INTERNATIONAL MONETARY FUND

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REPUBLIC OF ARMENIA

December 2020

THIRD REVIEW UNDER THE STAND-BY ARRANGEMENT AND MODIFICATION OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; STAFF SUPPLEMENT; AND STATEMENT BY THE ALTERNATE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF ARMENIA

In the context of the Staff Report for the Third Review under the Stand-By Arrangement 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 and summarizing the views of the Executive Board as expressed during its December 11, 2020 consideration of the Staff Report on issues related to the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 11, 2020, following discussions that ended on November 18, 2020 with the officials of Armenia on economic developments and policies underpinning the IMF arrangement under the Stand-By Arrangement. Based on information available at the time of these discussions, the staff report was completed on November 30, 2020.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Alternate Executive Director** for the Republic of Armenia.

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

PR20/371

IMF Executive Board Completes Third Review under the Stand-By Arrangement for the Republic of Armenia and Approves US$36.9 Million Disbursement

FOR IMMEDIATE RELEASE

- *Due to the COVID-19 pandemic (now in its second wave), and the recent military hostilities involving the Nagorno-Karabakh conflict zone, Armenia's real GDP is projected to contract by 7 percent in 2020, with a return to positive growth expected next year.*
- *To address these shocks, the authorities have responded with a broad-range of health, fiscal, financial, and monetary policy measures.*
- *Despite the pressures and highly uncertain economic outlook, the authorities are committed to continued economic reforms aimed at preserving macroeconomic stability and safeguarding social spending.*

WASHINGTON, DC – December 11, 2020 the Executive Board of the International Monetary Fund (IMF) completed the third review of the Republic of Armenia's performance under the program supported by the Stand-By Arrangement (SBA). The completion of the review will allow the authorities to draw SDR 25.714 million (about US$37 million), bringing total disbursements to SDR 231.7 million (about US$ 332 million).

Armenia's three-year SBA of SDR 308.8 million (about US$ 443 million), equivalent to 239.75 percent of Armenia's quota in the IMF, was approved by the IMF's Board on May 17, 2019 and augmented on May 28, 2020 (see Press Release No. 19/173 and Press Release No. 20/2019).

The Armenian economy has been hit hard by the worst military confrontation since the early 1990s and a large second wave of the COVID-19 infections. These twin shocks have had a significant impact on the economy. Economic activity is projected to contract significantly in 2020, with growth of -7¼ percent, ending the recent period of high economic growth. The crisis has led to a deterioration of the fiscal position and while there are currently no signs of stress in the financial sector, the full impact of the twin crises is still unfolding. Nonetheless, the authorities have responded promptly with healthcare and anti-crisis measures to limit the pandemic's impact while protecting vulnerable groups and safeguarding sustainability, as well as macroeconomic and financial stability. The Fund's financial support will help Armenia meet these challenges, including the urgent social and economic implications of COVID-19 pandemic. Beyond the current crises, the economic outlook is generally positive, contingent upon the anticipated global recovery and domestic reform implementation.

Executive Board Assessment[1]

Following the Executive Board's discussion today, Mr. Tao Zhang, Deputy Managing Director and Acting Chair, made the following statement:

"Armenia has been hit hard by twin—pandemic and security—shocks. These shocks have negatively impacted its economy and population and brought to an end a period of strong growth seen in recent years. The authorities have responded proactively to mitigate the socio-economic and health effects of these shocks. Notwithstanding the sizable challenges Armenia has faced this year, its performance under the Stand-By arrangement has remained satisfactory.

"The authorities' 2021 budget is appropriate given weak growth and is embedded in a clear medium-term fiscal strategy. The authorities remain committed to taking measures to safeguard debt sustainability as a result of which public debt is expected to fall to around 60 percent of GDP over the medium-term.

"Monetary policy has rightly been accommodative, supporting the economy and keeping the banking sector liquid. Inflation remains low, with the exchange rate relatively stable over much of this year. Nevertheless, the Central Bank of Armenia should carefully monitor market developments and stand ready to adjust its monetary policy stance, as necessary, to preserve macroeconomic stability, while maintaining exchange rate flexibility to absorb shocks under its inflation targeting framework.

"Financial sector reforms, some of which are underway, will support the recovery and long-term growth. While the financial system has not shown signs of stress, supervisors should continue to identify vulnerabilities and risk factors in the banking system and stand ready to take relevant regulatory actions.

"Implementation of the authorities' structural reform agenda remains critical to support the economic recovery and promote inclusive growth. Reform efforts include those to improve the business climate and support SMEs, strengthen the governance framework, and continue support to the health and education sectors."

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[1] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Table 1. Armenia: Selected Economic and Financial Indicators, 2017–25

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Act.	Act.	Act.	Proj.					
National income and prices									
Real GDP (percent change)	7.5	5.2	7.6	-7.3	1.0	3.5	5.2	4.7	4.5
Consumption expenditure, Contrib. to Growth	9.0	3.1	9.3	-5.0	2.5	0.9	2.9	2.2	2.1
Gross fixed capital formation, Contrib. to Growth	1.9	0.8	0.8	-2.0	-1.0	2.3	2.3	2.4	2.4
Changes in inventories, Contrib. to Growth	0.1	5.0	-3.7	-1.0	0.0	0.0	0.0	0.0	0.0
Net exports of goods and services, Contrib. to Growth	-0.4	-2.5	1.2	0.8	-0.5	0.3	0.1	0.1	0.0
Gross domestic product (in billions of drams)	5,564	6,017	6,569	6,140	6,344	6,776	7,399	8,066	8,798
Gross domestic product (in millions of USD)	11,527	12,458	13,673	12,663	12,819	13,499	14,607	15,751	16,960
Gross domestic product per capita (in USD)	3,869	4,196	4,605	4,264	4,317	4,545	4,918	5,303	5,709
CPI (period average; percent change)	1.0	2.5	1.4	1.0	2.1	2.9	3.3	4.0	4.0
CPI (end of period; percent change)	2.6	1.8	0.7	1.5	2.3	3.1	3.8	4.0	4.0
GDP deflator (percent change)	2.1	2.8	1.5	0.8	2.3	3.1	3.8	4.1	4.4
Unemployment rate (in percent)	20.8	20.5	18.9	24.1	24.3	24.3	24.0	23.9	23.7
Investment and saving	(in percent of GDP)								
Investment	18.4	22.4	17.4	18.1	16.4	17.3	17.8	18.5	19.1
National savings	16.9	15.5	10.2	12.2	9.9	11.1	11.6	12.4	13.1
Money and credit (end of period)	(percent change)								
Reserve money	-1.0	17.8	8.8	6.8	7.3	2.5	4.1	6.2	4.9
Broad money	18.5	7.4	11.2	1.6	12.6	9.0	4.4	7.8	6.8
Private sector credit growth	16.5	17.2	18.5	4.0	6.0	5.8	2.0	2.7	3.0
Central government operations	(in percent of GDP; unless otherwise indicated)								
Revenue and grants	21.2	22.3	23.8	24.4	23.6	25.1	25.6	25.7	25.7
Of which: tax revenue	20.2	20.9	22.3	22.0	22.1	23.0	23.3	23.5	23.5
Expenditure	26.0	24.0	24.8	31.4	29.2	27.7	27.2	27.2	26.9
Overall balance on a cash basis	-4.8	-1.8	-1.0	-7.0	-5.6	-2.6	-1.7	-1.5	-1.2
Public and publicly-guaranteed (PPG) debt	58.9	55.7	53.5	66.3	72.5	71.2	67.5	64.8	62.0
Central Government's PPG debt (in percent)	53.7	51.2	49.9	63.1	69.4	68.5	65.4	63.2	61.0
Share of foreign currency debt (in percent)	81.1	80.0	79.0	72.1	72.3	72.0	72.4	71.4	70.9
External sector	(in millions of USD; unless otherwise indicated)								
Exports of goods and services	4,409	4,907	5,641	3,749	4,078	4,802	5,307	5,661	6,025
Imports of goods and services	-5,651	-6,610	-7,470	-5,370	-5,780	-6,550	-7,173	-7,641	-8,130
Exports of goods and services (percent change)	23.7	11.3	14.9	-33.5	8.8	17.8	10.5	6.7	6.4
Imports of goods and services (percent change)	26.4	17.0	13.0	-28.1	7.6	13.3	9.5	6.5	6.4
Current account balance (in percent of GDP)	-1.5	-6.9	-7.2	-6.0	-6.5	-6.2	-6.1	-6.0	-6.0
FDI (net)	222	247	397	178	196	255	319	383	421
Gross international reserves	2,314	2,259	2,850	2,251	2,534	2,568	2,608	2,621	2,640
Import cover 1/	4.2	3.6	6.4	4.7	4.6	4.3	4.1	3.9	3.6
End-of-period exchange rate (dram per USD)	484	484	480	…	…	…	…	…	…
Average exchange rate (dram per USD)	483	483	480	…	…	…	…	…	…

Sources: Armenian authorities, and IMF staff estimates and projections.

1/ Gross international reserves in months of next year's imports of goods and services, including the SDR holdings.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

THIRD REVIEW UNDER THE STAND-BY ARRANGEMENT AND MODIFICATION OF PERFORMANCE CRITERIA

November 30, 2020

EXECUTIVE SUMMARY

Context. Armenia's economy has been hit hard by twin shocks: the COVID-19 pandemic (now in its second wave), and the recent military hostilities involving the Nagorno-Karabakh conflict zone. Reflecting these shocks, growth is expected at -7¼ percent this year, with the fiscal deficit and debt rising considerably. Nonetheless, the authorities have responded promptly with healthcare and anti-crisis measures to limit the pandemic's impact while protecting vulnerable groups and safeguarding macroeconomic stability.

Outlook and risks. Growth is expected to remain subdued in 2021, and inflation to remain low and gradually converge to its target from below. Beyond the current crises, the economic outlook is generally positive, contingent upon the anticipated global recovery and domestic reform implementation. While uncertainty is high, near-term risks are relatively balanced, with downside risks associated with the external environment, the durability of the ceasefire, political instability, and an intensification of the pandemic balanced against upsides from more limited scarring and faster reform implementation.

Focus. Discussions centered on: (i) the macroeconomic impact of the twin shocks; (ii) the execution of the 2020 budget and 2021 budget plans; (iii) monetary and exchange rate policy; (iv) financial sector stability and reforms; and (v) structural reforms.

Program Performance. Amidst difficult economic conditions, performance under the SBA remains satisfactory. All end-June quantitative performance criteria (QPCs) were met. Except for the marginal underperformance of the indicative target (IT) on social spending for June, all end-June and end-September ITs were observed. Progress towards structural benchmarks (SBs) was mixed. Out of the ten SBs under this review, three have been met, one met with delay, and actions for a further three expected ahead of the Board. The authorities request reset of the SBs related to the PPPs to early 2021, and the SB related to the CBA exit strategy from non-core activities to April 2021. Progress continues towards the end-December SBs.

Third Review. Given the authorities' commitment to the program's objectives, and response to these twin shocks, staff supports the completion of the third review under the SBA, as well as the modification of the end-December QPC on the program fiscal balance. Reflecting delays related to these shocks, staff also supports the request to reset two SBs related to Private-Public Partnerships to early 2021, as well as the request to use the purchase attached to this review for budget financing.

Approved By
Thanos Arvanitis and Martin Cihak

The team comprised N. Porter (head), M. El Said, K. Akepanidtaworn, and G. Ramirez (MCD), Y. Ustyugova (Resident Representative), K. Tokuoka (SPR), K. Funke (FAD) and M. Pani (MCM). V. Janvelyan and L. Karapetyan (IMF Office) assisted the mission. V. Rashkovan (OED) participated in meetings with the authorities. R. Al Farah (MCD) provided assistance and B. Laumann (MCD) provided document management. The team met remotely during September 2–29, and intermittently during October 5–November 18, 2020 with Deputy Prime Minister Grigoryan, Governor of the Central Bank of Armenia Galstyan, Minister of Finance Janjughazyan, Minister of Economy Khachatryan, State Revenue Committee Deputy Chairman Mashadyan and other senior government officials.

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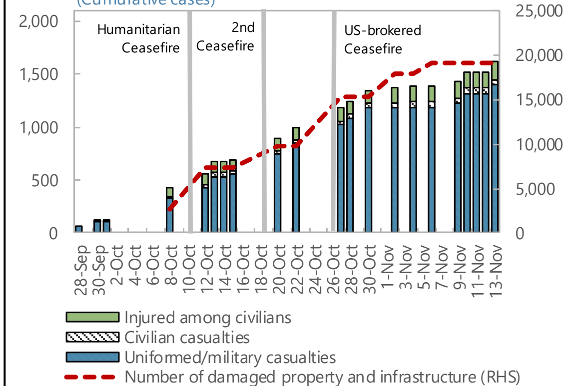
DEVELOPMENTS AND PROGRAM IMPLEMENTATION

A. Context

1. The worst armed conflict since 1994 erupted between Armenia and Azerbaijan in late September. On September 27, large-scale military hostilities broke out along the line of contact in the Nagorno-Karabakh conflict zone. Both sides immediately declared martial law and mobilized their armies. Fierce fighting lasted for several weeks and affected densely populated areas in the conflict zone. The Armenian authorities have reported more than 2300 Armenian military causalities, and more than 200 civilian causalities and wounded. After three failed ceasefire attempts, the situation deescalated on November 10, when a trilateral Armenia-Azerbaijan-Russia ceasefire agreement was signed, and Russian peacekeepers were deployed. Box 1 elaborates on the economic and financial links between the Republic of Armenia and Nagorno-Karabakh.

Escalation of Armed Conflict in Nagorno-Karabakh
(Cumulative cases)



Source: United Nations Situation Report - Unofficial Document. Data is compiled from a scan of open media sources without supplemental analysis, conveying no United Nations recognition or endorsement.

Box 1. Economic and Financial Links between the Republic of Armenia and the Nagorno-Karabakh Region

This box provides a rough estimate of the possible size of economic and financial links between the Nagorno-Karabakh region (NK) and the Republic of Armenia. Data availability is weak and a major constraint. In general, while the links span trade, finance, and banking, their implications are likely to be relatively limited for the Armenia economy.

Economy and trade. Available data suggests limited trade links. The NK's economy is relatively small compared with that of the Republic Armenia. As of 2019, NK's GDP and foreign trade turnover were estimated at around 5 and 8 percent of Armenia's GDP and external trade, respectively. As the NK's trade with the outside world passes through the Republic of Armenian's borders without customs points, it is difficult to accurately assesses the extent of trade linkages. Some reports suggest that the NK's trading partners expand well beyond the region to European and North American countries, potentially including Georgia, Iran, the United Kingdom, France, Germany, Italy, the Baltic States, and the United States. Available data on their bilateral foreign trade between NK and Armenia only captures the energy sector: NK's exports and imports are the equivalent of only 0.1 percent of the total of Armenia's export and imports.

Public finance. As of November 2020, the outstanding stock of loans by the Republic of Armenia to NK is around 11 percent of Armenia's GDP. These loans from the Government of Armenia have been treated as net lending without repayment assumed in the medium term.

Financial sector. NK household deposits in the Republic of Armenia's banking sector were estimated at 1 percent of Armenia's GDP (1.5 percent of banking sector liabilities) at end-2019. Loans by banks operating in the Republic of Armenia's to the NK are estimated at about 3 percent of Armenia's GDP (3.3 percent of total Armenia's banking sector assets) as at end-2019.

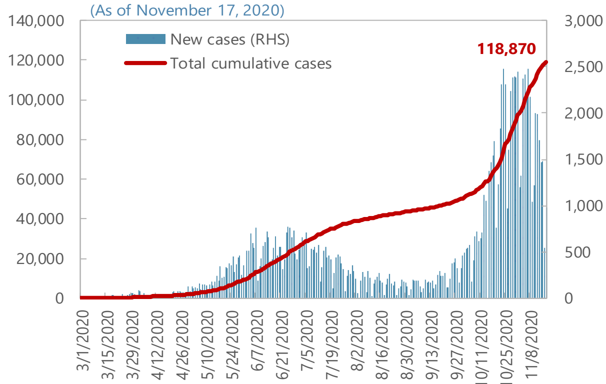
Sources: Republic of Armenia, Nagorno-Karabakh, and staff estimates.

2. **In addition, Armenia continues to face new challenges from the pandemic** (Box 2). After reaching a first peak in infections during the second quarter, infections moderated considerably through September. However, a second wave started in October, with new cases quickly surpassing their first peak (Box 2).

Box 2. COVID-19 Evolution and Policy Responses Measures

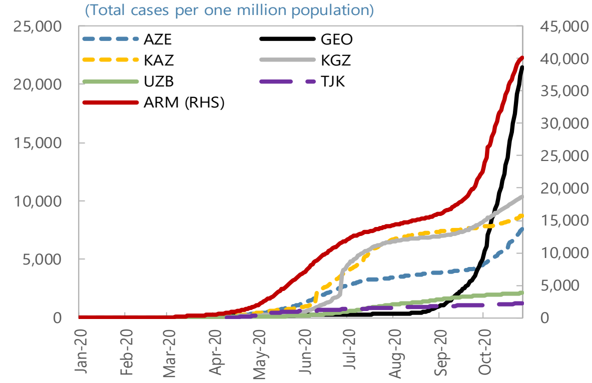
Containment measures were eased in May, with the spread of COVID-19 contained over July to September. New cases accelerated again, with cumulative and new cases around 118,870 and 984, respectively, by November 17.

Confirmed COVID-19 Cases in Armenia
(As of November 17, 2020)



Source: European Centre for Disease Prevention and Control, and IMF staff calculations.

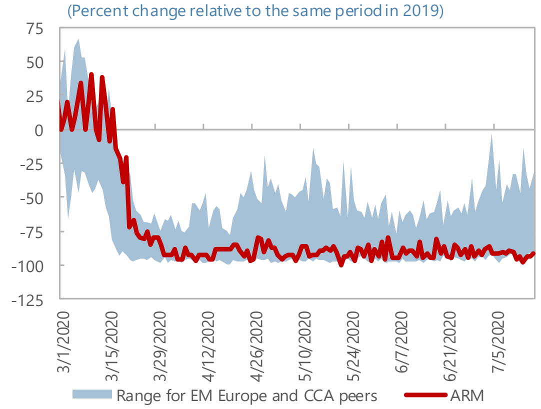
COVID-19 Cases
(Total cases per one million population)



Source: European Centre for Disease Prevention and Control, and IMF staff calculations.

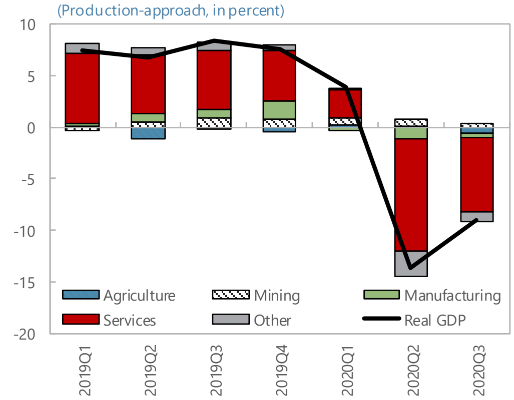
The government imposed strict containment measures on March 16 including a ban on foreign citizens from high-risk countries. International arrivals decreased sharply. Although first quarter growth was robust, activity has contracted sharply since, particularly in services.

Number of International Arrivals Flights
(Percent change relative to the same period in 2019)



Source: FlightRadar24, and IMF staff calculations.

Contributions to Real GDP Growth
(Production-approach, in percent)



Source: National Authorities, Haver, and IMF staff calculations.

To mitigate the socio-economic impact of COVID-19, the government announced 24 measures, and increased health spending.

Anti-Crisis Support in Armenia
(In billions of AMD (Percent of GDP), as of August 31, 2020)

Anti-Crisis Support	Above-the-line	Below-the-line	Commerical Bank Support
Liquidity Provision to Business via interest subsidies	7.1 (0.1%)	14.9 (0.3%)	104.2 (1.7%)
Direct Labor Subsidies	16 (0.3%)	-	-
Lump sum transfers to vulnerable individuals	17.1 (0.3%)	-	-
Utility Support	4.8 (0.1%)	-	-
Transfers to families	7.3 (0.1%)	-	-
Transfers to the unemployed and pandemic-affected workers	4.3 (0.1%)	-	-
Educational support	0.8 (0%)	0.2 (0.%)	
Total	***40.2 (0.7%)***	***15 (0.3%)***	***104.2 (1.7%)***
COVID-19 related Heath Spending	20 (0.3%)	-	-

Source: National authorities, and IMF staff calculations.

3. **The authorities responded to the pandemic with a broad range of health, fiscal, financial, and monetary policy measures.** The authorities spent AMD55 billion on anti-crisis support, and AMD20 billion on one-off health spending related to COVID-19 (Box 2). In addition, to alleviate corporate liquidity pressures, the MoF exempted corporate income taxpayers from their pre-payment obligation in 2020Q2 (AMD 65 bn). The CBA cut its policy rate four times this year, and provided liquidity, including through FX-swaps and repos. In addition, it encouraged banks to grant short-term payment holidays (and correspondingly extend loan maturities), to ease the liquidity pressures facing borrowers, with AMD1.3 trillion—around one-third of end-June credit—restructured between March and June. Moreover, the government's credit support measures generated additional loans of AMD126.4 billion, 31 percent of the credit growth in September. Many of the government's anti-crisis support measures have been phased-out, although some have evolved into support for the subsequent post-COVID recovery.[1]

B. Recent Economic Developments

4. **These twin shocks have had a significant impact on the economy.** Driven by weakness in service and trade sectors, real GDP contracted by 13.7 percent and 9.1 percent in the second and third quarters of 2020, respectively, cumulatively declining by 7.1 percent over the first three quarters of 2020. Despite broad-based declines, mining and technology sectors have contributed positively to growth, and monthly economic indicator show a slight recovery in construction during September. The conflict likely affected activity in October and early-November given the mobilization of prime-age workers. Inflation remains low but increased modestly to 1.3 percent (y-o-y) in October on the back of expansionary monetary policy and an unwinding of disinflationary agricultural factors.

Armenia: Selected Economic and Financial Indicators, 2019–22

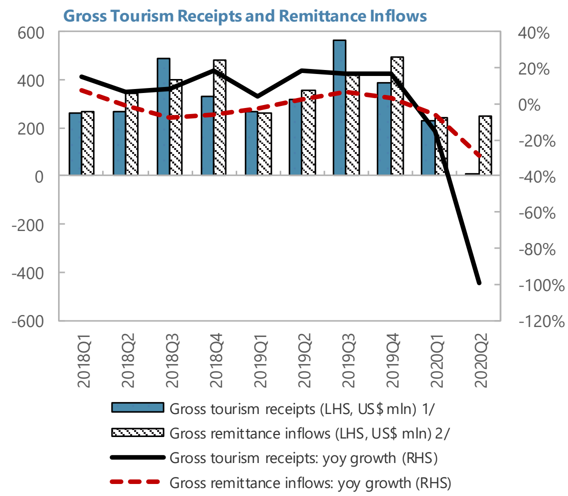
	2019	2020		2021		2022	
	Act.	2nd Review	Proj.	2nd Review	Proj.	2nd Review	Proj.
Real GDP (percent change)	7.6	-1.5	-7.3	4.8	1.0	4.5	3.5
Gross domestic product (in billions of drams)	6,569	6,519	6,140	6,990	6,344	7,543	6,776
Fiscal balance (in percent of GDP)	-1.0	-5.0	-7.0	-2.9	-5.6	-2.0	-2.6
Public and publicly-guaranteed (PPG) debt (in percent of GDP)	53.5	64.1	66.3	62.1	72.5	59.8	71.2
Central Government's PPG debt (in percent)	49.9	60.9	63.1	59.1	69.4	57.3	68.5
Current account balance (in percent of GDP)	-7.2	-8.6	-6.0	-7.2	-6.5	-6.7	-6.2

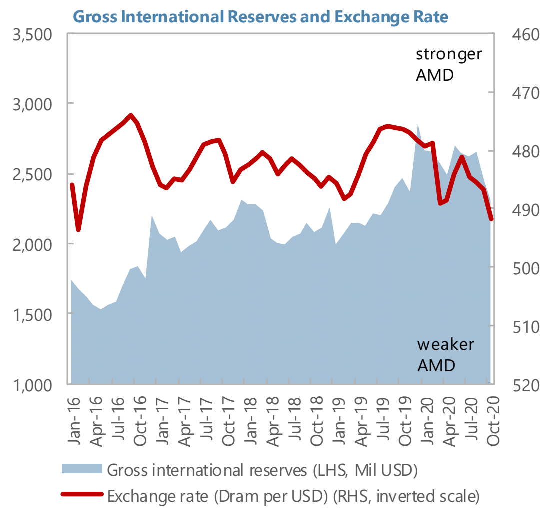
Sources: Armenian authorities; and Fund staff estimates and projections.

5. **The external sector weakened markedly in 2020.** After strong private inflows and accumulation of reserves in 2019, the pandemic weakened exports, tourism receipts, remittances, FDI, and private capital inflows. By end-October, these developments and net debt service, which was particularly large in Q3, placed downward pressure on the dram and reduced reserves by about US$300 million. External bond spreads temporarily increased by 106 bps up to November 2, before declining by almost 100 bps after the announcement of the November 10 ceasefire. Despite these

[1] For example, Measure 1 (Government liquidity provision to businesses) was adapted to provide loans to encourage post-pandemic investment.

pressures, reserves are expected to remain adequate (105 percent of Fund ARA metric) at end-2020, supported by Fund financing.



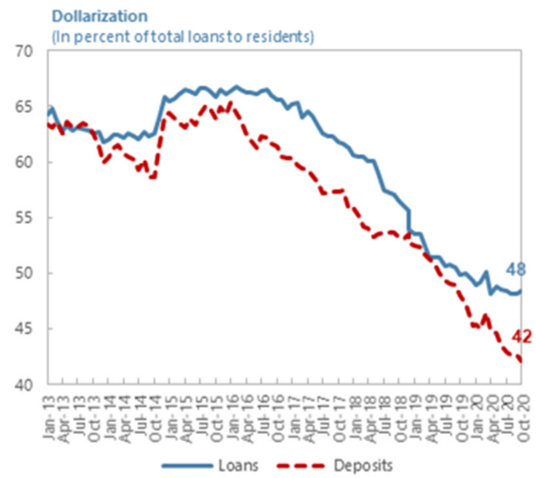


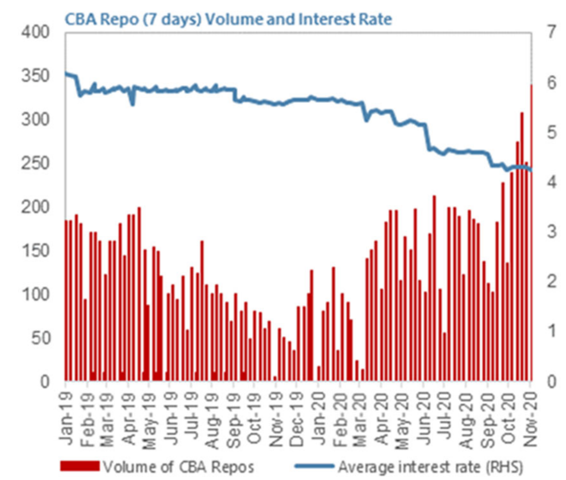
Sources: National authorities, Haver, and IMF staff calculations.
1/ "Tourism-related services in travel and passenger transport" in official BOP statistics.
2/ Gross inflows of "compensation of employees" + "personal transfers" in official BOP statistics.

