International Monetary Fund

Armenia and the IMF

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Republic of Armenia: Letter of Intent and Technical Memorandum of Understanding

October 22, 2015

Letter of Intent

Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
United States of America

Yerevan, October 22, 2015

Dear Madam Lagarde:

1. **In late 2014 and 2015, Armenia's economic performance has been affected by weaker external conditions**, including the slowdown in Russia, ruble depreciation, and lower copper prices. Remittances have declined sharply, and exports also have been lower. Pressures emerged in the foreign exchange (FX) market, leading to depreciation of the dram in late 2014 and tighter monetary policy. Although inflation has remained below the upper boundary of the confidence band (4 ± 1.5 percent), it rose at end 2014 and in the first half of 2015, while bank credit slowed, nonperforming loans (NPLs) increased, and bank profitability worsened. Favorable weather and strong agricultural output, along with the opening of a new copper mine, have boosted growth in 2015, but activity in other sectors remains subdued. The external current account deficit has adjusted significantly in 2015, as dram deprecation and lower remittances and hydrocarbon prices and volumes have contributed to a sharp decline of imports. Meanwhile, dram depreciation vis-à-vis the U.S. dollar has expanded exports to non-traditional and new markets. There has been strong export growth in agriculture and mining and to countries outside of the Eurasian Economic Union, for example, in the Middle East.

2. **The outlook is challenging**. Activity is expected to pick up only moderately in 2015–16. Fiscal revenues are lower than budget projections—increasing the deficit and financing needs—and public debt is expected to rise above 50 percent of GDP. The outlook is subject to a high degree of uncertainty, as intensification of regional geopolitical tensions or slowing global growth could cause negative spillovers. By contrast, if oil prices and activity in Russia pick up, conditions would improve. We will hold a referendum on constitutional changes in December that would change the governance structure of Armenia from a mixed presidential-parliamentary system to a parliamentary system.

3. **Performance under the IMF-supported program has come under pressure.** Most December 2014 and June 2015 performance criteria (PCs) were missed. These were agreed in September 2014, before the worsening of external conditions. December and June PCs on net international reserves (NIR) and net domestic assets (NDA) of the Central Bank (CBA) were missed due to FX sales and liquidity support to banks. The December and June fiscal deficit targets were missed due to budgetary lending that exceeded programmed amounts.

4. We have made progress in our structural reform agenda. A fiscal risk assessment division at the MOF was established (December 2014 structural benchmark, SB), a taxpayer compliance program was prepared (December 2014 SB), and an action plan to enhance tax compliance in selected sectors was completed (December 2014 SB). In addition, we completed a policy paper on CBA liquidity and reserve requirements (March 2015 SB), and prepared legislation to improve the bankruptcy process (June 2015 SB). We prepared a policy note on strengthening taxation of high-wealth individuals and made progress in the financial and strategic assessment of CBA-owned companies related to financial development and architecture (June SBs), although further work is needed in these areas. Other structural reforms are progressing.

The Program for 2015–16

5. Our policy objectives remain focused on sustaining macroeconomic stability and fostering strong, inclusive growth. Our immediate focus is to continue to stabilize conditions in the financial and FX markets and to implement countercyclical fiscal policies to support growth. Structural reforms aim at an improved business environment and enhanced and more diversified regional and global economic integration. We consider that the adjustment of the external current account deficit that has taken place in 2015 is sustainable. Energy imports could pickup with cold winter weather, and while higher growth will lead to additional imports, this should be balanced by higher remittances and capital and investment inflows.

6. As public debt has increased in recent years, strengthening debt sustainability is a key priority. Accordingly, we will consolidate the fiscal position from 2016 and pursue concessional financing where possible. Given the uncertain environment, we issued a second Eurobond in March to provide financing, increase buffers, and repay a portion of 2013 Eurobond, improving our debt profile. Further financing is needed to cover remaining gaps and maintain buffers, and we have approached the Eurasian Fund for Stability and Development for budget support of $300 million for 2015–17. We will continue to consult with the Fund staff before taking on significant new liabilities.

Fiscal Policy

7. We are taking steps to bring fiscal performance in line with program objectives. While the 2014 headline deficit was below the budgeted amount, the end-2014 fiscal deficit PC was missed, due to higher budgetary lending.[1] A large loan ($65 million or 0.6 percent of GDP) not originally planned in the budget was made to support development of a new copper mine that will

[1] Budget lending, which is recorded as a financing item, is *excluded* from the calculation of the program fiscal balance, effectively treating lending as expenditure when loans are made and as a revenue when loans are repaid (see the Technical Memorandum of Understanding).

boost exports and employment in a depressed region. Similarly, the June 2015 fiscal deficit PC was missed due to unbudgeted lending, focused on support to the Nagorno-Karabakh administration to deal with the difficult economic environment, on support to SMEs in agriculture via an interest rate subsidy on local bank loans, and on a loan to support development of a major real estate project, while addressing property and housing claims. These loans are expected to be funded partly by sale of a large sports and entertainment complex in Yerevan. Going forward, we will limit direct government loans, focusing instead on facilitating private investment and addressing legal and social issues related to projects. We will work to bring in private and IFI investments, thereby retaining government financial liquidity and buffers and mitigating risks to public finances. In view of the missed fiscal deficit PC, a new PC will be established on domestic budget lending as a corrective action to focus more attention on our lending programs. We consider budgetary lending to be an effective way to boost activity and jobs, while sharing risks with local banks and investors and generating future repayments. To strengthen effectiveness and risk minimization, we will publish regular, consolidated statements across all domestic lending programs, including outstanding stocks of budget loans (new December 2015 SB). We will also arrange for a review of our lending operations by the Fiscal Risk Assessment Division (FRAD) of the MOF to identify risks and management improvements (new June 2016 SB). In light of the larger-than-expected lending that took place in 2014 and the first half of 2015, we will also reduce the IT limit on government guarantees.

8. **Meeting the 2015 fiscal targets has proved challenging, and budget implementation has aimed to support activity.** The 2015 budget was based on growth of 4.1 percent, and we have experienced revenue shortfalls due to both lower activity and policy changes. These have included elimination of the minimum profits tax, reduction of the turnover tax rate, extension of the payment date for VAT collections for imports from Eurasian Economic Union (EEU) countries, and a shift to reporting VAT on an accrual basis. Transfers from the EEU customs pool have been smaller than expected, due to a contraction of EEU imports this year. We now envisage a headline deficit of around 4 percent of GDP this year, compared with 2.3 percent in the budget, reflecting lower revenues and additional capital spending, including on roads, school modernization, and defense procurement. Additional spending items have also arisen, including related to higher electricity tariffs and a referendum on constitutional reform. Our current tax revenue estimates (including VAT refunds and individual pension contributions) suggest collections this year of approximately AMD 1,070 billion, about AMD 70 billion below the budget. Improved economic developments in the remainder of the year and strengthened tax administration efforts in areas where policy changes have taken place could possibly yield additional revenues of AMD 10–15 billion.

