria, and completion of third review	15.65	12.15
September 30, 2016	Observance of end-June 2016 performance criteria and continuous performance criteria, and completion of fourth review	15.65	12.15
March 30, 2017	Observance of end-December 2016 performance criteria and continuous performance criteria, and completion of fifth review	15.69	12.18
	Total	82.21	63.83

Source: Fund staff estimates and projections.

1/ Armenia's quota increased from SDR 92 million to SDR 128.8 million in February 2016.
2/ This review was based on end-June 2015 PCs, which became the controlling PCs.

Annex I. Current Account Adjustment

The current account deficit narrowed significantly in 2015, driven mainly by a large fall in the trade deficit. Export performance proved to be relatively strong, in the context of a difficult external environment and falling international prices. In contrast ,the value of imports declined dramatically reflecting a combination of factors, including reduced remittances and weaker credit and the impact of entry into the EEU, particularly the frontloading of imports in 2014 and possibly the transition in customs practices. Looking ahead, imports and the current account deficit are projected to gradually increase as credit growth resumes, remittances slowly recover and the impact of the entry into the EEU dissipates. However, this is likely to be a gradual process, with remittances expected to remain subdued in the near term and large inventories still to be unwound, particularly if strong export performance is sustained.

The current account deficit narrowed significantly in 2015. The current account deficit was US $279 million (2.6 percent of GDP) in 2015, roughly one third of the 2014 level and over 2 percentage points lower than projected at the time of the Second Review.

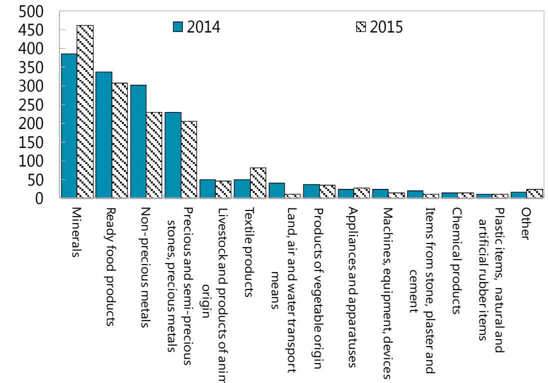
The contraction was driven by a large adjustment in the trade deficit, with a dramatic fall in the value of imports far outpacing the fall in the value of exports.[1] According to preliminary data, the trade deficit contracted from 18 percent to 11 percent from 2014 to 2015, reflecting a 26.5 percent fall in the value of imported goods (US$ 1.17 billion). In contrast, goods exports held up relatively well, falling by only around 4 percent in value terms. The Fund's rough estimate of the export and import deflators for Armenia is around 12 percent for 2015, which implies an increase in export volumes of around 9 percent and a reduction in import volumes of 17 percent, respectively, which is broadly consistent with the authorities' estimates from the national accounts. While detailed trade data decomposing the price and volume change for specific goods are not yet available, detailed 'value' trade data suggests the following:

- **Exports were supported by the opening of the new copper mine and diversification into new geographical markets.** Exports of most goods remained relatively stable in 2015 in value terms. The significant increase in the value of mineral exports, due to the opening of the new copper mine, was more than enough to offset the fall in the value of non-precious metal exports and the fall in commodity prices, more generally. Notably, the value of 'textile' exports also rose significantly and the value of 'ready prepared food' exports only fell marginally, despite falling international prices. Geographically, the share of exports to the

[1] In addition to the improvement in the trade balance, the fall in the current account deficit also reflects a stronger primary income account in 2015, resulting from a large net outflow of reinvested earnings of the Armrusgasprom (ARG) deal that was recorded in Q1 of 2014 and the strong base effect in 2015.

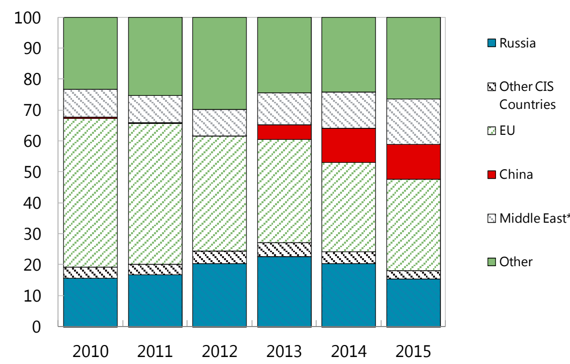
Middle East increased, reflecting strong demand for tobacco and alcohol, while the share of exports to Russia fell, most likely driven by the decline in the value of the Ruble.

Exports 2014 vs 2015
(US Dollars (millions))



Sources: [NSS Trade Data]

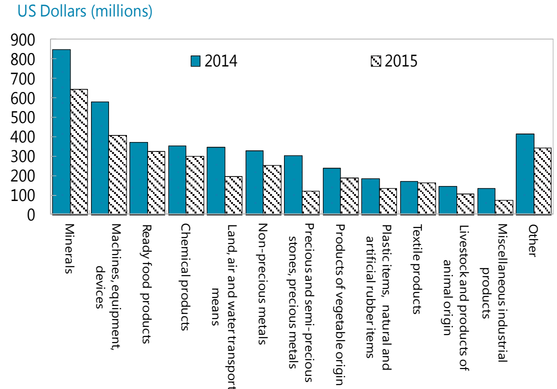
Exports by Country of Origin
(Share %)



Sources: NSS Trade Data

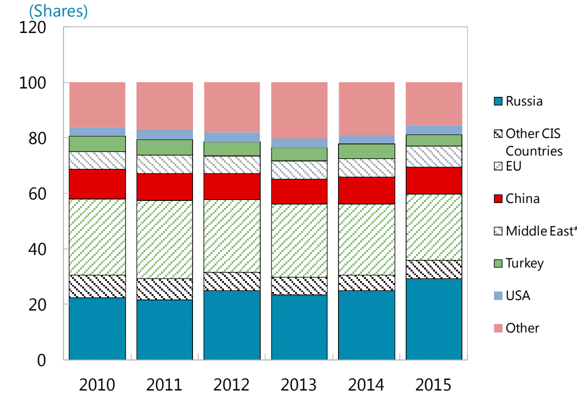
- **The large fall in imports was broad-based, across most goods and a majority of originating countries.** There were major declines in the value of imports of: minerals; precious stones and metals; machines, equipment, devices; and land, air and water transport vehicles. The significant reduction in the value of mineral imports reflects the very mild winter and gas price discount of 15 percent agreed with Russia for 2015. More broadly, the share of Russian imports increased, again likely reflecting the fall in the Ruble. Notably, the value of imports from the EU and 'other' countries both fell by around 30 percent, with imports from Switzerland and Japan falling by 65 percent and 50 percent respectively.

Imports: 2014 vs 2015
US Dollars (millions)



Sources: [NSS Trade Data]

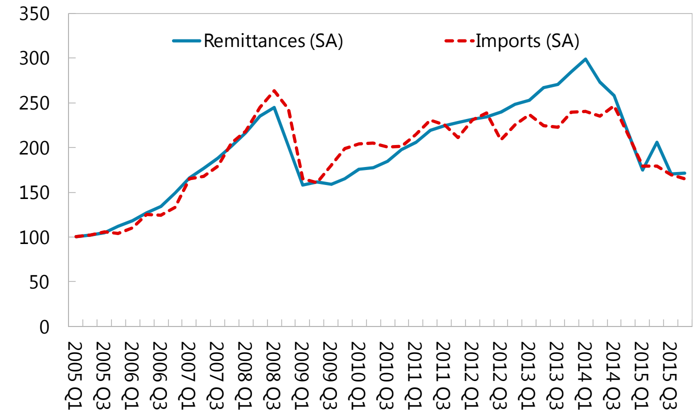
Imports by Country of Origin
(Shares)



Sources: NSS Trade Data

The fall in remittances is likely to have been an important driver of the large contraction in imports. Remittances play a key role in the Armenian economy, financing around 40 percent of imports, on average, since 2010. Remittances fell by around 35 percent in 2015, largely reflecting the fall in remittances from Russia, where the vast majority of remittance flows originate.[2] The chart below indicates the high level of correlation between imports and remittances. A fall in remittances, along with the broader contraction of credit and is likely to have been an important factor in the fall in consumption and investment, and therefore imported goods. Notably, the current fall remittances and imports looks similar to the pattern seen in 2009. Remittances are expected to remain subdued, consistent with the growth outlook for Russia.

Imports and Remittances
(Index 2005 Q1=100)



Sources: CBA Data

Armenia's entry into the Eurasian Economic Union (EEU) may also have been an important factor. The drop in the value of imports across all countries suggests that the decline was not isolated to EEU countries. However, anecdotal evidence suggests that the uncertainty of prospective EEU rules and the potential for an increase in tariffs may have driven an increase in the import of durable goods in 2014, particularly large items such as cars, furniture and equipment. Detailed value trade data appears to support this, with very large contractions in these import categories (i.e., land, air and water transport, machinery and equipment, precious stones). More detailed customs data for the import of motor vehicles also indicates a significant frontloading – with imports climbing in 2014 before falling by over 50 percent in 2015. This effect is likely to be temporary, to the extent that large inventories built in 2014 gradually unwind, though it may take time for imports to fully recover. Separately, the transition to new EEU customs practices may also have had an impact on the value of 'recorded' imports. While the authorities believe that initial recording issues were resolved in the second half of 2015, the transition to new customs practices included the adoption of new reference prices and some initial flexibility in the declaration of import values, may also explain some of the reduction in the value of imports from the EEU.

Looking ahead, the current account deficit is projected to gradually widen over the medium term, but remain significantly below the 2014 level. Early data for Q1 2016 suggests that the contraction in the value of remittance inflows and imports has slowed, with both expected to

[2] Russian remittances account for around 90 percent of total remittances between 2010 and 2015.

bottom out in 2016, while export performance remains relatively strong. The current account deficit is expected to widen to around 5 percent of GDP over the medium-term, as remittances and imports recover and the temporary effects of EEU entry dissipate. However, this is likely to be a gradual process, with remittances expected to remain subdued in the near term and large inventories still to be unwound, particularly if strong export performance is sustained.

Annex II. Armenia—Risk Assessment Matrix

Potential Deviations from the Baseline (April G-RAM)[1]

Nature/source of risk	**Relative likelihood**	**Possible impact if risk is realized**	**Policy response**
Global Risks			
Tighter or more volatile global financial conditions: - Sharp asset price decline and decompression of credit spreads as investors reassess underlying risk and respond to unanticipated changes in growth and financial fundamentals in large economies, Fed policy rate path, and increases in U.S. term premia, with poor market liquidity amplifying volatility. - Surge in the US dollar. Improving U.S. economic prospects versus the rest of the world leads to a further dollar surge, boosting non-U.S. trade but creating balance sheet strains for dollar debtors.	**Assessment**: -Medium - High	**Staff assessment: Low/Medium** The current account deficit remains a source of vulnerability (albeit more moderate), along with a reversal of bank flows and a significant decline in the FX reserves buffer. Official support mitigates risks.	Increase ER flexibility with intervention only to prevent disorderly conditions and to build buffers. Prepare contingency plans for potential financial spillovers. Enhance monitoring of FX risks.
Risks to energy prices: - Persistently lower energy prices, triggered by supply factors reversing only gradually.	**Assessment**: - High	**Staff assessment: Medium/High** Negative indirect effects through remittance, trade, finance, and investment channels via Russia.	Accelerate reforms to increase growth and diversify export destinations and products. Increase ER flexibility.
Dislocation in capital and labor flows: -Reduced financial services by global/regional banks ("de-risking"): Further loss of correspondent banking services significantly curtails cross-border payments, trade finance, and remittances in small economies. -Heightened risk of fragmentation/security dislocation in part of the Middle East, Africa, and Europe, leading to a sharp rise in migrant flows, with negative global spillovers.	**Assessment**: - Medium - High	**Staff assessment: High** Effects would be strong, comprising both direct impacts from Russia and impacts from global disruptions. Tougher sanctions against Russia would lead to more severe impacts, including in the banking sector.	Prepare and implement contingency plans for potential financial spillovers related to regional geopolitical risks.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability.

Nature/source of risk	Relative likelihood	Possible impact if risk is realized	Policy response
Global Risks (Continued)			
Sharper-than-expected global growth slowdown: -Significant China slowdown, triggered by corporate distress that propagates through shadow banks, precipitating deleveraging, uncertainty and capital outflows. Weak domestic demand further suppresses commodity prices, roils global financial markets, and reduces global growth (Likelihood: low in short-term, medium thereafter). -Significant slowdown in other large EMs/frontier economies. Turning of the credit cycle and fallout from excess household and corporate leverage (incl. in FX) as investors withdraw from EM corporate debt, generating disorderly deleveraging, with potential spillbacks to advanced economies. -Structurally weak growth in key advanced and emerging economies. Weak demand and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms, leading to low medium-term growth and persisting financial imbalances in the Euro area and Japan (high likelihood). Easy global financial conditions coming to an end and insufficient reform progress undermine medium-term growth in emerging markets and suppress commodity prices (medium likelihood).	**Assessment**: - Low/Medium - Medium - High/ Medium	**Staff assessment: Medium** Mining exports, an important area for export growth and source of foreign exchange earnings, would be hit hard.	 Diversify export destinations and products.
Country-Specific Risks			
Regional conflict: - Risks from sharp, renewed tensions over Nagorno-Karabakh. - Deterioration of Russian-Georgian relations	**Assessment**: - High - Medium	**Staff assessment: High** - Conflict would involve severe impacts, possibly Russia and Turkey. - Deterioration of Russian-Georgian relations could lead to transport / trade / energy supply disruptions.	 Prepare and implement contingency plans.

Annex III. Public Debt Sustainability Analysis

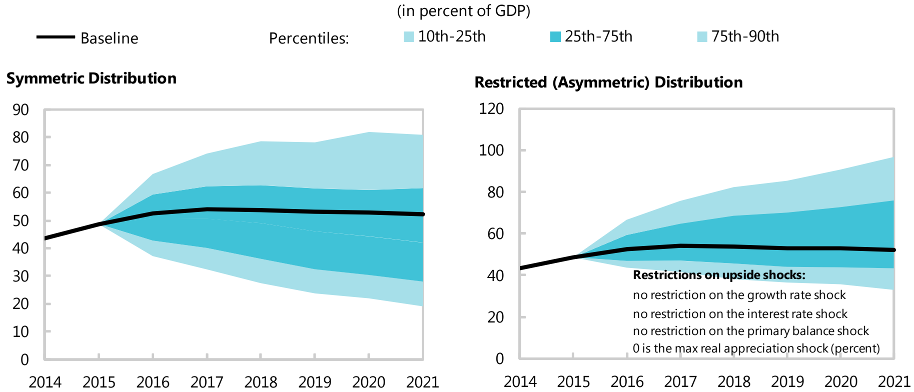
Armenia Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

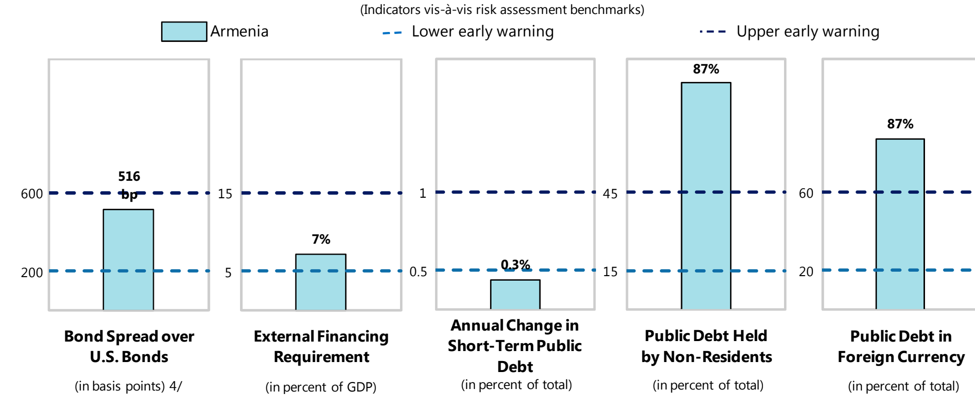
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

