

Republic of Armenia: Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion—Staff Report; and Press Release on the Executive Board Consideration

In the context of the second review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for a waiver of a performance criterion, the following documents have been released and are included in this package:

- the staff report for the Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion, prepared by a staff team of the IMF, following discussions that ended on March 14, 2006, with the officials of Republic of Armenia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 3, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Press Release summarizing the views of the Executive Board consideration of the staff report that completed the review and request.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Republic of Armenia*
Memorandum of Economic and Financial Policies by the authorities of Republic of Armenia*
Amendments to the Technical Memorandum of Understanding by the authorities of
Republic of Armenia*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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Price: \$15.00 a copy

**International Monetary Fund
Washington, D.C.**

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion

Prepared by Middle East and Central Asia Department
(In consultation with other departments)

Approved by Julian Berengaut and Adnan Mazarei

May 3, 2006

- Program discussions were held in Yerevan during March 1–14, 2006. The mission met with Mr. Khachatryan (Minister of Finance and Economy), Mr. Chshmarityan (Minister of Trade and Economic Development), Mr. Movsisyan (Minister of Energy), Mr. Sargsyan (Chairman of the Central Bank), and other senior officials. It also met with Mr. Baghdasaryan, Speaker of the National Assembly.
- The mission team consisted of Mr. Al-Atrash (head), Ms. Dabla-Norris, Mr. Floerkemeier (all MCD), Mr. Hauner (FAD), and Mr. Kelmanson (PDR). It was assisted by Mr. McHugh, resident representative, and Mr. Stepanyan and Ms. Minasyan, economists in the local office.
- The attached Letter of Intent (Attachment I) and the Memorandum of Economic and Financial Policies (MEFP, Attachment II) set out the authorities' economic program for 2006.
- Country notes on relations with the Fund, World Bank, and the European Bank for Reconstruction and Development and on statistical issues are attached.
- The mission and resident representative conducted outreach work through media contacts, meetings with NGOs, and the diplomatic and business communities as well as a seminar for students on the activities of the IMF in Armenia.

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EXECUTIVE SUMMARY

Background

- **Armenia's economy continued to perform very strongly in 2005:** double digit growth in an environment of no inflation; continued reduction in poverty; and a notable improvement in tax performance. The PRGF-supported program is on track.

Focus of discussions

- Policy discussions centered around the macroeconomic prospects for 2006, measures to improve revenue performance, and financial sector development.

Main policy recommendations

- **The planned tightening of monetary policy in 2006 is appropriate.** The rapid increase in monetary aggregates in 2005 and uncertainties about remonetization carry inflationary risks. The credibility of the monetary stance is particularly important in light of the authorities' move toward a full-fledged inflation targeting regime over the medium term. In this context, it will be important to limit intervention in the foreign exchange market and to maintain a floating exchange rate regime.
- **The 2006 budget is compatible with PRSP objectives.** It rightly emphasizes improving revenue performance and increasing expenditures for infrastructure and social services. It would be important to increase tax buoyancy without resorting to ad hoc discretionary measures to increase collection.
- **The focus of the 2006 program continues to be on reducing tax privileges and loopholes as well as strengthening tax and customs administrations.**
- **Financial sector reforms will focus on improving corporate governance, strengthening regulation and supervision, and deepening financial intermediation.** Their implementation, together with the envisaged entry of foreign banks, should increase competition and contribute to the narrowing of interest rate spreads.

Risks

- **The program's prospects remain very good, but there are risks.** Effective policy coordination between the monetary and fiscal authorities is needed to ensure that the inflation target can be met and fiscal performance maintained. In this context, it will be important to maintain a prudent fiscal policy as the campaign for next year's parliamentary elections picks up.

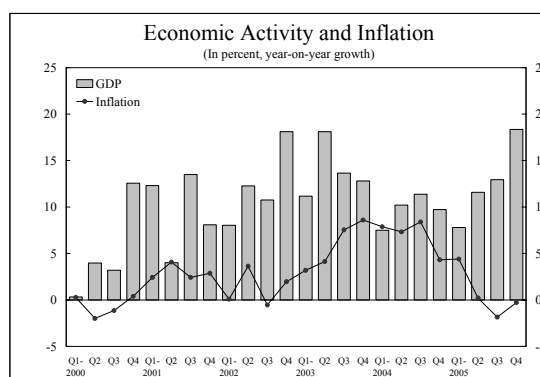
I. BACKGROUND TO THE DISCUSSIONS

1. **Armenia's economy continued to perform very strongly in 2005:** double-digit growth in an environment of no inflation; a strengthened external position; continued reduction in poverty and unemployment (Box 1 and Table 1); and a notable improvement in tax performance.
2. **The PRGF-supported program remains on track.** All but one end-December quantitative performance criteria as well as all structural performance criteria and benchmarks were observed (MEFP, paras. 6 and 7, and Tables 2 and 3).¹
3. **The political situation is stable.** However, discussions between Armenia and Azerbaijan over the future status of Nagorno-Karabakh at a high-level summit held in Paris in February proved inconclusive, which could increase tensions in the region. Parliamentary elections in May 2007 are expected to dominate the political landscape in the coming months.
4. **Policy discussions centered around the macroeconomic prospects for 2006, measures to improve revenue performance, and financial sector development.** In light of some uncertainties—partly related to the impact of gas price increases—about near-term inflation and growth prospects, the challenge for the authorities is to maintain low inflation through monetary restraint, while supporting economic activity through better budget execution and continued implementation of structural reforms. These reforms focus on improving tax and customs performance and boosting the quality and depth of financial intermediation (Box 1).

II. ECONOMIC ENVIRONMENT AND POLICY DISCUSSIONS

A. Growth

5. **Developments to date:** Real GDP grew by 14 percent in 2005, the fourth consecutive year of double-digit growth, underpinned by favorable weather conditions that boosted agricultural production and a boom in construction. Domestic demand continued to be buoyed by rising incomes, investment, and remittances. In the first two months of 2006, real GDP grew by 7 percent (year-on-year), led by services and construction.



¹ In addition, two end-December indicative targets were not observed. The ceiling on reserve money was exceeded, reflecting higher-than-projected net international reserve (NIR) accumulation, while the floor on the contributions to the State Fund for Social Insurance was missed because of transitional problems associated with the transfer of the collection function to the State Tax Service (STS).

Box 1. Poverty in Armenia

The 2004 household survey shows a further decline in poverty and inequality, but the overall level of poverty remains high. The headline poverty rate fell from 56 percent in 1999 to 39 percent in 2004, with extreme poverty declining slightly in 2004, following the sharp drop in 2003. Unlike in previous years, the reduction in poverty was driven by a decline in rural poverty, and, to a lesser extent, of poverty in non-Yerevan urban areas, owing mainly to higher growth of agricultural incomes, private transfers from abroad, and state social assistance. The update of the authorities' Poverty Reduction Strategy Paper (PRSP) is expected to be completed by end-2006.

Armenia: Poverty and Inequality, 1999–2004 1/
(Percent of population, unless otherwise noted)

	1999	2001	2003	2004
Real GDP growth (in percent)	3.3	9.6	13.9	10.1
Overall poverty rate	56.3	50.9	42.9	39.0
Urban areas	58.3	51.9	39.7	38.0
Yerevan	58.7	46.7	29.6	29.4
Other towns	66.5	56.7	49.9	46.9
Rural areas	50.8	48.7	47.5	40.7
Extreme poverty	22.9	16.2	7.4	7.2
Gini coefficient (current income) 2/	0.59	0.54	0.44	0.41
Gini coefficient (consumption) 2/	...	0.34	0.27	0.31

Source: Armenian authorities; based on data from household surveys.

1/ Revised series based on data from the National Statistical Service. For the 2004 survey, the complete poverty line, which includes the food poverty line and a non-food allowance, was AMD 14,595 per person per month (less than US\$30). The food poverty line, defined as the amount of consumption necessary to satisfy basic food needs and used to assess extreme poverty, was AMD 8,954 (less than US\$20). Urban and rural poverty are based on the population size of *marzes* (regions).

2/ Ranges from 0 (perfect equality) to 1 (total inequality).

6. **Outlook:** Real GDP growth is projected to be 7.5 percent in 2006, assuming a slowdown of agricultural growth to trend levels. There are risks from higher gas prices on production costs, but more recent developments suggest that the macroeconomic impact of the gas import price increase is likely to be muted (Box 2). At the same time, continued buoyant activity in the construction and services sectors and government efforts to improve budget execution, especially in the area of public investment, are likely to strengthen growth prospects. On balance, the projected growth rate is realistic but on the conservative side.

7. **Authorities' views:** The authorities believe that a growth forecast of 7.5 percent in 2006, which underlies their budget projections, is appropriate in light of the uncertainties associated with the agricultural harvest and the potential impact of the gas price increase on the economy (MEFP, para. 13). They will revise their macroeconomic framework in the second half of the year, if warranted by economic developments.

Box 2: Gas Price Increase

The Armenian authorities negotiated a new gas delivery contract with their Russian supplier Gazprom that increases the gas import price from US\$55 to US\$110 per 1000 cubic meters, effective April 1, 2006.

The impact of the price increase on end-user tariffs will, however, be lower than initially expected. While the specific details and modalities have not yet been determined, in early April the government announced its intention to subsidize the local gas supplier Armrusgazard in order to limit gas tariff increases to around 10 percent for monthly consumption of up to 10,000 cubic meters and 20 percent for larger consumers. This compares to an average increase of 50 percent (80 percent for larger consumers) approved earlier this year. The subsidy, which is intended to last through 2008, will be financed by the sale of the fifth bloc of the Hrazdan power plant (currently under construction) to Gazprom for US\$248.8 million. While most of the proceeds of the sale will be used to finance the subsidy, about US\$60 million will be transferred to the government budget in two installments, starting in 2007. There may be other additional energy sector assets involved as well.

B. Inflation, Monetary Policy, and the Exchange Rate

8. **Developments to date:** Inflation remained subdued in 2005, with the end-year inflation rate falling to -0.2 percent, reflecting a drop in food prices associated with a good harvest and lower import prices as a result of dram appreciation. The 12-month inflation rate was 0.3 percent in March 2006.

Against a backdrop of muted inflationary pressures, **broad money** grew briskly over the year, reflecting high demand for money and continued monetization, increased confidence in the banking system, and an appreciating dram (Table 4). **Reserve money** grew by 52 percent in 2005 on account of partially unsterilized

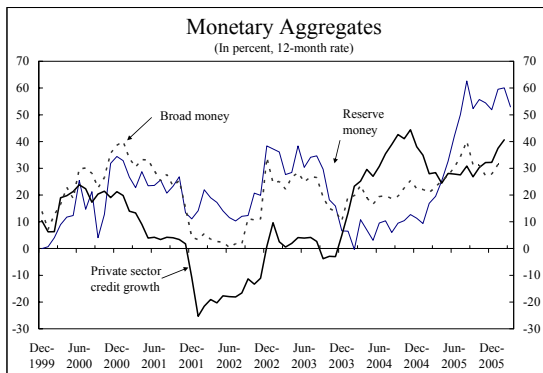
Armenia: Monetary Indicators, December 2005

	Dec. 05 Prog.	Dec. 05 Est.
	(In percent)	
12-month change in reserve money	39.8	51.9
12-month change in broad money	27.2	27.8
12-month change in credit to the economy	33.6	32.2
	(In millions of USD)	
Net international reserves 1/	490.0	509.0

1/ At program exchange rates, excluding the SPA.

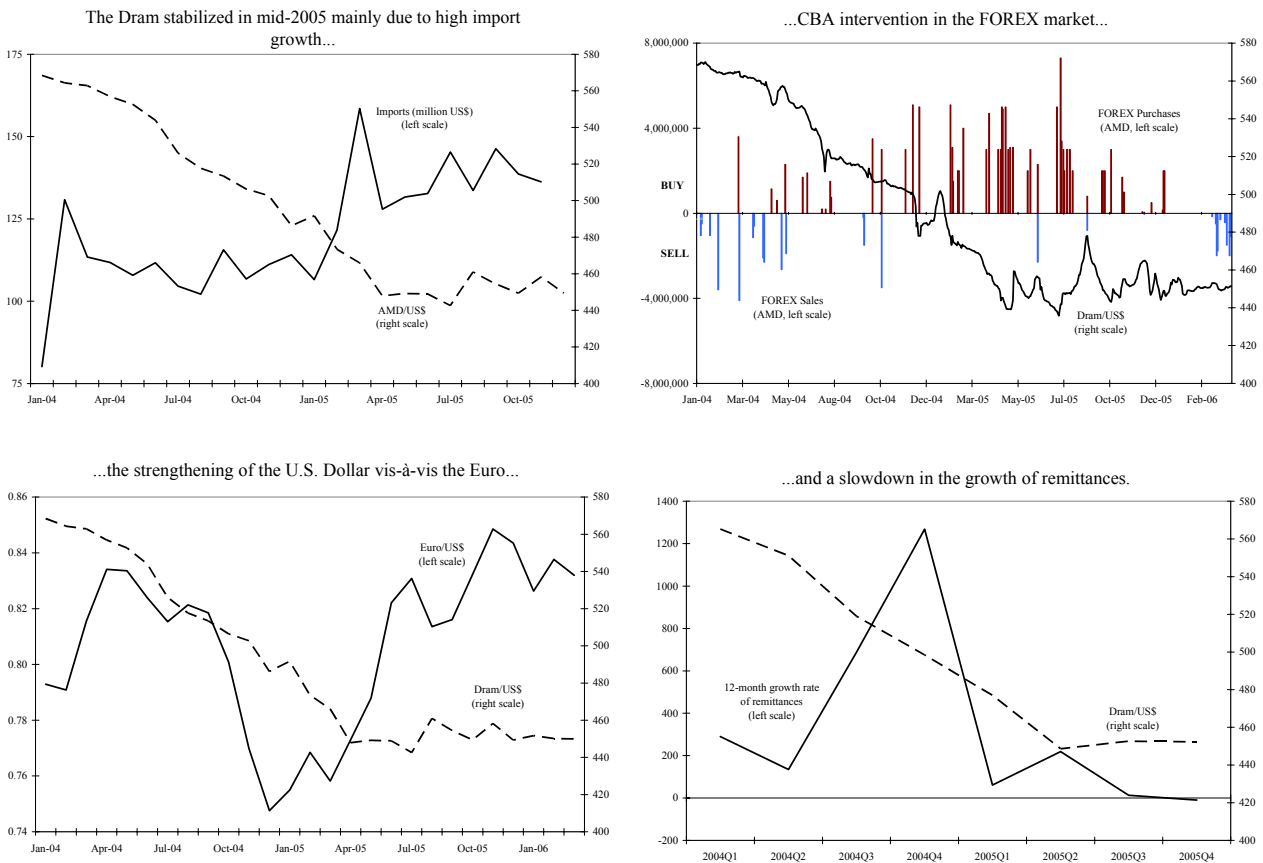
intervention in the foreign exchange market; a modification in reserve requirements in June

(see IMF Country Report No. 05/422); and a drawdown of government deposits toward the end of the year. The 12-month growth rates of reserve money and broad money remained broadly unchanged in the first quarter of 2006. In early 2006, CBA increased the repurchase rate, its key policy interest rate, by 0.5 percentage points to 4 percent.



9. Reflecting an improved external outturn and firming confidence, the dram appreciated around 8 percent against the U.S. dollar and 4 percent in real effective terms through end-2005. However, the dram has remained broadly stable since May 2005 on account of CBA intervention in the foreign exchange market through September, high import growth, the strengthening of the U.S. dollar vis-à-vis other major currencies, and a slowdown in the growth of remittances. Since December, there have been no CBA purchases of foreign exchange. More recently, there have been small scale sales of foreign exchange for liquidity management purposes.

Armenia: Exchange Rate Developments



10. **Outlook:** The 2006 monetary program targets end-year **inflation** at 3 percent. Inflationary pressures are likely to increase in 2006 on account of higher expected agricultural and energy prices, as well as a somewhat more expansionary fiscal policy stance. The lagged impact of the rapid monetary expansion during 2005 and a slower increase in money demand could also add to inflation.² However, inflation should be contained within

² The increase in demand for domestic money in 2005 was partly the result of the implementation of the *Law on the Use of Domestic Currency*. While this is likely a one-off effect, it could have a continued impact due to the law's stricter enforcement planned for 2006 (see MEFP, para. 25).

the authorities' target of up to 3 percent. Reserve money growth is programmed to slow to 19.2 percent, while credit growth is projected to remain robust at 27 percent. Continuing de-dollarization on the back of rising confidence and an appreciated currency is envisaged to expand dram broad money at a faster pace than broad money.