6. **The fiscal deficit is expected to widen significantly in 2020, with debt rising above 60 percent of GDP.** Tax revenue is projected to decline by 8 percent in nominal terms to 22 percent of GDP. Despite a reprioritization of current spending and under-execution of capital expenditure, expenditure is expected to rise to 31½ percent of GDP, due to higher healthcare and social and economic support spending, as well as additional security spending (accommodated through a supplementary budget in October). As a result, the 2020 fiscal deficit is expected to widen to around 7 percent of GDP (relative to 5 percent in the second review), with debt increasing to around 63 percent of GDP.

7. **Domestic financial conditions remain relatively stable, as indicated by financial soundness indicators, although they do not yet reflect the full impact of the crises.** Government socio-economic support measures, including interest subsidies, have helped support credit to date. Credit expanded by 12 percent y-o-y to October, with continued demand for mortgage credit, as well as demand from private enterprises in the construction, and industry sectors. This expansion has supported private investment (replacing equity and other sources of financing) and the accumulation of precautionary private savings buffers (including in the form of higher demand for money), even as private consumption and imports contracted. The full impact of the COVID-19 crisis and of the conflict on borrowers' financial position will however be felt with a lag and is probably not captured by the data currently available. The share of nonperforming loans has been increasing since May, although provisioning coverage has declined. Bank capital buffers have declined marginally since December, while liquidity has been broadly stable. Bank profitability has marginally improved given a rise in the loan-to-deposit ratio and some one-off savings in noninterest expense associated with the adoption of new technologies. Deposits were stable through end-August, with an increase in resident deposits offsetting an outflow of nonresident deposits in Q2. They have since declined by around 4 percent, with the largest declines in

nonresident and household FX deposits. Reflecting this, dollarization has continued to decline through. Nonetheless, as noted in ¶17, the full impact of the crises is not yet reflected in FSIs.





Sources: National authorities; and Fund staff calculations.

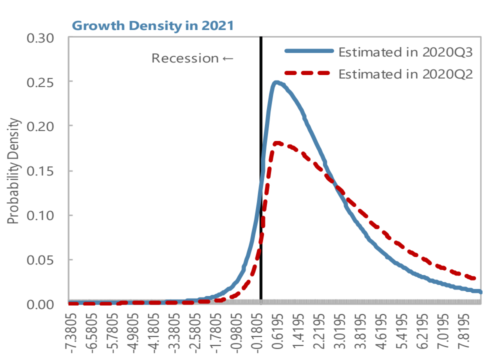
8. Given the elevated uncertainty, staff's macroeconomic baseline is conservative, reflecting the impact of the twin shocks. While the November 10 ceasefire agreement provides an encouraging framework for the restoration of stability, uncertainty remains very high. In addition, the depth and duration of the pandemic (and associated scarring) remain also uncertain. Our near-term outlook assumes that the impact on consumer and business confidence will affect economic activity well into next year.

- *Growth* is projected to be -7¼ percent in 2020, with a modest rebound into the range of 0.5–1.5 percent expected in 2021 and a recovery to around 3½ percent in 2022. Anticipated growth in 2021 is in the left tail of the distribution possible outcomes (Box 3).

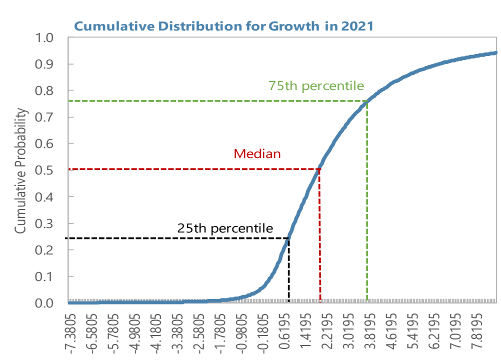
Box 3. Growth-at-Risk (GaR)

GaR methodology links current macro-financial conditions to the distribution of future growth, allowing a probabilistic assessment of growth projections. Applying this analysis to Armenia's 2021 growth distribution (based on 2020Q3 domestic and external activity and financial conditions) suggests:

- The interquartile interval of the forecasted 2021 growth ranges from 0.86 to 3.7 percent.
- Staff's central estimate of 1 percent corresponds to the 30th percentile in the distribution.
- Third quarter data has shifted the distribution to the left by about 1 percentage point compared with that based on second quarter data, indicating that a slower recovery has become more likely.



Source: IMF staff calculations and estimates.



Source: IMF staff calculations and estimates.

- *Inflation* is expected to rise to 1.5 percent in 2020 on the back of accommodative monetary policy, pandemic- and conflict-related supply frictions, and dram depreciation. Staff expects inflation to continue its increase and gradually converge to the CBA target over the medium term.

- *External sector.* While the current account deficit is expected to remain around 6.0 percent of GDP in 2020 due to sizable import compression, a modest widening and—given ongoing uncertainty—continued limited private capital inflows are projected in 2021. Over the medium term, the current account deficit would gradually return to around 6 percent of GDP, as exports continue to benefit from ongoing reforms, and import growth moderates on the back of prudent macroeconomic policies.

- The *financial* sector is expected to remain resilient, amid heightened uncertainty, although credit losses will continue to be recognized over coming months.

9. Reflecting the conservative baseline, risks to the outlook are relatively balanced, although uncertainty about the duration and magnitude of the impact of the twin shocks is very high (Annex 1). A deeper and further delayed recovery from the pandemic, political instability, a significant renewal of hostilities, or weaker external growth, would harm the near-term outlook. Delays in reforms and policy adjustment could also harm the outlook, including through reduced confidence possibly involving a delay in planned adjustment, as could heightened global financial volatility or trade tensions. Potential upside risks include early advances in vaccination and treatment for COVID-19, as well as smaller than anticipated scarring from the impact of the twin shocks. The authorities' contingency measures in the event of the realization of a significant negative shock include mobilizing additional donor financing, reprioritizing spending, allowing the exchange rate to act as a buffer (intervening only to stem excessive volatility), while ensuring the financial system remains liquid and closely monitoring banks' credit and capital positions.

C. Program Implementation

10. Program implementation remains satisfactory. The authorities have continued to demonstrate their commitment to the program meeting most program objectives and targets while adapting their policies in the face of twin disruptive shocks (see Memorandum of Economic and Financial Policies (MEFP)). All end-June quantitative performance criteria (QPC) were met (text table and MEFP Table 1). While inflation is below CBA's target, it remained within the inner band of the Monetary Policy Consultation Clause (MPCC). All end-June and end-September indicative targets (ITs) were met except for the IT on social spending, which was only marginally missed for June only due to: (i) some COVID-related social spending (including off-budget donor-provide health sector support) not captured by standing safety net instruments and hence the IT; (ii) changes to the household vulnerability criteria which has improved the targeting and efficiency of the safety net; and (iii) eligible families facing difficulties in applying for benefits during the full lockdown. The government plans further steps to strengthen social policies, including in the 2021 budget (see ¶21).

Armenia: Quantitative Performance Criteria 1/
(In billions of drams, at program exchange rates, unless otherwise specified)

	2019	2020			
	Dec.	Mar. 3/	Jun. 2/		Status
	Act.	Act.	EBS 20/90	Act.	
Performance Criteria					
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,808	1,641	1,382	1,555	Met
Program fiscal balance (flow, floor) 4/	-78	14	-345	-89	Met
Budget domestic lending (cumulative flow, ceiling)	0	15	115	16	Met
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	Met
MPCC 5/					
Inflation (upper-outer band, inflation consultation, percent)	...	...	4.0	4.0	
Inflation (upper-inner band, percent)	4.0	4.2	3.0	3.0	
Inflation (mid-point, percent)	0.7	-0.1	1.0	1.7	Met
inflation (lower-inner band, percent)	1.0	1.2	0.0	0.0	
Inflation (lower-outer band, inflation consultation, percent)	...		0.0	0.0	
Indicative Targets					
Net domestic assets of the CBA (stock, ceiling)	235	287	438	276	Met
Avg. concessionality of newly contracted ext. debt (flow, floor, in percent) 6/	39	...	...	...	n.a.
New government guaranteed external debt (stock, ceiling, in millions of USD) 7/	0	0	100	0	Met
Social spending of the government (flow, floor) 8/	55	14	30	27	Not Met

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU, based on program exchange rates in the TMU.

2/ Quantitative performance criteria at test dates.

3/ Indicative target.

4/ Below-the-line overall balance excluding net lending.

5/ If the end of period year-on-year headline inflation is outside the upper/lower bound, a formal consultation with the Executive Board as part of program reviews would be triggered.

6/ Assessed on a calendar year basis, excluding the Eurobond and any similar refinancing instruments.

7/ Includes both concessional and non-concessional debt, excluding the Eurobond and any simliar refinancing instruments.

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.

11. **Progress on the structural benchmarks (SB) was mixed.** Out of the ten SBs under this delayed review, three have been met, one met with delay, three not met and we expect actions for a further three to be finalized in early December 2020 ahead of the Board (MEFP Table 2). Completion of several benchmarks was hampered, inter alia, by pandemic-related working arrangements as well as the recent conflict. Of the remaining SBs the authorities request that those related to the estimation of PPP-related contingent liabilities and the CBA exit strategy be reset to January and April 2021, respectively, while with the assistance of the World Bank, the authorities commit in their MEFP to finalize their SME efficiency review in 2021. In particular:

- The cabinet approved the capital market development program (May 2020 SB) in mid-July.
- A comprehensive education reform strategy (June 2020 SB) was developed and posted on the e-gov platform, beginning public consultations.
- The State Revenue Committee approved a new Compliance Risk Management strategy (September 2020 SB) and introduced a tax compliance risk register.

- Ministry of Finance developed an improvement plan for government finance statistics (GFS) (September 2020 SB).

- The CBA presented staff with a draft time-bound medium-term exit strategy to phase out the CBA involvement in non-core central bank activities (September 2020 SB). The plan will be approved after incorporating comments from staff, with the SB reset to April 2021.

- The authorities are finalizing the analysis of Armenia's tax gap (October 2020 SB).

- The draft law on a single autonomous and central anti-corruption entity with enhanced detection and investigative powers was submitted to the Cabinet after undergoing a public discussion (September 2020 SB) and is expected to be and submitted to the National Assembly in December.

- The draft law on Higher Education and Science (June 2020 SB) was developed and went through several rounds of revisions based on extensive stakeholder consultation. The draft law is expected to be approved by Cabinet and submitted to the National Assembly in December.

- The work on the efficiency review of existing SME programs (September 2020 SB) remains ongoing. The authorities have developed a detailed analytic description of Armenia's SME support schemes and will, with the assistance of the World Bank, undertake their follow-up efficiency review.

- The authorities request resetting the SB on compilation and estimation of all existing and future contingent liabilities associated with implemented and approved PPPs (November 2020 SB) to January 2020.

POLICY DISCUSSIONS

A. Fiscal Policy: Maintaining Fiscal Prudence and Supporting the Recovery

12. The 2021 budget addresses pressures from a slower recovery and the lingering impact of the twin shocks within a clear medium-term fiscal strategy. The 2021 budget envisages a deficit of around 5½ percent of GDP, about 2½ percentage points higher than expected in second review. Budgeted revenues—around 23¼ percent of GDP—reflect the expected path for GDP growth together with efforts to improve compliance and a legislated increase in excise rates. In the context of weaker growth and heightened COVID-related uncertainty, the budget strives to reduce socio-economic scarring by maintaining largely constant nominal current spending, allowing space for adequate social expenditure, including on those affected by conflict. Capital spending—planned at 3.4 percent of GDP—allows the budget to accommodate priority infrastructure spending.

13. Financing of the 2021 budget will come from IFIs as well as domestic and international markets. The authorities plan to request $200 million in budget support from the World Bank, ADB, and potentially other partners, and intend to raise a further $500 million from international markets and about AMD200 billion on domestic markets. The planned financing from international markets is credible as Armenia has maintained market access and has good track of market financing and spreads are below some peers who have recently issued. These funds will also help maintain an adequate liquidity buffer for the government at the CBA. Government debt is expected to reach slightly more than 69 percent of GDP by end-2021.

14. The authorities are committed to ensuring sustainability and to rebuilding fiscal buffers over the medium term. After using the fiscal rule's escape clause in 2020–21, medium-term efforts will be guided by Armenia's fiscal rule with the aim to bring debt-to-GDP below 60 percent by end-2026. To this end, the authorities intend to introduce various tax measures yielding additional revenues of 0.6 percent of GDP in 2022 and an additional 0.3 and 0.2 percent of GDP in 2023 and 2024, respectively, while also containing current spending. Envisaged revenue reforms and expenditure restraint would allow the authorities to support growth while bringing fiscal deficits to below 2 percent of GDP and with debt declining to around 61 percent of GDP by end-2025. Key reforms are based on:

- ***Tax reforms*** including (i) adjusting the turnover tax threshold and rate to equalize the burden across various tax regimes; (ii) introducing an environmental tax on mining waste in 2021; (iii) increasing rates of various environmental taxes and nature use fees in 2022; (iv) abolishing the VAT exemption for medical services for foreigners; (v) limiting the use of documents issued by micro enterprises to make deductions from the base; and (vi) improving tax audit practices by ceasing the advanced publication of intended audit subjects (see text table). At the same time, staff urged the State Revenue Committee to implement its recently formulated compliance risk strategy, as well as build on its ongoing tax gap analysis to identify ways to raise additional revenue.
- An ***expenditure review***, planned for early 2021, will identify efficiencies in current spending and is intended to feed into the 2022 budget process. The identification of efficiencies should support fiscal consolidation, allow current spending to return to its pre-crisis level, while ensuring space for priority social and investment spending.

Tax Revenues and Measures

	2020	2021	2022	2023	2024
Tax revenues in percent of GDP	22	22.1	23	23.3	23.5
Legislated measures under implementation					
Excise rate increase		0.1	0.3	-	-
Additional tax measures commited by the authorities			0.6	0.3	0.2
of which:					
Turnover tax threshold and rate adjustment			0.1	0.1	0.1
Various tax measures			0.5	0.1	
Revenue administration measures					
Implementing the tax compliance risk strategy and building on the tax compliance gap analysis				0.1	0.1

Source: IMF staff calculations.

15. The authorities should continue advancing other critical reforms:

- ***Fiscal transparency.*** Staff welcomed the plan to improve government finance statistics (GFS) and encouraged the authorities to continue their efforts to strengthen the transparency of the SOE sector through a comprehensive sectorized list of all public sector entities. This exercise will contribute to the extension of GFS coverage and improve fiscal risk monitoring. The application of market-determined exchange rates for all budgetary transaction from the January 2021 is also a welcome step towards managing exchange rate risks transparently and in a cost-effective manner.

- ***Budget process.*** Staff emphasized the importance of the budget process in enhancing the efficiency of the public resource allocation. To allocate resources in line with government priorities, sectoral strategies linking resource allocation to policy objectives, should be prepared by all government entities (including line ministries) in line with the government's PFM strategy. These strategies should be presented together with each budget. Staff also stressed the importance of the budget directorate playing a major analytical role in (i) assessing the fiscal implications of existing policies, policy suggestions, proposed public investment projects, and resource requests; (ii) identifying options for savings whenever necessary; and (iii) ensuring the appropriate reflection of fiscal risks in budget planning and presentation.

- ***Fiscal risk management.*** Staff emphasized the importance of strengthening the MoF's approach to identifying, assessing, and managing fiscal risks by ensuring (i) a clear assignment of responsibilities for the risk function within the MoF; (ii) the allocation of adequate resources to this function; (iii) the full integration of the fiscal risk function into other relevant procedures, including both the public investment process and the budget process; and (iv) close supervision of the function to ensure its effective operation. Staff highlighted that, to start managing the fiscal risks resulting from public investment projects (including PPPs), the MoF and MoE should jointly finalize the design and population of a database maintaining all relevant information on public investment projects, including PPPs. This database should be used to provide an overview of the lifetime fiscal implications—i.e., all fiscal costs and risks—of all ongoing and new projects in future budget documents.

- ***Public investment management.*** Staff welcomed the authorities' ongoing efforts to enhance the public investment process by introducing a unified process for the assessment and selection of all projects based on common procedures. Staff recommended ensuring that all projects, including PPPs, follow the same process, which is integrated with the budget process in a way to ensure transparent and efficient project selection regardless of implementation modality. Improving the current process should help identify priority projects and develop them to a standard that facilitates efficient implementation.

- ***Public-private partnerships (PPPs).*** Staff welcomed the enactment of the contingent liability legislation in support of the implementation of Armenia's PPP law. At the same time, staff raised concerns regarding risks around the authorities' intention to accommodate unsolicited proposals under a revised PPP law. To this end, staff stressed that the need for a minimal set of safeguards ensuring that all projects are: (i) subject to the same rigorous assessments under the public investment process; (ii) selected and procured transparently; and (iii) procured through a competitive process. It is important that the fiscal costs and risks of PPPs are assessed before a project is selected, and a fully functional risk assessment function within the MoF should be in place before any new PPPs are considered. Close cooperation between the MoF and the MoE throughout the public investment process (including the efficient exchange of information) will be critical for this function to operate. The setting of a stock and a flow ceiling for PPPs is an important next step for early in the new year.[2] Activities related to assessing and monitoring existing PPP projects and analyzing potential PPP projects under consideration should be accelerated to ensure that any PPP-related decisions are based on a comprehensive understanding of the project's lifetime implications.

B. Monetary and Financial Policies in a Turbulent Era

16. The CBA's accommodative monetary policy stance remains broadly appropriate, although the authorities should stand ready to adjust as needed amid high volatility and uncertainty. The current stance reflects the large negative output gap (including slack in key sectors) and weak inflation. While inflation remains subdued, supply-side constraints in the context of renewed surge in COVID-19 infections could pose pressures on prices in the wake of growth and exchange rate movements. If such shocks induce upward price pressures, the authorities could accommodate an increase in inflation, provided it did not become embedded in expectations that bring inflation persistently above the target. In any event, the authorities should monitor developments carefully and stand ready to adjust the monetary stance as necessary, while allowing the exchange rate to be a shock absorber. The authorities should also aim to rebuild recently depleted reserve buffers while limiting active intervention to managing excessive short-term volatility.

17. Although there are currently no evident signs of financial sector strains, downside risks remain. Banks entered 2020 stronger than they were ahead of the 2008 and 2014 shocks. Nonetheless, reflecting the economic contraction and impact of the twin shocks, as well as the end of payment holidays and government liquidity support, NPLs could continue rise beyond the 5.5 percent of total loans at end-2019. According to CBA stress tests, under a severe scenario (with growth of -9 percent and 5 percent depreciation), a small number of banks would become somewhat undercapitalized. In this regard, the authorities should continue closely monitoring capital and liquidity buffers, regularly performing top-down, scenario-based, stress tests, and stand ready to enact emergency measures should such risks materialize, including by: (i) encouraging appropriate loan restructuring (while maintaining proper risk assessment and provisioning requirements); (ii) ensuring banks that incur losses sufficient to use their capital buffers and temporarily infringe their capital requirements submit credible capital restoration plans, which should include temporary restrictions on dividend distributions; and (iii) using the existing Emergency Liquidity Assistance framework, including FX swaps, provide liquidity in domestic and foreign currency, as needed, against good collateral.

[2] The stock ceiling applied to the total investment and/or liabilities related to PPPs, while the flow ceiling applies to total payment commitments for PPPs for any future budget year.

18. While some banks could temporarily dip below capital requirements, risks need to be accurately assessed with potential losses adequately provisioned. Loan performance, in particular, should continue to be assessed accurately on the basis of a forward-looking evaluation and in accordance with currently applicable accounting standards. Provisioning requirements should not be eased, although supervisors could allow (or encourage) banks to utilize their usable capital buffers to absorb any related losses. In this framework, the CBA's decision to require banks to obtain supervisory approval before distributing dividends and bonuses to managers appears commendable and should be maintained while conditions require.

19. Implementation of FSAP's recommendations continues. The authorities resumed the conversion of required reserves on foreign currency deposits (remaining ahead of schedule),[3] and have adopted a comprehensive capital market development strategy. To facilitate implementation of this strategy, the authorities have formed several thematic working groups and are in process of creating a high-level steering committee. Other measures include: (i) coordinating the flow of budget data to enhance liquidity forecasts; (ii) preparing draft regulations to redefine nonperforming loans in line with Basel III standards; (iii) moving ahead with plans to introduce stressed Loan-to-Value limits by March 2021 while collecting information to allow the introduction of debt service-to-income (DSTI) limits; and (iv) enhancing their communication strategy through regular press conferences and meetings with financial organizations.

20. The September 2019 Safeguards Assessment found that the CBA continued to maintain a strong safeguards framework, including well established audit (internal and external) arrangements and financial reporting practices. In addition, amendments to the CBA law and internal regulations were implemented to address previous safeguards concerns, but there is scope for further legislative reforms to reinforce the CBA's autonomy and governance arrangements. The safeguards assessment found a strong control environment at the CBA, and recommended it establish a risk management function (currently in progress), and further enhance the oversight role of the Board, and the Audit Committee's operations. The authorities prepared a medium-term exit strategy to reduce and, in an orderly manner, eventually phase-out its involvement in non-core central banking activities (September 2020 SB). The current negotiations to sell a controlling share of the Armenia Securities Exchange to a foreign investor are an example of actions under this new strategy. The strategy will be approved after incorporating comments from staff, including those on the proposed timeframe to exit these activities (MEFP ¶20).

C. Strengthening Governance and Promoting Inclusive Growth

21. The authorities see the need to reinvigorate structural reforms to support the recovery and strengthen Armenia's resilience.

- **Social policies.** The fallout from COVID-19 has underscored the need to scale-up and improve the effectiveness of the national healthcare system and social safety nets. Notwithstanding the

[3] Effective September 16, banks are required to hold 10 (instead of 12) percent of the attracted FX funds in dram-denominated reserves and 8 (instead of 6) percent in FX-denominated reserves at the CBA. Initially, this change was planned for June 2021.

authorities' efforts in containing the pandemic, a large second wave of infections is now underway. Staff highlighted that the near-term priority is to control the second wave, while ensuring preparedness to purchase and widely distribute vaccines and treatments as they become available. Staff welcomes the launch of comprehensive social sector reforms aimed at developing services based on meeting the needs identified through a unified assessment of multidimensional poverty *(*MEFP ¶22*)*.

- **Labor market policies.** The pandemic's impact on the labor market will likely manifest itself with a lag. As government support measures have expired, the authorities have implemented a new program to reduce long-time scarring in the labor market. The program facilitates rehiring those individuals who lost their jobs amid the crisis and makes a greater use of digital technologies to ease access to information and programs provided by the state employment agency. Staff agrees with the authorities on the need to reevaluate labor market conditions, including those in the informal sector.

- **Education.** The authorities finalized their comprehensive education reform strategy, including its action plan and monitoring and evaluation framework. The draft Law on Higher Education and Science (June 2020 SB) underwent several rounds of revisions following extensive consultations with various stakeholders and is expected to be approved by the Cabinet and submitted to the National Assembly in December 2020. The final version of the draft law lays the legal ground for reforming tertiary education management systems and upgrades licensing and accreditation requirements, state financing principles, and supervision mechanisms to ensure the quality of education services and efficiency of funding.

- **SMEs and business environment.** The recent adoption of SME development strategy reinforces the importance of SMEs in creating employment opportunities and promoting inclusive growth. The strategy aims to address gaps in the legal and institutional framework to lower administrative access hurdles and increase access to finance. To further SME policy support, the authorities prepared an analytic summary of existing support schemes to SMEs in September. Going forward, a follow-up efficiency review of these SME support schemes, undertaken with World Bank support, will lead to the programs being better integrated and more effective.

- **Governance.** The authorities are strengthening their anti-corruption legal framework. The law on a single autonomous and central anti-corruption entity with enhanced detection and investigative powers (September 2020 SB) was submitted to the Cabinet for approval and is expected to be submitted to the National assembly by December 2020. This will be followed by operationalizing the new corruption prevention commission and asset declaration entity (MEFP ¶23). In line with June 2019 structural benchmark, the authorities established a registry of beneficial ownership information for the companies in the extractive industry. The registry is operational and available online. The government is extending the disclosure registry to other companies, and the Ministry of Justice drafted relevant legislation which is now undergoing an internal review process. As advised by the IMF, the definition of beneficial ownership is drafted in a way that is consistent with the UNCAC and FATF recommendations.

PROGRAM MODALITIES

22. **All end-June and end-September quantitative targets are met.** Most upcoming quantitative targets are feasible, although they remain subject to uncertainty around the impact of the pandemic through the first half of 2021. The authorities request an increase (of AMD22.5 billion, less than 0.4 percent of GDP) in the end-December fiscal QPC related to the additional security spending appropriated in their October supplementary budget. Staff also proposes quantitative targets applicable through end-June 2021 (MEFP Table 1).

23. **The authorities request the reset of three SBs, and request four new SBs in line with their reform priorities.** Given the turbulence over the past few months, they propose that the SB to "Compile and estimate all the existing and future contingent liabilities associated with implemented and approved PPPs" be reset to January 2021, the SB to "Approve and publish a decree setting a cap to the total contingent liabilities contracted from PPPs" be reset to February 2021, while the SB to "Prepare a medium-term exit strategy to phase out the CBA involvement in non-core central bank activities" be reset to April 2021. Progress continues towards the other end-December SBs, although the setting of the ceiling on PPP-related contingent liabilities will be pushed to February 2021. The proposed new SBs are:

- Revise the turnover tax legislation by reducing the VAT registration threshold to AMD 60.00 million and adjusting tax rates to equalize the tax-burden across the turnover and general taxation regimes, effective from January 1, 2022 (May 2021 SB).

- Undertake a public expenditure review, with a view to identifying options for efficiency gains and improving social protection (May 2021 SB).

- Conduct a review of securities' taxation to ensure appropriate taxation in this area and identify possible distortions and impediments to capital market development (June 2021 SB).

- Include in the 2022 budget documentation a comprehensive list of all ongoing and new public investment projects, including PPPs, starting in the budget year. The list will provide comprehensive information on the lifetime fiscal implications,[4] including project-by-project information for all externally financed and large domestically financed (at least 50 percent of investment volume from domestic financing) projects (October 2021 SB).