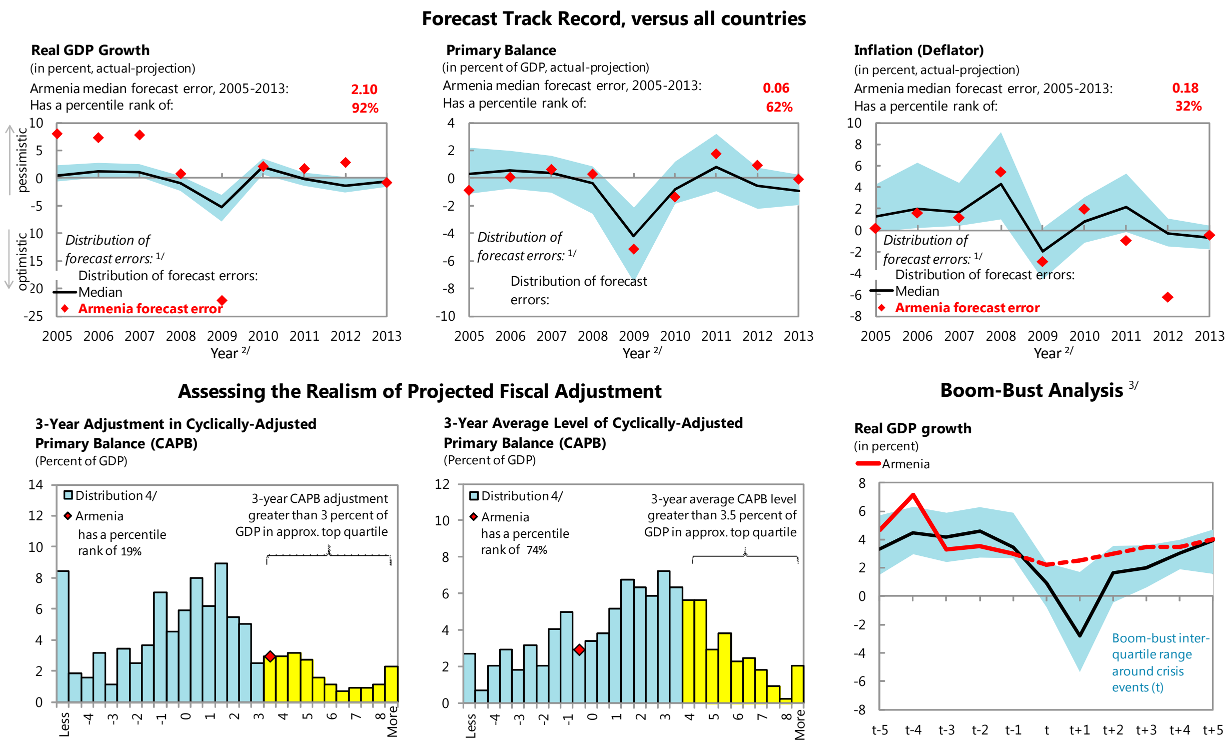
2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ An average over the last 3 months, 04-Feb-16 through 04-May-16.

Armenia Public DSA - Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Armenia has had a positive output gap for 3 consecutive years, 2013-2015 and a cumulative increase in private sector credit of 4 percent of GDP, 2012-2015. For Armenia, t corresponds to 2016; .
for the distribution, t corresponds to the first year of the crisis.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Armenia Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

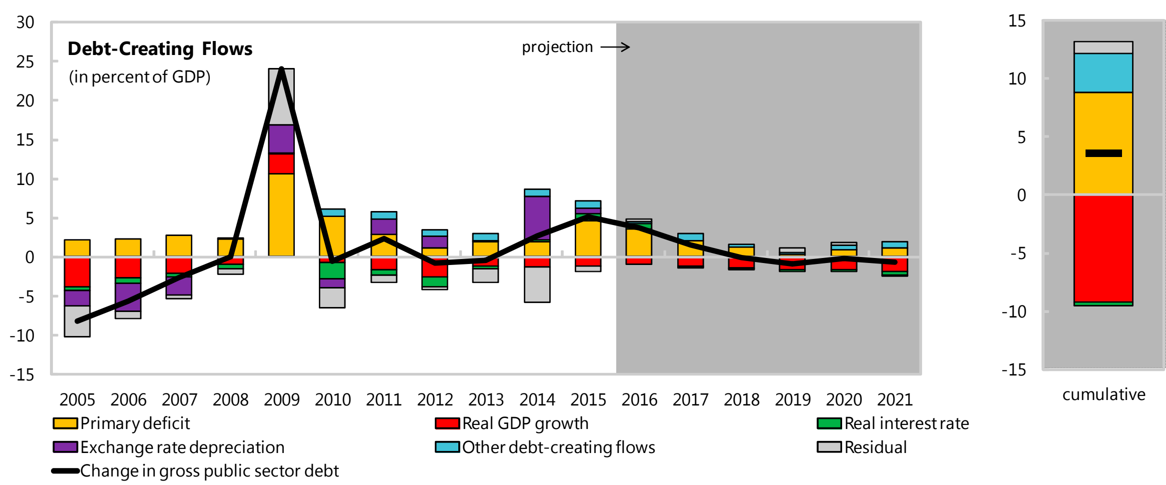
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of May 04, 2016		
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021	Sovereign Spreads		
Nominal gross public debt	31.0	43.5	48.7	52.4	54.0	53.9	53.0	52.9	52.2	Spread (bp) 3/		490
Public gross financing needs	6.4	5.0	9.6	7.1	5.8	6.2	5.9	10.2	7.9	CDS (bp)		n.a.
Net public debt		35.7	41.1	44.9	46.8	47.1	47.3	47.6	47.3			
Real GDP growth (in percent)	5.7	3.5	3.0	2.2	2.5	3.0	3.5	3.5	4.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	4.6	2.7	1.2	2.7	4.0	4.0	4.0	4.0	4.0	Moody's	B1	n.a.
Nominal GDP growth (in percent)	10.5	6.3	4.2	4.9	6.6	7.1	7.6	7.6	8.2	S&Ps	BB-	n.a.
Effective interest rate (in percent) [4/]	2.3	3.3	3.5	4.1	4.0	3.9	3.7	3.8	3.3	Fitch	B+	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing
Change in gross public sector debt	0.9	2.73	5.16	3.8	1.5	-0.1	-0.9	-0.1	-0.6	3.6	primary
Identified debt-creating flows	1.4	7.25	5.83	5.1	2.5	0.8	-0.6	0.5	0.2	8.5	balance [9/]
Primary deficit	3.4	1.9	4.5	3.6	2.0	1.2	0.2	0.8	1.0	8.8	-0.8
Primary (noninterest) revenue and grants	20.4	22.0	21.5	21.5	21.6	22.1	22.6	22.8	23.0	133.6	
Primary (noninterest) expenditure	23.8	23.9	26.0	25.0	23.6	23.3	22.8	23.7	24.0	142.4	
Automatic debt dynamics [5/]	-2.4	4.5	0.4	1.3	-0.4	-0.7	-1.1	-1.0	-1.7	-3.6	
Interest rate/growth differential [6/]	-2.2	-1.1	-0.3	-0.4	-1.3	-1.6	-2.0	-1.9	-2.4	-9.6	
Of which: real interest rate	-0.7	0.2	1.0	0.6	-0.1	-0.1	-0.2	-0.2	-0.4	-0.4	
Of which: real GDP growth	-1.5	-1.4	-1.3	-1.0	-1.2	-1.5	-1.8	-1.7	-2.0	-9.2	
Exchange rate depreciation [7/]	-0.2	5.6	0.7	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.4	0.9	0.9	0.3	0.9	0.4	0.3	0.6	0.8	3.3	
Domestic net lend./drawdown of gov. dep.	0.0	0.0	-0.4	-0.6	0.1	-0.5	-0.6	-0.2	0.0	-1.8	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
External net lending	0.4	0.9	1.3	0.9	0.9	0.9	0.8	0.8	0.8	5.1	
Residual, including asset changes [8/]	-0.5	-4.5	-0.7	0.3	-0.1	0.0	0.6	0.3	-0.1	1.0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Bond Spread over U.S. Bonds.

4/ Defined as interest payments divided by debt stock at the end of previous year.

5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

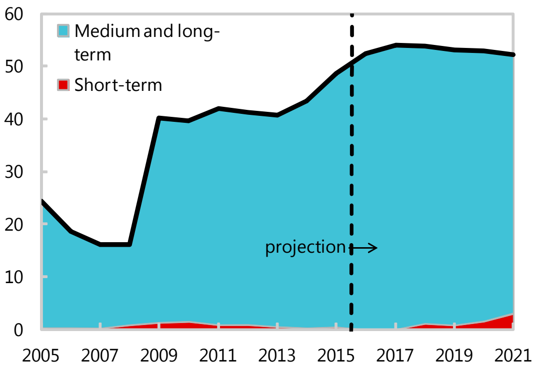
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

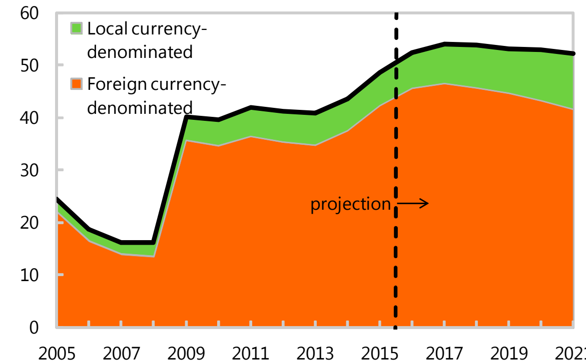
Armenia Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



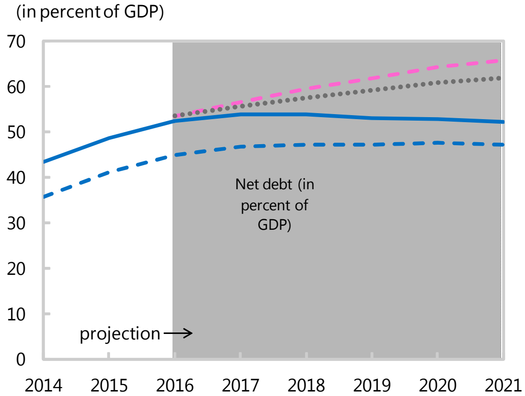
By Currency
(in percent of GDP)



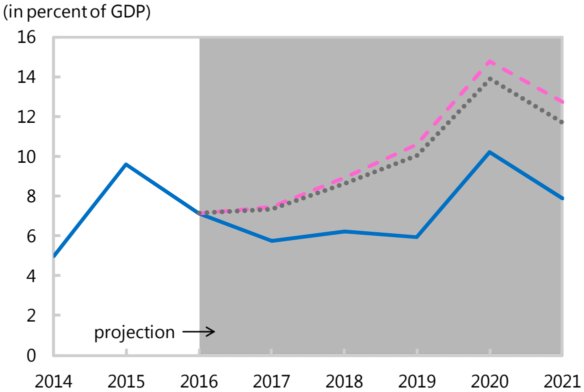
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

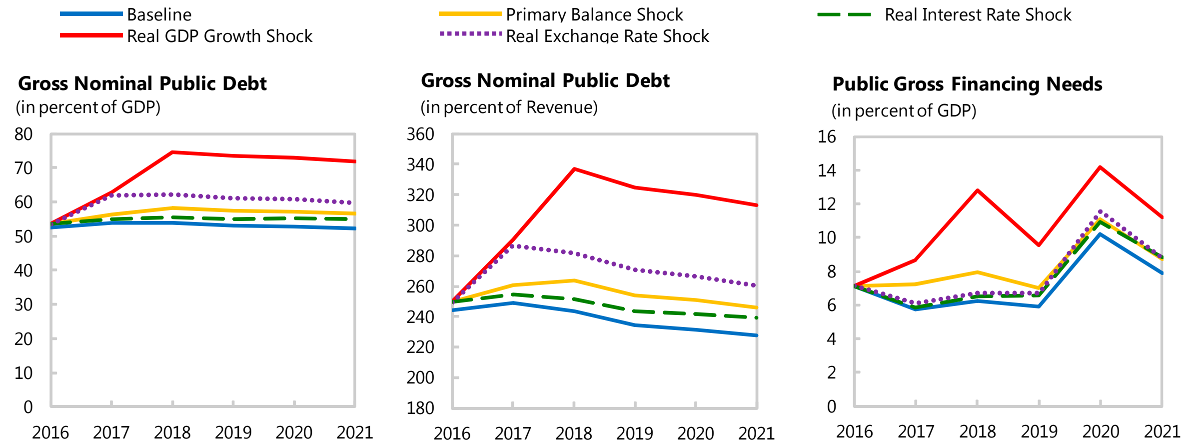
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.2	2.5	3.0	3.5	3.5	4.0
Inflation	2.7	4.0	4.0	4.0	4.0	4.0
Primary Balance	-3.6	-2.0	-1.2	-0.2	-0.8	-1.0
Effective interest rate	4.1	4.0	3.9	3.7	3.8	3.3
Constant Primary Balance Scenario						
Real GDP growth	2.2	2.5	3.0	3.5	3.5	4.0
Inflation	2.7	4.0	4.0	4.0	4.0	4.0
Primary Balance	-3.6	-3.6	-3.6	-3.6	-3.6	-3.6
Effective interest rate	4.1	4.0	3.9	3.8	3.8	3.4

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.2	4.4	4.4	4.4	4.4	4.4
Inflation	2.7	4.0	4.0	4.0	4.0	4.0
Primary Balance	-3.6	-3.5	-3.5	-3.5	-3.5	-3.5
Effective interest rate	4.1	4.0	3.7	3.4	3.3	2.6

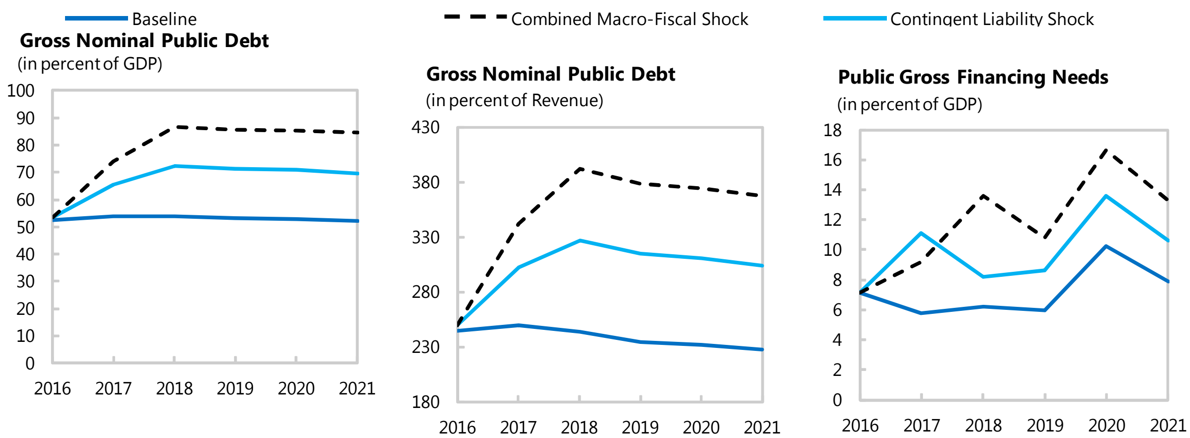
Source: IMF staff.

Armenia Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	2.2	2.5	3.0	3.5	3.5	4.0
Inflation	2.7	4.0	4.0	4.0	4.0	4.0
Primary balance	-3.6	-3.3	-2.6	-0.2	-0.8	-1.0
Effective interest rate	4.1	4.0	4.0	3.9	3.9	3.4
Real Interest Rate Shock						
Real GDP growth	2.2	2.5	3.0	3.5	3.5	4.0
Inflation	2.7	4.0	4.0	4.0	4.0	4.0
Primary balance	-3.6	-2.0	-1.2	-0.2	-0.8	-1.0
Effective interest rate	4.1	4.0	4.1	4.2	4.4	4.3
Combined Shock						
Real GDP growth	2.2	-5.2	-4.7	3.5	3.5	4.0
Inflation	2.7	2.1	2.1	4.0	4.0	4.0
Primary balance	-3.6	-4.3	-6.2	-0.2	-0.8	-1.0
Effective interest rate	4.1	4.5	4.0	4.3	4.4	4.3

Real GDP Growth Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	2.2	-5.2	-4.7	3.5	3.5	4.0
Inflation	2.7	2.1	2.1	4.0	4.0	4.0
Primary balance	-3.6	-4.3	-6.2	-0.2	-0.8	-1.0
Effective interest rate	4.1	4.0	4.0	4.1	4.0	3.5
Real Exchange Rate Shock						
Real GDP growth	2.2	2.5	3.0	3.5	3.5	4.0
Inflation	2.7	9.6	4.0	4.0	4.0	4.0
Primary balance	-3.6	-2.0	-1.2	-0.2	-0.8	-1.0
Effective interest rate	4.1	4.5	3.7	3.6	3.6	3.2
Contingent Liability Shock						
Real GDP growth	2.2	-5.2	-4.7	3.5	3.5	4.0
Inflation	2.7	2.1	2.1	4.0	4.0	4.0
Primary balance	-3.6	-6.6	-1.2	-0.2	-0.8	-1.0
Effective interest rate	4.1	4.3	4.2	4.0	3.9	3.4

Source: IMF staff.

