EXECUTIVE BOARD MEETING

EBS/20/90

May 4, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Republic of Armenia—Second Review Under the Stand-By Arrangement, Requests for Augmentation of Access, Modification of Performance Criteria, and Monetary Policy Consultation Clause**

Board Action:	Executive Directors' **consideration** (Formal)
Tentative Board Date:	**Monday, May 18, 2020**
Proposed Decision:	Pages 19–20
Publication:	Yes*
Questions:	Mr. Porter, MCD (ext. 37316) Mr. El Said, MCD (ext. 35918) Mr. Tabarraei, MCD (ext. 35558)
Document Transmittal in the Absence of an Objection and in accordance with Board policy:	After Board Consideration—European Bank for Reconstruction and Development, Organisation for Economic Cooperation and Development, World Trade Organization

***The authorities have indicated that they consent to the Fund's publication of this paper.**

REPUBLIC OF ARMENIA

SECOND REVIEW UNDER THE STAND-BY ARRANGEMENT, REQUESTS FOR AUGMENTATION OF ACCESS, MODIFICATION OF PERFORMANCE CRITERIA, AND MONETARY POLICY CONSULTATION CLAUSE

May 4, 2020

EXECUTIVE SUMMARY

Context. The impact of the COVID-19 pandemic and the tightening of global financial conditions have disrupted the, until recently, favorable macroeconomic conditions. The near-term outlook has significantly weakened, with growth expected to decline to -1½ percent in 2020, and the fiscal and the current account deficits widening considerably this year. These projections are subject to more than the usual uncertainty. The authorities' response has been timely and proactive, focusing on strengthening the provision of public health services, limiting domestic contagion, and introducing targeted economic relief measures aimed at assisting viable businesses and vulnerable people weather the crisis.

Request for Fund Support. The authorities are seeking to augment access under the Stand-By Arrangement (SBA) by 100 percent of quota (SDR 128.80 million) and to purchase available drawing rights under the SBA to address emergency external and budgetary needs. They request that this financing be disbursed as direct budget support. Support from other multilateral partners would cover remaining financing needs.

Policy Discussions centered on the pandemic response: (i) treating those affected by the virus and taking measures to mitigating its spread and impact on vulnerable people and firms; (ii) immediate policies to support external and financial stability; and (iii) policies and reforms once the crisis abates to rebuild buffers and support strong economic recovery.

Program Performance. The program was broadly on track until end-2019 with strong performance vis-à-vis quantitative indicators but more mixed performance against structural measures. All end-December 2019 quantitative performance Criteria (QPCs) and indicative targets (ITs) were met, although inflation remained lower than expected, breaching the lower-bound of the Monetary Policy Consultation Clause (MPCC). Progress towards structural benchmarks (SB) was mixed, with one benchmark met, and the remaining three benchmarks expected to be met in the coming months.

Staff Views. Staff supports the completion of the second review under the SBA and the authorities' request to augment access by 100 percent of quota (SDR 128.80 million) given the emergence of large external financing needs. Staff also supports the request for drawing to be available for budget support.

Approved By
Thanos Arvanitis and Vikram Haksar

The team comprised N. Porter (head), M. El Said, H. Tabarraei, and K. Akepanidtaworn (MCD), Y. Ustyugova (Resident Representative), K. Tokuoka (SPR), and M. Bellon (FAD). V. Janvelyan and L. Karapetyan (IMF Office) assisted the mission. LEG participated in the mission to follow up on governance-related conditionality. S. Harutyunyan (OED) participated in meetings with the authorities. R. Al Farah (MCD) provided assistance and B. Laumann (MCD) provided document management (MCD). The team met remotely during March 16–April 8, 2020 with Deputy Prime Minister Grigoryan, Governor of the Central Bank of Armenia Javadyan, Minister of Finance Janjughazyan, Minister of Economy Khachatryan, State Revenue Committee Deputy Chairman Mashadyan and other senior government officials.

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DEVELOPMENTS AND PROGRAM IMPLEMENTATION

A. Context

1. Macroeconomic conditions were favorable before the COVID-19 pandemic shock.

- Real GDP growth in 2019 was exceptionally strong at 7.6 percent, driven by strong private consumption on the back of rising household incomes and strong household credit. Manufacturing and service sector activity was also buoyant (Figure 2, Table 1). Growth is becoming more inclusive as labor market conditions improve. In 2019 the unemployment rate decreased by almost 3 percentage points, and remittance income increased slightly. The poverty rate fell from 25.7 percent in 2017 to 23.5 percent in 2018.

- Despite strong domestic demand conditions, annual CPI inflation fell to 0.7 percent (y/y) in December due to lower food prices and some exchange rate appreciation.[1]

- The fiscal deficit was around 1 percent of GDP in 2019. Revenue significantly overperformed, due to growth in tax-paying sectors and strengthened compliance, while spending fell short of budget as capital execution remained below plans. The lower fiscal deficit helped reduce central government debt to around 50 percent of GDP, the authorities' medium-term objective.

- Financial conditions were stable in 2019. Dollarization continued its downward trend. While private sector credit grew rapidly (18.5 percent (y/y to December)), led by household credit growth (32 percent (y/y)), financial soundness indicators (FSIs) do not suggest signs of distress given stable non-performing loan (NPL) and relatively high capital and liquidity (Figure 1 and Table 6).

- The external position strengthened in 2019 and is assessed as broadly consistent with fundamentals and desired policies (Annex II). Higher FX receipts from non-resident deposits, coupled with stable market conditions and de-dollarization, allowed a build-up of international reserves. Despite strong domestic demand, the current account deficit narrowed to 8.2 percent of GDP in 2019 reflecting strong services exports (especially tourism), although the composition of trade changed considerably (Figure 1).[2] Net remittances in 2019 edged up by 1½ percent in US dollar terms but fell relative to GDP. Reserve buffers were broadly adequate at 123 percent of the ARA metric at end-2019.

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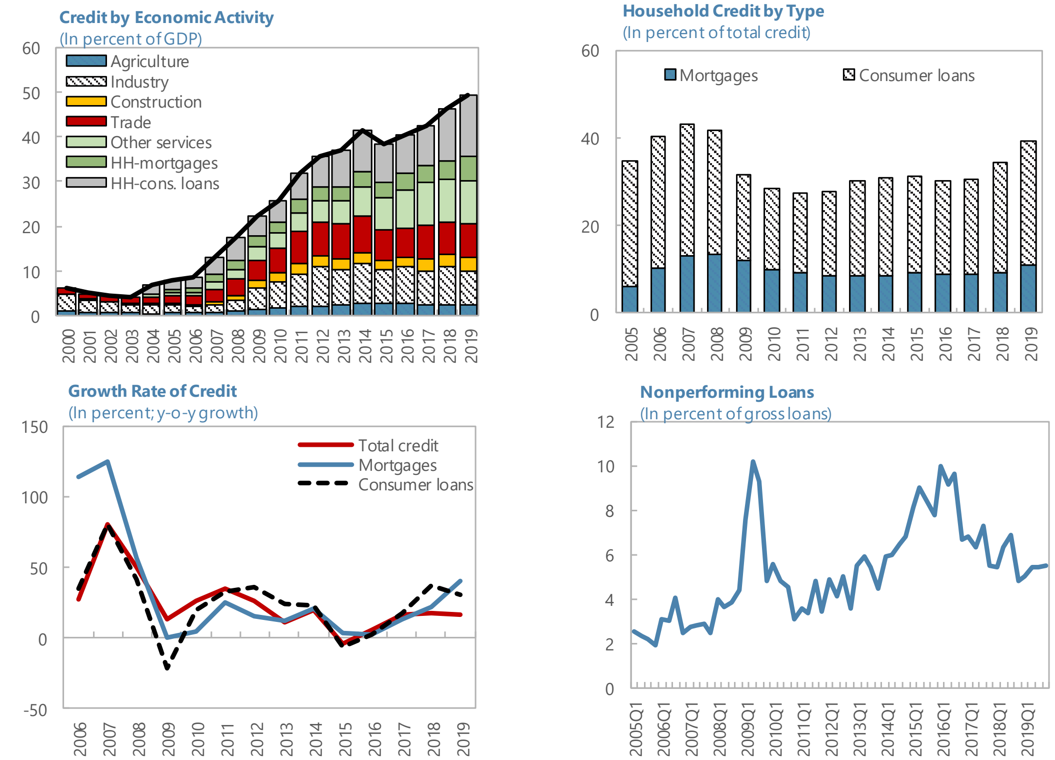
[1] Ongoing IMF TA aims to improve the reliability of food price statistics, and the associated CPI sub-indexes. Besides increasing overall resources allocated to ArmStat, key recommendations include: (i) automating some price compilation and increased training; (ii) updating basket weights every three years; and (iii) improving the reporting methodology for key food items to reduce volatility.

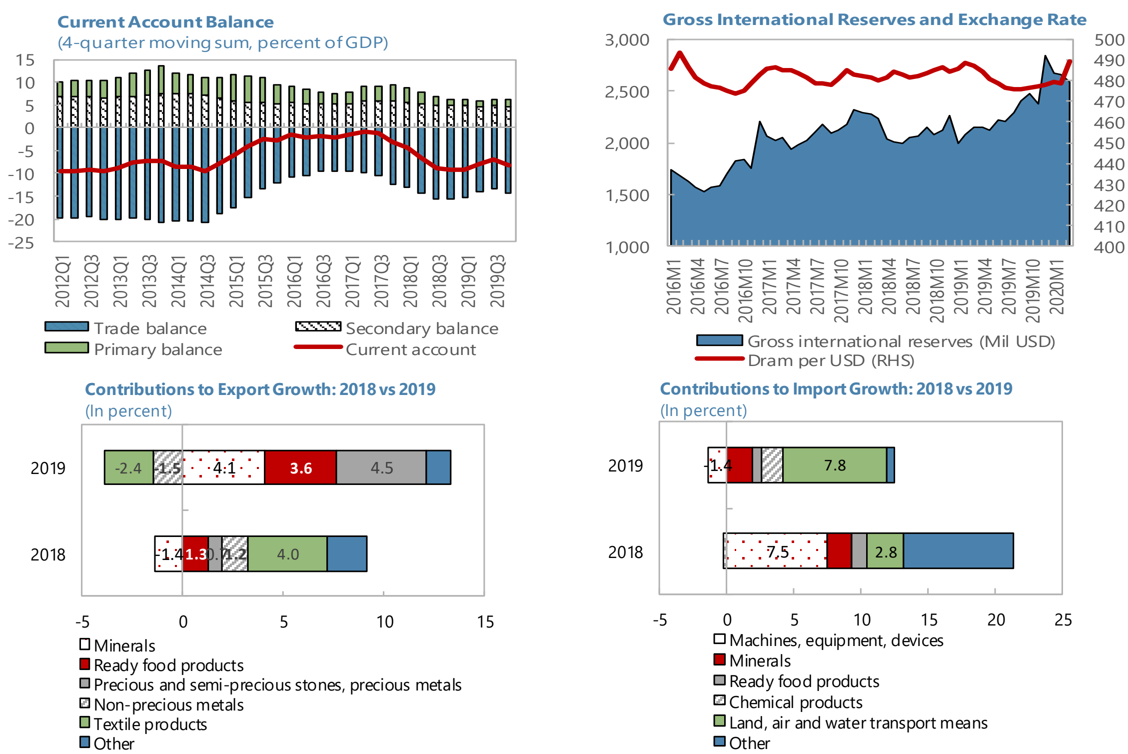
[2] Errors and omissions have also been large, possibly reflecting under-reported car re-exports.

Figure 1. Armenia: Selected External and Financial Developments

Over one third of total credit is allocated to households which has seen an average annual growth rate of over 30 percent in real terms since 2017, of which a significant share—28 percent for consumer loans, and 11 percent for mortgages—is in foreign currency. NPLs have been relatively stable in recent times.



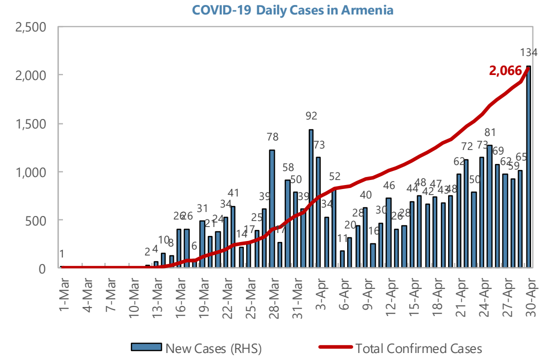
The composition of goods trade changed considerably in 2019 with higher contributions from mineral exports, lower textile exports; slower imports of machinery and equipment; and accelerated imports of transport equipment (cars) given the anticipated expiration of certain tariff exemptions.



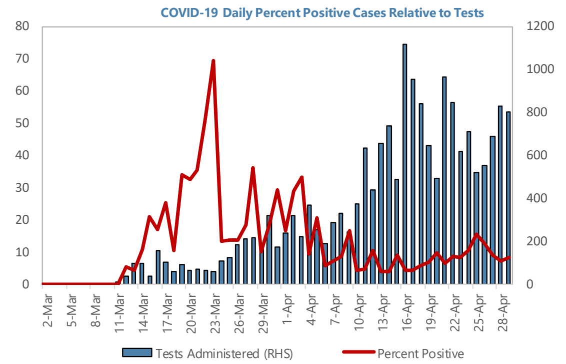
Sources: National authorities, Haver, and IMF staff calculations.

B. Impact of the COVID-19 Shock

2. The COVID-19 pandemic spread rapidly in Armenia. The first case was reported on March 1st, and two more cases were reported on March 11. Since then, the number of cases surged. As of April 30, the number of confirmed cases stood at 2066 with 32 fatalities.



Source: United Nations, Johns Hopkins University, and IMF staff calculations.



Source: United Nations, and IMF staff calculations.

3. The Government has proactively responded to COVID-19. To contain the local spread of the virus, the authorities declared a national state of emergency on March 16, undertook strong social distancing and containment measures. Those measures include travel bans, prohibiting public gatherings, closing schools, restaurants and imposing restrictions on recreational facilities and public transportation, and applying fines for violating isolation orders during the state of emergency. Meanwhile, the government equipped the Ministry of Health with additional resources and legislative powers to expeditiously acquire medical supplies and necessary health equipment, including testing kits. Additionally, to support the economy, the government has announced three types of near-term support (Box 1): (i) direct social assistance transfers to the vulnerable; (ii) labor subsidies to help SME employers maintain core employees; and (iii) subsidized government-sponsored 2–3-year loans to provide short-term support to selected agricultural enterprises and SMEs in heavily affected sectors. Early action has helped blunt the potential socio-economic damage from the crisis. Beyond these crisis measures, the authorities are considering options to support the recovery. One measure they may consider is to support companies investing in innovative sectors through limited convertible equity.

4. Nonetheless, the COVID-19 pandemic and the sharp tightening of global financial conditions have significantly changed Armenia's 2020 outlook (text table). Given the unique nature of this crisis, there is unprecedented uncertainty around estimates of its impact. Despite the uncertainty, this shock will significantly affect Armenia. External demand and remittances are expected to decline sharply, external funding costs have increased markedly, while restrictions on domestic mobility associated with virus containment will directly limit activity in many sectors. Reflecting these factors:

Box 1. COVID-19 Policy Response Measures

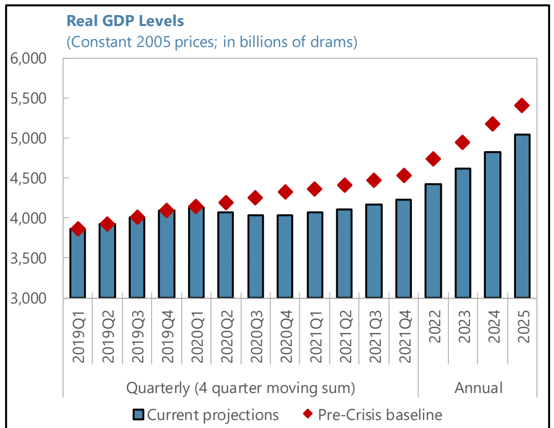
The government announced a number of measures to mitigate the near-term impact of COVID-19 summarized in the following table. The fiscal impact of these measures is summarized in a text table (¶11).

Package	From of Support/Amount	Eligibility
	Subsidized Loans 1/	
1. Maintaining liquidity of Businesses	Loans (up to 500m AMD), co-financing/refinancing (up to 250m AMD). Maturity: 2 years, 1 year grace.	Businesses must have good credit and tax history.
2. Helping Businesses/Individual workers in agriculture	Co-financing, or interest-rate subsidies. Amount/Maturity depends on purposes of the loans or leases .	Businesses must have good credit and tax history
3. Helping SMEs in affected sectors (manufacturing, accommodation, tourism, transportation and services)	36-month loans (up to 50m AMD or 10% of 2019 turnover, whichever is less)	Business must be in affected sectors with turnover between 24m AMD and 500m AMD. No overdue loans or taxes in 2019.
	Lump-sum Transfer	
4. Supporting families with children	68,000 AMD per child	Parents lost job from March 13-26 and remained unemployed.
5. Preserving jobs for businesses with 2-50 employees	Approximately one-fifth of total employee's wages.	Businesses must not be in financial or gambling and employ less than 50 people.
6. Protecting vulnerable employees who lost jobs due to COVID-19	68,000 AMD	Employees must work in non-financial and non-gambling sectors. Their salary must be less than 500,000 AMD.
7 Protecting pregnant women who faced difficulties due to COVID-19	100,000 AMD	She must be unemployed, or her husband lost jobs due to COVID-19.
8. Helping Individuals and entrepreneurs in affected industries	Average salary or 10% of Q4 turnover, up to 136,000 AMD	Affected sectors include hotel, restaurant, tourism, retail and service.
9. Protecting families with underage children	26,500 AMD per child	Parents are/became unemployed during the COVID-19 pandemic.
10. Protecting micro businesses	10% of Q1 2020 turnover, up to 136,000 AMD. Or 68,000 AMD if not activating cash-register machine with SRC.	Businesses must have less than two employees and have turnover less than 6m AMD in Q1 2020.
11. Protecting vulnerable residents against hardship in paying utility	50 percent of natural gas and electricity bills in February	Resident's bills for natural gas and electricity must not exceed 10,000 AMD, and 5,000 AMD respectively.
12. Protecting vulnerable residents against hardship in paying utility	30 percent of natural gas and electricity bills in February	Resident's bills range between 10,000 and 30,000 AMD for utility, and between 5,000 and 10,000 AMD for electricity.
13. Protecting vulnerable families facing social problems	50% of household's family and social benefits (35% cash payment, and 15% electricity payment)	Households must be eligible for government's family and social benefits as of April 2020.
14. Protecting students in higher education 2/	Tuition subsidy up to 100%, and interest reduction on student loan up to 0%, conditional on GPA and year of studies.	Students must be in state universities to receive the tuition subsidy, and in state-accredited higher education institutions to receive the interest reduction.

1/ The government's portions of the loans must be in dram and often carry below-market or zero interest rates. The interest rates from private lenders participating in these schemes are capped.

2/ This package is announced but the official decree has not been finalized.

- **Growth**. The economy is expected to contract by 1½ percent, compared with growth of 5½ percent anticipated prior to the pandemic, with the growth assumed to gradually strengthen in Q3, becoming slightly positive in Q4, and accelerating in 2021as mobility restrictions ease. The shutdown and border closures will significantly hit value added from Armenia's three largest sectors: agriculture, manufacturing, and wholesale and retail trade. However, as economic activities are curtailed, the unemployment rate is expected to increase, and the marked progress in poverty reduction could stall.



Source: National authorities, IMF World Economic Outlook, and IMF staff estimates.

- **Inflation** is expected to gradually pick up towards the Central Bank of Armenia's (CBA) inflation target on the back of fiscal expansion, recovering food prices, and depreciation of the dram.

- **Fiscal**. The deficit is projected to widen to 5 percent of GDP compared to 2¼ percent in the 2020 Budget. This reflects the cyclical impact on revenues and higher current spending for healthcare and economic support, with debt expected to rise above 60 percent of GDP (see ¶9).

- **External**. The external position is also expected to weaken severely. The pandemic has hit tourism receipts, remittances and FDI, and it is expected to cause a reversal of private capital inflows. The dram depreciated by 5 percent against the USD in March 2020 and the authorities intervened by about US$ 127 million between mid-March and early April. However, the dram recovered by around 5 percent from its trough and the CBA intervened on the buy side since, lowering total net intervention this year to $51 million. In 2020, the current account deficit is projected to widen to 8.6 percent of GDP driven by lower remittances (mostly from Russia) and tourism receipts, while the financial account would decline sharply, reflecting the reversal of private flows in the form of non-resident deposits. Without additional financing, this would result in gross international reserves falling below 100 percent of the ARA metric, creating a BoP financing gap of about US$316 million in 2020 (and a total financing gap of around US$422 million over 2020–22) (Table 8).

- **Financial**. Rapid credit growth is expected to slow due to lower aggregate demand and restrictions on activity. Nonetheless, several government support packages (Box 1), which offer co- and re-financing, may support credit growth this year.

Armenia: Selected Economic and Financial Indicators, 2019–22

	2019	2020		2021		2022	
	Prel.	Pre-Covid	Proj.	Pre-Covid	Proj.	Pre-Covid	Proj.
Real GDP (percent change)	7.6	5.5	-1.5	5.0	4.8	4.5	4.5
Gross domestic product (in billions of drams)	6,552	7,127	6,519	7,730	6,990	8,382	7,543
Fiscal balance (in percent of GDP)	-1.0	-2.3	-5.0	-1.9	-2.9	-1.9	-2.0
Public and publicly-guaranteed (PPG) debt (in percent of GDP)	53.7	51.6	64.1	50.8	62.1	50.1	59.8
Central Government's PPG debt (in percent)	50.1	48.9	60.9	48.7	59.1	48.6	57.3
Current account balance (in percent of GDP)	-8.2	-8.4	-8.6	-8.0	-7.2	-7.2	-6.7

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

C. Medium Term Outlook and Risks

5. Medium-term prospects remain favorable. The economic outlook assumes that the impact of the pandemic would subside during 2020H2, as normal mobility resumes as testing expands and new cases decline, improving both external economic and financial conditions and allowing normal domestic activity to resume. The recovery would be expected to accelerate in 2021, with growth reaching around 4¾ percent. The 2020 increase in the government deficit is expected to be temporary, as much of increased spending would be one-off, and revenue buoyancy would return to its underlying level. Given this, public debt would decline over the medium term in line with the authorities' commitment to their fiscal rule.

6. However, risks are to the downside and there is large uncertainty around the duration and intensity of the pandemic. A more extensive and prolonged domestic COVID-19 outbreak would have severe humanitarian consequences and lead to a prolonged economic contraction in 2020, increasing BoP needs as well as the fiscal deficit, financing needs, and public debt. It would also worsen bank asset quality and liquidity conditions, and harm the pace of the recovery through 2020–21 and potentially into the medium term depending on the degree of scarring. Supply shocks and sharp dram depreciation could increase dollarization, and would push headline inflation and public debt above projections. Dealing with these risks would require additional fiscal spending and judicious monetary and foreign exchange intervention with continued exchange rate flexibility, and proactive measures to support financial stability extending those contemplated by the authorities (¶17). The potential global repercussions of an extended COVID-19 outbreak could further adversely affect Armenia by weakening external demand, maintaining tighter financing conditions, and extend weakness in the oil market (harming remittances from Russia), while intensified geopolitical conflict would also further deepen the adverse effects of the shock and delay the recovery and add to external pressures (Annex I). The authorities remain committed to consulting with staff on their policy choices as the situation evolves.

D. Program Implementation

7. Program implementation remains broadly on track.

- Available data indicate that all quantitative performance criteria (QPC) for end-December have been met (text table and MEFP Table 1).

- The MPCC was triggered in December as inflation fell below the lower bound (¶23, Letter of Intent (LOI), MEFP and Attachment III). Temporary and supply-side factors, including food prices, and appreciation through 2019 contributed to low inflation, and the CBA has responded to the worse outlook in 2020 with monetary loosening which, combined with planned fiscal expansion, is expected to steer inflation back to towards target.

Armenia: Quantitative Performance Criteria 1/

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

	2018	2019					
	Dec.	Mar.	Jun. 2/	Sep. 3/	Dec. 2/		Status
	Act.	Act.	Act.	Act.	EBS 19/118	Est.	
Performance Criteria							
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,404	1,320	1439	1,661	1444	1,808	Met
Program fiscal balance (flow, floor)	…	28	98	-77	-196	-127	Met
Budget domestic lending (cumulative flow, ceiling)	…	0	0	0	15	4	Met
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	0	0	Met
MPCC 4/							
Inflation (upper-band, percent)	…	3.4	4.0	3.4	4.0	4.0	
Inflation (mid-point, percent)	1.8	1.9	2.5	0.5	2.5	0.7	Not Met
inflation (lower-band, percent)	…	0.4	1.0	0.4	1.0	1.0	
Indicative Targets							
Net domestic assets of the CBA (stock, ceiling)	449	473	375	269	831	244	Met
Avg. concessionality of newly contracted ext. debt (flow, floor, in percent) 5/	…	…	…	…	30	39	Met
New government guaranteed external debt (stock, ceiling, in millions of USD) 6/	…	0	0	0	100	0	Met
Social spending of the government (flow, floor) 7/	…	15	27	…	54	55	Met

Sources: Armenian authorities; and Fund staff estimates.