11. **Authorities' views:** The CBA emphasized its commitment to a more restrained monetary policy to achieve its end-year inflation target of not more than 3 percent in 2006. It intends to limit the increase in net foreign assets, increase further the policy interest rate if necessary, and step up open market operations (MEFP, para. 14). Acknowledging the drawbacks of the previous monetary targeting strategy in an environment of unstable money demand and external shocks, the CBA decided to move to a full-fledged inflation targeting monetary policy framework over the medium term (see MEFP, paras. 9 and 15). The current monetary policy framework—a reserve money program with quantitative targets for NIR and NDA and with changes to the repurchase rate as the main policy instrument—would be retained during the transition. The authorities view the development of financial markets (see Section E below) as key to strengthening the transmission mechanism from short-term rates to economic activity and inflation. In this context, CBA introduced weekly tenders for repos and other changes in its operational framework, including the issuance of CBA bills of AMD 20 billion in 2006, to improve liquidity management. The CBA also plans to develop forward-looking inflation forecasting models to help guide monetary policy in the context of inflation targeting (MEFP para. 15). In this context, the CBA has restated its commitment to the market determination of the exchange rate, noting that foreign exchange interventions will only be used as an instrument for liquidity management and to smooth out volatility of the exchange rate (MEFP, para. 14).

C. Fiscal Policy

12. **Developments to date:** Fiscal policy remained sound in 2005, with an overall deficit of 2.6 percent of GDP, slightly higher than programmed (2.4 percent of GDP), and a notable increase in tax revenue (Table 5). As a result, the floor on the cash balance of the central government was missed by a small margin, largely on account of unforeseen end-year capital expenditures. Tax revenues rose by 0.3 percent of GDP relative to 2004, the largest increase since 1999, reflecting better administration and further closing of loopholes in the tax system, particularly in value added and profit taxes. Both current and capital expenditures increased relative to the 2004 outturn, largely on account of higher social outlays and increased construction. Tax revenues in the first quarter of 2006 were 16 percent higher than during the same period in 2005. Public debt declined to 26 percent of GDP in 2005 from 31 percent in 2004.

Armenia: Fiscal Indicators, December 2005

	Dec. 05 Prog.	Dec. 05 Est.
	(In billions of drams)	
Tax revenue 1/	314.0	321.5
Total expenditures 1/	390.2	409.8
Overall balance 1/, 2/	-52.0	-57.9
Nominal GDP	2,168.0	2,227.8
	(In percent of GDP)	
Tax revenue 1/	14.5	14.4
Total expenditures 1/	18.0	18.4
Overall balance 1/, 2/	-2.4	-2.6

1/ Cumulative flow from the beginning of the year until the end of December.

2/ Overall balance on a commitment basis.

13. **Outlook:** The 2006 budget envisages an overall **deficit** of 2.8 percent of GDP, consistent with the authorities' Medium-Term Expenditure Framework (MTEF) for 2006–08, with half of the deficit financed externally and the remainder by drawing down government deposits. Tax **revenues** are envisaged to increase by 0.4 percent of GDP relative to the 2005 outturn on account of tax and customs reforms (see Section E below). Total **expenditures** (excluding grants from the Millennium Challenge Account (MCA)) are to increase by 1.2 percent of GDP relative to the 2005 outturn, largely matched by grants of the same magnitude. The combined education, health, and social security allocations are budgeted to rise by 0.9 percent of GDP, while capital expenditure is budgeted to rise by 1.3 percent of GDP (excluding disbursements from the MCA). At the same time, some savings are envisaged, particularly in subsidies to the water and irrigation sectors and interest payments, while wages are budgeted to increase only slightly relative to GDP. Bringing forward the budget process and introduction of a public investment plan in the authorities' 2006–08 MTEF should improve budget execution relative to previous years.³

Armenia: Functional Classification of Government Expenditures, 2003–08
(In percent of total expenditure)

	2003	2004	2005	2006-08
	Act.	Act.	Act.	Proj.
General public services	9.1	10.1	10.0	9.8
Defense and public order	20.9	22.9	23.3	22.3
Health, education, and social security	32.0	35.2	38.2	40.9
Housing and public utilities	14.0	8.2	8.7	7.8
Transportation, construction, and agriculture	14.1	11.2	10.4	10.9
Interest on public debt	3.0	3.3	3.5	3.4
Unclassified	7.0	9.0	5.9	4.3
Total expenditure and net lending	100.0	100.0	100.0	99.5

Sources: Ministry of Finance; and Fund staff estimates and projections.

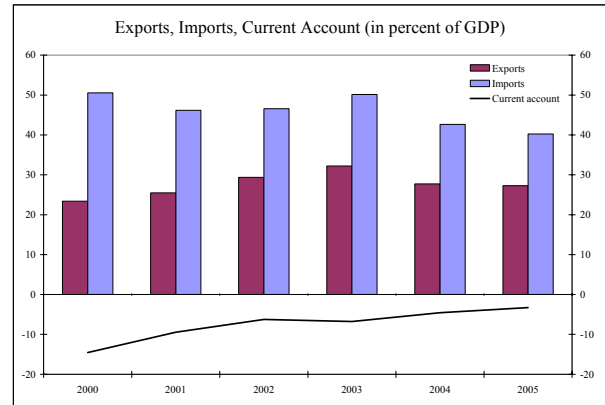
14. **Coordination issues:** Coordination between the monetary and fiscal authorities has recently weakened, both with respect to an overall framework for monetary policy objectives and government debt management. The absence of adequate coordination mechanisms as well as more frequent informal consultations to discuss expected changes in government balances for central bank liquidity management could complicate macroeconomic policy in the period ahead.

15. **Authorities' views:** Raising the tax-to-GDP ratio remains a key priority. The authorities recognize the need to increase revenue buoyancy and remain committed to further improving the tax system and strengthening tax and customs administration (Section E below). The authorities believe that expenditure execution is likely to improve further given an earlier approval of the budget, but they agreed to remain vigilant regarding expenditure efficiency.

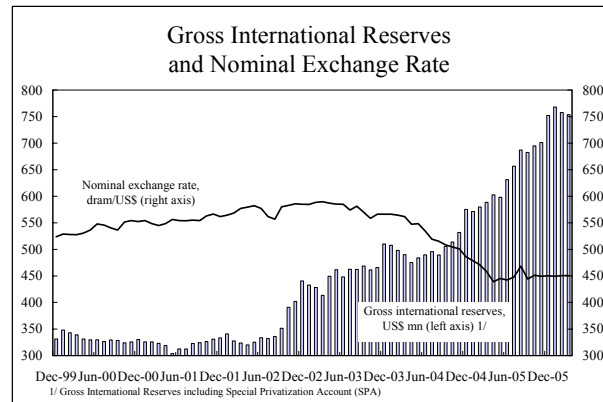
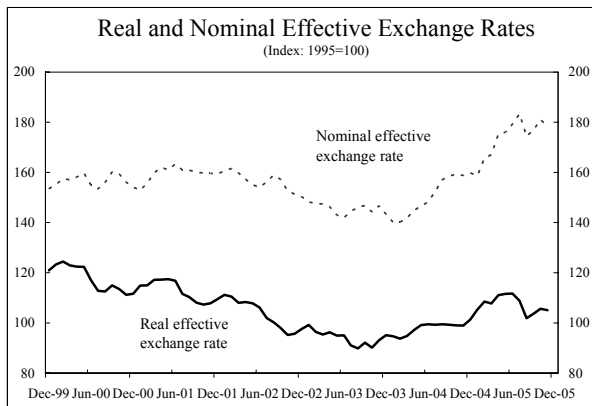
³ The introduction of program budgeting in four line ministries and the implementation of the action plan on the financial management of noncommercial organizations (NCOs) should also contribute to improved expenditure efficiency and execution in the period ahead.

D. External Sector

16. **Developments to date:** The external current account strengthened considerably (from a deficit of 4.6 percent of GDP in 2004 to a deficit of 3.3 percent of GDP in 2005), driven by robust exports of base metals and processed foodstuffs, tourism earnings, and strong remittance inflows (Table 6). Gross official reserves increased by US\$134 million, providing 3.7 months of import coverage. The authorities finalized their MCA Compact (worth US\$236 million over 5 years), and agreement was reached with the Lincy Foundation on a sizeable private grant.



17. **Outlook:** The external current account deficit is projected to widen somewhat in 2006 on account of a weakening in the trade balance driven by a moderation in export growth, along with a deceleration of the growth of remittances relative to recent years (Box 3). Nevertheless, the continued strength of the capital and financial account is projected to allow gross international reserves to increase by US\$76 million, providing for an increase in reserve coverage of 3.8 months of imports.



E. Structural Reforms and Other Issues

Tax and customs reforms

18. **Measures taken since last review:** Good progress was made in fiscal reforms, with a particular focus on closing loopholes in the tax system and improving tax and customs administration (MEFP, para. 8). In tax policy, the minimum social security contribution was raised and legislation for a presumptive tax on property development to reduce tax evasion in construction will be shortly submitted to parliament; however, the amendment to reduce the list of goods exempt from VAT payment at the border was not approved by parliament. In

tax and customs administration, sanctions for providing false documentation to revenue agencies were raised and tax audits strengthened; a 2006–08 IT strategy for the tax agency was finalized; a review of the customs agency by independent experts was concluded; and a pilot was initiated to introduce self-declaration and assessment in customs.⁴

Box 3. Remittances: Evolution and Estimation

Given both the absolute volume and the rapid growth of remittances in recent years, there is much interest in understanding the factors influencing these flows and their likely evolution.

Based on private transfers through the banking system, the sources of remittances are reasonably well understood. The CBA estimates that, in 2005, some 81 percent of such flows came from Russia. Furthermore, the CBA has developed a simple model of the economic chain behind remittances. The chain starts with the price of oil, which is transmitted through income growth and prices in Russia's nontradable sector (where most Armenians in Russia work), and results in the growth of transfers and factor incomes flowing into Armenia.

Nevertheless, banking system and official data do not capture all flows, and questions persist as to the 'true' level of remittances. Estimates vary from around 10 percent of GDP to over 25 percent of GDP.

As a result, there is much interest in deepening analysis in this area. The Armenian authorities, with support from the World Bank and other donors, have recently undertaken a study of the sources, nature, and extent of private transfers. In addition, Armenia will be included in a cross country analysis of remittances currently planned by the Asian Development Bank. Furthermore, the Armenian authorities are involved in discussions (with the Luxembourg Group) aimed at improving national statistics in this area.

19. **Measures expected in 2006:** Tax and customs reforms in 2006 will remain focused on enhancing revenue performance and strengthening tax and customs administration (MEFP, paras. 18–22). In tax policy, access to the simplified tax will be narrowed further to reduce tax evasion in profit and value-added taxes. While the 2007 elections make more far-reaching tax policy reforms difficult, the authorities expressed their commitment to bring the agricultural sector into the normal tax regime effective 2009; to move large-scale operations from the presumptive tax to the regular tax regime; and to allow the current profit tax exemptions for foreign enterprises to expire in 2008. In tax administration, completion of an IT acquisition action plan will reduce technical impediments to tax administration reforms. Steps to improve tax compliance include: applying universal VAT cross-checks from mid-year; strengthening of the verification of tax losses; and improving tax audits and arrears collection. In customs administration, measures will focus on increasing capacity for, and use of, risk assessment by establishing a dedicated risk management unit; expanding the use of self-declaration and assessment; and improving transparency.

Financial sector reforms

20. **Measures taken since last review:** The authorities continued their efforts to strengthen the financial sector's regulatory and supervisory framework (MEFP, para. 9).

⁴ Supported by the World Bank's Poverty Reduction Strategy Credit.

Amendments to the Law on Banks and Banking regarding consolidated supervision, corporate bank governance, and enhancing the effectiveness of external audits in risk management were passed by parliament. A unified financial regulation and supervision system was adopted, and by-laws on prudential regulation as well as accounting and reporting requirements in the insurance sector were finalized.

21. **Measures expected in 2006:** Financial sector reforms in 2006 will focus on further improving corporate governance of banks, strengthening regulation and supervision, and deepening financial intermediation (MEFP, paras. 24–25). The authorities intend to specify and implement a consolidated supervision framework for monitoring beneficiary owners of banks beyond the licensing stage in order to better control related-party influence on bank operations. They also intend to publish reports on the compliance of commercial banks with the amended Law on Banks and Banking, and amend legislation enabling the CBA to publish violations of, and sanctions against, noncompliant commercial banks. Lastly, the authorities plan to improve regulation and supervision of foreign exchange cash operations. The implementation of such reforms, together with the envisaged entry of foreign banks, should increase competition and contribute to the narrowing of interest spreads.

22. Further reforms are envisaged in the **nonbank financial sector** (MEFP, paras. 26–27). These will focus on implementing a regulatory and supervisory framework in the insurance sector; eliminating limitations on the range of services that insurance providers with substantial foreign ownership can offer in Armenia, and encouraging entry into the sector of reputable international companies. Finally, the authorities are embarking on a major reform of the pension system.

Program monitoring

23. The performance criteria, structural benchmarks, and indicative targets under the program are specified in the attached MEFP and the addendum to the technical memorandum of understanding (Attachments II and III). Performance under the third review will be assessed based on end-June 2006 data and measures (Attachment II, Tables 1 and 2). The third review of the program is expected to take place in September 2006.

III. STAFF APPRAISAL

24. **The economy continues to perform very well.** Prudent fiscal and monetary policies, strong external transfers, and ongoing structural reforms have contributed to the impressive growth performance and decline in poverty of recent years. The main challenge is to sustain economic growth, which will require *inter alia* continued prudent macroeconomic policies, strong revenue performance to fund infrastructure development and expand public services targeted at poverty alleviation, as well as financial sector development.

25. **The planned tightening of monetary policy is appropriate.** The rapid increase in monetary aggregates in 2005 and uncertainties about remonetization carry inflationary risks. Price developments should be monitored closely and monetary policy tightened further, should inflationary pressures increase. The credibility of the monetary stance is particularly important in light of the authorities' move toward a full-fledged inflation targeting regime

over the medium term. In this context, clear communication of CBA's policy stance will enhance the effectiveness of monetary policy and the development of a forward-looking framework for inflation forecasting will strengthen monetary policy decision making. Moreover, staff also encourages the authorities to maintain a flexible exchange rate regime.

26. **The 2006 budget is compatible with macroeconomic stability and PRSP objectives.** It rightly emphasizes improving revenue performance and increasing expenditures for infrastructure and social services. Given that tax performance is relatively poor by regional standards, staff places particular emphasis on improving further the tax-to-GDP ratio in line with PRSP objectives. To this end, tax revenue performance should be revisited during the year and the tax target increased if warranted by a revision of the 2006 nominal GDP growth forecast. More fundamentally, tax buoyancy needs to be increased without resorting to ad hoc discretionary measures to increase collection. Staff also encourages the authorities to improve further expenditure efficiency and targeting to ensure adequate and high quality public investment and social spending.

27. **The authorities' plan to subsidize the local gas supplier to limit gas tariff increases for end-users is cause for concern.** While the modalities and details have not yet been finalized, staff urges the authorities to (i) ensure full transparency in accounting for the subsidy by incorporating potential proceeds of any asset transfer to the budget; (ii) avoid general subsidies to offset higher gas prices, as they are inefficient and will be difficult to eliminate; (iii) target subsidies to the most vulnerable groups; and (iv) phase out any subsidies by end-2008 to ensure full cost-recovery and reduce medium-term fiscal risks.

28. **The authorities' emphasis on pressing ahead with reforms in tax and customs administration, if sustained, would be welcome.** In tax policy, privileges and loopholes in the tax system should be further reduced. In this regard, it is regrettable that the amendment to reduce the list of goods exempt from VAT payment at the border, which would strengthen the VAT chain, was not approved by parliament. In tax administration, it will be important to adopt the IT strategy to improve information sharing and implement a risk-based selection criteria in the areas of audits, arrears collection, and VAT refunds. In customs administration, the main recommendations of the recent review conducted by a specialized agency should be implemented.

29. **Financial sector development is critical for sustaining economic growth over the medium term.** The reforms being undertaken should improve further corporate governance, strengthen regulation and supervision, and deepen financial intermediation. Their implementation, together with the envisaged entry of foreign banks should increase competition, improve market efficiency, and contribute to the narrowing of interest rate spreads.

30. **The program's prospects remain very good, but there are risks.** Effective policy coordination between the monetary and fiscal authorities is needed to ensure that the inflation target can be met and fiscal performance maintained. In this context, it will be important to maintain a prudent fiscal policy as the campaign for next year's parliamentary elections picks up.

31. **Based on the authorities' good track record and the strength of the 2006 program, staff supports the authorities' request for completion of the second review under the program,** a waiver for the nonobservance of the performance criterion on the cash balance of the central government as it was minor, and modification of the end-June quantitative performance criteria.