Annex IV. Exchange Rate Assessment, Reserve Adequacy, and External Debt Sustainability

Exchange Rate Assessment

The external position is broadly consistent with fundamentals and desirable policy settings. Staff's estimates suggest that the dram remains close to its equilibrium level. Estimates of the real effective exchange rate (REER) alignment are based on the IMF's External Balance Approach-lite (EBA-lite):

i. The *macro-balance* approach, suggests a current account norm of –3.7 percent of GDP for 2015 – 1 percentage points weaker than the actual balance for 2015. This reflects the significant narrowing of the current account deficit in 2015 and implies a swing from a 10 percent overvaluation from the last staff estimate of the REER in 2014 to a 5.8 percent undervaluation for the REER in 2015.

Estimated Real Exchange Rate Misalignment
(In percent of GDP, unless indicated otherwise)

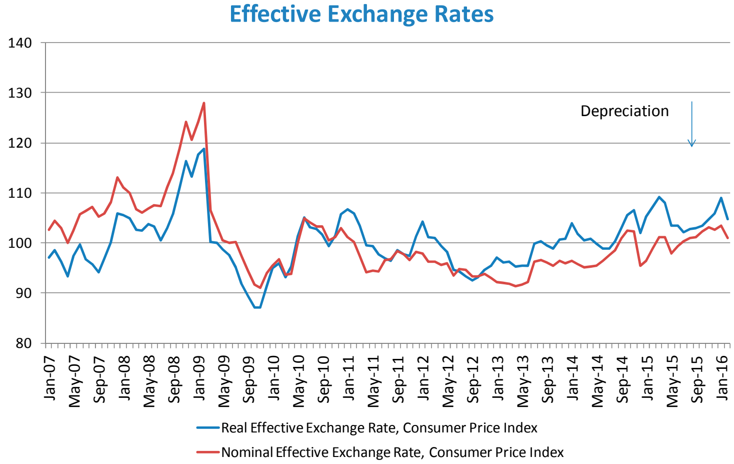
	Macrobalance approach (EBA-lite)	REER approach (EBA-lite)	External sustainability (EBA-lite)
Current account norm	-3.7		-4.8
Underlying current account 1/	-2.6		-5.2
CA gap	1.0		-0.4
Elasticity	-0.18		-0.18
Real exchange rate gap 2/	-5.8	12.0	2.1

1/ 2015 actual value for the macrobalance and 2021 projections for the external sustainability approach.

2/ Movement in real exchange rate needed to close the gap between norm and underlying current account

ii. The *external sustainability* approach estimates a current account norm of –4.8 percent of GDP to stabilize the ratio of Net Foreign Assets to GDP at its end - 2015 level (–76.4 percent of GDP). When compared with the medium-term projection for the current account (–5.2 percent of GDP in 2021), this implies a slight REER overvaluation of 2.1 percent.

Effective Exchange Rates



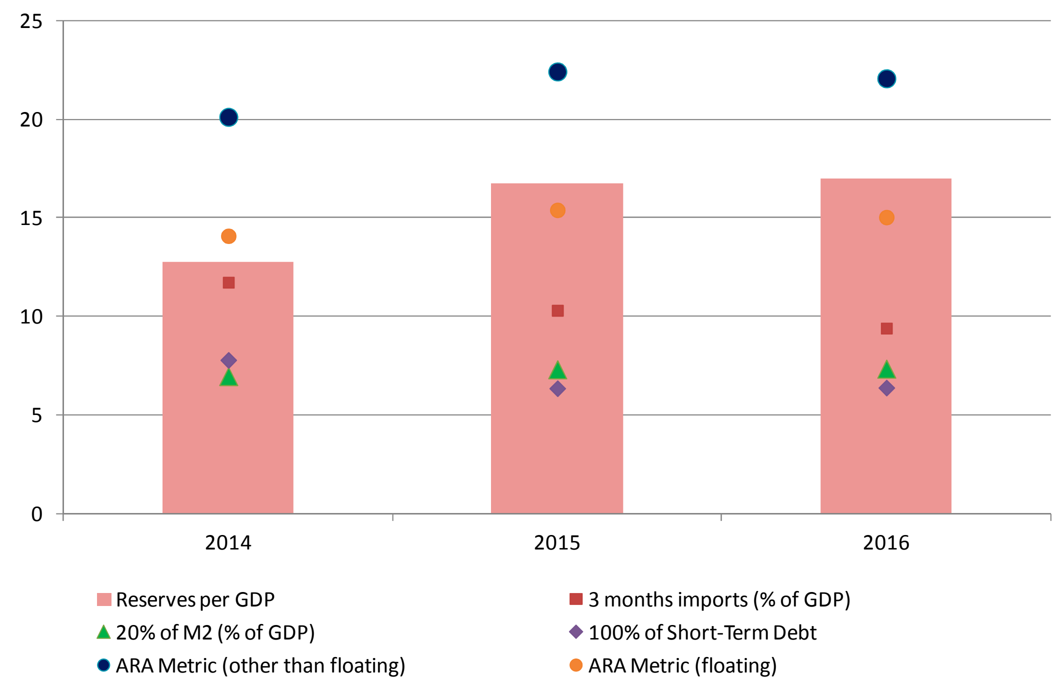
Source: IMF Information Notice System.

iii. The *REER* approach estimates an overvaluation of 12 percent of GDP, reflecting. The CPI-based real effective exchange rate depreciated significantly in the first half of 2015. Despite some appreciation in the second half of the year, it ended 2015 at level close to the average seen since 2007.

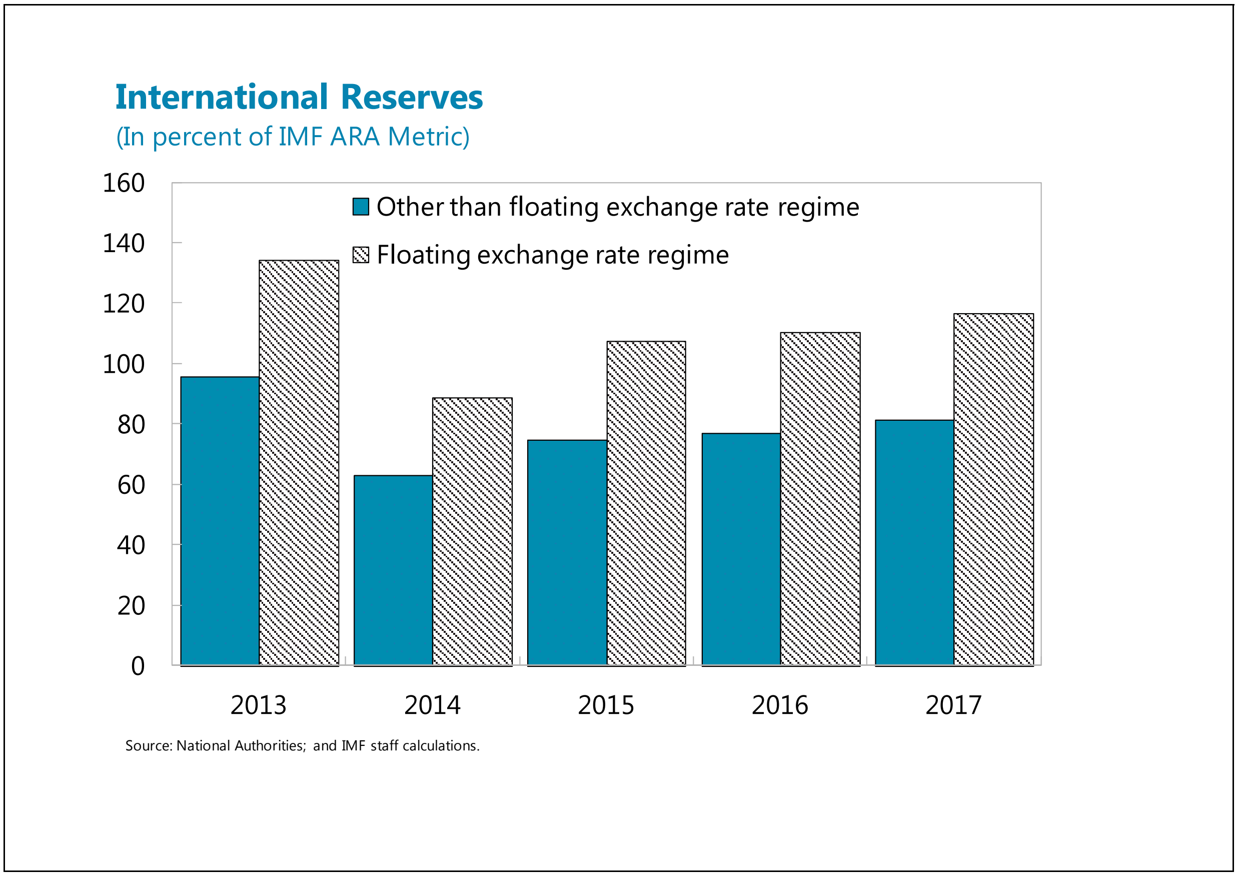
The current account norm for both the *macro-balance* and *external sustainability* approaches is relatively similar (around 4-5 percent). The contrast in the estimates of misalignment (undervaluation versus overvaluation) is generated by the difference in the underlying current account balances used. The macro-balance approach uses the much lower 2015 CA deficit, which likely reflects the impact of a number of temporary factors (see annex I). In contrast, the external sustainability approach uses the higher 2021 projection (-5.2 percent of GDP), which reflects staff's view that the current account balance is likely to gradually widen again over the medium term with the recovery of imports. Taking the medium-term current account projection as the base, the macro-balance approach would also imply that the REER is slightly overvalued but close to equilibrium, consistent with the ES and the REER approach, which focuses more on fundamentals.

Projected Reserve Adequacy Indicators, end-year

(as a % of GDP)



Source: National Authorities; and IMF staff calculations.



Reserve Adequacy

Under most standard metrics, reserve coverage appears adequate, though it remains below the Fund's reserve adequacy (ARA) metric for non-floating regimes. Reserves fell significantly in 2014 and recovered marginally in 2015. By most standard metrics, reserve coverage appears adequate. Armenia's de facto exchange rate regime has been reclassified to "floating", effective November 2014. Assuming a floating exchange rate regime, reserves would be at 107 percent of the Fund's ARA metric at end-2015 and are projected to rise to 116 percent of the metric by end-2017, within the 100-150 percent range that is considered adequate. Under a "non-floating" exchange rate regime, reserves reached 75 percent of the ARA metric at end-2015 and are projected to rise to 81 percent of the metric by 2017, well below the 100-150 percent adequacy range. The adequacy or reserve coverage depends on future policy implementation. A continuation of the historical pattern of large-scale FX intervention to address exchange rate pressures would imply a higher coverage need, in line with the non-floating regime metric. However, more limited intervention and increased exchange rate flexibility, consistent with staff advice, would point to a lower coverage need, as highlighted by the floating regime metric.

External Debt Sustainability

Armenia's external debt-to-GDP ratio remains high but is projected to gradually improve over the medium term. The ratio of debt to GDP rose substantially from 71.3 percent at end-2014 to around 84 percent at end-2015, a higher level than projected in the previous assessment (80.5 percent). It is projected to fall steadily to around 78 percent by end-2021 in the baseline scenario. This path is broadly in line with the previous assessment, albeit at a higher level given the correspondingly higher end-2015 position. The large fall in the current account deficit is the key driver of the improvement. Public sector debt is projected to grow more quickly than private sector debt. The debt stabilizing non-interest current account deficit is estimated at 4.4 percent of GDP. In the baseline, the change in external debt is dominated by current account deficits (excluding interest payments), which is offset by projected non-debt creating FDI. In contrast, automatic debt dynamics have a smaller impact.

External sustainability remains sensitive to standardized shocks, with the exception of the nominal interest rate shock. The external debt ratio increases to between 90 and 93 percent of GDP under standardized shocks to growth and the noninterest current account, as well as the combined scenario. A one-time 30 percent real ER depreciation would significantly raise the debt ratio by around 30 percentage points above the baseline path to 115 percent of GDP in 2021. In contrast, the sustainability of the debt path is more robust to a standardized shock to the interest rate because of the large share of concessional financing in external public debt—this scenario only raises the debt path by 4 percentage points.

External Debt Sustainability Framework, 2011-2021
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2011	2012	2013	2014	2015			2016	2017	2018	2019	2020	2021	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	71.5	70.2	78.1	71.1	84.3			**86.5**	**86.5**	**84.3**	**82.2**	**79.7**	**78.1**	**-4.4**
2 Change in external debt	5.1	-1.3	7.9	-7.0	13.2			2.2	0.0	-2.1	-2.1	-2.5	-1.6	
3 Identified external debt-creating flows (4+8+9)	0.4	2.2	-0.1	0.5	8.3			-1.4	-1.2	-1.1	-1.1	-0.6	-0.1	
4 Current account deficit, excluding interest payments	8.5	7.8	5.4	4.7	-0.5			-0.2	0.3	0.7	1.2	1.8	2.7	
5 Deficit in balance of goods and services	21.5	20.8	19.9	18.5	11.5			9.1	9.6	9.9	10.1	10.5	11.0	
6 Exports	27.0	27.5	28.4	28.5	29.7			28.5	28.2	27.7	27.0	26.3	25.1	
7 Imports	48.5	48.3	48.2	47.0	41.3			37.6	37.8	37.5	37.1	36.7	36.1	
8 Net non-debt creating capital inflows (negative)	-4.3	-4.5	-4.6	-3.3	-1.6			-2.5	-2.5	-2.5	-2.4	-2.4	-2.3	
9 Automatic debt dynamics 1/	-3.8	-1.1	-0.9	-0.9	10.4			1.4	1.1	0.6	0.1	0.1	-0.6	
10 Contribution from nominal interest rate	2.0	2.2	2.2	2.6	3.1			3.3	3.2	3.0	2.9	2.8	2.4	
11 Contribution from real GDP growth	-2.8	-4.9	-2.2	-2.6	-2.4			-1.8	-2.1	-2.5	-2.8	-2.7	-3.0	
12 Contribution from price and exchange rate changes 2/	-2.9	1.7	-1.0	-0.9	9.6			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	4.8	-3.5	8.0	-7.5	4.9			3.6	1.1	-1.0	-1.0	-1.9	-1.5	
External debt-to-exports ratio (in percent)	264.5	255.5	275.1	249.3	283.5			303.5	306.3	304.6	304.9	303.3	311.4	
Gross external financing need (in billions of US dollars) 4/	2.0	2.7	2.7	2.5	1.9			1.5	1.6	1.7	1.9	2.5	2.2	
in percent of GDP	19.5	25.1	24.1	21.6	17.6	10-Year	10-Year	13.9	14.5	14.8	15.2	19.4	16.1	
Scenario with key variables at their historical averages 5/								**86.5**	**85.3**	**83.0**	**80.7**	**77.6**	**75.2**	**-10.1**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	4.7	7.1	3.3	3.5	3.0	4.4	7.7	2.2	2.5	3.0	3.5	3.5	4.0	
GDP deflator in US dollars (change in percent)	4.6	-2.3	1.4	1.1	-11.9	4.4	12.8	-0.6	1.0	2.0	2.0	1.9	2.0	
Nominal external interest rate (in percent)	3.2	3.1	3.3	3.4	4.0	2.2	2.2	4.0	3.8	3.7	3.6	3.6	3.3	
Growth of exports (US dollar terms, in percent)	24.0	6.4	8.2	5.2	-5.4	9.2	17.0	-2.6	2.5	3.0	2.8	2.8	1.2	
Growth of imports (US dollar terms, in percent)	8.4	4.3	4.6	1.9	-20.3	8.7	20.7	-7.3	4.0	4.3	4.2	4.5	4.1	
Current account balance, excluding interest payments	-8.5	-7.8	-5.4	-4.7	0.5	-7.8	4.9	0.2	-0.3	-0.7	-1.2	-1.8	-2.7	
Net non-debt creating capital inflows	4.3	4.5	4.6	3.3	1.6	5.4	2.1	2.5	2.5	2.5	2.4	2.4	2.3	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Appendix I. Letter of Intent

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

Yerevan, May 30, 2016

Dear Madam Lagarde:

1. **Armenia's economic performance has continued to be affected by weak external conditions.** Economic activity in Russia—Armenia's main trading partner and source of remittances—has continued to decline, while the price of copper—one of Armenia's main exports—remains at levels last seen during the global financial crisis in 2009 despite some recovery in 2016. Tightening global financial conditions and weakening growth prospects in emerging markets have intensified external pressures. Nevertheless, real GDP growth in 2015 was somewhat higher than expected (supported by fiscal policy and specific industrial developments), although nominal GDP was weaker as lower prices more than offset higher growth. This, together with further declines in imports and remittances, has led to lower fiscal revenues than expected in the 2015 and 2016 budgets. Monetary conditions have generally stabilized, following policy tightening by the CBA in 2014, but periodic foreign exchange rate interventions have been needed to prevent undue volatility.