24. **The program is fully financed and Armenia's capacity to repay the Fund is adequate.** Despite the twin shocks, there is no BoP financing gap over the next 12 months with sufficient financing, including from international markets, and there are good prospects for financing over the remainder of the program. Armenia's capacity to repay the Fund is supported by (i) the medium-term downward trajectory of both public and external debt; (ii) the authorities' proven ability to follow through on reforms; and (iii) their long track-record of sound macroeconomic management. IMF payment obligations are projected to be, at most, 7½ percent of gross reserves (Table 7). The

[4] Lifetime fiscal implications include investment cost under the project, firm government commitments, and contingent liabilities.

authorities have also indicated an intention to channel the SDR 25.714 million available upon completion of this review towards budget financing.

STAFF APPRAISAL

25. **The Armenian economy has been hit hard by the worst military confrontation since the early 1990s and a larger second wave of the COVID-19 infections.** Economic activity is projected to contract significantly in 2020, ending the recent period of high economic growth. Risks are relatively balanced, although uncertainty remains high, and the realization of downside risks could cause a much steeper economic decline next year, and further delay the recovery thereafter. Notwithstanding these unexpected shocks, the authorities have managed to keep the program broadly on track and remain committed to program objectives.

26. **Containing the second wave and continuing timely and targeted policy support, remain essential in the near term.** Prioritizing health spending and targeted support to the most vulnerable is appropriate and should continue. The government's policy measures have so far played a role in limiting the economic fallout. As the recovery gains momentum, it will be essential to unwind the remaining temporary measures and accelerate fiscal reforms to preserve sustainability, while ensuring sufficient space for priority spending. Transparency and accountability for COVID-19 related expenditures remains important. In this regard, staff commends the authorities for the publication all COVID-19 support measures and for their commitment to have these outlays audited.

27. **Staff considers the 2021 budget stance appropriate, given the ongoing impact of difficulties related to the pandemic and security, and is embedded in a clear medium-term fiscal strategy.** The accommodation of revenue shortfalls and additional pandemic-related spending is appropriate. To avoid an excessive deterioration of public finances, the authorities decided to temporarily contain 2021 capital expenditures. The authorities envisage financing the deficit from development partners as well as domestic and international markets. This will lead to government debt of around 69½ percent of GDP by end-2021.

28. **Despite the pressures the authorities face, staff welcomes their ongoing commitment to a strong fiscal framework.** Beyond the pandemic, the authorities are committed to the medium-term debt sustainability guided by the fiscal rule. To this end, the authorities will intensify revenue mobilization efforts, undertaking tax policy and administration measures, while containing current spending and safeguarding priority spending. As a result, central government debt expected to gradually decline over the medium term and fall below 60 percent of GDP in 2026 in line with the authorities' new target. Despite delays partly inflicted by the twin shocks this year, the authorities have continued progress with their reform agenda and are committed to staying the course.

29. **The current accommodative monetary policy stance is appropriate.** The easing of key monetary policy conditions, including the reduction in the policy rate is expected to increase liquidity in the banking system and support domestic credit. Nevertheless, the CBA should carefully monitor market developments and stand ready to adjust its monetary stance, as necessary, while maintaining exchange rate flexibility under its IT framework.

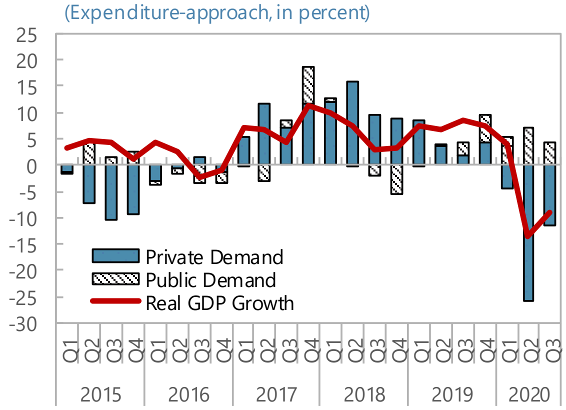
30. The financial system does not show signs of stress at present, but the authorities should stand ready to respond to any signs of emerging risk. Prudential measures implemented by the CBA have helped so far in limiting the impact of the health crisis on the banking system. However, the impact of the twin shocks and deteriorating macroeconomic conditions and continuing high uncertainty could impact banks' asset quality and prolong the rise in NPLs. Therefore, the CBA should continue to identify vulnerabilities and risk factors at specific banks and in the system as a whole, while standing ready to take relevant regulatory actions.

31. Staff supports authorities' request for completion of the third review. Upon completion of the review, an additional SDR 25.714 million would be made available to Armenia.

Figure 1. Armenia: Real Sector Developments

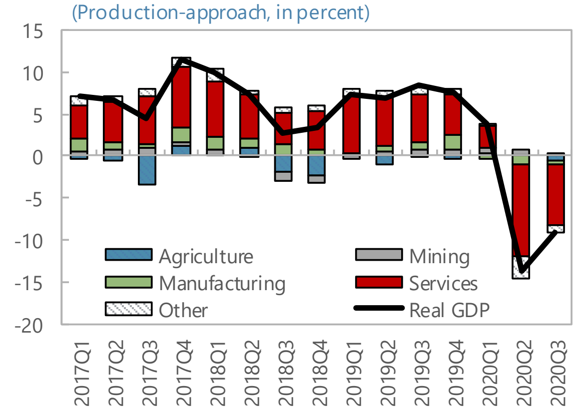
Growth contracted sharply due to the pandemic in the second quarter of 2020 with a modest improvement in the third.

Contributions to Real GDP Growth
(Expenditure-approach, in percent)



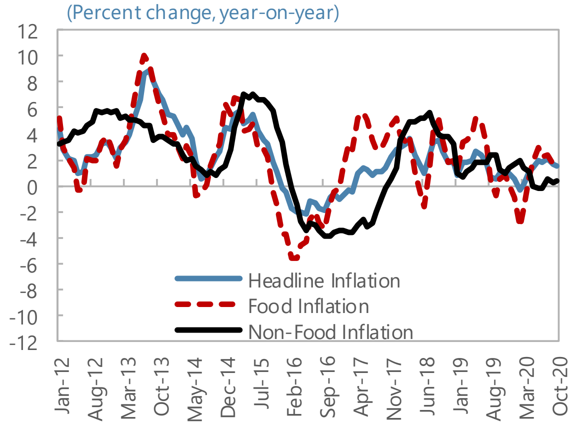
The services sector was particularly hard hit.

Contributions to Real GDP Growth
(Production-approach, in percent)



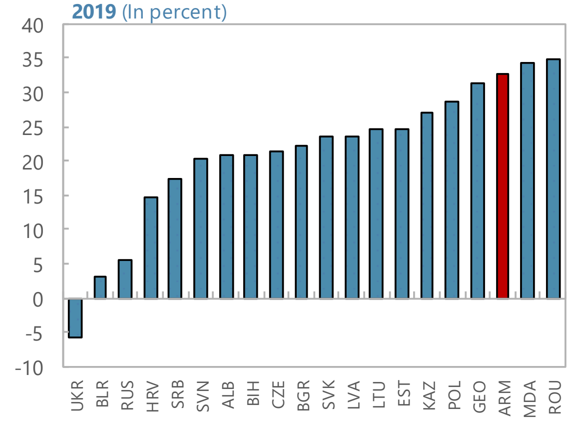
Inflation picks up on the back of recovering food prices.

Consumer Price Inflation
(Percent change, year-on-year)



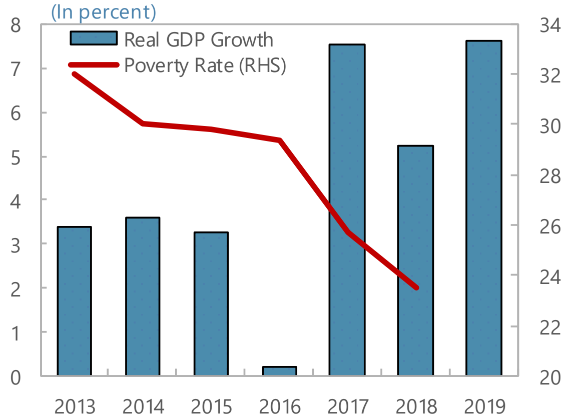
Armenia's per capita income growth is high, compared with peers

Growth in Real GDP per capita between 2012 and 2019 (In percent)



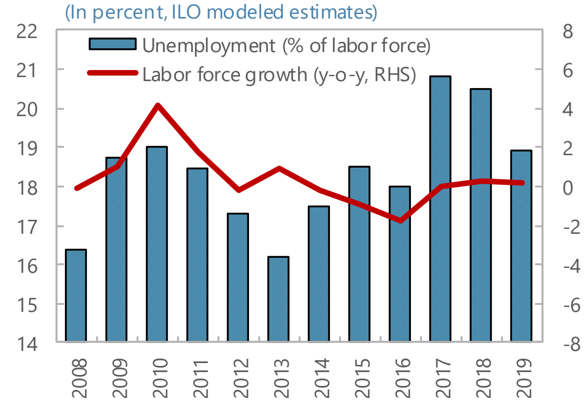
Robust GDP growth helped poverty rates fall significantly

Real GDP Growth Rate and Poverty Rate
(In percent)



Employment growth increased in recent years, although unemployment remains high

Labor Market Indicators
(In percent, ILO modeled estimates)

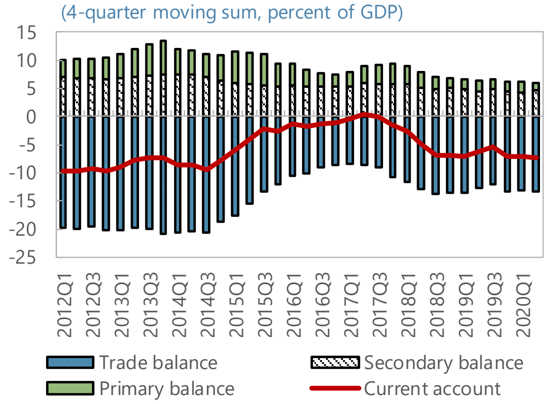


Sources: National authorities, Haver, IMF World Economic Outlook, and IMF staff calculations.

Figure 2. Armenia: External Developments

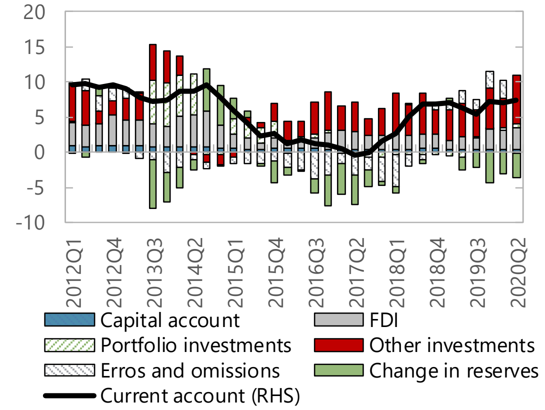
The current account deficit has narrowed in 2020.

Current Account Balance
(4-quarter moving sum, percent of GDP)



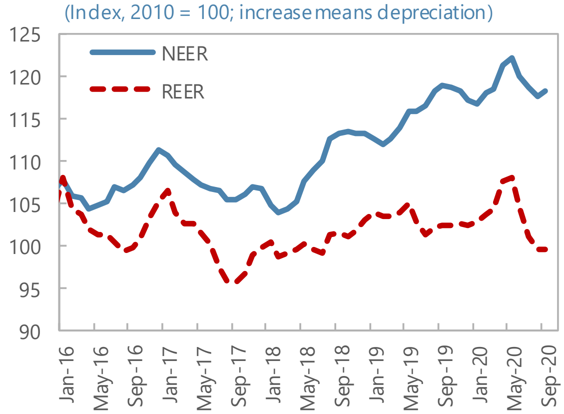
The pandemic weakened remittances, FDI, and private capital inflows.

Financing of the Current Account Deficit
(4-quarter moving sum, percent of GDP)



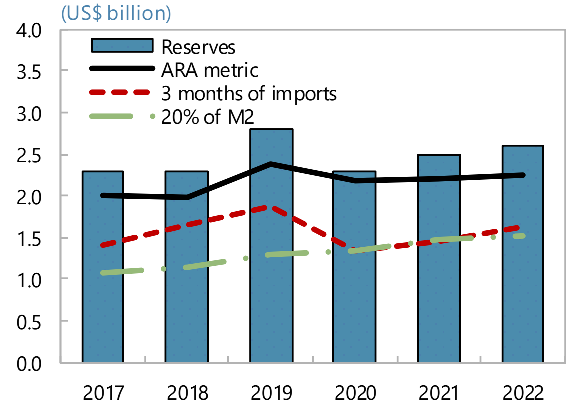
The real exchange rate has been relatively stable since 2015.

Real and Nominal Effective Exchange Rates
(Index, 2010 = 100; increase means depreciation)



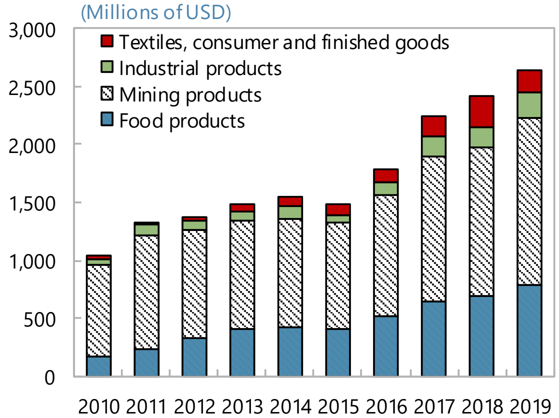
With additional financing from the IMF, reserves would remain adequate according to various metrics.

Reserve Adequacy Indicators
(US$ billion)



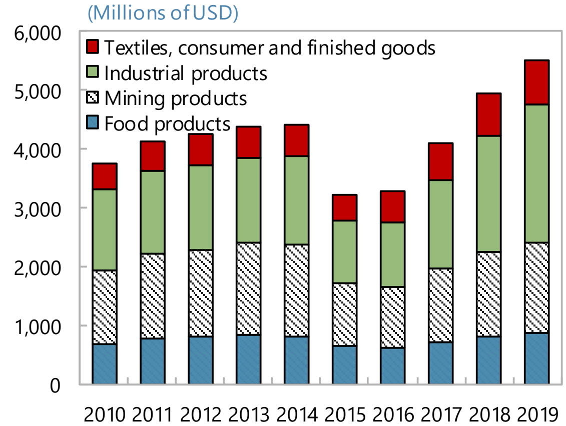
Before the pandemic, exports more than doubled between 2010 and 2019, and have become more diversified.

Export of Goods by Type
(Millions of USD)



The imports of capital goods and durables, which had declined in 2015–16, have grown since.

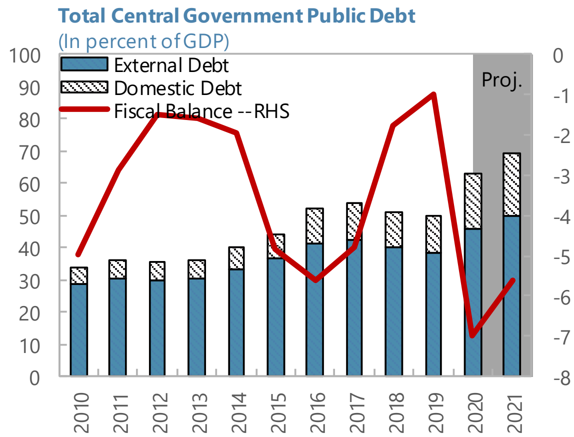
Import of Goods by Type
(Millions of USD)



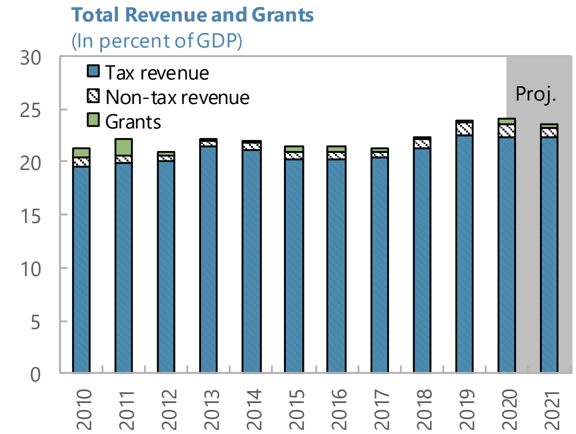
Sources: National authorities, IMF Information Notice Systems Database, and IMF staff calculations.

Figure 3. Armenia: Fiscal Developments

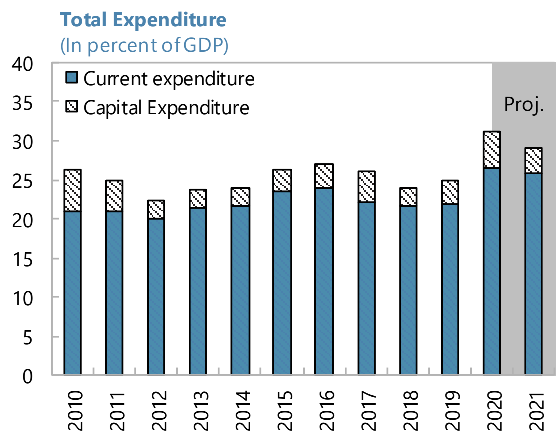
After years of decline central government public debt is expected to rise sharply in 2020–21.



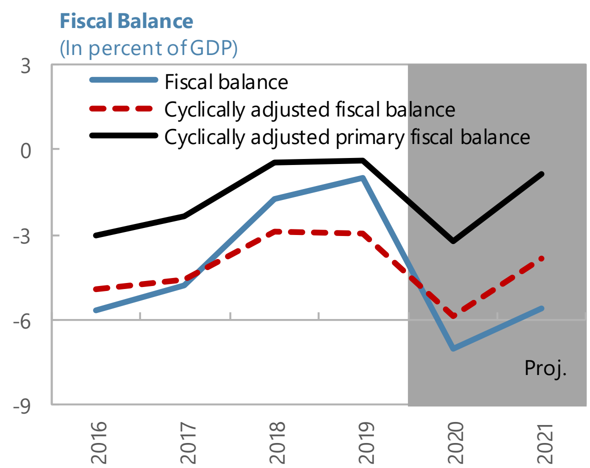
Revenues increased through 2019 but have been affected by the pandemic.



Due to the pandemic, current expenditure is expected to increase again.



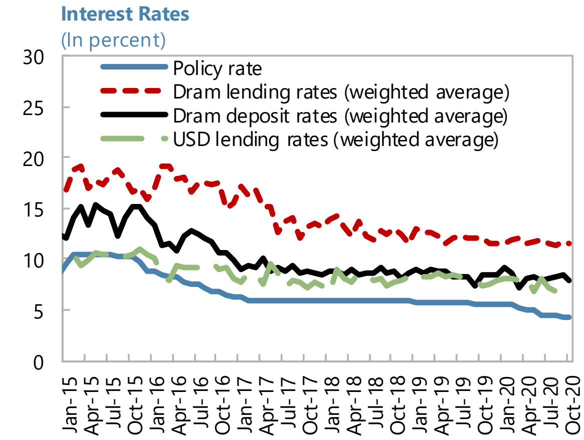
The cyclically adjusted deficit is expected to increase again as a result of the pandemic.



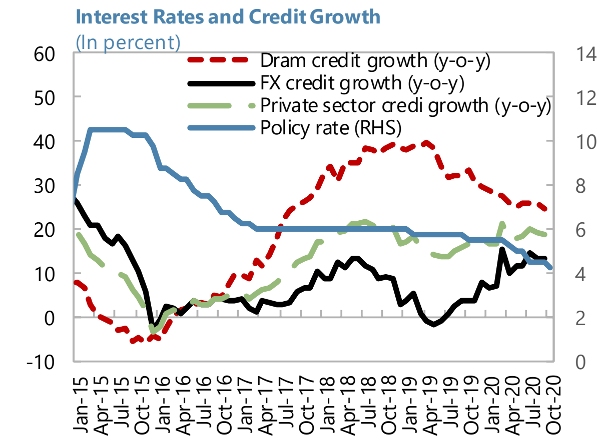
Sources: National authorities and IMF staff calculations.

Figure 4. Armenia: Monetary Developments

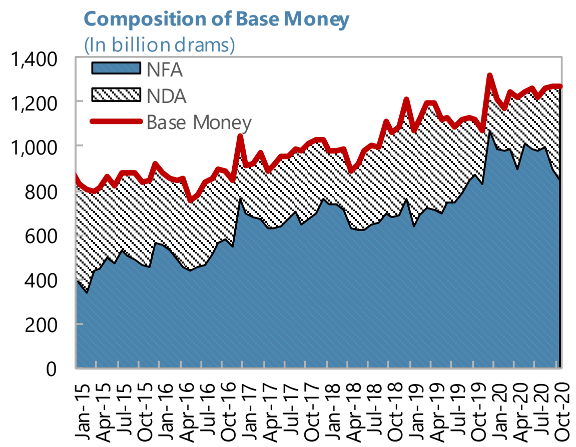
Both deposit and lending rates have been on downward path, on the back of recent rate cuts.



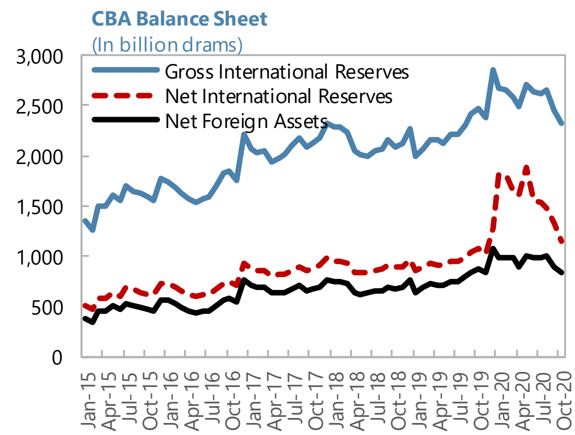
Credit growth in 2020 has remained relatively robust.



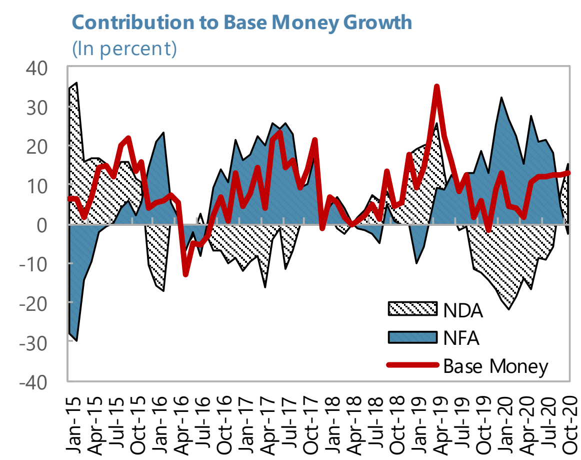
The money base dropped initially in 2020, and then gradually increased.



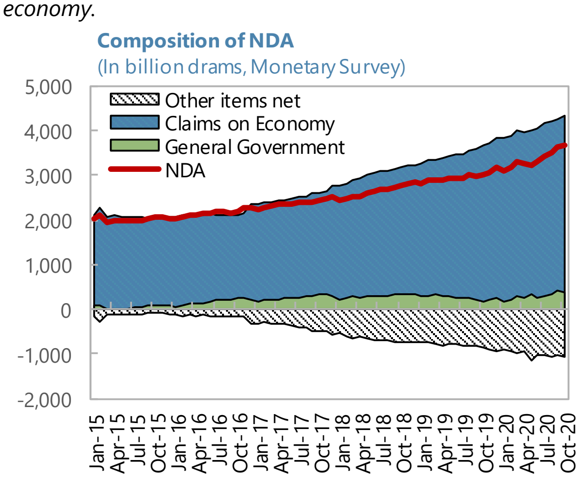
The CBA's foreign assets has decreased since the pandemic.



Growth in base money has slowed down this year.



NDA in 2020 has risen owning to the growth in claims on economy.

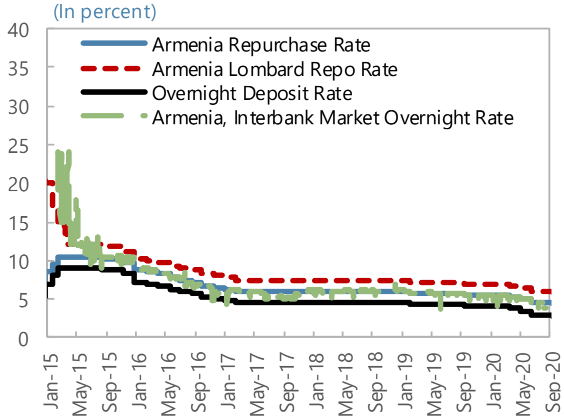


Sources: Central Bank of Armenia, and IMF staff calculations.

Figure 5. Armenia: Financial Developments

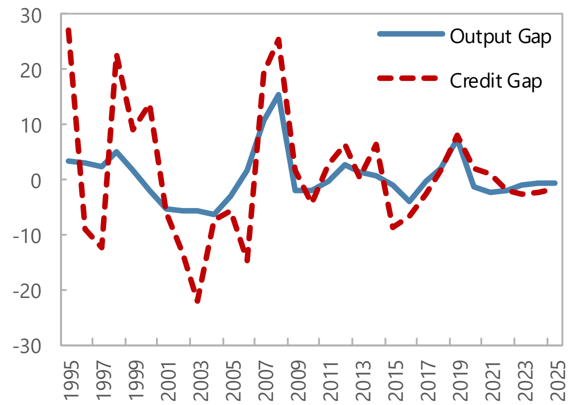
The CBA lowered the policy rate four times in 2020: March (25 bps) April (25 bps), June (50 bps), September (25 bps).

Interest Rate Corridor
(In percent)



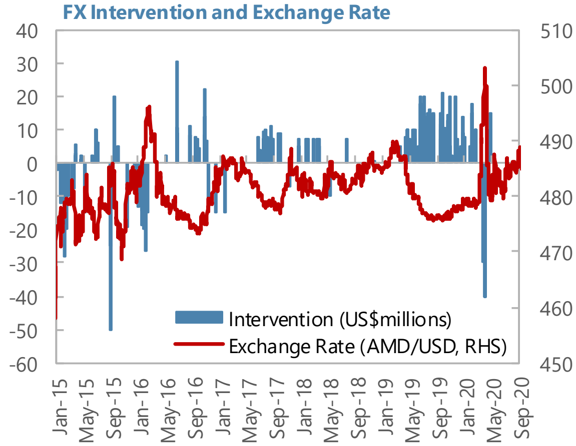
The output and credit-to-GDP gaps are estimated to be negative.