9. **We will initiate consolidation in 2016 to reduce the deficit over the medium term to a level consistent with debt sustainability.** We will bring the headline deficit down to 3.5 percent of GDP next year, with further consolidation in 2017–18 to reduce the deficit below the debt-stabilizing level and put debt on a declining path. A combination of revenue measures and expenditure restraint will underpin the adjustment. Notwithstanding new tax measures, revenue projections for 2016 are cautious, reflecting continuing macroeconomic difficulties, depressed profitability in key sectors (banking, mining), and continuing uncertainty from policy changes (turnover tax, VAT). For example, during 2016–18, we will increase the VAT threshold, while increasing the turnover tax rate

from 3.5 to 5 percent. Small taxpayers will have the possibility to apply for a reduced turnover tax rate of 1 percent if they present invoices on purchases. This measure aims to enhance reporting and VAT collections from wholesalers, but it may lead to revenue losses. We will strengthen administration by extending the coverage of goods required to carry stamps as evidence of tax payment, and we stand ready to take additional tax policy and/or revenue administration measures to offset revenue shortfalls.

10. In tax policy, the focus will be on adjusting excise tax rates and broadening the tax base by eliminating exemptions and gaps. Excise revenues have eroded in recent years, as adjustment of specific rates has not kept pace with growth and inflation. The case for increasing excise rates is supported by their relatively low impact on growth, addressing negative externalities and health effects, and lower global energy prices. The National Assembly is expected to approve in October an increase of excise tax rates on gasoline and diesel fuel, vodka and cigarettes, and a new excise tax on compressed natural gas (CNG)—these measures (prior action) are expected to yield at least 0.1 percent of GDP in 2016. We will also seek parliamentary approval of further excise tax rate increases from 2017 to bring them gradually in line with rates in other EEU member countries.

11. We have drafted a new tax code that aims to address long-standing tax policy and revenue administration issues. The code envisages a reduction of compliance costs through well-defined tax principles and rights and obligations of taxpayers and the tax administration, in line with best international practices. It also envisages a redesign of the tax system to achieve greater simplicity and fairness, better promote growth, and reduce inequality, by revisiting the level and structure of income taxes, eliminating exemptions, and strengthening coverage of high-wealth individuals and large companies. This, in turn, should lead to higher tax revenues to support consolidation starting from 2017 with additional contributions thereafter and also permitting higher growth-enhancing capital and social spending. The new tax code envisages a shift to greater taxation of consumption, a reduction of tax expenditures by reducing non-targeted VAT and income tax exemptions and incentives. More specifically, the tax code proposes to eliminate income tax and VAT exemptions in health and education, commercial agriculture, and other sectors (e.g., some financial sector services), while bringing diesel fuel under the VAT regime. Depending on revenue gains, income tax rates expect to be decreased in the future. The transition will be phased (e.g., through initially lower rates) to ease the impact of these policy changes. The draft tax code was issued for public comment in October, and it will also benefit from a review by the IMF's Fiscal Affairs and Legal Departments on every major tax. A final proposed code will be submitted to the National Assembly by early 2016 (new March 2016 SB).

12. Strengthening tax and customs administration remains a priority. The degree of compliance affects both collections and the efficiency and fairness of the tax system. Our 2015 tax compliance program (December 2014 SB) combines enhanced risk-based audit with taxpayer training and support and simplification of laws and procedures. We expect to fully transition to electronic documentation from 2016. A particular focus area is on underreporting of turnover, including by both SMEs and large taxpayers. To address this, we have increased by 10 percent the number of taxpayers covered by the large taxpayers unit (LTU) and also increased LTU staff by 10 percent. Accession to the EEU has presented challenges for customs administration, for example, with respect to customs procedures and documentation at border crossings, customs offices, and warehouses. Changes related to EEU accession resulted in delays in compiling trade data, and we will ensure that export and import data are provided on a timely basis to the National Statistical Service. To improve efficiency of customs administration, we will undertake a thorough review of responsibilities and eliminate overlaps and duplication in line with IMF FAD advice.

13. On expenditures, we are improving investment budget execution, while continuing to strengthen social spending. In line with our analysis of capital budget implementation shortcomings (April 2015 SB), project implementation units (PIUs) are now required to submit to the Prime Minister's office monthly progress reports, with expected outcomes and implementation risks. We are moving ahead on several important major capital projects, including the North-South and M6 highways, roads around Yerevan, and school modernization and rehabilitation. Social spending was increased by nearly 11 percent in the 2015 budget, compared with the 2014 outturn. The difficult budget situation will reflect on current spending in the coming years, but we aim to at least maintain the level of expenditure under our social programs, and where possible, increase coverage. A new Social Assistance Law became effective in 2015, along with secondary legislation. We will consider the possibility of supporting energy consumption by the poor by means of increasing monthly direct payments and by bringing directly into the budget a "lifeline" gas subsidy that has been financed by state-owned power companies.

14. We aim to ensure that fiscal risks are better identified, analyzed, disclosed, and managed. We have established a fiscal risk assessment division (FRAD) in the MOF to monitor risks from regulated utilities, enterprises with state participation, concessions, and PPPs (December 2014 SB). We are working to build the division's capacity, and we have received IMF TA to develop an operating manual and will ensure that the legal framework and data sharing mechanisms are in place for the FRAD to fulfill its mandate.

15. Implementation of our flagship pension reform is continuing. About 132 thousand workers have enrolled in the new pension system since the revised pension law was approved in 2014, including 60 thousand from the private sector. To support implementation of the reform, we have issued an action plan with technical and policy measures, including appointing a reform 'champion'—a Deputy Finance Minister—to lead interagency efforts and fixing the IT system to ensure swift accounting and reporting of individual contributions. We will also strengthen our outreach campaign with TV commercials, printed materials, an Internet portal and information hotlines. The 2016 budget includes funding for the Pension System Awareness Center and the outreach campaign.

Monetary and Exchange Policy

16. Monetary and ER policy actions taken in 2014–15 aimed to mitigate inflationary and FX pressures within the inflation-targeting framework. Heightened uncertainty in late 2014 and risks to inflation and financial stability called for decisive actions. These covered both ER actions (FX sales, communications with the public and the market) and monetary policy actions (tightening dram liquidity through higher reserve requirements and Lombard interest rates). Renewed pressures from January, compounded by seasonal FX demand for gas imports, led us to provide additional FX to the market. While we were mindful that our Q1 2015 intervention exceeded the FX sales envisaged in our December understanding with the Fund staff, we considered that greater intervention was needed to prevent disorderly adjustment. The external position has improved and the FX market has largely stabilized, but remains fragile, as inflation expectations are not properly anchored. This was shown in August, when the depreciation of the Kazakh tenge and market volatility in China led to renewed pressures and temporary CBA intervention.

17. Our ER policy objectives are to allow for flexibility while enhancing reserve buffers when conditions permit. We have reduced FX sales since February, with the exception of August pressures, and we intend to strictly limit further net FX sales prior to IMF Executive Board consideration of the Second Review (prior action), for the rest of 2015, and in 2016. We also intend to enhance FX buffers when market conditions permit. This return to a more flexible ER regime constitutes a corrective action for the missed December 2014 and June 2015 PCs. With the adjustment of the external current account deficit in 2015, we consider that the dram is not overvalued. Going forward, we will be prepared to mitigate excessive, transitory ER pressures, while allowing the dram to respond to structural changes in both directions (appreciation and depreciation). If unexpected strong and sustained pressures emerge, we will allow the dram to move to a new equilibrium level, with limited intervention to smooth excessive fluctuations. As uncertainties remain high, the CBA will continue active communications with the financial sector, the business community and the public, both in terms of explaining developments (e.g., via the inflation report and press releases) and assessing forward-looking prospects and risks (press conferences and other mass-market channels).