2. **The outlook remains challenging.** Activity is expected to grow modestly in 2016-17, reflecting a gradual recovery in external conditions. The lower-than-projected fiscal revenues will put pressure on the fiscal deficit and government debt, while the high level of financial dollarization will remain a source of vulnerability for the banking sector. The lower current account deficit along with the diversification of export destinations achieved in recent years will, however, serve as mitigating factors. Near-term risks are on the downside, reflecting uncertainties in the outlook for Russia, metal prices, and global financial conditions. Upside risks could materialize in the event of faster growth in Iran and increased trade as international sanctions on that country are lifted.

3. **Performance under the IMF-supported program has improved.** All end-December PCs and indicative targets were met, with two exceptions: the fiscal deficit PC and the inflation indicative target. The fiscal deficit PC (ceiling) was missed by 0.3 percent of GDP mostly due to the non-completion of a large asset sale. The inflation indicative target (central point within a confidence band) was missed primarily because of negative food inflation. The two continuous PCs on public debt arrears and absorption by the government of losses/liabilities of companies were met.

4. **We have made significant progress in our structural reform agenda, but further work is necessary.** The end-December SB on publication of domestic lending programs was met, which has increased transparency of government operations. In addition, with support from the World Bank, the government has adopted a comprehensive plan to strengthen the financial position of Armenia's energy sector (March 2016 SB). The government has also submitted to the National Assembly a new Tax Code (March 2016 SB), following several months of consultations with both domestic and international counterparts (including IFIs). The proposed Tax Code not only reduces compliance costs by unifying Armenia's previously fragmented tax system and addressing inconsistencies, but also includes the necessary revenue gains to maintain debt on a sustainable path in the medium term. Furthermore, we have expanded our connectivity with the rest of the world through our open skies policy and a new aviation legal framework. We have also strengthened our regional integration through our accession in early 2015 to the Eurasian Economic Union. Furthermore, we have streamlined regulations through our Regulatory Guillotine program, and have made progress in strengthening policies to foster domestic competition.

The Program for 2016-17

5. **Our policy objectives are to support a sustainable and inclusive economic recovery while maintaining macroeconomic stability.** Our near-term fiscal and monetary policies will remain mindful, of maintaining medium-term debt sustainability and macroeconomic stability, especially our hard-earned inflation anchor. As a result, we plan to accompany our short-term measures with a credible medium-term strategy that guarantees fiscal and external sustainability. In addition, we will implement a broader set of economic policies and structural reforms aimed at making our medium-term policy framework more robust, our financial sector more resilient, our business environment more efficient, and our economy more integrated with the rest of the world.

Fiscal Policy

6. **Fiscal policy faced significant challenges in 2015.** In response to the deteriorating external economic conditions we had to take some remedial fiscal action, including some expansion of domestic lending programs and countercyclical capital spending. Budgetary lending was channeled to support SMEs in agriculture, urban development, and the Nagorno Karabakh administration. These loans were expected to be financed by the sale of a large sports entertainment complex in Yerevan, but this sale did not materialize in 2015 due to withdrawal of investors. The implementation of important infrastructure projects improved markedly last year, including the execution of donor-financed projects delayed from previous years. In an attempt to alleviate the difficult liquidity situation in the mining sector amid falling copper prices, we expedited the refund of VAT credit at the end of the year. The worsening external environment and subdued domestic demand, along with some legislative changes, resulted in a revenue shortfall of about AMD 80 billion (more than 1.5 percent of GDP) compared to the original budget. This, in conjunction with our policy responses described above, led to the weakening of the fiscal position and missing the budget deficit PC for 2015.

7. While in an environment of below-potential growth and low inflation the original 2016 budget targets seem beyond reach, fiscal policy will remain contractionary as planned. With nominal GDP expected to be lower by 2.7 percent relative to the budget, tax revenues are now expected to be below the target by about 2.0 percent. In addition, we intend to increase foreign-financed capital spending marginally by about 0.15 percent of GDP and budgetary lending by a similar amount. Budgetary lending would continue to focus on priority sectors, such as agriculture and housing, including supporting small farmers and expediting the resolution of legal issues related to the completion of real estate projects in Yerevan, whose paralysis after the 2008-09 crisis has caused problems for a large number of households. We will as always collateralize these loans and subject them to proper assessment under the Fiscal Risk Assessment Division to prevent future fiscal risks. Headline deficit in 2016 is now projected to be in the range of 4.1 percent of GDP (compared to 3.5 percent of GDP in the budget), but the cyclically-adjusted deficit is expected to decrease by more than 1 percent of GDP relative to 2015.

8. We remain committed to pursuing medium-term fiscal consolidation in view of high and rising public debt. Policies in 2017 and over the medium term will reduce the fiscal deficit below the debt-stabilizing level. The required adjustment will be achieved largely through a combination of revenue increases and increased expenditure efficiency (see below). To strengthen the credibility of our program and correct for the missed 2015 PC, we will bring forward some of the planned revenue-enhancing measures in the new Tax Code; in particular we will increase the excises for alcohol and tobacco by 15 percent in 2017 with an expected gain of 0.15 percent of GDP. In addition, we will introduce revenue administration measures to boost collections.

9. Tax policy and improved compliance will be essential for ensuring debt sustainability. Following broad consultations with stakeholders, we have submitted to the National Assembly a draft Tax Code that consolidates the existing legislation, addresses a number of structural weaknesses in the current tax system by reducing exemptions and increasing coverage, and generates additional revenue in the medium term. We are committed to have the new Tax Code approved by the National Assembly within 2016. At the core of our reform effort is the understanding that tax policy can play an important role in enhancing the economy's growth potential and improving equity. In particular, the following changes have been introduced:

- *Excise taxes.* Specific excise tax rates for alcohol, tobacco, and fuels are scheduled to increase every year in the period 2017-2021 and in addition, ad valorem rates will be introduced for cigarettes that will help prevent erosion of the tax base over time.

- *VAT and turnover tax.* We intend to reduce the turnover tax threshold from the current AMD 115 million to AMD 40 million effective from 2019 and ensure that agricultural businesses with turnover above the AMD 40 million threshold will be subject to VAT. This is expected to increase significantly the number of companies operating under the VAT regime and generate revenue for the budget. The VAT base will be broadened by removing some exemptions, e.g. on brokerage services, and diesel fuel. Other exemptions, pertaining to healthcare and education, will be retained until a mechanism is introduced to mitigate the effect on the most vulnerable groups of society.

- *Taxation of labor income*. The draft Tax Code contains proposals for modification of personal income taxation. The PIT schedule remains progressive but the tax rates and income brackets to which they apply will be modified. Lower income earners will see a reduction in the tax rate from 24.4 percent to 23 percent. The highest marginal rate will also be reduced (from 36 to 33 percent) but will apply to incomes above AMD 1 million as opposed to AMD 2 million currently. For incomes between AMD 120 thousand and AMD 1 million, a marginal rate of 28 percent is proposed.

- *Taxation of capital income*. A fuller taxation of capital income is essential for increasing the fairness of the tax system and for limiting the possibilities for tax avoidance by shifting from labor to capital income. In this regard, transactions relating to sales of property will be subject to a 10 percent income tax. In addition, a tax on dividends will be introduced at a 10 percent rate for non-residents and a 5 percent rate for residents, from 2018.

A number of additional measures such as increase in the stamp duty, revision of the minimum depreciation period for the purposes of CIT, and adjustments in road and environmental taxes will contribute to improving tax collections. Overall, we estimate that the proposed tax policy reform package will raise the tax-to-GDP ratio by about 2 percentage points by 2021. Improved administration is expected to further increase revenue collection. In addition, we will seek IMF TA to prepare a plan to improve property taxation, according to which we would amend the Tax Code by end-2017 with new provisions, such as ensuring cadastral values are gradually updated and aligned with market values.

10. Tax administration measures will complement tax policy measures by increasing the transparency and efficiency of the tax system, reducing compliance costs, and supporting revenue collection. The new Tax Code envisages a number of changes aimed at improving tax compliance, simplifying procedures and clarifying the rights and obligations of taxpayers. Specifically, we will introduce transfer pricing regulations in line with international best practices. We will also expand the list of goods subject to mandatory labeling. These two measures are expected to have a positive effect on budget revenue, although the precise amounts are difficult to estimate. A number of regulations pertaining to tax audits will be included to better inform taxpayers on the reasons for audits or re-audits, clarify the procedures for appeal, minimize discretion, and make audit results more transparent. We will establish a system of taxpayers' single accounts, to speed up VAT refunds and enable taxpayers to net out future tax obligations. In addition, we will review the regulations for indirect measurement of tax liabilities and the system of penalties in case of non-compliance.

11. Strengthening capital and social spending and increasing expenditure efficiency will remain a priority. The consolidation needs in the coming years will make it difficult to expand the current expenditure envelope, so our efforts will be focused mainly on increasing the efficiency and quality of spending, especially in critical areas such as healthcare and education. Capital and social expenditure will continue to be a priority. The increase in the capital project execution rate last year attests to our efforts to improve the public investment management process. In 2016, we will provide for additional donor-financed capital expenditure of about AMD 7 billion relative to the budget target to support domestic demand and reduce the infrastructure gap. The support could be larger if more fiscal space becomes available (e.g., if the revenue outlook improves) and project implementation remains strong. With respect to social programs, we will improve coverage and the quality of services provided through the integrated social service centers. We expect all these centers to be fully functional in 2019. We will consider bringing into the budget the "lifeline" gas subsidy that has been financed by state-owned power companies and provisioning in our MTEF for extending an in-kind subsidy for poor families to provide food to malnourished children from 2018.

12. We will ensure that fiscal risks are properly identified and monitored. The recently established Fiscal Risk Assessment Division (FRAD) was tasked with the preparation of an analysis of fiscal risks related to concessions, regulated utilities, state-owned enterprises, and public-private partnerships (PPPs), with the support of IMF TA. Accordingly, the 2016 budget documentation included disclosure of fiscal risks associated with nonfinancial corporations in the energy, transport, and water sectors. In addition, in light of the recent expansion of government domestic lending, we have started publishing monthly consolidated statements across all budgetary lending programs (December 2015 SB). We will also complete a review of lending operations, including operations related to real estate projects in Yerevan, to identify risks and management improvements (September 2016 SB). The review, which will be shared with IMF staff, will include information on the amounts, the groups and numbers of beneficiaries, borrowing terms, and collateral and guarantees requested by the Treasury.

13. We are making progress toward introduction of program budgeting and implementation of accounting reform. We have prepared a plan for the introduction of fully-fledged program budgeting in the 2019 budget, including appropriations by individual programs. We will work to address the recent TA mission's suggestions for enhancing the comprehensiveness, clarity, timing, and sequencing of the plan. We have started to implement accounting reform in a group of central government organizations on a pilot basis. For this purpose, we have adopted the Armenian Public Sector Accounting Standards (APSASs) based on the accrual International Public Sector Accounting Standards (IPSASs) and a unified chart of accounts (COA) supporting accrual reporting according to *Government Finance Statistics Manual (GFSM) 2001*. We will take further steps to advance the accounting reform in line with recent FAD TA advice.

14. Implementation of our flagship pension reform is continuing. About 140 thousand workers have enrolled in the new pension system since the revised pension law was approved in 2014, with nearly half working in the private sector. In line with our action plan, we have increased our outreach campaign through TV commercials, printed materials, and direct education campaigns, among others. We will continue to increase awareness and make preparations (including by upgrading our IT systems) for the expansion of the reform in July 2018 when participation will become mandatory for all workers covered by the law. To this end, the 2017 Budget will maintain funding for the Pension System Awareness Center and the Outreach Campaign (December 2016 SB).

Monetary and Exchange Policy

15. Monetary and exchange rate policies continued to be aimed at anchoring market expectations and maintaining orderly market conditions. Tightening of monetary policy in December 2014 has ensured that inflation remains below its ceiling, but more recently it has turned slightly negative, mainly owing to declining import and food prices. With a view to bringing inflation closer to its target in the next 12-18 months, the Central Bank of Armenia (CBA) reduced its refinancing rate by 1.5 pp to 8.75 percent in Q4 2015, and then to 8.25 percent in 2016Q1. Following some interventions in the FX market to counteract seasonal factors in 2016Q1, the exchange rate has remained relatively stable as imports have fallen further and the volume of transactions in the FX market has declined.

16. We will continue easing monetary policy cautiously within our inflation targeting framework, if current conditions continue. The focus will be on lowering the policy interest rate. Even though the interest rate channel has limited effectiveness because of the high dollarization, we believe that lowering the relatively high required reserve ratio on FX deposits (held in domestic currency) at this stage would not stimulate domestic lending given the existing corporate and consumer debt overhang and the lack of bankable projects. Instead the freed domestic liquidity would likely spill into the FX market putting undue pressure on the exchange rate and contributing to further dollarization. Furthermore, the effective required reserve ratio is gradually coming down as the banks seek to extend their liability base beyond two-year term maturity and attract funding from international development institutions, for which the reserve requirement was lowered as a response to the 2014 shock.

17. We are taking steps to build a coherent and coordinated policy framework that will integrate the two main objectives of price and financial stability. We will continue to develop our analytical frameworks and capacity to improve policy judgments, focusing on developing an internal operational financial stability index, introducing a financial sector module into the CBA's macroeconomic model, and enhancing coordination between the Monetary Policy and Financial Stability Departments of the CBA. We will also continue our crisis simulation exercises to improve our decision making at times of crises. We intend to seek technical assistance from the IMF to integrate the two mandates building up on the valuable extensive assistance already received from the IMF Research Department.

18. Maintaining a flexible exchange rate regime and strengthening external reserve buffers remain key policy objectives. Since the Second Review, we have limited our FX interventions: while some FX sales have been necessary to counter the repeat of pressures seen in January and August 2015, sales since the Second Review have been one-third of the level during the same period a year earlier. Our approach has helped mitigate the risk of a disorderly adjustment and ensure that inflation expectations remain anchored. Given the significant narrowing of the current account deficit in 2015 and Q1 2016, we consider the dram exchange rate to be close to its equilibrium level. Looking ahead, we will continue to allow the dram to adjust flexibly in both directions to structural pressures, while standing ready to use limited intervention to smooth excessive fluctuations and mitigate transitory pressures. Consistent with this approach, we intend to strengthen reserve buffers in the coming months, where conditions permit.

19. We have taken further actions to address the recommendations of the 2014 Safeguards Assessment. Specifically, the CBA requested its external auditor to reflect the CBA's investment activities in the annual financial report, which is a major part of the Annual Report of the CBA. The CBA also advised the external auditor to reflect the objectives, risks and risk-mitigation efforts related to these investments in the published audit reports based on the principle of relevance and significance. The 2014 Annual Report of the CBA already included this clause in the explanatory notes to the audited financial report. In addition, the 2015 Annual Report of the CBA will also include a note on the CBA's intention to accelerate efforts with institutional investors to divest investments in its subsidiaries. We continue efforts to strengthen CBA operations by strengthening our statistical capacity. We are working on amendments to the Law on the CBA or the Law on Statistics to provide the CBA with access to company-level data for non-financial firms needed to better compile the BOP statistics and to analyze developments.