Table 1. Armenia: Selected Economic and Financial Indicators, 2001–06

	2001	2002	2003	2004	2005		2006
					Prog.	Est.	Proj.
(Annual percentage change, unless otherwise indicated)							
National income and prices							
Real GDP growth	9.6	13.2	13.9	10.1	11.0	13.9	7.5
Gross domestic product (in billions of drams)	1,176	1,362	1,623	1,896	2,168	2,228	2,467
Gross domestic product (in millions of U.S. dollars)	2,120	2,373	2,805	3,558	4,580	4,876	5,528
Gross domestic product per capita (in U.S. dollars)	660	739	873	1,107	1,425	1,517	1,711
CPI (period average)	3.1	1.1	4.7	7.0	1.0	0.6	3.0
CPI (end of period)	2.9	2.0	8.6	2.0	1.5	-0.2	3.0
GDP deflator	4.0	2.4	4.6	6.1	3.0	3.1	3.0
Unemployment rate (in percent)	10.4	9.4	10.1	9.6	8.9	8.1	...
Poverty rate (in percent)	50.9	...	42.9	39.0	...	...	...
Investment and saving (in percent of GDP)							
Investment	19.8	21.7	24.7	23.9	24.4	24.7	25.7
National savings	10.3	15.4	17.9	19.4	20.5	21.4	21.8
Money and credit (end of period)							
Reserve money	11.1	38.4	6.6	11.4	39.8	51.9	19.2
Broad money	4.3	34.0	10.4	22.3	27.2	27.8	21.0
Commercial banks' 3-month lending rate (in percent) 1/	27.7	23.4	22.3	15.4	...	16.9	...
Central government operations (in percent of GDP)							
Revenue and grants	17.0	18.8	17.8	15.5	15.6	15.8	16.8
<i>Of which</i> : tax revenue	14.3	14.6	14.0	14.1	14.5	14.4	14.8
Expenditure and net lending	20.9	19.3	18.9	17.2	18.0	18.4	19.6
Overall balance on a commitment basis	-3.8	-0.4	-1.1	-1.8	-2.4	-2.6	-2.8
Overall balance on a cash basis	-4.0	-2.6	-1.5	-1.6	-2.4	-2.6	-2.8
Stock of domestic expenditure arrears	2.8	0.5	0.0	0.0	0.0	0.0	0.0
Government and government-guaranteed debt (in percent of GDP)	45.3	46.6	40.9	30.7	30.1	25.5	24.3
Share of foreign currency debt (in percent)	95.5	94.4	93.5	92.6	93.9	92.5	91.0
Primary balance of the energy sector (in percent of GDP) 2/	-2.5	-0.4	0.0	0.1	...	...	...
External sector							
Exports of goods and services (in millions of U.S. dollars)	540	698	903	985	1,180	1,330	1,494
Imports of goods and services (in millions of U.S. dollars)	-978	-1,107	-1,406	-1,514	-1,819	-1,962	-2,214
Exports of goods and services	20.8	29.3	29.5	9.0	19.8	35.0	12.4
Imports of goods and services	1.2	13.2	27.0	7.7	20.2	29.6	12.8
Current account (in percent of GDP)	-9.5	-6.2	-6.8	-4.6	-3.9	-3.3	-3.9
FDI (net, in millions of U.S. dollars)	70	111	121	217	255	234	204
External debt-to-exports ratio	132	131	60	59	60	60	55
Debt service ratio 3/	9.7	9.8	15.6	9.7	5.7	5.7	4.6
Gross international reserves (in millions of U.S. dollars) 4/	329	430	502	547	677	681	757
Import cover 5/	3.6	3.7	4.0	3.3	4.0	3.7	3.8
Nominal effective exchange rate 6/	3.4	-5.8	-4.6	11.5	...	...	...
Real effective exchange rate 6/	-2.0	-10.8	-2.6	6.5	...	...	...
Average exchange rate (dram per dollar)	555	575	578	530	...	456.9	...
Memorandum item:							
Population (in millions)	3.213	3.210	3.212	3.214	3.215	3.215	...

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

1/ End of period.

2/ Comprises state-owned energy companies. Data for 2001–02 include the electricity distribution company, Armelnet, which was privatized in late-2002. Data for 2003–04 exclude Armelnet and two generation companies that were also privatized.

3/ In percent of exports of goods and services.

4/ Gross international reserves excluding the special privatization account (SPA).

5/ Gross international reserves in months of next year's imports of goods and services.

6/ A positive sign denotes appreciation. Base year 1995=100. The calculations are based on 1999–2001 average trade weights.

Table 2. Armenia: Quantitative Targets, June – December 2005 1/
(End of period ceilings on stocks, unless otherwise specified)

	2005				
	Jun.	Sep.		Dec.	
	Act. 2/	Prog.	Act. 2/	Prog.	Proj. 3/
Net domestic assets of the CBA 4/ Adjusted target 5/	-56.0	-56.7	-56.7	-51.4 -41.4	-42.5
Net banking system credit to the government Adjusted target 5/	-25.1	-20.8	-19.2	-4.8 5.2	5.16
Domestic arrears of the central government and the	0.0	0	0	0	0
Tax revenues of the central government (floor) 6/	139.8	224.2	224.0	314.0	321.5
Balance of the central government on a cash basis (floor) 6/	-7.0	-23.3	-29.3	-52.0	-58.0
Reserve money (band/level) 2/	150.8	(169-176)	173.8	(181-188)	(197-205)
Contributions to the State Fund for Social Insurance 2/ 6/	28.7	46.4	43.7	64.8	60.1
Contracting or guaranteeing of new nonconcessional external debt 6/ 7/	0	0	0	0	0
External arrears (continuous criterion)	0	0	0	0	0
Net official international reserves (floor) 8/ Adjusted target 5/	436.4	437.8	437.8	449.9 439.9	458.4

1/ All items as defined in the Technical Memorandum of Understanding.

2/ Indicative target.

3/ Performance criterion.

4/ At program exchange rate of 500 dram per U.S. dollar for 2005 and program exchange rate of 450 dram per U.S. dollar for 2006.

5/ The December 2005 target has been adjusted by AMD 10 billion on account of lower-than-expected World Bank project lending.

6/ Cumulative flow from the beginning of the calendar year until the end of the month indicated.

7/ Includes debt with maturity of more than a year as well as obligations with maturity of one year or less, excluding normal import-related credit and sales of treasury bills to nonresidents.

8/ Excludes reserve money liabilities denominated in foreign currencies from September 2005 onwards.

Table 3. Status of Structural Measures for the Second Review under the PRGF

Measure	Type of Conditionality	Target Date (End of Period)	Status
<u>Tax policy</u> Parliament adopt an amendment to the Law on Simplified Tax to abolish the presumptive social security payment for simplified tax payers and incorporate them into the regular social security tax payments system.	Structural Performance Criterion	December 2005	Observed
Submit to parliament a law introducing a presumptive tax on property developers based on square meters of development to reduce tax evasion in the construction sector.	Structural Benchmark	March 2006	Not observed on time (Submitted to Parliament in May)
<u>Tax administration</u> Submit a law to parliament that raises the sanctions to at least AMD 1 million for providing false documentation to revenue agencies.	Structural Performance Criterion	March 2006 1/	Observed
<u>Customs administration</u> Increase by 5 percentage points the share of the number of declarations of imports for which the approved customs value is determined on the basis of declared transaction prices.	Structural Benchmark	December 2005	Observed
Complete operational review of customs operations through a specialized international company.	Structural Benchmark	March 2006	Observed
<u>Financial Sector</u> Parliament adopt the amendment to the Law on Banks and Banking to (i) to empower the CBA to identify ultimate beneficial owners, in the event of upward consolidation; (ii) define the separate duties and rights of shareholders, boards of directors, and executives of banks; (iii) require disclosure of potential conflicts of interest of board members; and (iv) require public disclosure of information on ownership and control of banks, including list of founders and copies of the company's statutes.	Structural Performance Criterion	December 2005	Observed

1/ This structural performance criterion is for the third review under the PRGF arrangement.

Table 4. Armenia: Monetary Accounts, 2005–06

	2005				2006			
	Sep.		Dec.		Mar.	June	Sep.	Dec.
	Prog	Act.	Prog.	Act.	Proj. 1/	Proj. 1/	Proj. 1/	Proj. 1/
Central Bank of Armenia								
Net foreign assets	211.8	211.7	278.6	249.9	254.3	253.0	266.3	272.7
Net international reserves	208.7	208.7	245.0	220.3	242.8	242.5	259.2	266.6
Special privatization account	12.0	12.0	42.6	38.5	20.5	20.5	18.2	18.2
Medium and long-term	-9.0	-9.0	-9.0	-8.9	-8.9	-10.0	-11.1	-12.1
Net domestic assets 2/	-37.9	-37.9	-94.0	-49.3	-61.4	-50.3	-45.4	-33.6
Claims on general government (net) 3/	-48.2	-48.2	-27.5	-17.4	-39.1	-27.1	-19.5	-7.6
<i>Of which</i> : central government (net) 3/	-26.6	-23.0	-4.9	6.6	-15.1	-3.1	4.5	16.3
Claims on banks	9.7	9.7	2.9	4.0	4.0	5.1	6.1	7.2
KfW	11.7	11.7	11.7	11.7	11.7	12.8	13.8	14.9
Monetary instruments (net) excluding CBA bills	-2.0	-2.0	-8.8	-7.7	-7.7	-7.7	-7.7	-7.7
CBA bills	-13.5	-13.5	-29.6	-21.2	-28.4	-29.6	-35.9	-36.9
Other items (net) 2/	14.1	14.1	-39.7	-14.7	2.1	1.3	3.8	3.8
SPA	-12.0	-12.0	-42.6	-38.5	-20.5	-20.5	-18.2	-18.2
Autonomous OIN	26.1	26.1	2.8	23.8	22.6	21.8	22.0	21.9
Reserve money	173.8	173.8	184.6	200.6	193.0	202.7	220.9	239.1
Currency issue	132.2	132.2	146.4	155.3	149.4	157.2	170.1	187.3
Deposits	41.6	41.6	38.2	45.3	43.5	45.4	50.8	51.8
Banking system								
Net foreign assets	290.6	251.0	324.7	274.9	271.9	269.7	282.1	287.4
Net domestic assets	50.6	81.4	39.0	90.6	94.7	115.4	133.2	154.9
Claims on government (net)	-20.8	-19.2	-4.8	5.2	2.6	-1.2	7.1	21.2
of which: claims on central government (net)	1.8	6.1	17.8	29.1	26.6	22.8	31.1	45.2
Claims on rest of the economy	174.3	167.3	190.4	188.3	190.7	203.2	222.1	239.4
Other items (net) 2/	-102.8	-66.7	-146.6	-102.9	-98.6	-86.7	-96.0	-105.7
Broad money	341.3	332.4	363.7	365.6	366.6	385.1	415.3	442.3
Currency in circulation	124.6	122.9	138.2	144.3	140.4	148.2	161.1	178.3
Deposits	216.7	209.5	225.5	221.2	226.2	236.8	254.2	264.1
Domestic currency	69.3	66.9	72.0	80.5	83.2	90.5	102.6	109.3
Foreign currency	147.4	142.6	153.5	140.8	143.0	146.3	151.6	154.8
Memorandum items								
Exchange rate (in drams per U.S. dollar, end of period)	444.2	444.2	...	450.2	...	...	...	...
Program e-rate	...	...	500.0	...	450.0	450.0	450.0	450.0
Privatization account (in millions of U.S. dollars)	27.0	27.0	85.1	85.6	45.6	45.6	40.4	40.4
NIR (in millions of U.S. dollars) 4/	469.9	469.9	...	489.4	...	...	...	...
NIR (in millions of U.S. dollars) 5/	484.0	484.0	490.0	509.0	539.5	538.9	576.1	592.5
NIR (in millions of U.S. dollars) 6/	424.3	424.3	...	439.9	...	...	...	...
NIR (in millions of U.S. dollars) 7/	437.8	437.8	449.9	458.4	494.6	492.0	527.2	542.1
NDA of the CBA (in billions of drams) 8/	-56.7	-56.7	-51.4	-42.5	-40.9	-29.8	-27.3	-15.4
12-month change in reserve money (in percent)	52.3	52.3	39.8	51.9	56.1	34.4	27.1	19.2
12-month change in broad money (in percent)	34.7	31.2	27.2	27.8	31.5	27.0	24.9	21.0
12-month change in private sector credit (in percent)	32.1	26.8	33.6	32.2	35.2	31.3	32.8	27.1
Velocity of broad money (end of period)	6.1	6.3	6.0	6.1	6.2	6.0	5.8	5.6
Money multiplier	2.0	1.9	2.0	1.8	1.9	1.9	1.9	1.9
Dollarization in bank deposits 9/	68.0	68.1	68.1	63.6	63.2	61.8	59.6	58.6
Dollarization in broad money 10/	43.2	42.9	42.2	38.5	39.0	38.0	36.5	35.0
Currency in circulation in percent of deposits	57.5	58.7	61.3	65.2	62.1	62.6	63.4	67.5
Stock of FCD (in millions of U.S. dollars)	294.9	321.0	307.0	312.7	317.7	325.2	336.8	344.0
Banking system financing of the central government (cumulative)	-2.1	2.2	13.9	25.2	-2.6	-6.4	2.0	16.0

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

1/ At program exchange rate of 450dram/US\$.

2/ The projected decline in other items (net) in 2005 is related to additional privatization proceeds primarily from the sale of a copper company. These proceeds will be deposited in the special privatization account (SPA) which is a separate account at the CBA and is subject to regular audit by Parliament. Those proceeds are not reflected in the fiscal accounts until funds are earmarked for spending within the budget.

3/ See footnote 5 of Table 2.

4/ At actual exchange rates, excluding the SPA.

5/ At program exchange rates, excluding the SPA.

6/ At actual exchange rates, excluding the SPA and foreign currency reserve money.

7/ At program exchange rates, excluding the SPA and foreign currency reserve money.

8/ Defined as reserve money minus NIR plus medium- and long-term liabilities. Reserve money denominated in foreign currencies is included in reserve money and NIR up to June 2005. They are excluded for September 2005 onward.