18. Maintaining price stability remains our guiding principle, and we continue to strive for dedollarization. Policy rate adjustments will continue to aim to keep inflation at the target of 4 percent. With FX market conditions stabilizing, we have eased the domestic liquidity actions taken in late 2014, while working to deepen the interbank money market. We have restored the interest rate corridor, reducing the Lombard rate sharply from January and increasing the policy rate. Given a perception that there are still inflationary pressures, we have maintained a tightening stance, and will reassess the situation continuously. Anchoring inflation expectations remains on the agenda of monetary policy; this may call for disinflation policy, if shocks persist. We have reduced reserve requirements for FX deposits from 24 to 20 percent (held in AMD), although these remain well above pre-December 2014 levels. We have introduced lower reserve requirements for more stable sources of funding. Further adjustments to reserve requirements, including the currency of denomination, will be implemented as conditions permit and informed by our recent policy paper on liquidity and reserve requirement regulations (March 2015 SB). We have finalized rules for an interbank money market for one- and seven-day collateralized instruments. This new market may develop slowly, as collateral remains a constraint, along with commercial bank risk perceptions. However, as the market develops, it will play a key role in our monetary infrastructure. We are also investigating mechanisms for bank ratings to help clarify risk. With further normalization of conditions, we expect to transition to inflation targeting-based conditionality under the Fund-supported program.

19. We continue efforts to strengthen CBA independence and operations. As part of the constitutional referendum, the National Assembly has approved legal changes that would strengthen the CBA's mandate to financial stability and the process for appointment and confirmation of CBA board members. The CBA has also revised its board charter to clarify the roles and responsibilities of board members. Further, the CBA has enhanced the presentation of its investments in firms in financial sector development and infrastructure (e.g., credit card processing, mortgage finance, cash collection). In its most recent annual report, the CBA presented financial statements for these firms, along with a consolidated financial position (June 2015 SB). Further work is underway to present in next year's annual report the objectives for these investments, risks and risk-mitigation efforts, and the CBA's development or divestment strategy. In the context of strengthening its independence and operations, the CBA will divest ownership of PanArmenian Bank, a development bank established in 2009 and fully owned by CBA, which is responsible for supervising its activities. The CBA will prepare a plan by December 2015 to sell PanArmenian Bank to a private investor, transfer its ownership to the government, or to close it and sell its loan portfolio. Finally, we have worked with the National Statistical Service to provide the CBA with access to company-level data for non-financial firms needed to analyze the BOP statistics and developments.

Financial Sector Stability and Development

20. The current environment is placing strains on local banks, and we are implementing measures to strengthen the sector's resilience and efficiency. We raised bank minimum capital requirements six fold to AMD 30 billion, effective January 1, 2017, to increase capital buffers and efficiency and enhance banking services via greater economies of scale. Some banks have already increased capital, while others are raising funding or considering mergers. Banks are expected to achieve the new requirement on their own, with no CBA or government involvement. The CBA and the government stand ready to assist the banks in making contacts with potential investors, especially IFIs (EBRD, IFC) to facilitate transactions, but will not provide financial support (except in cases when the CBA may provide loans to banks under lender-of-last-resort or systemic provisions of Article 38 the CBA Law). We will provide the Fund staff with the necessary information for continuous assessment of banking conditions, including capital plans of local banks.

21. We are also strengthening safety nets and contingency planning. We have further strengthened safety nets by (i) formalizing an agreement for the DGF to become eligible to engage in liquidity repo transactions with the CBA; (ii) issuing regulations to preclude the DGF from engaging in transactions with banks outside of its core mandate; (iii) issuing a joint CBA-MOF decision stating that the CBA and MOF will refrain from appointing or electing active bankers to the DGF board; and (iv) further developing crisis management skills through periodic crisis simulation exercises, along the lines of the exercise held last year with help of the World Bank. We will also work with the Association of Banks to ensure that the Association's representative on the DGF board is not an active banker. In addition, we are planning to raise the maximum amount of deposits insured by the Deposit Guarantee Fund (DGF) and reduce the deposit insurance payout period. Furthermore the CBA continues to strengthen its contingency planning and has required banks to prepare contingency plans. We are taking steps to improve and enhance our stress testing framework, including by continuously assessing the adequacy of key stress testing parameters and developing new scenarios based on alternative default probabilities and macroeconomic assumptions. When conditions warrant, the CBA will take early, remedial action—before legal triggers to appoint a provisional administrators are activated and within the scope of powers under the Law on Banks and Banking—to mitigate risks of financial deterioration or asset stripping of a bank and to protect depositor and creditor interests. If conditions weaken further (e.g., NPLs, profitability), the CBA will intensify its asset quality review for the most-affected banks.

22. Progress in other areas will strengthen buffers and ease constraints on intermediation. In line with Basel III guidance for transitioning to a risk-based supervision framework, the methodology on domestic systemically important banking institutions has been adopted, with additional supervisory resources being devoted to these institutions. Basel III requirements for new issuances of subordinated debt as regulatory capital, and more generally, for minimum capital requirements, have been in place since the beginning of 2015, and banks are gradually transitioning to them. We continue to support financial sector development by removing obstacles hindering the registration and execution of collateral; we submitted a draft law in this area to the National Assembly (September 2015 SB).

Structural Reforms

23. Objectives. The external shock that we have experienced since late 2014 has not only affected the short-term outlook, but also potential growth. Given lower medium-term growth forecasts for Russia and prospects for an extended period of lower remittances and other financial inflows, our potential growth is now estimated at 3.5 percent versus 4.5–5 percent previously. Therefore, along with stepped up capital spending, the comprehensive reforms set out in our Armenian Development Strategy to mitigate risks and improve institutions, the business climate, competition, openness, connectivity, and diversification, are even more pressing.

24. Sound management of the energy sector is critical to mitigating risks and sustaining strong growth. Local energy companies have experienced financial strains, due to dram depreciation, slowing growth, lags in tariff adjustment, short-term borrowing, and non-core activities. Our actions have focused on mitigating short-term impacts, including through tariff adjustments and a lower gas price agreed with Russia and Gazprom. More specifically:

- A significant concern has been the weaker financial position of the privately-owned electricity distributor, ENA, including the accumulation of short-term debt to local banks and state generation and transmission companies. This was caused, in part, by higher-than-planned generation costs (more thermal, less hydro and nuclear) in 2014. The Public Service Regulatory Commission approved higher electricity tariffs in June 2015 to recover past losses, but this decision was met by public protests and questions. Accordingly, we suspended the application of the higher tariffs for households and SMEs, pending completion of external audits of the ENA and of the regulatory process. The examination of the PSRC tariff setting has been just completed by an international audit firm, which upheld the Commission's decision. Given the financial hardships of the year, we decided to continue financing tariff differential temporarily for one year from non-budget resources outside of the public sector; this financial support does not cover big business or wealthy individuals and will be strictly limited to a maximum of

$12 million.

- More broadly, we are considering options for energy sector operations, finances, tariff policies, and investment, guided by the two audits and cooperation with the World Bank on an energy sector financial recovery plan. ENA is being sold to a new investor who has committed not to incur new debts and within 5 years to bring the management of the company to international quality standards. The financial recovery plan will involve: new loans from IFIs to restructure expensive short-term debt; agreement on a repayment plan for accumulated debt to energy suppliers; a strict prohibition on expenses, borrowing and lending by energy companies outside of their core mandate; tariff adjustments, where needed; and a new tariff mechanism to more quickly transfer the risk of deviations from the planned energy-generation mix to consumers, in line with best international practices (new March 2016 SB). We have reduced to a minimum support from the state to two financially-ailing chemical companies, Nairit and Vanadzor, with Nairit's wage arrears cleared in August. Now, Nairit is in bankruptcy proceedings. Throughout this process, the public sector will not absorb losses or liabilities or make payments on behalf of utility companies or other companies (continuous PC), including in the context of a possible sale of ENA.