20. In agreement with the IMF, the monetary policy program conditionality under the EFF will be aligned with the CBA inflation targeting framework. Starting from June 2016 test date the NDA performance criterion will be replaced by a monetary policy consultation clause (MPCC) based on the agreed quarterly inflation path within the ±1.5pp tolerance range. NDA will be retained as an indicative target to complement the monitoring of monetary conditions.

Financial Sector Stability and Development

21. Banks continue their effort to raise their capital levels to achieve the new minimum capital requirement as of January 1, 2017. Banks brought roughly AMD 75 billion in new capital in 2015. One merger has been completed with the two institutions fully integrated and compliant with the minimum capital requirement. A shareholder agreement has been signed between two other banks, which are in the process of being integrated. Further capital injections and other mergers are in the works and CBA has requested banks that are not complying yet to present a revised strategy by end-June 2016 regarding their plans to achieve the required capital by the January 1, 2017 deadline, and has informed that non-compliant banks will have their bank licenses revoked. The CBA continues to proactively assist the banks in making contacts with potential investors, especially IFIs (EBRD, IFC) to facilitate transactions, but will not provide financial support, except in cases when the CBA may provide loans to banks under lender-of-last-resort or systemic provisions of Article 38 the CBA Law. CBA is conducting viability analysis to ensure that only mergers and acquisitions that lead to stronger institutions and a sounder financial sector landscape are permitted to take place. In the meantime, the CBA will prepare contingency plans (to be discussed with IMF staff), by end-September 2016 (SB), to deal with banks that do not manage to comply with the new minimum capital requirement. The CBA will continue to provide the IMF staff with the necessary information needed for continuous assessment of banking conditions and capitalization.

22. The CBA continues to improve its regulatory macroprudential framework designed to mitigate risks to bank balance sheets. More specifically, and in line with Basel III suggested macroprudential requirements, the CBA is preparing a draft supplement to the Law on Banks and Banking, to be submitted to the National Assembly by end-June 2016, giving the CBA powers to define additional capital charges for systemically important banking institutions and establish permissible thresholds (buffers) above (below) the ratio limits of the key prudential standards. These capital charges will be phased to avoid imposing excessive burden on the banks that are already making substantial effort to comply with the new minimum capital requirement. In addition, and if the situation so warrants, the CBA will intensify its asset quality review for banks most affected by higher levels of NPLs, in order to safeguard financial stability.

23. We are taking steps to further develop domestic capital markets. The Government and CBA will propose and implement necessary legal, regulatory, and infrastructure reforms for ensuring full enforceability/implementation of International Swaps and Derivatives Association (ISDA) Master Agreements (including ISDA credit support documentation) in Armenia in line with EBRD recommendations. We will submit to the National Assembly the required draft laws by September 2016 (SB).

24. We will prepare a comprehensive plan by end-December 2016 for full divestment of the CBA shares in PanArmenian Bank (PAB) (SB). Private investors will be required to present solid business and funding plans for PAB and must commit to purchase all CBA's shares within a defined time period in the contract agreement. A thorough due diligence on investors' capacity, experience, knowledge, available funding sources, and business and funding plans will be conducted by the CBA and shared with IMF staff. The CBA will also ensure that PAB continues to meet prudential requirements at par with international best practices. Any debt issuance by PAB during the period in which the CBA remains a shareholder must be submitted to and approved by CBA, in consultation with IMF staff.

Structural Reforms

25. The focus of our plans is on reforming the energy sector and related public enterprises, which have emerged in recent years as a source of vulnerability and drain of public resources. As a first step in this process, we hired in late-2015 an international audit firm to review the most recent tariff setting decision. The audits upheld the decision undertaken last summer by our Public Sector Regulatory Commission (PSRC) as regards the electricity tariff increase. More recently, in February of this year we passed a government decree outlining a program for the financial strengthening of the state companies involved in the country's energy sector. The program, prepared with technical and financial support from the World Bank, includes refinancing high-interest commercial short term debt owed by state companies with lower-interest and longer term debts with the World Bank and eliminates expenditures of state companies outside their core areas. In the coming months, the PSRC will be conducting a revision of current electricity tariffs and the government will stop the temporary electricity subsidy introduced in the second semester of 2015. We will also advance the resolution of other state companies, which have in recent years represented a burden for the energy sector and, more generally, on public resources. Throughout this process, the public sector will not absorb losses or liabilities or make payments on behalf of utility companies or other companies (continuous PC) and the budgetary as well as off-budgetary spending on Nairit will be strictly limited only to maintaining the public safety of the industrial site. We plan to decommission the Nairit chemical plant within one year after the completion of the court bankruptcy proceedings against the company.

26. In parallel, we are moving forward with reforms to improve the business environment and make the economy more competitive and integrated. In particular, we are advancing in the following reform areas:

- ***Business climate and domestic competition***. Efforts to improve the business climate continue to produce positive results. In particular, progress in terms of enforcing contracts, external trade, and dealing with construction permits, helped Armenia move up three positions in the 2016 World Bank's Doing Business rankings. We are now directing our efforts to make our domestic markets more competitive. More specifically, we are introducing changes to the law on domestic competition (September 2016 SB) with the objective of increasing penalties for anti-competitive behavior, introducing the possibility of penalties for public and private sector officials, and clarifying the main definitions of the law (e.g., abuse of dominance and unfair competition). Furthermore, we are analyzing the public procurement process in order to assess the presence of anti-competitive practices.

- ***Regulatory reforms***. Since 2012, our Regulatory Guillotine Project has helped us streamline business procedures and complete the planned review of regulations. Nonetheless, a significant share of the proposed regulatory amendments still needs to be approved at the government level. As a result, we will redouble our efforts to complete this step, and move the amendments for consideration in the National Assembly. Simultaneously, the National Center for Legislative Regulation (NCLR), in charge of implementing the Regulatory Guillotine Project, will be converted into a foundation. This will provide institutional continuity to the project and facilitate the attraction of donor funding. The NCLR will start implementing a new methodology for regulatory impact assessments in a series of pilot cases (including in areas such as education, mining, and renewable energy), and will work on training line ministries in order to expand the use of the methodology.

- ***Bankruptcy reform and collateral registration***. We are in the process of submitting to the National Assembly draft amendments to the bankruptcy law aimed at strengthening the judicial specialization in handling bankruptcy cases, qualification criteria for bankruptcy administrators, recovery procedures, and the early-mitigation system to reduce/avoid bankruptcy risks. Recently, we also introduced a unified online electronic database for registering movable assets with the aim of facilitating the use of movable property as collateral for lending purposes. In addition, we will seek the National Assembly's approval of a draft law on collateral, which would criminalize deliberate damage to collateral and would liberalize free disposition of collateral, including that under judicial seizure.

- ***Civil aviation***. We continue to make progress in improving Armenia's connectivity via our "Open Skies" policy, which has been effective in reducing costs and providing a boost to tourism. In this context, we expect to conclude the Common Aviation Agreement with the EU by the end of the year, which should provide additional gains in terms of connectivity and lower costs.

Conclusion

27. We request that the IMF Executive Board complete the Third Review of the EFF-supported program. We also request that an amount equivalent to SDR 15.65 million be made available upon completion of the review. We request a waiver of the end-December 2015 fiscal deficit PC and a modification of the end-June NDA PC in the context of introducing MPCC conditionality.

28. We will maintain a close policy dialogue with the IMF and stand ready to take additional measures, as appropriate, to ensure the achievement of our social and economic objectives under the IMF–supported program. We will continue to consult with the IMF on the adoption of measures, and in advance of revisions of the policies contained in the MEFP, in accordance with the IMF's policies on such consultation. We will also provide the IMF with the information it requests for monitoring program implementation. The program's proposed performance criteria (PCs), indicative targets (ITs), and structural benchmarks (SBs) are set out in Tables 1 and 2 and described in the attached Technical Memorandum of Understanding (TMU).

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

Very truly yours,

/s/
Hovik Abrahamyan
Prime Minister
Republic of Armenia

/s/
Gagik Khachatryan
Minister of Finance
Republic of Armenia

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

Table 1. Armenia: Quantitative Targets, 2014-16 [1]

(in billions of drams, at program exchange rates, unless otherwise indicated)

	2014			2015			2016							
	Dec.			Dec.			Mar.			Jun.			Sep.	Dec.
	EBS 14/18	Adj. Prog.	Act.	EBS 15/119	Adj. Prog.	Act.	EBS 15/119	Adj. Prog.	Proj. 2/	EBS 15/119	Rev. Target	Proj.	Prog. 2/	Prog.
Performance Criteria														
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,026	999	796	992	994	1,013	954	904	896	955	955	977	984	1,055
Net domestic assets of the CBA (stock, ceiling) 3/	318	445	478	444	441	395	387	401	393	426				
Program fiscal balance (flow, floor) 4/	-139	-122	-161	-264	-285	-299	-58	-62	-57	-112	-135	-123	-195	-266
Budget domestic lending (cumulative flow, ceiling)				31	31	21	15	15	3	15	23	18	23	23
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Absorption of losses or liabilities and making of payments on behalf of utilities and other companies (flow, ceiling, continuous criterion)	0	0	0	0	0	0	0	0	0	0	0	0	0	0
MPCC														
Inflation (mid-point, percent) 5/											-1.7	-0.8	-1.2	0.4
Indicative Targets														
Inflation (mid-point, percent) 5/	4.0	4.0	4.6	3.4	3.4	-0.1	3.0	3.0	-2.0	3.3				
Net domestic assets of the CBA (stock, ceiling) 3/											426	393	400	464
Avg. concessionality of newly contracted ext. debt (flow, floor, in percent) 6/	30	30	39	30	30	19								30
New government guaranteed external debt (stock, ceiling, in millions of USD) 7/	100	100	0	50	50	0	50		50	50	50	50	50	50
Social spending of the government (flow, floor) 8/	48	48	47	54	54	55	13		13	27	27	27	42	57
Memorandum items:														
Budget support grants (cumulative from end of previous year)	55		55	66		64	66		66	66		66	66	70
o.w. EU MFA grant	19		19	19		19	19		19	19		19	19	19
Budget support loans (cumulative from end of previous year)	191		186	378		381	398		381	398		401	418	459
o.w. non-IMF loans	153		148	339		343	360		343	360		363	379	420
Project financing (cumulative during the same year)	83		67	71		91	19		27	37		54	82	109
KFW and IBRD loan disbursements (cumulative from end of prevous year)	40		39	71		70	76		72	79		75	83	88
Reserve money	828		887	930		921	866		850	904		888	912	975

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU.
2/ Indicative target.
3/ PC until december 2015 (indicative target afterwards). NDA ceiling will be considered met if the outcome is within AMD 15 billion of the target.
4/ Below-the-line overall balance excluding net lending.
5/ End of period, year-on-year headline inflation. Mid-point within a +/- 1.5 range.
6/ Assessed on a calendar year basis.
7/ Includes both concessional and non-concessional debt.
8/ Defined as spending on the family benefit program and lump-sum financial aid, one-time childbirth benefits, and childcare benefits for children less than two years of age.

Table 2. Armenia: Existing Structural Benchmarks Under the Fund-Supported Program

Area	Measure	Time Frame (End of Period)	Status/comment
Public Financial Management	Publish regular consolidated statements across all budget domestic lending programs.	December 2015	Met
	Complete review of budgetary lending operations to identify risks and management improvements.	June 2016	Revised and extended to September 2016
Tax Policy	Secure parliamentary approval of further excise tax rate increases from 2017 to bring gradually them in line with rates in other EEU member countries.	March 2016	Not Met (because it was included in the the Tax Code)
	Submit to the National Assembly final proposed tax code containing reduction/elimination of exemptions (VAT, income tax) and of other tax policy gaps (sectoral coverage, tax types) to deliver revenue gains.	March 2016	Not Met (Met with delay to enable incorporation of IMF staff recommendations)
Energy Sector	Adopt by Cabinet of energy sector financial recovery plan involving new loans from IFIs to restructure expensive short-term debt; agreement on a repayment plan for accumulated debt to energy suppliers; a strict prohibition on expenses, borrowing and lending by energy companies outside of their core mandate; tariff adjustments, where needed; and a new tariff mechanism to more quickly transfer the risk of deviations from the planned energy-generation mix to consumers, in line with best international practices.	March 2016	Met

Table 3. Armenia: Prior Actions and New Structural Benchmarks Under the Fund-Supported Program

Area	Measure	Time Frame (End of Period)	Responsible Agency	Status/comment
Prior Actions				
Tax policy	Submit to the National Assembly the draft Tax Code agreed with IMF staff during the March mission that includes measures to: increase by 15 percent excise tax rates on alcohol and tobacco (in 2017); remove VAT exemptions on diesel fuel (in 2018); introduce a 5 percent tax on dividends for residents (in 2018); and ensure that agricultural businesses with turnover above the AMD 40 million threshold will be subject to VAT (by 2019).	June 8, 2016	Ministry of Finance	Met
Structural Benchmarks				
Tax policy	Adopt a Tax Code consistent with the prior action for the Third Review of the EFF Arrangement.	Sep. 2016	Ministry of Finance	
Public Financial Management	Complete a review of lending operations, including operations related to real estate projects in Yerevan, to identify risks and management improvements.	Sep. 2016	Ministry of Finance	
Financial sector	Prepare contingency plans specifying a strategy to deal with banks that may not potentially manage to comply with the new minimum capital requirement.	Sep. 2016	Central Bank	
	Submit to the National Assembly the draft laws to ensure implementation of ISDA Master Agreements.	Sep. 2016	Central Bank	
	Prepare a comprehensive plan for full divestment of the CBA shares in PanArmenian Bank (currently fully owned by the CBA).	Dec 2016	Central Bank	
Pension Reform	Maintain support for the Pension System Awareness Center and the pension reform outreach campaign in the 2017 budget.	Dec. 2016	Ministry of Finance	
Regulatory and competition policy	Submit to the National Assembly amendments to the law on domestic competition, specifying higher penalties for anti-competitive behavior, the possibility of penalties for public and private sector officials, and clarifying the main definitions of the law (abuse of dominance, unfair competition, among others)	Sep. 2016	Ministry of Economy	

Attachment I. Technical Memorandum of Understanding

1. This memorandum sets out understandings between the Armenian authorities and the IMF staff regarding the definition of performance criteria (PCs) and indicative targets (ITs), adjusters, and data reporting requirements for the Extended Arrangement as per the Letter of Intent and Memorandum of Economic and Financial Policies (LOI/MEFP) dated October 22, 2015, and previous letters of intent dated February 17, 2014 and December 3, 2014.

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 410 dram per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

Quantitative Targets

3. The program sets PCs, ITs, and the Monetary Policy Consultation Clause (MPCC) for defined test dates (see Table 1 in the LOI/MEFP).

The program sets the following PCs:

- Floor on the net official international reserves (NIR) of the Central Bank of Armenia (CBA); Ceiling on external public debt arrears (continuous);
- Floor on the program fiscal balance;
- Ceiling on domestic budgetary lending; and,
- Ceiling on absorption of losses or liabilities and making of payments on behalf of utilities and other companies (continuous).

The program sets the following ITs:

- Ceiling on the net domestic assets (NDA) of the CBA; Floor on average concessionality of newly contracted external debt;
- Ceiling on new government guaranteed external debt; and,
- Floor on social spending of the government.

The program sets the following MPCC:

- Headline inflation.

4. The net official international reserves (NIR) (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). [4] 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 convertible currencies other than the U.S. dollar shall be converted into dollar-equivalent values using the convertible exchange rates as specified in Table 1.

5. MPCC headline inflation is defined as the year-on-year rate of change of the Consumer Price Index as measured by Armenia's National Statistics Service. The MPCC will be considered met if headline inflation falls within a range of +/- 1½ percentage point around the mid-point target specified in Table 1 in the LOI/MEFP.

- If the observed headline inflation falls outside the +/- 1½ percentage point range around the mid-point target for end-June 2016 and end-December 2016 test dates, the authorities will complete a consultation with the Executive IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for program deviations, taking into account compensating factors; and

[4] Convertible currencies are limited to: U.S. dollar, U.K. pound, euro, Japanese yen, SDR, Australian dollar, Canadian dollar, and Swiss franc.