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

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

Table 5. Armenia: Central Government Operations, 2004-06

	2004		2005								2006								
	Jan-Dec		Q1		Q2		Q3		Q4		Q1		Q2		Q3		Q4		
	Act.	Prog. I/	Act.	Prog. I/	Act.	Prog. I/	Act.	Prog. I/	Act.	Prog. I/	Act.	Prog. I/	Act.	Prog. I/	Act.	Prog. I/	Act.	Prog. I/	
Total revenue and grants	293.6	67.1	69.6	79.4	80.7	90.9	89.2	112.3	93.9	112.3	338.2	351.9	82.1	97.3	109.6	125.4	414.4	412.4	412.4
Tax revenue	283.8	66.2	66.7	76.5	80.6	86.6	89.2	89.9	89.9	105.6	324.8	342.1	76.8	90.5	100.0	107.9	375.2	375.2	375.2
Value-added tax	266.7	64.1	64.1	73.1	75.7	83.4	84.1	89.8	89.8	97.6	314.0	321.5	74.1	87.9	97.0	105.2	364.3	364.3	364.3
Excises	117.9	...	31.3	...	29.9	...	37.0	...	48.5	...	...	146.8	...	...	...	...	...	...	...
Profits, simplified, and presumptive taxes	40.7	...	8.0	...	8.6	...	11.5	...	10.5	...	...	38.6	...	...	...	...	...	...	...
Personal income tax	50.9	...	11.4	...	21.0	...	16.0	...	17.8	...	...	66.2	...	...	...	...	...	...	...
Customs duties	20.4	...	5.2	...	6.0	...	7.0	...	8.4	...	...	26.6	...	...	...	...	...	...	...
Other taxes	12.5	...	3.5	...	3.8	...	4.1	...	5.1	...	...	16.5	...	...	...	...	...	...	...
Nontax revenue	24.3	...	4.8	...	8.4	...	8.4	...	7.3	...	...	26.8	...	...	...	...	...	...	...
Capital revenue	8.0	1.3	2.1	1.3	1.4	1.3	2.1	0.5	2.7	5.3	8.2	1.9	1.2	1.8	2.3	7.3	7.3	7.3	7.3
Grants	9.1	0.8	0.5	2.0	3.5	1.9	3.0	-0.4	5.3	5.5	12.4	0.8	1.3	1.2	0.4	3.6	3.6	3.6	3.6
Grants	9.7	0.9	2.9	3.0	0.2	4.3	0.0	4.0	6.8	13.4	9.8	5.3	6.8	9.6	17.5	37.2	37.2	37.2	37.2
Total expenditure	326.8	64.2	68.1	107.3	94.2	115.0	112.1	115.0	115.0	135.5	390.2	409.8	93.5	117.8	126.2	146.8	484.3	482.2	482.2
Current expenditure	253.1	53.1	56.9	83.1	71.0	78.5	79.9	84.3	96.3	96.3	290.8	304.1	78.5	86.7	82.5	85.6	333.3	331.2	331.2
Wages	40.2	9.5	8.3	11.3	10.0	11.2	11.6	12.3	14.2	14.2	46.1	44.1	12.2	13.7	13.3	12.9	52.1	52.1	52.1
Subsidies	18.2	4.7	3.6	5.0	3.8	1.7	4.5	4.0	3.1	13.1	14.9	6.8	3.5	2.6	2.6	2.9	15.7	15.7	15.7
Interest	9.8	2.5	2.2	2.6	2.3	3.8	2.4	3.5	3.4	11.7	10.3	2.5	2.6	2.7	2.8	2.8	10.6	10.3	10.3
Transfers 4/	64.9	16.1	15.5	17.2	18.9	18.2	22.5	16.1	26.3	68.7	68.7	21.0	21.2	21.7	22.3	86.2	86.2	86.2	86.2
Goods and services	120.0	20.3	27.3	47.1	35.9	43.6	39.0	48.3	49.3	151.2	151.5	36.1	45.6	42.2	44.7	168.7	166.8	166.8	166.8
Capital expenditure and net lending	73.7	11.0	11.2	24.3	23.1	36.5	32.2	30.7	39.2	99.4	105.7	15.0	31.2	43.7	61.2	151.0	151.0	151.0	151.0
Capital expenditure	62.2	8.5	8.4	20.4	19.7	32.4	28.5	31.1	36.0	89.3	92.4	10.8	26.8	38.6	57.8	134.0	134.0	134.0	134.0
Net lending	11.5	2.5	2.9	3.9	3.5	4.1	3.7	-0.3	3.2	10.1	13.3	4.2	4.4	5.1	3.4	17.0	17.0	17.0	17.0
Overall balance (commitment)	-33.2	2.9	1.5	-27.9	-13.4	-24.1	-22.8	-21.1	-23.1	-23.1	-52.0	-57.9	-11.4	-20.5	-16.7	-21.4	-69.9	-69.9	-69.9
Net clearance of arrears	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy/financing gap 5/	3.3	0.0	4.3	0.0	0.6	0.0	0.5	-7.6	-5.6	-5.6	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash)	-29.9	2.9	5.8	-27.9	-12.9	-24.1	-22.3	-28.7	-28.7	-28.7	-52.0	-58.0	-11.4	-20.5	-16.7	-21.4	-69.9	-69.9	-69.9
Deficit/financing	29.9	-2.9	-5.8	27.9	12.9	24.1	22.3	28.7	28.7	28.7	52.0	58.0	11.4	20.5	16.7	21.4	69.9	69.9	69.9
Domestic financing	-5.4	-9.2	-9.5	21.7	9.2	16.6	15.6	15.4	27.2	22.1	42.5	22.1	-2.5	14.5	10.7	14.3	37.1	39.1	39.1
Banking system	-2.6	-17.2	-16.7	19.2	10.3	9.2	8.6	16.0	27.3	13.9	29.5	-2.6	-3.8	8.3	8.3	14.1	16.0	18.1	18.1
Central Bank of Armenia 6/	-5.3	-21.2	-21.2	13.5	5.0	6.6	8.9	21.7	33.2	10.8	25.8	-3.7	-6.0	7.6	11.9	9.7	11.8	11.8	11.8
Commercial Banks	2.7	4.1	4.6	5.8	5.3	2.6	-0.3	-5.7	-5.8	3.1	3.7	1.2	2.2	0.7	2.2	6.3	6.3	6.3	6.3
Nonbank	-2.7	8.0	7.2	2.5	-1.1	7.4	7.0	-0.6	-0.1	8.2	13.0	0.1	18.2	2.4	0.2	21.0	21.0	21.0	21.0
of which: Special Privatization Account 6/	0.0	6.3	6.3	0.0	0.0	6.3	6.3	0.0	0.0	12.5	12.5	0.0	18.0	2.3	0.0	20.3	20.3	20.3	20.3
External financing	35.3	6.3	3.7	6.7	3.6	7.5	6.7	13.3	1.5	30.0	15.5	13.8	6.0	5.9	7.1	32.8	30.8	30.8	30.8
Gross inflow	46.3	9.5	5.4	7.7	4.9	9.4	8.4	17.7	4.0	39.5	22.7	16.4	7.4	8.3	8.4	40.6	38.0	38.0	38.0
Amortization due	-11.1	-3.1	-1.7	-1.5	-1.3	-1.9	-1.7	-4.3	-2.5	-9.5	-7.2	-2.6	-1.4	-2.4	-1.4	-7.7	-7.7	-7.7	-7.7

Table 5. Armenia: Central Government Operations, 2004-06 (concluded)

	2004		2005				2006							
	Jan-Dec	Act.	Q1	Q2	Q3	Q4	Jan-Dec	Q1	Q2	Q3	Jan-Dec			
	Act.	Prog./	Act.	Prog./	Act.	Prog./	Act.	Prog./	Act.	Prog./	Act.			
Total revenue and grants	15.5	3.2	3.1	3.8	4.3	4.0	4.3	5.0	15.8	3.3	3.9	4.4	5.1	16.8
Total revenue	15.0	3.1	3.0	3.6	4.1	4.0	4.1	4.7	15.0	3.1	3.7	4.1	4.4	15.2
Tax revenue	14.1	3.0	2.9	3.5	4.0	3.8	4.1	4.4	14.5	3.0	3.6	3.9	4.3	14.8
Value-added tax	6.2	1.4	1.4	1.3	1.7	1.7	1.7	2.2	6.6	1.7	1.7	1.7	1.7	6.6
Excises	2.1	0.4	0.4	0.4	0.5	0.5	0.5	0.8	1.7	0.5	0.5	0.5	0.5	1.7
Profits, simplified, and presumptive taxes	2.7	0.5	0.5	0.9	0.9	0.7	0.7	0.8	3.0	0.8	0.8	0.8	0.8	3.0
Personal income tax	1.1	0.2	0.2	0.3	0.3	0.3	0.3	0.4	1.2	0.4	0.4	0.4	0.4	1.2
Customs duties	0.7	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.7	0.2	0.2	0.2	0.2	0.7
Other taxes	1.3	0.2	0.2	0.3	0.3	0.4	0.3	0.3	1.2	0.3	0.3	0.3	0.3	1.2
Nontax revenue	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.2
Capital revenue	0.5	0.0	0.0	0.1	0.2	0.1	0.1	0.0	0.2	0.1	0.1	0.1	0.1	0.2
Grants	0.5	0.0	0.1	0.1	0.2	0.0	0.2	0.3	0.6	0.2	0.3	0.4	0.7	1.6
Total expenditure	17.2	3.0	3.1	5.1	4.2	5.5	5.0	6.1	18.0	3.8	4.8	5.1	6.0	19.6
Current expenditure	13.3	2.5	2.6	3.9	3.2	3.7	3.6	4.3	13.4	3.2	3.5	3.3	3.5	13.5
Wages	2.1	0.5	0.4	0.5	0.5	0.5	0.5	0.6	2.1	0.5	0.6	0.5	0.5	2.1
Subsidies	1.0	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.6	0.2	0.3	0.1	0.1	0.6
Interest	0.5	0.1	0.1	0.1	0.1	0.2	0.1	0.2	0.5	0.1	0.1	0.1	0.1	0.4
Transfers 4/	3.4	0.8	0.7	0.8	0.8	0.9	1.0	0.7	1.2	0.8	0.9	0.9	0.9	3.5
Goods and services	6.3	1.0	1.2	2.2	1.6	2.1	1.7	2.2	7.0	6.8	1.5	1.9	1.7	1.8
Capital expenditure and net lending	3.9	0.5	0.5	1.2	1.0	1.7	1.4	1.8	4.6	4.7	1.3	1.8	2.5	6.1
Capital expenditure	3.3	0.4	0.4	1.0	0.9	1.5	1.3	1.4	1.6	4.1	1.1	1.6	2.3	5.4
Net lending	0.6	0.1	0.1	0.2	0.2	0.2	0.2	0.1	0.5	0.6	0.2	0.2	0.1	0.7
Overall balance (commitment)	-1.8	0.1	0.1	-1.3	-0.6	-1.1	-1.0	-1.0	-2.4	-2.6	-0.5	-0.8	-0.7	-2.8
Net clearance of arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy/financing gap 5/	0.2	0.0	0.2	0.0	0.0	0.0	0.0	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0
Overall balance (cash)	-1.6	0.1	0.3	-1.3	-0.6	-1.1	-1.0	-1.3	-2.4	-2.6	-0.5	-0.8	-0.7	-2.8
Deficit/financing	1.6	-0.1	-0.3	1.3	0.6	1.1	1.0	1.3	2.4	2.6	0.5	0.8	0.7	2.8
Domestic financing	-0.3	-0.4	-0.4	1.0	0.4	0.8	0.7	0.7	1.2	1.0	1.9	0.6	0.4	1.5
Banking system	-0.1	-0.1	-0.1	0.9	0.5	0.4	0.4	0.7	1.2	0.6	1.3	-0.1	-0.2	0.3
Central Bank of Armenia 6/	-0.3	-1.0	-1.0	0.6	0.2	0.3	0.4	1.0	1.5	1.2	-0.2	-0.2	0.3	0.5
Commercial Banks	0.1	0.2	0.2	0.3	0.2	0.1	0.0	-0.3	-0.3	0.1	0.2	0.0	0.1	0.3
Nonbank	-0.1	0.4	0.3	0.1	0.0	0.4	0.3	0.0	0.4	0.6	0.0	0.7	0.1	0.9
of which: Special Privatization Account 6/	0.0	0.3	0.3	0.0	0.0	0.3	0.3	0.0	0.6	0.6	0.0	0.7	0.1	0.8
External financing	1.9	0.3	0.2	0.3	0.2	0.4	0.3	0.6	0.1	0.7	0.6	0.2	0.2	1.3
Gross inflow	2.4	0.4	0.2	0.4	0.2	0.4	0.4	0.8	1.8	1.0	0.7	0.3	0.3	1.6
Amortization due	-0.6	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.3	-0.1	-0.1	-0.1	-0.3
Memorandum items														
Underlying balance (excl. grants and interest, commitment)	-1.7	0.2	0.0	-1.3	-0.5	-1.2	-0.9	-1.0	-2.2	-2.6	-0.6	-1.0	-1.0	-4.0
Primary balance (excl. interest, commitment)	-1.2	0.3	0.2	-1.2	-0.5	-1.0	-0.9	-0.8	-0.9	-2.1	-0.4	-0.7	-0.6	-2.4
Net borrowing/lending (commitment)(-)/7/	-1.8	0.4	0.3	-1.3	-0.6	-0.8	-0.7	-1.0	-1.8	-2.0	-0.5	-0.1	-0.6	-2.0
Domestic expenditure arrears (stock in billions of drams)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government and government-guaranteed debt	30.7	...	...	...	...	...	...	...	30.1	25.7	...	...	...	24.3
Of which: domestic debt	2.3	...	...	...	...	...	...	...	2.4	2.1	...	...	...	2.2
Nominal GDP (annual, in billions of drams)	1,896	2,106	2,228	2,106	2,228	2,106	2,228	2,168	2,228	2,467	2,467	2,467	2,467	2,467

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

1/ Relative to the 2005 budget, the staff presentation makes the following adjustments: (i) estimated military wages are reclassified from Other goods and services to Wages; (ii) an AMD 12.5 billion fee for the participation in the tender for the Molybdenum copper plant is recorded as privatization proceeds instead of nontax revenue; (iii) external grants, external interest, and external financing are converted at the program exchange rate of 500 AMD per US dollar and AMD 680.4 per euro.

2/ Relative to the 2006 budget, the staff presentation makes the following adjustments: (i) estimated military wages are reclassified from Other goods and services to Wages; (ii) external grants, external interest, and external financing are converted at the program exchange rate of AMD 450 per US dollar and AMD 504 per euro.

3/ Staff presentation based on the budget exchange rate of AMD 420 per U.S. dollar.

4/ Includes current spending funded from the reserve fund; capital spending is recorded under capital expenditure.

5/ The statistical discrepancy is corrected for accumulation of deposits in non-central government treasury accounts at the central bank and below-the-line operations that are not reflected in the budget reports.

6/ Use of funds from the Special Privatization Account (SPA) is shown in nonbank financing. The timing of the use of these funds does not always coincide with the timing of the conversion into domestic currency. At conversion, CBA net claims on central government (NCCG) are reduced. Thus, in a given period the sum of central bank financing and use of the SPA in the fiscal accounts equals the change in the sum of the stock of NCCG and the SPA in the CBA balance sheet.

7/ Overall balance plus privatization proceeds.

Table 6. Armenia: Balance of Payments, 2004–09
(In millions of U.S. dollars, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009
	Est.	Est.	Proj.	Projections		
Current account	-162	-160	-213	-268	-301	-316
Trade balance	-458	-596	-678	-684	-705	-747
Exports, fob	738	976	1,098	1,250	1,374	1,514
Imports, fob	-1,196	-1,571	-1,776	-1,935	-2,080	-2,262
Services (net)	-71	-37	-41	-49	-74	-73
Credits	247	354	396	411	432	482
Debits	-317	-391	-438	-460	-506	-555
Income (net)	37	90	103	92	99	102
Transfers (net)	330	383	404	373	379	402
Private	269	320	352	354	361	382
Official	61	63	52	20	19	20
Capital and financial account	206	319	289	297	350	374
Capital transfers (net)	34	37	60	73	70	73
Foreign direct investment (net)	217	234	204	180	170	160
<i>Of which</i> : Privatization/debt swap	20	114	0	0	0	0
Portfolio investment (net)	-3	-3	0	0	0	0
Public sector (net)	38	34	53	119	149	121
Disbursements	88	50	70	135	163	140
<i>Of which</i> : World Bank program support	20	...	...	...	...	...
Amortization	-49	-16	-17	-17	-14	-19
Other capital (net)	-81	17	-27	-75	-39	20
<i>Of which</i> : Special Privatization Account	-20	-56	45	0	0	0
Errors and omissions	2	1	0	0	0	0
Overall balance	46	160	76	29	49	58
Financing	-46	-170	-106	-59	-54	-58
Gross international reserves (increase: -)	-45	-134	-76	-37	-30	-38
Use of Fund credit, net	-6	-36	-32	-23	-25	-23
Disbursements	28	...	...	...	...	...
Repurchases/repayments	-35	-36	-31	-23	-25	-23
Exceptional financing	0	1	1	1	1	2
Debt relief 1/	0	1	1	1	1	2
Financing gap	...	10	30	30	5	0
IMF	...	10	10	10	5	0
World Bank	...	0	20	20	0	0
Memorandum items:						
Current account (in percent of GDP)	-4.6	-3.3	-3.9	-4.3	-4.4	-4.2
Gross international reserves (end of period)	547	681	757	794	823	861
In months of imports	3.3	3.7	3.8	3.7	3.5	3.4
Merchandise export growth, percent change	6.1	32.1	12.5	13.9	9.9	10.2
Merchandise import growth, percent change	5.8	31.4	13.0	9.0	7.5	8.7
Nominal external debt 2/	1,183	1,099	1,196	1,307	1,436	1,451
Nominal external debt stock (in percent of GDP) 2/	33	23	22	21	21	19
NPV of external debt in percent of exports 3/	60	60	55	54	56	55
External debt service in percent of exports 2/	9.7	5.7	4.6	3.6	3.3	3.1
Stock of external arrears	0	0	0	0	0	0

Sources: Armenian authorities; and Fund staff estimates.

1/ From the United Kingdom through 2015 (in respect of IDA credits).

2/ Based on government and government-guaranteed medium- and long-term debt as at end-2005.

3/ Based on the low-income country debt sustainability analysis presented in IMF Country Report No. 05/422.

Table 7. Armenia: Medium-Term Macroeconomic Framework, 2004–09

	2004	2005	2006	2007	2008	2009
	Act.	Est.		Projections		
(In percent of GDP, unless otherwise indicated)						
National income and prices						
Real GDP growth (percent change)	10.1	13.9	7.5	6.0	6.0	6.0
Gross domestic product (in millions of U.S. dollars)	3,558	4,876	5,528	6,186	6,923	7,597
Gross national income per capita (in U.S. dollars)	1,119	1,545	1,743	1,933	2,151	2,347
CPI inflation, end-of-period (annual percent change)	2.0	-0.2	3.0	3.0	3.0	3.0
Investment and saving						
Investment	23.9	24.7	25.7	25.9	26.2	26.5
Government	3.9	4.4	6.1	6.4	6.6	6.9
Other	20.0	20.4	19.6	19.5	19.6	19.6
National savings	19.4	21.4	21.8	21.6	21.8	22.3
Government	2.1	1.8	3.3	3.5	3.7	4.0
Other	17.2	19.7	18.5	18.1	18.1	18.3
Government operations						
Revenue and grants	15.5	15.8	16.8	17.0	17.2	17.5
<i>Of which:</i> tax revenue	14.1	14.4	14.8	15.2	15.6	16.0
grants 1/	0.5	0.4	1.6	1.4	1.2	1.1
Expenditure	17.2	18.4	19.6	19.9	20.1	20.4
<i>Of which:</i> social expenditure 2/	5.4	6.1	7.0	7.5	7.8	8.0
Current expenditure	13.3	14.0	13.5	13.5	13.5	13.5
Capital expenditure and net lending	3.9	4.4	6.1	6.4	6.6	6.9
Overall balance (including grants)	-1.8	-2.6	-2.8	-2.9	-2.9	-2.9
Domestic financing	-0.3	1.9	1.5	0.6	0.6	1.2
External financing	1.9	0.7	1.3	2.3	2.3	1.7
Government and government-guaranteed debt	30.7	25.5	24.3	23.4	21.0	19.2
External sector						
Exports of goods and services	27.7	27.3	27.0	26.9	26.1	26.3
Imports of goods and services	42.6	40.2	40.0	38.7	37.3	37.1
Current account	-4.6	-3.3	-3.9	-4.3	-4.4	-4.2
Current account (in millions of U.S. dollars)	-162	-160	-213	-268	-301	-316
Capital and financial account (in millions of U.S. dollars)	206	319	289	297	350	374
<i>Of which:</i> direct foreign investment	217	234	204	180	170	160
public sector disbursements	88	50	70	135	163	140
Change in gross international reserves (in millions of U.S. dollars) 3/	-45	-134	-76	-37	-30	-38
Arrears and debt relief (in millions of U.S. dollars)	0	1	1	1	1	2
Financing/gap (in millions of U.S. dollars)	0	10	30	30	5	0
<i>Of which:</i> IMF	0	10	10	10	5	0
World Bank	0	0	20	20	0	0
External debt (NPV, in percent of exports of goods and services)	59	60	55	54	56	55
Debt service (in percent of exports of goods and services)	9.7	5.7	4.6	3.6	3.3	3.1
Gross international reserves in months of imports	3.3	3.7	3.8	3.7	3.5	3.4

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

1/ For 2007-09, the figures include preliminary projections for disbursements under the U.S. Millennium Challenge Account.