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

2/ Quantitative performance criteria at test dates.

3/ Indicative target.

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

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

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

7/ Defined as spending on the family benefit program and lump-sum financial aid, one-time childbirth benefits, and childcare benefits for children less than two years of age.

8. Structural reforms are progressing, albeit slowly in some areas.

- A draft employment strategy for 2019–23 (December 2019 SB) was developed and presented to the Cabinet on December 27, 2019. The strategy is part of ongoing labor market reforms critical for stronger job creation in Armenia.

- A draft law, in line with international standards, establishing a single autonomous anti-corruption entity (December 2019 SB) is expected to be submitted to the National Assembly (NA) by September 2020.[3] The draft law has been a subject of extensive public consultation which required more time than earlier envisaged. This entailed revisions to articles related to the Anti-Corruption Committee, which will be designated with revealing corruption crimes, to have investigation functions, and to have sufficient guarantees of independence.

- While the work to design an action plan to improve tax compliance (December 2019 SB) is ongoing, the study identifying tax potential and factors preventing tax collection from reaching its potential is being split into new proposed SBs (see ¶24).

- The authorities completed a draft law on higher education and science which sets the legal basis to: (i) reform the management of tertiary education; and (ii) upgrade the licensing and accreditation requirements, state financing principles, and mechanisms to supervise educational quality. However, the law is still to be submitted to the NA (December 2019 SB) as stakeholder dialogue has led to changes requiring review by the Ministry of Justice. The law is expected to be submitted to the NA by end-June.

[3] Fund staff have commented on previous versions of the draft law and a final draft will be reviewed before submission.

POLICY DISCUSSIONS

A. Fiscal Policy: The Crisis Response and Beyond

9. The impact of the pandemic and the policy response will inevitably result in a higher deficit in 2020. Given the size of the shock, the crisis is expected to have an outsized impact on 2020 revenues, with tax revenue undergoing one of its largest declines relative to GDP. Current spending increases, reflecting additional spending on healthcare and economic support to vulnerable firms and households. In 2020, additional health spending is estimated at around ½ percent of GDP, while the near-term economic support measures are estimated to involve above-the-line costs (subsidies and interest) of almost 1 percent of GDP. Taken together, these factors will result in a widening of the deficit to around 5 percent of GDP (from 2.3 in the budget) which, coupled with potential exchange rate depreciation, would be expected to increase debt above 60 percent of GDP. Public debt is expected to remain sustainable and decline over the medium term in line with Armenia's fiscal rule which, on current projections would bring central government debt below 53 percent in 2025.

10. In addition, crisis-related government on-lending support to firms is expected to amount to around 1½ percent of GDP. This on-lending is treated as a below-the-line financing item and will stay on the governments balance sheet until the loans are repaid (2–3 years).

11. Financing the larger deficit and these below-the-line measures is expected to be challenging, without Fund support. Some space can come from reallocating resources within the budget envelop (especially from non-COVID-19-related current spending) and due to delays in public investment inherently resulting from short-term domestic mobility restrictions. Nonetheless, the magnitude of the shock means the emergence of a financing gap of 4 percent of GDP in 2020, which is expected to be filled by drawing on the SBA, additional domestic bond issuance and, mobilizing support from other international partners.

Selected Fiscal Indicators (in percent of GDP)

	2020	2021	2022	2023
Revenue impact of the crisis before policy action[1/]	**-2.7**	**-2.1**	**-0.1**	**-0.1**
New tax policy measures (possibly including:)	**0.0**	**0.4**	**0.6**	**0.8**
Increase in the turnover tax	0.0	0.1	0.2	0.3
Reduction of tax expenditures	0.0	0.3	0.4	0.5
Additional expenditure compared to budget	**-1.5**	**-0.3**	**-0.3**	**-0.3**
Health spending	-0.6			
Lifeline of support to households and firms (subsidies)[2/]	-0.9	-0.3	-0.3	-0.3
Expenditure under-execution and reallocation	**1.6**	**1.5**	**0.0**	**0.0**
Current expenditures	0.5	0.0	0.0	0.0
Capital expenditure	1.1	1.5	0.0	0.0
Overall impact on fiscal balance	**-2.7**	**-0.5**	**0.2**	**0.4**
Liquidity and economic support to firms	-1.4	0.0	0.6	0.8
Overall impact on program balance (incl. lending)	**-4.0**	**-0.5**	**0.8**	**1.1**
Domestic financing	0.8			
IMF financing	2.4			
Other financing (additional domestic/other IFIs)	0.8			

Source: IMF staff estimates.
1/ A negative sign means addition to the fiscal deficit. For example, increased health spending because of COVID-19 pandemic by 0.6 percent of GDP increasedthe deficit by the same amount.
2/ Includes interest subsidies and estimates losses from below-the-line support.

12. Given the significance of the crisis-related measures, the authorities are committed to ensure strong governance and transparency around the implementation of these programs. This includes, transparent public procurement, regular reporting of program implementation, and inclusion of fiscal risks in budget documents. Losses associated with below-the-line operations should be factored in the preparation of the MTEF and expensed when they occur.

13. Strengthening the budget process and execution of high-quality capital projects will help underpin the recovery. Staff welcomed ongoing public investment management (PIM) reforms aimed at improving the appraisal, selection and monitoring of public capital projects (MEFP ¶12). The ability to quickly develop a pipeline of quality implementation-ready projects to commence as containment measures allow would support the recovery. The authorities are also committed to presenting a MTEF in accordance with the fiscal rule and to start implementing program-based budgeting from this year.

14. Looking beyond the crisis, fiscal policy should be guided by cyclical and debt sustainability considerations, while safeguarding social spending. The authorities restated their commitment to their fiscal rule and its objective of reducing debt over the medium-term. Staff estimate that pursuing tax policy and administration reforms would allow debt to decline gradually over time to 50 percent of GDP, while preserving space for priority spending.[4] In this regard, the authorities are following-up by: (i) preparing to commence their property tax reform in 2021; (ii) moving towards broad-based income declarations, expanding PIT revenue beyond wage and salary income; (iii) containing the growth of non-priority current spending to channel resources towards social and capital spending; and (iv) raising social contributions to improve the sustainability of the pension system. The State Revenue Committee (SRC) is advancing plans to improve data management, predictive analysis, detection of non-compliance, and audit processes (MEFP ¶11). Staff suggested extending these efforts to better align resources with compliance risks and to remove impediments—pre-announced audits and generous ex post adjustment allowances—to fully effective audit processes. Staff also urged an acceleration of tax policy reforms—including through the rationalization of tax expenditures and alignment the of tax burden on businesses across alternative regimes—as this could generate critical resources for priority spending.

15. The authorities should continue advancing other critical reforms.

- **Fiscal transparency.** Staff emphasized the importance of strengthening public sector transparency. Timely quality budgetary data could be leveraged for better internal decision making. Staff encouraged the authorities to extend the coverage of public sector statistics in accordance with best practice, starting with the classification of SOEs and state financial corporations. Plans to report wider public sector balance sheet information and to use market-determined exchange rates for budget purposes should also be accelerated (MEFP ¶13).

- **Fiscal risks management**. Staff welcomed the adoption of a roadmap to strengthen risk management and extend the coverage of monitored risks to those arising from natural disasters, legal proceedings against the State, the financial system, and potential environmental liabilities. Staff recommended strengthening the legislation for implementation of PPPs, accelerating efforts towards the production of a comprehensive and consolidated fiscal risk summary in the

[4] The full impact of the package reallocating tax revenues away from PIT and CIT towards taxes on G&S is already incorporated in program tables (see the program request staff report for details).

budget documentation and the development of coordinated and centralized capacity within the Ministry of Finance with clarified functions and responsibilities (MEFP ¶13). In the near-term, staff encouraged the authorities to transparently report estimated contingent fiscal risks associated with the crisis response measures alongside annual budgets.

16. The authorities are contemplating actions to support the post-crisis recovery. Although the most direct action would be through the implementation of a pipeline of high-quality capital projects aimed at strengthening national infrastructure, the government is also considering spurring innovation through limited direct equity investment into innovative companies. Staff noted that alternative measures to encourage private innovation would be preferable, including targeted and limited direct subsidies or co-financing. If the authorities decide to go ahead with equity investment, transparency and careful management of any fiscal risks created will be essential. Additionally, direct equity investment would require independent management of the equity portfolio, transparency over the selection of projects and partners as well as the financial performance of the equity portfolio, protections to limit the impact on competition and governance, and safeguards to prevent the value of the state's investment being undercut.

B. Monetary and Financial Policies in the Era of COVID-19

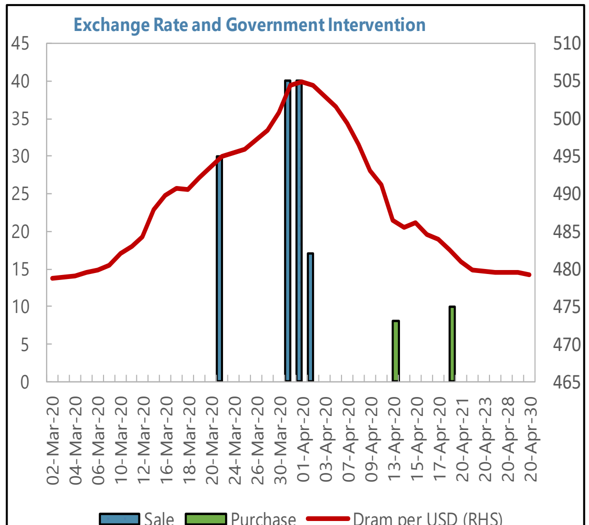
17. The CBA has responded to the COVID-19 crisis, balancing its mandates for price and financial stability. Since the pandemic's outbreak, markets have generally functioned smoothly. Policy responses include:

- **Policy rate.** Balancing pressures from capital outflows with the space provided by low inflation, the CBA lowered its policy interest rate by ¼ percentage point in March, and by a further ¼ percentage point in late April, bringing it to 5 percent. Given the high uncertainty on external developments and the high levels of dollarization, there is no scope for further rate cuts at this point.

- **FX intervention**. The CBA undertook limited FX sales intervention in March to address excessive dram volatility. Since then the dram has appreciated relative to the USD and the CBA has undertaken some FX purchases. While CBA may need to respond to prevent disorderly movements, it should also ensure that the exchange rate remains flexible and should not lean against necessary exchange rate adjustments.

- **Liquidity.** The interbank market has been relatively active since the beginning of the crisis. In addition, the CBA has conducted repos and FX swap operations to ensure ample liquidity conditions across the market.

Exchange Rate and Government Intervention



Source: National authorities, and IMF staff calculations.

- **Supervisory measures.** The CBA has enhanced engagement between banks and supervisors to continuously assess the impact of the crisis on asset quality, capital, and liquidity. They have encouraged voluntary prudent loan restructuring, where necessary, to help the borrowers heavily impacted by the crisis manage the shock.

- **Macroprudential measures.** To limit FX liquidity pressures during the pandemic, the CBA has temporarily halted the redenomination of FX reserve requirements (as allowed under their plan). The CBA will develop a revised timeline for the redenomination, which will come into effect once pressures abate. If liquidly pressures become larger than can be managed through regular operations, the CBA may consider a temporary reduction in reserve requirements. The CBA has announced a reduction of Tier 1 capital requirements (from 10 to 9 percent), as part of a broader strategic change in the holdings of capital in the banking system, with capital held in capital conservation, systematically important banks and counter-cyclical buffers. Currently banks have excess capital cushions.

18. The authorities are making further progress implementing FSAP recommendations (MEFP ¶17–18):

- **Developing capital markets** (May 2020 SB). The authorities have prepared a draft capital market development program, with the support of IMF TA. The document identifies areas for improvement and lays out actions (and prerequisites) in three phases: (i) establishing the foundation for development, including reforms in securities taxation, (ii) broadening the market, and (iii) achieving longer-term goals. The development program is scheduled to be finalized in May 2020.

- **Adopting a stressed Loan-to-Value (LTV) limit** (March 2021, new SB). To strengthen the macroprudential toolkit, the CBA will introduce differentiated LTV ratios by currency for mortgages. The authorities have also started collecting information from all banks and credit institutions on borrower and loan characteristics, preparing the way for adoption of debt-service-to-income (DSTI) limits.

- **Liquidity buffers.** Separate LCR and NSFR requirements by currency were approved to increase liquidity buffers. These were planned to commence in 2020Q2, but so as not to add pressures on banks during the crisis, enforcement of these requirements will begin in January 2021. Initially, the LCR and NSFR are set at 100 percent for dram liabilities, and 60 percent for FX liabilities, with the latter rising to 100 percent by end-2022.

- **Other measures** taken include the approval and operationalization of the emergency liquidity assistance for solvent but illiquid banks in March 2020 and finalization of regulations related to the redefinition of nonperforming and restructured loans in line with international best practices.

19. A recent update Safeguards Assessment that was concluded in September 2019 found that the CBA has a strong safeguards framework. The assessment found that the CBA's control culture continues to be strong, and external and internal audit practices remain sound. The CBA Law was amended in 2017 per previous safeguards recommendations, but there is scope for further legislative reforms to reinforce the central bank's autonomy and governance arrangements in particular with respect to stronger Board oversight of executive management and more active engagement by the Audit Committee. To further strengthen CBA safeguards, the authorities will, in collaboration with relevant stakeholders, prepare a 5–10-year strategy to reduce and, in an orderly manner, eventually completely phase-out its involvement in non-core central banking activities, including development lending and association in mortgage companies (September 2020 SB). The CBA is making progress in implementing safeguard recommendations, with the establishment of a risk management function underway.

C. Strengthening Governance and Promoting Inclusive Growth

20. Continued efforts to implement structural reforms are critical to promoting investment and advancing sustainable and inclusive growth.

- **Governance.** The authorities' efforts to tackle corruption are ongoing. In line with staff's advice, revisions were drafted in the criminal code to eliminate threshold amounts on embezzlement and introduce criminal liability for legal persons. The revisions are expected to be submitted to the NA in June 2020. The migration of the asset declaration system to the new Corruption Prevention Commission (CPC) is welcome but authorities need to continue efforts to operationalize the new platform. In addition, a law creating a single autonomous anti-corruption entity—combining all detection and investigative functions—was drafted. Although this has taken longer than anticipated (December 2019 SB), it is now in its final stages and is expected to be submitted to the NA for approval by September 2020.

- **Business environment.** The authorities approved their annual action plan to improve the business environment by tackling issues identified by the 2019 Doing Business Report (February 2020 SB). An Investment Support Center, housed in the Ministry of Economy, was created to promote both domestic and foreign investment in an efficient and streamlined manner. In addition, the authorities drafted an SME development strategy and are currently preparing an efficiency review of SME support while working consolidate these programs (April 2020 SB). The efficiency review is now expected to be completed by September 2020 given crisis-related delays. A framework establishing a new public oversight body and the Chamber of Accountants and Auditors was developed to help streamline SME financial reporting requirements and enhance financial transparency (March 2020 SB).

- **Labor market and social policies.** The employment strategy that establishes an active labor market policy (December 2019 SB) was approved by the government in December. In addition, the family and welfare benefit allowance was increased to enhance its adequacy. Meanwhile, progress is being made in a project designed to create self-sustaining income-generating opportunities for vulnerable families.

- **Education.** The draft Law on Higher Education and Science paves the way for reforms to (i) the tertiary education sector's management system and human resource management; and (ii) the organizational and financial autonomy of higher education institutions. After extensive stakeholder consultation, the draft law is expected to be submitted to the NA by end-June 2020.

PROGRAM MODALITIES

21. The authorities intend to draw on Fund support to help manage the crisis. Financing from international partners such as the World Bank and ADB, which has been facilitated by the SBA, is expected to continue easing BoP pressure (Table 8). However, the crisis has generated the BoP financing gap around US$422 million over 2020–22, but most of which are concentrated in 2020. To cover this gap, the authorities have requested an augmentation of 100 percent of quota (SDR 128.8 million, about $176 million) and intend to purchase this amount together with their drawing rights under the current SBA (SDR 77.1 million) upon completion of the second review. Staff support such upfront Fund financing as it would be needed to keep gross international reserves at least at 100 percent of the Fund's ARA metric in 2020, where crisis-related fiscal needs emerge in Q2–Q3 this year and BoP needs widen. The funding provides critical resources to cover the fiscal needs by allocating SDR 232 million (about US$316 million) for budget support as financing from the domestic sector is constrained by tighter financial conditions following the global COVID-19 pandemic. Program phasing, through availability dates, have also been modified slightly.

22. The program is fully financed and Armenia's capacity to repay the Fund is adequate. The BoP financing gap for the first 12 months of the arrangement is closed, supported by financing from the World Bank, ADB and EU (projected around $350 over 2020–21), and there are good prospects that there will be adequate financing for the remainder of the program as well. While disbursements from the Fund will raise debt by about 3 percent of GDP, Armenia's capacity to repay the Fund is supported by (i) the firm downward trajectory of both public and external debt; (ii) the authorities' proven ability to follow through on their reform program; and (iii) their long track-record of sound macroeconomic management. IMF payment obligation ratios are projected at most 7½ percent of gross reserves and 3 percent of exports (Table 7).

23. Program targets. In view of the revised outlook and policies, the June and December 2020 QPCs on net international reserves, program fiscal balance, and ceiling on budget domestic lending have been modified. In addition, the modalities of the MPCC have also been revised. Currently a Board consultation under the MPCC is triggered by inflation outturns at the program test dates which lie outside projections by a ±1.5 percentage point band.[5] This band is narrow relative to the volatility of Armenian inflation, lags in policy transmission, and relative to that in many other programs with MPCCs. The authorities propose introducing a staff consultation clause, whereby the CBA will consult with staff on the outlook for inflation and proposed policies if year-on-year inflation at program test dates (June 2020 and December 2020) falls between the inner- and outer-bands of the MPCC (text table). A Board consultation

Inflation Consultation Bands

	Jun-20	Dec-20
Upper outer band	4.0	4.5
Upper inner band	3.0	3.5
Center point	1.0	1.5
Lower inner band	0.0	0.0
Lower outer band	0.0	0.0

Source: IMF staff.

[5] The old MPCC band (+/-1.5 percent) was too narrow. The estimated standard deviation for quarterly inflation (YoY) in Armenia is 2.04 percent, over the past 5 years.

would occur if inflation falls outside the outer bands at program test dates.

24. The structural conditionality has also been updated. Staff proposes:

New Structural Benchmarks		
Measures	**Responsible Agency**	**Time Frame**
Fiscal		
Design a Compliance Risk Management strategy to improve tax administration and compliance, based on IMF TA recommendations.	State Revenue Committee	September 2020
Conduct a study identifying tax potential and factors preventing tax collection reaching its potential.	Deputy Prime Minister's Office	October 2020
Design an action plan to reduce the tax policy gap identified in the study.	MoF	December 2020
Develop and approve [by ministerial order] a plan for how GFS in Armenia will be extended and improved over the next two to three years.	MoF, in collaboration with the CBA and Armstat	September 2020
Compile a comprehensive sectorized list of all public sector entities, with IMF TA support.	MoF and Armstat	March 2021
Compile and estimate all the existing and future contingent liabilities associated with implemented and approved PPPs	MoF	November 2020
Approve and publish a decree setting a cap to the total contingent liabilities contracted from PPPs.	MoF	December 2020
Build a database of projects covering both externally and domestically funded projects that provides information on projects throughout their life-cycle.	MoE and MoF	December 2020
Monetary and Financial		
Introduce limits to stressed Loan-to-Value (LTV) ratio	CBA	March 2021

- Three SBs to strengthen tax administration and compliance, with the assistance of IMF TA: (i) preparing a compliance risk management strategy (September 2020 SB); (ii) developing a study identifying tax potential and factors preventing tax collection from reaching its potential (October 2020 SB); and (iii) designing a tax policy action plan based on identified areas for improvements (December 2020).

- Two SBs following up on recent recommendations to improve GFS accounts: (i) develop and approve by ministerial order a plan for how GFS in Armenia will be extended and improved over the next two to three years (September 2020); and (ii) prepare a comprehensive sectorized list of all public sector entities (March 2021).

- An SB on building a database of both externally and domestically funded projects, in line with recent TA recommendations, to facilitate better PIM management (December 2020).

- Two SBs to strengthen fiscal risk management: (i) compile and estimate all the existing and future contingent liabilities associated with implemented and approved PPPs (November 2020); and (ii) approve and publish a decree setting a cap to the total contingent liabilities from contracted PPPs (December 2020).

- An SB to introduce limits to stressed Loan-to-Value (LTV) ratio to mitigate credit risks vulnerabilities from unhedged FX borrowers (March 2021).

STAFF APPRAISAL

25. The COVID-19 pandemic has significantly affected Armenia's near-term outlook. Although projections are subject to very high uncertainty, growth is projected to slow substantially, financial conditions are expected to be tightened, and exports and tax revenues will be lower than expected just a few months ago leading to the emergence of large external and fiscal financing gaps.

26. The authorities have acted proactively to contain the spread of COVID-19 and mitigate its near-term socio-economic impact. Following the first cases of COVID-19, the government committed funding for additional health expenditures and launched several support measures aimed at aiding businesses and vulnerable individuals in order to avoid more permanent socio-economic damage. The authorities are committed to ensuring strong governance and transparency in implementation of these programs, and staff encourage them to continuously monitor the implementation of these measures to ensure their ongoing need, effectiveness and evenhanded coverage. The authorities should also transparently report realized losses, and contingent risks, associated with their support programs with a multi-year impact. When contemplating post-crisis support, the authorities should consider the pros and cons of various alternatives. For measures that include direct investment in companies, they should enact sufficient transparency and safeguards to limit risks to the public sector balance sheet, and the potential for distorting competition or creating opening for corruption.

27. Staff welcomes the authorities' ongoing commitment to the SBA's objectives. While government debt is projected to exceed 60 percent of GDP in 2020, the authorities are committed to the medium-term goal of debt sustainability, once the crisis abates, in line with Armenia's fiscal rule, with central government debt expected to gradually fall over the medium term to below 53 percent of GDP by 2025. In this regard, the authorities should continue pursuing actions to raise revenue-to-GDP over the medium term, creating space for priority investment and social spending. The authorities are also committed to bring inflation back to its target and requested the addition a staff consultation band to the MPCC.

28. Staff support the authorities' request for augmentation, modification of performance criteria, and completion of this review. The severe impact of the COVID-19 pandemic results in a significant BoP gap. The authorities' commitment to the program's objectives, ownership of planned reforms, and track-record of sound policy implementation support the completion of the review. Combined, this will make available a cumulative amount of SDR205.94 million (159.89 percent of quota). The augmentation would allow the authorities to close the BoP gap. Given the large fiscal financing gap, staff also supports the use of any drawing for budget support.

Proposed Decision

The following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:

1. The Republic of Armenia has consulted with the Fund in accordance with paragraph 3.(d) of the Stand-By Arrangement for Republic of Armenia (EBS/19/27, 5/6/19) (the "**Arrangement**") in order to review program implementation and conclude the monetary policy consultation.

2. The letter dated April 30, 2020 from the Prime Minister, the Minister of Finance, and the Chairman of the Central Bank of Republic of Armenia (the "April 2020 Letter"), together with its attached Memorandum of Economic and Financial Policies (the "April 2020 MEFP") and Technical Memorandum of Understanding (the "April 2020 TMU") shall be attached to the Arrangement, and the letter dated May 2, 2019 from the Prime Minister, the Minister of Finance, and the Chairman of the Central Bank of Republic of Armenia, together with its attachments, as supplemented and modified, shall be read as further supplemented and modified by the April 2020 Letter and its attachments.

3. Accordingly, the Arrangement for Republic of Armenia shall be amended as follows:

In paragraph 1 of the Arrangement, the reference to "SDR 180 million" shall be replaced with "SDR 308.8 million".

a) Paragraph 2.(a) of the Arrangement shall be replaced with the following text:

"Purchases under this Arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 25.714 million until September 30, 2019, the equivalent of SDR 51.428 million until May 18, 2020, the equivalent of SDR 205.942 until October 15, 2020, the equivalent of SDR 231.656 million until May 20, 2021, the equivalent of SDR 257.37 million until October 15, 2021, and the equivalent of SDR 283.084 million until April 15, 2022."

b) Paragraph 3.(d) of the Arrangement shall be replaced with the following text:

"(d) after September 29, 2019, May 17, 2020, October 14, 2020, May 19, 2021, October 14, 2021, and April 14, 2022, until the respective reviews contemplated in paragraph 21 of the April 2020 MEFP are completed."

c) The targets for June 30, 2020 and December 31, 2020 for the performance criteria set forth in paragraphs 3.(a)(i) through 3.(a)(iii) of the Arrangement shall be as specified in Table 1 of the April 2020 MEFP and further specified in the April 2020 TMU.