(iii) proposed remedial actions if deemed necessary. When the consultation with the IMF Executive Board is triggered, access to Fund resources will be interrupted until the consultation takes place.

- If the observed headline inflation falls outside the +/- 1½ percentage point range around the mid-point target for end-September 2016 test date, the authorities will conduct discussions with the Fund staff.

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. The ceiling will be considered as met if the outcome is within AMD 15 billion of the targets sets in Table 1 attached to the LOI/MEFP.

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 to non-residents, including unpaid penalties or interest charges associated with these obligations that are overdue beyond 30 days after the due date.[5] The ceiling on external payment arrears is set at zero.

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

[5] 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 14).

accrued interest for treasury bonds);[6] (2) any other disbursement or transaction that increases nonbanks' claims on the central government plus withdrawals from the Special Privatization Account (SPA) 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. Net external financing also includes any privatization proceeds received from non-residents in foreign currency and not held in the SPA.

- **A budgetary ER** of 411 drams per one US dollar was used for foreign currency-denominated transactions included in the 2015 budget with the exception of the amounts received for project implementation units (PIU) for which the prevailing ER at the time of the transaction was used. Proceeds from the March 2015 Eurobond issuance and related coupon payments in 2015 were valued at the ER of March 30, 2015. Any additional unbudgeted transactions for 2015 took place at the market exchange rate. Under the existing budgetary ER framework arrangement, for 2016, the ER stated in the Budgetary Address, 473.4 drams per one US dollar, will be used for foreign currency-denominated transactions included in the 2016 budget, with the exception of the amounts received for PIU for which the prevailing ER at the time of the transaction will be used. In addition, if new foreign currency-denominated transactions are introduced at any time, these will take place at the prevailing ER at the time of the transaction. The framework arrangement will not be modified (in substance), but may be clarified as this would imply noncompliance with the program continuous PC on ER arrangements and multiple-currency practices.

9. External and domestic net lending, which are recorded as financing items, are *excluded* from the calculation of the program fiscal balance, which is calculated from the financing side (see ¶8). This effectively treats net lending as an expenditure item when loans are made and as a revenue item when the loans are repaid.

10. Transactions related to the extension of the operating life of the Metsamor nuclear power station—which will take place via lending from the Russian Federation to the Ministry of Finance of Armenia and from the MOF of Armenia to the Armenian Nuclear Power Plant JSC—will be excluded from the measure of the program fiscal deficit.

11. 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

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

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.

12. Foreign currency proceeds from selling enterprises are credited to the SPA and their use is reflected in the state budget. In addition, the Government will ensure full transparency of revenues and spending from the sales of major assets (beyond regular day-to-day operations) of enterprises with state ownership. This will include presentation of use of funds from the sale of the hydroelectric assets of the Vorotan Cascade Company, including for electricity subsidies and payment of wage arrears of Nairit. 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 withdrawal from the SPA will be accounted for as privatization proceeds used to finance the budget and will be recorded below the line. 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. Finally, as noted in ¶8, privatization proceeds received from non-residents in foreign currency and not held in the SPA are also treated as a financing item (sale of financial assets) and recorded below the line.

13. **Domestic budgetary lending** is defined as the gross amount of new loans made to resident individuals, enterprises, or entities financed from the state budget or other general government resources. This includes, but is not limited to, loans financed from the Economic Stabilization Fund and lending under existing or prospective government programs, such as agricultural sector support and real estate development programs, among others. Lending operations related to targeted projects financed with external loans and grants will be excluded from the calculation of the ceiling on budget domestic lending.

14. **Absorption of losses or liabilities and making of payments on behalf of utilities and other companies**. The program sets a continuous ceiling on absorption by the public sector of losses or liabilities from outside the budgetary sector. The public sector is defined as institutions covering the state budget and state debt—including the central and local governments—plus the CBA and enterprises or other entities with state ownership or control. Absorption of losses or liabilities is defined as direct payment by the public sector of the losses or liabilities of other parties or coverage of losses or liabilities by other transactions, such as debt-for-equity swaps or a write-off of tax obligations or other state claims. The ceiling is set at zero, and excludes AMD 13.7 billion, (approximately $33 million) of subsidies in the 2015 budget for Yerevan Metro, Yerevan Electric Transport, Irrigations Systems, Armenian Water and Sanitation, Nor Akunk, Lori Water and Sanitation, Shirak Water and Sanitation, and irrigation water intake entities. For 2016, the ceiling will exclude subsidies to these same entities of not more than AMD 16.9 billion. The ceiling will also exclude government support for the electricity tariff differential, which should not exceed $12 million. During the program period, there may be occasions when absorption of a limited amount of losses or liabilities, or making limited payments on behalf of utilities or other companies would facilitate a positive outcome (e.g., a major foreign investment transaction, poverty alleviation or equity enhancement, or prevention of even greater losses that would endanger financial stability).

The PC will be considered to be met, if new subsidy amounts do not exceed AMD 2.5 billion. In the case of new subsidies, the Armenian authorities will discuss the circumstances and possible options with the Fund staff prior to transactions more than AMD 500 million. Any modification of the PC to make any such payments or absorb any losses will require approval by the IMF Executive Board, at the time of the next review.

15. Floor on average concessionality of newly contracted external debt. The program sets an annual indicative floor of 30 percent on the average concessionality of new debt on a contraction basis with nonresidents with original maturities of one year or more as contracted and guaranteed by the public sector. The concessionality floor is calculated on a calendar-year basis.

- 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 rate used for this purpose is a unified discount rate set at 5 percent.

- The public sector here comprises the general government (central, plus local governments and covering the state budget and state debt), 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.

16. Ceiling on government guaranteed external debt. In addition to the indicative floor on average concessionality, a separate, cumulative ceiling (IT) of $50 million for the program period applies to new government guarantees of the total of concessional and non-concessional external financing. The issuance of debt guarantees will be measured at the exchange rates listed in Table 1. The above limit covers debt guarantees issued by the general government to entities outside the general government (excluding the CBA). Guarantee issuance will be monitored on a monthly basis and the Ministry of Finance will provide data within 21 days from the end of the month.

17. 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 95 percent of the budgeted amount of the family benefit program and lump-sum financial aid, one-time childbirth benefits, and childcare benefits for children less than two years of age.

18. 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 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, Asian Development Bank, 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, Asian Development Bank, 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 commercial loans (e.g., Eurobonds), 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 purchases by 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 as well as for privatization proceeds received from non-residents in foreign currency and not held in the SPA.

- **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 per year 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 $50 million in either direction.

- **The ceiling on domestic budgetary lending** will be adjusted upward by the amount of undisbursed funds under domestic budgetary lending programs approved in the previous year.

B. Data Reporting

19. The government and the CBA 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)	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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
				the end of each month
	Balance of payments	Detailed balance of payments data	Quarterly	Within 60 days of the end of each quarter
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 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,	Monthly	Within 7 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.		
	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 and lending 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.
	Financial information on utilities and other major companies with a state interest	Profit and loss indicators for regulated utilities, for companies with state shareholding of 50 percent or greater, and for companies with state shareholding of 0–50 percent and annual sales or outstanding liabilities of AMD 10 billion.	Quarterly	Within 60 days of the end of each quarter
	Pension system	Number of participants in the pension second pillar, social payments and funded contributions	Monthly	Within 45 days of the end of each quarter (monthly data provided on a quarterly basis)
NSS	Balance of payments	Detailed export and import data (issues that have arisen in 2015	Monthly	Within 28 days of the end of each

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		with EEU trade data need to be overcome as soon as possible)		month
		Detailed export and import data	Quarterly	Within 45 days of the end of each quarter
	CPI	By category	Monthly	Within 5 days of the end of each month
MOF (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 and by sectors (i.e. Agriculture, Industry, Mining, Construction, Trade and Services), in both net and gross terms	Monthly	Within 45 days of the end of each (monthly data provided on a quarterly basis)
	Tax Revenues	Tax Revenue by Economic Sectors (i.e. Agriculture, Industry, Mining, Construction, Trade and Services)	Monthly	Within 45 days of the end of each quarter (monthly data provided on a quarterly basis)
	VAT and turnover tax	Number of registered taxpayers	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 July 31, 2013 in U.S. dollars per currency rates)

Country	Drams Per Currency	Dollars Per Currency
Australian dollar	371.95	0.9072
Canadian dollar	398.33	0.9715
Swiss franc	440.91	1.0754
Danish krone	73.06	0.1782
Euro	544.28	1.3275
Pound sterling	627.83	1.5313
Japanese yen	4.18	0.0102
Norwegian krone	69.14	0.1686
Russian ruble	12.47	0.0304
Swedish krone	62.47	0.1524
SDR	621.04	1.5147

Table 2. Armenia: KFW, AsDB, and IBRD SME Loan Disbursements [1]

(In millions of U.S. dollars)

Dec-14		Dec-15		Mar-16		Jun-16		Sep-16	Dec-16
EBS/14/18	Act.	EBS/15/119	Act.	EBS/15/119	Proj.	EBS/15/119	Proj.	Prog.	Prog.
98	96	173	171	185	176	193	184	202	215

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-14		Dec-15		Mar-16		Jun-16		Sep-16	Dec-16
	EBS/14/18	Act.	EBS/15/119	Act.	EBS/15/119	Proj.	EBS/15/119	Prog.	Prog.	Prog.
Project financing	203	163	173	223	45	66	91	133	199	265
Budget support loans	466	454	921	929	971	929	971	979	1,019	1,119
Budget support grants	133	135	160	157	160	161	160	161	161	172
of which: EU MFA	47	47	47	47	47	47	47	47	47	47

1/ Budget support cumulative from the end of the previous year. Project financing cumulative during the same year.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

May 31, 2016

THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT, AND REQUEST FOR WAIVER AND MODIFICATION OF PERFORMANCE CRITERIA—INFORMATIONAL ANNEX

Prepared By

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

CONTENTS

FUND RELATIONS

(April 30, 2016)

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

General Resources Account:

	SDR Million	Percent of Quota
Quota	128.80	100.00
Fund holdings of currency	288.67	224.13
Reserve Tranche Position	0.00	0.00

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	87.99	100.00
Holdings	9.91	11.26

Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
ECF Arrangements	137.26	106.57
Extended Arrangements	159.87	124.12

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	03/07/2014	05/06/2017	82.21	35.22
ECF	06/28/2010	07/02/2013	133.40	133.40
EFF	06/28/2010	06/24/2013	133.40	133.40

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

	Forthcoming				
	2016	2017	2018	2019	2020
Principal	21.96	36.88	45.17	52.83	53.33
Charges/interest	1.27	1.56	1.34	1.28	0.93
Total	**23.22**	**38.44**	**46.51**	**54.10**	**54.26**

Safeguards Assessment

An update safeguards assessment was concluded in August 2014 with respect to the Extended Fund Facility approved in March 2014. The assessment found that the CBA maintains safeguards in its financial reporting practices, external audit mechanism, and internal audit function. However, the assessment recommended amendments to the central bank law to strengthen the CBA's governance arrangements, and also to provide the CBA with marketable, interest-bearing government securities to cover its losses. In addition, the assessment noted that the CBA has investments in enterprises engaged in financial sector development and infrastructure, including a credit card processing company, a mortgage finance company, and a cash collection agency. In its audited financial statements, the CBA now presents a consolidated position inclusive of these enterprises, and is in the process of implementing the safeguards recommendation to provide details on risks, risk-mitigation efforts, and divestment strategies.

The CBA and Ministry of Finance (MoF) have made progress in implementing the recommendations of the most recent Safeguards Assessment, but further work remains. The CBA has adopted a charter for its board members to clarify roles and responsibilities. The CBA has investments in enterprises engaged in financial sector development and infrastructure, including a credit card processing company, a mortgage finance company, and a cash collection agency. The CBA has worked with its external auditors to present a consolidated position inclusive of these enterprises and an annex to its annual report describing the rationale for the investments and management of the enterprises. In the future, the annex should cover risks, risk-mitigation efforts, or divestment strategies. Also, pending legislation to provide the CBA with marketable, interest-bearing government securities to cover losses has not advanced in parliament.

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. Following a sequence of interventions to rebuild reserves in the last three quarters of 2013, the de facto exchange rate arrangement was reclassified from floating to crawl-like arrangement, effective March 12, 2013. More recently, the de facto exchange rate arrangement has been reclassified to floating from a crawl-like arrangement, effective November 4, 2014. The official exchange rate is quoted daily as a weighted average of the buying and selling rates in the foreign exchange market.

Armenia maintains one multiple currency practice, which arises from a 2007 agreement between the MoF and CBA to settle some budgetary transactions at an agreed accounting ER throughout the fiscal year. The authorities are not requesting and staff does not recommend the Board's approval to maintain this MCP. A previous MCP related to the conversion of Funds to make a September 2015 Eurobond coupon payment has expired.

Armenia maintains no other 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 2014 Article IV consultation with Armenia was concluded on December 22, 2014. 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 report was approved by the Executive Board in June 2012. The most recent previous FSAP Update took place in 2005.

Resident Representative

Ms. Teresa Daban Sanchez, since August 2013.

Technical Assistance

The following table summarizes the Fund's technical assistance (TA) to Armenia since 2010.

Armenia: Technical Assistance from the Fund, 2010–16

Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Tax administration	Short-term	March –May 2010	MoF, SRC
Tax administration	Short-term	August - November 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 2011	MoF
Budget process	Short-term	October 2011	MoF
Public Financial Management	Short-term	November 2012	MoF
Tax Administration	Short-term	April 2013	MoF, SRC
Tax Administration	Short-term	September 2013	MoF, SRC
Fiscal Risk	Short-term	October 2013	MoF, SRC
Tax Administration	Short-term	December 2013	MoF, SRC
Public Finance Management	Short-term	March 2014	MoF
Fiscal Risk	Short-term	November 2014	MoF
Tax administration (LTI)	Short-term	April 2015	MoF
Customs Administration	Short-term	May 2015	MoF
Public Financial Management	Short-term	May-June-September 2015, February, May 2016	MoF
Tax Policy	Short-term	November 2015	MoF
Legal Department			
Banking Law	Short-term	June 2011	CBA
AML/CFT	Short-term	Various	MoF
Monetary and Capital Markets Department			
Contingency planning, crisis preparedness Workshop on Inflation Targeting (with IMF Research Dept.)	Short-term Workshop	March–April 2010 April–May 2011	CBA CBA
Bank resolution framework	Short-term	June 2011	CBA
Medium-term debt management strategy	Short-term	December 2011	CBA

Armenia: Technical Assistance from the Fund, 2010–16 (concluded)

FSAP update	Short-term	February 2012	CBA
Inflation targeting (with IMF Research Dept.)	Short-term	February-March 2012	CBA
Inflation targeting	Short-term	November 2012	CBA
Inflation targeting	Short-term	January 2013	CBA
Bank prudential framework	Short-term	April 2013	CBA
Monetary and Foreign Exchange Policy	Short-term	June 2013	CBA
Safeguard Assessment	Short-term	March 2014	CBA
Central Bank Communication	Short-term	April 2014	CBA
Inflation Targeting	Short-term	April 2014	CBA
Inflation Targeting	Short-term	April, November 2015	CBA
Inflation Targeting	Short-term	March 2016	CBA
Statistics Department			
National accounts	Short-term	September 2010	NSS
BOP and external debt statistics	Short-term	October 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
Construction Price Index	Short-term	September 2013	NSS

WORLD BANK AND IMF COLLABORATIONS—JMAP IMPLEMENTATION

(As of May 5, 2016)

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
World Bank's Country Partnership Strategy for Armenia (2013-17)	Country Partnership Strategy Performance and Learning Review for Armenia (extending the CPS until 2018)	Submitted to the World Bank's Board of Directors for consideration	May 2016
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 closed in January 2017
	Tax Administration Modernization Project (US$12 m)	Semi Annual	WB Board approval July 2012, effective since Dec. 2012, closing date is December, 2017;
	DPO series to support competitiveness and ensure sustainability (US$ 197m)	Quarterly	Board date for DPO-2 ($75 mln) : November 12, 2014 DPO-3 ($50 mln)): December 7, 2015 DPO-4 ($50 mln))– November 2016
	New Health Project for Disease Prevention and Control (US$30m)	Semi Annual	WB Board approved – March 2013
	Public Sector Modernization (III) and PFM project (US$26.5 mln)		Board Date – Sept. 30 , 2015, effective since March 2016