2/ Defined as total expenditure on health, education, and social security.

3/ A negative figure indicates an increase.

Table 8. Armenia: Indicators of Fund Credit, 2004–09

	2004	2005	2006	2007	2008	2009
	Projections					
(In units indicated)						
Existing and prospective Fund outstanding credit 1/						
In millions of SDRs	140.1	139.9	118.7	103.2	86.2	71.0
In percent of exports 2/	21.1	17.6	13.1	10.4	8.0	6.0
In percent of external debt	17.6	16.9	13.7	11.2	9.4	8.0
In percent of gross reserves	38.0	30.6	25.4	21.3	17.2	13.9
In percent of quota	152.3	152.0	129.0	112.2	93.7	77.2
Existing Fund outstanding credit 1/						
In millions of SDRs	140.1	120.1	99.0	83.5	66.5	51.3
In percent of exports 2/	21.1	15.1	10.9	8.4	6.2	4.3
In percent of external debt	17.6	14.5	11.5	9.1	7.3	5.8
In percent of gross reserves	38.0	26.3	21.2	17.2	13.3	10.0
In percent of quota	152.3	130.6	107.6	90.8	72.2	55.7
Prospective Fund outstanding credit 1/						
In millions of SDRs	...	19.7	19.7	19.7	19.7	19.7
In percent of exports 2/	...	2.5	2.2	2.0	1.8	1.7
In percent of external debt	...	2.4	2.3	2.1	2.2	2.2
In percent of gross reserves	...	4.3	4.2	4.1	3.9	3.9
In percent of quota	...	21.4	21.4	21.4	21.4	21.4
Repurchases, repayments, and charges due from existing and prospective drawings						
In millions of SDRs	...	24.0	21.8	16.0	17.5	15.6
In percent of exports 2/	...	3.0	2.4	1.6	1.6	1.3
In percent of external debt	...	2.9	2.5	1.7	1.9	1.7
In percent of gross reserves	...	5.3	4.7	3.3	3.5	3.0
In percent of quota	...	26.1	23.7	17.4	19.1	16.9
Repurchases and charges due from existing drawings						
In millions of SDRs	...	24.0	21.7	15.9	17.4	15.5
In percent of exports 2/	...	3.0	2.4	1.6	1.6	1.3
In percent of external debt	...	2.9	2.5	1.7	1.9	1.7
In percent of gross reserves	...	5.2	4.6	3.3	3.5	3.0
In percent of quota	...	26.0	23.6	17.3	19.0	16.8
Repurchases and charges due from prospective drawings						
In millions of SDRs	...	0.0	0.1	0.1	0.1	0.1
In percent of exports 2/	...	0.0	0.0	0.0	0.0	0.0
In percent of external debt	...	0.0	0.0	0.0	0.0	0.0
In percent of gross reserves	...	0.0	0.0	0.0	0.0	0.0
In percent of quota	...	0.0	0.1	0.1	0.1	0.1

Sources: Armenian authorities; and Fund staff estimates.

1/ End of period stocks.

2/ Exports of goods and services.

Table 9. Armenia: Poverty Indicators and Millennium Development Goals, 1990–2015

	1990	1998/99	2000	2003	2004	2015 Target
(In percent of total population unless otherwise stated)						
1 Eradicate extreme poverty and hunger						
Population below US\$2.15 (PPP) a day	...	35.8	...	...	...	...
Overall poverty rate	...	56.3	50.9	42.9	39.0	19.7
Rural poverty	...	47.7	45.7	47.5	40.7	...
Extreme Poverty	...	26.1	16.2	7.4	7.2	4.1
Prevalence of child malnutrition (in percent of children under 5)	...	3.3	2.6	...	...	1.4
2 Achieve universal primary education						
Net primary enrollment ratio (in percent of relevant age group)	...	...	84.5	94.4	...	100
Youth literacy rate (in percent of group ages 15-24)	99.5	99.7	99.8	...	...	100
3 Promote gender equality						
Ratio of girls to boys in primary and secondary education (in percent)	...	...	104.0	101.1	...	100
Ratio of young literate females to males (in percent of group ages 15-24)	99.7	99.8	100.1	...	...	...
Proportion of seats held by women in national parliament (in percent)	36.0	6.0	3.0	3.0	5.0	...
4 Reduce child mortality						
Under 5 mortality rate (per 1,000)	60.0	47.0	37.0	33.0	33.0	20.0
Infant mortality rate (per 1,000 live births)	26.0	...	33.0	30.0	30.0	8.7
Immunization, measles (in percent of children under 12 months)	94.8	91.0	92.0	94.0	94.0	...
5 Improve maternal health						
Maternal mortality ratio (modeled estimate, per 100,000 live births)	40.1	32.9	21.8	18.6	...	10.0
Births attended by skilled health staff (in percent of total)	99.7	98.8	96.8	...	...	...
6 Combat HIV/AIDS, malaria and other diseases						
Prevalence of HIV, female (in percent of group ages 15-24)	...	0.0	0.1	0.1	0.1	Stabilize and reduce
Incidence of tuberculosis (per 100,000 people)	26.3	39.2	63.5	70.1	70.1	Stabilize and reduce
Tuberculosis cases detected under DOTS (in percent)	...	8.0	51.4	43.3	43.3	Stabilize and reduce
7 Ensure environmental sustainability						
Nationally protected areas (in percent of total land area)	...	7.4	7.6	7.6	7.6	...
GDP per unit of energy use (PPP \$ per kg oil equivalent)	...	3.5	3.3	4.8	...	...
CO2 emissions (metric tons per capita)	...	1.0	1.1	...	...	...
Access to an improved water source (% of population)	...	...	...	92	...	...
Access to improved sanitation (% of population)	...	...	...	84	...	...
8 Develop a Global Partnership for Development						
Fixed line and mobile telephones (per 1,000 people)	157.0	145.2	144.9	178.4	178.4	...
Personal computers (per 1,000 people)	...	5.3	6.6	15.8	...	...
General indicators						
Population (in millions)	3.5	3.1	3.1	3.1	3.0	...
Adult literacy rate (in percent of group ages 15 and over)	97.5	98.3	98.5	98.6	...	...
Total fertility rate (births per woman)	2.6	1.2	1.2	1.1	1.1	...
Life expectancy at birth (years)	71.7	73.0	73.0	75	75	...
Gini index of inequality (consumption)	...	...	34.4	27.1	31.0	...
Gini index of inequality (total income)	...	57.0	52.8	44.0	41.0	...

Sources: World Bank, and Armenian authorities.

Goal 1: Halve, between 1990 and 2015, the proportion of people whose income is less than \$2.15 a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

Goal 2: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

Goal 3: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

Goal 4: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

Goal 5: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

Goal 6: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

Goal 7: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water.

Goal 8: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth.

Table 10. Armenia: Financial Soundness Indicators for the Banking Sector, 2003–05
(In percent, unless otherwise indicated)

	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
	2003			2004			2005		
Capital adequacy									
Total regulatory capital to risk-weighted assets	33.8	35.5	34.3	33.7	32.3	36.4	31.7	33.6	33.7
Tier I regulatory capital to risk-weighted assets	32.2	33.5	32.3	31.7	30.2	33.7	29.6	31.9	31.7
Capital (net worth) to assets	18.1	16.9	17.9	17.5	17.8	19.3	19.5	20.6	21.5
Asset composition									
Sectoral distribution of loans (billions of drams)									
Industry (excluding energy sector)	19.0	19.4	20.6	23.8	29.0	26.0	26.9	28.9	30.4
Energy Sector	10.7	9.5	11.6	11.6	6.6	5.6	6.5	7.4	8.7
Agriculture	8.2	8.4	9.0	7.6	8.6	10.0	12.5	10.7	11.3
Construction	4.8	5.4	5.1	5.9	5.3	5.9	6.0	7.4	7.9
Transport and communication	0.7	0.8	1.0	1.2	1.2	2.2	3.3	3.0	3.7
Trade/commerce	21.5	23.1	24.9	28.8	31.1	30.6	32.8	34.8	42.2
Sectoral distribution of loans to total loans (percent of total)									
Industry (excluding energy sector)	20.1	19.1	18.3	19.4	22.2	19.7	18.4	18.3	17.0
Energy Sector	11.4	9.4	10.3	9.4	5.0	4.2	4.5	4.7	4.8
Agriculture	8.6	8.2	8.0	6.2	6.6	7.6	8.5	6.8	6.3
Construction	5.1	5.3	4.5	4.8	4.0	4.5	4.1	4.7	4.4
Transport and communication	0.7	0.8	0.9	1.0	0.9	1.7	2.3	1.9	2.0
Trade/commerce	22.7	22.7	22.1	23.4	23.8	23.2	22.4	22.1	23.5
Foreign exchange loans to total loans	72.7	74.6	72.1	71.8	70.4	73.6	70.2	66.6	63.7
Asset quality									
Nonperforming loans (billions of drams)									
Watch (up to 90 days past due)	6.7	5.8	4.3	5.0	3.1	4.0	4.0	4.1	3.8
Substandard (91-180 days past due)	4.9	3.0	2.5	2.9	1.5	2.8	2.7	2.8	2.9
Doubtful (181-270 days past due)	0.9	1.8	1.5	0.9	0.4	0.8	0.9	0.6	0.5
Loss (>270 days past due)	0.9	1.0	0.4	1.2	1.1	0.5	0.4	0.7	0.5
Nonperforming loans to gross loans	11.6	9.8	10.1	9.3	0.0	0.0	0.0	0.0	0.0
Provisions to nonperforming loans 1/	5.4	4.4	3.1	3.3	2.1	2.5	2.3	2.2	1.9
Spread between highest and lowest rates of interbank borrowing in AMD	34.3	41.8	47.8	50.4	77.0	58.8	61.3	65.5	70.7
Spread between highest and lowest rates of interbank borrowing in foreign currency	2.6	2.3	2.5	2.5	2.0	1.8	3.5	0.5	3.7
	3.7	2.0	2.7	1.0	1.0	0.9	4.0	6.1	1.0
Earnings and profitability									
ROA (profits to period average assets) 2/ 3/	2.7	2.7	2.9	3.2	3.2	2.9	2.8	3.2	3.1
ROE (profits to period average equity) 2/ 3/	14.4	16.2	16.2	18.0	18.4	15.8	14.7	16.8	15.5
Interest margin to gross income	42.0	46.0	46.8	44.6	44.2	43.4	39.6	40.5	41.1
Interest income to gross income	62.7	67.9	67.8	64.6	63.7	63.9	58.2	59.4	59.8
Noninterest expenses to gross income	48.5	45.7	47.0	45.5	46.5	45.2	54.5	49.9	49.7
Liquidity									
Liquid assets to total assets	47.5	46.5	44.6	47.6	47.1	46.3	45.2	45.7	44.2
Liquid assets to total short-term liabilities	101.3	100.3	96.1	99.9	98.7	107.9	106.1	109.9	110.5
Customer deposits to total (non-interbank) loans	177.1	175.0	160.3	175.0	177.3	161.4	148.1	149.3	140.5
Foreign exchange liabilities to total liabilities	73.2	75.1	72.6	74.1	73.3	72.4	71.1	69.5	66.8
Sensitivity to market risk									
Duration (or average repricing period) of assets									
Duration (or average repricing period) of liabilities									
Gross open positions in foreign exchange to capital	13.8	10.8	12.5	9.9	7.4	10.5	5.6	5.3	4.9

Source: Central Bank of Armenia.

1/ Includes the data of 20 banks and excludes the data of 4 banks under interim administration.

2/ Includes the data of 20 banks and excludes the data of 2 banks under interim administration.

3/ Includes the data of 20 banks and excludes the data of 1 bank under interim administration. The data of 1 bank are included which operated until 24 December.

ARMENIA: RELATIONS WITH THE FUND
(As of March 31, 2006)

I. **Membership Status:** Joined 05/28/1992; Article VIII

II. General Resources Account:	SDR Million	Percent of Quota
Quota	92.00	100.00
Fund holdings of currency	92.00	100.01
III. SDR Department:	SDR Million	Percent of Allocation
Holdings	12.81	n.a.
IV. Outstanding Purchases and Loans:	SDR Million	Percent of Quota
PRGF arrangements	120.04	130.48

V. **Latest Financial Arrangements:**

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
PRGF	05/25/2005	05/24/2008	23.00	6.56
PRGF	05/23/2001	12/31/2004	69.00	69.00
PRGF	02/14/1996	12/20/1999	109.35	109.35

VI. **Projected Payments to Fund**

(SDR Million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2006	2007	2008	2009	2010
Principal	17.81	15.43	17.06	15.19	14.13
Charges/interest	<u>0.57</u>	<u>0.48</u>	<u>0.40</u>	<u>0.32</u>	<u>0.25</u>
Total	18.38	15.91	17.46	15.50	14.37

VII. **Safeguards Assessment**

Under the Fund's safeguards assessment policy, the Central Bank of Armenia (CBA) is subject to a safeguards assessment update in the context of the current arrangement. A safeguards update of the CBA was completed on November 7, 2005. The update found that the CBA's safeguards framework has been strengthened since the previous assessment completed in 2002. In particular, measures have been put in place to improve data reported to the Fund, to strengthen controls and reporting on externally managed foreign exchange investments, and to address weaknesses in the legal framework. Furthermore, the appointment term of the external audit firm has been lengthened and new regulations and procedures have been put in place to better define the actions and scope of the internal audit function. A number of areas were identified where further steps could be taken. This includes strengthening controls over

reporting of monetary program data to the Fund, improving oversight of the audit processes and the internal control systems by establishing an audit committee, and enhancing the CBA’s internal audit function. The CBA agreed with the specific recommendations and their implementation schedule.

VIII. Exchange Rate Arrangement

- (a) On November 22, 1993, the Republic of Armenia introduced its national currency, the dram, at a rate of 200 Armenian rubles per dram. The exchange rate has been allowed to float since then, but in 2005, the CBA intervened in the foreign exchange market to smooth out volatility in the exchange rate. The foreign exchange interventions undertaken through September 2005 were against the backdrop of large intermittent inflows, downward pressure on prices, and a strong increase in money demand. The official exchange rate is quoted daily as a weighted average of the previous day’s interbank exchange rates.
- (b) Armenia maintains no exchange restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons, and notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

IX. Article IV Consultations

The 2004 Article IV consultation with Armenia was concluded on December 1, 2004. Armenia is subject to the 24-month consultation cycle.

X. FSAP Participation and ROSCs

A joint World Bank-International Monetary Fund mission assessed Armenia’s financial sector as part of the Financial Sector Assessment Program (FSAP) update during February 16–March 4, 2005. The Financial Sector Stability Assessment (FSSA) report was discussed by the Executive Board on May 25, 2005.

ROSC Modules

Standard	Timing	Publication Status	Document Number
Basel Core Principles for Effective Banking Supervision (BCP)	April 2001	Unpublished	...
Core Principles for Systemically Important Payments Systems (CPSS)	April 2001	Unpublished	...
Insurance Principles set by the International Association of Insurance Supervisors (IAIS)	2001	Unpublished	...
Principles set by the International Organization of Securities Commissions (IOSCO)	2001	Unpublished	...
Code of Good Practices in Monetary and Financial Policy Transparency (MFPT)	April 2001	Unpublished	...

Code of Good Practices on Fiscal Transparency	March 2001	Published	02/37
Data ROSC module	September 2000	Published	02/06
AML-CFT assessment by MONEYVAL	July 2004	Unpublished	...
Basel Core Principles for Effective Banking Supervision (BCP) update	May 2005	Unpublished	...
Corporate Governance	May 2005	Unpublished	...

