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International Monetary Fund  
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### **IMF Approves US\$540 Million Stand-By Arrangement for Armenia**

The Executive Board of the International Monetary Fund (IMF) today approved a 28-month SDR 368 million (about US\$540 million) Stand-By Arrangement for Armenia to support the country's program to adjust to the deteriorated global outlook, restore confidence in the currency and financial system, and protect the poor. The approval makes the amount equivalent to SDR 161.5 million (about US\$237 million) immediately available and the remainder in nine installments subject to quarterly reviews. The Stand-By Arrangement entails exceptional access to IMF resources, amounting to about 400 percent of Armenia's quota. It was approved under the Fund's fast-track Emergency Financing Mechanism procedures.

The authorities' program is based on a consistent set of measures regarding exchange rate, monetary, financial, and fiscal policies, as well as continued structural reforms. Key elements include:

- **Return to a flexible exchange rate regime.** The Central Bank of Armenia (CBA) announced on March 3 that it will no longer intervene in the market, except to smooth extreme volatility, and raised its policy interest rate by 100 basis points. Following the announcement, the dram depreciated about 20 percent, and since then, has broadly remained in that range.
- **Strengthening of the financial sector to maintain stability and confidence.** Key aspects of the CBA's policy response include liquidity support operations, as needed, and enhanced banking supervision.
- **A revision of fiscal priorities to maintain macroeconomic stability, while protecting social outlays and public investment,** in light of the expected revenue shortfall. The authorities intend to cut back on non-priority spending while providing an increase in social spending of 0.3 percent of GDP, relative to the budget, to protect the poor through well-targeted social safety nets. Additional external financing will be used to boost public investment.

Armenia's gross external financing requirements are projected at about US\$1.6 billion for 2009, and will remain elevated through 2011, albeit with a slight downward trend. The Stand-By Arrangement will cover a large share of the country's 2009-2011 financing gap. Additional financing will be provided by Armenia's donors and international partners, including the World Bank.

Following the Executive Board discussion on Armenia, Mr. Murillo Portugal, Deputy Managing Director and Acting Chair, said:

“Since the approval of a low-access PRGF arrangement in November 2008, Armenia has been confronted by a variety of major external shocks. Reflecting the sharp deterioration in global economic conditions, private transfers and capital inflows slowed considerably and international commodity prices have dropped severely, affecting mining exports and production. In light of a rapid decline in international reserves and growing financing needs, the authorities have requested additional financial assistance from the Fund.

“With the adverse global developments, real growth is expected to contract in 2009, reflecting the downturn in Russia and other countries in the region. Falling international prices, lower growth, and exchange rate depreciation will help reduce the external current account deficit. Medium-term prospects remain good.

“Sound policies are essential to maintain macroeconomic stability. The recent return to a flexible exchange rate will help cushion the impact of the global downturn and eventual further regional deterioration. An appropriately tight monetary policy is necessary to contain the inflationary pressures stemming from the depreciation and support demand for dram-denominated assets. While potential negative impact of the depreciation on the financial sector seems unlikely, contingency plans are available to help address any such effects. In light of the expected revenue shortfall, fiscal policy will remain prudent, protecting social outlays and public investment by reducing non-priority spending.

“Maintaining the structural reform agenda will contribute to macroeconomic stability and a strengthened business environment. Key elements include the completion of the unfinished tax policy and tax administration reform agenda, and progress on financial sector reforms.

“The Fund is confident that the policy package put in place by the authorities is appropriate and strong,” Mr. Portugal said.

## Recent Economic Developments

The global crisis has confronted Armenia with a number of large external shocks. Remittances and capital inflows, which sustained rapid economic growth in recent years, have decelerated markedly. Falling international commodity prices adversely affected mining, a key export sector. GDP growth came to a halt in the fourth quarter, and fell to 6.8 percent for the year as a whole, from over 13 percent in 2007. Following the rapid unwinding of international prices and domestic demand, annual CPI inflation fell to 1 percent in February 2009. With exports being hit by the global downturn and imports growing strongly through October, the external current account deficit rose to an estimated 12½ percent of GDP in 2008.

The rapid and unexpected deterioration of the economic situation had a strong impact on program performance under the PRGF arrangement. Most of the end-December 2008 quantitative performance criteria were missed. The authorities, recognizing the changed circumstances and the large increase in their financing needs, have requested the Stand-By arrangement and also requested the cancellation of the PRGF arrangement.

## Program Summary

The authorities' program aims to achieve the necessary external adjustment, restore confidence in the domestic currency and the banking sector, and protect the poor. Their program is based on a consistent set of policies in the exchange rate, monetary, financial, and fiscal areas as well continued structural reforms.

As part of the program, **the authorities are returning to a flexible exchange rate regime.** In particular, the authorities have indicated that they will no longer intervene in the market, except to smooth extreme volatility. Under a managed float, the authorities would gradually return to their inflation-targeting framework.

**Strengthening financial stability will be a key part of the authorities' program.** The authorities will implement short-term emergency measures to stabilize the system, while at the same time enacting more structural measures to ensure the soundness of the system going forward. Key aspects to be addressed are liquidity support operations and enhancing banking supervision.

**Fiscal priorities will be revised.** To partly offset the anticipated revenue shortfall for 2008, the authorities intend to cut back on non-priority spending and introduce some tax policy measures, yielding savings of about 0.8 percent of GDP. Accordingly, the program aims at limiting the deficit, excluding non-programmed externally financed investment projects, to 2.8 percent of GDP compared to a deficit target of 1 percent of GDP in the announced budget.

**The IMF supports the protection of social spending embedded in the program.** The program accommodates an increase in social spending of 0.3 percent of GDP, relative to the budget, to protect the poor through well-targeted social safety nets. The program also provides room for additional infrastructure and investment spending as foreign financing materializes.

**The authorities will continue their wide-ranging structural reform agenda outlined in their Sustainable Development Program.** This agenda is aimed at deepening productivity-enhancing structural reforms, and improving governance. A key area will be continued efforts to strengthen the business environment, with a focus on tax administration reforms and the fight against corruption.

Armenia joined the IMF on May 28, 1992; its quota is SDR 92 million (about US\$135.2 million) and its outstanding credit to the IMF (as of end-January 2009) is SDR 87.495 million (US\$128.6 million).