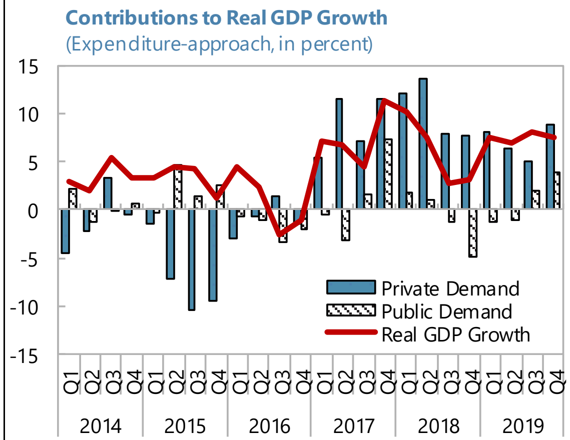
d) The continuous performance criterion set forth in paragraph 3.(b)(i) of the Arrangement shall be as specified in Table 1 of the April 2020 MEFP and further specified in the April 2020 TMU.

e) The consultation set forth in paragraph 3.(c) of the Arrangement shall be as specified in Table 1 of the April 2020 MEFP and further specified in the April 2020 TMU.

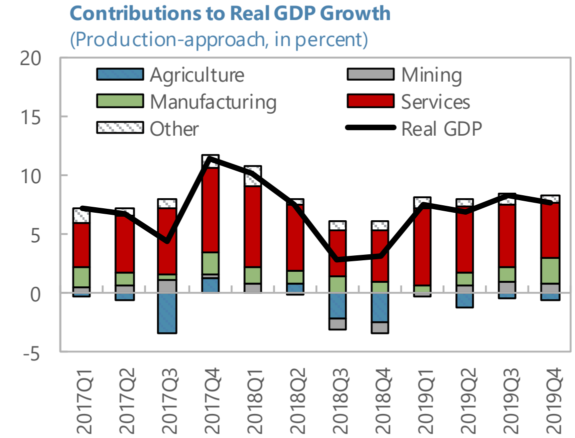
4. The Fund decides that the monetary policy consultation specified in paragraph 3.(c) of the Arrangement with respect to end-December 2019 is concluded and the second review specified in paragraph 3.(d) of the Arrangement is completed and Republic of Armenia may make purchases in accordance with the terms under the Arrangement.

Figure 2. Armenia: Real Sector Developments

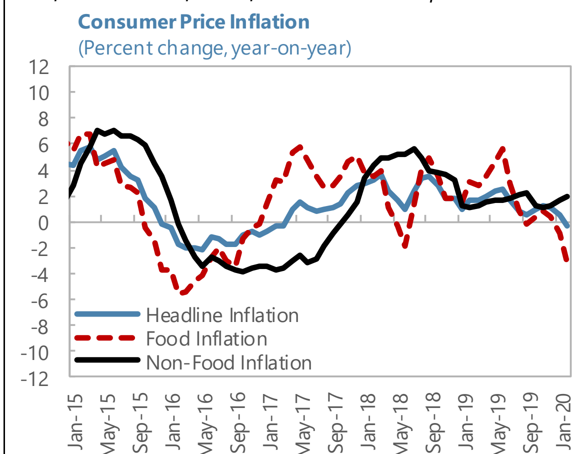
Growth in 2018–19 was mainly driven by private demand



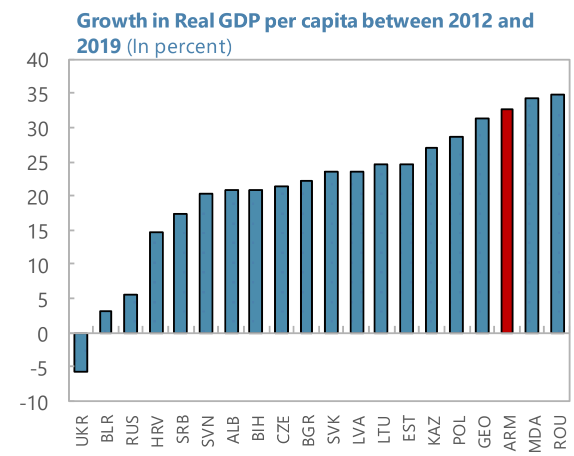
Preliminary data show strong growth performance in 2019Q4 on the back of stronger than anticipated activity in the service and manufacturing sectors



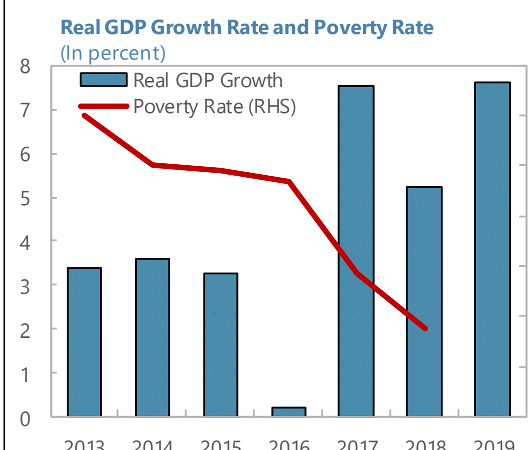
Both food and non-food inflation are below expectations



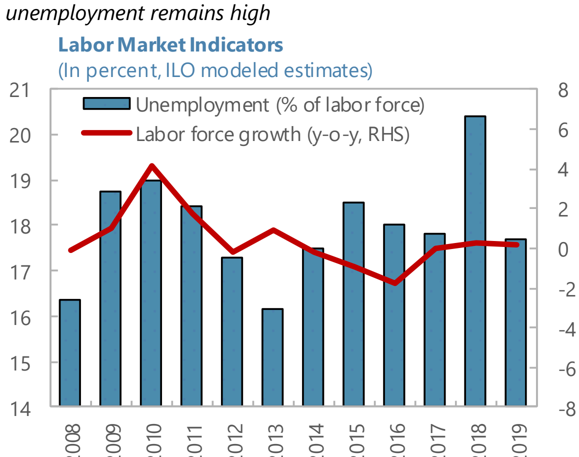
Armenia's per capita income growth is high, compared with peers



Robust GDP growth helped poverty rates fall significantly



Employment growth increased in recent years, although unemployment remains high

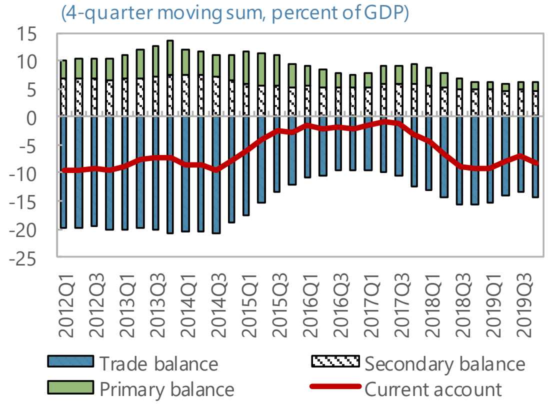


Sources: National authorities, Haver, IMF World Economic Outlook, and IMF staff calculations.

Figure 3. Armenia: External Developments

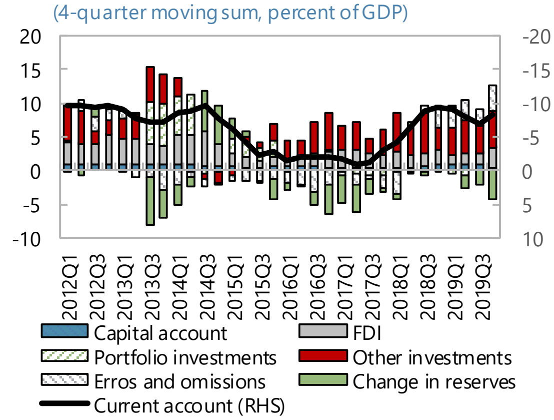
After widening in 2018 the current account deficit narrowed in 2019.

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



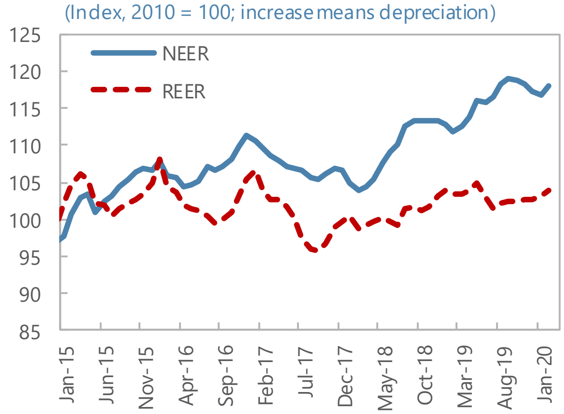
Current account has been financed mainly by private inflows recently, while loan disbursements to public sector were significantly lower as project execution slowed.

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



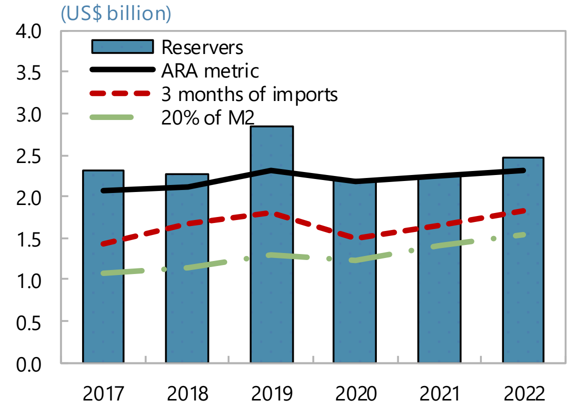
Exchange rate has been relatively stable since 2015.

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



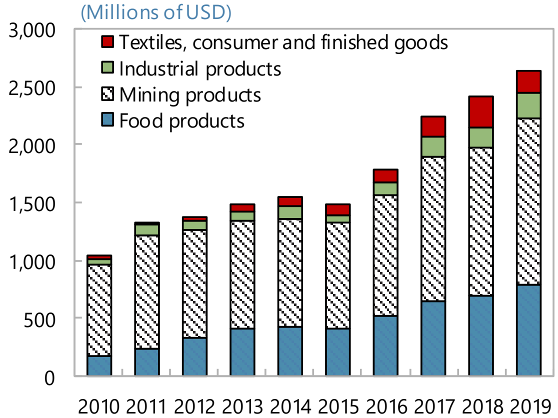
With additional financing from the IMF, reserves would remain adequate according to various metrics.

Reserve Adequacy Indicators
(US$ billion)



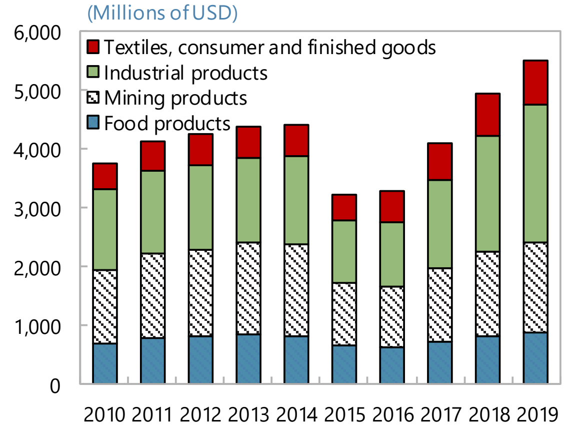
Exports have more than doubled since 2010 and are somewhat more diversified.

Export of Goods by Type
(Millions of USD)



The imports of capital goods and durables, which had declined in 2015, picked up over 2018–19.

Import of Goods by Type
(Millions of USD)



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

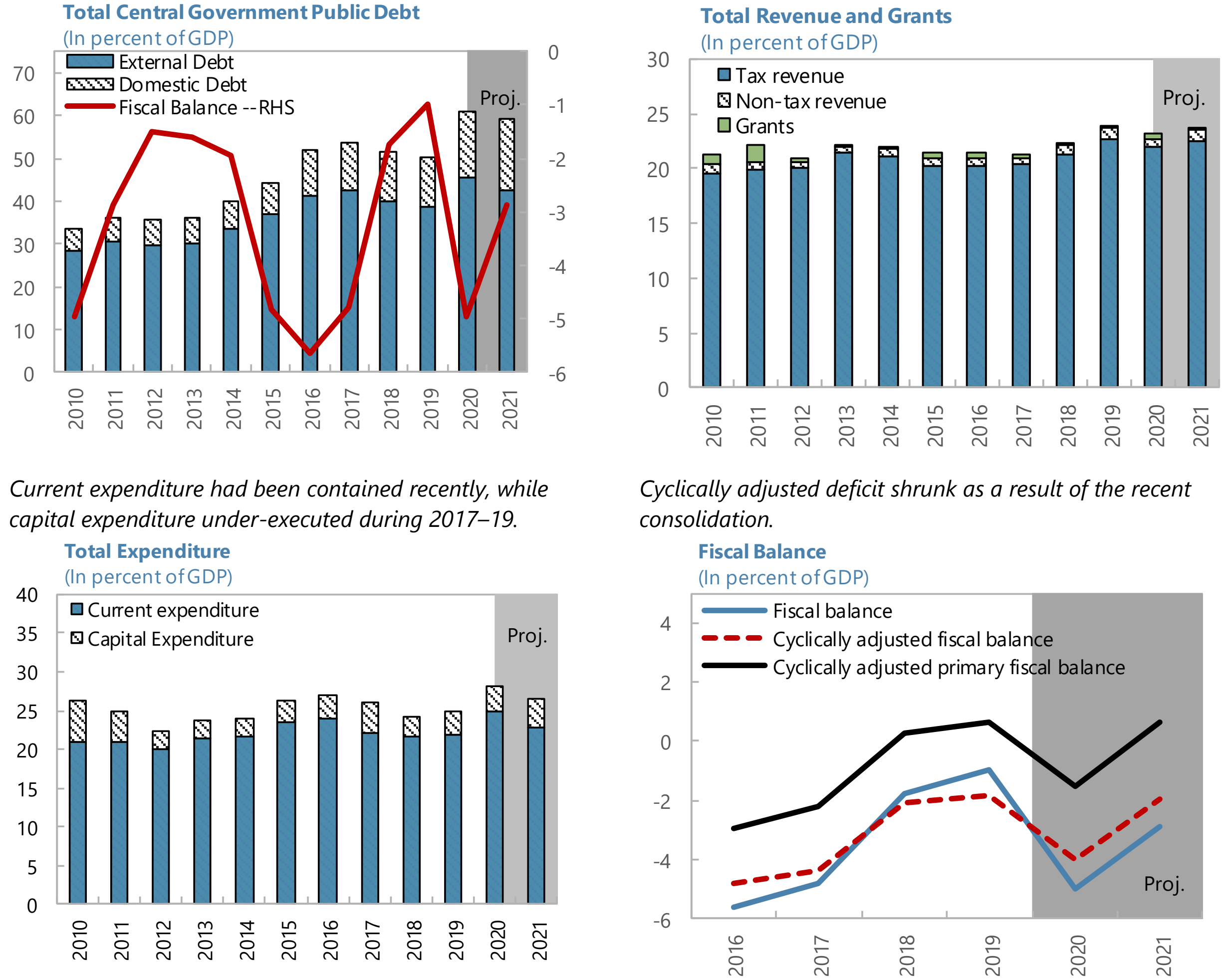
Figure 4. Armenia: Fiscal Developments

Following the 2014 external shock, central government public debt peaked at end-2017 before falling in 2018–19.

Revenues had been stable and started to increase following the 2016 tax code change and tax administration efforts.

Current expenditure had been contained recently, while capital expenditure under-executed during 2017–19.

Cyclically adjusted deficit shrunk as a result of the recent consolidation.

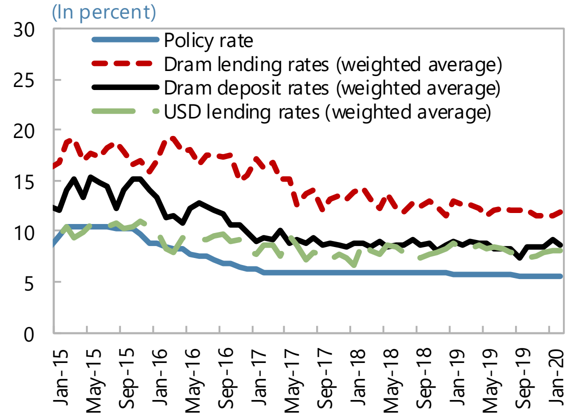


Sources: National authorities and IMF staff calculations.

Figure 5. Armenia: Monetary Developments

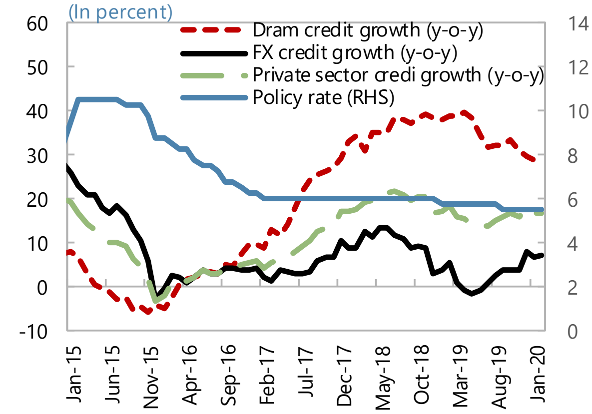
A fall in both deposit and lending rates has been moderating since the second half of 2018–19.

Interest Rates
(In percent)



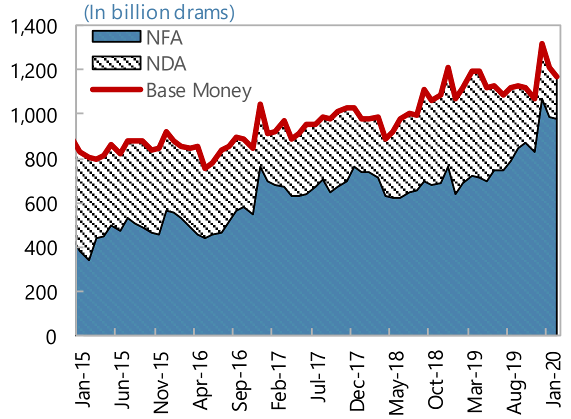
Credit growth, which had picked up, has been moderating since the second half of 2018.

Interest Rates and Credit Growth
(In percent)



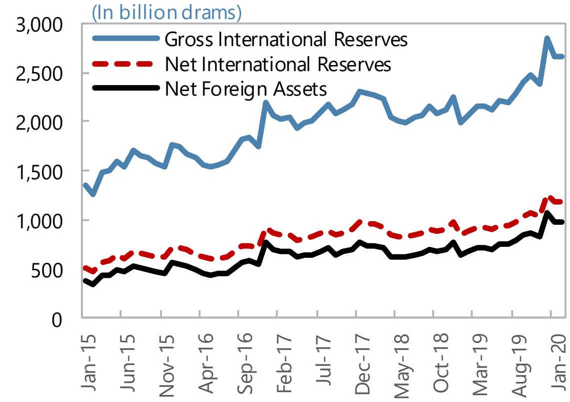
The money base has increased in 2018.

Composition of Base Money
(In billion drams)



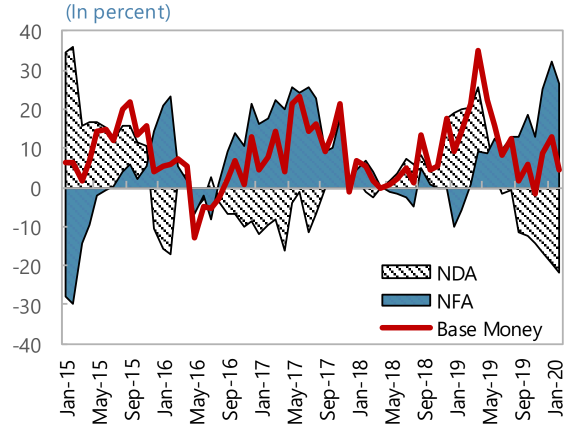
The CBA's foreign assets have been increasing after a temporary decline following the revolution.

CBA Balance Sheet
(In billion drams)



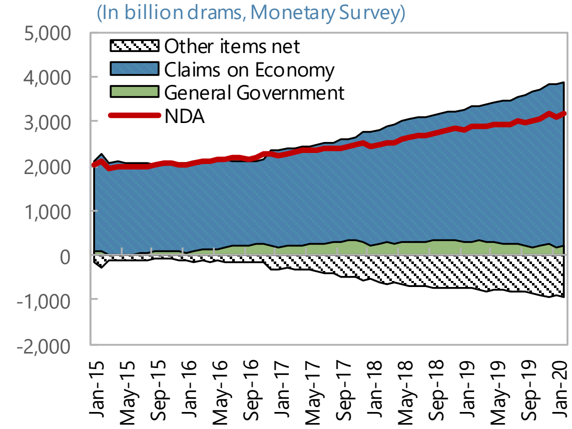
The base money growth in 2019 was mainly due to the increase in NFA.

Contribution to Base Money Growth
(In percent)



The main component in the rise of NDA was the growth in claims on economy.

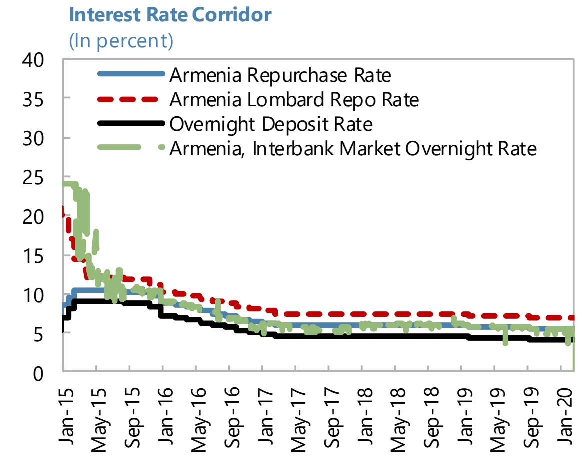
Composition of NDA
(In billion drams, Monetary Survey)



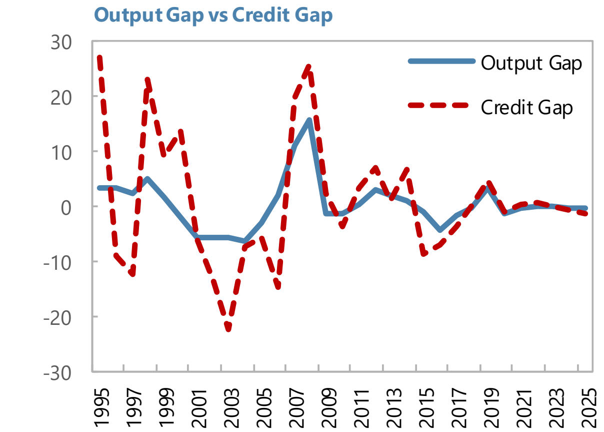
Sources: Central Bank of Armenia, and IMF staff calculations.

Figure 6. Armenia: Financial Developments

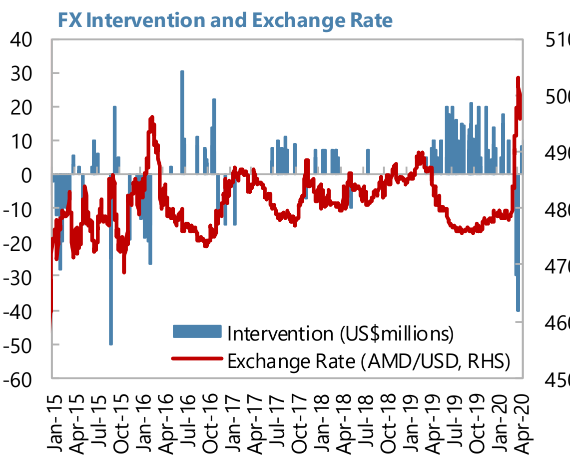
The CBA lowered the policy rate twice in 2019, each time by 25 bps, and did it again on March 17, 2020.



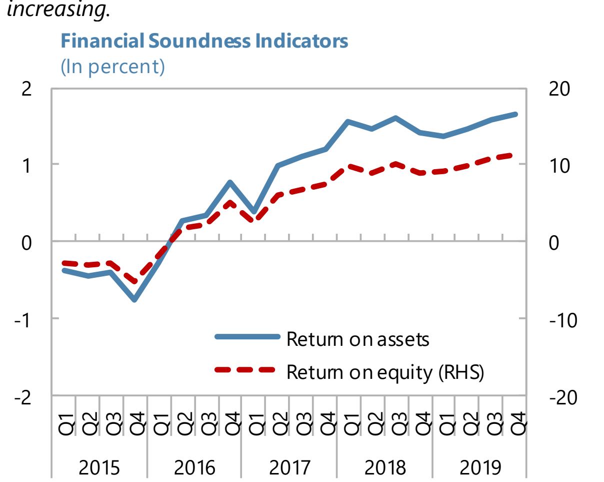
The credit-to-GDP gap is estimated to be marginally negative.