Output Gap vs Credit Gap



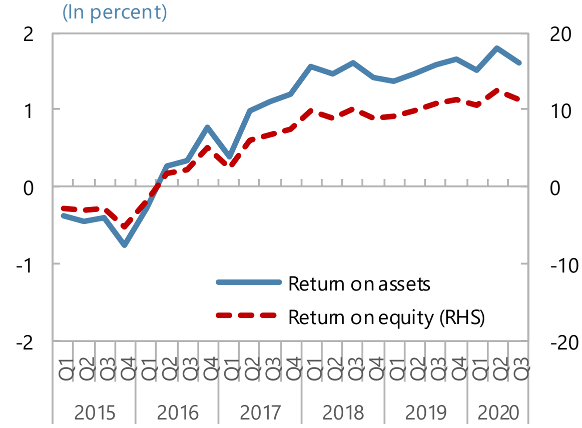
The exchange rate has weakened in 2020 despite early sharp reversal in late March.

FX Intervention and Exchange Rate



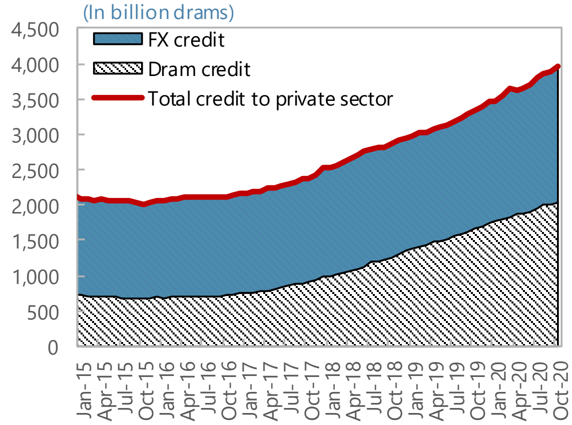
Profitability slightly dropped amidst the pandemic.

Financial Soundness Indicators
(In percent)



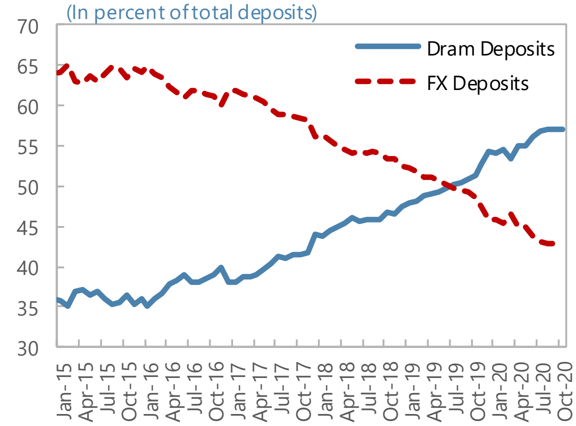
Partly due to anti-crisis support measures, credit dollarization has fallen.

Private Sector Credit
(In billion drams)



Deposit dollarization has declined as well.

Deposit dollarization
(In percent of total deposits)



Sources: National authorities, Central Bank of Armenia, Bloomberg, and IMF staff calculations.

Table 1. Armenia: Selected Economic and Financial Indicators, 2017–25

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Act.	Act.	Act.	Proj.					
National income and prices:									
Real GDP (percent change)	7.5	5.2	7.6	-7.3	1.0	3.5	5.2	4.7	4.5
Final consumption expenditure, Contrib. to Growth	9.0	3.1	9.3	-5.3	2.5	0.9	2.9	2.2	2.1
Gross fixed capital formation, Contrib. to Growth	1.9	0.8	0.8	-1.8	-1.0	2.3	2.3	2.4	2.4
Changes in inventories, Contrib. to Growth	0.1	5.0	-3.7	-1.0	0.0	0.0	0.0	0.0	0.0
Net exports of goods and services, Contrib. to Growth	-0.4	-2.5	1.2	0.8	-0.5	0.3	0.1	0.1	0.0
Gross domestic product (in billions of drams)	5,564	6,017	6,569	6,140	6,344	6,776	7,399	8,066	8,798
Gross domestic product (in millions of U.S. dollars)	11,527	12,458	13,673	12,663	12,819	13,499	14,607	15,751	16,960
Gross domestic product per capita (in U.S. dollars)	3,869	4,196	4,605	4,264	4,317	4,545	4,918	5,303	5,709
CPI (period average; percent change)	1.0	2.5	1.4	1.0	2.1	2.9	3.3	4.0	4.0
CPI (end of period; percent change)	2.6	1.8	0.7	1.5	2.3	3.1	3.8	4.0	4.0
GDP deflator (percent change)	2.1	2.8	1.5	0.8	2.3	3.1	3.8	4.1	4.4
Unemployment rate (in percent)	20.8	20.5	18.9	24.1	24.3	24.3	24.0	23.9	23.7
Investment and saving (in percent of GDP)									
Investment	18.4	22.4	17.4	17.0	16.4	17.3	17.8	18.5	19.1
National savings	16.9	15.5	10.2	11.1	9.9	11.1	11.6	12.4	13.1
Money and credit (end of period)									
Reserve money (percent change)	-1.0	17.8	8.8	6.8	7.3	2.5	4.1	6.2	4.9
Broad money (percent change)	18.5	7.4	11.2	1.6	12.6	9.0	4.4	7.8	6.8
Private sector credit growth (percent change)	16.5	17.2	18.5	4.0	6.0	5.8	2.0	2.7	3.0
Central government operations (in percent of GDP)									
Revenue and grants	21.2	22.3	23.8	24.4	23.6	25.1	25.6	25.7	25.7
Of which : tax revenue	20.2	20.9	22.3	22.0	22.1	23.0	23.3	23.5	23.5
Expenditure	26.0	24.0	24.8	31.4	29.2	27.7	27.2	27.2	26.9
Overall balance on a cash basis	-4.8	-1.8	-1.0	-7.0	-5.6	-2.6	-1.7	-1.5	-1.2
Public and publicly-guaranteed (PPG) debt (in percent of GDP)	58.9	55.7	53.5	66.3	72.5	71.2	67.5	64.8	62.0
Central Government's PPG debt (in percent)	53.7	51.2	49.9	63.1	69.4	68.5	65.4	63.2	61.0
Share of foreign currency debt (in percent)	81.1	80.0	79.0	72.1	72.3	72.0	72.4	71.4	70.9
External sector									
Exports of goods and services (in millions of U.S. dollars)	4,409	4,907	5,641	3,749	4,078	4,802	5,307	5,661	6,025
Imports of goods and services (in millions of U.S. dollars)	-5,651	-6,610	-7,470	-5,370	-5,780	-6,550	-7,173	-7,641	-8,130
Exports of goods and services (percent change)	23.7	11.3	14.9	-33.5	8.8	17.8	10.5	6.7	6.4
Imports of goods and services (percent change)	26.4	17.0	13.0	-28.1	7.6	13.3	9.5	6.5	6.4
Current account balance (in percent of GDP)	-1.5	-6.9	-7.2	-6.0	-6.5	-6.2	-6.1	-6.0	-6.0
FDI (net, in millions of U.S. dollars)	222	247	397	178	196	255	319	383	421
Gross international reserves (in millions of U.S. dollars)	2,314	2,259	2,850	2,251	2,534	2,568	2,608	2,621	2,640
Import cover 1/	4.2	3.6	6.4	4.7	4.6	4.3	4.1	3.9	3.6
End-of-period exchange rate (dram per U.S. dollar)	484	484	480	...	...	...	...	...	...
Average exchange rate (dram per U.S. dollar)	483	483	480	...	...	...	...	...	...

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

1/ Gross international reserves in months of next year's imports of goods and services, including the SDR holdings.

Table 2. Armenia: Balance of Payments, 2017–25

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

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Act.	Act.	Act.			Proj.			
Current account	-174	-860	-988	-755	-830	-837	-898	-952	-1,014
Trade balance	-1,401	-1,759	-1,805	-1,597	-1,633	-1,653	-1,726	-1,819	-1,918
Exports	2,387	2,689	3,210	2,658	2,741	2,963	3,209	3,408	3,613
Imports	-3,788	-4,448	-5,015	-4,255	-4,374	-4,616	-4,935	-5,228	-5,531
Services (net)	159	57	-23	-23	-69	-95	-140	-161	-187
Credits	2,022	2,218	2,431	1,091	1,337	1,839	2,098	2,252	2,412
Debits	-1,863	-2,162	-2,454	-1,115	-1,406	-1,934	-2,238	-2,413	-2,598
Income (net)	407	219	228	114	200	198	226	257	289
Transfers (net)	660	624	614	752	672	713	741	771	802
Private	497	479	468	636	550	578	607	637	669
Official	164	144	145	116	121	135	135	134	134
Capital and financial account	711	761	1,333	-91	1,110	879	1,044	1,161	1,188
Capital transfers (net)	46	68	54	79	84	84	84	84	84
Foreign direct investment (net)	222	247	397	178	196	255	319	383	421
Portfolio investment (net)	-87	-33	8	8	8	8	8	8	8
Public sector borrowing (net)	493	168	292	-21	654	241	284	278	274
Disbursements	585	320	859	290	911	493	555	555	1,061
Amortization	-92	-152	-567	-312	-257	-252	-271	-277	-787
Other capital (net)	38	311	582	-335	167	290	348	408	401
Errors and omissions	-396	110	318	0	0	0	0	0	0
Overall balance	141	10	663	-846	280	42	146	208	174
Financing	-141	-10	-663	530	-350	-77	-146	-208	-174
Gross international reserves (increase: -)	-110	55	-590	599	-284	-34	-40	-12	-20
Use of Fund credit, net	-31	-65	-73	-69	-67	-44	-105	-196	-154
Financing needs	0	0	0	316	70	35	0	0	0
IMF									
IMF (SBA) budget support	0	0	0	316	0	0	0	0	0
IMF (SBA) BoP support	0	0	0	0	70	35	0	0	0
Memorandum items:									
Current account (in percent of GDP)	-1.5	-6.9	-7.2	-6.0	-6.5	-6.2	-6.1	-6.0	-6.0
Trade balance (in percent of GDP)	-12.2	-14.1	-13.2	-12.6	-12.7	-12.2	-11.8	-11.6	-11.3
Gross international reserves (end of period)	2,314	2,259	2,850	2,251	2,534	2,568	2,608	2,621	2,640
In months of next year's imports	4.2	3.6	6.4	4.7	4.6	4.3	4.1	3.9	3.6
In percent of IMF's Reserve Adqeuacy Metric (ARA)	115	95	120	105	116	114	113	109	108
Goods export growth, percent change	26.2	12.7	19.4	-17.2	3.1	8.1	8.3	6.2	6.0
Goods import growth, percent change	32.0	17.4	12.8	-15.2	2.8	5.5	6.9	5.9	5.8
Nominal external debt	10,228	10,683	12,081	12,543	13,565	14,181	14,787	15,349	15,960
o.w. public external debt	5,495	5,536	5,785	5,995	6,657	6,893	7,098	7,237	7,402
Nominal external debt stock (in percent of GDP)	88.7	85.7	88.4	99.1	105.8	105.1	101.2	97.4	94.1
External public debt-to-exports ratio (in percent)	124.6	112.8	102.6	159.9	163.2	143.5	133.7	127.9	122.9
External public debt service (in percent of exports)	6.5	7.5	14.7	15.2	11.9	10.0	10.1	10.4	17.3

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

Table 3a. Armenia: Central Government Operations, 2017–25

(In billions of Armenian drams)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Act.	Act.	Act.			Proj.			
Total revenue and grants	1,182.0	1,341.7	1,565.5	1,496.7	1,495.8	1,702.1	1,891.4	2,074.7	2,259.7
Total revenue	1,168.7	1,330.5	1,553.1	1,460.9	1,472.2	1,673.3	1,863.5	2,047.6	2,233.4
Tax revenues 1/	1,123.9	1,240.7	1,445.6	1,349.8	1,401.2	1,557.5	1,722.9	1,894.4	2,066.3
VAT	392.1	438.2	506.5	468.5	489.6	534.0	596.0	665.9	730.0
Profits, simplified and presumptive	113.6	170.4	234.0	216.3	202.6	216.8	244.2	266.2	290.3
Personal income tax	341.3	356.6	440.8	407.7	384.2	352.6	366.7	399.8	436.1
Customs duties	72.6	80.2	95.1	88.0	86.4	88.1	96.2	104.9	114.4
Other	204.4	195.3	169.2	169.3	238.3	365.9	419.8	457.6	495.5
Social contributions	15.8	17.4	18.7	22.0	18.1	54.8	74.0	80.7	88.0
Other revenue	28.9	72.3	88.8	89.1	52.9	61.0	66.6	72.6	79.2
Grants	13.3	11.2	12.4	35.7	23.6	28.8	27.9	27.1	26.2
Total expenditure	1,448.3	1,447.1	1,629.4	1,926.3	1,850.6	1,879.4	2,016.0	2,194.5	2,362.9
Expenses	1,225.7	1,299.0	1,437.1	1,641.6	1,635.2	1,608.7	1,690.8	1,815.8	1,923.4
Wages	299.1	304.4	327.0	343.7	345.1	347.5	372.1	405.6	442.5
Payments to individual pension accts.	13.0	29.0	49.4	49.4	47.3	43.4	32.6	35.5	38.7
Subsidies	1.5	4.3	4.4	82.1	82.5	67.8	51.8	48.4	26.4
Interest	119.8	139.0	157.6	167.8	197.9	231.3	235.1	234.0	233.6
Social allowances and pensions	397.9	396.5	403.9	500.6	505.1	508.2	569.7	637.2	695.0
Pensions/social security benefits	267.3	265.7	269.9	329.2	340.2	352.4	392.1	435.6	475.1
Social assistance benefits	130.6	130.8	134.0	171.4	165.0	155.8	177.6	201.7	220.0
Goods and services	104.4	155.6	192.1	202.6	165.0	149.1	155.4	169.4	184.8
Grants	109.1	126.3	150.0	158.9	133.2	132.1	133.2	132.3	135.5
Other expenditure 2/	180.8	143.8	152.8	136.5	131.5	129.4	141.0	153.4	167.0
Transactions in nonfinancial assets	222.6	148.1	192.3	284.7	215.4	270.7	325.2	378.7	439.5
Acquisition of nonfinancial assets	223.5	152.0	193.0	284.7	215.4	270.7	325.2	378.7	439.5
Disposals of nonfinancial assets	1.0	3.9	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-266.3	-105.4	-63.9	-429.7	-354.8	-177.4	-124.7	-119.9	-103.2
Statistical discrepancy	-7.7	0.8	-4.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-274.0	-104.6	-68.2	-429.7	-354.8	-177.4	-124.7	-119.9	-103.2
Financing	274.0	104.6	68.2	429.7	354.8	177.4	124.7	119.9	103.2
Domestic financing	86.5	69.4	-13.3	364.1	88.2	98.8	63.5	109.3	84.3
Banking system	80.4	109.8	-39.1	341.7	49.9	51.0	9.2	91.0	70.2
CBA	18.0	43.4	-96.5	83.8	-66.2	0.0	0.0	0.0	0.0
Commercial Banks	62.4	66.4	57.5	257.9	116.1	51.0	9.2	91.0	70.2
Nonbanks	6.1	-40.4	25.7	22.4	38.2	47.8	54.4	18.4	14.2
T-Bills/other	-7.5	-13.5	41.5	52.1	83.9	10.3	1.9	18.4	14.2
Promissory note/other	-94.1	0.0	0.0	-0.9	0.0	0.0	0.0	0.0	0.0
Net lending	107.7	-26.9	-15.8	-28.8	-45.6	37.5	52.5	0.0	0.0
External financing	187.5	35.2	81.6	65.6	266.6	78.5	61.1	10.5	18.9
Gross disbursement	282.3	154.4	412.8	293.9	450.8	247.7	243.3	203.2	507.1
Amortization due	-47.9	-68.5	-274.2	-150.8	-119.0	-113.1	-121.0	-126.0	-415.5
Net lending	-46.8	-50.8	-57.1	-77.5	-65.2	-56.0	-61.2	-66.7	-72.7
Other financing 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	5,564.5	6,017.0	6,569.0	6,139.7	6,344.4	6,776.0	7,399.0	8,066.1	8,798.0
Program balance 4/	-202.5	-155.7	-90.1	-517.3	-434.1	-195.9	-133.3	-186.5	-176.0
Primary balance 5/	-85.7	-44.1	20.7	-368.3	-267.7	35.4	101.8	47.5	57.6

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

1/ From 2018, the temporary tax credits used to cover tax obligations are not included in total tax revenues and are also not netted out from individual tax categories.

2/ Includes acquisition of military equipment.

3/ Covid19 fiscal gap.

4/ The program balance is measured as below-the-line balance minus net lending.

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

Table 3b. Armenia: Central Government Operations, 2017–25

(In percent of GDP, unless otherwise specified)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Act.	Act.	Act.			Proj.			
Total revenue and grants	21.2	22.3	23.8	24.4	23.6	25.1	25.6	25.7	25.7
Total revenue	21.0	22.1	23.6	23.8	23.2	24.7	25.2	25.4	25.4
Tax revenues 1/	20.2	20.6	22.0	22.0	22.1	23.0	23.3	23.5	23.5
VAT	7.0	7.3	7.7	7.6	7.7	7.9	8.1	8.3	8.3
Profits, simplified and presumptive	2.0	2.8	3.6	3.5	3.2	3.2	3.3	3.3	3.3
Personal income tax	6.1	5.9	6.7	6.6	6.1	5.2	5.0	5.0	5.0
Customs duties	1.3	1.3	1.4	1.4	1.4	1.3	1.3	1.3	1.3
Other	3.7	3.2	2.6	2.8	3.8	5.4	5.7	5.7	5.6
Social contributions	0.3	0.3	0.3	0.4	0.3	0.8	1.0	1.0	1.0
Other revenue	0.5	1.2	1.4	1.5	0.8	0.9	0.9	0.9	0.9
Grants	0.2	0.2	0.2	0.6	0.4	0.4	0.4	0.3	0.3
Total expenditure	26.0	24.0	24.8	31.4	29.2	27.7	27.2	27.2	26.9
Expense	22.0	21.6	21.9	26.7	25.8	23.7	22.9	22.5	21.9
Wages	5.4	5.1	5.0	5.6	5.4	5.1	5.0	5.0	5.0
Payments to individual pension accts.	0.2	0.5	0.8	0.8	0.7	0.6	0.4	0.4	0.4
Subsidies	0.0	0.1	0.1	1.3	1.3	1.0	0.7	0.6	0.3
Interest	2.2	2.3	2.4	2.7	3.1	3.4	3.2	2.9	2.7
Social allowances and pensions	7.2	6.6	6.1	8.2	8.0	7.5	7.7	7.9	7.9
Pensions/social security benefits	4.8	4.4	4.1	5.4	5.4	5.2	5.3	5.4	5.4
Social assistance benefits	2.3	2.2	2.0	2.8	2.6	2.3	2.4	2.5	2.5
Goods and services	1.9	2.6	2.9	3.3	2.6	2.2	2.1	2.1	2.1
Grants	2.0	2.1	2.3	2.6	2.1	2.0	1.8	1.6	1.5
Other expenditure 2/	3.2	2.4	2.3	2.2	2.1	1.9	1.9	1.9	1.9
Transactions in nonfinancial assets	4.0	2.5	2.9	4.6	3.4	4.0	4.4	4.7	5.0
Acquisition of nonfinancial assets	4.0	2.5	2.9	4.6	3.4	4.0	4.4	4.7	5.0
Disposals of nonfinancial assets	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-4.8	-1.8	-1.0	-7.0	-5.6	-2.6	-1.7	-1.5	-1.2
Statistical discrepancy	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-4.9	-1.7	-1.0	-7.0	-5.6	-2.6	-1.7	-1.5	-1.2
Financing	4.9	1.7	1.0	7.0	5.6	2.6	1.7	1.5	1.2
Domestic financing	1.6	1.2	-0.2	5.9	1.4	1.5	0.9	1.4	1.0
Banking system	1.4	1.8	-0.6	5.6	0.8	0.8	0.1	1.1	0.8
CBA	0.3	0.7	-1.5	1.4	-1.0	0.0	0.0	0.0	0.0
Commercial Banks	1.1	1.1	0.9	4.2	1.8	0.8	0.1	1.1	0.8
Nonbanks	0.1	-0.7	0.4	0.4	0.6	0.7	0.7	0.2	0.2
T-Bills/other	-0.1	-0.2	0.6	0.8	1.3	0.2	0.0	0.2	0.2
Promissory note/other	-1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	1.9	-0.4	-0.2	-0.5	-0.7	0.6	0.7	0.0	0.0
External financing	3.4	0.6	1.2	1.1	4.2	1.2	0.8	0.1	0.2
Gross disbursement	5.1	2.6	6.3	4.8	7.1	3.7	3.3	2.5	5.8
Amortization due	-0.9	-1.1	-4.2	-2.5	-1.9	-1.7	-1.6	-1.6	-4.7
Net lending	-0.8	-0.8	-0.9	-1.3	-1.0	-0.8	-0.8	-0.8	-0.8
Other financing 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	5,564	6,017	6,569	6,140	6,344	6,776	7,399	8,066	8,798
Program balance 4/	-3.6	-2.6	-1.4	-8.4	-6.8	-2.9	-1.8	-2.3	-2.0
Primary balance 5/	-1.5	-0.7	0.3	-6.0	-4.2	0.5	1.4	0.6	0.7

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

1/ From 2018, the temporary tax credits used to cover tax obligations are not included in total tax revenues and are also not netted out from individual tax categories.

2/ Includes acquisition of military equipment.

3/ Covid19 fiscal gap.

4/ The program balance is measured as below-the-line balance minus net lending.

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

Table 4. Armenia: Monetary Accounts, 2017–21
(In billions of drams, unless otherwise indicated)

	2017	2018	2019	2020				2021			
				Mar.	Jun.	Sep.	Dec.	Mar.	Dec.	Sep.	Dec.
	Act.	Act.	Act.	Act.		Proj.			Proj.		
Central Bank of Armenia											
Net foreign assets	766.6	765.8	1071.8	988.2	988.8	896.0	791.0	1000.0	1000.0	1010.0	960.4
Net international reserves	977.0	679.6	865.4	820.2	745.9	653.1	508.2	711.8	707.1	710.3	659.5
Other	-210.4	86.2	206.3	168.0	242.9	242.9	282.8	288.2	292.9	299.7	300.9
Net domestic assets	265.4	449.8	250.5	255.6	277.1	376.8	448.6	432.1	415.6	399.0	382.5
Claims on general government (net)	-144.3	-172.3	-314.1	-349.7	-418.8	-332.3	-233.1	-249.6	-266.2	-282.7	-299.3
Of which : central government (net)	-121.0	-124.5	-252.8	-291.3	-354.7	-268.3	-169.0	-185.6	-202.1	-218.7	-235.2
central government deposits	161.8	186.0	327.3	362.9	432.3	345.8	182.4	198.8	215.2	231.6	248.1
Claims on banks	107.6	299.1	231.7	275.1	364.1	371.6	362.7	362.7	362.7	362.7	362.7
Other items (net)	302.1	323.0	332.9	330.2	331.7	337.5	319.0	319.0	319.0	319.0	319.0
Reserve money	1,032.0	1,215.6	1,322.2	1,243.8	1,265.9	1,272.8	1,412.6	1,605.1	1,588.6	1,582.0	1,515.9
Currency issue	516.1	566.7	607.2	554.4	589.0	633.2	613.9	658.1	666.5	689.3	691.5
Banks' reserves	515.9	648.9	715.0	689.4	676.9	639.6	625.7	774.0	749.0	719.7	651.4
In drams	329.2	392.7	336.4	339.4	399.7	348.4	334.4	477.8	446.7	405.4	332.1
In foreign currency	186.8	256.2	378.6	349.9	277.2	291.2	291.3	296.3	302.3	314.3	319.3
Banking system											
Net foreign assets	61.8	-78.7	-74.0	-241.1	-201.8	-383.0	-425.7	-235.0	-250.0	-255.0	-318.3
Net domestic assets	2,521.0	2,853.8	3,159.4	3,316.1	3,291.4	3,617.5	3,561.7	3,596.4	3,654.7	3,776.1	3,850.7
Claims on government (net)	302.0	313.2	280.7	292.3	284.4	402.0	619.6	632.1	644.6	657.1	669.6
Of which : claims on central government (net)	325.3	381.4	342.0	350.6	348.5	466.1	683.7	696.2	708.6	721.1	733.6
Claims on rest of the economy	2,758.5	3,232.0	3,830.6	4,006.1	4,051.9	4,245.7	3,983.9	4,006.1	4,051.9	4,160.8	4,222.9
Other items (net)	-539.6	-691.4	-951.9	-982.3	-1,045.0	-1,030.2	-1,041.8	-1,041.8	-1,041.8	-1,041.8	-1,041.8
Broad money	2,582.8	2,775.1	3,085.5	3,075.0	3,089.6	3,234.5	3,136.0	3,361.4	3,404.7	3,521.1	3,532.4
Currency in circulation	425.8	477.0	502.3	474.8	508.7	550.2	533.4	571.7	579.1	598.9	600.8
Deposits	2,140.7	2,298.1	2,583.2	2,600.2	2,580.9	2,684.4	2,712.7	2,994.7	3,102.5	3,251.3	3,296.5
Domestic currency	940.6	1,089.8	1,400.8	1,390.2	1,450.7	1,531.7	1,559.0	1,807.2	1,885.9	1,991.2	2,026.7
Foreign currency	1,200.1	1,208.3	1,182.3	1,210.0	1,130.2	1,152.7	1,153.7	1,187.5	1,216.5	1,260.1	1,269.8
Memorandum items:											
Exchange rate (drams per U.S. dollar, end of period)	484.1	483.8	479.7	482.3	484.9	487.4	...	...	...	...	...
12-month change in reserve money (in percent)	-1.0	17.8	8.8	4.0	12.1	12.6	6.8	29.1	25.5	24.3	7.3
12-month change in broad money (in percent)	18.5	7.4	11.2	11.8	10.6	11.9	1.6	9.3	10.2	8.9	12.6
12-month change in dram broad money (in percent)	27.3	14.7	21.5	19.2	21.7	22.6	9.9	27.6	25.8	24.4	25.6
12-month change in private sector credit (in percent)	16.5	17.2	18.5	19.7	17.5	18.2	4.0	0.0	0.0	-2.0	6.0
Velocity of broad money (end of period)	2.2	2.2	2.1	2.1	2.1	1.9	2.0	1.8	1.8	1.8	1.8
Money multiplier	2.5	2.3	2.3	2.5	2.4	2.5	2.2	2.1	2.1	2.2	2.3
Private sector credit (in percent of GDP)	49.6	53.7	58.3	65.2	66.0	69.2	64.9	63.1	63.9	65.6	66.6
Dollarization in bank deposits 1/	56.1	52.6	45.8	46.5	43.8	42.9	42.5	39.7	39.2	38.8	38.5
Dollarization in broad money 2/	46.5	43.5	38.3	39.3	36.6	35.6	36.8	35.3	35.7	35.8	35.9
Currency in circulation in percent of deposits	19.9	20.8	19.4	18.3	19.7	20.5	19.7	19.1	18.7	18.4	18.2
NIR (U.S. dollars, program exchange rate)	1,571.8	1,405.4	1,811.5	1,645.9	1,554.9	1,326.4	1,050.5	1,471.4	1,461.8	1,468.2	1,363.3
NIR (U.S. dollars, actual exchange rate)	2,039.2	1,404.9	1,804.1	1,700.7	1,538.5	1,339.9	1,050.5	1,471.4	1,461.8	1,468.2	1,363.3

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

1/ Ratio of foreign currency deposits to total deposits (in percent).