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
	Power Sector Financial Recovery Project ($ 32 mln)	Quarterly	WB Board approved – April 28, 2016
	Analytic Work Programmatic Poverty work Programmatic Fiscal work (fiscal incidence assessment, public sector wage assessment, review of social assistance programs)	Continuous	Annual Series, 2014 report Delivered in June 2014 and Disseminated in November 2014.
	PER on Quasi-fiscal activities, Macro-Fiscal sustainability and fiscal Subsidies		Is due by June, 2016, dissemination – by July 2016
	New Country Economic Memorandum on Drivers of Dynamism	Ongoing	The 2015 report was finished June 2015, dissemination – in November, 2015
	Assessment of EEU membership on Armenia's economy		Disseminated in October, 2015
	Promoting Productive employment in Armenia – a note on labor market activation		Disseminated in Dec 2014 Policy workshop -in December 2014
	Systematic Country Diagnoses (SCD)		Start – June 2016, delivery - June 2017
	Selected Technical Assistance IDF grant for guillotine exercise Macro-monitoring		2014-15
	One-stop shop for providing construction permits		February, 2016

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
	CGE model-based technical assistance to simulate trade and growth projections ($120K) Technical Assistance on Tax Policy ($100K) Technical Assistance on Tax Policy (75K)		Start: January 2016 End: June 2016 Start: July 2015 End: June 2016, Start: June 2016, End: June 2017 Mobilized to support MoF for Tax Code preparation and discussion,
2. IMF work program in the next 12 months	Fourth EFF Review Fifth EFF Review **Selected Technical Assistance/Training** FAD (follow-up on Pub. Financial Management) MCM/RES (Inflation targeting)	September 2016 March 2017 May 2016 September 2016	November 2016 May 2017 June 2016 October 2016

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

(As of April 15, 2016)

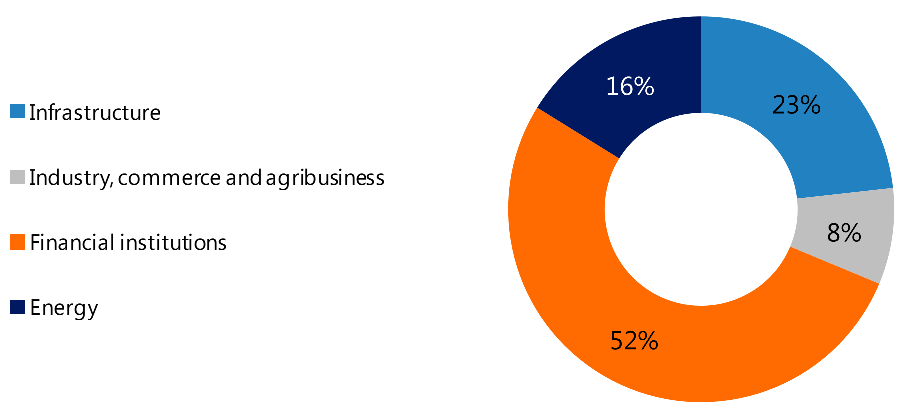
EBRD Scorecard

1. **The EBRD is the largest single investor in Armenia.** To date, the Bank has committed almost €950 million in over 140 projects in all major sectors of the economy.

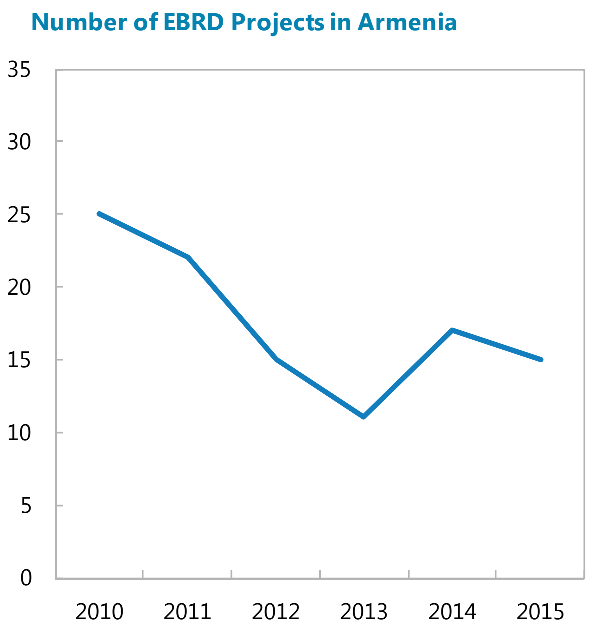
EBRD Activity in Armenia to Date (last updated April 1st 2016)	
149 Numbers of projects to date	**€1,012 million** Cumulative EBRD investment
€713 million Cumulative disbursements	**85 percent** Private sector share of portfolio

Portfolio Composition

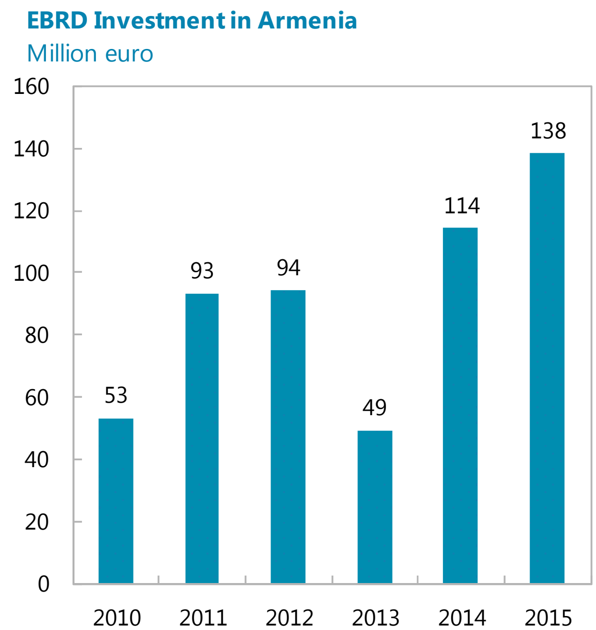
Current portfolio: 318 million euro*



Source: European Bank for Reconstruction and Development (EBRD)
*Includes undisbursed commitments



Source: European Bank for Reconstruction and Development (EBRD)



Source: European Bank for Reconstruction and Development (EBRD)

Milestone deals for the last 2 years

- ***<u>EBRD and government of Armenia sign a contribution agreement on Armenia's participation in E5P</u>***

2. **In 2015, the EBRD and the Ministry of Energy and Natural Resources of Armenia have signed an agreement on Armenia's participation in the Eastern Europe Energy Efficiency and Environment Partnership (E5P).** Armenia has already contributed € 250 K out of €1 m to E5P which will enable Armenia to access grant funds of €20 million for priority energy efficiency investments in the municipal sector. The E5P is a multi-donor fund providing grants to support energy efficiency projects that aim to improve energy efficiency and the environment in the Eastern Partnership countries. The main objective of the initiative is to use grants to leverage loans dedicated to municipal energy efficiency and environmental projects, for example the rehabilitation of water and wastewater systems, solid waste management, street lighting and the insulation of public buildings.E5P is part of the strategic response to energy issues, allowing municipal authorities to invest in projects that make the most of opportunities for energy savings. As a partnership, E5P also includes a strong commitment to policy dialogue, allowing partners to address policy issues in their efforts to find practical solutions to problems municipalities face when investing in energy efficiency measures.

- ***Yerevan Street Lighting project***

3. The Yerevan Street Lighting project (€ 3.6 million) signed in May 2015, will introduce energy efficient lighting technologies in the 28 streets of the City, along with modern control system to serve the wider city during the years to come. This project is an important landmark as it is the first project to benefit an E5P grant facility (€ 1.9 million) since the facility became operational in Armenia in March 2015.

- ***Kotayk Solid Waste management project***

4. In 2014, the EBRD provided a €3.5 million loan to Armenia to finance the construction of the country's first European Union compliant solid waste landfill. The loan is complemented by a €3.5 million capital grant provided by the European Union Neighbourhood Investment Facility. The new landfill, to be located in the city of Hrazdan in Kotayk Province and managed by eight participating municipalities—Hrazdan, Abovian, Charentsavan, Tsakhkadzor, Byureghavan, Yeghvard, Nor Hachn and Sevan—will be operating as a commercially sustainable unit with modern solid waste management systems, covering the collection and disposal of municipal solid waste. This will provide major environmental and social benefits for some 215,000 people in the area covered by the facility.

- ***Yerevan Solid Waste management project***

5. In 2015, the EBRD provided a €8 million loan to Armenia to finance the construction of a solid waste landfill in Yerevan that complies with European Union (EU) regulations. The loan is co-financed by a €8 million credit line from the European Investment Bank and a capital grant of €8 million from the European Union.

6. The new landfill will meet international standards and operate as a commercially sustainable unit with modern solid-waste management systems, covering the collection and disposal of municipal solid waste. The facility, located on the outskirts of Yerevan, will provide major environmental and social benefits for the 1.1 million residents of the Armenian capital.

- ***Supporting consolidation in Armenia's banking sector***

7. In 2015, the EBRD made an equity investment of AMD 9.8 billion (equivalent to US$ 20.3 million) for up to 22.7 percent of shares in Inecobank, a specialist micro, small and medium-sized enterprise (MSME) and retail bank in Armenia. Inecobank used the proceeds of the EBRD investment to finance the acquisition of ProCredit Bank Armenia, another local bank oriented towards MSMEs. The merged bank will become a leading MSME lender in the country, serving over 10,000 businesses and 200,000 individuals. This investment marked a milestone, providing an excellent platform for more consolidation in the Armenian banking sector and further improving standards of corporate governance. With a strong management team in place, a more efficient branch network and well-tested products and services, the combined bank will be able to provide Armenian MSMEs with better access to finance.

8. **Later the EBRD invested US$ 40 million in the acquisition of an equity stake in Ameriabank CJSC, a leading private bank in Armenia.** This is the largest single-ticket equity deal the EBRD has signed in the region to date. As a first step the EBRD acquired a stake of around 20 percent for US$ 30 million. The remaining US$ 10 million will be used for future capital increases. The goal of the investment is to strengthen Ameriabank and prepare the bank for a future IPO.

- ***EBRD launches SME Local Currency Program in Armenia***

9. **In 2016, Armenia has renewed a Memorandum of Understanding with the EBRD to become eligible for lending to local small and medium-sized enterprises (SMEs) in local currency under a new EBRD facility**. In parallel with access to affordable local currency funds, the country continues to commit itself to a reform program which will improve, broaden and deepen local currency and capital markets in Armenia. To achieve this goal the authorities will promote a macroeconomic, regulatory and market environment that supports local currency borrowing and lending with a detailed reform package. The signing follows the approval of the EBRD's Local Currency Program for SMEs in its countries of operations to mitigate their exposure to exchange rate movements. It includes a new €500 million SME Local Currency Lending Facility that will combine EBRD capital and donor resources to provide eligible companies with access to affordable funding.

10. **The development of local currency finance remains a challenge in most of the Bank's countries of operations**, some of which are among the countries that have the highest exposures to exchange rate movements anywhere in the world. SMEs that sell their goods and services domestically in local currency, but borrow in foreign currency, are highly exposed to this currency risk.

11. **The EBRD's Local Currency and Local Capital Markets Initiative, launched in May 2010, aims to enhance the macroeconomic, regulatory and market framework to ensure long-term sustainable and liquid local currency markets.** The initiative's goal is to strengthen local capital markets and encourage the use of local currencies in the Bank's countries of operations.

- ***EBRD's Caucasus Energy Efficiency Program (CEEP)***

12. **Developing both demand for and supply of energy efficiency investments through credit lines issued under CEEP, and extending its scope beyond corporates to include retail lending.** Since 2013, 6 Armenian banks and two credit organizations have joined the program, signing about than USD 31.5 million for on-lending to industrial and residential EE sub-projects. More than USD 14 m has been disbursed already by CEEP participant banks to its customers.

- ***Zvartnots International Airport***

13. In 2015, the EBRD participated in a landmark international syndication (USD 30 m) for Zvartnots International Airport which will provide significant new resources for further investment in Armenia.

➢ ***EBRD launches new Strategy for Armenia***

14. In 2015, the EBRD has adopted a new strategy for Armenia under which it will over the next four years give priority to enhancing the competitiveness of the private sector, improving the business environment, developing local the capital markets and funding infrastructure development.

15. Armenia's economic growth has slowed down this year as a result of the broader regional downturn which affects the country via reduced trade, remittances and investment flows. In addition, the depreciation of the Armenian dram and a decrease of foreign currency reserves have impacted the country's economy.

16. To speed up economic growth and support the government's ambitious reform program, which includes improving the business environment, the EBRD will focus on the following key priorities in its new strategy for Armenia:

- Enhancing private sector competitiveness: For Armenia's small and open economy, a significant improvement in competitiveness is key to attracting investment. The EBRD will continue financing the private sector. The Bank will target assistance for improvements to the regulatory and administrative environment and strengthen its assistance to micro, SMEs.

- Developing capital markets and promoting local currency financing: As the authorities roll out mandatory pension reforms, the majority of pension fund investments will be channeled in local currency. Success will largely depend on the emergence of a healthy supply of capital market issues on the local market, and enough different investors to create market liquidity. The EBRD stands ready to support the development of the local capital market.

- Developing public utilities: Armenia's energy, transport and municipal infrastructure still needs much update. For this, it is important to increase private participation in public service provision. The Bank will support commercially viable energy and energy efficiency, transport and municipal service projects and engage in policy dialogue.

➢ ***Advice for Small Businesses***

17. Through the Advice for Small Businesses, the EBRD delivered technical assistance and consulting services to over 1,200 local advisory projects and 50 international advisory projects since 2003, helping high quality companies (including a significant number of rural businesses) improve their financial reporting, management capacity and marketing. Within this effort, during the last 3 years, international advisory has provided international expertise to 13 dynamic corporates, which has been particularly effective in helping them design and execute business development strategies. Over the life of the program, nearly 30 percent of ASB clients secured financing within one year, 57 percent hired additional employees, and over 91 per cent increased turnover.

- ***<u>EBRD recent policy dialogue activities</u>***

  - Investment Council, a platform for policy dialogue between the Government and the private sector
  - Assistance with regulatory framework on Armenian Post Bank
  - TCs for shareholder's and CEO's on achieving robust capital structure and corporate governance
  - TA and capacity building to improve the legal/regulatory frameworks for leasing and factoring
  - MOU with Armenia to further lending to local SMEs in local currency and Action Plan with a focus on money markets and derivatives
  - Assistance to CBA on bank consolidation process; jointly organized seminar for bank shareholders and CEO's.
  - Together with other donors coordinate to promote responsible mining and best practices through policy dialogue, including with NGOs, mining companies and the authorities.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ASDB)

(As of May 2, 2016)

1. **Armenia joined the AsDB in September 2005.** AsDB's first Country Partnership Strategy for Armenia for 2014–2018 (endorsed by AsDB's Board on 27 January 2015) focuses on three sectors: (i) transport, (ii) water supply and other municipal services, and (iii) energy. In August 2014, AsDB's Board approved the reclassification of Armenia for the purpose of access to ordinary capital resources and graduation from the Asian Development Fund resources, effective January 1, 2017.

2. **As of May 1, 2016, the AsDB cumulative sovereign lending amounted to $910 million for 16 loans.** In 2015 AsDB approved a Results-Based Loan of $88.5 million for the Seismic Safety Improvement Program. The program will support the government in seismic strengthening and renovation of priority school buildings and to improve seismic safety planning and management competencies.

3. **In 2014, the AsDB approved a $37 million loan for the Power Transmission Rehabilitation Project** to help the government diversify energy sources, and rehabilitate and upgrade electricity transmission and distribution networks. The Infrastructure Sustainability Support Program ($49 million) was approved in August 2014 and helped improve road and water service provision through results-based public management and financing reforms. The program focused on critical expenditures, sustainability, and life-cycle costing to ensure investments in these two sectors is carefully prioritized and fully sustainable.

4. **In 2012, the AsDB approved two public sector loans.** The Women's Entrepreneurship Support Sector Development Program, approved in October 2012, promotes gender-inclusive growth by improving the enabling environment and capacity of women entrepreneurs and MSMEs. The program includes two components: (i) a program loan ($20 million) supporting reforms to improve the business environment for women; and (ii) a financial intermediation loan ($20 million) through the German-Armenian Fund in which medium-term local currency loans will be made by participating financial institutions to MSMEs, with at least 50% of the loans going to women's MSMEs. In 2012, AsDB provided $40 million as additional financing for the Water Sector and Sanitation Sector Project, approved in 2007, for improving access to safe, reliable, and sustainable services in 18 towns and 92 project villages, managed on commercial principles and with environmentally sound practices.