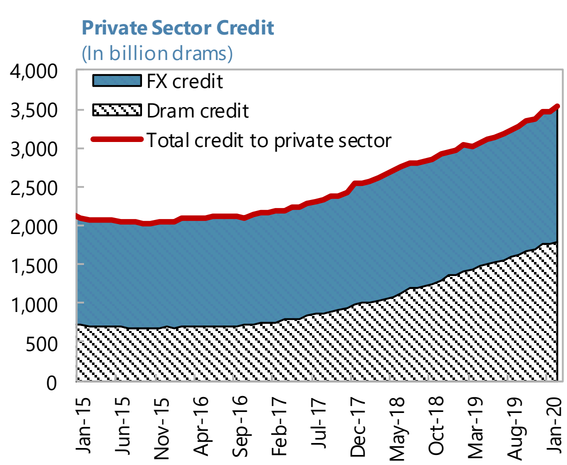
The exchange rate slightly depreciated in the beginning of 2020.



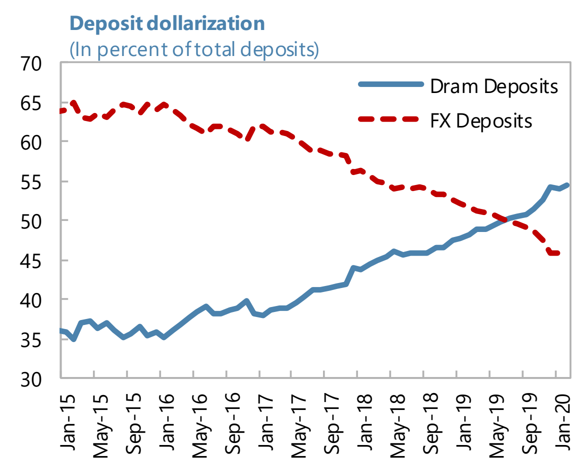
With stable monetary and financial conditions, profitability is increasing.



Given stable exchange rates, credit dollarization has fallen.



Deposit dollarization has declined as well.



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

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

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Act.	Act.	Prel.			Proj.			
National income and prices:									
Real GDP (percent change)	7.5	5.2	7.6	-1.5	4.8	4.5	4.5	4.5	4.5
Final consumption expenditure, Contrib. to Growth	7.4	4.1	8.8	1.2	1.5	1.8	1.8	1.5	1.9
Gross fixed capital formation, Contrib. to Growth	1.5	0.7	0.8	0.0	2.3	2.4	2.5	2.5	2.6
Changes in inventories, Contrib. to Growth	1.1	3.8	-1.7	-2.5	0.0	0.0	0.0	0.0	0.0
Net exports of goods and services, Contrib. to Growth	-1.2	-2.7	0.1	-0.2	1.0	0.3	0.1	0.1	0.0
Gross domestic product (in billions of drams)	5,564	6,005	6,552	6,519	6,990	7,543	8,181	8,909	9,721
Gross domestic product (in millions of U.S. dollars)	11,527	12,433	13,637	12,977	13,422	14,536	15,597	16,768	18,041
Gross domestic product per capita (in U.S. dollars)	3,869	4,188	4,593	4,370	4,520	4,894	5,251	5,645	6,073
CPI (period average; percent change)	1.0	2.4	1.4	0.9	2.0	3.0	3.5	3.8	3.9
CPI (end of period; percent change)	2.6	1.8	0.7	1.5	2.5	3.5	4.0	4.0	4.0
GDP deflator (percent change)	2.1	2.5	1.4	1.0	2.3	3.3	3.8	4.2	4.4
Unemployment rate (in percent)	17.8	20.4	17.7	19.0	17.9	17.6	17.5	17.4	17.3
Investment and saving (in percent of GDP)									
Investment	19.3	22.4	19.2	21.4	21.9	22.4	23.0	23.5	24.1
National savings	16.3	13.0	11.0	12.8	14.7	15.7	16.6	17.4	18.1
Money and credit (end of period)									
Reserve money (percent change)	-1.0	17.8	8.8	5.4	13.2	11.1	10.8	8.0	8.2
Broad money (percent change)	18.5	7.4	11.2	3.9	13.2	11.1	10.8	8.0	8.2
Private sector credit growth (percent change)	16.5	17.2	18.5	7.0	13.0	11.0	9.0	8.5	8.5
Central government operations (in percent of GDP)									
Revenue and grants	21.2	22.3	23.9	23.3	23.7	24.9	25.3	25.4	25.4
Of which : tax revenue	20.2	21.0	22.3	21.7	22.0	22.9	23.1	23.2	23.3
Expenditure	26.0	24.1	24.9	28.3	26.5	26.9	26.9	26.9	26.9
Overall balance on a cash basis	-4.8	-1.8	-1.0	-5.0	-2.9	-2.0	-1.7	-1.5	-1.5
Public and publicly-guaranteed (PPG) debt (in percent of GDP)	58.9	55.8	53.7	64.1	62.1	59.8	57.0	54.8	52.8
Central Government's PPG debt (in percent)	53.7	51.3	50.1	60.9	59.1	57.3	55.0	53.3	51.8
Share of foreign currency debt (in percent)	81.1	80.0	79.0	75.7	73.5	74.1	75.1	74.3	73.7
External sector									
Exports of goods and services (in millions of U.S. dollars)	4,312	4,700	5,274	4,091	4,817	5,344	5,765	6,150	6,557
Imports of goods and services (in millions of U.S. dollars)	-5,723	-6,647	-7,246	-5,946	-6,606	-7,289	-7,815	-8,307	-8,830
Exports of goods and services (percent change)	23.2	9.0	12.2	-22.4	17.7	10.9	7.9	6.7	6.6
Imports of goods and services (percent change)	26.7	16.1	9.0	-17.9	11.1	10.3	7.2	6.3	6.3
Current account balance (in percent of GDP)	-3.0	-9.4	-8.2	-8.6	-7.2	-6.7	-6.4	-6.1	-6.0
FDI (net, in millions of U.S. dollars)	222	247	397	161	292	385	404	439	461
Gross international reserves (in millions of U.S. dollars)	2,314	2,259	2,840	2,190	2,245	2,446	2,578	2,587	2,598
Import cover 1/	4.2	3.7	5.7	4.0	3.7	3.8	3.7	3.5	3.3
End-of-period exchange rate (dram per U.S. dollar)	484	484	480	…	…	…	…	…	…
Average exchange rate (dram per U.S. dollar)	483	483	480	…	…	…	…	…	…

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

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

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

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

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Act.	Act.	Act.			Proj.			
Current account	-344	-1,165	-1,118	-1,122	-969	-974	-997	-1,029	-1,084
Trade balance	-1,376	-1,789	-2,051	-1,768	-1,770	-1,882	-1,969	-2,061	-2,163
Exports, fob	2,385	2,630	2,873	2,463	2,767	2,955	3,148	3,345	3,545
Imports, fob	-3,761	-4,420	-4,924	-4,231	-4,537	-4,837	-5,117	-5,406	-5,708
Services (net)	-36	-158	80	-86	-20	-63	-82	-96	-109
Credits	1,926	2,070	2,402	1,628	2,050	2,389	2,617	2,805	3,013
Debits	-1,962	-2,228	-2,322	-1,714	-2,070	-2,452	-2,699	-2,901	-3,121
Income (net)	407	161	228	203	250	279	309	340	373
Transfers (net)	660	620	625	529	570	691	745	787	815
Private	497	479	482	345	426	486	559	609	658
Official	163	141	143	185	144	205	185	178	157
Capital and financial account	572	810	1,267	225	1,019	1,182	1,231	1,227	1,245
Capital transfers (net)	46	125	54	70	70	70	70	70	70
Foreign direct investment (net)	222	247	397	161	292	385	404	439	461
Portfolio investment (net)	-87	-33	8	8	8	8	8	8	8
Public sector borrowing (net)	493	168	301	-11	152	249	298	294	292
Disbursements	585	320	859	288	381	493	555	555	1,061
Amortization	-92	-152	-558	-299	-229	-245	-257	-261	-769
Other capital (net)	-101	303	506	-3	496	470	451	416	413
Errors and omissions	-228	356	505	0	0	0	0	0	0
Overall balance	0	0	653	-897	49	208	234	198	160
Financing	-139	-13	-653	581	-119	-243	-234	-198	-160
Gross international reserves (increase: -)	-110	55	-581	650	-55	-201	-132	-9	-11
Use of Fund credit, net	-29	-68	-73	-69	-65	-42	-102	-189	-149
Financing gap	0	0	0	316	70	35	0	0	0
Identified financing									
IMF (SBA) budget support	0	0	0	316	0	0	0	0	0
IMF (SBA) BoP support	0	0	0	0	70	35	0	0	0
Memorandum items:									
Current account (in percent of GDP)	-3.0	-9.4	-8.2	-8.6	-7.2	-6.7	-6.4	-6.1	-6.0
Trade balance (in percent of GDP)	-11.9	-14.4	-15.0	-13.6	-13.2	-12.9	-12.6	-12.3	-12.0
Gross international reserves (end of period)	2,314	2,259	2,840	2,190	2,245	2,446	2,578	2,587	2,598
In months of next year's imports	4.2	3.7	5.7	4.0	3.7	3.8	3.7	3.5	3.3
In percent of IMF's Reserve Adqeuacy Metric (ARA)	112	98	123	101	100	105	107	104	102
Merchandise export growth, percent change	26.2	10.3	9.2	-14.3	12.3	6.8	6.5	6.3	6.0
Merchandise import growth, percent change	32.6	17.5	11.4	-14.1	7.2	6.6	5.8	5.7	5.6
Nominal external debt	10,228	10,683	11,385	12,103	12,589	13,184	13,773	14,320	14,917
o.w. public external debt	5,495	5,536	5,790	6,020	6,171	6,413	6,629	6,783	6,965
Nominal external debt stock (in percent of GDP)	88.7	85.9	83.5	93.3	93.8	90.7	88.3	85.4	82.7
External public debt-to-exports ratio (in percent)	127.4	117.8	109.8	147.1	128.1	120.0	115.0	110.3	106.2
External public debt service (in percent of exports)	6.7	7.9	15.4	13.7	9.4	8.1	8.3	8.6	15.2

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

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

(In billions of Armenian drams)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Act.	Act.	Act.			Proj.			
Total revenue and grants	1,182.0	1,341.7	1,565.5	1,517.8	1,653.8	1,878.5	2,066.4	2,262.9	2,472.5
Total revenue	1,168.7	1,330.5	1,553.1	1,480.3	1,640.9	1,858.3	2,046.8	2,244.0	2,454.1
Tax revenues 1/	1,123.9	1,258.1	1,464.3	1,415.5	1,538.1	1,728.7	1,886.1	2,068.9	2,263.1
VAT	392.1	438.2	506.5	491.4	552.2	610.9	665.1	730.4	797.0
Profits, simplified and presumptive	113.6	170.4	234.0	223.1	188.4	225.9	245.0	275.7	310.6
Personal income tax	341.3	356.6	440.8	373.4	377.4	392.5	405.5	441.5	481.7
Customs duties	72.6	80.2	95.1	65.5	90.9	98.0	106.3	115.8	126.4
Other	204.4	212.7	187.9	262.1	329.3	401.3	464.1	505.4	547.4
Social contributions	15.8	17.4	18.7	19.0	37.0	58.6	83.9	91.3	99.7
Other revenue	28.9	54.9	70.1	45.9	65.7	70.9	76.9	83.7	91.4
Grants	13.3	11.2	12.4	37.4	12.9	20.2	19.6	19.0	18.4
Total expenditure	1,448.3	1,447.1	1,629.4	1,842.3	1,855.5	2,030.3	2,203.1	2,397.9	2,617.1
Expenses	1,225.7	1,299.0	1,437.1	1,628.2	1,596.8	1,690.9	1,810.4	1,922.5	2,078.6
Wages	299.1	304.4	327.0	350.8	370.4	395.2	417.2	457.6	500.4
Payments to individual pension accts.	13.0	29.0	49.4	49.4	50.5	43.0	34.2	34.9	36.0
Subsidies	1.5	4.3	4.4	117.1	43.8	45.7	52.8	29.4	23.4
Interest	119.8	139.0	157.6	168.1	190.5	205.0	209.6	210.2	211.3
Social allowances and pensions	397.9	396.5	403.9	480.6	500.3	549.3	621.8	686.1	766.3
Pensions/social security benefits	267.3	265.7	269.9	329.2	351.2	388.3	439.4	478.5	529.5
Social assistance benefits	130.6	130.8	134.0	151.4	149.2	161.0	182.3	207.6	236.8
Goods and services	104.4	155.6	192.1	166.8	149.6	161.8	171.8	188.8	207.1
Grants	109.1	126.3	150.0	158.9	146.8	147.1	147.2	146.1	149.7
Other expenditure 2/	180.8	143.8	152.8	136.5	144.9	144.0	155.8	169.4	184.5
Transactions in nonfinancial assets	222.6	148.1	192.3	214.0	258.6	339.4	392.7	475.4	538.5
Acquisition of nonfinancial assets	223.5	152.0	193.0	214.0	258.6	339.4	392.7	475.4	538.5
Disposals of nonfinancial assets	1.0	3.9	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-266.3	-105.4	-63.9	-324.5	-201.7	-151.8	-136.7	-135.0	-144.6
Statistical discrepancy	-7.7	0.8	-8.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-274.0	-104.6	-72.4	-324.5	-201.7	-151.8	-136.7	-135.0	-144.6
Financing	274.0	104.6	72.4	324.5	201.7	151.8	136.7	135.0	144.6
Domestic financing	86.5	69.4	-13.3	135.7	181.9	72.3	32.3	36.8	74.8
Banking system	80.4	109.8	-39.1	157.5	89.9	6.3	-32.9	22.3	45.3
CBA	18.0	43.4	-96.5	57.9	-20.4	-37.5	-52.5	0.0	0.0
Commercial Banks	62.4	66.4	57.5	99.5	110.2	43.8	19.6	22.3	45.3
Nonbanks	6.1	-40.4	25.7	-21.8	92.0	66.0	65.2	14.5	29.5
T-Bills/other	-7.5	-13.5	41.5	98.5	71.6	28.5	12.7	14.5	29.5
Promissory note/other	-94.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	107.7	-26.9	-15.8	-120.2	20.4	37.5	52.5	0.0	0.0
External financing	187.5	35.2	85.7	-70.5	19.8	79.5	104.4	98.2	69.8
Gross disbursement	282.3	154.4	412.8	144.9	198.3	256.0	291.1	294.9	571.7
Amortization due	-47.9	-68.5	-270.0	-150.3	-111.8	-114.2	-119.1	-123.1	-421.6
Net lending	-46.8	-50.8	-57.1	-65.0	-66.7	-62.3	-67.6	-73.6	-80.3
Other financing 3/	0.0	0.0	0.0	259.2	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	5,564.5	6,005.1	6,551.8	6,519.1	6,989.6	7,542.9	8,181.4	8,909.1	9,720.9
Program balance 4/	-202.5	-155.7	-94.3	-494.8	-248.0	-176.7	-151.8	-208.6	-224.9
Primary balance 5/	-85.7	-44.1	20.7	-341.6	-57.5	28.3	57.8	1.6	-13.7

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

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

2/ Includes acquisition of military equipment.

3/ Covid19 fiscal gap.

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

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

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

(In percent of GDP, unless otherwise specified)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Act.	Act.	Act.			Proj.			
Total revenue and grants	21.2	22.3	23.9	23.3	23.7	24.9	25.3	25.4	25.4
Total revenue	21.0	22.2	23.7	22.7	23.5	24.6	25.0	25.2	25.2
Tax revenues 1/	20.2	21.0	22.3	21.7	22.0	22.9	23.1	23.2	23.3
VAT	7.0	7.3	7.7	7.5	7.9	8.1	8.1	8.2	8.2
Profits, simplified and presumptive	2.0	2.8	3.6	3.4	2.7	3.0	3.0	3.1	3.2
Personal income tax	6.1	5.9	6.7	5.7	5.4	5.2	5.0	5.0	5.0
Customs duties	1.3	1.3	1.5	1.0	1.3	1.3	1.3	1.3	1.3
Other	3.7	3.5	2.9	4.0	4.7	5.3	5.7	5.7	5.6
Social contributions	0.3	0.3	0.3	0.3	0.5	0.8	1.0	1.0	1.0
Other revenue	0.5	0.9	1.1	0.7	0.9	0.9	0.9	0.9	0.9
Grants	0.2	0.2	0.2	0.6	0.2	0.3	0.2	0.2	0.2
Total expenditure	26.0	24.1	24.9	28.3	26.5	26.9	26.9	26.9	26.9
Expense	22.0	21.6	21.9	25.0	22.8	22.4	22.1	21.6	21.4
Wages	5.4	5.1	5.0	5.4	5.3	5.2	5.1	5.1	5.1
Payments to individual pension accts.	0.2	0.5	0.8	0.8	0.7	0.6	0.4	0.4	0.4
Subsidies	0.0	0.1	0.1	1.8	0.6	0.6	0.6	0.3	0.2
Interest	2.2	2.3	2.4	2.6	2.7	2.7	2.6	2.4	2.2
Social allowances and pensions	7.2	6.6	6.2	7.4	7.2	7.3	7.6	7.7	7.9
Pensions/social security benefits	4.8	4.4	4.1	5.0	5.0	5.1	5.4	5.4	5.4
Social assistance benefits	2.3	2.2	2.0	2.3	2.1	2.1	2.2	2.3	2.4
Goods and services	1.9	2.6	2.9	2.6	2.1	2.1	2.1	2.1	2.1
Grants	2.0	2.1	2.3	2.4	2.1	1.9	1.8	1.6	1.5
Other expenditure 2/	3.2	2.4	2.3	2.1	2.1	1.9	1.9	1.9	1.9
Transactions in nonfinancial assets	4.0	2.5	2.9	3.3	3.7	4.5	4.8	5.3	5.5
Acquisition of nonfinancial assets	4.0	2.5	2.9	3.3	3.7	4.5	4.8	5.3	5.5
Disposals of nonfinancial assets	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (above-the-line)	-4.8	-1.8	-1.0	-5.0	-2.9	-2.0	-1.7	-1.5	-1.5
Statistical discrepancy	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-4.9	-1.7	-1.1	-5.0	-2.9	-2.0	-1.7	-1.5	-1.5
Financing	4.9	1.7	1.1	5.0	2.9	2.0	1.7	1.5	1.5
Domestic financing	1.6	1.2	-0.2	2.1	2.6	1.0	0.4	0.4	0.8
Banking system	1.4	1.8	-0.6	2.4	1.3	0.1	-0.4	0.3	0.5
CBA	0.3	0.7	-1.5	0.9	-0.3	-0.5	-0.6	0.0	0.0
Commercial Banks	1.1	1.1	0.9	1.5	1.6	0.6	0.2	0.3	0.5
Nonbanks	0.1	-0.7	0.4	-0.3	1.3	0.9	0.8	0.2	0.3
T-Bills/other	-0.1	-0.2	0.6	1.5	1.0	0.4	0.2	0.2	0.3
Promissory note/other	-1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	1.9	-0.4	-0.2	-1.8	0.3	0.5	0.6	0.0	0.0
External financing	3.4	0.6	1.3	-1.1	0.3	1.1	1.3	1.1	0.7
Gross disbursement	5.1	2.6	6.3	2.2	2.8	3.4	3.6	3.3	5.9
Amortization due	-0.9	-1.1	-4.1	-2.3	-1.6	-1.5	-1.5	-1.4	-4.3
Net lending	-0.8	-0.8	-0.9	-1.0	-1.0	-0.8	-0.8	-0.8	-0.8
Other financing 3/	0.0	0.0	0.0	4.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Nominal GDP (in billion of drams)	5,564	6,005	6,552	6,519	6,990	7,543	8,181	8,909	9,721
Program balance 4/	-3.6	-2.6	-1.4	-7.6	-3.5	-2.3	-1.9	-2.3	-2.3
Primary balance 5/	-1.5	-0.7	0.3	-5.2	-0.8	0.4	0.7	0.0	-0.1

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

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

2/ Includes acquisition of military equipment.

3/ Covid19 fiscal gap.

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

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

Table 4. Armenia: Monetary Accounts, 2017–21

(In billions of drams, unless otherwise indicated)

	2017	2018	2019				2020				2021
	Act.	Act.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Dec.
			Act			Est	Proj.				Proj.
Central Bank of Armenia											
Net foreign assets	766.6	765.8	721.4	747.0	843.0	1071.8	949.7	872.8	850.1	847.4	919.9
Net international reserves	977.0	971.6	927.1	946.3	1040.3	1268.5	1146.5	1069.6	1046.9	1044.1	1116.7
Other	-210.4	-205.8	-205.7	-199.2	-197.3	-196.8	-196.8	-196.8	-196.8	-196.8	-196.8
Net domestic assets	265.4	449.8	474.2	381.9	287.8	250.5	335.2	325.2	426.5	546.9	670.6
Claims on general government (net)	-144.3	-172.3	-216.2	-275.9	-333.1	-314.1	-304.3	-295.5	-287.7	-280.9	-269.5
Of which: central government (net)	-121.0	-137.8	-179.6	-168.8	-141.8	-173.6	-163.8	-155.0	-147.2	-140.4	-129.0
Claims on banks	107.6	299.1	364.3	325.2	294.4	231.7	231.7	231.7	231.7	231.7	231.7
Other items (net)	302.1	323.0	326.1	332.5	326.5	332.9	407.8	389.0	482.5	596.1	708.5
Reserve money	1,032.0	1,215.6	1,195.6	1,128.9	1,130.8	1,322.2	1,284.9	1,198.0	1,276.5	1,394.2	1,590.6
Currency issue	516.1	566.7	503.3	515.3	542.2	607.2	541.5	554.0	582.0	649.1	692.3
Deposits	515.9	648.9	692.3	613.6	588.6	715.0	743.4	644.0	694.5	745.2	898.2
Deposits in drams	329.2	392.7	443.9	386.5	355.9	336.4	352.3	234.6	265.2	294.5	397.2
Deposits in foreign currency	186.8	256.2	248.4	227.0	232.7	378.6	391.1	409.4	429.3	450.7	501.0
Banking system											
Net foreign assets	61.8	-78.7	-147.5	-142.4	-77.4	-74.0	-205.0	-291.9	-325.7	-340.4	-325.8
Net domestic assets	2,521.0	2,853.8	2,897.7	2,935.2	2,968.0	3,159.4	3,160.6	3,047.6	3,262.0	3,547.4	3,984.4
Claims on government (net)	302.0	333.6	325.5	262.1	197.1	241.5	282.8	324.2	365.5	406.8	566.3
Of which: claims on central government (net)	325.3	368.1	362.1	369.2	388.4	382.1	423.4	464.7	506.0	547.3	706.8
Claims on rest of the economy	2,758.5	3,232.0	3,345.7	3,448.3	3,592.3	3,830.6	3,730.5	3,551.7	3,700.1	4,098.8	4,631.6
Other items (net)	-539.6	-711.8	-773.5	-775.2	-821.4	-912.7	-852.7	-828.3	-803.6	-958.2	-1,213.5
Broad money	2,582.8	2,775.1	2,750.1	2,792.8	2,890.6	3,085.5	2,955.6	2,755.7	2,936.3	3,207.0	3,658.6
Currency in circulation	425.8	477.0	434.4	442.1	464.5	502.3	457.5	465.6	489.2	529.0	557.0
Deposits	2,140.7	2,298.1	2,315.7	2,350.7	2,426.1	2,583.2	2,498.1	2,290.1	2,447.1	2,678.1	3,101.6
Domestic currency	940.6	1,089.8	1,129.7	1,168.3	1,233.3	1,400.8	1,299.2	1,109.9	1,188.1	1,386.8	1,802.9
Foreign currency	1,200.1	1,208.3	1,186.0	1,182.4	1,192.8	1,182.3	1,198.9	1,180.2	1,259.0	1,291.3	1,298.7
Memorandum items:											
Exchange rate (drams per U.S. dollar, end of period)	484.1	483.8	482.7	481.7	492.8	479.7	...	...	...	...	...
12-month change in reserve money (in percent)	-1.0	17.8	22.5	14.4	1.8	8.8	7.5	6.1	12.9	5.4	14.1
12-month change in broad money (in percent)	18.5	7.4	7.2	8.9	9.7	11.2	7.5	-1.3	1.6	3.9	14.1
12-month change in dram broad money (in percent)	27.3	14.7	13.7	13.9	16.4	21.5	12.3	-2.2	-1.2	0.7	23.2
12-month change in private sector credit (in percent)	16.5	17.2	16.0	13.1	15.2	18.5	11.5	3.0	3.0	7.0	13.0
Velocity of broad money (end of period)	2.2	2.2	2.2	2.2	2.2	2.1	2.2	2.4	2.2	2.0	1.9
Money multiplier	2.5	2.3	2.3	2.5	2.6	2.3	2.3	2.3	2.3	2.3	2.3
Private sector credit (in percent of GDP)	49.6	53.8	51.1	52.6	54.8	58.5	57.2	54.5	56.8	62.9	66.3
Dollarization in bank deposits 1/	56.1	52.6	51.2	50.3	49.2	45.8	48.0	51.5	51.4	48.2	41.9
Dollarization in broad money 2/	46.5	43.5	43.1	42.3	41.3	38.3	40.6	42.8	42.9	40.3	35.5
Currency in circulation in percent of deposits	19.9	20.8	18.8	18.8	19.1	19.4	18.3	20.3	20.0	19.8	18.0