2/ Ratio of foreign currency deposits to broad money (in percent).

Table 5. Armenia: Financial Soundness Indicators for the Banking Sector, 2016–20
(In percent, unless otherwise indicated)

	2016	2017	2018	2019				2020		
	Dec	Dec	Dec	Mar	June	Sept	Dec	Mar	Jun	Sept
Capital adequacy										
Total regulatory capital to risk-weighted assets	20.0	18.6	17.7	17.9	17.4	17.5	17.6	17.0	17.4	17.1
Capital (net worth) to assets	16.2	15.7	15.0	15.0	14.7	14.8	14.1	14.1	14.6	14.0
Asset composition										
Sectoral distribution of loans (in billions of drams)										
Industry (excluding energy sector)	227.1	256.3	327.9	337.7	340.5	345.2	357.4	375.2	371.8	404.5
Energy sector	162.2	191.4	182.2	158.3	130.8	143.0	134.0	153.5	154.0	180.8
Agriculture	140.1	144.2	143.3	146.6	155.1	154.6	161.4	171.6	177.7	189.4
Construction	102.8	143.8	161.2	170.8	172.6	182.0	192.7	213.8	225.1	247.6
Transport and communication	79.7	73.8	106.4	105.4	102.9	105.5	101.7	114.7	108.4	110.4
Trade/commerce	335.8	419.6	441.1	443.5	460.9	467.5	508.6	501.1	513.4	537.7
Consumer credits	434.2	511.4	701.1	744.4	795.4	846.0	915.9	951.9	955.5	960.9
Mortgage loans	183.7	209.0	255.2	270.2	295.3	321.6	358.8	395.0	404.6	441.2
Sectoral distribution of loans to total loans (percent of total)										
Industry (excluding energy sector)	10.6	8.8	11.1	11.2	10.8	10.6	10.1	10.3	10.0	10.4
Energy sector	6.5	7.4	6.3	5.2	4.2	4.4	3.8	4.2	4.1	4.6
Agriculture	8.7	5.6	4.8	4.8	4.9	4.7	4.6	4.7	4.8	4.9
Construction	4.8	5.6	5.6	5.6	5.9	5.6	5.5	5.9	6.1	6.3
Transport and communication	3.7	2.9	3.6	3.5	3.3	3.2	2.9	3.2	2.9	2.8
Trade/commerce	15.7	16.3	14.7	14.7	14.7	14.3	14.4	13.8	13.8	13.8
Mortgage loans	8.6	8.1	8.7	8.9	9.4	9.8	10.2	10.8	10.9	11.3
Consumer credits	20.3	19.9	24.1	24.6	25.3	25.9	26.0	26.2	25.7	24.6
Other sectors	21.1	25.3	21.1	21.4	21.5	21.6	22.5	21.0	21.7	21.3
Foreign exchange loans to total loans	64.6	63.5	57.1	55.8	54.5	53.5	52.4	53.1	51.4	50.6
Asset quality										
Nonperforming loans (in billions of drams)	162.2	146.7	146.4	158.5	177.7	186.2	200.0	211.0	217.8	241.7
Watch (up to 90 days past due)	50.8	40.7	48.0	64.5	71.6	64.3	75.1	73.9	81.6	100.6
Substandard (91-180 days past due)	45.0	58.3	40.9	42.5	49.0	67.2	68.3	79.9	85.3	89.6
Doubtful (181-270 days past due)	66.4	47.7	57.5	51.6	57.1	54.7	56.6	57.2	50.8	51.4
Loss (>270 days past due, in billions of drams)	354.3	442.5	272.0	278.4	278.4	285.4	286.5	313.5	315.5	328.5
Nonperforming loans to gross loans	6.7	5.5	4.8	5.0	5.4	5.5	5.5	5.5	5.7	6.0
Provisions to nonperforming loans	52.0	51.5	56.6	52.1	50.9	51.1	49.9	48.7	46.2	41.8
Spread between highest and lowest rates of interbank borrowing in AMD	0.8	0.8	1.5	0.9	0.4	0.6	0.9	0.9	0.9	1.1
Spread between highest and lowest rates of interbank borrowing in FX	0.0	0.3	3.8	1.3	1.0	0.4	1.7	0.6	0.1	1.5
Earnings and profitability										
ROA (profits to period average assets)	1.1	1.2	1.2	1.6	1.4	1.6	1.7	1.5	1.8	1.6
ROE (profits to period average equity)	7.0	7.7	7.6	10.4	9.6	10.7	11.2	10.6	12.4	11.3
Interest margin to gross income	29.2	30.6	32.1	32.1	31.8	31.9	31.8	33.3	33.7	33.6
Interest income to gross income	76.7	77.2	75.1	75.7	75.2	74.3	73.4	74.7	75.5	75.4
Noninterest expenses to gross income	29.1	29.9	33.4	30.9	30.0	29.8	30.6	28.8	27.6	27.1
Liquidity										
Liquid assets to total assets	32.5	32.1	27.3	27.2	27.2	27.6	27.1	27.0	26.9	27.7
Liquid assets to total short-term liabilities	170.8	141.7	116.6	116.0	111.4	108.2	111.7	118.5	119.3	117.0
Customer deposits to total (non-interbank) loans	115.0	117.0	111.9	110.4	109.3	109.5	112.1	109.7	107.1	105.2
Foreign exchange liabilities to total liabilities	62.6	60.0	58.3	56.9	56.6	56.6	55.4	56.0	52.6	52.5
Sensitivity to market risk										
Gross open positions in foreign exchange to capital	6.9	4.0	6.1	3.71	3.7	4.6	4.0	4.3	3.1	3.1
Net open position in FX to capital	-3.3	-1.4	-3.2	-0.13	0.5	-2.0	0.3	-3.6	0.3	1.1

Source: Central Bank of Armenia.

Table 6. Armenia: Fund Credit Available and Proposed Timing of Reviews Under the Stand-By Arrangement

Date of Availability	Conditions	Amount (millions of SDRs)	Percent of Quota	Percent of Quota (cumulative)
May 17, 2019	Board approval of the arrangement	25.714	19.96	19.96
September 30, 2019	Observance of end-June 2019 performance criteria and continuous performance criteria, and completion of first review	25.714	19.96	39.93
May 18, 2020	Observance of end-December 2019 performance criteria and continuous performance criteria, and completion of second review	154.514	119.96	159.89
October 15, 2020	Observance of end-June 2020 performance criteria and continuous performance criteria, and completion of third review	25.714	19.96	179.86
May 20, 2021	Observance of end-December 2020 performance criteria and continuous performance criteria, and completion of fourth review	25.714	19.96	199.82
October 15, 2021	Observance of end-June 2021 performance criteria and continuous performance criteria, and completion of fifth review	25.714	19.96	219.79
April 15, 2022	Observance of end-December 2021 performance criteria and continuous performance criteria, and completion of sixth review	25.716	19.97	239.75
	Total	308.8	239.75	239.75

Sources: Fund staff estimates and projections.

Table 7. Armenia: Indicators of Capacity to Repay the Fund, 2019–25

	2019	2020	2021	2022	2023	2024	2025
		Projections					
Fund obligations based on existing and prospective credit (in millions of SDRs)							
Principal	52.8	49.9	46.5	30.3	72.9	135.0	106.3
Charges and interest	3.0	4.7	5.6	6.0	5.7	3.1	1.1
Fund obligations based on existing and prospective credit							
In millions of SDRs	55.8	54.6	52.2	36.3	78.5	138.0	107.4
In millions of US$	77.2	76.0	74.5	52.2	113.5	200.2	156.1
In percent of Gross International Reserves	2.7	3.4	2.9	2.0	4.4	7.6	5.9
In percent of exports of goods and services	1.4	2.0	1.8	1.1	2.1	3.5	2.6
In percent of debt service	9.3	13.3	15.4	10.8	21.3	34.0	15.0
In percent of GDP	0.6	0.6	0.6	0.4	0.8	1.3	0.9
In percent of quota	43.4	42.4	40.5	28.2	61.0	107.2	83.4
Outstanding Fund credit based on existing and prospective drawings							
In millions of SDRs	183.2	360.2	365.1	360.5	287.7	152.7	46.4
In billions of US$	0.25	0.50	0.52	0.52	0.42	0.22	0.07
In percent of Gross International Reserves	8.9	22.3	20.6	20.2	15.9	8.5	2.6
In percent of exports of goods and services	4.5	13.4	12.8	10.8	7.8	3.9	1.1
In percent of debt service	30.6	88.0	107.8	107.5	77.9	37.6	6.5
In percent of GDP	1.9	4.0	4.1	3.8	2.8	1.4	0.4
In percent of quota	142.2	279.7	283.5	279.9	223.3	118.5	36.0
Net use of Fund credit (millions of SDRs) existing and prospective	-52.8	181.7	4.9	-4.6	-72.9	-135.0	-106.3
Disbursements	0.0	231.6	51.4	25.7	0.0	0.0	0.0
Repayments and Repurchases	52.8	49.9	46.5	30.3	72.9	135.0	106.3

Sources: IMF staff estimates and projections.

Table 8. Armenia: External Financing Requirements and Sources, 2019–25
(In millions of U.S. dollars, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025
				Proj.			
Gross Financing Requirements	2,832	1,289	2,109	1,879	2,056	2,209	2,778
External current account deficit (excl. transfers)	1,601	1,507	1,502	1,550	1,639	1,724	1,816
Debt amortization and Fund repurchases	640	381	323	296	376	473	942
Gross international reserve accumulation 1/	590	-599	284	34	40	12	20
Of which: IMF repurchases and repayments	73	69	67	44	105	196	154
Available financing	2,832	972	2,039	1,844	2,056	2,209	2,778
Capital and Financial Account and Current Transfers	2,832	972	2,039	1,844	2,056	2,209	2,778
of which: Capital transfers (net)	54	79	84	84	84	84	84
Foreign Direct Investment (net)	397	178	196	255	319	383	421
Public Borrowing (net)	292	-21	654	241	284	278	274
Disbursements	859	290	911	493	555	555	1,061
Amortization	-567	-312	-257	-252	-271	-277	-787
Private transfers (net)	468	636	550	578	607	637	669
Other private capital (net)	582	-335	167	290	348	408	401
Financing needs	0	316	70	35	0	0	0
Exceptional Financing	0	316	70	35	0	0	0
IMF (SBA) budget support	0	316	0	0	0	0	0
IMF (SBA) BOP support	0	0	70	35	0	0	0
Memorandum item:							
Current Account deficit, percent of GDP	-7.2	-6.0	-6.5	-6.2	-6.1	-6.0	-6.0
Gross Reserves	2,850	2,251	2,534	2,568	2,608	2,621	2,640
In percent of ARA metric 1/	120	105	116	114	113	109	108
In months of prospective imports	6.4	4.7	4.6	4.3	4.1	3.9	3.6

1/ ARA metric for Assesing Reservers Adequacy (floating)

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

Annex I. Risk Assessment Matrix[1]

Risks	Likelihood	Possible impact if risk is realized	Policy response
Conjunctural shock and scenario			
Unexpected shift in the COVID-19 pandemic. ▪ **Downside.** The disease proves harder to eradicate (e.g., due to difficulties in finding/distributing a vaccine), requiring more containment efforts and impacting economic activity directly and through persistent behavioral changes (prompting costly reallocations of resources). Monetary and fiscal policy response is insufficient amid dwindling policy space and concerns about debt sustainability. Financial markets reassess real economy risks leading to a repricing of risk assets, unmasking of debt-related vulnerabilities, and weakening banks and nonbank financial intermediaries–forcing them to reduce credit (further weighing on growth). Financing difficulties extend to vulnerable sovereigns, leading to cascading debt defaults, capital outflows, depreciation pressures, and in some cases inflation. Pandemic-prompted protectionist actions (e.g., export controls) reemerge, disrupting trade and global value chains. ▪ **Upside.** Alternatively, recovery from the pandemic is faster than expected due to the discovery of an effective and widely available vaccine and/or a faster-than-expected behavioral adjustment to the virus that boosts confidence and economic activity.	**High** **Low**	**High** Lower growth and widespread and prolonged disruptions to economic activity directly, through global trade and supply chain spillovers, and via confidence effects on financial markets and investment.	Maintain fiscal spending to the health sector and protect vulnerable population. Prepare and implement contingency plans to absorb the impact of the shock economic activity.
Widespread social discontent and political instability. Social tensions erupt as the pandemic and inadequate policy response cause economic hardship (including unemployment, higher incidence of poverty, and shortages and higher prices of essentials) and exacerbate preexisting socioeconomic inequities. Economic activity is disrupted. Growing political polarization and instability (e.g., contested elections) weaken policy-making and confidence.	**High**	**Medium** Delay recovery efforts once the pandemic abates and delay return of economic activity to normalcy. Results in lower growth and continued widespread and prolonged disruptions to economic activity. Intensifies policy challenges.	• Continue policy reforms and safeguard progress to date. • Resist populist demands. • Protect social spending on poor, improve targeting, and strengthen social safety net.
Oversupply and volatility in the oil market. Supply increases following OPEC+ disagreements and lower demand keep energy prices close to historical lows, but uncertainty about possible production cuts and the pace of demand recovery lead to bouts of volatility.	**Medium**	**Medium/High** Negative indirect effects via trading partners.	Diversify trading partners. Improve the business environment for international investors.

[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 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 between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. Conjectural risks are especially relevant over shorter horizons (up to 2 years) given the current baseline. Structural risks (omitted from this streamlined version) remain salient over shorter and longer horizons (up to 3 years).

Risks	Likelihood	Possible impact if risk is realized	Policy response
Intensified geopolitical tensions and security risks (e.g., in response to pandemic) cause socio-economic and political disruption, disorderly migration, higher commodity prices (if supply is disrupted), and lower confidence.	High	Medium Intensification of tension in neighboring countries in the Middle East and renewed sanctions on Iran could potentially also reduce trade and investment.	Accelerate structural reforms and prepare contingency plans for potential spillovers. Strengthen social safety nets to mitigate shocks on vulnerable sectors.
Structural risks			
Accelerating de-globalization. Geopolitical competition and fraying consensus about the benefits of globalization lead to further fragmentation. Reshoring and less trade reduce potential growth.	High	Medium Decline in global trade and productivity growth, resulting in higher costs and weaker confidence	• Ensure prudent budgetary management to contain financing need. • Continue to Bolster regional policy coordination and regional trade. • Maintain exchange rate flexibility.
Cyber-attacks on critical global infrastructure, institutions, and financial systems trigger systemic financial instability or widespread disruptions in socio-economic activities and remote work arrangements.	Medium	Medium Decline in global trade and productivity growth, resulting in higher costs and weaker confidence.	• Enhance cybersecurity regulatory framework. • Strengthen information sharing across countries and develop capacity.
Higher frequency and severity of natural disasters related to climate change cause severe economic damage to smaller economies susceptible to disruptions (medium probability). A sequence of severe events in large economies reduces global GDP and prompts a recalculation of risk and growth prospects. Disasters hitting key infrastructure or disrupting trade raise commodity price levels and volatility (low probability).	Medium/ Low	Low Decline in global trade and productivity growth, resulting in higher costs and weaker confidence	Accelerate environmental reforms.
Country-Specific Risks			
Regional conflict: Risks from sharp, renewed regional tensions.	High	High Conflict would have severe impacts, including military action, and losses of human capital.	Continue with dialogue. Prepare and implement contingency plans.

Annex II. Public Debt Sustainability Analysis[1]

Results from an updated DSA using the staff's baseline projections indicate that, despite recent shocks and further deterioration in macro framework compared to previous DSA (May 2020), Armenia's public debt remains sustainable, but both the high share of foreign currency debt and a sharp rise in the debt level are important sources of vulnerability. Alternative scenarios and stress tests suggest that shocks to growth and the exchange rate would have the largest impact on debt dynamics and government financing needs.

1. Debt will increase substantially in 2020 due to lower tax revenue, and higher spending related to pandemic and military needs, although reflecting measures starting in 2022, it is projected to decline to around 61 percent over the medium-term. The fiscal deficit is estimated to widen to 7 percent of GDP in 2020 (relative to 5 percent in the second review). Lower growth, and hence lower tax revenue, as well as higher expenditure on health, anti-crisis support, and military needs have contributed to the rise in the deficit this year. In 2021, the budget envisages a deficit of 5½ percent of GDP, which the government plans to finance from IFIs and international markets (around $700 million combined), with a further AMD200 billion on domestic markets. As a result, the end-2021 central government debt will be around 69 percent of GDP. After 2021, gross financing needs are estimated to revert to the norm—around 7–8 percent of GDP to 2024—and increase to 10.2 percent in 2025 due to expected repayments on existing Eurobonds. After using the fiscal rule's escape clause during 2020–21, the authorities are committed to bringing the central government debt below 60 percent of GDP by 2026. The baseline scenario shows this goal is achievable given planned revenue measures and current spending restraint. The share of FX-denominated debt is projected to be around 70.9 percent of GDP in 2025, due to sizable planned external financing in 2021.

2. Baseline projections are subject to significant uncertainty. Historically, Armenian growth, primary balance, and inflation have all been volatile, which implies potential uncertainty in the baseline projections. Assuming the symmetric distribution of shocks, a fan chart for the public debt-to-GDP ratio—corresponding to the range between the 10th and 90th percentiles—points to a range between 49 and 82 percent in 2020 and between 24 and 83 percent in 2025. An asymmetric fan chart, which rules out real exchange rate depreciation, suggests that debt could range between 40 and 98 percent of GDP at the end of the projection horizon.

3. The heat map highlights vulnerabilities stemming from debt level, large external public debt, and market perception. The rise in public debt poses sustainability risks, especially if Armenia faces deeper macroeconomic shocks. FX-denominated debt and debt held by non-residents remain important risk factors for debt sustainability. A depreciation of the exchange rate would worsen the debt outlook as indicated by the relevant stress test (see Figure A4).

[1] The coverage of public debt is general government debt and debt of the CBA.

Another potential vulnerability stems from the increased cost of funding, with spread recently rising to 371 bp over the U.S. bonds following downgrades by Moody's and Fitch.

4. Scenarios assuming key variables at their historical averages underscore the need for consolidation. The paths of public debt and gross financing needs deviate significantly from the baseline under the historical scenario; the debt ratio would be slightly over 69 percent in 2025. This would place debt sustainability at risk and increase financing needs to around 14 percent of GDP in 2025. This implies that without active policy measures aimed at reducing the fiscal deficit, debt sustainability would be jeopardized.

5. Stress tests suggest that shocks to growth have the largest impact on debt indicators. A combined macro-fiscal shock, whereby real GDP contracts by another 2.5 percent in 2021–22 in each year together with worsening primary balance, can cause public debt to increase to 79.5 percent of GDP, and for public gross financing needs to remain around 14 percent of GDP in 2025. Given the twin shocks of 2020, the government plans to conduct an expenditure review in 2021 to reduce current expenditure and implement quality revenue measures over the medium term starting in 2022. These are important to mitigating risks which could come from higher primary balances and macroeconomic shocks. In isolation, shocks to growth, followed by shocks to the real exchange rate, have the most sizable adverse impact on the public debt path, relative to the baseline.

Figure A1. Armenia: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(In percent of GDP unless otherwise indicated)

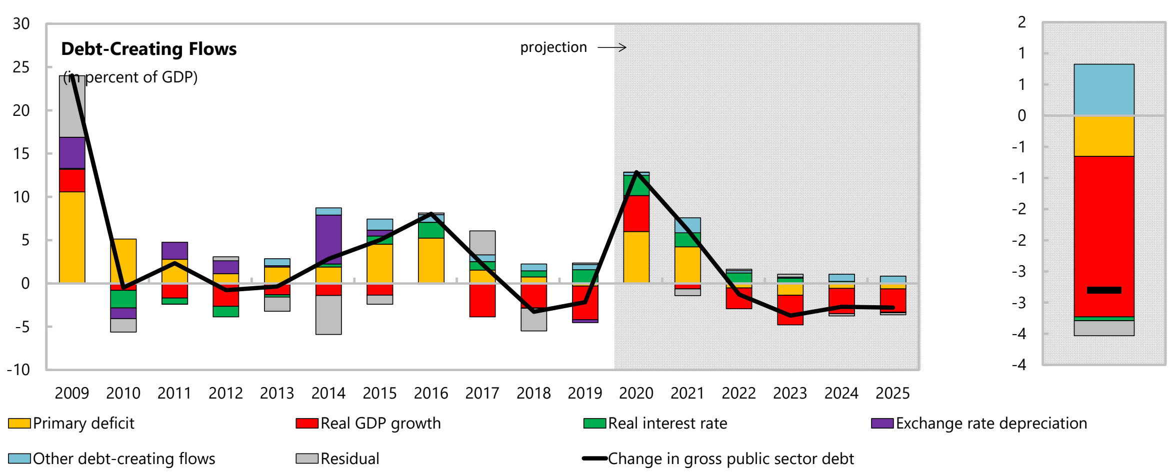
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2009-2017 [2/]	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	45.8	55.7	53.5	66.3	72.5	71.2	67.5	64.8	62.0
Public gross financing needs	8.2	6.7	8.6	13.7	12.9	8.4	7.4	7.9	10.2
Net public debt		49.6	47.5	59.5	65.2	64.9	62.4	60.1	57.7
Real GDP growth (in percent)	2.0	5.2	7.6	-7.3	1.0	3.5	5.2	4.7	4.5
Inflation (GDP deflator, in percent)	3.2	2.8	1.5	0.8	2.3	3.1	3.8	4.1	4.4
Nominal GDP growth (in percent)	5.3	8.1	9.2	-6.5	3.3	6.8	9.2	9.0	9.1
Effective interest rate (in percent) [4/]	3.1	4.2	4.7	4.8	4.9	5.0	4.9	4.7	4.5

As of November 23, 2020		
Sovereign Spreads		
Spread (bp) 3/		371
CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	B1	n.a.
S&Ps	n.a.	n.a.
Fitch	B+	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	4.8	-3.3	-2.2	12.9	6.2	-1.3	-3.7	-2.7	-2.8	8.5	
Identified debt-creating flows	4.6	-0.7	-2.3	13.8	7.9	-1.0	-3.6	-1.9	-2.0	13.3	
Primary deficit	3.9	0.7	-0.3	6.0	4.2	-0.5	-1.4	-0.6	-0.7	7.1	-1.3
Primary (noninterest) revenue and grants	21.5	22.3	23.8	24.4	23.6	25.1	25.6	25.7	25.7	150.0	
Primary (noninterest) expenditure	25.4	23.0	23.5	30.4	27.8	24.6	24.2	25.1	25.0	157.1	
Automatic debt dynamics [5/]	0.2	-2.2	-2.6	7.5	1.9	-0.8	-2.4	-2.1	-2.1	2.0	
Interest rate/growth differential [6/]	-1.2	-2.1	-2.3	6.5	1.0	-1.2	-2.8	-2.7	-2.7	-2.0	
Of which: real interest rate	0.0	0.7	1.6	2.3	1.6	1.2	0.6	0.2	-0.1	5.9	
Of which: real GDP growth	-1.2	-2.8	-3.9	4.2	-0.6	-2.4	-3.4	-2.9	-2.7	-7.9	
Exchange rate depreciation [7/]	1.4	0.0	-0.4	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.5	0.8	0.6	0.4	1.7	0.3	0.1	0.8	0.8	4.2	
Domestic net lend./drawdown of gov. dep. (n	0.0	0.0	-0.3	-0.9	0.7	-0.6	-0.7	0.0	0.0	-1.4	
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	0.5	0.8	0.9	1.3	1.0	0.8	0.8	0.8	0.8	5.6	
Residual, including asset changes [8/]	0.2	-2.6	0.2	0.0	-0.8	0.2	0.3	-0.3	-0.2	-0.8	



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).