XI. Resident Representatives

Mr. James McHugh, since September 2002.

XII. Technical Assistance

The following table summarizes the Fund’s technical assistance to Armenia since 2002.

Armenia: Technical Assistance from the Fund, 2002–06

Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Tax policy and administration	Short-term	September 17–October 3, 2003	MFE, State Tax Service (STS), and Customs Committee
Tax policy	Short-term	April 22–May 6, 2004	MFE, STS, and Customs Committee
Tax administration	Short-term	July 13–July 27, 2004	MFE, STS, and Customs Committee
Monetary and Exchange Affairs Department			
Banking system issues	Short-term	April 15–19, 2002	CBA
Banking system, deposit insurance, foreign exchange market development, and CBA monetary operations.	Short-term	June 24–July 4, 2002	CBA
Unified financial supervision, mortgage financing markets and inflation targeting	Short-term	January 26–February 6, 2004	CBA
Financial sector assessment program update	Short-term	February 16–March 4, 2005	CBA
Recapitalization of the Central Bank of Armenia	Short-term	December 8 – 14, 2005	CBA
Strengthening the implementation of monetary policy	Short-term	March 8 – 21, 2006	CBA

Statistics Department

Data dissemination standards	Short-term	September 18–25, 2003	National Statistical Service
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International Capital Market Department

Sovereign credit quality	Short-term	September 6–10, 2005	CBA
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ARMENIA: RELATIONS WITH THE WORLD BANK
(March 31, 2006)

Country Director: Donna Dowsett-Coirolo

Telephone: (202) 473-0121

I. IMPLEMENTATION OF STRUCTURAL REFORM MEASURES

A. Legal Framework

1. The World Bank has supported the Armenian government to establish the core legal framework necessary for private sector operations, including the Civil Procedure Code, the Procurement law, the Business Registration law and the Public Auction law. The fully restructured and enacted Bankruptcy law is now harmonized with the Civil Code and the Civil Procedure Code, and strengthens the enforcement mechanisms for bankruptcy procedures. The Concession law has been enacted and the National Assembly has adopted a new Labor Code, which is compatible with the requirements of a market economy and is an important instrument of flexible job-creation. The government also has made significant progress in drafting the necessary legislation to improve the lending environment through strengthening the procedures for collateral registration and for foreclosure and enhancing the knowledge of the judiciary concerning commercial contracts. Specifically, the government has adopted amendments to civil code, criminal code, civil procedure law, law on compulsory enforcement, and public auction law.

B. Business Environment

2. The World Bank has supported the government to make satisfactory progress in removing administrative barriers for business and investment and has strengthened the consultative mechanisms with the business community. The steps taken include, inter alia, consolidating, downsizing, and clarifying mandates of various government inspections; enacting the new law on business registration; streamlining licensing procedures; issuing new accounting recommendations for small and medium-sized enterprises; establishing a regulatory framework that allows privatization of urban land by business entities; and adopting simplified procedures for obtaining site development and construction permits. The capacity of the Armenian Development Agency as a focal point for government's efforts to promote investment and exports as well as for identifying the remaining bottlenecks in the business environment has been strengthened. The functioning of the Business Council has been improved and the private sector's awareness of its activities has been enhanced.

3. The recent business surveys of Armenian entrepreneurs suggest that these efforts have already resulted in a more positive private sector perception of the business and investment environment. For example, the average time necessary to get construction and building renovation permits was reduced from 310 days in 2001 to 76 days in 2003. The number of goods subject to mandatory certification at the border was reduced from 80 in 2001 to 60 in 2003. The FDI increased by 46 percent in 2004 compared with 2003. The State

Customs Committee's websites became operational and during 2003, on average 467 references per month were made to it. As part of the PRSC I and II, the Customs introduced a self declaration system, reduced the role of reference prices and strengthened Post Clearance Unit. On tax administration, the government strengthened the operation of Large Tax Payers Unit (LTPU), placed a high priority on reducing the stock of VAT refunds owed to exporters and ensured that no additional VAT arrears were incurred to exporters. The government adopted decision announcing its intention to widen participation in the provision of international civil aviation services, raise efficiency and cut costs and initiated policy work. Despite these improvements, there is still considerable scope for further reforms in the areas of competition, deregulation and strengthening of business and investment climate, especially in commercial debt recovery procedures, improvements in the transparency and efficiency of the judicial system, tax and customs administrations, improvements in governance and implementing the anti-corruption strategy. In addition to the above-stated, further strengthening of both tax and customs administration are at the core of the PRSC III, in particular implementation of self-assessment systems; adherence to reforms for the Large Taxpayer Unit and good practices on VAT refund and tax arrears; completion and implementation DTI facilities in major customs and implementation of intelligence-based system based on risk assessment.

C. Energy and Infrastructure

4. Since its privatization in the second half of 2002, the Electricity Distribution Company has remained in compliance with its licenses agreement as confirmed by making full payments to the generation and service providers, reporting to the regulator on a timely basis, and submitting investment plan to the regulator. Supported by the World Bank, the government has also made satisfactory efforts to improve the legal and regulatory framework in the energy sector in order to establish a supportive environment for the new private operator. Budget allocations have been increased to ensure full payments to the energy sector by the budgetary organizations and public utilities. The government implemented the Integrated Rehabilitation Plan for state-owned utilities (including energy, irrigation, drinking water companies and Yerevan metro) with strengthened corporate governance, creation of electricity market, and cessation of operations of the state electricity wholesale company. In addition, the Public Sector Regulatory Commission (PSRC) has made considerable progress in improving utilities regulatory framework and adopted several measures including, monitoring indicators for electricity service quality and standard. Despite this satisfactory performance, continued efforts are crucial for improvements in the energy sector through restructuring the midstream companies and strengthening the regulatory framework to ensure adequate functioning, transparency, and reliability of this sector.

5. There has been progress in improving fiscal discipline and reducing losses in the irrigation and water sectors. The World Bank has been working with the government to: (i) upgrade the management capacity of public companies in these sectors; (ii) ensure a gradual increase in tariffs to cost recovery; (iii) provide additional investments to improve technical efficiency; and (iv) ensure that the budget provides adequate financing for water

consumed by public sector entities.. To provide full cost recovery, the government has adopted a schedule for irrigation tariff increase in 2002–2007 in order to achieve full cost recovery in the irrigation system by 2007.

D. Education and Health

6. The World Bank has supported reforms in education and health. The government implemented a major rationalization program during the 2003 school year. As a result, 37 schools were merged or closed and about 9,000 teachers were made redundant. The medium-term action plan for improving the financial management, accounting, and financial reporting for higher education institutions was adopted by the government on January 26, 2003. Accountants at the higher institutions have been trained and special software has been prepared for use. Since the second quarter of 2003, the new accounting procedures are being used. The government increased the state budget allocation for primary and secondary education and improved teachers' salaries. The government also developed an action plan and cleared arrears in the education sector and prevented further arrears in this sector. The ratio of pupils to full-time equivalent teachers increased to over 14 and teacher salaries increased by 65 percent in 2005. In addition, the government developed a strategy on early childhood education and options for its piloting in two marzes. The government has also made initiatives to carry out the three year implementation plan for higher education reforms. Despite these improvements, there is scope for further reforms in education, including adoption of new curricula for secondary education, enhancement of standards for higher education to make it more responsive to employers' needs, improving preschool systems, and strengthening monitoring and financial reporting of the noncommercial organizations (NCOs) in the education sector.

7. The government adopted the hospital master plan for Yerevan in late 2002. As a result, the remaining public hospitals in Yerevan were to be merged into smaller number of hospital networks with necessary steps to be taken to restructure them. The government adopted a decree on November 21, 2003, identifying the configuration of ten hospital networks through consolidation of twenty-four public hospitals and thirteen outpatient health care institutions. Directors for nine of these hospital networks have been appointed. While the hospital merger process is being implemented, introduction of further appropriate adjustments may be required. The medium-term action plan for improving financial management accounting and reporting for the public hospitals was adopted by the government to prepare new reporting and accounting procedures and cost accounting manuals.

8. Implementation progress has been satisfactory and about 200 hospital accountants have been trained in new accounting procedures. The government developed an action plan for clearing the accumulated arrears in the health sector and prevented further arrears in this sector. The government also adopted a decision to introduce further reforms in the Basic Benefit Package in the health sector. The government undertook measures for financing and management of the Primary Health Care departments of polyclinic that are included in the

hospital networks. Further reforms are needed in increasing the population overall health status, reducing child and maternal mortality, increasing use of healthcare system by rural and low-income groups, monitoring public health and promoting better health behavior, and strengthening monitoring and financial reporting of the noncommercial organizations (NCOs) in the health sector. The government developed the national strategy on combating non-communicable diseases and plans to take necessary steps to address the public health threats from non-communicable diseases through development and implementation of specific priority programs on non-communicable diseases and through allocation of adequate public resources in the health care budget.

E. Social Protection and Insurance

9. Since 1999, the government has been replacing a range of fragmented cash and non-cash benefits and privileges with better-targeted transfers to families. The government has been supported by the World Bank to complete several important steps to enhance its capacity for administration of transfers to families, including: (i) re-registration of poverty benefit recipients; (ii) beneficiary assessment of the existing benefits; and (iii) establishment of a central database for poverty benefit recipients. Data from the recent household survey suggest that the system of benefits and transfers to the poor has become an efficient instrument for reducing extreme poverty. The government introduced differentiation of benefits within the family poverty benefits. Continued efforts are needed to ensure the adequacy of the level and administrative capacity of the social protection systems to guarantee coverage of transfers to people with special needs. Based on the 2004 household survey results the government plans to evaluate effectiveness of the family poverty benefits.

10. The law on Public Pension focuses on strengthening and streamlining the pension system. It provides significant improvements in the pension systems, including: (i) introduction of an equal retirement age for men and women at age 63; (ii) separation of social insurance benefits from social pensions; (iii) elimination of most early retirement provisions; (iv) indexation of pension to inflation; and (v) establishment of more direct links between benefits and contributions, with adequate provision for a minimum benefit. Following adoption of the law, the government has made satisfactory progress in its implementation. The government Decree No. 309 of July 2003, established an inter agency working group to monitor introduction of the Personal Identification Numbers (PINs) into the pension system. Additionally, a range of necessary implementation regulations, based on the Public Pension Law, was developed, including: (i) the documents required for award of pensions; (ii) rules for awarding and making payments for partial pensions to those with less than the minimum required length of insurance history; (iii) procedures for making payments of the survivors' pensions to children under full state custody; and (iv) procedures for awarding, computing and making payments of the privileged pensions. While the fiscal performance of the State Pension Fund has improved and as a result, the average pension has increased, the level, coverage and sustainability of pensions are issues for further elaboration.

II. LENDING

11. World Bank lending to Armenia as of January 19, 2006 totals US\$901.0 million, of which US\$748.8 million has been disbursed. The current Bank portfolio consists of 17 IDA credits with a total commitment of \$270.4 million, of which \$123.7 million is disbursed.

12. Building on the major Poverty Reduction Strategy Paper's (PRSP) themes, the fourth Country Assistance Strategy (CAS) for Armenia was discussed in the World Bank Board of Executive Directors on June 10, 2004 to focus on three main objectives of: (i) promoting private sector led economic growth; (ii) making growth more pro-poor; and (iii) reducing non-income poverty. Pursuant to agreements reached in the context of IDA-14, country resource envelopes are determined annually based on the Country Policy and Institutional Assessments and performance of the ongoing portfolio. Armenia has a very strong IDA performance rating and as a consequence was eligible for about \$58 million in FY06. Towards the end of the CAS period, there could be a first IBRD loan if Armenia's creditworthiness improves sufficiently. The CAS includes three Poverty Reduction Support Credits (PRSCs) for FY05, 06 and 07. These will support the PRSP objectives and focus on four main components: (i) supporting private sector development; (ii) advancing public infrastructure reforms; (iii) improving core public sector functions; and (iv) enhancing human development and improving social safety nets. Macroeconomic stability is a precondition for the PRSC and is vital for facilitating an enabling environment necessary for successful structural reforms implementation. The PRSC's preparation is being closely coordinated with the IMF Poverty Reduction and Growth Facility (PRGF). The first PRSC was approved by the World Bank Board on November 18, 2004, became effective and disbursement of about \$21 million was made in December 2004. The second PRSC in the amount of \$20 million equivalent was approved by the World Bank's Board on January 19 2006.

List of World Bank Lending to Armenia
(In millions of U.S. dollars)

Active Projects	Credit Amount as of 04/21/06	Disbursement as of 04/21/06	Approval Date	Closing Date
<i>Active Projects</i>	<i>265.4</i>	<i>101.1</i>		
1. Electric. Trans. & dist.	21.0	20.8	03/04/99	10/31/06
2. Enterprise incubator	5.0	3.7	11/30/01	12/31/06
3. Judicial reform	11.4	11.11	09/14/00	06/30/06
4. Irrigation dam safety	26.6	20.4	06/24/99	09/30/07
5. Irrigation development	24.9	19.4	08/30/01	03/31/07
6. Social protection admin.	5.2	0.4	06/10/04	12/31/07
7. Natural resource management	8.3	2.8	06/04/02	07/31/08
7. Natural resource management (GEF)	5.1	1.3		
8. Educ. qual. & relevance (APL#1)	19.0	4.2	01/20/04	11/30/08
Municipal water and WW	23.0	7.1	05/04/04	02/28/09
9. Health system mod.	19.0	3.2	06/10/04	06/30/09
10. Irrigation dam safety 2	6.8	1.0	06/10/04	03/31/09
11. Public sector mod.	10.1	0.7	05/04/04	03/31/09
12. Rural Enterprise & small scale	20.0	0.9	07/07/05	05/31/10
13. Urban Heating Project	15.0	1.7	07/12/05	06/30/10
14. Yerevan water/waste water services	20.0	2.3	02/24/05	02/28/11
15. PRSC-II	20.0	0.0	01/19/06	06/30/07
16. Renewable Energy	5.0	0.0	03/29/06	12/31/10
<i>Completed Projects</i>	<i>660.6</i>	<i>681.1</i>		
18. Municipal development	30.0	32.2	06/11/98	01/31/06
19. Economic rehabilitation	60.0	64.3	02/28/95	06/30/96
20. SAC	60.0	58.1	02/29/96	12/31/97
21. Institution building	12.0	10.7	03/30/93	11/30/97
22. Earthquake rehabilitation	28.0	27.4	02/01/94	06/30/97
23. Power maintenance	13.7	13.2	12/08/94	06/30/99
24. SAC II	60.0	62.7	08/26/97	06/30/99
25. SATAC I	3.8	2.9	02/29/96	06/30/00
26. Highway	31.0	30.5	09/14/95	12/31/00
27. Social Investment Fund	12.0	11.6	11/09/95	12/31/00
28. Irrigation rehabilitation	43.0	41.2	12/08/94	05/31/01
29. SAC III	65.0	67.2	12/22/98	06/30/01
30. Enterprise development	16.8	16.5	12/24/96	07/01/02
31. SATAC II	5.0	4.8	08/26/97	12/31/02
32. Education	15.0	16.1	11/20/97	10/31/02
33. SAC IV	50.0	55.9	05/22/01	03/31/03
34. Health	10.0	10.3	07/29/97	12/30/03
35. SAC V	40.0	43.9	03/13/03	06/30/04
36. Title registration	8.0	8.5	10/13/98	09/30/04
37. Transport	40.0	43.5	06/08/00	12/31/04
38. PRSC I	20.0	19.9	18/11/04	12/31/05
39. Agric. Reform support	16.3	17.2	01/27/98	06/30/05
40. Social Investment Fund II	20.0	21.5	05/11/00	12/31/05
41. Investment and export facilitation	1.0	1.0	04/16/02	12/31/05
Total	926	782.11		

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

(As of March 23, 2006)

1. As of December 31, 2005, the EBRD approved 27 projects in the power, transport, agribusiness, textile, mining, construction and financial sectors. Total commitments amounted to EUR 114.2 million.
2. There are two sovereign projects. First, the EBRD approved a sovereign guaranteed loan of EUR 54.8 million for construction of the Hrazdan Unit 5 thermal power plant in March 1993, partly aimed at the eventual closure of Armenia's nuclear plant in Medzamor. The government is contemplating the privatization of Hrazdan Unit 5 as the completion of this plant is constrained by limited budgetary resources. The EBRD had funded technical assistance for the Hrazdan privatization prospectus and continues to follow the privatization process. The Hrazdan Thermal Power Complex excluding the unfinished Unit 5 has been transferred to the Russian Federation in the context of the debt-for-equity deal. Second, in November 1994, the agreement on a EUR 21.8 million loan to build an air cargo terminal in Zvartnots airport was signed under a guarantee by the Armenian government. The airport was transferred to private management in 2002. The new management has prepared a master plan for the development of the airport, which is expected to generate further cargo traffic for the cargo terminal.
3. Most of the Bank's projects in Armenia are in the private sector. The EBRD has provided a loan to the Yerevan Brandy Company owned by Pernod Ricard of France (EUR 16.5 million). In the banking sector, a first equity participation in the Commercial Bank of Greece-Armenia (EUR 1.1 million) was approved in late 1999 and a second equity participation in Armeconombank was approved in 2004. The Bank also acquired an equity stake in an Armenian non-bank financial intermediary, CIRCO, an insurance subsidiary of Cascade Capital. Moreover, a multi-bank on-lending facility of EUR 10 million was activated in early 2000. Within the framework of multi-bank facility the Bank currently has credit lines for micro and small enterprises with three local banks (a total of EUR 8.0 million). The EBRD is committed to further expanding lending under this facility to other banks. A Trade Facilitation Program with the purpose to facilitate access of Armenian banks to trade financing was also made available to four Armenian banks. In 2002, a loan to finance EUR 2.9 million in working capital expansion was signed with the Armenian Copper Programme (the only copper smelter in the region), and a new loan (EUR 4.3 million), including the refinancing of the existing loan, was signed in August 2004. Moreover, the EBRD has launched the Turn Around Management (TAM) and Business Advisory Service programmes in Armenia in 2003, originally funded by the EU-Tacis program but now funded from the ETC Fund, to support micro, small, and medium-sized enterprises. There were seven new projects completed during 2004 for a total amount of EUR 6.7 million. Two of them are in the banking sector (including equity investment), one in general industry sector (direct investment in equity of a local enterprise), one pre-export finance facility with a local company in the extractive industry and three trade facilitation programmes with local commercial banks. During 2005 the EBRD signed 11 projects with the total commitments of Euro 18 million.