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

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

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

Table 5. Armenia: Financial Soundness Indicators for the Banking Sector, 2016–20

(In percent, unless otherwise indicated)

	2016	2017	2018	2019				2020
	Dec	Dec	Dec	Mar	June	Sept	Dec	Jan
Capital adequacy								
Total regulatory capital to risk-weighted assets	20.0	18.6	17.7	17.9	17.4	17.5	17.6	17.2
Capital (net worth) to assets	16.2	15.7	15.0	15.0	14.7	14.8	14.1	14.5
Asset composition								
Sectoral distribution of loans (in billions of drams)								
Industry (excluding energy sector)	227.1	256.3	327.9	337.7	340.5	345.2	357.4	348.8
Energy sector	162.2	191.4	182.2	158.3	130.8	143.0	134.0	140.4
Agriculture	140.1	144.2	143.3	146.6	155.1	154.6	161.4	159.8
Construction	102.8	143.8	161.2	170.8	172.6	182.0	192.7	191.3
Transport and communication	79.7	73.8	106.4	105.4	102.9	105.5	101.7	111.1
Trade/commerce	335.8	419.6	441.1	443.5	460.9	467.5	508.6	485.6
Consumer credits	434.2	511.4	701.1	744.4	795.4	846.0	915.9	928.2
Mortgage loans	183.7	209.0	255.2	270.2	295.3	321.6	358.8	363.4
Sectoral distribution of loans to total loans (percent of total)								
Industry (excluding energy sector)	10.6	8.8	11.1	11.2	10.8	10.6	10.1	10.0
Energy sector	6.5	7.4	6.3	5.2	4.2	4.4	3.8	4.0
Agriculture	8.7	5.6	4.8	4.8	4.9	4.7	4.6	4.6
Construction	4.8	5.6	5.6	5.6	5.9	5.6	5.5	5.5
Transport and communication	3.7	2.9	3.6	3.5	3.3	3.2	2.9	3.2
Trade/commerce	15.7	16.3	14.7	14.7	14.7	14.3	14.4	13.9
Mortgage loans	8.6	8.1	8.7	8.9	9.4	9.8	10.2	10.4
Consumer credits	20.3	19.9	24.1	24.6	25.3	25.9	26.0	26.6
Other sectors	21.1	25.3	21.1	21.4	21.5	21.6	22.5	21.8
Foreign exchange loans to total loans	64.6	63.5	57.1	55.8	54.5	53.5	52.4	52.0
Asset quality								
Nonperforming loans (in billions of drams)	162.2	146.7	146.4	158.5	177.7	186.2	200.0	210.8
Watch (up to 90 days past due)	50.8	40.7	48.0	64.5	71.6	64.3	75.1	84.0
Substandard (91-180 days past due)	45.0	58.3	40.9	42.5	49.0	67.2	68.3	72.4
Doubtful (181-270 days past due)	66.4	47.7	57.5	51.6	57.1	54.7	56.6	54.3
Loss (>270 days past due, in billions of drams)	354.3	442.5	272.0	278.4	278.4	285.4	286.5	294.9
Nonperforming loans to gross loans	6.7	5.5	4.8	5.0	5.4	5.5	5.5	5.8
Provisions to nonperforming loans	52.0	51.5	56.6	52.1	50.9	51.1	49.9	46.9
Spread between highest and lowest rates of interbank borrowing in AMD	0.8	0.8	1.5	0.9	0.4	0.6	0.9	0.8
Spread between highest and lowest rates of interbank borrowing in FX	0.0	0.3	3.8	1.3	1.0	0.4	1.7	2.7
Earnings and profitability								
ROA (profits to period average assets)	1.1	1.2	1.2	1.6	1.4	1.6	1.7	1.7
ROE (profits to period average equity)	7.0	7.7	7.6	10.4	9.6	10.7	11.2	12.0
Interest margin to gross income	29.2	30.6	32.1	32.1	31.8	31.9	31.8	35.9
Interest income to gross income	76.7	77.2	75.1	75.7	75.2	74.3	73.4	78.0
Noninterest expenses to gross income	29.1	29.9	33.4	30.9	30.0	29.8	30.6	28.8
Liquidity								
Liquid assets to total assets	32.5	32.1	27.3	27.2	27.2	27.6	27.1	27.5
Liquid assets to total short-term liabilities	170.8	141.7	116.6	116.0	111.4	108.2	111.7	112.8
Customer deposits to total (non-interbank) loans	115.0	117.0	111.9	110.4	109.3	109.5	112.1	112.6
Foreign exchange liabilities to total liabilities	62.6	60.0	58.3	56.9	56.6	56.6	55.4	55.4
Sensitivity to market risk								
Gross open positions in foreign exchange to capital	6.9	4.0	6.1	3.71	3.7	4.6	4.0	4.4
Net open position in FX to capital	-3.3	-1.4	-3.2	-0.13	0.5	-2.0	0.3	0.8

Source: Central Bank of Armenia.

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

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

Sources: Fund staff estimates and projections.

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

	2019	2020	2021	2022	2023	2024	2025
		Projections					
Fund obligations based on existing and prospective credit							
(in millions of SDRs)							
Principal	52.8	49.9	46.5	30.3	72.9	135.0	106.3
Charges and interest	3.0	3.3	4.7	5.1	4.9	2.5	1.0
Total obligations based on existing and prospective credit							
In millions of SDRs	55.8	53.3	51.2	35.4	77.8	137.5	107.2
In millions of US$	77.2	73.5	71.1	49.3	108.6	192.5	150.6
In percent of Gross International Reserves	2.7	3.4	3.2	2.0	4.2	7.4	5.8
In percent of exports of goods and services	1.5	1.8	1.5	0.9	1.9	3.1	2.3
In percent of debt service	9.5	13.1	15.7	11.4	22.7	36.3	15.1
In percent of GDP	0.6	0.6	0.5	0.3	0.7	1.1	0.8
In percent of quota	43.4	41.3	39.8	27.5	60.4	106.8	83.2
Outstanding Fund credit based on existing and prospective drawings							
In millions of SDRs	183.2	360.2	365.1	360.5	287.7	152.7	46.4
In billions of US$	0.25	0.50	0.51	0.50	0.40	0.21	0.07
In percent of Gross International Reserves	8.9	22.7	22.6	20.5	15.6	8.3	2.5
In percent of exports of goods and services	4.8	12.2	10.5	9.4	7.0	3.5	1.0
In percent of debt service	31.2	88.7	112.0	115.6	83.8	40.3	6.5
In percent of GDP	1.9	3.8	3.8	3.5	2.6	1.3	0.4
In percent of quota	142.2	279.7	283.5	279.9	223.3	118.5	36.0
Net use of Fund credit (millions of SDRs) existing and prospective	-52.8	181.7	4.9	-4.6	-72.9	-135.0	-106.3
Disbursements	0.0	231.6	51.4	25.7	0.0	0.0	0.0
Repayments and Repurchases	52.8	49.9	46.5	30.3	72.9	135.0	106.3

Sources: IMF staff estimates and projections.

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

	2019	2020	2021	2022	2023	2024	2025
				Proj.			
Gross Financing Requirements	2,955	1,370	1,888	2,153	2,233	2,275	2,829
External current account deficit (excl. transfers)	1,743	1,652	1,539	1,666	1,742	1,816	1,899
Debt amortization and Fund repurchases	631	368	294	287	359	450	918
Gross international reserve accumulation	581	-650	55	201	132	9	11
Of which: IMF repurchases and repayments	73	69	65	42	102	189	149
Available financing	2,955	1,054	1,818	2,118	2,233	2,275	2,829
Capital and Financial Account and Current Transfers	2,955	1,054	1,818	2,118	2,233	2,275	2,829
of which: Capital transfers (net)	54	70	70	70	70	70	70
Foreign Direct Investment (net)	397	161	292	385	404	439	461
Public Borrowing (net)	301	-11	152	249	298	294	292
Disbursements	859	288	381	493	555	555	1,061
of which: WB	95	69	45				
ADB	88	77	90				
EU (EIB/EBRD)	2	42	28				
Amortization	-558	-299	-229	-245	-257	-261	-769
Private transfers (net)	482	345	426	486	559	609	658
Other private capital (net)	506	-3	496	470	451	416	413
Financing gap	0	316	70	35	0	0	0
Exceptional Financing	0	316	70	35	0	0	0
IMF (SBA) budget support	0	316	0	0	0	0	0
IMF (SBA) BOP support	0	0	70	35	0	0	0
Memorandum item:							
Current Account deficit, percent of GDP	-8.2	-8.6	-7.2	-6.7	-6.4	-6.1	-6.0
Gross Reserves	2,840	2,190	2,245	2,446	2,578	2,587	2,598
In percent of ARA metric 1/	123	101	100	105	107	104	102
In months of prospective imports	5.7	4.0	3.7	3.8	3.7	3.5	3.3

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

1/ ARA metric for Assesing Reservers Adequacy (floating)

Annex I. Risk Assessment Matrix[1]

Risks	Likelihood	Possible impact if risk is realized	Policy response
Conjunctural shock and scenario			
Prolonged COVID-19 outbreak. Containment measures remain in place (in some places intensify or need to be re-introduced) through early 2021. Longer containment and uncertainties about the intensity and the duration of the outbreak reduce supply (including through global value chains' disruption) and domestic and external demand. Deteriorating economic fundamentals and the associated decline in risk appetite result in a second wave of financial tightening (amplified as hidden fragilities are unmasked) and in debt service and refinancing difficulties for corporates and households. Rising bankruptcies translate into financial institutions' losses, forcing them to cut credit, with further adverse implications for growth. Concerns about public debt sustainability mount, and EMs and frontier economies experience a greater number of sudden stops.	High	**High** Lower growth and widespread and prolonged disruptions to economic activity directly, through global trade and supply chain spillovers, and via confidence effects on financial markets and investment. ·	Reallocate fiscal spending to the health sector and prepare and implement contingency plans to absorb the impact of the shock economic activity.
Widespread social discontent and political instability. Social tensions erupt due to dissatisfaction with the policy response to the epidemic and the economic fallout, including massive unemployment, higher incidence of poverty and shortages of essentials. Beyond immediate economic disruption and adverse confidence effects, the resulting pollical instability complicates adjustment following COVID-19.	High	**Low** Delay recovery efforts once the pandemic abates and delay return of economic activity to normalcy. Results in lower growth and continued widespread and prolonged disruptions to economic activity. Intensifies policy challenges.	• Continue policy reforms and safeguard progress to date. • Resist populist demands. • Protect social spending on poor, improve targeting, and strengthen social safety net.
More protectionism. Pandemic-prompted protectionist actions (e.g., export controls) stay in place and deteriorating economic conditions re-ignite broader protectionist measures.	High	**Medium** Reduced global policy collaboration and regional integration may limit FDI, trade flows, and growth.	• Ensure prudent budgetary management to contain financing need • Continue to Bolster regional policy coordination and regional trade. • Maintain exchange rate flexibility
Oversupply in the oil market. Supply increases following the breakdown of the OPEC+ agreement together with demand shocks mean that energy prices remain at depressed levels. Uncertainty about future production contribute to continued high price volatility.	High	**Medium/High** Negative indirect effects via trading partners.	Diversify trading partners. Improve the business environment for international investors.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. Conjectural risks are especially relevant over shorter horizons (up to 2 years) given the current baseline. Structural risks (omitted from this streamlined version) remain salient over shorter and longer horizons (up to 3 years).

Risks	Likelihood	Possible impact if risk is realized	Policy response
Intensified geopolitical tensions and security risks (e.g., in response to pandemic) cause socio-economic and political disruption, disorderly migration, and lower confidence.	Medium	**Medium** Intensification of tension in neighboring countries in the Middle East and renewed sanctions on Iran could potentially also reduce trade and investment.	Accelerate structural reforms and prepare contingency plans for potential spillovers. Strengthen social safety nets to mitigate shocks on vulnerable sectors.
Country-Specific Risks			
Regional conflict: Risks from sharp, renewed regional tensions.	Low	**High/Medium** Conflict would have severe impacts, including possible regional military action.	Continue with dialogue. Prepare and implement contingency plans.

Annex II. Public Debt Sustainability Analysis[1]

Results from an updated DSA using the staff's baseline projections indicate that Armenia's public debt remains sustainable, but the high share of foreign currency debt continues to be an important source of vulnerability. Alternative scenarios and stress tests suggest that an adverse growth shock would have the largest impact on debt dynamics and government financing needs.

1. Debts will increase substantially in 2020 due to fiscal financing needs for fighting the pandemic and are projected to decline to 52.6 percent in the medium-term. Government debt will increase substantially to finance spending related to fighting the pandemic. The estimated fiscal deficit will be 5 percent of GDP this year. Due to lower tax revenue this year, the government will seek financing mainly from the IMF, other donors and domestic sources, to finance the spending. Prior to the shock, the government has been prudent, and the debt-to-GDP ratio has been declining, reflecting overperformance in tax revenue collection, strong GDP growth, and under execution of planned capital expenditure. After the pandemic, gross financing needs are estimated to revert to the norm, around 6–7 percent of GDP to 2024 and increase to 9.1 percent in 2025 due to expected repayments on existing Eurobonds. Under their medium-term expenditure framework and fiscal rule, the authorities are committed to bringing the central government debt below 54 percent of GDP by 2025, and 50 percent by 2028. The baseline scenario shows this goal is achievable. The share of FX-denominated debt in total debt are projected to decline to 35 percent of GDP in 2025, due to a more rapid increase in amortization than new disbursements. External financing will continue to be contracted primarily on concessional terms, in the form of project-related loans and limited budget support from multilateral donors. Domestic financing is expected to remain relatively small, although increasing and with longer average maturity.

2. Baseline projections are subject to significant uncertainty. Historically, growth rates, primary balance, and inflation in Armenia have been volatile, which implies potential uncertainty in the baseline projections. Assuming the symmetric distribution of shocks, a fan chart for the public debt-to-GDP ratio points to a range between 47 and 79 percent (corresponding to the 10th–90th percentile) in 2020 and between 19 and 72 percent in 2025. An asymmetric fan chart, which rules out real exchange rate depreciation, suggests that debt could range between 33 and 84 percent of GDP (10th–90th percentile) at the end of the projection horizon.

3. The heat map highlights vulnerabilities stemming from the large external public debt and market perception. The high share of FX debt and debt held by non-residents remains important risk factors for debt sustainability. A depreciation of the exchange rate would worsen the debt outlook as indicated by the relevant stress test (see Figure A4). Recently, Armenian dram has slightly depreciated, though much less than other emerging market's currencies. Another potential vulnerability is the change in the country risk premia, recently

[1] The coverage of public Debt is general government debt including the Central bank's debt.

increasing to 523 bp over the U.S. bonds. Due to a high reliance on external financing, an increase in risk premia would increase the costs of new debts and worsen the public debt path.

4. Scenarios assuming key variables at their historical averages underscore the need for consolidation. The paths of public debt and gross financing needs deviate significantly from the baseline under the historical scenario; the debt ratio would reach 68 percent in 2025. This would result in putting debt sustainability at risk and financing needs increases to close to 14 percent of GDP in 2025. This implies that without active policy measures aimed at reducing the fiscal deficit, debt sustainability would be jeopardized.

5. Stress tests suggest that real GDP growth shocks have the largest impact on debt indicators. A combined macro-fiscal shock, whereby real GDP contracts about 2.5 percent in 2021–22 in each year together with worsening primary balance, can cause public debt to increase to 69.1 percent of GDP, and public gross financing needs to remain around 11 percent of GDP in 2025. This scenario, where real GDP slumps for two consecutive years, may occur if the disruption due to COVID-19 extends to 2021 or the repercussion of the shock leaves permanent damages to firms, employees, and important sectors in the economy. In isolation, shocks to real GDP growth, followed by shocks to the real exchange rate, have most sizable adverse impact on the public debt path, relative to the baseline.

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

(In percent of GDP unless otherwise indicated)

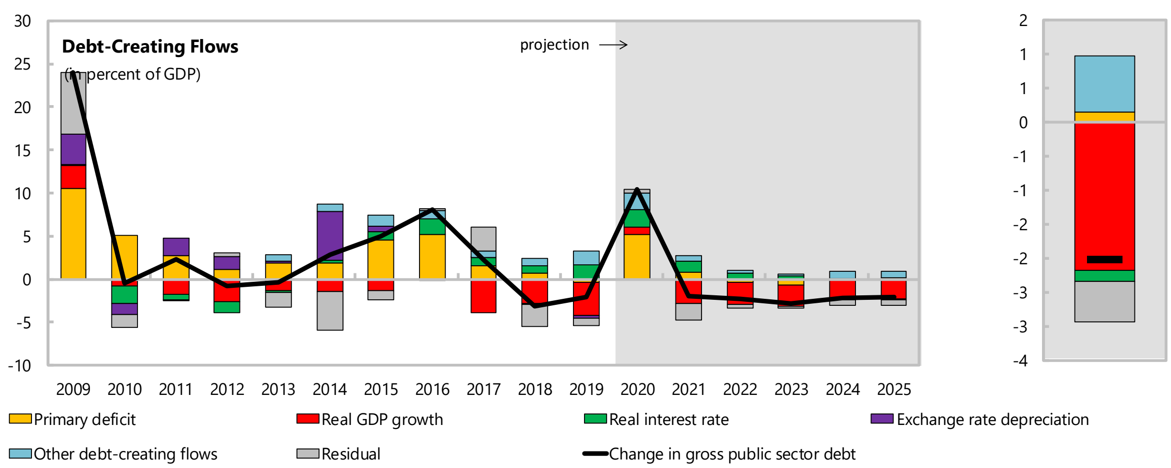
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2009-2017 [2/]	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	45.8	55.8	53.7	64.1	62.1	59.8	57.0	54.8	52.8
Public gross financing needs	8.2	6.7	8.5	12.9	8.4	7.1	6.2	6.6	9.3
Net public debt		49.7	47.7	56.2	55.1	53.8	52.1	50.3	48.7
Real GDP growth (in percent)	2.0	5.2	7.6	-1.5	4.8	4.5	4.5	4.5	4.5
Inflation (GDP deflator, in percent)	3.2	2.5	1.4	1.0	2.3	3.3	3.8	4.2	4.4
Nominal GDP growth (in percent)	5.3	7.9	9.1	-0.5	7.2	7.9	8.5	8.9	9.1
Effective interest rate (in percent) [4/]	3.1	4.2	4.7	4.8	4.6	4.7	4.6	4.5	4.3

As of April 10, 2020		
Sovereign Spreads		
Spread (bp) 3/		608
CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	Ba3	n.a.
S&Ps	n.a.	n.a.
Fitch	BB-	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	4.8	-3.2	-2.1	10.4	-2.0	-2.3	-2.8	-2.2	-2.0	-0.9	
Identified debt-creating flows	4.6	-0.5	-1.3	14.2	-0.9	-1.5	-2.1	-0.9	-0.9	7.9	
Primary deficit	3.9	0.7	-0.3	5.2	0.8	-0.4	-0.7	0.0	0.1	5.1	-1.0
Primary (noninterest) revenue and grants	21.5	22.3	23.9	23.3	23.7	24.9	25.3	25.4	25.4	148.0	
Primary (noninterest) expenditure	25.4	23.1	23.6	28.5	24.5	24.5	24.6	25.4	25.6	153.1	
Automatic debt dynamics [5/]	0.2	-2.0	-2.6	7.0	-2.3	-1.4	-1.6	-1.7	-1.8	-2.0	
Interest rate/growth differential [6/]	-1.2	-2.0	-2.2	2.8	-1.6	-1.8	-2.1	-2.3	-2.4	-7.4	
Of which: real interest rate	0.0	0.9	1.6	2.1	1.3	0.7	0.4	0.0	-0.2	4.3	
Of which: real GDP growth	-1.2	-2.9	-3.9	0.8	-2.9	-2.6	-2.5	-2.3	-2.2	-11.7	
Exchange rate depreciation [7/]	1.4	0.0	-0.4	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.5	0.8	1.6	2.0	0.7	0.3	0.2	0.8	0.8	4.8	
Domestic net lend./drawdown of gov. dep. (	0.0	0.0	0.7	1.0	-0.3	-0.5	-0.6	0.0	0.0	-0.5	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
External net lending	0.5	0.8	0.9	1.0	1.0	0.8	0.8	0.8	0.8	5.3	
Residual, including asset changes [8/]	0.2	-2.6	-0.8	0.4	-1.9	-0.4	-0.2	-0.7	-0.6	-3.4	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Bond Spread over U.S. Bonds.