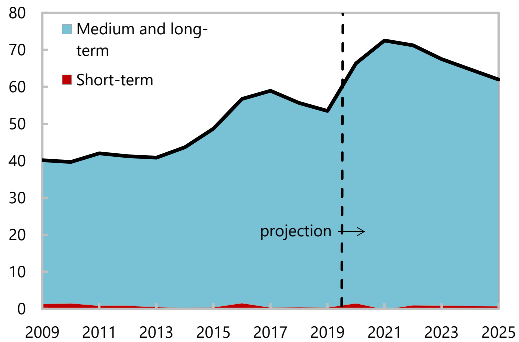
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

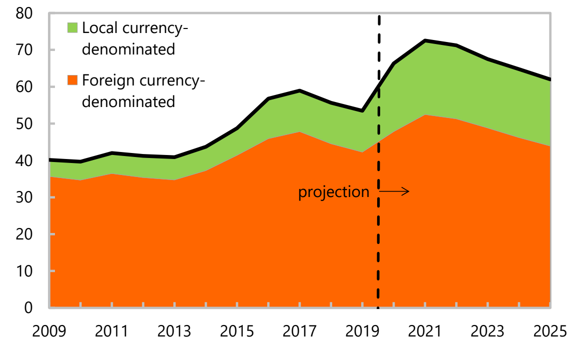
Figure A2. Armenia: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



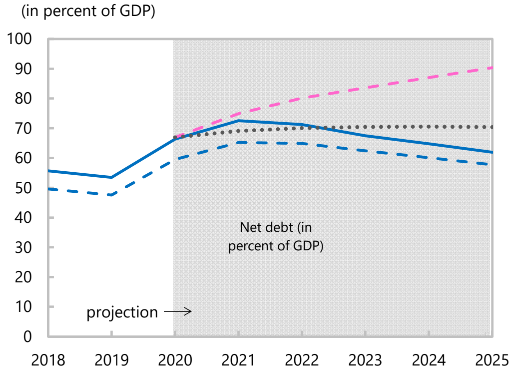
By Currency
(in percent of GDP)



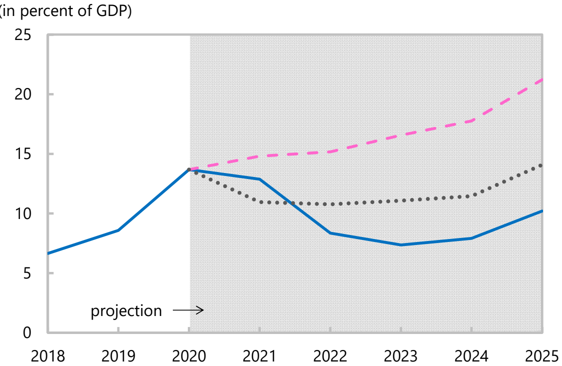
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



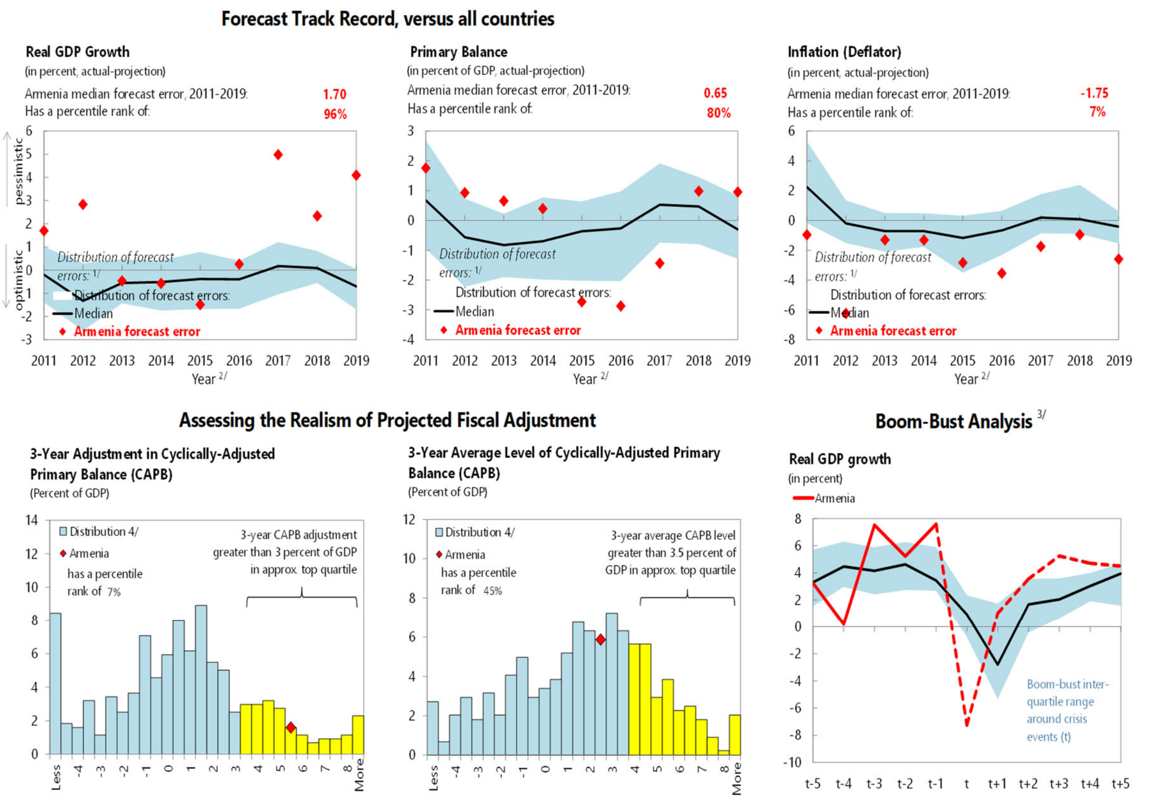
Underlying Assumptions
(in percent)

Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-7.3	1.0	3.5	5.2	4.7	4.5
Inflation	0.8	2.3	3.1	3.8	4.1	4.4
Primary Balance	-6.0	-4.2	0.5	1.4	0.6	0.7
Effective interest rate	4.8	4.9	5.0	4.9	4.7	4.5
Constant Primary Balance Scenario						
Real GDP growth	-7.3	1.0	3.5	5.2	4.7	4.5
Inflation	0.8	2.3	3.1	3.8	4.1	4.4
Primary Balance	-6.0	-6.0	-6.0	-6.0	-6.0	-6.0
Effective interest rate	4.8	4.9	5.0	5.0	4.8	4.8

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-7.3	4.5	4.5	4.5	4.5	4.5
Inflation	0.8	2.3	3.1	3.8	4.1	4.4
Primary Balance	-6.0	-2.5	-2.5	-2.5	-2.5	-2.5
Effective interest rate	4.8	4.9	4.8	4.5	4.3	4.0

Source: IMF staff.

Figure A3. Armenia: Public DSA - Realism of Baseline Assumptions



Source : IMF Staff.

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

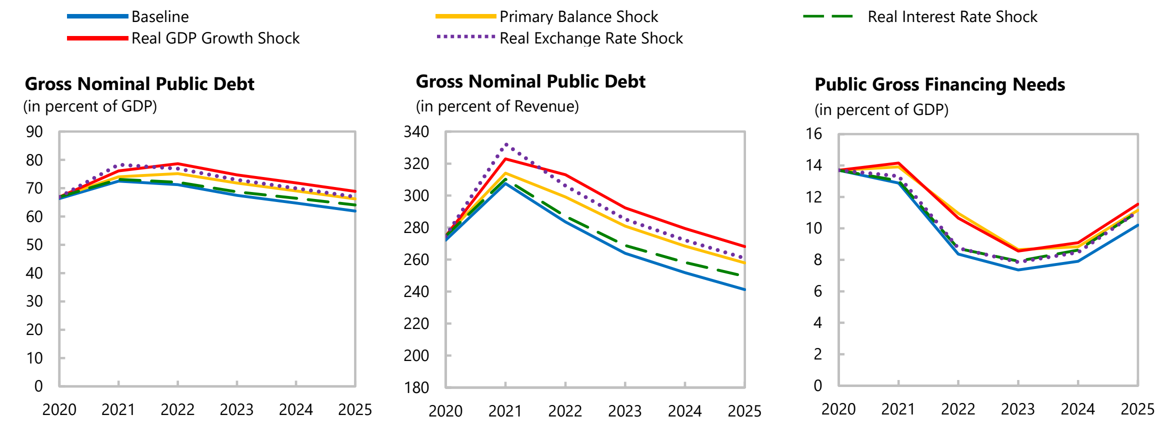
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Armenia has had a positive output gap for 3 consecutive years, 2017-2019 and a cumulative increase in private sector credit of 12 percent of GDP, 2016-2019. For Armenia, t corresponds to 2020; for the distribution, t corresponds to the first year of the crisis.

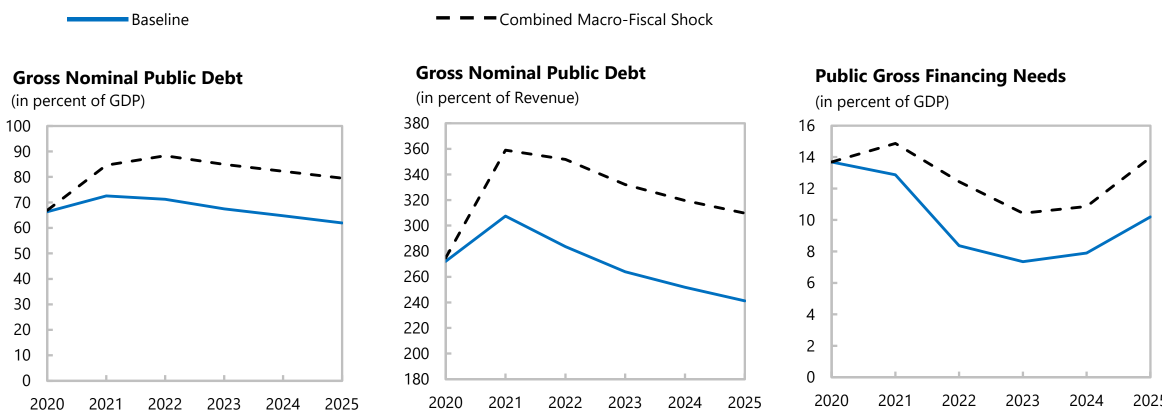
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure A4. Armenia: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2020	2021	2022	2023	2024	2025
Real GDP growth	-7.3	1.0	3.5	5.2	4.7	4.5
Inflation	0.8	2.3	3.1	3.8	4.1	4.4
Primary balance	-6.0	-5.1	-1.8	0.9	0.6	0.6
Effective interest rate	4.8	4.9	5.1	5.0	4.8	4.6
Real Interest Rate Shock						
Real GDP growth	-7.3	1.0	3.5	5.2	4.7	4.5
Inflation	0.8	2.3	3.1	3.8	4.1	4.4
Primary balance	-6.0	-4.2	0.5	1.4	0.6	0.7
Effective interest rate	4.8	4.9	5.4	5.5	5.4	5.3
Combined Shock						
Real GDP growth	-7.3	-1.4	1.1	5.2	4.7	4.5
Inflation	0.8	1.7	2.5	3.8	4.1	4.4
Primary balance	-6.0	-5.1	-1.8	0.9	0.6	0.6
Effective interest rate	4.8	5.3	5.3	5.4	5.4	5.3

Real GDP Growth Shock	2020	2021	2022	2023	2024	2025
Real GDP growth	-7.3	-1.4	1.1	5.2	4.7	4.5
Inflation	0.8	1.7	2.5	3.8	4.1	4.4
Primary balance	-6.0	-5.1	-1.0	1.4	0.6	0.7
Effective interest rate	4.8	4.9	5.1	5.0	4.8	4.6
Real Exchange Rate Shock						
Real GDP growth	-7.3	1.0	3.5	5.2	4.7	4.5
Inflation	0.8	6.5	3.1	3.8	4.1	4.4
Primary balance	-6.0	-4.2	0.5	1.4	0.6	0.7
Effective interest rate	4.8	5.3	4.9	4.8	4.6	4.4

Source: IMF staff.

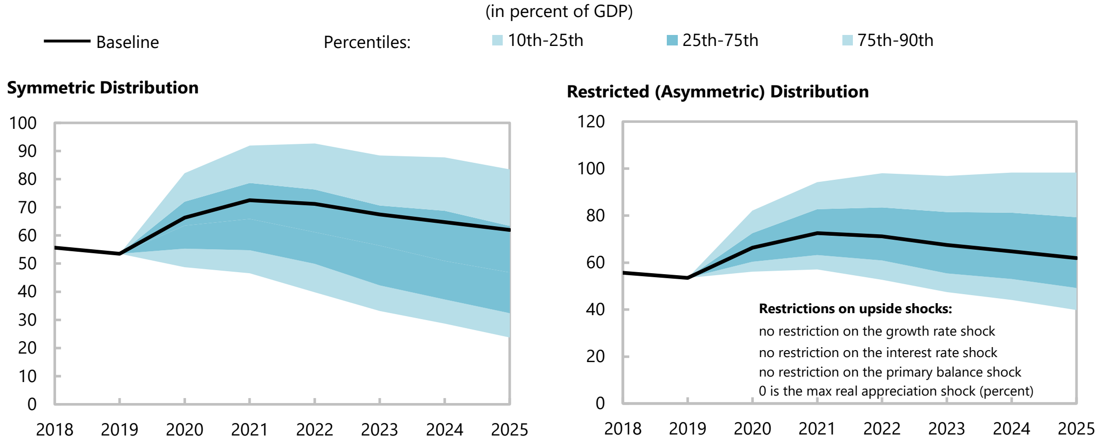
Figure A5. Armenia: Public DSA Risk Assessment

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

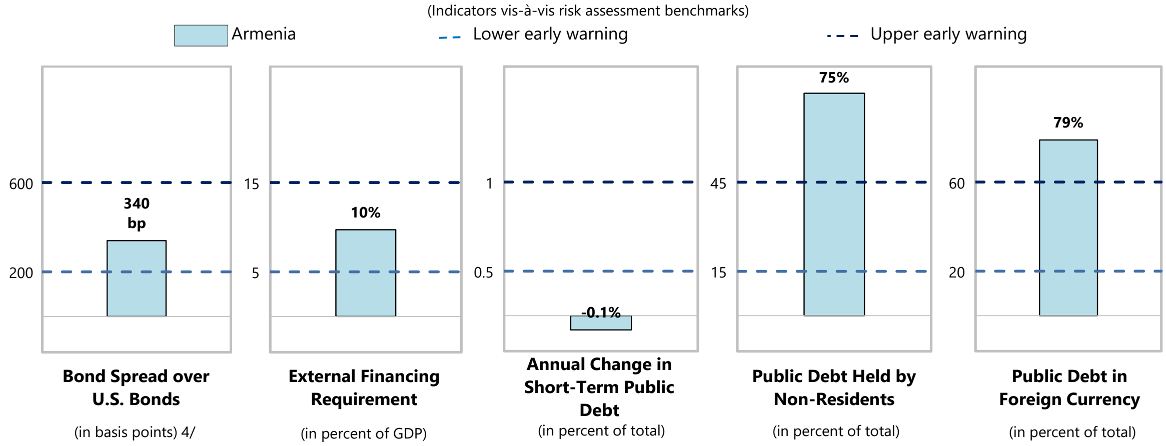
Evolution of Predictive Densities of Gross Nominal Public Debt

(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, 25-Aug-20 through 23-Nov-20.

Appendix I. Letter of Intent

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, DC 20431

Yerevan, November 24, 2020

Dear Ms. Georgieva:

1. In the attached update to the Memorandum of Economic and Financial Policies (MEFP) from May 2, 2019, we reconfirm our strong commitment to sound policies and the objectives of the economic program supported by our IMF Stand-by Arrangement (SBA), notwithstanding the challenging COVID-19 circumstances and hostilities we have faced.

2. After several years of strong macroeconomic performance, Armenia's economy is set to contract in 2020 amid the COVID-19 pandemic and the outbreak of regional hostilities, which remained largely concentrated within the Nagorno-Karabakh conflict zone. These shocks affect the Armenian economy mostly through domestic demand and supply disruptions, which have been exacerbated by a sharp decline in export and tourism revenues, remittances, and to some extent net capital inflows. The decline in GDP is now expected to exceed 7 percent in real terms in 2020, which is significantly larger than what was projected at the time of the second review of the SBA (-1.5 percent).

3. To respond to pandemic and mitigate the economic and social effects of the COVID-19 shock, we have prioritized healthcare expenditure and deployed multiple measures, including changing the CIT prepayment system to make anticipated payments more accurate while also, exempting CIT prepayment for 2020Q2, providing wage subsidies, implementing cash transfers to vulnerable individuals and channeling liquidity to private firms businesses. We have been closely monitoring the implementation of these measures, and a number of measures have, as necessary, been adjusted to ensure their effectiveness and adequate coverage, with some measures extended and others coming to an end. On the monetary and financial fronts, we responded by cutting the key policy rate, strengthening communication, injecting liquidity in the banking system, and temporary adjusting macroprudential, regulatory and supervisory policies.

4. The impact of the COVID-19 shock and military hostilities have led to a deterioration of our fiscal accounts. The sharp drop in fiscal revenues, coupled with the measures to support vulnerable businesses and individuals, are bringing the overall fiscal deficit this year to 7 percent of GDP, compared to 2.3 percent of GDP in the initial 2020 budget. We expect the fiscal deficit to narrow to about 5½ percent of GDP next year, given the projected pace of the economic recovery, despite our intention to gradually phase out our initial pandemic-related economic support measures. Public debt, which was declining steadily in previous years, is now expected to increase to over 60 percent of GDP in 2020, and the prolonged recovery will see debt rise further in 2021. However, we wish to emphasize our commitment to restoring fiscal sustainability and, as elaborated in the attached memorandum, will implement permanent revenue measures to take effect in 2021–22 which will allow debt to resume its downward path from 2022, and allow us to reduce debt to below 60 percent of GDP by 2025–26. On the external side, the dual shocks we face have hit remittances and the tourism sector hard and, to some extent, also net capital flows reducing our reserve buffers. Access to IMF financing for budget support purposes has helped us contain short-term fiscal and external risks by providing resources to meet urgent medical and socio-economic needs during the peak of the virus outbreak, thereby protecting the gains Armenia has made in economic potential and inclusion over recent years. Accordingly, we intend to channel SDR 25.714 million that will become available upon completion of the third review to budget support in 2020.

5. Despite the shocks, we have managed to keep program implementation broadly on track. We met all the performance criteria (PC) under the program for end-June 2020. Structural reforms continue to progress, albeit with some delay mostly due to the shocks. Inflation has remained low and stable and within the inner staff consultation band of the program monetary policy consultation clause. We remain committed to completing the actions underpinning structural benchmarks (SB) relating to the anticorruption body, the law on higher education and science, and an efficiency review of the existing government SME support programs notwithstanding the delays associated with the pandemic and escalation of hostilities, and will complete these measures once revisions, technical work and public consultations are final. We also propose some new benchmarks related a public expenditure review, tax reform, and public investment management. A revised list of structural benchmarks is attached to this letter. As the fallout from the COVID-19 shock and hostilities continue to influence 2020 economic outcomes, we are requesting modifications of performance criteria on program fiscal balance.

6. On the basis of steps that we have already taken and our commitments under the program, we request completion of the third review. While we believe that the policies set forth in the attached MEFP are adequate to respond to the shocks and achieve the macroeconomic and financial objectives of the program, and we will take any additional measures that may be needed. We will consult with the IMF on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation. We will also provide IMF staff with the data and information requested for the purpose of monitoring program implementation. Reaffirming our commitment to transparency, we consent to the IMF's publication of this letter along with the attached MEFP and the Technical Memorandum of Understanding (TMU), as well as the IMF staff report on the third review of the SBA, subject to Executive Board approval.

Yours sincerely,

/s/
Nikol Pashinyan
Prime Minister

/s/
Atom Janjughazyan
Minister of Finance

/s/
Martin Galstyan
Governor, Central Bank of Armenia

Attachment I. Memorandum of Economic and Financial Policies (MEFP)

1. This memorandum supplements our memorandum of May 2, 2019, provides information on recent developments, and sets out our key policies for the remainder of 2020 and 2021.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

2. After several years of strong macroeconomic performance, Armenia's economy is set to contract in 2020 amid the COVID-19 outbreak and the regional hostilities. These dual shocks have affected the Armenian economy through both domestic demand and supply disruptions, exacerbated by a sharp decline in export and tourism revenues, remittances and, to some extent, net capital inflows. Regional hostilities exacerbated these pressures given the general mobilization of young men and heightened uncertainty. The decline in 2020 GDP is now expected to be more than 7 percent in real terms, which is significantly larger than what was projected at the time of the second review of the SBA (-1.5 percent). Annual CPI inflation picked up to 1.3 percent in October on the back of expansionary monetary policy and the unwinding of agricultural factors which suppressed 2019 inflation. The current account deficit is expected to narrow to 6 percent due to sizable contraction in imports. Despite a set of major shocks to the economy, financial stability has been maintained. The currency saw limited depreciation (less than 2 percent against the US dollar) during the period of escalated hostilities, and capital outflows have been limited. Capital and liquidity buffers on the banking system have remained solid, helped by the government support to borrowers and temporary payment holidays.

3. The macro-economic outlook is weaker than previously anticipated. Assuming the pandemic somewhat abates in 2021, growth is expected to rebound in 2021. For the purpose of the IMF program, we conservatively assume a rebound in growth at 1 percent only, as the economy slowly adjusts towards new working conditions and the shocks leave economic scarring. Our initial objective for 2021, however, was to achieve growth close to 5 percent, as our economic policies continue stimulating aggregate demand, but given the downside risks raising from the second wave of COVID-19 and Nagorno-Karabakh conflict the objective could be adjusted to around 3 percent during ongoing 2021 Budget discussions in the Parliament. Beyond 2021, we expect growth to slowly converge to pre-COVID potential with inflation gradually rising towards the inflation target, although downside risks are large given high uncertainty about the duration of the pandemic. The current account deficit is projected at around 6 percent of GDP over the medium term amid solid exports and moderate imports growth on the back of prudent macroeconomic policies. On the financial sector side, we expect credit losses to remain manageable, and will ensure that banks maintain adequate provisioning and capital.

POLICY RESPONSE TO COVID-19 AND REGIONAL HOSTILITIES

4. In response to the pandemic, our key priority has been to provide rapid and effective public health response to the COVID-19 outbreak to slow down its transmission, reduce mortality, and subsequently sustain low levels of transmission as socio-economic activities resume. The Ministry of Health has been equipped with additional financial resources and legislative powers to expeditiously acquire necessary goods. We have also leveraged timely support from international partners in procuring medical equipment and providing technical expertise. Importantly, we have made COVID-19 medical carefree for all and actively employed digital tools to consolidate the relevant information and ensure coherent policy response across the country. While the National State of Emergency associated with a broad range of restriction was in place from March till mid-September, we have been gradually lifting certain restrictions since May being attuned to the epidemiological situation and broad socio-economic consequences of a broad lockdown. Even though we have made notable progress in containing the COVID-19 by September, we continue employing non-pharmaceutical containment measures. Notwithstanding these efforts, a second wave of infections has occurred, and we stand ready to respond to this wave as aggressively as we responded to the first one.

5. Policy response to regional hostilities. On 27 September 2020, renewed fighting broke out along the line of contact in the Nagorno-Karabakh conflict zone. This is the heaviest fighting and worst outbreak of hostilities since 1994. Hundreds of civilians and combatants have been killed, with densely populated areas of Nagorno-Karabakh, including its capital Stepanakert, suffering major damage. On 27 September 2020, Armenia declared martial law and general mobilization; Azerbaijan took similar steps. Heavy fighting continued until November 10, when a trilateral ceasefire agreement was signed. These hostilities, on top of the pandemic, will further reduce GDP growth and, reflecting the impact on revenue and the need for higher security spending, widen the fiscal deficit to about 7 percent of GDP this year. In accordance with the legislation the amendment to 2020 budget has been initiated by the Government and adopted by the Parliament.

6. To mitigate the economic and social effects of the COVID-19 pandemic, we have deployed a wide set of fiscal, financial and monetary measures. The governmental policy response is estimated at AMD 215 billion or 3.4 percent of GDP (without health expenditures), with AMD 150 billion for total socio-economic support package and AMD 65 billion due to exempting corporate income taxpayers from their advance payment obligations in 2020Q2, and providing for more accurate anticipated payments in the rest of the year. The socio-economic support package was established to include AMD 60 billion for 25 crisis-related support measures targeting various beneficiaries, AMD 10 billion as a reserve amount for possible reallocations and AMD 80 billion for supporting post-crisis recovery. Key types of measures include:

- ***Liquidity provision to businesses.*** We adopted three separate programs offering subsidized government-sponsored loans for co-financing and refinancing to selected businesses to provide short-term support. These measures target small and medium enterprises (SMEs) in affected sectors (manufacturing, hospitality, transportation, tourism, and services), agricultural enterprises, as well as larger firms impaired by the crisis. Having analyzed the effectiveness of these measures, we phased out one of the measures and adjusted another. These programs proved to be in demand, and as of mid-August, the government disbursed more than AMD 20 billion under these measures with the commercial banks' participation reaching almost AMD 100 billion. Separately, we have provided direct subsidies to micro businesses, grants or loans to high-tech entrepreneurs, monthly subsidy to entrepreneurs in tourism, and loans to grape producers.

- ***Direct labor subsidies.*** Four measures envisaged provision of direct labor subsidies to micro enterprises and SMEs that retain their employees and maintain their wages, totaling AMD 16 billion and ultimately benefitting more than 175 thousand of beneficiaries (as of mid-August).

- ***Lump sum transfers to vulnerable individuals.*** We adopted twelve measures to support vulnerable individuals during the pandemic by providing: (1) lump-sum transfers to those unemployed following the COVID-19 outbreak and those employed in the hard-hit sectors; (2) transfers to families with/expecting children; (3) tuition subsidies and subsidizing student loans; (4) subsidies for utility services. As of mid-August, these measures reached about 2 million beneficiaries and to a large extent have been phased out as many the restrictions on economic activity were lifted.

- ***Reviewing corporate income tax advance payment system.*** We exempted taxpayers from corporate income tax advance payment obligation for the second quarter of 2020. This tax deferral, estimated at AMD 65 billion, helped ease compliance burden for the taxpayers, alleviated liquidly pressure and limited the amount of tax refunds due in early 2021. Going forward, we have made the corporate income tax advance payment system more flexible for taxpayers. Specifically, the advance payment obligations will be calculated automatically in favor of taxpayers, based on the turnover over the previous quarter, or the previous year's profit tax. This will result in a more accurate, reflective of the economic cycle, pre-payment of CIT obligations.

- ***Investment to support post-crisis recovery.*** Looking beyond the short term, we aim to spur investment, both through the development of a portfolio of high-quality public investment projects, as well as innovation through limited direct equity investment into innovative companies. Specifically, we have earmarked up to AMD 50 billion in budget funds for this type of investment that could be allocated in tranches of AMD 5 billion to the Armenian National Investment Fund (ANIF) if the early stages of the initiative prove to be successful. The ANIF will carry responsibility of sourcing and selecting potential productive investment, as well as managing the equity portfolio. We are committed to continuously monitor of this investment portfolio and ensure (1) transparency over the selection of projects and partners as well as the financial performance of the equity portfolio (including through a continually updated page on the Ministry of Economy website, and estimates presented with the budget documents); (2) protections to limit the impact on competition and governance; and (3) safeguards to prevent the value of the state's investment being undercut. The use of the remaining amount of AMD 30 billion is subject to further consideration.

- ***Monetary and financial sector response.*** The CBA responded by cutting the key policy rate, strengthening communication, injecting liquidity in the banking system, and temporary adjusting macroprudential, regulatory and supervisory policies. (¶15).

7. We remain committed to ensure strong governance and transparency in implementation of these programs. We have been closely monitoring the implementation of these measures and a number of measures have, as necessary, been adjusted to ensure their effectiveness and adequate coverage, with some measures extended and others coming to an end. Moreover, the list of beneficiaries receiving support under certain measures is public and constantly being updated by the relevant authorities. In fact, as of October, the crisis-related support measures reached more than 2 million beneficiaries. We will continue reviewing the implementation of these measures on a monthly basis, with the objective of phasing them once they are no longer needed, cognizant of their fiscal implications. We plan to arrange for an ex-post audit of the on-lending business support schemes in the COVID-19 package by mid-2023 and publish the results of the audit.