New commitments include a trade facilitation project with a local bank, two direct lending facility with a small hydro power plant and gold mining company, three new SME loans, three equity investment projects with a pharmaceutical company, plastic preform manufacturer (under Direct Investment Facility), an insurance and reinsurance company, and two medium-sized co-financing facility allowing local banks to share the risk of their selected clients with EBRD.

4. The key priorities of the EBRD for the coming years are: (i) financial sector; (ii) enterprise sector, particularly SME and micro-enterprise financing through credit lines to Armenian banks or direct loans and equity investments, (iii) infrastructure investments in the development of alternative energy sources and municipal infrastructure projects and (iv) portfolio monitoring and implementation support. The EBRD's current country strategy was approved in February 2006.

ARMENIA: STATISTICAL ISSUES

While data provision for surveillance is adequate overall, further improvements are needed in real, fiscal, and external sector statistics in order to enhance the design and monitoring of economic policies. The overall quality, timeliness, and coverage of macroeconomic statistics in Armenia have improved significantly over the past few years. The Fund has substantially participated in this process, through technical assistance from the Statistics Department, the Fiscal Affairs Department, and the Monetary and Exchange Affairs Department. On November 7, 2003 Armenia subscribed to the Special Data Dissemination Standard (SDDS) and has since then provided timely data for all SDDS prescribed data categories.

National accounts and price statistics. The National Statistics Service (NSS) has made significant changes to the national accounts methodology to bring it in line with best international practices. Progress has been made in developing estimates of monthly and (constant price) quarterly GDP that are now published. Basic data collection procedures have also improved. The national accounts have adopted the concept of gross value added using transaction prices mostly recorded on an accrual basis. However, progress has been slow in improving the compilation of national accounts at constant prices; annual data are still mainly derived by re-valuing current output and inputs at previous year prices instead of deflating them by the relevant components of the producer price index. The CPI covers nine large population centers in the Republic of Armenia (excluding the Ararat region) and the capital city, Yerevan. The base year and expenditure weights are for 2002. Data on the consumer price index (CPI) and wages are reported on a timely basis. A ten-day CPI is compiled by the NSS and the Central Bank of Armenia, though its scope, geographical coverage, and dissemination is limited.

Fiscal statistics. The budget execution reporting system is compiled on a cash basis and supplemented with monthly reports on arrears and quarterly reports on receivables and payables. Daily revenue and cash expenditure data for the central government are available with a lag of one to two days. The Ministry of Finance is undertaking a comprehensive reform of the treasury system, including the introduction of an internal auditing system in line ministries and their budgetary institutions. A single treasury account (TSA) was introduced in 1996, and all bank accounts held by budgetary institutions were closed, except for Project Implementation Units that are required by donors to operate with commercial banks' accounts. Starting in 2002, some budgetary institutions have been converted into "noncommercial organizations" (NCOs). These units have been taken out of the treasury system and have their own bank accounts. They have just started reporting data on their operations to the Ministry of Finance. These exceptions notwithstanding, all government receipts and payments are processed through the TSA, although there are still shortcomings on the timeliness and quality of data on the operations of local governments. Classification of government transactions by function and economic category are generally in line with the *Manual on Government Finance Statistics 1986*, and monthly data on central government operations are disseminated within 40 days of the end of the month.

However, the budget presentation and the classification of items under the economic and functional classification of expenditures needs to be made more transparent; for instance, the data has been subject to frequent reclassifications and wages for military personnel are reported in the broader category of “other” goods and services rather than as a wage item. The reconciliation of central government with general government operations is also difficult because of the need to manually identify transactions among central government, local government, and the Social Insurance State Fund.

The authorities submitted cash data, converted to the framework of the *Government Finance Statistics Manual 2001*, for publication in the *2005 Government Finance Statistics Yearbook*. Although the authorities expected to begin providing data for publication in the *IFS* in early 2005, no such data yet have been received. The *GFSM 2001* implementation plan is currently limited to bringing the classification of budgetary central government revenue, expense, and transactions in nonfinancial assets in line with international practices.

Money and banking statistics. Money and banking statistics are provided on a timely basis. Daily data on the accounts of the CBA are provided weekly with a one-day lag, while weekly data on the monetary survey are provided with a one-week lag. Monthly interest rate data are provided with an one-week lag. A new chart of accounts meeting International Accounting Standards (IAS) was introduced in January 1998. Since then, the balance sheets of the CBA and of the deposit money banks follow IAS methodology.

Responding to a STA request, the CBA has compiled and submitted, as pilot project, a set of monetary data for September-November 2004 using STA’s Standardized Report Forms (SRF). STA review validated the resulting monetary aggregates, and the authorities are proceeding to convert the historic monetary database into the SRF format and update the pilot data to include recent periods.

External sector statistics. The coverage of external sector data has improved in recent years. Trade statistics are provided on a timely basis, and trade data by origin or destination and by commodity are generally available within a month. Price data for exports and imports are less readily available. Quarterly balance of payment data are generally available with a three-month lag. However, data on private non-guaranteed external debt are not compiled, while data on direct investment abroad (available from 2003) and on other capital outflows are likely underestimated. The balance of payments data will need to be revised in light of recent studies showing that remittance inflows have been underestimated. The absence of a comprehensive, continuously updated business register hampers the coverage of transactions and institutional units. The latest quarterly data on international investment position are available for 2005.

Armenia: Table of Common Indicators Required for Surveillance
(As of April 17, 2006)

	Date of latest observation	Date received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of publication ⁶
Exchange Rates	9/30/05	9/30/05	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	9/29/05	9/30/05	D	W	M
Reserve/Base Money	2/28/2006	4/14/2006	D	W	M
Broad Money	2/28/2006	4/14/2006	M	M	M
Central Bank Balance Sheet	2/28/2006	4/14/2006	D	W	M
Consolidated Balance Sheet of the Banking System	2/28/2006	4/14/2006	M	W	M
Interest Rates ²	2/28/2006	4/14/2006	W	W	M
Consumer Price Index	Dec 05	1/19/2006	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ —General Government ⁴	Q2 05	8/28/05	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing ³ —Central Government	Jun 05	7/30/05	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	Q2 05	8/31/05	Q	Q	Q
External Current Account Balance	Q1 05	6/20/05	Q	Q	Q
Exports and Imports of Goods and Services	Q3 05	12/23/05	Q	Q	Q
GDP/GNP	Q3 05	1/04/06	M	M	M
Gross External Debt	Q1 05	6/30/05	Q	Q	Q

¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA).

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

April 27, 2006

Dear Mr. de Rato:

In the attached Memorandum of Economic and Financial Policies, we summarize progress to date in implementing our PRGF-supported program and set out our economic and financial policies for 2006. We request hereby the completion of the second review under the PRGF arrangement and the disbursement of SDR3.28 million.

The PRGF-supported program is on track. The Armenian economy continues to perform very well and all but one quantitative performance criteria and all structural performance criteria for end-December 2005 were observed. We request a waiver for the nonobservance of the performance criterion on the cash balance of the central government at end-December 2005. The target was missed by a small margin, largely due to unforeseen expenditures late in the year.

We recognize that a number of significant challenges remain to sustain high economic growth and reduce poverty. To this end, our economic program for 2006 contains specific measures to address weaknesses in tax and customs administration and strengthen the financial sector. The Government of the Republic of Armenia believes that the policies and measures set forth in the attached Memorandum are adequate to achieve the objectives of the program, but it stands ready to take any additional measures that may be appropriate for this purpose. The Government will consult with the Fund in advance on the adoption of these measures in accordance with the Fund's policies on such consultation. The Government intends to make these understandings public and authorizes the IMF to publish this letter, the attached Memorandum, and the IMF staff report.

Sincerely yours,

/s/

Andranik Margaryan
Prime Minister
Republic of Armenia

/s/

Vartan Khachatryan
Minister of Finance and Economy

/s/

Tigran S. Sargsyan
Chairman of the Central Bank

REPUBLIC OF ARMENIA
MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

April 27, 2006

1. This memorandum sets forth the government's economic objectives and policies for 2006, the second year of the program supported under the Poverty Reduction and Growth Facility (PRGF). These policies constitute an integral part of the government's medium-term strategy for poverty reduction as envisaged in the Poverty Reduction Strategy Paper (PRSP), which is expected to be updated by September 2006.

I. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

2. The Armenian economy continued to register strong noninflationary growth in 2005, and a notable reduction in poverty. **Real GDP** grew by 14 percent, the fourth consecutive year of double-digit growth, led by construction and agriculture. Domestic demand continued to be buoyed by investment and robust remittances inflows. The end-of-period **inflation** rate fell from 2 percent in 2004 to -0.2 percent in 2005, reflecting a significant drop in food prices associated with a good harvest and an appreciation of the dram. The most recent household survey shows a further decline in **poverty** from 43 percent in 2003 to 39 percent in 2004, driven mainly by a decline in rural poverty.

3. **Fiscal policy** remained sound, with a central government cash deficit of 2.6 percent of GDP in 2005, and improving revenue performance. The tax-to-GDP ratio rose by 0.3 percentage points, the largest increase since 1999, on account of improved collection, particularly in value added and profit taxes. Both current and capital expenditures increased as budgeted, largely on account of higher social outlays and increased road construction. As a result, the central government deficit on a cash basis amounted to AMD 58 billion, within the budget limit of AMD 62 billion but slightly higher than programmed at AMD 52 billion.⁵

4. Broad **money** grew briskly, reflecting high demand for money and continued monetization in an environment of subdued inflation, increased confidence in the banking system, and an appreciating dram. Reserve money grew by 52 percent year-on-year in December due to Central Bank of Armenia (CBA) intervention in the foreign exchange market through September in the face of strong remittance flows and a run-down of government deposits in December.

5. Robust exports of base metals and processed foodstuffs, higher-than-expected tourism receipts, and large remittance inflows strengthened the **external current account** position, and gross official reserves increased by US\$134 million in 2005. Armenia's

⁵ The deficit figures exclude the privatization fee of AMD 12.5 billion from revenues.

Millennium Challenge Account (MCA) Compact was signed in March 2006, and agreement was reached with the Lincy Foundation for a sizeable private grant.

6. All but one end-December **quantitative performance criteria** were observed (Table 1). The floor on the cash balance of the central government was missed by a small margin, largely on account of unforeseen current and capital expenditures. Moreover, two indicative targets were not observed. The ceiling on reserve money was exceeded, reflecting higher-than-projected net international reserve (NIR) accumulation. The floor on the contributions to the State Fund for Social Insurance was missed by a small margin because of transitional problems associated with the transfer of the collection function to the State Tax Service (STS).

7. We continued to make good progress in **structural reforms**. All end-December 2005 structural performance criteria and benchmarks were observed. In addition, the end-June 2005 benchmark on amending the legal provisions on tax audits was approved by parliament in December.

8. We have continued to strengthen tax and customs administration as well as budget execution:

- In **tax policy**, we passed a law to increase the minimum contribution on social security payments from AMD 5,000 to AMD 7,000. We changed the denomination of excise taxes to drams and increased the rates to stem revenue losses associated with the dram appreciation. We submitted to parliament several amendments to existing tax legislation to (i) eliminate the exemptions for foreign exchange gains and narrow the carry-forward loss for the profit tax; and (ii) move numerous capital goods that were exempt from VAT payment at the border to the capital deferral system. The amendment to reduce the list of goods exempt from VAT payment at the border was not approved by parliament. We will also shortly submit to parliament legislation to broaden the base of the property tax.
- In **tax administration**, we raised sanctions for providing false documentation to revenue agencies; extended the time periods for audits of large enterprises to 90 days; permitted offsite examinations; and established a special large taxpayer unit for the mining sector. Additionally, we extended the STS territorial divisions and have finalized a 2006-08 IT strategy for STS that will form the basis for an action plan for the period ahead.
- A review of **customs administration** identifying the strengths and weaknesses of the State Customs Committee (SCC) was recently concluded. We increased the share of declarations of imports for which customs value is determined on the basis of declared transaction prices by over 5 percent. In addition, we reduced the share of import consignments selected for physical examination in the red and yellow channels. In the context of our Poverty Reduction Support Credit (PRSC), we have been working with the World Bank to implement a direct trader input (DTI) system

in customs. We also established a pilot program for the TIR (Transport Internationale Routiers) customs house to conduct all customs processing through self-declaration and self-assessment.

- On the **expenditure** side, we moved forward the annual procurement process, which should improve budget execution in 2006, and introduced program budgeting for four ministries. We have continued to implement our action plan for improving noncommercial organizations' (NCOs) financial management and reporting and have passed a decree on sanction mechanisms for NCOs that fail to comply with reporting requirements.

9. We are continuing to strengthen the **financial sector** and its regulatory and supervisory framework. The amended Law on Banks and Banking was passed by parliament in December. It will strengthen consolidated banking supervision, improve corporate governance of banks, and enhance the effectiveness of external audits in risk management. With regards to the insurance sector, by-laws on prudential regulation as well as accounting and reporting requirements have been finalized. We also adopted a unified financial supervision system, integrating the insurance and security market licensing, regulation, and supervision functions into the CBA. Effective January 1, 2006, we announced the adoption of an implicit inflation targeting monetary policy framework.

10. We continue to make progress in other areas of structural reforms. In the **energy sector**, the Public Sector Regulatory Commission is deliberating over a proposal to increase gas tariffs for end-users on account of a new gas delivery contract price effective April 1, 2006.⁶ The audit of Armenergo's balance sheet and its subsequent liquidation, which was postponed owing to delays in the judicial process, has been approved and a World Bank loan secured for its funding. Overall performance of the **water and irrigation** sectors has improved owing to reduced losses, tariff increases and improved collection. In cooperation with the World Bank, we started a 7-year program aimed at mitigating the impact of water tariff increases on socially vulnerable groups in the service area covered by the Yerevan Water and Sewage Company.

II. THE 2006 PROGRAM

11. We remain committed to our growth and poverty-reduction strategy and intend to update our PRSP by September 2006. Our macroeconomic policies will continue to focus on price stability and forceful implementation of tax, customs, and financial sector reforms to generate additional resources to fund infrastructure development, expand poverty-reducing services, and improve the quality and depth of financial intermediation. We expect real GDP

⁶ The new gas delivery contract envisages an increase in gas import prices from \$55 to \$110 per 1000 cubic meters, effective April 1, 2006, and will have implications for end-user gas and electricity tariffs.

growth to be 7.5 percent in 2006, unchanged from our previous forecast, in light of the uncertainties associated with the impact of the gas price increase on our economy, the agricultural harvest, and a slowdown in the growth of remittances. We intend to revise our macroeconomic framework in consultation with Fund staff in the second half of the year. Inflation is expected to be 3 percent.

A. Fiscal Policy

12. The approved **2006 budget** aims for a deficit of AMD 69.9 billion (2.8 percent of GDP), consistent with our Medium-Term Expenditure Framework for 2006-08. Tax revenues and total expenditures are budgeted at AMD 364.3 billion (14.8 percent of GDP) and AMD 482.2 billion (19.6 percent of GDP), respectively. On the **revenue** side, we are committed to increasing the tax-to-GDP ratio by 0.3-0.4 percentage points in 2006, in line with our PRSP objectives. To this end, we will revisit tax revenue performance during the year and adjust the tax target upward if warranted by a revision of our nominal GDP growth forecast. We recognize that our tax target is ambitious, but are confident that it will be achieved.