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

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

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

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

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

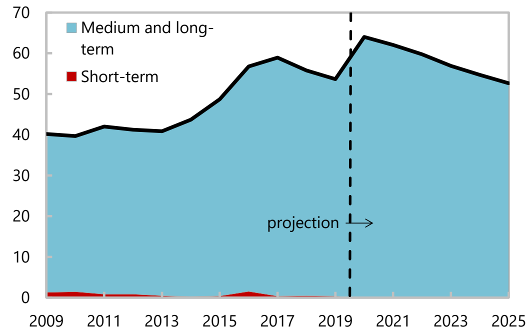
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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

Composition of Public Debt

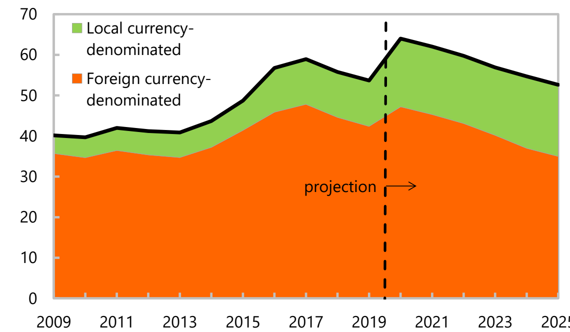
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

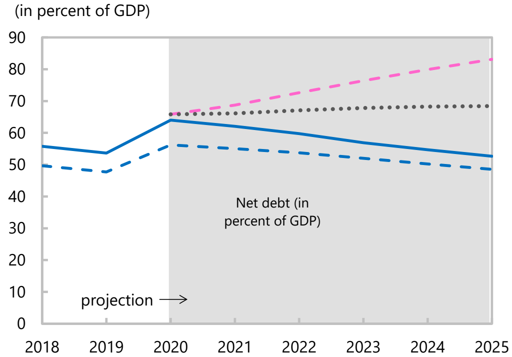


Alternative Scenarios

Baseline Historical Constant Primary Balance

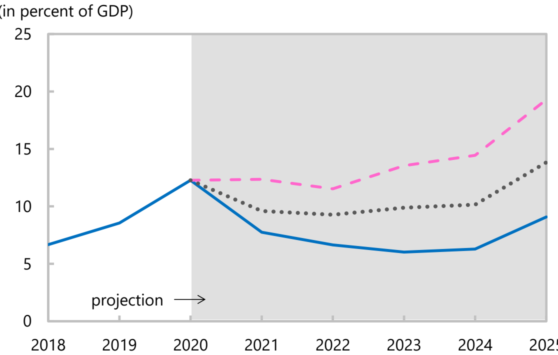
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

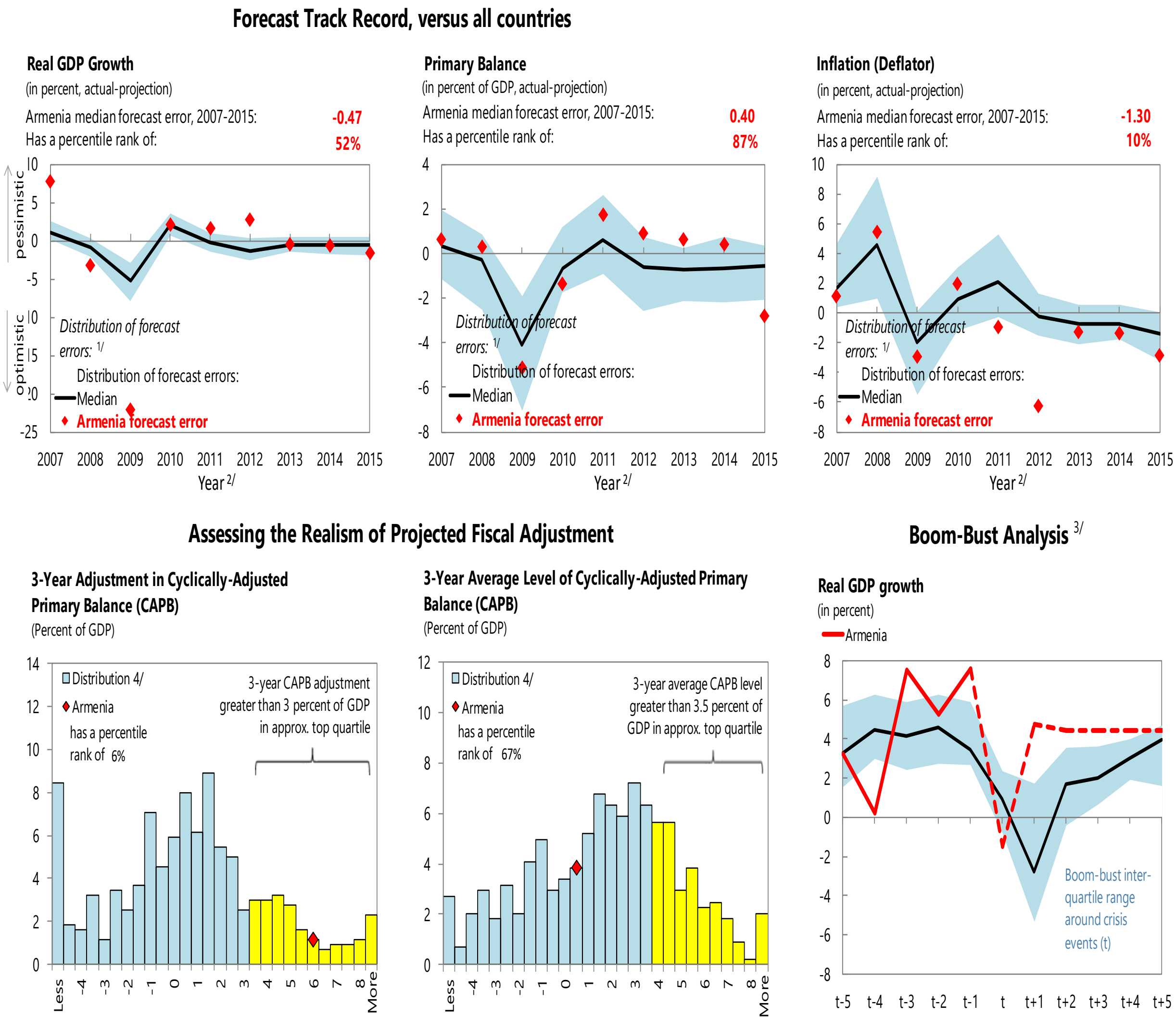
(in percent)

Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-1.5	4.8	4.5	4.5	4.5	4.5
Inflation	1.0	2.3	3.3	3.8	4.2	4.4
Primary Balance	-5.2	-0.8	0.4	0.7	0.0	-0.1
Effective interest rate	4.8	4.6	4.7	4.7	4.5	4.3
Constant Primary Balance Scenario						
Real GDP growth	-1.5	4.8	4.5	4.5	4.5	4.5
Inflation	1.0	2.3	3.3	3.8	4.2	4.4
Primary Balance	-5.2	-5.2	-5.2	-5.2	-5.2	-5.2
Effective interest rate	4.8	4.7	5.1	5.4	5.5	5.5

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-1.5	4.5	4.5	4.5	4.5	4.5
Inflation	1.0	2.3	3.3	3.8	4.2	4.4
Primary Balance	-5.2	-2.5	-2.5	-2.5	-2.5	-2.5
Effective interest rate	4.8	4.7	4.8	4.8	4.7	4.5

Source: IMF staff.

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



Source : IMF Staff.

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

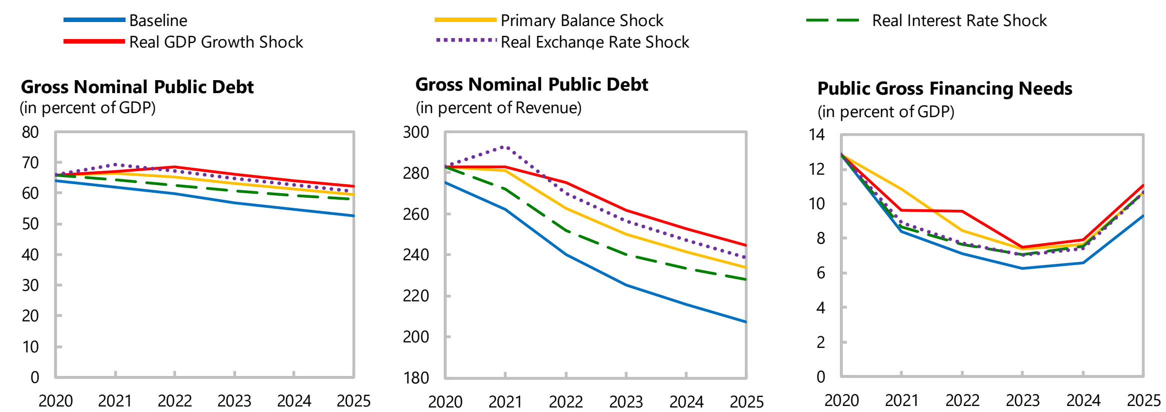
2/ Projections made in the spring WEO vintage of the preceding year.

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

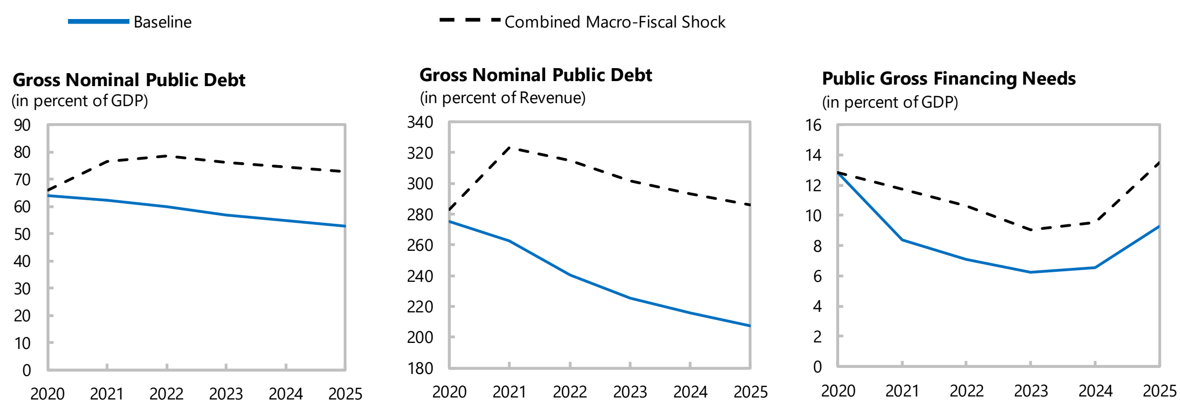
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure A4. Armenia: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2020	2021	2022	2023	2024	2025
Primary Balance Shock						
Real GDP growth	-1.5	4.8	4.5	4.5	4.5	4.5
Inflation	1.0	2.3	3.3	3.8	4.2	4.4
Primary balance	-5.2	-3.0	-0.2	0.5	0.0	-0.1
Effective interest rate	4.8	4.6	4.9	4.9	4.7	4.5
Real Interest Rate Shock						
Real GDP growth	-1.5	4.8	4.5	4.5	4.5	4.5
Inflation	1.0	2.3	3.3	3.8	4.2	4.4
Primary balance	-5.2	-0.8	0.4	0.7	0.0	-0.1
Effective interest rate	4.8	4.6	5.1	5.3	5.3	5.3
Combined Shock						
Real GDP growth	-1.5	2.3	2.0	4.5	4.5	4.5
Inflation	1.0	1.7	2.7	3.8	4.2	4.4
Primary balance	-5.2	-3.0	-1.1	0.5	0.0	-0.1
Effective interest rate	4.8	5.0	5.0	5.3	5.4	5.4

	2020	2021	2022	2023	2024	2025
Real GDP Growth Shock						
Real GDP growth	-1.5	2.3	2.0	4.5	4.5	4.5
Inflation	1.0	1.7	2.7	3.8	4.2	4.4
Primary balance	-5.2	-1.6	-1.1	0.7	0.0	-0.1
Effective interest rate	4.8	4.6	4.8	4.8	4.7	4.5
Real Exchange Rate Shock						
Real GDP growth	-1.5	4.8	4.5	4.5	4.5	4.5
Inflation	1.0	6.5	3.3	3.8	4.2	4.4
Primary balance	-5.2	-0.8	0.4	0.7	0.0	-0.1
Effective interest rate	4.8	5.0	4.6	4.6	4.4	4.3

Source: IMF staff.

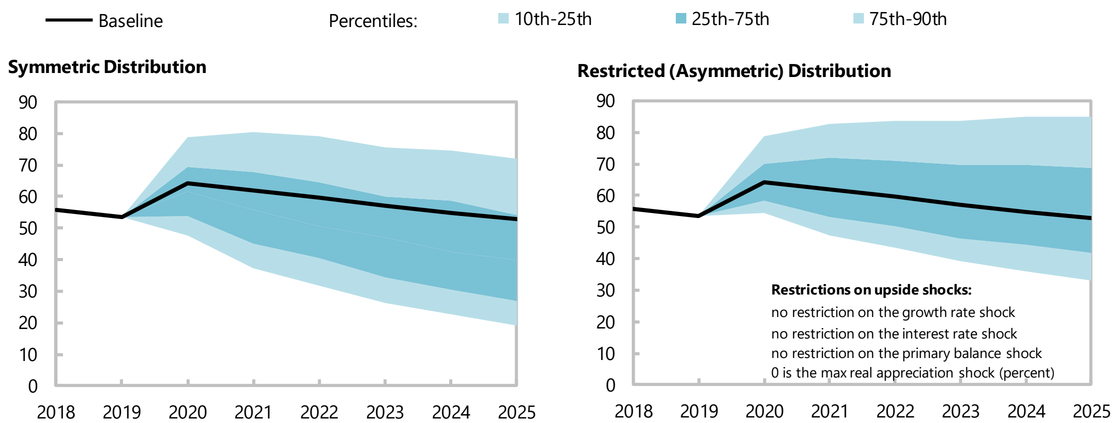
Figure A5. Armenia: Public DSA Risk Assessment

Heat Map

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

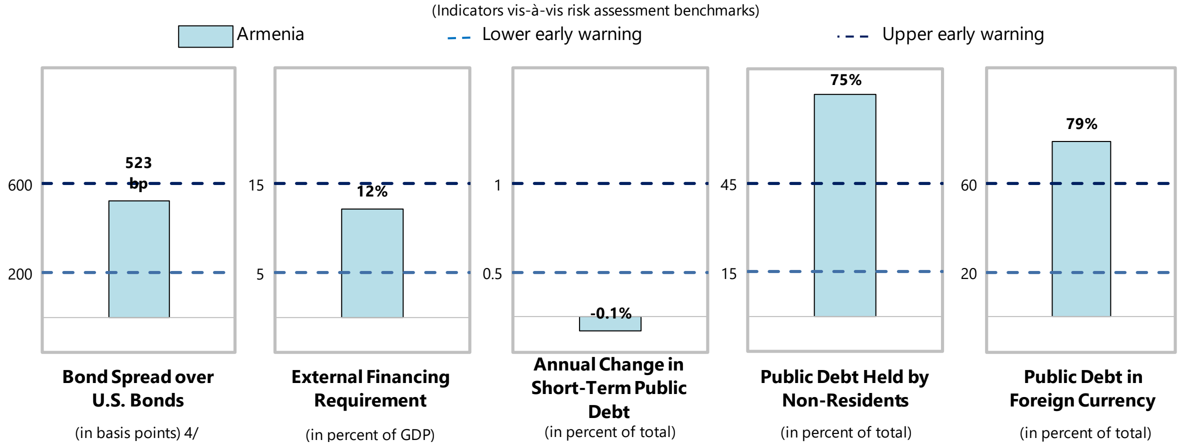
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

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

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

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

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

4/ An average over the last 3 months, 11-Jan-20 through 10-Apr-20.

Annex III. External Sector Assessment

Armenia's external position in 2019 is assessed to be broadly consistent with fundamentals and desired policies. The current account is expected to improve gradually over the medium term on the back of higher export growth while the need for investment-related imports persists but moderates, and transitory factors related to large imports of cars driven by tariff exemptions fade. Going forward, continued prudent fiscal policy, exchange rate flexibility, and structural reforms to diversify the economy and boost competitiveness would further bolster buffers and support the economy's resilience.

Recent Developments

1. **External conditions remained stable in 2019.** As the current account deficit improved to 8.2 percent of GDP in 2019 (from 9.4 percent in 2018), gross reserves climbed to $2,840 million by end-year. The net international investment position (NIIP) declined from -$9.4 billion in Q4 2018 to -$9.8 billion in Q4 2019 (latest data point), but it improved from -76 percent of GDP to -72 percent of GDP over this period. Increases in non-residents' deposits contributed to accumulation of both assets and liabilities.

Armenia: Net International Investment Position (NIIP)
(In billions of U.S. dollars)

	2018Q4	2019Q4
NIIP	-9.4	-9.8
Assets	5.3	6.2
Reserves	2.3	2.8
Other	3	3.3
Liabilities	14.7	16
Direct Investment	5.5	5.7
Other	9.2	10.3

Source: National authorities, and IMF staff calculations.

Current Account and Real Exchange Rate Assessment

2. **The *current account* (CA) gap is assessed to be in the range from -1¾ to ¼percent of GDP in 2019, a level broadly consistent with fundamentals.** Using the EBA-lite model, Armenia's cyclically adjusted CA norm is estimated at -5.1 percent of GDP. This compares to a cyclically adjusted CA balance of -8.3 percent of GDP, implying a model-estimated current account gap of -3.2 percent. The positive contribution from the policy gap (1.5 percent of GDP) is small, and the CA residual—the part of CA gap that cannot be explained by the policy gap—is large at -4.7 percent of GDP. This could reflect important Armenia-specific factors that have driven the actual CA lower and/or would have driven the CA norm lower than the level predicted by model. These factors include a persistent need for investment-related imports, structurally narrow export bases which tend to structurally affect the current account balance. In this light, staff assesses the CA norm to be 1 percentage point of GDP lower. In addition, staff incorporates a 1½ percentage point of GDP temporary statistical adjustment for CA in 2019,[1] reflecting the

[1] While Armenia's car re-exports within the Eurasian Economic Union are not captured by official trade statistics, Armenia' imports of cars are estimated to be at least 1½ percent of GDP higher than the trend level. In light of this, staff introduced an adjustment of a 1½ percentage point.

shortcomings in accounting for re-exports of goods, implying a staff-assessed CA gap of -0.7 percent of GDP after this adjustment, within the range from -1¾ to ¼ percent, implying an external position broadly consistent with fundamentals and desired policies. The External Sustainability approach comes to a similar conclusion.

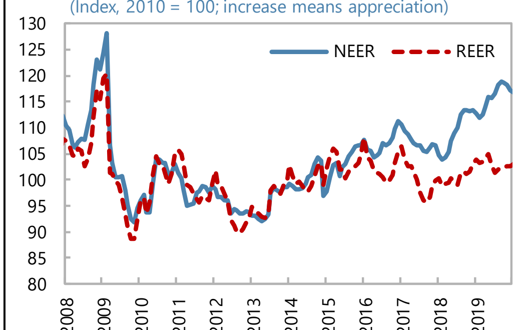
Armenia: External Sector Assessment
(In percent of GDP, unless indicated otherwise)

	Current Account (EBA-lite CA)	External Sustainability (EBA-lite ES)	REER (EBA-lite REER)
CA actual (in 2019)	-8.2	-8.2	
Cyclical contributions (from model)	0.1	0.1	
Cyclically adjusted CA (from model) (A)	**-8.3**	**-8.3**	
Estimated impact of temporary/statistical factors	-1.5	-1.5	
Staff adjusted cyclically adjusted CA (B)	**-6.8**	**-6.8**	
CA norm (from model)	-5.5	-5.8	
Cyclically adjusted CA norm (from model) (C)	**-5.1 1/**	**-5.9**	
Additional adjustments to the norm	1		
Staff adjusted cyclically adjusted CA norm (D)	**-6.1**	**-5.9**	
CA gap (from model) (A-C)	**-3.2**	**-0.9**	
Staff assessed CA gap (B-D)	**-0.7**	**-0.9**	
o/w policy gap	1.5		
Elasticity	-0.3	-0.3	
Real exchange rate gap 2/	**2.3**	**3.1**	**-9.1**

1/ Multilaterally consistent cyclically adjusted CA norm.
2/ Movement in real exchange rate needed to close the gap between norm and underlying current account. Positive means overvaluation.
External Sustainability refers to scenario stabilizing NIIP at -75 percent of GDP (2017-end level).

3. By contrast, the EBA-lite *REER* approach estimates an undervaluation of 9 percent in 2019. The CPI-based REER remained relatively stable over between 2010 and early 2020, although it depreciated during 2014–15 but recovered afterwards.

Real and Nominal Effective Exchange rates
(Index, 2010 = 100; increase means appreciation)



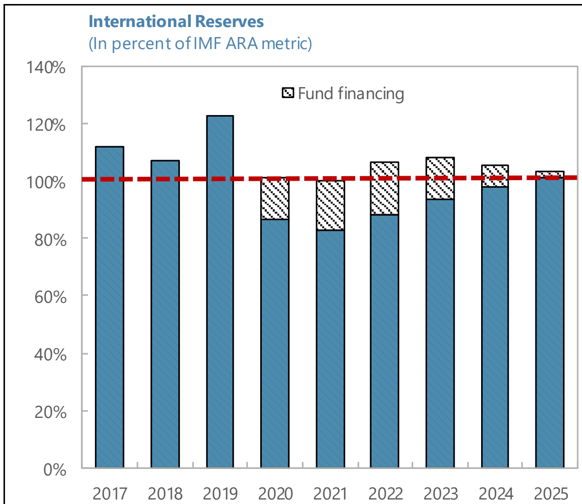
Source: IMF staf calculations.

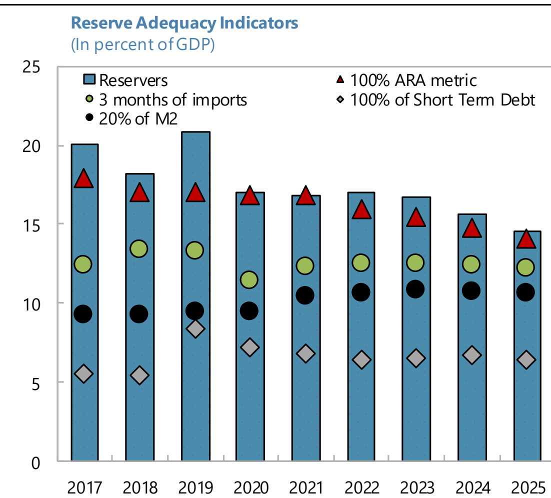
4. Overall staff considers the CA norm of around 6 percent of GDP consistent with the goal of reducing vulnerabilities gradually. The CA and ES methods point to some exchange rate overvaluation in the range of 2–3 percent in 2019 and CA deficit norm of around 6 percent of GDP, which implies a CA gap in 2019 is projected to be gradually closed in the medium term (see text table).[2]

[2] Staff's overall assessment relies on the CA and ES methods as the REER estimate at odds with the former two methods is driven by a few relatively volatile variables (e.g., remittances).

Reserve Adequacy

5. With additional financing including from the Fund, Armenia's foreign exchange reserves would remain broadly adequate according to a range of indicators, but vulnerabilities are sizable. After reaching $2,259 million by end-2018, gross international reserves further climbed to $2,840 million by end-2019, driven by robust private inflows. Under the Fund's reserve adequacy metric (ARA) for floating exchange rate regimes – the reserves are estimated at 123 percent at end-2019. Reserves came down to $2,659 million by end-February in 2020 as the end-2019 number reflects some seasonality. Going forward, without additional financing, the reversal of capital inflows triggered by the COVID-19 pandemic would push the reserves well below 100 percent of the ARA metric. Additional financing including from the Fund would keep the reserves above 100 percent of the ARA metric over 2020–25, and the reserves would remain adequate according to several other metrics: more than 3 months of imports, and ample coverage of short-term debt and broad money. Nonetheless, vulnerabilities remain. Public sector debt amortizations remain sizable over the forecast period, potentially creating drains on reserves. Moreover, reflecting the dollarized economy and presence of sizable non-resident foreign currency deposits (FX) in banking system, in the case of additional adverse external shocks, there could be greater pressure on central bank reserves arising from FX demand by banks. The additional FX holdings of required reserves after the recent reforms should help mitigate pressure on central bank reserves in the case of shocks.





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

External Debt Sustainability

6. Armenia's external debt-to-GDP ratio remains high but is projected to gradually improve over the medium-term. In the baseline scenario, debt is projected to rise to 93 percent of GDP in 2020 and gross external financing needs would stay at elevated levels around 20–25 percent of GDP over the medium term, reflecting the sharp growth decline and new external public borrowing, but the debt would gradually decline over the medium term. However, the results of standardized shocks highlight vulnerabilities. Shocks to growth, the non-interest current account and the combined shock scenario all result in a significant increase in external debt to around 90 percent of GDP or higher by the end of the projection period. Consistent with the previous assessment, a one-time 30 percent real exchange rate depreciation would have an even larger impact on external debt, increasing debt to around 115 percent of GDP. However, external debt remains more resilient to interest rate shocks because of the relatively large share of concessional financing in external public debt.