FISCAL POLICY

8. Lower revenues and higher spending on healthcare, socio-economic support, and security spending, will raise the fiscal deficit and public debt in 2020 by a significant extent. Tax revenue is projected to decline to 22.0 percent of GDP from 22.3 percent in 2019, while additional spending on healthcare, social and economic support (including below the line on-lending support operations) would add up to around 2.6 percent of GDP. Despite the under-execution of capital expenditure, including due to the COVID-19 restrictions, and our efforts to find savings by reprioritizing expenditure within the budget envelope, the fiscal deficit is expected to widen to 7 percent of GDP largely reflecting the impact of weaker growth on revenues. Government debt, which was declining steadily in previous years, is now expected to increase by more than 10 percentage points to above 60 percent of GDP in 2020. In this context, access to IMF financing for budget support purposes following the second review under the SBA, as well as various types of support from other international partners have helped us meet urgent medical and socio-economic needs during the peak of the virus outbreak and reduce the fiscal financing gap. We intend to channel the SDR 25.714 million that will become available upon completion of the third SBA review to budget support in 2020.

9. In a context of heightened COVID-related uncertainty, our 2021 budget will strive to reduce socio-economic scarring while preserving fiscal sustainability. We intend to limit the 2021 budget deficit to AMD 355 billion or around 5.6 percent of GDP, while maintaining current spending largely constant in nominal terms at AMD 1,635 billion (25.8 percent of GDP) to ensure adequate social expenditure. Capital spending is planned at AMD 215 billion (3.4 percent of GDP). We will expect to raise tax revenue collection to AMD1,401 billion or 22.1 percent of GDP in 2021, amidst the economic rebound, the legislated increase in excise rates, and our efforts to improve tax compliance in line with our newly adopted compliance strategy and untapped tax potential. In the event of any shortfall in revenue, we stand ready to take compensating measures while striving to protect the social spending envelope. A budget in line with these elements will pass formal procedures in National Assembly (NA) and is expected to be approved by the end of the year.

10. We plan to raise the necessary financing for the 2021 budget from domestic and external sources, including our development partners. We expect our development partners to provide at least $200–300 million in budget support, and commit to request this from the World Banks, ADB, and potentially other partners. For the remainder, we are planning to borrow about $500 million on international markets and raise about AMD 200 billion domestically. In meeting our financing needs, we will ensure that the government's cash deposits maintain a sufficient cushion for cash-flow management purposes and possibly for future needs, while also not creating undue pressure on the external sector.

11. We reiterate our commitment to the medium-term fiscal goal of debt sustainability, while maintaining space for investment and social spending. Once the pandemic shock dissipates and renewed regional hostilities moderate, we will implement gradual fiscal consolidation with explicit measures from 2022 (see below) to allow the government debt to GDP ratio to begin declining in 2022, and place debt on a path to fall below 60 percent of GDP by 2026, in line with our fiscal rule. This would require lowering fiscal deficit to below 2 percent of GDP over the medium term. To this end, we will work to gradually raise the revenue to GDP ratio to levels including be exploiting options to realize revenues identified through our ongoing study identifying tax potential, including through the reduction of tax expenditures. In addition, we intend to undertake long-anticipated reforms to the turnover tax and microenterprise regimes to remove the tax-arbitrage options created by the current regime (see below), while also placing electronic services under the VAT net, introducing individual tax declarations and implementing, as well as other measures to boost tax revenues. Finally, we will strive to ensure that current expenditure growth is in line with the associated fiscal rule. By raising domestic revenues and containing current spending, we will be able to allocate additional resources towards capital expenditure that is critical to building Armenia's potential.

12. In case of major downside shock, we will strive to mitigate its macro-fiscal impact. In such an event, our primary concern will be to ensure national security, social protection for the vulnerable and necessary health spending. To limit the impact of this on the budget, we will, as in 2020, reallocate and reprioritize spending within the current spending envelope, as well as reallocate underutilized/delayed capital spending, and consider other potential options.

STRUCTURAL FISCAL POLICIES

13. We continue to modernize our tax policy and administration to promote growth and increased compliance. We are bringing forward reforms that improve efficiency and fairness of the tax system, remove distortions, support inclusive growth, foster compliance and boost revenue collection.

- In June 2020, the National Assembly of Armenia approved a major property tax reform, that brings the cadastral value of properties closer to the market price, scraps the tax-exemption threshold to strengthen compliance culture, and introduces differential rates for various types of property. Tax collection under this new regime will start in 2021, with a transition period allowing for a gradual increase in the taxation burden through 2026. This reform will allow for increasing the tax revenue collected by the local governments and supporting inclusive growth.

- In August 2020, the State Revenue Committee approved a new Compliance Risk Management strategy (September 2020 SB) and introduced a tax compliance risk register. Once the Risk Council reviews and assigns priorities across compliance risks and identifies the areas for which tax compliance improvement programs must be developed, a 2021 tax compliance improvement program will be prepared and approved by December-2020.

- We have started working towards the introduction of individual income tax declarations in the medium term. We consider individual income tax declarations to be an important tool for reducing informality and narrowing tax gap. Moreover, individual income tax declarations could be instrumental for identifying the vulnerable and help us improve the design and targeting of social assistance programs, including during the crisis episodes.

- We will aim to improve the efficiency and fairness of SME taxation. We plan to revise the turnover tax legislation by reducing the VAT registration threshold to AMD 60 million and adjusting tax rates at least to equalize the tax-burden across the turnover and general taxation regimes, effective from January 1, 2022 (new May 2021 SB). We will commence public consultations well ahead of drafting the legislation and before the end of May 2021. We will also review the approach towards the micro-business taxation, including by removing tax-arbitrage opportunities that may arise by January 1, 2022.

- We will introduce reforms to our tax system to improve the efficiency and equity of the system while generating additional revenues to provide fiscal space for addressing pressing social spending needs. To this end, in line with existing legislation, from January 2021, we will introduce an environmental tax for mining waste and we will raise the rate starting January 1, 2022. In addition, also from January 2022, we will (i) increase rates of most existing environmental taxes and nature use fees by 30 percent, (ii) abolish the VAT exemption for medical services for foreigners, and (iii) limit deductions from the CIT tax base based on documents issued by micro-enterprises. In addition, with immediate effect, we will cease publishing, in advance of tax audits, the list of taxpayers to be audited. We expect that all together, these tax measures will deliver additional revenues of 0.5 percent of GDP from 2022.

- With the help of the IMF TA, we will conduct the review of securities' taxation (new June 2021 SB) to ensure appropriate taxation in this area and identify possible distortions and impediments to capital market development.

- Finally, we are finalizing the analysis of Armenia's tax gap, which will help identify additional areas for improvements and policy action (December 2020). Guided by RA-GAP methodology, we will introduce a process of continuous compliance gap estimation to detect the biggest non-compliance tax revenue losses and to measure the effectiveness of compliance improvement measures undertaken by the revenue authorities on a continuous basis.

- Taken together, the revenue measures we plan to introduce to apply from January 1, 2022 will not only reduce distortions in the tax system and improve progressivity, but also generate 1.1 percentage points of GDP in permanent additional revenue over time.

14. In line with our public financial management strategy we are working on strengthening fiscal governance, transparency, and long-term sustainability.

- ***Budget process.*** We have been using an enhanced rolling baseline process to prepare 2021 draft budget by delineating projections of on-going and mandatory expenditure commitments as well as new measures including discretionary spending and proposals for permanent expenditure adjustments. Going forward, we will strive to enhance transparency and the credibility of our budget process further and will (i) base our budget planning on sectoral strategies that are defined in line with the overall government priorities and that will be presented together with the budget, (ii) make improved costing of existing and new policies the basis for budget allocations, and (iii) enhance the contingency planning in the budget by aligning the allocation for contingencies with identified risks in fiscal risk summary to budget implementation and allocations for fiscal reserves.

- ***Public expenditure review*.** We will work to improve the efficiency of current spending to create room for reallocating resources to high priority areas, including to ensure an adequate social safety net. To this end, we will undertake an expenditure review, for which we will request the assistance of the IMF, by May 2021 (new May 2021 SB), so that the outcome of the review could inform the 2022 budget process.

- ***Fiscal risks management***. We understand that ongoing fiscal stress due to the COVID-19 pandemic has put additional premium on managing fiscal risks, especially since some response measures are likely creating new fiscal risks. With this in mind, we are enhancing the centralized fiscal risk function in the MOF to provide for a comprehensive monitoring and assessment of fiscal risks and advising the Minister of Finance on risk management. We will request support for developing the capacity of the function once additional staff has been assigned. With this in place, we will include a comprehensive and consolidated fiscal risk summary in the 2022 budget documentation.

- ***Public investment management.*** We are working to further strengthen the execution of the public investment budget. We are placing even more emphasis on making the PIM process robust, efficient and clearly defined in order to improve appraisal, selection, and monitoring of public investment projects, with better execution as the final goal. To this end:

- We have developed a system that will (i) allow us to prioritize projects systematically in line with policy priorities as reflected in sectoral strategies; and (ii) better inform and enhance decision making during the budget process.

- By January 2021, we will refine the system further to ensure that all public investment projects, including PPPs, can be efficiently handled under the process. Our new PIM manual–developed in cooperation with the World Bank–will be fine-tuned further to provide clear guidance on the development, assessment and selection of public investment projects. To understand areas where fine-tuning may be important, we will look for lessons from the {recently concluded} piloting of the PIM process.

- It remains critical for the MOF to play its gatekeeping role to ensure fiscal affordability of all the projects selected through the PIM process, as well as to ensure the appropriate management of fiscal risks.

- We are developing a project database that will provide comprehensive information on all newly proposed domestically and externally financed projects (December 2020 SB). For transparency purposes, starting with the 2022 budget, we will include in the budget documents a list of all ongoing public investment projects and new public investment projects starting in the budget year, including PPPs, and disclose their lifetime fiscal implications (new October 2021 SB).

At the same time, to support the recovery, we will prepare a pipeline of fully assessed and prioritized public investment projects that are ready for immediate execution once the health crisis and the security situation permits. We expect this to be ready no later than March 2021.

- ***Public-private partnerships (PPPs).*** As we are moving towards making our new PPP framework fully operational, we are committed to strengthening the management and reporting of PPP-related fiscal risks to be able to reap the benefits from PPPs without undermining fiscal sustainability.

  - We will refrain from introducing revisions to the PPP law that would allow the government, or any public body, to invest in PPPs as a shareholder (i.e., engaging in institutional PPPs). While we think that institutional support in PPPs is one way to help align investment with the government's investment strategy and limit the profits attributable to the private sector, as well as accelerate the implementation process, the risks associated with such PPPs outweigh the potential benefits. We recognize that these benefits can be achieved through a robust PIM process with appropriate contractual provisions.

  - In line with the provisions under the decree on contingent liabilities, we are preparing a comprehensive assessment of contingent liabilities and fiscal implications associated with the existing and newly approved PPPs. Once the assessment is finalized, we will introduce a decree setting a cap on the aggregate amount of contingent liabilities that can be contracted under PPPs.[1]

- We will incorporate the PPPs in the enhanced public investment management process where all public investment projects are developed, assessed, selected, procured in a transparent and competitive procedure, and implemented according to unified procedures, rules, priorities and constraints. We will ensure that the process for unsolicited proposals, which we intend to incorporate in the PPP legislation, will follow these principles.

- We will review the procurement legal framework to ensure that it is applicable to PPPs, and under the authority of the MoF, if necessary, will revise the procurement law or introduce a PPP specific procurement legal framework that is aligned with best international practice.

- We will also ensure timely and transparent communication of PPP related costs and risks in line with international best practice (Fiscal Transparency Handbook 2017).

- Finally, cognizant of significant fiscal risks that the PPPs may carry, we will refrain from entering into any new PPPs except for any project that has already been legislated by a government decree at any government level until the Ministry of Finance is prepared to fully evaluate and manage such risks, i.e., until the enhanced public investment management process is fully rolled out and applied to PPPs, and a fully operational centralized risk management function has been established in the MOF.

- By end-June 2023, we will review the implementation of the PPP program through end-2022 to assess the efficiency and value for money achieved through PPPs as procurement method and the effectiveness of the PPP institutional framework.

• ***Fiscal transparency.*** In line with our commitment to transparency, we have developed an improvement plan for government finance statistics (GFS) (September 2020 SB). With the help of the IMF TA and in collaboration with the CBA and Armstat, the MoF will compile a comprehensive sectorized list of all public sector entities (March 2021 SB) to allow for the extension of GFS coverage and improvement of fiscal risk monitoring.

• ***Exchange rate arrangement.*** In line with our previous commitments, the MOF will be using market-determined exchange rates for all budget transactions from January 1, 2021 and for transactions by project implementation units from July 1, 2021, while managing exchange-rate risks in a transparent and cost-effective manner. The CBA and MoF have already agreed on the draft amendments to the 2007 contract and the final agreement is expected to be

[1] Contingent liabilities will be limited by limiting the investment that can be undertaken under PPPs (stock ceiling) and by limiting the annual payment commitments for any future year (flow ceiling).

signed in the near future. It is envisaged to use market-determined bid/ask exchange rate in the foreign exchange market set by the CBA.

MONETARY AND FINANCIAL SECTOR POLICIES

15. In fulfilling its dual mandate of price and financial stability, the CBA has supported economic activity through 2020.

- ***Policy rate.*** Inflation has remained low and stable and within the inner staff consultation band of the program monetary policy consultation clause. In the context of low inflation and weakening domestic demand, we implemented four policy rate cuts, by cumulative 125 basis points, since the beginning of 2020 to support economic activity adversely affected by the pandemic. The policy rate currently stands at 4.25 percent. We stand ready to adjust monetary policy in response to changes in the economic outlook and inflation expectations while considering implications for financial stability.

- ***Foreign exchange intervention.*** Under the free-floating exchange rate regime, we remain committed to exchange rate flexibility and will not obstruct any necessary exchange rate adjustment, while ensuring that international reserves remain adequate. According to our strategy, which we have started communicating to market participants since September 2020 through our *Inflation Report*, we intervene in the FX market only in exceptional cases, while explaining the underlying reasons and rationale for our actions. We do not target any level or growth of the exchange rate. Early in the pandemic, the CBA undertook foreign exchange interventions to support the normal functioning of the market, critical to the effective implementation of monetary and financial stability policies.

- ***Liquidity provision.*** Domestic markets have generally functioned smoothly since the onset of the pandemic, as the CBA has conducted repos and FX swap operations to provide the market with liquidity in line with the demand. The CBA has repeatedly communicated its readiness to provide the banks with the required amount of dram liquidity. As a result, the short-term interbank interest rate remained around the target policy rate.

- ***Regulatory and supervisory responses.*** Our goal is to maintain financial stability and banking system soundness.

  - The CBA has encouraged voluntary prudent loan restructuring to help the borrowers heavily impacted by the crisis manage the shock. These restructuring, enacted on a voluntary basis by the commercial banks, has consisted mostly of postponing the repayment schedule through maturity extensions of up to a few months, and did not worsen the borrowers' credit history. Such credit organizations as the "National Mortgage Company", "Home for Youth", as well as the "German-Armenian Fund" have also made it possible for partner banks to defer repayment of principals on loans to the customers for up to 6 months.

- The CBA has not relaxed loan classification and provisioning rules and has instructed banks to measure NPL and potential losses as accurately as possible while monitoring closely developments in this area. In fact, we have significantly enhanced engagement between banks and banking supervisors to continuously assessed the impact of the COVID-19 crisis on their asset quality, liquidity, and other parameters, including under alternative stress scenarios.

- To preserve bank capital buffers in the face of economic slowdown and higher uncertainty we have also required all banks to request CBA authorization in order to distribute dividends or pay bonuses to management.

- In August, the CBA resumed the redenomination of foreign exchange reserve requirements that was previously halted to alleviate some pressure on banks' foreign exchange liquidity. Starting from September 16, the composition of 18-percent reserve requirements on attracted FX funds was changed to 10 percent in AMD/8 percent in FX from 12 and 6 percent, respectively.

- ***Macroprudential response***. In May we lowered Tier 1 capital adequacy ratio from 10 percent to 9 as part of a broader strategic change in the nature of capital in the banking system, with the introduction of (and capital being held in) Basel III capital buffers (capital conservation, systemic, counter-cyclical). At the same time, we have encouraged banks to use the newly introduced combined capital buffers in order to absorb losses and maintain lending to the economy. Consistent with the assessment of the cyclical risks and the high degree of uncertainty about future developments, the CBA also kept the countercyclical capital buffer rate at zero percent of risk weighted assets. All banks have excess capital cushions and these structural changes are aligned with Basel III recommendations.

16. The CBA has significantly strengthened its communication strategy as a part of broader effort to enhance monetary transmission and in response to COVID-19 situation.

- The CBA Governor has started holding regular press conferences on monetary policy and financial stability issues.

- The CBA has been holding daily meetings with financial organizations to provide guidance on the economic support measures approved by the government and carried out by the banks, as well as assist with any other issues which financial organizations are facing.

- The CBA issued statements urging population to use online financial services and payment apps, to contain the COVID-19 spread while supporting the operational capacity of financial organizations.

- The CBA hotline service has been working in emergency mode to address promptly public's questions, concerns and queries.

17. We continue working on promoting capital market development. In line with our commitments under the SBA, we developed and approved a comprehensive capital market development strategy and an action plan. Moreover, we have already formed several thematic working groups to bring forward concrete actions of the strategy. We are in process of creating a high-level steering committee that would guide the activities of the working groups to ensure timely progress and coherence of efforts of various stakeholders. In the meantime, we are negotiating the sale of a controlling share of the Armenia Securities Exchange to the Warsaw Stock Exchange.

18. We remain committed to strengthening our macroprudential toolkit by adopting a stressed Loan-to-Value (LTV) limit. We will introduce limits to stressed LTV ratios at differentiated levels for LC and FX loans (March 2021 SB). We have been collecting information from all banks and credit institutions on borrower and loan characteristics to prepare for a smooth introduction of the debt service-to-income (DSTI) limits.

19. We continue strengthening our policy framework to support financial sector stability in line with FSAP recommendations: (1) In line with Basel III, we have introduced capital conservation and countercyclical capital buffers, as well as a surcharge for domestic systemically-important banks; (2) We introduced LCR and NSFR in AMD and FX to boost liquidity buffers, but due to current circumstances, we will start enforcing them from January 2021. LCR and NSFR are set at 100 percent for dram liabilities. The ratios are initially set at 60 percent for FX liabilities and will reach 100 percent by early 2022; (3) We approved and operationalized the emergency liquidity assistance for banks that are solvent but illiquid, against collateral; and (4) The CBA is finalizing the draft regulations related to the redefinition of nonperforming loans and restructured loans in line with international best practices and taking into account the comments received from the MOF, and this should be completed by the end of 2020.

20. We have prepared a draft time-bound medium-term exit strategy to phase out the CBA involvement in non-core central bank activities, which will be approved after consultations with the Fund's mission team. The strategy anticipates a phased approach to exiting from non-core CBA operations, which includes: (i) transferring full control of the activities to independent and professional Boards of Directors; (ii) clearly defining any public objectives that should continue to be pursued by these entities after the exit of the CBA, including safeguards for users and consumers; (iii) setting up a comprehensive strategy for the pursuit of these objectives after the exit of the CBA, defining any roles played by regulation, public supervisory bodies, public agencies and government entities, subsidies, or strategic minority public participation in the company's capital; (iv) undertaking feasibility analysis of market conditions and defining CBA's exit options, principles and models; (v) in line with the strategies thus defined, attracting institutional private sector investors or, in case of critical infrastructure, transforming into an independent, transparent and sustainable institutions. In the selection of institutional investors, which could include multinational or reputable international companies and organizations providing extensive transfer of knowledge and know-how, we will follow best international practices to ensure transparency and accountability in the process. Our upcoming agreement with the Warsaw Stock Exchange is an illustration of our strategic approach to exiting from some non-core activities. Some activities providing infrastructural services could also be merged and rendered more efficient though innovation, including by adopting and expanding Digital and Fintech solution for high quality, competitive and affordable services. We will finalize our medium-term strategy to phase out involvement in non-core activities, in line with IMF comments, by April 2021. The strategy will then be articulated into an action plan with clear indications on the timing of the measures contemplated therein.

21. In the event of a major adverse shock, we could consider a number of contingency measures to ensure banking sector stability. We will continue to monitor the solvency and liquidity conditions of banks closely, including by performing regular stress tests. If economic conditions induce renewed stress on households and small enterprises, we could encourage some further loan restructuring along the lines of that seen in the initial response to the pandemic earlier in 2020. At the same time, we will maintain our prudent approach to risk assessment and provisioning requirements. Banks that experience a temporary liquidity drain (beyond what can be addressed through regular operations) could be allowed to infringe the minimum LCR ratio temporarily. We also stand ready to provide Emergency Liquidity Assistance against good collateral and, if this were to prove inadequate, we may temporarily ease banks' reserve requirements.

STRUCTURAL REFORMS

22. We will continue implementing structural reforms to promote investment and advance sustainable and inclusive growth.

- ***Business environment.*** Recognizing the importance of SMEs in creating employment opportunities and promoting inclusive growth, we adopted an SME development strategy that aims at fostering vibrant and competitive SMEs in Armenia. The strategy focuses on (1) promoting entrepreneurial culture, (2) increasing access to finance, (3) ensuring market access, (4) creating enabling legal and institutional environment. As we strive to further identify the most effective policy interventions and schemes to support SME development, we have prepared a summary of Armenia's SME support schemes. In 2021, we will rely on the World Bank's assistance to undertake a follow-up efficiency review of these SME support programs in order to conduct policy intervention through the most efficient channels.

- ***Labor market policies.*** To reduce long-time scarring in the labor market, we have implemented a new state program that facilitated rehiring of those who lost their jobs amid the crisis. In parallel, we have been striving to make a greater use of digital technologies to ease access to information and programs provided by state employment agency. Reflecting our efforts, the unemployment rate in 2Q2020 was only 1.1 percentage point higher than in 2Q2019, while the number of the employed has actually increased. We have also started analyzing the potential changes in labor market over the medium-term as the current crisis prompts structural changes in sources of growth.

- ***Social policies.*** In line with the Government Program, the Ministry of Labor and Social Affairs has launched a major social assistance sector reform. The cornerstone of this reform is the introduction of an integrated social services system that will be based on a unified system of social needs assessment, with social case management as its main operation tool. The assessment will be based on the concept of multidimensional poverty with the aim of providing households not only with monetary support, but also ensuring their access to the services in respect of which the household is considered deprived, i.e. labor market, education, housing, and health. Such a comprehensive approach within the Integrated Social Services System will enhance efficiency of the social protection system management and quality of social services. The relevant laws and other regulations that have already been adopted in 2020 will enter in force on April 1, 2021. Also, we have been working on improving targeting and efficiency of our family and social benefits system and addressing the issues identified by a recent task force with a goal of creating opportunities for beneficiary families to generate sustainable income on their own, and demotivate their reliance on state benefits only. To this end, we have introduced changes to the household vulnerability criteria and their values.

- ***Education.***

  - *Law on Higher Education and Science*. We have made significant progress with the draft Law on Higher Education and Science that had to undergo several rounds of revisions following the extensive consultations with various stakeholders. In line with the structural benchmark, the final version of the draft Law sets the legal ground for reforming the tertiary education management system and is upgrading licensing and accreditation requirements, state financing principles, supervision mechanisms for quality of education services and efficiency of funding of higher education and science. We expect to the draft law to be approved by Cabinet and submitted to the National Assembly in December 2020.

  - *Education reform strategy.* The work on a new comprehensive reform strategy has been delayed due to COVID-19 and related setbacks to public discussions and TA delivery. As the epidemiological situation allowed to resume the discussions in August, we have finalized the strategy, the action plan and its monitoring and evaluation framework. We also plan to conduct the reform costing exercise with the support of the Asian Development Bank.

23. We are making progress in strengthening our anti-corruption framework. In this regard we have drafted a law on a single autonomous and central anti-corruption entity with enhanced detection and investigative powers that was submitted to the Cabinet after undergoing a public discussion. We are aware of the importance of swiftly enacting and fully implementing the law in a timely manner as this will be critical to enhance the fight against corruption including to prevent the misuse of emergency financing. The Parliament will approve the law on a single autonomous anti-corruption entity to ensure that the entity is independent from undue influence and combines all detection and investigative functions in line with Fund advice and international best practices in early 2021. Once the National Assembly adopts the law, we will immediately operationalize the newly established entity and provide it with a sufficient budget to ensure that it properly performs its functions.

PROGRAM MONITORING AND SAFEGUARDS

24. The program will continue being monitored through quantitative performance criteria, indicative targets (Table 1), a monetary policy consultation clause, and structural benchmarks (Table 2). The fourth review to be completed on or after May 20, 2021 will be based on end-December 2020 targets and other relevant performance criteria; and the fifth review to be completed on or after October 15, 2021 based on the end-June 2021 targets and other relevant performance criteria.

Table 1. Armenia: Quantitative Performance Criteria 1/

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

	2019	2020								2021				
	Dec. 2/	Mar. 3/	Jun. 2/			Sep. 3/		Dec. 2/		Mar. 3/		Jun. 2/	Sep. 3/	Dec. 3/
	Act.	Act.	EBS 20/90	Act.	Status	EBS 20/90	Act.	EBS 20/90	Rev. Prog	EBS 20/90	Rev. Prog	Rev. Prog	Proj.	Proj.
Performance Criteria														
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,808	1,641	1382	1,555	Met	1,321	1,332	1,348	1,348	1,369	1,474	1,464	1,471	1,366
Program fiscal balance (flow, floor) 4/	-78	14	-345	-89	Met	-459	-240	-495	-517	-122	-181	-253	-356	-434
Budget domestic lending (cumulative flow, ceiling)	0	15	115	16	Met	115	40	115	115	15	45	45	45	45
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	Met	0	0	0	0	0	0	0	0	0
MPCC 5/														
Inflation (upper-outer band, inflation consultation, percent)	...	...	4.0	4.0		4.3	4.3	4.5	4.5	5.4	5.0	5.1	5.2	5.3
Inflation (upper-inner band, percent)	4.0	4.2	3.0	3.0		3.3	3.3	3.5	3.5	4.4	4.0	4.1	4.2	4.3
Inflation (mid-point, percent)	0.7	-0.1	1.0	1.7	Met	1.3	1.4	1.5	1.5	2.4	2.0	2.1	2.2	2.3
inflation (lower-inner band, percent)	1.0	1.2	0.0	0.0		0.0	0.0	0.0	0.0	0.9	0.0	0.1	0.2	0.3
Inflation (lower-outer band, inflation consultation, percent)	...	...	0.0	0.0		0.0	0.0	0.0	0.0	0.7	0.0	0.0	0.0	0.0
Indicative Targets														
Net domestic assets of the CBA (stock, ceiling)	235	287	438	276	Met	514	390	629	622	630	605	589	572	555
Avg. concessionality of newly contracted ext. debt (flow, floor, in percent) 6/	39	...	...	...	n.a.	...	...	30	30	30	30	30	30	30
New government guaranteed external debt (stock, ceiling, in millions of USD) 7/	0	0	100	0	Met	100	0	100	100	100	100	100	100	100
Social spending of the government (flow, floor) 8/	55	14	30	27	Not met	44	44	58	58	20	16	32	48	65

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU, based on program exchange rates in the TMU.