- We need to replace the aging Armenia Nuclear Power Plant (ANPP) over the next decade in a way consistent with long-term financial sustainability. ANPP provides 25 percent of our electricity, and we have secured $300 million in concessional financing from Russia to extend its life until 2026. We are considering options to replace ANPP with a new nuclear reactor or gas-fired plants. As this could potentially cost 50 percent of GDP or more, we will work with the World Bank and other partners to consider options in a least cost framework, compatible with debt sustainability and involving other partners and the private sector to reduce risks. Finally, we recognize that continued modernization and upgrading of aging gas and electricity transmission and distribution networks will require significant investment going forward. This will need to be reflected in tariffs, while companies make significant efforts to improve efficiency and ease cost pressures.

25. Other structural reforms areas:

- ***Business climate.*** Efforts to improve the business climate have been positive. Armenia ranks 45th of 189 countries in the World Bank's 2015 Doing Business rankings—the highest among EEU members. Our 2015 Doing Business action plan aims at further gains in areas where we lag behind, such as electricity connections, trading across borders, enforcing contracts, and construction permits. The government has approved a Small and Medium Enterprise (SME) Action Plan to boost competitiveness and create jobs in this critical sector. With assistance from the AsDB and JICA, the plan includes measures to improve training, provide support for startups, set up a loan guarantee program for SMEs, link local SMEs to global supply chains, and foster women entrepreneurship and youth mobilization.

- ***Regulatory guillotine.*** We continue streamlining efforts through the regulatory guillotine program. In 2012, our goal was to streamline regulations to cut the cost of doing business by 50 percent. Since then, measures have been implemented to reduce costs by roughly

8 percent. Unfortunately, there are administrative and legislative backlogs for about 600 proposals to cut costs further. To expedite the process and maximize cost reduction, in March 2015, the cabinet approved a decree authorizing 41 measures in tax and customs administration, patents, and government processes to yield further cost reductions of about 30 percent. We have approved a decree establishing the practice of regulatory impact assessment for new regulations to better identify costs and benefits of new regulations and help monitor effectiveness once they are in place.

- ***Institutional administration.*** Improving tax compliance through stronger documentary evidence of transactions is a key element in raising revenues and ensuring that the tax burden is shared fairly. We approved an action plan to improve tools for recording value added by overhauling accounting, reporting, and IT systems (December 2014 SB). Implementation of the plan is helping to improve collection of tax base information in energy, health, construction, private education, transportation, and agriculture. This, in turn, will help assess taxes and fees and ensure timely payment to the budget.

- ***Bankruptcy reform.*** Shortcomings in bankruptcy and court processes result in significant delays. Together with other state agencies and stakeholders, the Ministry of Justice has reviewed lessons from the bankruptcy outlining undertaken last year and prepared draft legislation for cabinet consideration. We are also developing programs for judicial specialization in bankruptcy, training for bankruptcy judges, and enhanced qualification criteria for bankruptcy administrators.

- ***Civil aviation***. Institutional improvements in civil aviation and the "Open Skies" policy have resulted in enhanced connectivity, lower costs, and a boost in tourism. The National Assembly has approved amendments to the Civil Aviation Law that put in place the separation of functions and responsibilities between the Ministry of Economy and the Directorate General for Civil Aviation. Growth prospects will improve further once we finish negotiations of 15 bilateral aviation agreements, including the Common Aviation Area Agreement with the EU, which will encourage entry of low-cost carriers.

Conclusion

26. We request that the IMF Executive Board completes the Second Review of the EFF-supported program. We also request waivers of nonobservance in respect of missed PCs on the basis of the temporary nature of the breaches and corrective actions taken. We have learned that the Fund staff considers that a longstanding agreement between the CBA and the MOF to use a budgetary exchange rate (ER) for government FX transactions gives rise to a multiple currency practice (MCP), subject to IMF jurisdiction. As the arrangement was introduced nearly a decade ago, we understand that it has no program implications. However, an amendment to the ER framework in

March constitutes nonobservance of the program PC, and we therefore request a waiver for this non-observed PC, given that the breach was temporary and limited to a single transaction, which was carried out at a rate that was within 2 percent of the prevailing market ER. We request that an amount equivalent to SDR 11.74 million be made available upon completion of the review. In light of the delay in considering the Second Review, we request that the remaining purchases under the arrangement be rephased, so that there will be two remaining purchases each in the equivalent of SDR 15.65 million, subject to two reviews and 15.69 million subject to the last review. The third, fourth and final reviews under this arrangement are expected to be completed on or after March 30, 2016, September 30, 2016 and March 30, 2017, respectively. The arrangement will expire as planned in May 2017.

27. We will maintain a close dialogue with the Fund and stand ready to take additional measures, as needed, to ensure achievement of our objectives under the Fund–supported program. We will continue to consult in advance with the Fund staff on adoption of measures or revision of the policies contained in the MEFP, in accordance with Fund policies on such consultations. We will provide the Fund with information it requests for monitoring program implementation. The program's proposed PCs, ITs, and SBs are set out in Tables 1 and 2 and described in the attached Technical Memorandum of Understanding (TMU).

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

Very truly yours,

/s/
Hovik Abrahamyan
Prime Minister
Republic of Armenia

/s/
Gagik Khachatryan
Minister of Finance
Republic of Armenia

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

Table 1. Armenia. Quantitative Targets for 2013-16[1]

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

	2013	2014			2015												2016			
	Dec.	Dec.			Mar. 2/			Jun.			Sep.			Dec.			Mar.	Jun.	Sep.	Dec.
	Act.	EBS 14/18	Adj. Prog.	Act.	EBS 14/148	Adj Prog.	Proj.	EBS 14/148	Adj. Prog.	Proj.	EBS 14/148 2/	Adj. Prog. 2/	Proj.	EBS 14/148 2/	Adj. Prog. 2/	Prog.	Prog. 2/	Prog.	Prog. 2/	Prog. 2
Performance Criteria																				
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,068	1,026	999	796	857	1,190	902	845	1,170	913	833	1,204	832	879	1,347	992	954	955	1,079	1,050
Net domestic assets of the CBA (stock, ceiling) 3/	231	318	445	478	301	299	370	337	306	377	366	346	434	419	356	444	387	426	400	464
Program fiscal balance (flow, floor) 4/	-40	-139	-122	-161	-36	-31	-34	-71	-76	-94	-107	-115	-189	-143	-159	-264	-58	-112	-165	-218
Budget domestic lending (cumulative flow, ceiling)																31	15	15	15	15
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	0	0	0	0	0	0	0		0	0		0	0	0	0	0
Absorption of losses or liabilities and making of payments on behalf of utilities and other companies (flow, ceiling, continuous criterion)		0	0	0	0	0	0	0	0	0	0		0	0		0	0	0	0	0
Indicative Targets																				
Inflation (mid-point, percent) 5/	5.6	4.0	4.0	4.6	3.1	3.1	5.7	3.3	3.3	5.5	3.4		3.2	3.6		3.4	3.0	3.3	3.5	4.0
Avg. concessionality of newly contracted external debt (flow, floor, in percent) 6/	30	30	30	39							30			30		30				30
New government guaranteed external debt (stock, ceiling, in millions of U.S. dollars) 7/		100	100	0	100	100	0	100	100	0	100		0	100		50	50	50	50	50
Social spending of the government (flow, floor) 8/	34	48	48	47	12	12	12	26	26	26	40		40	54		54	13	27	42	57
Memorandum items:																				
Budget support grants	48	55		55	55		55	55		55	55		59	62		66	66	66	66	72
o.w. EU MFA grant	19	19		19	19		19	19		19	19		19	19		19	19	19	19	19
Budget support loans	144	191		186	168		304	168		304	168		304	201		378	398	398	455	455
o.w. non-IMF loans	105	153		148	130		266	130		266	130		266	162		339	360	360	417	417
Project financing	83	83		67	11		7	23		27	34		48	46		71	19	37	56	74
KFW and IBRD loan disbursements	27	40		39	47		48	51		49	56		69	60		71	76	79	87	89
Reserve money	888	828		887	825		792	782		818	796		883	1001		930	866	904	909	975