Table A1. Armenia: External Debt Sustainability Framework, 2015–25

(in percent of GDP, unless otherwise indicated)

	2015	2016	2017	2018	2019	10-Year Historical Average	10-Year Standard Deviation	2020	2021	2022	2023	2024	2025	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	83.2	92.2	88.7	85.9	83.5			**93.3**	**93.8**	**90.7**	**88.3**	**85.4**	**82.7**	**-5.4**
2 Change in external debt	10.9	9.0	-3.5	-2.8	-2.4			9.8	0.5	-3.1	-2.4	-2.9	-2.7	
3 Identified external debt-creating flows (4+8+9)	6.3	-0.7	-6.0	1.2	-2.4			11.6	1.9	-3.2	-2.4	-2.7	-2.6	
4 Current account deficit, excluding interest payments	-0.9	-1.7	-0.8	5.8	4.6			4.6	3.4	3.0	2.9	2.8	2.8	
5 Deficit in balance of goods and services	12.1	9.6	12.2	15.7	14.5			14.3	13.3	13.4	13.1	12.9	12.6	
6 Exports	29.7	33.2	37.4	37.8	38.7			31.5	35.9	36.8	37.0	36.7	36.3	
7 Imports	41.9	42.8	49.6	53.5	53.1			45.8	49.2	50.1	50.1	49.5	48.9	
8 Net non-debt creating capital inflows (negative)	-3.7	-2.8	-1.2	-1.7	-3.0			-1.3	-2.2	-2.7	-2.6	-2.7	-2.6	
9 Automatic debt dynamics 1/	10.8	3.8	-4.0	-2.8	-4.0			8.2	0.7	-3.5	-2.7	-2.8	-2.9	
10 Contribution from nominal interest rate	3.6	3.7	3.8	3.6	3.6			4.0	3.9	3.7	3.5	3.3	3.2	
11 Contribution from real GDP growth	-2.6	-0.2	-6.3	-4.3	-6.0			1.3	-4.3	-3.9	-3.8	-3.7	-3.5	
12 Contribution from price and exchange rate changes 2/	9.8	0.2	-1.5	-2.2	-1.6			2.9	1.2	-3.3	-2.4	-2.5	-2.5	
13 Residual, incl. change in gross foreign assets (2-3) 3/	4.6	9.7	2.5	-4.0	-0.1			-1.8	-1.3	0.1	0.0	-0.2	-0.1	
External debt-to-exports ratio (in percent)	280.0	277.8	237.2	227.3	215.9			295.8	261.4	246.7	238.9	232.8	227.5	
Gross external financing need (in billions of US dollars) 4/	1.9	1.6	2.1	2.8	2.9			3.1	2.8	3.0	3.2	3.5	4.1	
in percent of GDP	18.4	15.3	18.3	22.1	21.4			24.1	20.6	20.9	20.8	20.8	22.9	
Scenario with key variables at their historical averages 5/								**81.6**	**80.1**	**79.9**	**79.7**	**79.3**	**79.0**	**-4.7**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	3.3	0.2	7.5	5.2	7.6	4.5	2.4	-1.5	4.8	4.5	4.5	4.5	4.5	
GDP deflator in US dollars (change in percent)	-12.0	-0.3	1.7	2.5	1.9	0.3	4.8	-3.4	-1.3	3.7	2.7	2.9	3.0	
Nominal external interest rate (in percent)	4.5	4.5	4.5	4.4	4.6	4.0	0.7	4.6	4.3	4.2	4.1	4.1	4.0	
Growth of exports (US dollar terms, in percent)	-5.5	11.6	23.2	9.0	12.2	13.6	13.1	-22.4	17.7	10.9	7.9	6.7	6.6	
Growth of imports (US dollar terms, in percent)	-19.5	2.2	26.7	16.1	9.0	4.9	16.4	-17.9	11.1	10.3	7.2	6.3	6.3	
Current account balance, excluding interest payments	0.9	1.7	0.8	-5.8	-4.6	-4.5	4.5	-4.6	-3.4	-3.0	-2.9	-2.8	-2.8	
Net non-debt creating capital inflows	3.7	2.8	1.2	1.7	3.0	4.1	2.5	1.3	2.2	2.7	2.6	2.7	2.6	

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

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

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

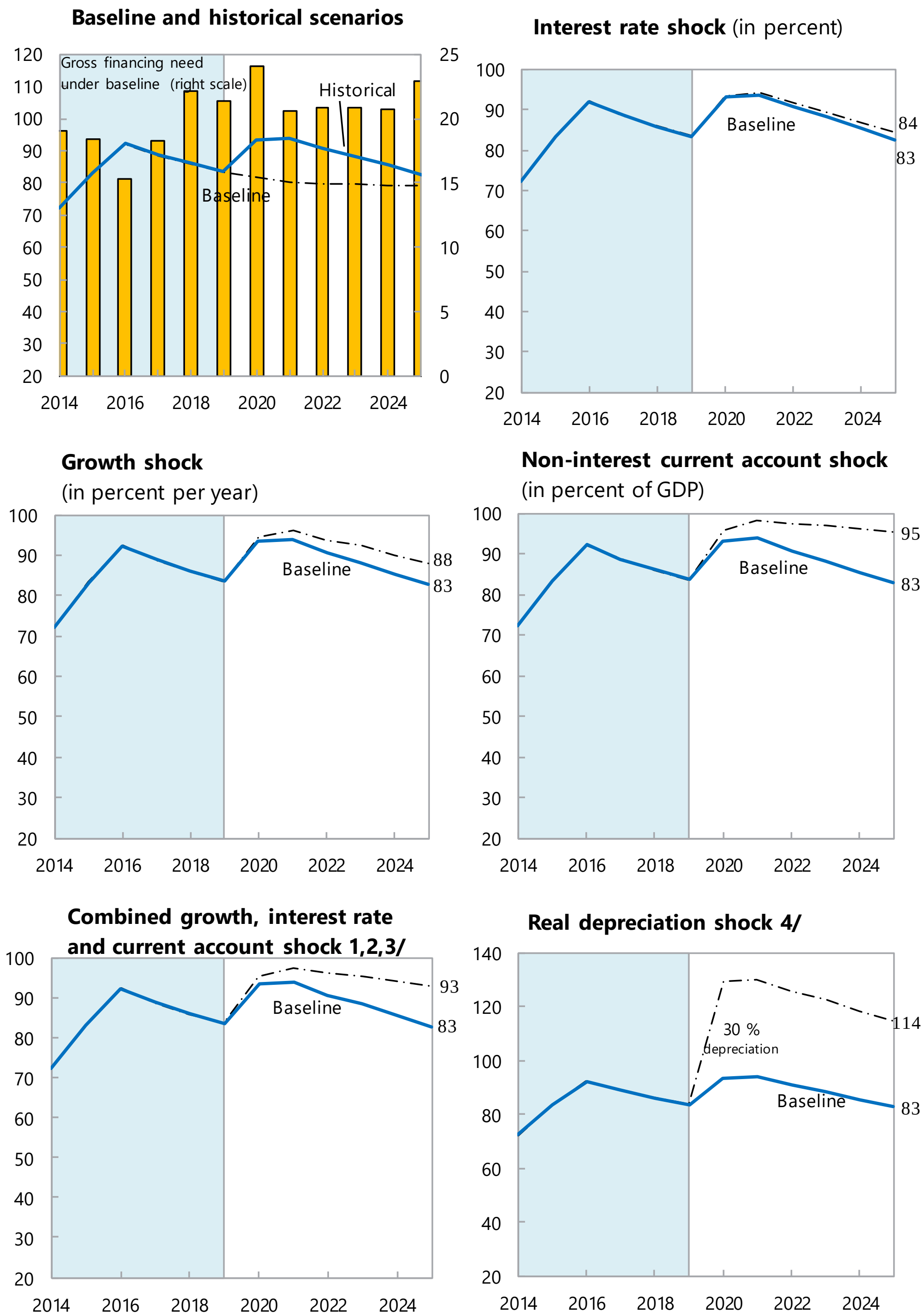
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Figure A1. Armenia: External Debt Sustainability – Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2020

Appendix I. Letter of Intent

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

Yerevan, April 30, 2020

Dear Ms. Georgieva:

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

2. Armenia's economic performance in 2019 was exceptionally strong. Growth far surpassed expectations, and foreign exchange market stability allowed us to significantly bolster our reserve buffers. We met all the performance criteria (PC) under the program for end-December 2019. While low inflation triggered the Monetary Policy Consultation Clause, we believe this is due to supply factors and expect this to be temporary given the CBA's policy response, and it will serve as an effective buffer for our anti-crises measures. Structural reforms continue to progress, albeit with some delay. We request that the December 2019 structural benchmarks (SB) relating to the anticorruption body, the law on higher education and science, and the action plan to improve tax compliance based on a study identifying tax potential be reset by a few months, allowing time for final technical work and public consultations. The March 2020 SB on preparing a capital market development program will also be met with a slight delay. A revised list of structural benchmarks is attached to this letter. We also request modification of performance criteria on net international reserves, program fiscal balance, and ceiling on budget domestic lending, as well as of the monetary policy consultation clause.

3. As elsewhere, the global COVID-19 pandemic is expected to severely weaken Armenia's economic and external position in 2020. Our proactive response to containing the COVID-19 outbreak will limit activity through domestic demand and supply disruptions, which will be exacerbated by a sharp decline in export and tourism revenues, remittances, and net capital inflows. As a result of these shocks there will be a substantial deterioration of our external and fiscal accounts, erosion of our reserve buffers, and additional financing needs for the Government of Armenia.

4. Our immediate policy focus is on measures to contain the spread of the COVID-19 virus and ensure that our health system ready to meet the coming needs of the Armenia people. Our economic response is framed around a set of measures estimated at about AMD150 billion, which will provide targeted and temporary assistance to businesses and our vulnerable population in order to prevent this shock doing more permanent and generalized economic damage. We are committed to ensuring strong governance and transparency around the implementation of our support measures. Beyond the short term, our efforts will continue their focus on advancing our reform agenda aimed at lifting inclusive and resilient growth, including by maintaining fiscal sustainability, safeguarding social spending, bolstering financial sector resilience, and enhancing business climate and governance.

5. Despite our efforts to reprioritize expenditure within the 2020 budget envelope, our actions to meet urgent medical needs and, more broadly, respond to the pandemic and associated economic impact means that we will need to mobilize slightly above US$500 million in additional financing to close the fiscal financing gap. These increased fiscal needs accompany increased BOP financing needs, as external pressures create pressure on available domestic funding. To help cover these urgent financing needs, we plan to purchase our accumulated drawing rights under the SBA on completion of the second review. We also request an augmentation access under the current SBA arrangement in the order of SDR128.80 million (about US$175 million), the equivalent of 100 percent of quota, as well as rephasing of purchases. Access to this IMF financing, including for budget support purposes, will help us contain our short-term fiscal and external risks by providing resources to meet urgent medical and socio-economic needs during the peak of the virus outbreak, thereby preserving the gains in economic potential and inclusion Armenia has achieved over recent years.

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

Yours sincerely,

/s/

Nikol Pashinyan
Prime Minister

/s/

Atom Janjughazyan
Minister of Finance

/s/

Arthur Javadyan
Governor, Central Bank of Armenia

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

1. This memorandum, supplementing our memorandum of May 2, 2019, provides information on recent developments, and sets out our key policies for the remainder of 2020 and 2021. We are also requesting IMF assistance through an augmentation of access equivalent to 100 percent of quota (SDR 128.80) under the current SBA arrangement to meet the urgent balance of payments financing gap stemming from the spread of the COVID-19 virus. This backing will help support our efforts to mitigate the economic and humanitarian impact of the crisis.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

2. Economic performance in 2019 has been strong with inflation subdued. Armenia's economy posted an impressive 7.6 percent growth in 2019 driven by private consumption amid rising household incomes and credit, as well as higher activity in the manufacturing and service sectors. Inflation is subdued—recording -½ percent in the year to February 2020—reflecting falling food prices amid ample supply. Despite strong domestic demand, the current account deficit narrowed to 8¼ percent of GDP in 2019 and financial conditions remained favorable. Reflecting strong private inflows, the Armenian dram appreciated through 2019, notwithstanding opportunistic reserve building by the CBA. The fiscal deficit declined to 1 percent of GDP as revenue overperformed while capital spending remained below plans.

3. The pandemic, together with the recent oil price shock, will significantly weaken Armenia's near-term economic prospects, although the novel nature of this pandemic means that there is an unusually large degree of uncertainty around the near-term outlook. Economic activity is expected to slow dramatically in 2020 given COVID-related restrictions on domestic mobility and activity, substantially lower external demand, tighter financial conditions, and disruptions in global trade and supply chains. Growth is projected to decline to -1.5 percent in 2020, with external financing pressures suggesting a widening of the external financing gap. As a result, the financial system will likely face tighter liquidity and credit conditions.

4. Looking beyond the current pandemic, the medium-term outlook remains favorable. We expect growth to rebound to above 4½ percent in 2021, once the impact of the pandemic dissipates, with inflation gradually rising towards the inflation target. The current account deficit would gradually converge to around 6 percent of GDP over the medium term, as exports continue to benefit from ongoing reforms, and import growth moderates on the back of prudent policies.

POLICY RESPONSE TO COVID-19

5. Our immediate focus is on measures to contain the spread of COVID-19 and ensure that our health system is ready to meet the needs of the population. We have been working to equip the Ministry of Health with additional resources and legislative powers to expeditiously acquire necessary goods and equipment. To this end, we have channeled resources from the Reserve Fund to health-related spending and simplified the associated procurement procedures. We have also promptly undertaken measures to slow viral transmission since late-February, with a national state of emergency declared on March 16. These measures include restrictions on public events, business activities and the free movement of people. At the same time, we moved quickly to prepare business continuity measures to ensure the ongoing provision of essential public services.

6. To mitigate the impact of the pandemic on businesses and vulnerable households, we have adopted a comprehensive set of targeted and temporary measures, estimated at AMD150 billion (2 percent of initially projected GDP). The measures fall into three broad categories:

- ***Liquidity provision to businesses.*** We have announced three separate programs offering subsidized government-sponsored loans for co-financing and refinancing to selected businesses to provide short-term support. These measures target small and medium enterprises (SMEs) in affected sectors (manufacturing, hospitality, transportation, tourism, and services), agricultural enterprises, as well as selected other firms impaired during the crisis. For SMEs, the loans are administered by a public investment agency, which will screen applications based on a wide range of characteristics including input invoices and tax compliance history. For other firms, the loans are co-financed with (and administered by) commercial banks who share the credit risk.

- ***Direct labor subsidies.*** Two packages envisage provision of direct labor subsidies to micro enterprises and SMEs that retain their employees and maintain their wages.

- ***Lump sum transfers to vulnerable individuals.*** Several separate schemes provide lump-sum transfers to individuals who became unemployed after the COVID-19 outbreak, with additional transfers for families with, or expecting, children.

The CBA has also moved quickly to respond to the COVID-19 within its dual price and financial stability mandates (¶17).

7. We are committed to ensure strong governance and transparency in implementation of these programs. We will review the implementation of these measures on a monthly basis, with the objective of phasing them once are no longer needed, cognizant of their fiscal implications. We will arrange for an ex-post audit of the on-lending business support schemes in the COVID-19 package and publish the results of the audit. The audit will be conducted by a top 10 internationally known independent audit company.[1]

[1] As listed at https://www.vault.com/best-companies-to-work-for/accounting/best-firms-in-each-practice-area/audit-assurance; and https://www.accountancyage.com/rankings/top-5050-accountancy-firms-2019/.

FISCAL POLICY

8. In 2020, the fiscal deficit is expected to widen to 5.0 percent of GDP, due to lower revenues and higher spending on healthcare and economic support. Consequently, a fiscal financing gap will emerge. Tax revenue is expected to decline to 21.7 percent of GDP (from 22.3 percent in 2019), while additional spending on healthcare and economic support could add up to 2.1 percent of GDP. We are committed to finding savings by reprioritizing and reallocating expenditure within the budget envelop. Nonetheless, we will need to mobilize about US$500 million in additional financing to close the fiscal financing gap in 2020, including to provide resources for our business liquidity support programs.

9. Funding our urgent healthcare needs and support for the economy, implies greater reliance on external financing from the IMF and other partners to complement that available from domestic capital market. We intend to draw on the resources available under the SBA—including those available if our augmentation request is approved—upon completion of the second review. We propose to channel up to SDR 231.66 million of the Fund's resources to budget support in 2020. We expect other external partners to also provide additional resources and have already received pledges of assistance to help with our COVID-19 response. We are committed to maintaining transparency over the use of these borrowed resources by channeling any additional spending through the budget and passed a supplementary budget on April 29, 2020. In meeting our financing needs, we will ensure that of the government's cash deposits maintain a sufficient cushion for cash-flow management purposes and possibly for future needs.

10. We remain committed to our medium-term fiscal goals of debt sustainability, while maintaining space for investment and social spending. The 2021–23 Medium-Term Expenditure Framework MTEF will underpin our commitment to the objective of reducing public debt once the pandemic shock dissipates. We will implement gradual fiscal consolidation to bring government debt to GDP ratio to below 50 percent, in line with our fiscal rule. This would require lowering fiscal deficit to about 1½ percent of GDP over the medium-term. This adjustment will be achieved by mobilizing revenue and containing current expenditure, while creating space for additional capital spending over the medium term. We will work to raise the revenue to GDP ratio over the medium term to the levels suggested by a study identifying tax potential (October 2020 SB) by exploring scope to reduce tax expenditures, reform the turnover tax regime, and increase excises while implementing reforms to boost tax compliance. By raising domestic revenues and containing current expenditure growth, will be able to allocate additional resources towards capital spending critical to building Armenia's potential.

STRUCTURAL FISCAL POLICIES

11. To promote growth and increased compliance we continue to modernize and simplify our tax system.

- ***Tax reform***. From January 2020, our tax reforms have simplified and flattened PIT rates, reduced the CIT rate, and paved the way for a legislated increase in the social contribution rate in January 2021. We are also on track to introduce individual income tax declarations from January 2022.

- ***Property taxation.*** We are in the final stage of deciding the taxation parameters across different types of property. Our guiding objective is to have a low eligibility threshold to strengthen compliance culture. We have also built an electronic property tax management system, which is expected to be in place by December 2020. We remain committed to start tax collections under this new regime in 2021, with a transition period allowing for a gradual increase in the taxation burden through 2024.

- ***Compliance.*** To improve compliance and fight evasion, we are improving data management, predictive analysis, non-compliance detection, and audit processes. Our efforts are already bearing fruit as evidenced by the large increases in recovered taxes from audits seen in 2019. The SRC's organizational structure was recently streamlined to increase the focus on risk management, information systems, and analytical capacity, including through the use of enhanced machine learning and prediction modeling. With the assistance of IMF technical assistance (TA), we are drafting a Compliance Risk Management strategy (September 2020 SB) to guide future developments, and continue our efforts to collect and organize data to finalize analysis of Armenia's tax gap (October 2020 SB) and identify areas for improvements and policy action (December 2020).

12. We have been working to improve the appraisal, selection, and monitoring of public investment projects. The MOE has been working with the World Bank to develop the appraisal methodology for projects and a new PIM manual to prioritize projects by economic returns and government objectives. The new methodology is being piloted in the ministries of health, education, and infrastructure. We are committed to strengthening the PIM process by developing a database of projects covering both externally and domestically funded projects to provide information on projects throughout their lifecycle (December 2020 SB). Our immediate focus, though, is to prepare for the recovery by creating a pipeline of public investment projects that will be ready for immediate execution as conditions allow.

13. Our newly adopted public financial management strategy underlines our commitment to improving fiscal governance, transparency, and long-term sustainability.

- ***Budget process.*** We are working to enhance program-based budgeting for the 2021 budget cycle: non-financial indicators are included for most programs and program measures; historical values are set for most programs to serve as a base for numerical output targets for future years. We are also using an enhanced rolling baseline MTEF/budgetary process by delineating projections of on-going and mandatory expenditure commitments as well as new measures including discretionary spending and proposals for permanent expenditure adjustments.

- ***Fiscal risks management***. In late 2019, we adopted a roadmap to strengthen risk management and extend the coverage of monitored risks to those arising from natural disasters, legal proceedings against the State, the financial system, and potential environmental liabilities. We will work on including a comprehensive and consolidated fiscal risk summary in the 2022 budget documentation while developing centralized capacity within the Ministry of Finance (MOF). We have also made progress on the PPP legislation by adopting two decrees operationalizing the law. The next step is to estimate contingent liabilities associated with the existing and newly approved PPPs (November 2020 SB) and produce a decree setting a cap on the aggregate amount of contingent liabilities that can be contracted with PPPs (December 2020 SB). Finally, we have strengthened the SOE reporting requirements by adopting a new law that imposes the mandatory audit and publication of financial reports of the SOEs exceeding certain criteria, starting from January 2020.

- ***Fiscal transparency.*** We are developing an improvement plan for government finance statistics (GFS) (September 2020 SB). We will leverage high-quality and timely budgetary data by economic transaction and functional categories from the budget reporting system to improve the accuracy and consistency of fiscal reporting in different publications. The MoF in collaboration with the CBA and Armstat will compile a comprehensive sectorized list of all public sector entities (March 2021 SB) to allow for the extension of GFS coverage and improvement of fiscal risk monitoring.

- ***Exchange rate arrangement.*** The CBA and MOF have worked closely on modalities for using market-determined exchange rates for all budget transactions. We plan to complement this with a new approach to manage exchange-rate risks in a transparent and cost-effective manner from the 2021 budget round.

MONETARY AND FINANCIAL SECTOR POLICIES

14. The monetary policy consultation clause (MPCC) was triggered by unexpectedly low inflation in December 2019. We have attaching a separate letter outlining the underlying reasons for the inflation deviation, as well as our policy response (Attachment III). Going forward, we propose the introduction of an inner staff consultation band into the MPCC to allow earlier consultations with Fund staff if moderate/significant inflation deviations arise again.

15. The CBA has moved quickly to provide a comprehensive temporary response to the COVID-19 crisis while balancing its dual mandate of price and financial stability.

- ***Policy rate.*** On March 17 and April 28, we reduced the policy rate by 25 basis points each time to 5.0 percent to boost inflation and support economic activity affected by the pandemic. Nonetheless, we stand ready to tighten policy in case of significant capital outflow pressures and/or disorderly exchange rate movements if needed to help preserve financial stability.

- ***Foreign exchange intervention.*** The CBA has undertaken some foreign exchange sales to limit excessive dram volatility since, in a highly dollarized economy, this can lead to a significant deterioration in domestic balance sheets and pose risks to financial stability.

Nonetheless, we will not obstruct any necessary exchange rate adjustment, and will ensure that international reserves remain adequate. We will communicate our broader intervention strategy to market participants.

- ***Liquidity provision.*** While domestic markets have generally functioned smoothly since the onset of the pandemic, the CBA has conducted repos and FX swap operations to underpin liquidity in the interbank market. We are prepared to conduct one- and three-month repo operations more frequently, in addition to seven-day operations, if needed. We are considering inquiring about use of the US Federal Reserve's new temporary lending facility, that will allow eligible central banks to convert their holdings of US Treasuries into US dollars.

- ***Regulatory and supervisory responses.*** Our goal is to maintain the balance between preserving financial stability, maintaining banking system soundness, and sustaining economic activity. To this end, the CBA has encouraged voluntary prudent loan restructuring where necessary to help the borrowers heavily impacted by the crisis manage the shock. The CBA has not relaxed loan classification and provisioning rules and has instructed banks to measure NPL and potential losses as accurately as possible. We have enhanced engagement between banks and banking supervisors to continuously assess the impact of the COVID-19 crisis on their asset quality, liquidity, and other parameters. To alleviate some pressure on banks and the exchange rate, the CBA temporarily halted the redenomination of foreign exchange reserve requirements (RR) during the crisis period, as provided for in the action plan governing redenomination. We will develop a revised timeline for the redenomination, which will come into effect once the pressures abate. If liquidity pressures intensify beyond what can be addressed through regular operations, the CBA may also consider a temporary reduction in reserve requirements.

- ***Macroprudential response***. We lowered Tier 1 capital adequacy ratio from 10 percent to 9 as part of a broader strategic change in the nature of capital in the banking system, with the introduction of (and capital being held in) Basel III capital buffers (capital conservation, systematically important banks, counter-cyclical). At the same time, we have encouraged banks to use newly introduced capital buffers in order to absorb losses and maintain lending to the economy. All banks have excess capital cushions and these structural changes are aligned with Basel III recommendations.

16. We remain committed to structural reforms to develop capital markets, which will improve the utilization of domestic savings and transparency in the non-finance corporate sector, as well as strengthen monetary policy transmission. In this regard, we have prepared a draft capital market development program with the help of the IMF TA. Further work is ongoing to comprehensively review the framework for securities, conduct a diagnostic analysis of existing challenges, and bring forward proposals for concrete actions. For this purpose, we request a postponement of this benchmark to May 2020.

17. We will strengthen our macroprudential toolkit by adopting a stressed Loan-to-Value (LTV) limit. We will introduce LTV ratios at differentiated levels for LC and FX loans

(March 2021 SB). We have also started collecting information from all banks and credit institutions on borrower and loan characteristics and are working towards the adoption of debt-service-to-income (DSTI) limits.

18. We continue strengthening our policy framework to support financial sector stability in line with FSAP recommendations: (1) In line with Basel III, we approved introduction of capital conservation and countercyclical capital buffers, as well as a surcharge for domestic systemically-important banks; (2) We introduced LCR and NSFR in AMD and FX to boost liquidity buffers, but due to current circumstances, we will start enforcing them from January 2021. LCR and NSFR are set at 100 percent for dram liabilities. The ratios are set at 60 percent for FX liabilities and will reach 100 percent by early 2022; (3) We approved and operationalized the emergency liquidity assistance for banks that are solvent but illiquid, against collateral; and (4) The CBA has drafted and submitted for the MOF's review the regulations related to the redefinition of nonperforming loans and restructured loans in line with international best practices.

STRUCTURAL REFORMS

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

- ***Business environment.*** We approved the annual action plan to improve the business environment by addressing core issues identified by the 2019 Doing Business Report. We have also created an Investment Support Center (ISC) within the MOE to promote domestic and foreign investment in an efficient and coordinated manner. Additionally, we have drafted an SME development strategy and are currently preparing an efficiency review of existing SME support programs in order to consolidate the existing support mechanisms and programs. We are expecting to complete the efficiency review, with a slight delay, by September 2020, as the outbreak of COVID-19 has impeded the work on this review.

- ***Labor market and social policies.*** We developed an employment strategy that targets establishing an active labor market program to ensure sustainable inclusive employment (December 2019 SB). On social policies, we expanded the coverage for the family and welfare benefit allowance to enhance the adequacy of social spending. There has also been a notable progress with a project designed to create self-sustaining income-generating opportunities for vulnerable families.

- ***Education.*** We have drafted a Law on Higher Education and Science paving the way for reforms to the tertiary education management system and allowing for improved human resource management as well as organizational and financial autonomy of higher education institutions. The document has benefitted from the detailed discussions with a wide range of stakeholders. We plan to submit the draft law to the National Assembly by end-June 2020.