2/ Quantitative performance criteria at test dates.

3/ Indicative target.

4/ Below-the-line overall balance excluding net lending.

5/ If the end of period year-on-year headline inflation is outside the upper/lower bound, a formal consultation with the Executive Board as part of program reviews would be triggered.

6/ Assessed on a calendar year basis, excluding the Eurobond and any similar refinancing instruments.

7/ Includes both concessional and non-concessional debt, excluding the Eurobond and any simliar refinancing instruments.

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: Structural Benchmarks				
Measures	**Responsible Agency**	**Time Frame**	**Status**	**Macro Criticality**
Fiscal				
Create an action plan to implement key recommendations from IMF TA on tax administration on developing a compliance strategy and strengthening core functions and processes	State Revenue Committee (SRC)	June 2019	Met	Improve tax administration and compliances
Submit a draft law "On Establishing Market Evaluation Procedure for Real Estate Taxation" to the National Assembly to implement a value-based recurrent property tax with appraised property values closely aligned to market prices	Deputy Prime Minister’s Office	June 2019	Met	Enhance revenue mobilization and fairness
Submit a public-private partnership (PPP) law to the National Assembly, establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships	Ministry of Economic Development and Investments (MoE)	June 2019	Met	Incentivize FDI and investment in infrastructure projects
Design an action plan to improve tax compliance and raise tax-to GDP ratio in the medium term, based on a study identifying tax potential and factors preventing tax collection reaching this potential	Deputy Prime Minister’s Office	December 2019	Not met. Split into new SBs with new dates.	Improve tax administration and compliances
Design a Compliance Risk Management strategy to improve tax administration and compliance, based on IMF TA recommendations.	State Revenue Committee	September 2020	Met	Improve tax administration and compliance
Conduct a study identifying tax potential and factors preventing tax collection reaching its potential.	Deputy Prime Minister’s Office	October 2020	Pending	Create fiscal space
Design an action plan to reduce the tax policy gap identified in the study.	MoF	December 2020		Create fiscal space
Develop and approve by ministerial order a plan for how GFS in Armenia will be extended and improved over the next two to three years.	MoF, in collaboration with the CBA and Armstat	September 2020	Met	Improve government statistics
Compile a comprehensive sectorized list of all public sector entities, with IMF TA support.	MoF and Armstat	March 2021		Improve government statistics

Compile and estimate all the existing and future contingent liabilities associated with implemented and approved PPPs	MoF	November 2020	Reset to January 2021	Improve fiscal risk management
Approve and publish a decree setting a cap to the total contingent liabilities contracted from PPPs.	MoF	December 2020	Reset to February 2021	Improve fiscal risk management
Build a database of projects covering both externally and domestically funded projects that provides information on projects throughout their lifecycle.	MoE and MoF	December 2020		Enhance project selection and monitoring
Revise the turnover tax legislation by reducing the VAT registration threshold to AMD 60.00 million and adjusting tax rates to equalize the tax-burden across the turnover and general taxation regimes, effective from January 1, 2022.	MoF	May 2021		Enhance revenue mobilization and fairness
Undertake a public expenditure review, with a view to identifying options for efficiency gains and improving the social protection system.	MoF	May 2021		Enhance revenue mobilization and fairness
Conduct the review of securities' taxation to ensure appropriate taxation in this area and identify possible distortions and impediments to capital market development.	MoF	June 2021		Promote capital market development and ensure fair taxation
Include in the 2022 budget documentation a comprehensive list with all ongoing public investment projects and new public investment projects starting in the budget year, including PPPs, providing comprehensive information on lifetime fiscal implications, including project by project information for all externally financed projects and large domestically financed projects (at least 50 percent of investment volume from domestic financing).	MoF	October 2021		Enhance project selection and monitoring
Monetary and Financial				
Prepare a time-bound action plan and communication strategy to boost foreign currency liquidity buffers as described in the 2018 FSAP recommendations (paras 19, 21 and 32) through a combination of liquidity tools	Central Bank of Armenia (CBA)	September 2019	Met	Enhancing macro prudential measures

Develop a capital market development program	MoE, CBA, MoF	May 2020	Met with delay	Create access to long-term, local-currency finance and improve monetary policy transmission
Develop a framework for strengthening financial reporting and auditing to establish the public oversight body and the Chamber of Accountants and Auditor, focusing on improving corporate financial information and reducing SME financial reporting requirements with assistance by the World Bank	MOF	March 2020	Met	Strengthen transparency and improve SME's access to finance
Prepare a medium-term exit strategy to phase out the CBA involvement in non-core central bank activities (i.e. development lending and subsidiaries)	CBA	September 2020	Not met. Reset to April 2021	Curtail engagement in quasi-fiscal activities that do not relate to core central bank's mandate; eliminate potential financial and reputational risks.
Introduce limits to stressed Loan-to-Value (LTV) ratio	CBA	March 2021		Mitigate credit risks from unhedged borrower and vulnerabilities from rapid credit growth and dollarization
Structural				
Submit to the National Assembly a draft law on a single autonomous anti-corruption entity in line with international standards, which combines all detection and investigative functions	Ministry of Justice (MoJ)	September 2020	Pending	Combat against corruption
Adopt a legislation to require the establishment of a registry of beneficial ownership information, which is adequately resourced and staffed, and can conduct verification, first beginning with companies in the extractive industry, as identified in the EITI 2016 Standard	MoJ	June 2019	Met	Combat against corruption
Prepare an annual action plan to improve the business environment to address core issues identified by the 2019 Doing Business	MoE	February 2020	Met	Improve business climate
Conduct an efficiency review of the existing government SME support programs and consolidate support mechanisms, tools and programs	MoE with support from the CBA	September 2020	Not met	Improve effectiveness of the SME state support activities and enhance access to finance

Develop Armenia's employment strategy for 2019–23	MoL	December 2019	Met	Reduce unemployment and enhance inclusiveness of vulnerable groups in the labor market
Submit to the National Assembly a draft law on Higher Education and Science which sets the legal ground for (i) reforming the tertiary education management system; (ii) upgrading licensing and accreditation requirements, state financing principles, supervision mechanisms for quality of education services.	Ministry of Education and Science	June 2020	Pending	Improve growth inclusiveness
Develop a comprehensive education reform strategy	Ministry of Education and Science	June 2020	Met	Enhance equitable access to education and improve physical conditions.

Attachment II. Technical Memorandum of Understanding (TMU)

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 Standby Arrangement as per the Letter of Intent and Memorandum of Economic and Financial Policies (LOI/MEFP) dated April 26, 2019.

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 483.75 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 MEFP).

The program sets the following PCs:

- Floor on the net official international reserves (NIR) of the Central Bank of Armenia (CBA);
- Floor on the program fiscal balance;
- Ceiling on domestic budgetary lending; and,
- Ceiling on the stock of external public debt arrears (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). 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 the upper and lower (outer bands) around the mid-point target specified in Table 1 in the LOI/MEFP. Consultation with IMF Board would be triggered for end December 2020 test date if inflation falls outside the outer bands. The consultation with the Board will be on the reasons for the deviation and the proposed policy response before further purchases could be requested under the SBA. Specifically, the consultation will explain (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for deviations from the specified band, taking into account compensating factors; and (iii) on proposed remedial actions, as deemed necessary. In addition, a staff consultation clause whereby the CBA will consult with IMF staff on the outlook for inflation and the proposed policy response will be triggered if inflation falls outside the inner bands and within the outer bands (Table 1 in the LOI/MEFP) for the December 2020 test date.

Inflation Consultation Bands

	Dec-20	Jun-21
Upper outer band	4.5	5.3
Upper inner band	3.5	4.3
Center point	1.5	2.3
Lower Inner band	0.0	0.3
Lower outer band	0.0	0.0

Source: IMF 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.

External public debt arrears are defined as external debt obligations of the government that have not been paid when due in accordance with the relevant contractual terms (taking into account any contractual grace periods). This PC excludes arrears on external financial obligations of the government subject to rescheduling.[1] This PC is to be monitored continuously by the authorities and any occurrence of new external arrears should be immediately reported to the Fund. The ceiling on external payment arrears is set at zero.

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

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

- **Net nonbank financing** equals the sum of: (1) the change during the period of outstanding treasury bills and bonds to nonbanks (including accrued interest for treasury bills and excluding accrued interest for treasury bonds);[2] (2) any other disbursement or transaction that increases nonbanks' claims on the central government plus withdrawals from the Special Privatization Account (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.

8. A budgetary ER of 476.46 drams per one US dollar will be used for foreign currency-denominated transactions included in the 2020 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. Any additional unbudgeted transactions for 2020 will take place at the market

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[1] The public sector is here defined following the Government Financial Statistics Manual (GFS 2001) and System of National Accounts (1993 SNA). It includes the general government and nonfinancial public enterprises (as defined in paragraph 14).

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

exchange rate. 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. 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.

9. 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.

10. Some project implementation units maintain accounts at the CBA. Grants received by these units are recorded in the fiscal accounts as external grants on the revenue side and as foreign-financed expenditure on the expenditure side. In addition, any loans to finance investments that are intermediated through the banking system are recorded in the financial accounts as a financing item below the line and are thus excluded from net lending.

11. 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. 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.

12. **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.

13. **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, but excludes purchases from the IMF, the Eurobond issuance, and any similar refinancing instruments. 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.

14. Ceiling on government guaranteed external debt. In addition to the indicative floor on average concessionality, a separate, cumulative ceiling (IT) of $100 million for the program period applies to new government guarantees of the total of concessional and non-concessional external financing, excluding the Eurobond and any similar refinancing instruments. 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.

15. The program sets a floor on **social spending of the government**. For the purposes of the program, social spending of the government comprises the family benefit program and maternity benefits, one-time childbirth benefits, childcare benefits for children less than two years of age, and additional emergency or temporary spending for social protection related purposes appropriated through the budget (or supplementary budget).

16. 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.

- **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.

- **Project support grants** are defined as grants received by the general government for public sector projects.

- **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, and project financing loans and grants disbursed through the CBA, compared to program amounts (excluding Fund purchases by the government) as indicated in the first line of Table 2. The downward adjustment will not exceed the amount as indicated in the second line of Table 2. 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 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, and project financing loans and grants disbursed through the CBA compared to program amounts (first line of Table 2). The upward adjustment will not exceed the amount as indicated in the second line of Table 2.

- **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 $100 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 loans received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $100 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.

DATA REPORTING

17. 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
	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	By currency and maturity	Weekly	First working day of the next week

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	attracted and allocated by commercial banks			
	T-bill and coupon bond financing, CBA securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Weekly	First working day of the next 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, 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 31 of the end of each month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
	Balance of payments	Detailed balance of payments data	Quarterly	Within 92 days of the end of each quarter
	T-bill and coupon	By holders, i.e., CBA, resident banks,	Monthly	Within 7 days of

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	government			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.
National Statistical Service	Balance of payments	Detailed export and import data (issues that have arisen in 2015 with EEU trade data need to be overcome as soon as possible)	Monthly	Within 28 days of the end of each month
		Detailed export and import data	Quarterly	Within 45 days of the end of each quarter
	CPI	By category	Monthly	Within 5 days of the end of each month
State Revenue Committee	Tax arrears	By type of tax	Monthly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)
		For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	Tax credits	Detailed data, by type of tax, of	Monthly	Within 45 days of

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		outstanding tax credits for all types of tax revenues, in both net and gross terms		the end of each (monthly data provided on a quarterly basis)
	Tax Revenues	Tax Revenue by type of tax	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 processed per month.	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax inspectorate	Monthly	Within 45days after the end of each month
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty-free recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving non-duty-free recorded imports 5. Value of recorded imports where customs value was assessed using transaction prices, breaking out raw	Quarterly	Within 30 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		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		
	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)
	Pension system	Number of participants in the pension second pillar, social payments and funded contributions	Monthly	Within two months of the end of each quarter (monthly data provided on a quarterly basis)

Table 1. Armenia: (Program) Exchange Rates of the CBA

(As of December 28, 2018, in U.S. dollars per currency rates)

		USD	AMD
AMD	Armenian Dram	0.002	1.00
XDR	SDR	1.387	670.79
USD	U.S. Dollar	1.000	483.75
CHF	Swiss Franc	1.015	491.12
GBP	Pound Sterling	1.264	611.61
JPY	Japanese Yen	0.009	4.38
EUR	EURO	1.144	553.65
CNY	Chinese Yuan	0.146	70.48
AUD	Australian Dollar	0.704	340.75
CAD	Canadian Dollar	0.735	355.46
XAU	Gold (1 gram)	40.76	19,721.11

Source: National Authorities and IMF Staff Calculations

Table 2. Armenia: External Disbursements through the CBA in 2020–21 1/

(In millions of U.S. dollars)

	Mar -20 Prog.	Jun-20 Prog.	Sep-20 Prog.	Dec-20 Prog.	Mar-21 Proj.	Jun-21 Proj. 2/
Loans and grants disbursed through the CBA	19	108	262	408	515	630
Maximum adjustment allowed	19	108	262	408	515	130

1/ Cumulative during the year

2/ The maximum cumulative adjustment in June is lower than in March to allow for possible temporary delays in the mobilization of $500m of financing.

Table 3 Armenia: External Disbursements to the Government in 2020–21 1/

(In millions of U.S. dollars)

	Mar -20 Prog.	Jun-20 Prog.	Sep-20 Prog.	Dec-20 Proj.	Mar-21 Proj.	Jun-21 Proj.
Budget support grants	0	0	0	43	0	0
Project financing loans	50	131	210	290	30	80

1/ Cumulative during the year

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

THIRD REVIEW UNDER THE STAND-BY ARRANGEMENT AND MODIFICATION OF PERFORMANCE CRITERIA—SUPPLEMENTARY INFORMATION

December 7, 2020

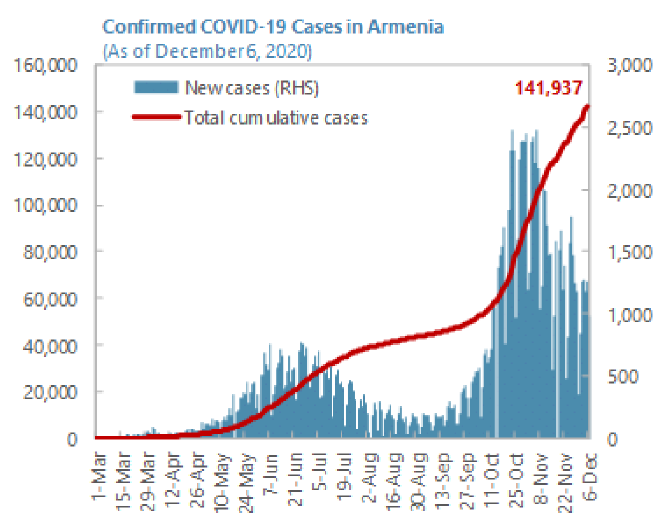
Prepared By Middle East and Central Asia Department

This statement provides information that has become available since the staff report (EBS/20/178) was issued on December 1, 2020. This information does not alter the thrust of the staff appraisal.

1. The actions for two pending structural benchmarks (SB) were completed. Specifically: (i) a draft law on a single autonomous anti-corruption entity in line with international standards, which combines all detection and investigative functions (September 2020 SB) was submitted to the National Assembly; and (ii) a draft law on Higher Education and Science which sets the legal ground for (a) reforming the tertiary education management system; (b) upgrading licensing and accreditation requirements, state financing principles, supervision mechanisms for quality of education services (June 2020 SB) was also submitted to the National Assembly.

2. The latest Economic Activity Index points to continued decline in economic activity in October. According to data released by the National Statistical Committee, the year-on-year change in economic activity over the past 12 months deepened in October 2020, reaching -8.1 percent (down from -7.5 percent in September). This principally reflected negative developments in the trade sector and is in line with staff's projections for fourth quarter GDP.

3. The pace of new COVID-19 cases has slowed down, but positivity rate is high. While considerable variability remains, the rate of new cases is well below that seen in October and early November. The positivity rate is still high at 36 percent.



Source: European Centre for Disease Prevention and Control, and IMF staff calculations.

4. **October data showed that, to date, the government has disbursed AMD57.1 billion across the anti-crisis support measures,** an increase from disbursements of AMD55.2 billion by end-August. Almost all the increase came from liquidity provision to business via interest subsidy. In addition, the commercial bank support—the portion of support to firms administered by commercial banks—has increased to AMD135 billion, with companies that previously received support allowed to apply for a second round.

Anti-Crisis Support in Armenia

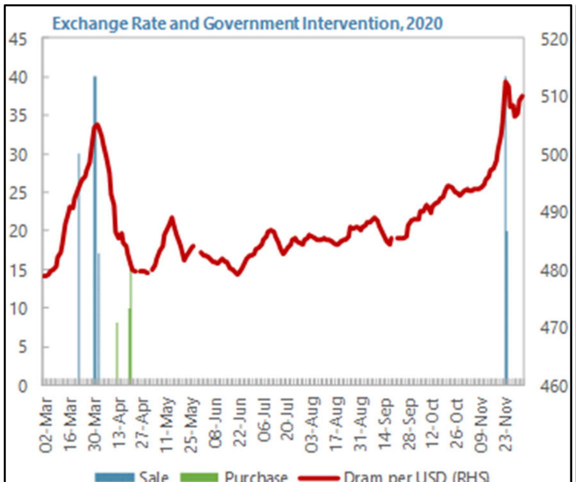
(In billions of AMD (Percent of GDP), as of October 31, 2020)

Anti-Crisis Support	Above-the-line	Below-the-line	Commerical Bank Support
Liquidity Provision to Business via interest subsidies	8.4 (0.1%)	15.4 (0.3%)	135.2 (2.2%)
Direct Labor Subsidies	16 (0.3%)	-	-
Lump sum transfers to vulnerable individuals	17.2 (0.3%)	-	-
Utility Support	4.8 (0.1%)	-	-
Transfers to families	7.4 (0.1%)	-	-
Transfers to the unemployed and pandemic-affected workers	4.3 (0.1%)	-	-
Educational support	0.8 (0%)	0.2 (0.%)	
Total	***41.6 (0.7%)***	***15.5 (0.3%)***	***135.2 (2.2%)***
COVID-19 related Heath Spending	20 (0.3%)	-	-

Source: National authorities, and IMF staff calculations.

5. **The CBA intervened in the FX market in late November, but conditions have recently eased, and sovereign spreads have come down.** The CBA sold $40 million on November 24, and $20 million on November 25. Its previous invention was a purchase in April. The CBA also provided banks $5.5 million in two-week FX swaps on December 2. Sovereign spreads declined substantially after the November 10 ceasefire, and are again below their pre-conflict level and the EMBI spread, reflecting lower risks.

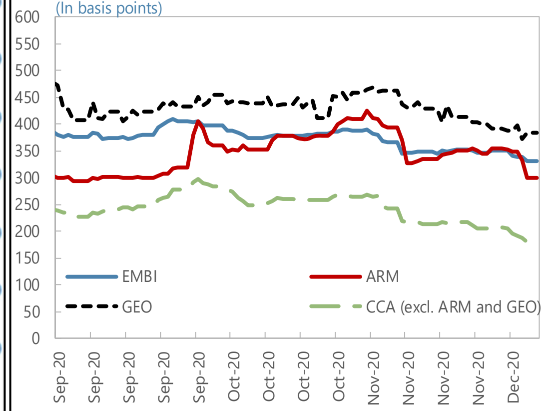
Exchange Rate and Government Intervention, 2020



Source: National authorities, and IMF staff calculations.

Sovereign Spreads

(In basis points)



Source: Bloomberg, JPMorgan EMBIG Diversified Index, and IMF staff calculations.

Note: Due to data availability, CCA average includes only AZE and KAZ.

6. **Remittances continued to rebound in October.** Remittances (proxied by net non-commercial inflows) increased by 16.9 percent in October, following 23.7 percent growth in September. On a cumulative basis, year-to-date remittances are 3.2 percent below that seen in the same period last year.

Statement by Vladyslav Rashkovan, Alternate Executive Director for the Republic of Armenia
December 11, 2020

On behalf of the Armenian authorities, we would like to thank staff for their in-depth reports, helpful technical assistance and constructive engagement during virtual meetings in the scope of the third review of the SBA program. The authorities specifically thank Mr. Nathan Porter and his team for their hard work and efforts under the exceptional circumstances caused by the Covid-19 outbreak. We also want to thank Management and the Executive Board for their continuous support of the Republic of Armenia.

The Armenian authorities are in a broad agreement with the well-balanced staff assessment of the economic outlook and key policy recommendations, which will be carefully considered in addressing the challenges the Armenian economy faces due to the twin shocks it has faced in recent months. The authorities reconfirm their strong commitment to sound policies and the objectives of the economic program supported by the current SBA, notwithstanding the challenging Covid-19 circumstances and regional hostilities.

This statement focuses on 3 specific elements affecting the program: (1) Covid-19 impact on macroeconomy, financial stability and outlook; (2) the government's policy response to pandemics; and (3) the SBA program implementation.

Covid-19 impact on the economic outlook

After several years of strong macroeconomic performance, Armenia's economy is set to contract in 2020 amid the Covid-19 pandemic and the outbreak of regional hostilities, which remained largely concentrated within the Nagorno-Karabakh conflict zone. These shocks have affected the Armenian economy mostly through domestic demand and supply disruptions, which have been exacerbated by a sharp decline in export and tourism revenues, remittances, and to some extent net capital inflows. Regional hostilities exacerbated these pressures given the general mobilization of young men and heightened uncertainty.

The macro-economic outlook is weaker than previously anticipated: the decline in GDP is now expected to exceed 7 percent in real terms in 2020, which is significantly larger than what was projected at the time of the second review of the SBA (-1.5 percent). The impact of the pandemic and military hostilities have also led to a deterioration of the fiscal accounts. The sharp drop in fiscal revenues, coupled with measures to support vulnerable businesses and individuals, bring the overall fiscal deficit this year to 7 percent of GDP, compared to 2.3 percent of GDP in the initial 2020 budget. Lower revenues and higher spending on healthcare, socio-economic support, and security also lead to the public debt increase in 2020. Despite the economic slowdown, the local currency saw only limited depreciation and limited capital outflows. Capital and liquidity buffers on the banking system have remained solid ensuring the financial stability.

Assuming the pandemic abates in 2021, **growth is expected to rebound**. For the purpose of the IMF program, the authorities conservatively assume only a partial rebound, as the economy slowly adjusts towards new working conditions and taking into account the economic scaring from the shocks. The authorities reiterate their commitment to the medium-term fiscal goal of debt sustainability and expect that beyond 2021 growth will slowly converge to its pre-Covid potential, with inflation gradually rising towards the inflation target.

The 2021 budget strives to reduce socio-economic scarring while preserving fiscal sustainability. The government intends to limit the 2021 budget deficit to around 5.6 percent of GDP, while maintaining current spending largely constant in nominal terms (more than 25 percent of GDP) to ensure adequate social expenditure. To finance the budget deficit, the government plans to raise the necessary financing from domestic and external sources including from development partners.

The government's policy response to the pandemic

In response to the Covid-19 outbreak, the **government's priority has been to provide rapid and effective public health response to slow down its spread, reduce mortality, and ensure that socio-economic activities resume.** The total governmental policy response is estimated at 3.4 percent of GDP (without health expenditures), including 2.4 percent of GDP spent for socio-economic support packages. Key socio-economic support measures include liquidity provision to SMEs in affected sectors (manufacturing, hospitality, transportation, tourism, and services), agricultural enterprises, as well as larger firms impaired by the crisis; direct labor subsidies to micro enterprises and SMEs that retain their employees and maintain their wages; lump sum transfers to vulnerable households. The government also provided around 1 percent of GDP in liquidity support through an exemption from advanced corporate income tax payment obligations for the second quarter of 2020. The government remains committed to take any additional measures that may be needed.

The Ministry of Health has been equipped with additional financial resources and legislative powers to expeditiously acquire necessary medical goods. Importantly, the government has made Covid-19 medical care gratis for all and actively employed digital tools to consolidate the relevant information and ensure a coherent policy response across the country.

The Central Bank of Armenia (CBA) also responded by cutting the key policy rate, strengthening communication, injecting liquidity in the banking system, and temporary adjusting macroprudential, regulatory and supervisory policies.

The authorities continue employing non-pharmaceutical containment measures to address the spread of Covid-19. Notwithstanding these efforts, a second wave of infections has occurred, and the **authorities have been responding to this wave as aggressively as they responded to the first one**.

Implementation of the SBA program

Despite the shocks it has faced, the government has managed to keep its program broadly on track. All end-June 2020 performance criteria (PC) under the program have been met. Structural reforms continue to progress, albeit with some delays, which are mostly due to the twin shocks. Inflation remains low and stable, and within the inner staff consultation band of the program's monetary policy consultation clause.

Modernizing tax policy and administration continues to promote growth and increased compliance. In line with their public financial management strategy, the authorities have been working on strengthening fiscal governance, transparency and long-term sustainability, particularly in the budget process term sustainability particularly in the budget process and through the management of fiscal risks, public investment, and public-private partnerships.

The CBA stands ready to adjust monetary policy in response to changes in the economic outlook and inflation expectations while considering implications for financial stability. Early in the pandemic, the CBA undertook foreign exchange interventions in the face of excessive volatility to support the normal functioning of the market. The CBA generally only intervenes in the FX market when its normal functioning is impeded. To ensure smooth functioning of the domestic liquidity market the CBA has conducted repos and FX swap operations to provide necessary liquidity in line with the demand. As a result, the short-term interbank interest rate has remained around the CBA's target policy rate. The CBA continues strengthening its policy framework to support financial sector stability in line with the last FSAP recommendations and remains committed to strengthening its macroprudential toolkit by adopting a stressed Loan-to-Value (LTV) limit.

The authorities continue working on promoting capital market development. In line with the commitments under the SBA, the authorities developed, approved and started implementing a comprehensive capital market development strategy and action plan.

Structural reforms continue to progress, albeit with some delay mostly due to the significant shocks seen this year. In line with their commitments, the authorities delivered on the actions for structural benchmarks related to the anticorruption body and the law on higher education and science. The authorities also remain committed to completing an efficiency review of the existing government SME support programs. The government has also proposed some new benchmarks related a public expenditure review, tax reform, and public investment management.

Conclusion

Access to the IMF financing under the SBA arrangement is instrumental to mitigate the social-economic impact of the shock, and to address anticipated financing needs. On the basis of steps that the Armenian authorities have already taken, and current program commitments, the authorities request completion of the third review. As the fallout from both the Covid-19 shock and recent hostilities continue to influence 2020 economic outcomes, the authorities also request modification of the performance criteria on program fiscal balance.

The authorities believe that the policies set forth in the MEFP are adequate to respond to the shocks and achieve the macroeconomic and financial objectives of the program, and they are committed to take any additional measures that may be needed.