5. **In 2011, the ADB approved a $400 million multi-tranche financing facility (MFF) for the Sustainable Urban Development Investment Program**, which aims to help Armenia upgrade its urban transport services, to improve living conditions, and bolster economic opportunities in 12 of the country's major and secondary cities. The Tranche 1 for $48.64 million (approved in 2011)

and the tranche 2 for $112.97 (approved in 2015) of the MFF will help improve and extend the urban infrastructure and to strengthen the institutional capacity in Yerevan.

6. **In 2009, ADB approved a $500 million MFF to fund the North–South Road Corridor Investment Program**. In 2009 AsDB approved Tranche 1 ($60 million) for improving the Yerevan-Ashtarak section of the road. Tranche 2 ($170 million) approved in 2010 finances the upgrade of the road between Ashtarak and Talin. In 2013 AsDB approved Tranche 3 for $100 million to finance continuing construction of the road to Gyumri (additional co-financing is provided by the European Investment Bank).

7. **The Crisis Recovery Support Program Loans ($80 million),** approved in July 2009, helped Armenia through the global financial crisis by allowing it to protect budgetary social spending and implement anti-crisis measures in a time of economic contraction and declining fiscal revenues.

8. **In 2007, the AsDB approved a $30.6 million loan for the Rural Road Sector Project to help the government upgrade 220 kilometers of rural roads.** A supplemental financing of $17.32 million was approved in 2008 to address financial shortcomings of the project. A $36 million loan for the Water Supply and Sanitation Sector Project, approved in 2007, helped the government repair and replace water supply infrastructure in small towns and villages.

9. **With the exception of the Tranche 2 and Tranche 3 of the North-South Road Corridor Investment Program and the Tranche 2 of the Sustainable Urban Development Investment Program**, all approved sovereign loans are from the AsDB's concessional Asian Development Fund.

10. **The ADB has approved $130 million in non-sovereign financing in Armenia for three private sector transactions.** In 2013, ADB signed a $25 million loan with International Energy Corporation to rehabilitate and improve the reliability and safety of Sevan-Hrazdan Cascade Hydropower, in a program cofinanced with the EBRD. In November 2011, AsDB approved a non-sovereign lending program totaling $65 million for four commercial banks to expand lending to SMEs. One non-sovereign loan for $40 million 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 a program co-financed with EBRD and DEG (German Investment and Development Corporation). AsDB’s Trade Finance Program works with four banks in Armenia and has supported over $39 million in trade across 55 transactions.

11. **In addition to financing projects and programs, the AsDB is also involved in advisory services and capacity development.** These include TA programs for urban development in secondary cities, export and innovation-led industrial development, infrastructure sustainability, preparation of an investment forum, and solid waste management. Armenia is also included in a number of the AsDB's multi-country TA projects, providing assessments, and development plans on topics of common interest across countries.

STATISTICAL ISSUES

(As of May 10, 2016)

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 IMF 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. As of 2015, the NSS has been preparing the national accounts under the methodology of the *System of National Accounts 2008 (2008 SNA)*. GDP under this new methodology have been extended back to 2012, and there are plans to also cover earlier years.

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 and instead 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. Since 2012, NSS has discontinued compiling GDP on average prices of 2005 and instead they just published GDP for 2009-2012 on average prices of year 2008. 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. The CPI is currently computed using 2015 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 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. Since 2010 these PIU accounts also are being moved gradually to the TSA. 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, teachers, and doctors are reported in the category of goods and services and other expense, 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, although some recent delays have emerged with the transitions towards the Eurasian Economic Union (EEU). Trade statistics are provided on a timely basis, and trade data by origin, destination, and commodity are generally available within a month. However, reporting problems have arisen in 2015 with EEU trade data. 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 May 10, 2016)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	May. 2016	5/10/2016	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May. 2016	5/10/2016	D	D	M
Reserve/Base Money	May. 2016	5/10/2016	D	D	D
Broad Money	Mar. 2016	5/5/2016	M	M	M
Central Bank Balance Sheet	Mar. 2016	5/5/2016	D	M	M
Consolidated Balance Sheet of the Banking System	Mar. 2016	5/5/2016	M	M	M
Interest Rates[2]	May. 2016	5/6/2016	W	W	M
Consumer Price Index	Mar. 2016	4/11/2016	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]— General Government[4]	Q4 2015	3/01/2016	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Q1. 2016	5/3/2016	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Mar. 2016	5/5/2016	M	M	Q
External Current Account Balance	Q4 2015	4/1/2016	Q	Q	Q
Exports and Imports of Goods and Services	Q4 2015	4/1/2016	M	M	Q
GDP/GNP	Q4 2015	3/3/2016	Q	Q	Q
Gross External Debt	Q4 2015	4/1/2016	Q	Q	Q
International Investment Position[6]	Q4 2015	4/1/2016	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).

Statement by Menno Snel, Executive Director for the Republic of Armenia and Amela Hubic, Senior Advisor
June 15, 2016

Mr. Snel and Ms. Hubic submitted the following statement:

The Armenian authorities would like to thank the IMF team, headed by Mr. Hossein Samiei, for the constructive dialogue and valuable advice during their mission in Yerevan. The authorities broadly agree with staff's assessment and policy recommendations provided in the report. The program implementation has improved and its objectives -to foster strong economic growth, reduce fiscal and external vulnerability, and preserve macroeconomic and financial stability- remain the authorities' priorities.

Recent economic developments and outlook

Since late 2014, the economic performance has been strongly affected by weaker external conditions, in particular due to the slowdown in Russia and lower copper prices. Remittances declined sharply, although recently, they have somewhat evened out. Domestic demand has also weakened, largely reflecting lower purchasing power and continued external uncertainty. Nevertheless, real GDP growth in 2015 was higher than expected, supported by fiscal policy and specific industrial developments. Also, favorable weather conditions have improved agricultural output. Unfortunately, this increase was not reflected in government revenue, which is expected to decrease in 2015 and 2016 - as some sectors that contributed to growth are exempt from taxes, and imports continue to decline. The external current account adjusted significantly in 2015, and recorded a deficit of 2.6 percent of GDP, down from 7.3 in 2014. This positive adjustment is explained by the dram depreciation, lower remittances and imports, and strong growth of real exports. Over the medium term, the current account deficit is expected to remain low at about 3 percent of GDP. The outlook remains challenging as the economic performance is closely linked to still turbulent/weak external conditions, and lower metal prices. On a more positive note, in the event of improved economic conditions in Iran with international sanctions being lifted, the Armenian economy could benefit via higher investment opportunities and increased tourism.

Public finances

The weak internal and external conditions, together with some policy changes, have put significant pressure on public finances. This resulted in a higher than projected budget deficit in 2015 and 2016, -4.8 and -4.1 percent of GDP respectively, and in an increase of public debt. The authorities had to take remedial fiscal actions, including some expansion of domestic lending programs and countercyclical capital spending. The budgetary lending was channeled mostly to support SMEs in agriculture and urban developments. Also, the implementation of important infrastructure projects improved markedly last year, including the execution of donor-financed projects delayed from previous years. The weak internal and external environment resulted in a revenue shortfall of about 1.5 percent of GDP compared to the adopted budget. All these elements led to the weakening of the fiscal positon in 2015.

Meeting the 2016 budget target of 3.5 percent of GDP has proven difficult, in an environment of below-potential growth and low inflation, fiscal policy remains contractionary as planned. The nominal GDP is estimated to be lower by 2.7 percent relative to the budget, with tax revenues now expected to be below the target by about 2 percent. In addition, foreign financed capital spending as well as budgetary lending will be increased, each by about 0.15 percent of GDP. This would lead to a projected fiscal deficit of about 4.1 percent to GDP in 2016, with a cyclically-adjusted deficit decrease by more than 1 percent of GDP compared to 2015.

The authorities consider strengthening the *debt sustainability a top priority* and therefore remain committed to pursuing medium-term fiscal consolidation, while continuing to address social and capital investment needs. This consolidation will be achieved by combining revenue increasing measures and improved expenditure efficiency. Also, to further strengthen the credibility of the program, the authorities will prioritize some of the planned revenue-enhancing measures in the new Tax Code. In addition, they will introduce revenue administration measures to boost tax collection.

In view of ensuring debt sustainability, the authorities have submitted to the National Assembly *a draft Tax Code* that consolidates the existing legislation, addresses a number of structural weaknesses in the current tax system by reducing exemptions and increasing coverage, and generates additional revenue in the medium term. This new Tax Code is expected to be approved by the end of year and the authorities estimate it will increase the tax-to-GDP ratio by 2 percentage points by 2021. Improved administration is also expected to further increase the revenue collection. The authorities would also like to emphasize that *tax policy measures will be complemented by tax administration measures* by increasing the transparency and efficiency of the tax system, reducing compliance costs and supporting revenue collection.

Notwithstanding the recent progress, the poverty rate remains high. The authorities continue to put poverty reduction and a strengthened and targeted social spending high on their agenda. Unfortunately, the consolidation needs in the coming years will make it difficult to expand the current expenditure envelope, and the authorities' efforts will be mainly focused on increasing the efficiency and quality of spending. The authorities aim to at least maintain the level of expenditures under the social programs. Support could increase if more fiscal space becomes available through a better revenue outlook.

The flagship pension reform is progressing well. About 140,000 workers have enrolled since the revised pension law was approved in 2014. In line with their action plan -aiming to further support the implementation of the report- the authorities have, inter alia, increased the outreach campaign through TV commercials, printed materials and direct education campaigns. They will continue to increase awareness and make preparations for the expansion of the reform in July 2018 when participation will become mandatory for all workers covered by the law. The 2017 Budget will maintain funding for this purpose.

The authorities are making progress toward *introduction of program budgeting*. They prepared a plan to start fully-fledged program budgeting in the 2019 budget, including appropriations by individual programs. They will also continue to address the recent TA mission's suggestions about enhancing the comprehensiveness, clarity, timing and sequencing of the plan.

Monetary and exchange rate policies
The Central Bank of Armenia (CBA) continues to implement monetary policy within an inflation-targeting framework with exchange-rate flexibility. Tightening of monetary policy in December 2014, and foreign exchange market decisions of last year, have ensured that inflation remains under control and that financial stability is preserved. More recently, the inflation has turned slightly negative. With an objective to bring it closer to the CBA's target in the next three-year horizon, the CBA reduced its refinancing rate by 2.5 pp to 7.75 since Q4 2015. It will look to further easing of monetary conditions, as expected economic developments unfold and no additional risks emerge in external and domestic sectors.

The exchange rate remains relatively stable as imports have fallen further and the volume of transactions in the FX market has declined. The CBA emphasizes that maintaining a flexible exchange rate regime and strengthening external reserve buffers remain key policy objectives. Given the significant narrowing of the current account deficit in 2015 and early 2016, it considers that the dram is close to its equilibrium level. Going forward, the CBA's policy will be to mitigate excessive, transitory exchange rate pressures, while allowing the dram to respond to structural changes in both directions. Consistent with this approach, the CBA expects its *external reserve buffers* to strengthen in the coming months.

The CBA is taking *important steps to build a coherent and coordinated policy framework* that will integrate the two main objectives of price and financial stability. With these two objectives, it will continue to develop its analytical framework and capacity to improve policy judgement, focusing on developing an internal operational financial stability index, introducing a financial sector module into the CBA's macroeconomic model, as well as enhancing coordination between relevant departments. In this context, we take this opportunity to seek technical assistance from the Fund to integrate the two mandates, and this building on the assistance already received from the Fund's research department.

In line with an agreement with the Fund, as of the June 2016 test date, the NDA performance criterion will be replaced by a monetary policy consultation clause based on the agreed quarterly inflation path within the +-1.5pp tolerance range. The MPCC would be better aligned with the CBA inflation targeting framework.

Financial sector
Improving resilience to shocks and ensuring further financial deepening remain at the core of financial sector policies. Given the strains that the current environment is placing on local banks, the CBA is implementing measures to consolidate and strengthen the banking sector's resilience and efficiency. *On January 1, 2017, a new minimum capital requirement will become effective.* The objective of this new requirement is to increase capital buffers and efficiency and enhance banking services via greater economies of scale. Some banks have already fulfilled this new requirement – either by increasing their

capital levels or through a merger - while others continue their efforts. In order to ensure a smooth transition as well as to preserve financial stability, the CBA has requested banks that are not yet complying to present a revised strategy by end-June 2016 regarding their plans to achieve the required capital by January 1, 2017. Moreover, the CBA informed them that non-compliant banks will have their bank licenses revoked. The CBA stressed that it will not provide financial support, except in cases when such loans to banks are allowed under lender-of-last-resort or systemic provisions of CBA Law. Also, the CBA is conducting a viability analysis to ensure that only mergers and acquisitions that lead to stronger institutions and a sounder financial sector are permitted to take place. In addition, the CBA will prepare contingency plans to deal with banks that do not manage to comply with this new minimum capital requirement.

The CBA *continues to improve its regulatory macroprudential framework* with an objective to mitigate risks to bank balance sheets. In this regard, the CBA is preparing a draft supplement to the Law on Banks and Banking that would allow it to define additional capital charges for systemically important banking institutions and establish permissible thresholds above the ratio limits of the key prudential standards, in line with Basel III macroprudential requirements.

Also, *the CBA is seeking to divest its shares in the PanArmenian Bank (PAB)*. As suggested by the IMF staff, by end-December 2016, the CBA will prepare a comprehensive plan for this full divestment. The investors will be asked to present solid business and funding plans for the PAB and would need to commit to purchase all CBA's shares within a defined timeframe. The CBA will ensure that the PAB continues to meet prudential requirements at par with international best practices. In order to ensure that the debt remains under control during the period in which the CBA remains a shareholder, any debt issuance by the PAB will need to be submitted to and approved by the CBA, and in consultation with IMF staff.

Structural reforms

Although challenges on the structural front remain numerous, progress has been made in several areas, namely: adoption of a comprehensive plan to strengthen the financial position of Armenia's energy sector, submission to the National Assembly of a new Tax Code, expansion of connectivity with the rest of the world through the open skies policy, strengthening of regional integration through the accession to the Eurasian Economic Union (EEU), and strengthening of policies to foster domestic competition. In other words, the focus of the authorities' plans is, on the one hand, on reforming the energy sector and related public enterprises, and on the other hand, on strengthening public revenue, improving the business environment and making the economy more competitive and integrated.

The energy sector is going through some challenging times. In particular, the local energy companies have experienced financial pressures, due to the depreciation of the dram, slowing growth, lags in tariff adjustment and short-term borrowing. For this reason, the authorities decided to put a specific and immediate focus on this sector. As a first step in this process, they hired in late-2015 an international audit firm to review the most recent tariff settings decision. The audit upheld the decision on electricity tariff increase taken last summer by the Public Sector Regulatory Commission (PSRC). In February, the government passed a government decree outlining a program for the financial strengthening of the state companies involved in the country's energy sector. This program includes refinancing high-interest commercial short term debt owed by state companies with lower-interest and longer term debts with the WB and eliminates expenditures of state companies outside their core business. In the coming months, the PSRC will be conducting a revision of current electricity tariffs and the government will halt the payment of the temporary electricity subsidy introduced in the second semester of 2015. The government will also advance the resolution of other state companies. Throughout this process, the public sector will not absorb losses or liabilities or make payments on behalf of utility companies, and the budgetary spending on Nairit will be limited on maintaining the public safety of the industrial site. In this regard, the government plans to decommission the Nairit chemical plant within one year.

The authorities continue to improve *domestic competition and the business environment*. Armenia has improved its rankings from 2015 by 3 points and ranks 35th of 189 countries in the World Bank's 2016 Doing Business Report, the highest among EEU members. They are introducing legislative changes to support domestic competition and improved bankruptcy procedures, while at the same time continuing to support streamlining business procedures via the Regulatory Guillotine initiative and regulatory impact assessments. They also continue to work on civil aviation reforms.

Other issues

The Armenian authorities would like to thank the Fund for the TA that continues to play a crucial role in supporting the reform agenda. They are looking forward to further broad TA support, which they view as indispensable to achieve the reform objectives.