20. We are making progress in strengthening our anti-corruption framework. In this regard, we have: (i) drafted revisions in the Criminal Code to eliminate threshold amounts on embezzlement and introducing criminal liability for legal persons, in line with Fund advice. These drafts are expected to be submitted to the National Assembly by June 2020; (ii) drafted a law on a single autonomous anti-corruption entity, which combines all detection and investigative functions. Although this has taken longer than hoped, it is now at the final stages having undergone extensively public discussion. Fund staff have commented on previous versions of the draft law and the final draft will be submitted to Fund staff once again for review before submission to the National Assembly with some delay, by September, 2020; (iii) We have transferred the functions, the main staff and electronic platforms from CEHRO to the newly created CPC. A new platform, which will include also declaration of interests will be launched soon by the support of the World Bank with a view to include also expenditure declarations and the automated risks-based analyses module during the 2020 cycle. Regarding the Fund staff recommendation on reviewing and amending the statute of limitations term for corruption cases so that it commences at the point of discovery, after a number of long discussions with participation of Government, Parliamentarians, judiciary, prosecution, experts, practitioners, working group members and in order not to hinder the logic of the criminal law policy it was finally agreed to retain the provision on the time when the act is conducted, but vastly extend limitation periods in the new draft Criminal Code and set 10 years in case of medium gravity corruption crimes, 15 years in case of a grave crime and twenty years in case of particularly grave crime.

PROGRAM MONITORING AND SAFEGUARDS

21. The program will be monitored through quantitative performance criteria, indicative targets (Table 1), a monetary policy consultation clause, and structural benchmarks (Table 2). The third review is expected to be completed on or after October 15, 2020 and will assess performance as of end-June 2020. The fourth review is expected to be completed on or after May 20, 2021 and will assess performance as of end-December 2020.

Table 1. Armenia: Quantitative Performance Criteria 1/

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

	2019						2020							2021
	Mar.	Jun. 2/	Sep. 3/	Dec. 2/			Mar. 3/		Jun. 2/		Sep. 3/		Dec. 2/	Mar. 3/
	Act.	Act.	Act.	EBS 19/118	Act.	Status	EBS 19/118	Proj.	EBS 19/118	Rev. Prog	EBS 19/118	Rev. Prog	Rev. Prog	Proj.
Performance Criteria														
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,320	1,439	1,661	1,444	1,808	Met	1,506	1,646	1,501	1,382	1,528	1,321	1,348	1,369
Program fiscal balance (flow, floor) 4/	28	98	-77	-196	-127	Met	-61	-49	-113	-345	-176	-459	-495	-122
Budget domestic lending (cumulative flow, ceiling)	0	0	0	15	0	Met	15	15	15	115	15	115	115	15
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	0	Met	0	0	0	0	0	0	0	0
MPCC 5/														
Inflation (upper-outer band, inflation consultation, percent)	...	...	...	...	...		...	...	...	4.0	...	4.3	4.5	5.4
Inflation (upper-inner band, percent)	3.4	4.0	3.4	4.0	4.0		4.2	4.2	4.3	3.0	4.5	3.3	3.5	4.4
Inflation (mid-point, percent)	1.9	2.5	0.5	2.5	0.7	Not Met	2.7	-0.1	2.8	1.0	3.0	1.3	1.5	2.4
inflation (lower-inner band, percent)	0.4	1.0	0.4	1.0	1.0		1.2	1.2	1.3	0.0	1.5	0.0	0.0	0.9
Inflation (lower-outer band, inflation consultation, percent)	...	...	...	...	...		...	...	...	0.0	...	0.0	0.0	0.7
Indicative Targets														
Net domestic assets of the CBA (stock, ceiling)	473	375	269	831	244	Met	519	287	438	438	514	514	629	630
Avg. concessionality of newly contracted ext. debt (flow, floor, in percent) 6/	...	...	...	30	39	Met	30	30	30	30	30	30	30	30
New government guaranteed external debt (stock, ceiling, in millions of USD) 7/	0	0	0	100	0	Met	100	100	100	100	100	100	100	100
Social spending of the government (flow, floor) 8/	15	27	...	54	55	Met	14	14	28	30	42	44	58	20
Memorandum items:														
Budget support grants (cumulative from beginning of each year)	0	0	0	4	0		0	0	5	0	5	0	17	0
o.w. EU MFA grant	0	0	0	4	0		0	0	5	0	5	0	17	0
Budget support loans (cumulative from beginning of each year)	0	0	1	71	73		0	0	0	0	0	0	0	0
Project financing loans (cumulative from beginning of each year)	10	22	38	99	101		0	24	98	64	146	102	140	36
Project financing grants (cumulative from beginning of each year)	0	2	3	14	3		0	6	3	13	3	21	29	3
KFW and IBRD loan disbursements (cumulative from beginning of each year)	0	3	16	39	39		0	0	3	3	16	16	39	0

Sources: Armenian authorities; and Fund staff estimates.

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

2/ Quantitative performance criteria at test dates.

3/ Indicative target.

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

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

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

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

8/ Defined as spending on the family benefit program and lump-sum financial aid, one-time childbirth benefits, and childcare benefits for children less than two years of age.

Table 2. Armenia: Structural Benchmarks

Measures	Responsible Agency	Time Frame	Status	Macro Criticality
Fiscal				
Create an action plan to implement key recommendations from IMF TA on tax administration on developing a compliance strategy and strengthening core functions and processes	State Revenue Committee (SRC)	June 2019	Met	Improve tax administration and compliances
Submit a draft law "On Establishing Market Evaluation Procedure for Real Estate Taxation" to the National Assembly to implement a value-based recurrent property tax with appraised property values closely aligned to market prices	Deputy Prime Minister's Office	June 2019	Met	Enhance revenue mobilization and fairness
Submit a public-private partnership (PPP) law to the National Assembly, establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships	Ministry of Economic Development and Investments (MoE)	June 2019	Met	Incentivize FDI and investment in infrastructure projects
Design an action plan to improve tax compliance and raise tax-to GDP ratio in the medium term, based on a study identifying tax potential and factors preventing tax collection reaching this potential	Deputy Prime Minister's Office	December 2019	Not met. Split into new SBs with new dates.	Improve tax administration and compliances
Design a Compliance Risk Management strategy to improve tax administration and compliance, based on IMF TA recommendations.	State Revenue Committee	September 2020	New	Improve tax administration and compliance

Conduct a study identifying tax potential and factors preventing tax collection reaching its potential.	Deputy Prime Minister's Office	October 2020	New	Create fiscal space
Design an action plan to reduce the tax policy gap identified in the study.	MoF	December 2020	New	Create fiscal space
Develop and approve by ministerial order a plan for how GFS in Armenia will be extended and improved over the next two to three years.	MoF, in collaboration with the CBA and Armstat	September 2020	New	Improve government statistics
Compile a comprehensive sectorized list of all public sector entities, with IMF TA support.	MoF and Armstat	March 2021	New	Improve government statistics
Compile and estimate all the existing and future contingent liabilities associated with implemented and approved PPPs	MoF	November 2020	New	Improve fiscal risk management
Approve and publish a decree setting a cap to the total contingent liabilities contracted from PPPs.	MoF	December 2020	New	Improve fiscal risk management
Build a database of projects covering both externally and domestically funded projects that provides information on projects throughout their lifecycle.	MoE and MoF	December 2020	New	Enhance project selection and monitoring
Monetary and Financial				
Prepare a time-bound action plan and communication strategy to boost foreign currency liquidity buffers as described in the 2018 FSAP recommendations (paras 19, 21 and 32) through a combination of liquidity tools	Central Bank of Armenia (CBA)	September 2019	Met	Enhancing macro prudential measures
Develop a capital market development program	MoE, CBA, MoF	March 2020	Not met. The date is	Create access to long-term, local-currency

			reset to May 2020	finance and improve monetary policy transmission
Develop a framework for strengthening financial reporting and auditing to establish the public oversight body and the Chamber of Accountants and Auditor, focusing on improving corporate financial information and reducing SME financial reporting requirements with assistance by the World Bank	MOF	March 2020	Met	Strengthen transparency and improve SME's access to finance
Prepare a medium-term exit strategy to phase out the CBA involvement in non-core central bank activities (i.e. development lending and subsidiaries)	CBA	September 2020		Curtail engagement in quasi-fiscal activities that do not relate to core central bank's mandate; eliminate potential financial and reputational risks.
Introduce limits to stressed Loan-to-Value (LTV) ratio	CBA	March 2021	New	Mitigate credit risks from unhedged borrower and vulnerabilities from rapid credit growth and dollarization
Structural				
Submit to the National Assembly a draft law on a single autonomous anti-corruption entity in line with international standards, which combines all detection and investigative functions	Ministry of Justice (MoJ)	December 2019	Not met. The date is reset to September 2020	Combat against corruption

Adopt a legislation to require the establishment of a registry of beneficial ownership information, which is adequately resourced and staffed, and can conduct verification, first beginning with companies in the extractive industry, as identified in the EITI 2016 Standard	MoJ	June 2019	Met	Combat against corruption
Prepare an annual action plan to improve the business environment to address core issues identified by the 2019 Doing Business	MoE	February 2020	Met	Improve business climate
Conduct an efficiency review of the existing government SME support programs and consolidate support mechanisms, tools and programs	MoE with support from the CBA	April 2020	The date is reset to September 2020	Improve effectiveness of the SME state support activities and enhance access to finance
Develop Armenia's employment strategy for 2019–23	MoL	December 2019	Met	Reduce unemployment and enhance inclusiveness of vulnerable groups in the labor market
Submit to the National Assembly a draft law on Higher Education and Science which sets the legal ground for (i) reforming the tertiary education management system; (ii) upgrading licensing and accreditation requirements, state financing principles, supervision mechanisms for quality of education services.	Ministry of Education and Science	December 2019	Not met. The date is reset to June 2020	Improve growth inclusiveness
Develop a comprehensive education reform strategy	Ministry of Education and Science	June 2020		Enhance equitable access to education and improve physical conditions.

Attachment II. Technical Memorandum of Understanding (TMU)

1. This memorandum sets out understandings between the Armenian authorities and the IMF staff regarding the definition of performance criteria (PCs) and indicative targets (ITs), adjusters, and data reporting requirements for the Standby Arrangement as per the Letter of Intent and Memorandum of Economic and Financial Policies (LOI/MEFP) dated April 26, 2019.

2. For program monitoring purposes, all foreign currency-related assets, liabilities, and flows in the monetary accounts will be evaluated at program exchange rates. The program exchange rate of the Armenian dram to the U.S. dollar is set at 483.75 dram per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

QUANTITATIVE TARGETS

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

The program sets the following PCs:

- Floor on the net official international reserves (NIR) of the Central Bank of Armenia (CBA);
- Floor on the program fiscal balance;
- Ceiling on domestic budgetary lending; and,
- Ceiling on the stock of external public debt arrears (continuous).

The program sets the following ITs:

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

The program sets the following MPCC:

- Headline inflation.

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

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

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

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

5. **MPCC headline inflation** is defined as the year-on-year rate of change of the Consumer Price Index as measured by Armenia's National Statistics Service. The MPCC will be considered met if headline inflation falls within the upper and lower (outer bands) around the mid-point target specified in Table 1 in the LOI/MEFP. Consultation with IMF Board would be triggered for end June 2020 test date if inflation falls outside the outer bands. The consultation with the Board will be on the reasons for the deviation and the proposed policy response before further purchases could be requested under the SBA. Specifically, the consultation will explain (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for deviations from the specified band, taking into account compensating factors; and (iii) on proposed remedial actions, as deemed necessary. In addition, a staff consultation clause whereby the CBA will consult with IMF staff on the outlook for inflation and the proposed policy response will be triggered if inflation falls outside the inner bands and within the outer bands (Table 1 in the LOI/MEFP) for the June 20208 test date.

Inflation Consultation Bands

	Jun-20	Dec-20
Upper outer band	4.0	4.5
Upper inner band	3.0	3.5
Center point	1.0	1.5
Lower inner band	0.0	0.0
Lower outer band	0.0	0.0

Source: IMF staff.

6. **Net domestic assets** are defined as reserve money minus NIR, minus other assets not included in gross official international reserves, minus commercial bank required and excess reserves at CBA in FX, plus medium and long-term foreign liabilities (i.e., liabilities with a maturity of one year or more) of the CBA, plus other foreign liabilities not included in official reserve liabilities, minus the balance of outstanding Fund purchases credited to the government account at the CBA. NDA is composed of net CBA credit to the general government plus outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money and other items net.

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

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

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

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

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

8. **A budgetary ER** of 476.46 drams per one US dollar will be used for foreign currency-denominated transactions included in the 2020 budget with the exception of the amounts received for project implementation units (PIU) for which the prevailing ER at the time of the transaction was used. Any additional unbudgeted transactions for 2020 will take place at the market

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

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

exchange rate. In addition, if new foreign currency-denominated transactions are introduced at any time, these will take place at the prevailing ER at the time of the transaction. The framework arrangement will not be modified (in substance) but may be clarified as this would imply noncompliance with the program continuous PC on ER arrangements and multiple-currency practices. External and domestic net lending, which are recorded as financing items, are excluded from the calculation of the program fiscal balance, which is calculated from the financing side (see ¶8). This effectively treats net lending as an expenditure item when loans are made and as a revenue item when the loans are repaid.

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

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

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

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

13. **Floor on average concessionality of newly contracted external debt.** The program sets an annual indicative floor of 30 percent on the average concessionality of new debt on a contraction basis with nonresidents with original maturities of one year or more as contracted and guaranteed by the public sector, but excludes purchases from the IMF, the Eurobond issuance, and any similar refinancing instruments. The concessionality floor is calculated on a calendar-year basis.

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

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

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

14. Ceiling on government guaranteed external debt. In addition to the indicative floor on average concessionality, a separate, cumulative ceiling (IT) of $100 million for the program period applies to new government guarantees of the total of concessional and non-concessional external financing, excluding the Eurobond and any similar refinancing instruments. The issuance of debt guarantees will be measured at the exchange rates listed in Table 1. The above limit covers debt guarantees issued by the general government to entities outside the general government (excluding the CBA). Guarantee issuance will be monitored on a monthly basis and the Ministry of Finance will provide data within 21 days from the end of the month.

15. The program sets a floor on **social spending of the government**. For the purposes of the program, social spending of the government comprises the family benefit program and maternity benefits, one-time childbirth benefits, and childcare benefits for children less than two years of age in the budget.

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

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

- **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.
- **Project support grants** are defined as grants received by the general government for public sector projects.
- **Budget support loans to the public sector** are defined as disbursements of commercial loans (e.g., Eurobonds), loans from bilateral and multilateral donors for budget support, and Fund purchases credited directly to the government accounts at the CBA.
- **Project financing to the public sector** is defined as disbursements of loans from bilateral and multilateral donors for public sector projects.
- **The floor on NIR** will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of budget support loans, budget support grants or project financing grants compared to program amounts (excluding Fund purchases by the government) (Table 3, last line). The floor on NIR will be adjusted downward for any external public debt amortization amounts in excess of program amounts. The floor on NIR will be adjusted upwards by the amount of any funds received for privatization proceeds received from non-residents in foreign currency and not held in the SPA.
- **The ceiling on NDA** will be adjusted downward (upward) by the cumulative amount of any excess (shortfall) of budget support loans, budget support grants or project financing grants compared to program amounts (Table 3, last line).
- **The floor on the program fiscal balance on a cash basis** will be adjusted upward (downward) by the cumulative total amount of the budget support grants received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $100 million per year in either direction. The floor on the program fiscal balance on a cash basis will also be adjusted downward (upward) by the cumulative total amount of the project financing loans received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $100 million in either direction.
- **The ceiling on domestic budgetary lending** will be adjusted upward by the amount of undisbursed funds under domestic budgetary lending programs approved in the previous year.

DATA REPORTING

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA	CBA balance sheet	Summary	Daily	The following working day
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within seven days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks by chart of accounts at actual official exchange rates	Monthly	Within 25 days of the end of each month
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Daily	The following working day
	Foreign exchange market	Official exchange rates (buying and selling); daily trade volume, and weighted average exchange rate of the interbank, intrabank and Nasdaq-OMX	Daily	Within 1 day
	Foreign exchange market	CBA foreign exchange operations, (exchange rate, volume)	Daily	Within 1 day
	Foreign exchange market	Exchange rate (buying and selling)	Daily	Within 1 day
	Interest rates	Refinance rate	At least monthly	Within 1 days of the CBA Board decision
	Interbank money market	Daily interbank repo volume and interest rate and number of trades	Daily	Within 1 day
	CBA operations	Repo (reverse repo) operations, open market operations, Lombard credits, deposit facility, and foreign exchange swaps (volumes, maturity, yields, exchange rates)	Daily	Within 1 day
	Bank liquidity	Reserves and excess reserves, by	Monthly	Within 15 days of

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		currency		the end of each reference period
	Interest rates and flows of the funds attracted and allocated by commercial banks	By currency and maturity	Weekly	First working day of the next 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	First working day of the next week
	Banking data	Sectoral distribution of loans and deposits; dollarization of loans and deposits; loan maturities; interbank rate, by volume and maturity; T-bill rate, bond yield; deposit and lending rates, by maturity; monthly weighted average interest rate on government bonds	Monthly	Within 25 days of the end of each month
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Monthly	Within 30 days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Monthly	Within 30 days of the end of each month
	On-lending via commercial banks	On lending via the CBA and government (from, KfW, WB, ADB, etc.) by type of on-lending projects (including loan disbursements and repayments)	Monthly	Within 10 days of the end of each month.
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Transfers	Non-commercial transfers of individuals	Monthly	Within 31 of the end of each month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	Balance of payments	Detailed balance of payments data	Quarterly	Within 92 days of the end of each quarter
	T-bill and coupon bond financing	By holders, i.e., CBA, resident banks, resident nonbanks, and nonresidents	Monthly	Within 7 days of each month
	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the CBA, and state-owned companies (by company); any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears	Monthly	Within 21 days of the end of each month. For project implementation units, within 21 days of the end of each month (preliminary data) and within 45 days of the end of each month (final data)
Ministry of Finance	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions	Monthly	Within 7 days of the end of each month
	Domestic expenditure arrears	All unpaid claims outstanding at the end of the month which includes wages, social contributions (including for pensions), family allowances, and amortization and domestic interest payments	Monthly	Within 45 days of the end of each month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month
	Treasury single account (TSA)	Detailed breakdown of central treasury account, including deposits at the central treasury, community budgets, off budget account, monetization account, state budget account and the Republic	Monthly	Within 7 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		correspondent account—flows during the month and end of month stocks.		
	Consolidated central government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Central and local governments, and Non-Commercial Enterprises that belong within the general government (NCEs)	Quarterly	Within 60 days of the end of each quarter
	Consolidated general government	Central and local governments, and NCEs that belong within the general government	Annual	Within 180 days of the end of each year
	Budget execution	All cash receipts, cash expenditures, including domestic and external debt-service payments, external and domestic borrowing and lending operations, and inflow of grants to the central government; expenditure data will be provided according to both economic and functional classifications, consistent with the GFSM2001 methodology	Monthly	Within one month following the end of each quarter.
National Statistical Service	Balance of payments	Detailed export and import data (issues that have arisen in 2015 with EEU trade data need to be overcome as soon as possible)	Monthly	Within 28 days of the end of each month
		Detailed export and import data	Quarterly	Within 45 days of the end of each quarter
	CPI	By category	Monthly	Within 5 days of the end of each month
State Revenue Committee	Tax arrears	By type of tax	Monthly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	Tax credits	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues, in both net and gross terms	Monthly	Within 45 days of the end of each (monthly data provided on a quarterly basis)
	Tax Revenues	Tax Revenue by type of tax	Monthly	Within 45 days of the end of each quarter (monthly data provided on a quarterly basis)
	VAT and turnover tax	Number of registered taxpayers	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	VAT refund claims in arrears	Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90-day statutory processing period. Number of refund applications processed per month.	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax inspectorate	Monthly	Within 45days after the end of each month
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty-free recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions	Quarterly	Within 30 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		involving non-duty-free recorded imports 5. Value of recorded imports where customs value was assessed using transaction prices, breaking out raw diamond imports; 6. Value of non-duty-free recorded imports where customs value was assessed using transaction prices; 7. Number of transactions involving recorded imports where customs value was assessed using transaction prices; 8. Number of transactions involving non duty-free recorded imports where customs value was assessed using transaction prices		
	Automated VAT refunds	Number of refunds that were processed automatically (share of total refunds); total value of automated and automatic refunds and offsets; average waiting time (days) to receive refund	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Risk-based selection approach	Percentage of selected companies chosen on the basis of risk-based approach, identified revenue from risk-based audits	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Pension system	Number of participants in the pension second pillar, social payments and funded contributions	Monthly	Within two months of the end of each quarter (monthly data provided on a quarterly basis)

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

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

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

Source: National Authorities and IMF Staff Calculations

Table 2. Armenia: KFW, AsDB, and IBRD SME Loan Disbursements in 2019–20 1/

(In millions of U.S. dollars)

Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Prog.	Proj.	Proj.	Proj.	Proj.
89.7	16.7	16.7	57	57

1/ Cumulative from the end of previous year.

Table 3. Armenia: External Disbursements to the Public Sector in 2019–20 1/

(In millions of U.S. dollars)

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
	Prog.	Proj.	Proj.	Proj.	Proj.
Project financing loans	208	50	131	210	288
Project financing grants	16	12	27	42	58
Budget support loans	151	0	0	50	100
Budget support grants	9	0	0	0	16
of which: EU MFA	9	0	0	0	16
Total	385	62	158	302	462
of which through the CBA		19	108	262	408

1/ Cumulative during the same year.

Attachment III. Consultation with the IMF Executive Board on the Missed Inflation Target Under the MPCC

Consultation on Breach of MPCC Target at December 2019

Central Bank of Armenia

April 30, 2020

In December 2019, CPI inflation fell to 0.7 percent, 0.3 percent below the lower bound of the inflation consultation band of 1.0 percent, agreed under the SBA. This letter explains: (1) the reasons why inflation has breached the lower limit of the inflation consultation band; and discusses: (2) the policy response and (3) the outlook of inflation.

1. Deviation from the target has been driven by several cyclical and structural factors, which we briefly discuss below:

Cyclical Factors

Fiscal Policy

2. Fiscal policy was more contractionary during 2019 than expected by the end of 2018. Tax-to-GDP ratio was higher by 1.6 pp and budget deficit was lower by 1.3 pp. than planned in the 2019 Budget law. Tax-to-GDP ratio in 2019 increased about 1.4 pp. compared to previous year, due to improvement in tax administration and reduction of the shadow economy.

Global Economy

3. Lower inflation in major trading partners, as well as lower commodity prices are another set of factors behind the deviation of headline inflation. Both: in the EU and Russia, inflation turned out to be lower than expected under the monetary program of CBA at the beginning of 2019 deviating by 0.3 and 1.2 pp. respectively by the end of 2019. Lower global inflation was partly due to lower-than-expected FAO prices during the first half of the year, which, however, started to gradually increase towards the end of 2019. This increase is yet to be gradually reflected in our domestic inflation, while inflation at the end of 2019 largely carries the effects of stable FAO prices during the most part of 2019.

Structural Factors

Competition

4. Structural reforms implemented by the Government resulted in more intense competition putting downward pressure on the level of prices. These include tax reforms and more effective customs, which shrunk the shadow economy and triggered/brought higher competition in the goods' market. The easier market entry prompted many businesses to lower prices to keep their market shares and created supply-side downward pressure on domestic inflation.

Changes in Consumption Structure

5. **Optimistic growth expectations as well as expected increase of import tariffs on cars led to higher share of disposable income spent on housing and durable consumer goods**. This was reflected in acceleration of new construction and dramatic increase of car imports in 2019. The combination of higher demand for housing and cars is consistent with high credit growth, mortgage and consumer in particular, accelerating activity and prices in the real estate market and low inflation in terms of CPI.

Policy Response

6. **In response to lower inflation CBA decreased the policy interest rate by 25 basis points in September 2019, but refrained from more aggressive response as (1) fiscal policy was falling behind the expected path during the whole year of 2019 and expected to be much expansionary in 2020 and (2) credit growth remained high, especially in terms of consumer credits and mortgages**. Overall, CBA assesses, that there was no large shortage of demand and the output gap was largely closed. At the same time, the CBA believes that temporarily low inflation would help to anchor inflation expectations better, given their still elevated level, which is reflected in high dollarization. This view was stated in all monetary policy programs during 2019. As latest COVID-19 events show, low inflation has already created an additional room for monetary policy to react to the adverse shock by lowering interest rate despite dramatic capital outflows from emerging markets.

Inflation Outlook

7. **The outbreak of COVID-19 and pandemic in the world created heightened uncertainty in the world and in Armenia**. CBA continues to keep monetary policy stance accommodative by lowering the policy rate further by 25 basis points in March 2020. As announced by the Government, fiscal policy is also expected to be massively expansionary in the near future to minimize negative effects of the pandemic on the domestic economy. On the other hand, large capital outflows are putting high pressure on emerging markets risk premiums, and Armenia is not an exception. The resulting depreciation of the Armenian dram led to more expansionary policy in terms of monetary conditions. Under the current baseline scenario, inflation is expected to be around 1.9 percent at the end of 2020. Given the elevated global and domestic uncertainty, the CBA closely monitors the economic performance and is prepared to act accordingly to ensure the price stability.