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU.
2/ Indicative target.
3/ NDA ceiling will be considered met if the outcome is within AMD 15 billion of the target.
4/Below-the-line overall balance excluding net lending.
5/ End of period, year-on-year headline inflation. Mid-point within a +/- 1.5 range.
6/ Assessed on a calendar year basis.
7/ Includes both concessional and non-concessional debt.
8/ Defined as 100 percent of the budgeted amount of the family benefit program and lump-sum financial aid.

Table 2. Armenia. Prior Actions for the Completion of the Second Review[1/]

Measure	Status
1. CBA net sales in the foreign exchange market not to exceed $209 million from January 1, 2015 until six days before the IMF Executive Board meeting. The computation of CBA net sales will include CBA outright net sales via the following channels: Nasdaq-OMX platform, auctions, and the interbank market. However, the computation of net sales may also include CBA net sales in other markets or instruments that the CBA may choose to substitute for outright net sales (e.g., transactions in derivatives). Transactions of the CBA with the Government or other private or public agencies in the context of budget operations of the Government are not considered net sales (unless they take place through one of the channels mentioned above). In this respect, purchases of the foreign currency proceeds of the Eurobond or other official financing will not be interpreted as CBA purchases of foreign exchange for the computation of the CBA net sales total.	Sales amount to $195.5 million through October 14.
2. Approval by parliament of legislation to (i) introduce an excise tax on compressed natural gas (CNG) in the amount of AMD 8,330 per 1000 cubic meters, (ii) set the sum of the excise tax and VAT on gasoline at AMD 120,000 per ton instead of the current AMD 112,000, and the excise tax on diesel fuel at AMD 35,000 per ton instead of the current AMD 32,500 and (iii) increase by 10 percent the excise tax on vodka and tobacco products.	First reading in parliament completed in June; final reading expected in October.

1/ Measures for implementation 6 days before IMF Executive Board consideration of the Second Review (November 6).

Table 3. Armenia. Program Structural Benchmarks

Item	Measure	Time Frame (End of Period)	Status	Comment
Tax administration				
	- Submit to the National Assembly legislative amendments to the customs code to introduce an Authorized Economic Operators (AEO) system, improve the appeals procedures, introduce an advance tariff information system, extend the scope of electronic declaration of goods, and introduce the possibility of postponing the payment by introducing a systems for financial guarantees	March 2014	**Met**	Amendments submitted to the National Assembly in March 2014 and approved in May 2014.
	- Establish a Risk Management Unit (RMU) in the State Revenue Committee (SRC) to develop and implement a modern tax compliance strategy	June 2014	**Met**	Unit was established in February, with functions approved in March. Risk management functions clarified in the newly reorganized MOF-SRC structure in August.
	- SRC Risk Management Unit to prepare a compliance strategy for 2015 and beyond, with comprehensive annual action plans, monitoring, and ex post evaluation of tax payments	December 2014	**Met**	
	- Cabinet to approve a decree with an action plan detailing specific measures to enhance accounting, inventory, and reporting practices of state entities operating in healthcare, natural resource use, energy, education, transport, agriculture, and urban development and construction sectors	December 2014	**Met**	
Tax policy				
	- Prepare a policy paper on strengthening collections from high-wealth individuals (HWI), covering necessary tax policy changes (e.g., dividend and capital gains taxation), revenue administration actions and legal or regulatory changes (risk and compliance profiles and audit), and the institutional set- up	September 2014	**Met**	Authorities provided a draft paper to the Fund staff, including a review of policies and practices in European countries and the region.
	- Submit to cabinet specific proposals to strengthen collections from high-wealth individuals (capital gains, dividends, property taxation, audit), along with estimated revenue effects, to be included in the new tax code	June 2015	**Met**	Discussion note submitted to Cabinet. However, it did not involve specific proposals (timing, required steps, possible yields).
Public Financial Management				
	- Establish a fiscal risk management unit at the Ministry of Finance that analyzes and manages fiscal risks related to concessions, regulated utilities, state-owned enterprises (notwithstanding the extent of state shareholding or line-ministry affiliation), and PPPs in an integrated manner	December 2014	**Met**	Fiscal Risk Assessment division established by ministerial order on 12/20/2014. Unit is functioning and has received FAD TA.
	- Submit to the Office of the Prime Minister an analysis of the reasons for underexecution of the capital budget, with proposals of how to increase capital budget execution	April 2015	**Met**	Analysis completed with government decree on accountability of the project implementation units adopted (N-884-N). Seminar for IFIs and others on reasons for underexecution. Implementation has improved in 2015.
Financial sector				
	- Issue regulations to require banks to set minimum capital requirements for common equity and Tier 1 capital according to the Basel III recommendations, and prepare the methodology on identifying domestic systemically important banking institutions (SIBIs)	June 2014	**Met**	Regulations and methodology approved in June 2014.
	- Prepare a policy paper with stakeholders on legal, regulatory, and institutional changes to simplify registration and execution of collateral	June 2014	**Met**	Authorities provided a draft paper to the Fund staff. Follow-up steps being taken.
	- Submit to National Assembly legislation to shorten the depositor pay-out period of the DGF	September 2014	**Met**	Draft legislation submitted to the National Assembly. Expected to be considered by National Assembly in Fall 2015 session (September-October 2015).
	- Submit to the National Assembly an amendment to the securities law to facilitate access of foreign participants in Armenia's capital market, bringing the framework in line with international standards	September 2014	**Met**	Draft legislation submitted to the National Assembly. Not yet considered by National Assembly.
	- Amend in a manner consistent with the 2012 FSAP Update recommendations the regulation on the calculation of large exposures to align it to international best practices in the areas of (i) weight of exposures to banks and sovereigns, and (ii) consideration of collateral	December 2014	**Dropped**	Benchmark was superseded by more recent Basel III recommendations, which are in line with CBA current practices.
	- Prepare a policy paper assessing CBA's liquidity and reserve requirement regulations, including their levels and currency of denomination, impacts on interest rates, bank liquidity and buffers, and dollarization, compliance with new Basel III recommendations, and exploring the scope for change	March 2015	**Met**	Authorities provided paper to the Fund staff.
	- Submit to National Assembly legislative changes to address the main obstacles hindering registration and execution of collateral	September 2015	**Not met**	Met with delay. Package of legal changes (civil code, criminal code, enforcement of court decisions, real estate appraisal, registration) was approved on October 1 and will be sent to the National Assembly.