13. On the **expenditure** side, the combined education, health, and social security allocations are budgeted to rise to 7 percent of GDP compared to an estimated outturn of 6.1 percent of GDP in 2005. Capital expenditure is budgeted to increase to 5.4 percent of GDP (excluding potential disbursements from the MCA) compared to 3.8 percent of GDP in 2005. In the event of any MCA disbursements in 2006, a supplementary budget will be passed to allocate the funds to additional capital expenditures.

B. Monetary and Exchange Rate Policies

14. Price stability will continue to be the main objective of monetary policy. We will also retain the flexible exchange rate regime, with foreign exchange interventions used as an instrument to address excess liquidity and to smooth out volatility in the exchange rate. Given the rapid increase in monetary aggregates in 2005 and the associated inflationary risks, the CBA is targeting a reduction of money supply growth in 2006. The monetary program seeks to limit reserve money growth to 19.2 percent and envisages a slower buildup in foreign reserves relative to 2005. The program, based on conservative assumptions on velocity and the money multiplier, targets inflation of 3 percent. We intend to increase the stock of treasury bills by AMD 7 billion, which will contribute to the development of the domestic government debt market. Additionally, we are working towards an agreement between the Ministry of Finance and Economy (MOFE) and the CBA regarding the recapitalization of the CBA.

15. Our medium-term goal is to move towards a full-fledged **inflation targeting** monetary policy framework. In this regard, we are in the process of identifying the necessary steps and formulating an action plan, including better understanding of the monetary transmission mechanism and developing forward looking inflation forecasting models.

C. Structural Reforms

16. We will continue to press ahead with reforms to improve tax and customs collection, improve the tax system, and strengthen the financial sector (Table 3).

Fiscal reforms

17. The government's two-year Tax Action Plan, approved in May 2005, will remain the centerpiece of our program to improve our tax system. Specific measures that we intend to implement in 2006 are discussed below.

18. In **tax policy**, we aim to broaden the tax base. Specifically, we intend to submit to parliament an amendment to the Law on the Simplified Tax to narrow the access to the simplified tax regime by excluding activities that require state licenses with annual stamp duties of AMD 1 million or more (structural performance criterion, end-September 2006).

19. Additional tax policy measures that we intend to implement over the medium term include finalizing a unified tax code; moving all remaining exemptions from VAT payment at the border; moving large-scale operations from the presumptive tax to the regular tax regime; replacing the presumptive taxes on petroleum, diesel, and cigarettes by a specific excise and the VAT; and establishing a consolidated VAT and customs duty payment for vehicle imports for personal use and revising the property tax rates for vehicles. We also intend to allow the current profit tax exemptions for foreign enterprises to expire as stipulated in the law, and will not introduce any new tax privileges. Finally, we intend to submit to parliament amendments to the respective tax laws to incorporate large-scale producers in the agricultural sector in the normal tax regime.

20. In **tax administration**, we will focus our efforts on arrears collection, taxpayer compliance, and information technology (IT). We intend to:

- complete a 2006-08 IT and acquisition action plan for the STS and secure budget resources (structural benchmark, end-June 2006) with a view to (i) improving the IT management capacity; (ii) implementing risk-based selection criteria in the areas of audits, arrears collection, and VAT refunds; (iii) improving information sharing between the tax inspectorates and headquarters; and (iv) establishing a unified database for social contributions, tax collection, and tax arrears to enable improved cross-checking.
- start applying universal VAT cross-checks (structural benchmark, June 2006).
- implement our plan for the collection of tax arrears with a view to collecting or writing off at least AMD 20 billion of the end-2005 stock of tax arrears by December 2006, with a particular focus on the largest arrears holders, and aim to ensure that no new arrears are incurred on a monthly basis.

- continue to implement an annual audit plan for large enterprise, adopt a methodology for off-site audits; limit the number of revisions in tax returns that may be submitted by taxpayers, and prohibit such revisions during tax audits.
- implement the action plans on the verification of reported tax losses and on raising revenues from large taxpayers and to produce end-year progress reports

21. The operational review of **customs administration** identified a number of areas for improvement in customs operations. In particular, to strengthen administration, and improve transparency, we intend to:

- establish a dedicated Risk Management Unit in the SCC. One of the objectives of the unit will be the regular review and updating of examination selectivity criteria. (structural benchmark, end-June 2006).
- expand the use of the examination selectivity module in ASYCUDA to all customs houses and customs points (structural benchmark, end-September 2006).

22. We also intend to publish quarterly newsletters clarifying customs legislation and changes in procedures; design and implement a new system for the examination and licensing of customs brokers; and, in addition to complying with our regular reporting requirements to the IMF, to prepare and submit to the IMF detailed statistics on violations of customs rules and smuggling cases. Finally, we will continue to work with the World Bank and other development partners on other measures, including implementing DTI in line with our discussions with the World Bank; and completing and introducing an intelligence-based system based on risk assessment.

23. We recognize the importance of better targeting government **expenditures** to ensure adequate public investment and social spending as well as high expenditure quality, particularly in light of the expenditure increases envisaged in 2006. In this regard, we plan to work towards the implementation of the NCO financial management and reporting action plan by end-year.

Financial sector reforms

24. We recognize the importance of increasing competition and improving confidence in the banking system. We are encouraging the entry of reputable international commercial banks to increase competition in the banking sector. As regards **banking regulation and supervision**, we will specify and implement a consolidated supervision framework for monitoring beneficiary owners beyond the licensing stage in order to determine the appropriate structure of corporate governance and to identify how affiliate companies and related parties impact on the bank's operations (structural benchmark, end-June 2006). We intend to publish a compliance report in June 2006, at the end of the six month grace period for compliance with the amended Law on Banks and Banking. In addition, we plan to draft and submit to government an amendment to the Law on Banking Secrecy which would

allow the CBA to publish violations of and sanctions against commercial banks that do not comply with the Law on Banks and Banking. This will increase CBA accountability as well as public scrutiny of commercial banks.

25. Regarding **foreign exchange cash operations**, and with a view to the containment of activities in the shadow economy and of money laundering, we will strengthen the regulation and supervision of foreign exchange offices and require foreign exchange offices to limit their operations to the provision of retail services to households. In addition, we intend to tighten the restrictions regarding the depositing of large amounts of foreign exchange cash on company bank accounts to those transactions where the legal origin of cash funds can be proven. Lastly, we plan to improve the enforcement of the prohibition of foreign exchange cash transactions in the retail sector. In this context, the STS together with CBA and MOFE will conduct a review and propose specific measures to strengthen enforcement prohibiting foreign cash transactions in the retail sector by June.

26. In the **insurance sector**, we are in the process of implementing a regulatory and supervisory framework, focusing on accounting, auditing, financial reporting, solvency, reserves, and reinsurance. An action plan to improve the general insurance market framework has already been prepared, including the implementation of a claims reporting system, a data base for actuarial projections, and prudential requirements. We intend to submit to parliament an amendment to the Law on Insurance that will eliminate the limitations on the range of services that insurance companies with substantial foreign ownership (above 49 percent of capital) can provide in Armenia (structural performance criterion, end-June 2006).⁷ We will also encourage the entry of reputable foreign insurance companies to facilitate the availability of a large range of life and non-life insurance products.

27. We are planning a fundamental reform of the **pension system**. In this regard, we have finalized a comprehensive actuarial analysis considering various alternative scenarios for the establishment of a new multi-pillar system. We aim at reaching a decision on the new pension system by September 2006. Implementation will begin on January 1, 2008. We are aligning the Capital Markets regulatory framework with our current developmental needs. In this context, we aim to reduce the reporting and regulatory burden on non-traded and non-listed companies and to encourage listings in the Stock Exchange. To achieve the latter, we will partner with a reputable foreign stock exchange company and encourage cross-border trade in securities.

⁷ According to Article 6 of the present law, insurance companies that have more than 49 percent foreign interest in their statutory capital may not carry out life insurance and mandatory insurance.

III. OTHER ISSUES

28. We have completed our **PRSP** progress report, which draws upon the results of the 2004 household survey to reflect the developments since the adoption of the PRSP in 2003. We plan to update our PRSP by end-2006 through a participatory process.

29. In the **energy sector**, we plan to complete the audit of Armenergo and its liquidation by September 2006. We will continue with our efforts to improve efficiency and reduce losses in the energy sector by strengthening technical and management links in midstream companies. We also intend to strengthen further the capacity of the water user associations and to restructure the state-owned water distribution company to move toward cost recovery in the irrigation sector. On governance, we intend to update our anti-corruption action plan at end-2006.

IV. PROGRAM MONITORING

30. Program monitoring will continue to be based on semi-annual quantitative performance criteria and quarterly indicative targets as well as structural performance criteria and benchmarks. The Technical Memorandum of Understanding (TMU) of October 2005 and the attached amendment to the TMU define the quantitative targets of Table 1, the program adjustors, and specific reporting requirements. Completion of the third review under the PRGF arrangement, scheduled for November 16, 2006, will require observance of the revised performance criteria for end-June 2006 shown in Table 1 as well as the structural performance criteria listed in Table 2. The completion of the fourth review under the PRGF arrangement scheduled for May 16, 2007 will require observance of the quantitative performance criteria for end-December 2006 shown in Table 1 as well as the December structural performance criteria listed in Table 2.

Table 1. Table of Structural Measures for the Third Review under the PRGF

Measure	Type of Conditionality	Target Date (End of Period)
<u>Tax policy</u> Submit to parliament an amendment to the Law on Simplified Tax that narrows access to the simplified tax regime by excluding activities that require state licenses with annual stamp duties of AMD 1 million or more.	Structural Performance Criterion	September 2006
<u>Tax administration</u> Complete a 2006-08 IT and acquisition plan for the STS based on the strategy paper and secure budget resources.	Structural Benchmark	June 2006
Start applying universal VAT cross-checks.	Structural Benchmark	June 2006
<u>Customs administration</u> Establish a dedicated Risk Management Unit in the SCC. One of the objectives of the unit will be the regular review and updating of examination selectivity criteria.	Structural Benchmark	June 2006
Expand the use of the examination selectivity module in ASYCUDA to all customs houses and customs points.	Structural Benchmark	September 2006
<u>Financial Sector</u> Submit to Parliament an amendment to the Law on Insurance that eliminates the limitation on the range of services that insurance companies with substantial foreign ownership (above 49 percent of capital) can provide in Armenia.	Structural Performance Criterion	June 2006
Specify and implement a consolidated supervision framework for monitoring beneficiary owners beyond the licensing stage, in order to determine the appropriate structure of corporate governance and to identify how affiliate companies and related parties impact on bank's operations.	Structural Benchmark	June 2006

Table 2. Armenia: Quantitative Targets, September 2005 – December 2006 1/
(End of period ceilings on stocks, unless otherwise specified)

	2005			2006				
	Prog.	Act. 2/	Prog.	Dec.	Mar.	Jun.	Sep.	
				Proj. 3/	Prog. 2/	Prog. 3/	Prog. 2/	
	Sep.						Dec.	
	Prog. 3/						Prog. 3/	
Net domestic assets of the CBA 4/ Adjusted target 5/	-56.7	-56.7	-51.4 -41.4	-42.5	-40.9	-29.8	-27.3	-15.4
Net banking system credit to the government Adjusted target 5/	-20.8	-19.2	-4.8 5.2	5.16	2.6	-1.2	7.1	21.2
Domestic arrears of the central government and the Tax revenues of the central government (floor) 6/	0	0	0	0	0	0	0	0
Balance of the central government on a cash basis (floor) 6/	224.2	224.0	314.0	321.5	74.1	162.1	259.1	364.3
Reserve money (band/level) 2/	-23.3	-29.3	-52.0	-58.0	-11.4	-31.9	-48.5	-69.9
Contributions to the State Fund for Social Insurance 2/ 6/	(169-176)	173.8	(181-188)	(197-205)	(189-197)	(199-207)	(216-225)	(234-244)
Contracting or guaranteeing of new nonconcessional external debt 6/ 7/	46.4	43.7	64.8	60.1	16.1	34.0	52.4	74.0
External arrears (continuous criterion)	0	0	0	0	0	0	0	0
Net official international reserves (floor) 8/ Adjusted target 5/	0	0	0	0	0	0	0	0
	437.8	437.8	449.9 439.9	458.4	494.6	492.0	527.2	542.1

1/ All items as defined in the Technical Memorandum of Understanding.

2/ Indicative target.

3/ Performance criterion.

4/ At program exchange rate of 500 dram per U.S. dollar for 2005 and program exchange rate of 450 dram per U.S. dollar for 2006.

5/ The December 2005 target has been adjusted by AMD 10 billion on account of lower-than-expected World Bank project lending.

6/ Cumulative flow from the beginning of the calendar year until the end of the month indicated.

7/ Includes debt with maturity of more than a year as well as obligations with maturity of one year or less, excluding normal import-related credit and sales of treasury bills to nonresidents.

8/ Excludes reserve money liabilities denominated in foreign currencies from September 2005 onwards.

AMENDMENTS TO THE TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

The TMU dated October 26, 2005 will remain valid for the remainder of 2006, with the revised baseline assumptions for (program) exchange rates of the CBA, foreign-financed project loan disbursements, World Bank lending, and KfW loan disbursements as indicated in Tables 1 to 4, and the following amendments to apply from June 1, 2006.

1. Sentence 5 of paragraph 1 in the TMU will be replaced by the following sentence: “Gross reserves are reported separate from the balance on the government’s Special Privatization Account (SPA) and Millennium Challenge Account (MCA) and exclude capital subscriptions in foreign financial institutions and illiquid foreign assets.”
2. Sentence 3 of paragraph 2 in the TMU will be replaced by the following sentence: “To evaluate program targets, the dram-equivalent values of NIR, medium- and long-term liabilities, and reserve money in U.S. dollar are calculated at the program exchange rate of dram 450.00 per U.S. dollar.”
3. In Section III on Structural Performance Criteria and Benchmarks, the performance criteria and benchmarks of the second review are replaced by those for the third review.
4. In Section IV on Data Reporting, the following amendments are made with regard to the timing of data provision to the IMF by the CBA:
 - CBA balance sheet (weekly): Replace “Within 1 day of the end of each week” by “Each Friday”;
 - Monetary survey: Replace “Within 21 days of the end of each month” by “Within 25 days of the end of each month”;
 - International reserves (weekly): Replace “Within 1 day of the end of each week” by “Each Friday”;
 - International reserves (monthly): Replace “Within 2 days of the end of each month” by “Within 21 days of the end of each month”;
 - Foreign exchange market: Replace “Within 1 day of the end of each week” by “Each Friday”;
 - Bank liquidity: Replace “Within 7 days of the end of each month” by “Within 10 days of the end of each biweekly period”.

Table 1. Armenia: (Program) Exchange Rates of the CBA
(As of December 30, 2005 for dollars per currency rates. Drams per
currency rates are calculated using the 450 drams per U.S. dollar rate)

Country	Drams Per Currency	Dollars Per Currency
Australian dollar	328.05	0.729003
Canadian dollar	386.63	0.859171
Swiss franc	341.53	0.758946
Danish krone	71.87	0.159710
Euro	532.13	1.182501
Pound sterling	773.10	1.718008
Japanese yen	3.82	0.008483
Norwegian krone	66.78	0.148404
Russian ruble	15.63	0.034741
Swedish krone	56.39	0.125303
U.S. dollar	450.00	1.000000
SDR	643.17	1.429266
Gold 1/	7483.03	16.628956

1/ Per gram.

Table 2. Armenia: Cumulative Foreign-Financed Project Loan Disbursements 1/, 2/
(In billions of drams)

2006			
<u>March</u>	<u>June</u>	<u>September</u>	<u>December</u>
7.4	14.9	23.1	31.6

1/ Cumulative from December 2005, at program exchange rates.

2/ Excludes World Bank PRSC lending and KfW loan disbursements.

Table 3. Armenia: World Bank PRSC Lending 1/
(In billions of drams)

2006			
<u>March</u>	<u>June</u>	<u>September</u>	<u>December</u>
9.0	9.0	9.0	9.0

1/ Cumulative from December 2005, at program exchange rates.

Table 4. Armenia: KfW Loan Disbursements 1/
(In billions of drams)

2006			
<u>March</u>	<u>June</u>	<u>September</u>	<u>December</u>
0	1.1	2.2	3.3

1/ Cumulative from December 2005, at program exchange rates.



Press Release No. 06/103
FOR IMMEDIATE RELEASE
May 18, 2006

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Executive Board Completes Second Review Under Armenia's PRGF Arrangement
and Approves US\$4.9 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) yesterday completed the second review under the Poverty Reduction and Growth Facility (PRGF) arrangement for Armenia (see [Press Release No. 05/123](#)). The completion of the review, which was undertaken on a lapse of time basis,¹ enables the release of a further SDR 3.28 million (about US\$4.9 million) under the arrangement. This will bring the total amount drawn under the arrangement to SDR 9.84 million (about US\$14.7 million).

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in the country's Poverty Reduction Strategy Paper. This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½ -year grace period on principal payments.

¹ The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.