Table 3. Armenia. Program Structural Benchmarks (concluded)

Item	Measure	Time Frame (End of Period)	Status	Comment
Central Bank Operations				
	- CBA to publish an annex describing investments in enterprises that are engaged in financial sector development and infrastructure activities in its annual report covering the rationale for these investments , along with objectives, development strategy, enterprise risks, and risk mitigation efforts, and where appropriate, the CBA's divestment strategy	June 2015	**Met**	Consolidated and individual financial statements were included in the CBA's 2014 Annual Report. Further work on risks and possible divestment strategies is needed.
Regulatory and competition policy				
	- Submit to the National Assembly a new draft law on inspection and inspection agencies, for introduction of risk based inspection, maximization of the automation, and elimination of the overlaps by reducing agencies	March 2014	**Not met**	Met with delay. Draft law was submitted to the National Assembly in October 2014 and adopted by the parliament on December 17, 2014.
	- Submit to the Cabinet a plan to restructure the Directorate General for Civil Aviation and establish the new set-up for moving towards open skies	April 2014	**Met**	
	- Submit to the National Assembly six Regulatory Guillotine legislative packages, covering entrepreneurship, tax, customs, social issues, foreign affairs and international relations, and culture, in addition to completion of packets in 2012-13	June 2014	**Not Met**	Met with delay. Legal packages were prepared, and discussed within governmental bodies and ministries. The process of preparation and submission was negatively impacted by the government change. After the new govenrment was formed, the legal package was dicussed again with the new officials in charge. Taking into account all suggestions, the drafts of the legal packages were discussed and approved by Cabinet.
	- Map the entire bankruptcy process to identify the obstacles and gaps that need to be addressed by changes in the legislation	June 2014	**Met**	MOJ completed the mapping, which was submitted to the MOE for comments and assessment of further actions.
	- Put in place memoranda of cooperation between the SCPEC and the SRC, the Economic Crimes Unit of the National Police, and the Office of the Public Prosecutor, covering investigative subpoena, and "dawn raid" operations, information required by the SCPEC, and participation by SCPEC staff in on-site examinations	June 2014	**Dropped**	A previously-existing decree for information exchange by government agencies can provide legal framework for collaboration envisaged in the envisaged memorandum of cooperation.
	- Submit to Cabinet draft legislation to (i) further improve the specialization in the examination of bankruptcy cases at courts; (ii) bring procedures in line with the international best practices; and (iii) increase the number and qualifications of bankruptcy administrators	June 2015	**Not met**	In progress. Concept paper approved by cabinet. The final draft of the legal amendments were submitted ot the government for review. The legal acts are planned to be adopted by the National Assembly in the first half of 2016.
Energy				
	- Issue a study of policy options (energy efficiency investments, tariffs, and targeted protection for vulnerable groups)	December 2014	**Not Met**	Met with delay. The Energy Ministry did not prepare study in time, but work is proceeding on the basis of a May 2015 strategy for 2016-36, with closer cooperation with the World Bank on energy sector financial rehabilitation.

Table 4. Armenia. Proposed New Structural Benchmarks

Area		Measure	Time Frame (End of Period)
Public Financial Management	1	Publish regular consolidated statements across all budget domestic lending programs	December 2015
	2	Complete review of budgetary lending operations to identify risks and management improvements	June 2016
Tax Policy	3	Secure parliamentary approval of further excise tax rate increases from 2017 to bring gradually them in line with rates in other EEU member countries	March 2016
	4	Submit to the National Assembly final proposed tax code containing reduction/elimination of exemptions (VAT, income tax) and of other tax policy gaps (sectoral coverage, tax types) to deliver revenue gains.	March 2016
Energy Sector	5	Adopt by Cabinet of energy sector financial recovery plan involving new loans from IFIs to restructure expensive short-term debt; agreement on a repayment plan for accumulated debt to energy suppliers; a trict prohibition on expenses, borrowing and lending by energy companies outside of their core mandate; tariff adjustments, where needed; and a new tariff mechanism to more quickly transfer the risk of deviations from the planned energy-generation mix to consumers, in line with best international practices	March 2016

Attachment I. Technical Memorandum of Understanding

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

2. For program monitoring purposes, all foreign currency-related assets, liabilities, and flows in the monetary accounts will be evaluated at program exchange rates. The program exchange rate of the Armenian dram to the U.S. dollar is set at 410 dram per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

Quantitative Targets

3. The program sets PCs and ITs for defined test dates (see Table 1 in the LOI/MEFP). The program sets the following PCs:

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

The program sets the following ITs:

- Headline inflation;
- Floor on average concessionality of newly contracted external debt;
- Ceiling on new government guaranteed external debt; and,
- Floor on social spending of the government.

4. **The net official international reserves** (NIR) (stock) of the Central Bank of Armenia (CBA) will be calculated as the difference between total gross official international reserves (excluding commercial bank required and excess reserves at CBA in FX) and gross official reserve liabilities.

- Gross official international reserves are defined as the CBA's holdings of monetary gold (excluding amounts pledged as collateral), holdings of Special Drawing Rights (SDRs), including the August 28, 2009 General Allocation and the September 9, 2009 Special Allocation, the country's reserve position at the IMF, and holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments). [1] Gross reserves held in the form of securities and other financial instruments are marked to market. Excluded from gross reserves are the balance on the government's Special Privatization Account (SPA), capital subscriptions in foreign financial institutions and illiquid foreign assets, any assets that are pledged, collateralized, or otherwise encumbered, claims on residents, claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options), precious metals other than gold, assets in nonconvertible currencies, and illiquid assets.

- Official reserve liabilities shall be defined as the total outstanding liabilities of the government and the CBA to the IMF and convertible currency liabilities of the CBA to nonresidents with an original maturity of up to and including one year, as well as commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options).

NIR is monitored in U.S. dollars, and, for program monitoring purposes, assets and liabilities in convertible currencies other than the U.S. dollar shall be converted into dollar-equivalent values using the convertible exchange rates as specified in Table 1.

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

6. **Net domestic assets** are defined as reserve money minus NIR, minus other assets not included in gross official international reserves, minus commercial bank required and excess reserves at CBA in FX, plus medium and long-term foreign liabilities (i.e., liabilities with a maturity of one year or more) of the CBA, plus other foreign liabilities not included in official reserve liabilities, minus the balance of outstanding Fund purchases credited to the government account at the CBA. NDA is composed of net CBA credit to the general government plus outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money and other items net. The ceiling will be considered as met if the outcome is within AMD 15 billion of the targets sets in Table 1 attached to the LOI/MEFP.

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

7. External public debt arrears are defined as all unpaid debt-service obligations (i.e., payments of principal and interest) arising in respect of public sector loans contracted or guaranteed to non-residents, including unpaid penalties or interest charges associated with these obligations that are overdue beyond 30 days after the due date.[2] The ceiling on external payment arrears is set at zero.

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

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

- **Net nonbank financing** equals the sum of: (1) the change during the period of outstanding treasury bills and bonds to nonbanks (including accrued interest for treasury bills and excluding accrued interest for treasury bonds);[3] (2) any other disbursement or transaction that increases nonbanks' claims on the central government plus withdrawals from the Special Privatization Account (SPA) or the treasury sub-account containing privatization proceeds in drams, less amortization paid by the central government to private resident nonbank agents.

- **Net external financing** equals total debt-increasing disbursements from non-residents to the central government (including Fund net purchases credited directly to the government accounts at the CBA) less total amortization from the central government to non-residents. Net external financing also includes any privatization proceeds received from non-residents in foreign currency and not held in the SPA.

- **A budgetary ER** of 411 drams per one US dollar will be used for foreign currency-denominated transactions included in the 2015 budget with the exception of the amounts received for project implementation units (PIU) for which the prevailing ER at the time of the transaction will be used. Proceeds from the March 2015 Eurobond issuance and related coupon payments in 2015 will be valued at the ER of March 30, 2015. Any additional unbudgeted transactions for 2015 will take place at the market exchange rate. Under the existing budgetary ER framework

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

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

arrangement, for 2016, the ER stated in the Budgetary Address (ER of the Draft Budgetary Law in case the state budget is not approved by the Parliament) will be used for foreign currency-denominated transactions included in the 2016 budget, with the exception of the amounts received for PIU for which the prevailing ER at the time of the transaction will be used. In addition, if new foreign currency-denominated transactions are introduced at any time, these will take place at the prevailing ER at the time of the transaction. The framework arrangement will not be modified (in substance), but may be clarified as this would imply noncompliance with the program continuous PC on ER arrangements and multiple-currency practices.

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

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

11. Some project implementation units maintain accounts at the CBA. Grants received by these units are recorded in the fiscal accounts as external grants on the revenue side and as foreign-financed expenditure on the expenditure side. In addition, any loans to finance investments that are intermediated through the banking system are recorded in the financial accounts as a financing item below the line and are thus excluded from net lending. Under previous Technical Memoranda of Understanding, these activities were excluded from the calculation of the program fiscal balance. This treatment reflected lags in receiving information from project implementation units and on project loans intermediated through the banking system. With the shift to semi-annual program reviews with the arrangements under the previous Fund-supported program and consolidation of the accounts of these units in the Treasury, there is no longer a need for such exclusion, and these activities are now fully accounted for in the program fiscal balance.

12. Foreign currency proceeds from selling enterprises are credited to the SPA and their use is reflected in the state budget. In addition, the Government will ensure full transparency of revenues and spending from the sales of major assets (beyond regular day-to-day operations) of enterprises with state ownership. This will include presentation of use of funds from the sale of the hydroelectric assets of the Vorotan Cascade Company, including for electricity subsidies and payment of wage arrears of Nairit. The SPA is held at the CBA and the proceeds are invested abroad together with the CBA's international reserves. These proceeds are included in the definition of the monetary accounts of the CBA as part of net foreign assets with a counter entry in other items net. Any withdrawal from the SPA will be accounted for as privatization proceeds used to finance the budget and will be recorded below the line. Domestic currency proceeds from selling enterprises to residents are deposited in a sub-account of the treasury single account and are also treated as a financing item and recorded below the line. Finally, as noted in ¶8, privatization proceeds received from non-residents in foreign currency and not held in the SPA are also treated as a financing item (sale of financial assets) and recorded below the line.

13. Domestic budgetary lending is defined as the gross amount of new loans made to resident individuals, enterprises, or entities financed from the state budget or other general government resources. This includes, but is not limited to, loans financed from the Economic Stabilization Fund and lending under existing or prospective government programs, such as agricultural sector support and real estate development programs, among others.

14. Absorption of losses or liabilities and making of payments on behalf of utilities and other companies. The program sets a continuous ceiling on absorption by the public sector of losses or liabilities from outside the budgetary sector. The public sector is defined as institutions covering the state budget and state debt—including the central and local governments—plus the CBA and enterprises or other entities with state ownership or control. Absorption of losses or liabilities is defined as direct payment by the public sector of the losses or liabilities of other parties or coverage of losses or liabilities by other transactions, such as debt-for-equity swaps or a write-off of tax obligations or other state claims. The ceiling is set at zero, and excludes AMD 13.7 billion, (approximately $33 million) of subsidies in the 2015 budget for Yerevan Metro, Yerevan Electric Transport, Irrigations Systems, Armenian Water and Sanitation, Nor Akunk, Lori Water and Sanitation, Shirak Water and Sanitation, and irrigation water intake entities. For 2016, the ceiling will exclude subsidies to these same entities of not more than AMD 16.1 billion. The ceiling will also exclude government support for the electricity tariff differential, which should not exceed $12 million. During the program period, there may be occasions when absorption of a limited amount of losses or liabilities, or making limited payments on behalf of utilities or other companies would facilitate a positive outcome (e.g., a major foreign investment transaction, poverty alleviation or equity enhancement, or prevention of even greater losses that would endanger financial stability). The PC will be considered to be met, if new subsidy amounts do not exceed AMD 2.5 billion. In the case of new subsidies, the Armenian authorities will discuss the circumstances and possible options with the Fund staff prior to transactions more than AMD 500 million. Any modification of the PC to make any such payments or absorb any losses will require approval by the IMF Executive Board, at the time of the text review.

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

- The grant element is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rate used for this purpose is a unified discount rate set at 5 percent.

- The public sector here comprises the general government (central, plus local governments and covering the state budget and state debt), the central bank, and nonfinancial public enterprises (enterprises and agencies in which the government holds a controlling stake—typically owns more than 50 percent of the shares, but which are not consolidated in the budget).

- For program purposes, the guarantee of a debt arises from any explicit legal obligation of the public sector to service a debt in the event of nonpayment by the debtor (involving payments in cash or in kind), or from any implicit legal or contractual obligation of the public sector to finance partially or in full any shortfall incurred by the debtor.

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

17. The program sets a floor on **social spending of the government**. For the purposes of the program, social spending of the government is defined as 95 percent of the budgeted amount of the family benefit program and lump-sum financial aid, one-time childbirth benefits, and childcare benefits for children less than two years of age.

18. The quantitative performance criteria and indicative targets under the program are subject to the following **adjusters**, calculated, where relevant, using program exchange rates:

- **Changes in reserve requirements**: The ceiling on the NDA of the CBA will be adjusted downward (upward) by the amount of banks' reserves freed (seized) by any reduction (increase) of the reserve requirement ratio on both domestic currency and foreign currency liabilities relative to the baseline assumption as per the following formula: $\Delta NDA = \Delta rB$, where B denotes the level of liabilities subject to reserve requirements in the initial definition and Δr is the change in the reserve requirement ratio.

- **KfW, Asian Development Bank, and World Bank loan disbursements**: the ceiling on the NDA of the CBA will be adjusted upward (downward) by the full amount of any excess (shortfall) of disbursements from the KfW, Asian Development Bank, and World Bank loans directed at SME financing compared to programmed amounts (Table 2). The floor on NIR will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of these disbursements compared to program amounts.

- **Budget support grants to the public sector** are defined as grants received by the general government for direct budget support from external donors and not related to project financing.

- **Budget support loans to the public sector** are defined as disbursements of commercial loans (e.g., Eurobonds), loans from bilateral and multilateral donors for budget support, and Fund purchases credited directly to the government accounts at the CBA.

- **Project financing to the public sector** is defined as disbursements of loans from bilateral and multilateral donors for public sector projects.

- **The floor on NIR** will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants (excluding Fund purchases by the government) compared to program amounts (Table 3). The floor on NIR will be adjusted downward for any external public debt amortization amounts in excess of program amounts. The floor on NIR will be adjusted upwards by the amount of any funds received in respect of deposits held at the Inter State Bank as well as for privatization proceeds received from non-residents in foreign currency and not held in the SPA.

- **The ceiling on NDA** will be adjusted downward (upward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants compared to program amounts (Table 3).

- **The floor on the program fiscal balance on a cash basis** will be adjusted upward (downward) by the cumulative total amount of the budget support grants received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $50 million per year in either direction. The floor on the program fiscal balance on a cash basis will also be adjusted downward (upward) by the cumulative total amount of the project financing received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $50 million in either direction.

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

B. Data Reporting

19. The government and the CBA will provide the IMF the information specified in the following table.

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA	CBA balance sheet	Summary	Daily	The following working day
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within seven days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks by chart of accounts at actual official exchange rates	Monthly	Within 25 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Daily	The following working day
	Foreign exchange market	Official exchange rates (buying and selling); daily trade volume, and weighted average exchange rate of the interbank, intrabank and Nasdaq-OMX	Daily	Within 1 day
	Foreign exchange market	CBA foreign exchange operations, (exchange rate, volume)	Daily	Within 1 day
	Foreign exchange market	Exchange rate (buying and selling)	Daily	Within 1 day
	Interest rates	Refinance rate	At least monthly	Within 1 days of the CBA Board decision
	Interbank money market	Daily interbank repo volume and interest rate and number of trades	Daily	Within 1 day
	CBA operations	Repo (reverse repo) operations, open market operations, Lombard credits, deposit facility, and foreign exchange swaps (volumes, maturity, yields, exchange rates)	Daily	Within 1 day
	Bank liquidity	Reserves and excess reserves, by currency	Monthly	Within 15 days of the end of each reference period
	Interest rates and flows of the funds attracted and allocated by commercial banks	By currency and maturity	Weekly	Last working day of the week
	T-bill and coupon bond financing, CBA securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Weekly	Last working day of the week
	Banking data	Sectoral distribution of loans and deposits; dollarization of loans and deposits; loan maturities; interbank rate, by volume and maturity; T-bill rate, bond yield; deposit and	Monthly	Within 25 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		lending rates, by maturity; monthly weighted average interest rate on government bonds		
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Monthly	Within 30 days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Monthly	Within 30 days of the end of each month
	On-lending via commercial banks	On lending via the CBA and government (from the Russian loan, KfW, WB, ADB, etc.) by type of on-lending projects (including loan disbursements and repayments)	Monthly	Within 10 days of the end of each month.
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Transfers	Non-commercial transfers of individuals	Monthly	Within 30 of the end of each month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
	Balance of payments	Detailed balance of payments data	Quarterly	Within 60 days of the end of each quarter
Ministry of Finance (MOF)	T-bill and coupon bond financing	By holders, i.e., CBA, resident banks, resident nonbanks, and nonresidents	Monthly	Within 7 days of each month
	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the CBA, and state-owned companies (by company); any stock of arrears on external debt service and outstanding stock of government guarantees and	Monthly	Within 21 days of the end of each month. For project implementation units, within 21 days of the end of each month (preliminary data) and within 45

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		external arrears		days of the end of each month (final data)
	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions	Monthly	Within 7 days of the end of each month
	Domestic expenditure arrears	All unpaid claims outstanding at the end of the month which includes wages, social contributions (including for pensions), family allowances, and amortization and domestic interest payments	Monthly	Within 45 days of the end of each month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month
	Treasury single account (TSA)	Detailed breakdown of central treasury account, including deposits at the central treasury, community budgets, off budget account, monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.	Monthly	Within 7 days of the end of each month
	Consolidated central government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Central and local governments, and Non-Commercial Enterprises that belong within the general government (NCEs)	Quarterly	Within 60 days of the end of each quarter
	Consolidated general government	Central and local governments, and NCEs that belong within the general government	Annual	Within 180 days of the end of each year
	Budget execution	All cash receipts, cash expenditures, including domestic and external debt-service payments, external and	Monthly	Within one month following the end of each

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		domestic borrowing and lending operations, and inflow of grants to the central government; expenditure data will be provided according to both economic and functional classifications, consistent with the GFSM2001 methodology		quarter.
	Financial information on utilities and other major companies with a state interest	Profit and loss indicators for regulated utilities, for companies with state shareholding of 50 percent or greater, and for companies with state shareholding of 0–50 percent and annual sales or outstanding liabilities of AMD 10 billion.	Quarterly	Within 60 days of the end of each quarter
	Pension system	Number of participants in the pension second pillar, social payments and funded contributions	Monthly	Within 45 days of the end of each quarter (monthly data provided on a quarterly basis)
NSS	Balance of payments	Detailed export and import data (issues that have arisen in 2015 with EEU trade data need to be overcome as soon as possible)	Monthly	Within 28 days of the end of each month
		Detailed export and import data	Quarterly	Within 45 days of the end of each quarter
	CPI	By category	Monthly	Within 5 days of the end of each month
MOF (State Revenue Committee)	Tax arrears	By type of tax	Monthly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)
		For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	Tax credits	Detailed data, by type of tax, of outstanding tax credits for all types	Monthly	Within 45 days of the end of each

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		of tax revenues and by sectors (i.e. Agriculture, Industry, Mining, Construction, Trade and Services), in both net and gross terms		(monthly data provided on a quarterly basis)
	Tax Revenues	Tax Revenue by Economic Sectors (i.e. Agriculture, Industry, Mining, Construction, Trade and Services)	Monthly	Within 45 days of the end of each quarter (monthly data provided on a quarterly basis)
	VAT and turnover tax	Number of registered taxpayers	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	VAT refund claims in arrears	Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90 day statutory processing period. Number of refund applications processed per month.	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax inspectorate	Monthly	Within 45days after the end of each month
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty free recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving non-duty free recorded imports 5. Value of recorded imports where customs value was assessed using transaction prices, breaking out raw diamond imports; 6. Value of non-duty free recorded	Quarterly	Within 30 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		imports where customs value was assessed using transaction prices; 7. Number of transactions involving recorded imports where customs value was assessed using transaction prices; 8. Number of transactions involving non duty free recorded imports where customs value was assessed using transaction prices		
	Automated VAT refunds	Number of refunds that were processed automatically (share of total refunds); total value of automated and automatic refunds and offsets; average waiting time (days) to receive refund	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Risk-based selection approach	Percentage of selected companies chosen on the basis of risk-based approach, identified revenue from risk-based audits	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)

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

(As of July 31, 2013 in U.S. dollars per currency rates)

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

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

(In millions of U.S. dollars)

Dec-14		Mar-15		Jun-15		Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
EBS/14/18	Proj.	EBS/14/148	Prel.	EBS/14/148	Prel.	Proj.	Prog.	Prog.	Prog.	Prog.	Prog.
98	96	115	116	125	119	167	173	185	193	213	217

1/ Cumulative from end of the previous year.
2/ Adjustors from EBS/14/18 remain the reference for 2014 targets.

Table 3. Armenia: External Disbursements to the Public Sector [1 2]

(In millions of U.S. dollars)

	Dec-14		Mar-15		Jun-15		Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
	EBS/14/18	Proj.	EBS/14/148	Proj.	EBS/14/148	Prog.	Proj.	Prog.	Proj.	Prog.	Prog.	Prog.
Project financing	203	163	28	17	56	66	116	173	45	91	136	182
Budget support loans	466	454	410	742	410	742	742	921	971	971	1,111	1,111
Budget support grants	133	135	135	135	135	135	143	160	160	160	160	175
of which: EU MFA	47	47	47	47	47	47	47	47	47	47	47	47

1/ Budget support cumulative from the end of the previous year. Project financing cumulative during the same year.
2/ Adjustors from EBS/14/18 remain the reference for 2014 targets.