Republic of Armenia
and the IMF

Press Release:
IMF Executive Board Approves Three Year, US$13.6 Million Poverty Reduction and Growth Facility Arrangement for the Republic of Armenia
November 18, 2008

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Republic of Armenia: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

September 16, 2008

REPUBLIC OF ARMENIA: LETTER OF INTENT

September 16, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

In support of its economic reform program, the Government of the Republic of Armenia requests a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent to SDR 9.2 million (10 percent of quota). The low access for this arrangement intends to signal Armenia's status as a mature stabilizer.

Under the three-year PRGF program that expired on May 24, 2008, we have achieved important results. The implementation of prudent monetary and fiscal policies and far-reaching structural reforms have supported strong economic growth, low inflation, rising real incomes, and declining poverty rates. The challenge before us is how to consolidate these gains. While stability is necessary for growth, it is only by boosting the productive potential of the economy that we can make growth sustainable. The new program addresses the unfinished structural reform agenda to fully equip policy frameworks and institutions for the next challenges facing the Armenian economy.

The attached Memorandum of Economic and Financial Policies (MEFP) outlines our broad macroeconomic objectives for 2008-11 and provides specific measures for 2008-09. The focus will be on strengthening the fiscal and monetary policy frameworks, deepening productivity-enhancing structural reforms, reducing barriers to competition, and improving governance. Fiscal reforms aimed at strengthening tax and customs administration are particularly important for the success of these efforts.

The Government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, but it will take other measures that may become necessary for this purpose. The Government will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. Moreover, after the period of the

PRGF arrangement, and while Armenia has outstanding financial obligations to the Fund from loans on earlier arrangements, the Government will consult with the Fund on Armenia's economic and financial policies from time to time, at the initiative of the Government or at the request of the Managing Director. We expect to complete the first semi-annual review under the proposed arrangement by June 2009.

Very truly yours,

/s/
Tigran Sargsyan
Prime Minister
Republic of Armenia

/s/
Tigran Davtyan
Minister of Finance
Republic of Armenia

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

REPUBLIC OF ARMENIA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES (SEPTEMBER 16, 2008)

1. This Memorandum sets out the economic and financial policies of the Armenian government for 2009–11, which are aimed at sustaining economic growth and reducing poverty. These policies form the basis for a new three-year Fund-supported program under a low-access PRGF arrangement, signaling Armenia's status as a mature stabilizer.

2. The new program will build on the substantial progress already achieved under the PRGF-supported arrangement that expired on May 24, 2008. The focus will be on strengthening the fiscal and monetary policy frameworks, deepening productivity-enhancing structural reforms, reducing barriers to competition, and improving governance. Fiscal reforms aimed at strengthening tax and customs administration are critical for the success of these efforts.

3. This Memorandum presents a summary of the performance under the government's 2005–08 program, outlines the medium-term objectives and policy framework for 2009–11, and sets out specific economic and financial policies for 2008-09. We have reached understandings with Fund staff on a set of macroeconomic targets and structural benchmarks for 2008-09, which are presented in Tables 1 and 2. Policies described in the Memorandum are consistent with our updated Poverty Reduction Strategy Paper (PRSP), renamed Sustainable Development Program (SDP), and the government's Medium-Term Expenditure Framework for 2009–11. We expect to complete the first semi-annual review under the proposed arrangement by end-June 2009; the second review by end-November 2009, and the third review by end-June 2010.

I. PERFORMANCE UNDER THE 2005–08 PROGRAM

4. The 2005–08 program focused primarily on three objectives: a) maintaining macroeconomic stability through prudent monetary and fiscal policies; b) generating additional domestic resources to finance poverty-reducing and growth-enhancing expenditures; and c) boosting private sector activities by fostering financial sector development, and improving public and corporate governance. To a large measure, these objectives have been achieved.

5. Prudent monetary and fiscal policies and far-reaching structural reforms supported strong economic growth, low inflation, rising real incomes, and declining poverty rates. Over the period 2005–07, GDP growth averaged 13.7 percent per year, and inflation remained below 3 percent on average. At the same time, the overall poverty rate declined from 34.6 percent in 2004 to 26.5 percent in 2006. Despite a rising external current account deficit, which reflected double-digit growth and strong investment activity, gross international reserves increased from 3.1 to 4.3 months of import coverage between 2004 and 2007. Large capital inflows, mostly in the form of FDI, provided the necessary financing, reflecting

improved investment opportunities in the Armenian economy. The increase in external borrowing led to a slight deterioration in external debt indicators, which, however, remain comfortably low.

6. Fiscal prudence was crucial for the success of our program. The overall fiscal deficit was kept at about 2 percent of GDP. The progress achieved with revenue mobilization was used to finance poverty-reducing and growth-enhancing expenditures. The tax revenue ratio was raised from 14 percent of GDP in 2004 to 16 percent of GDP in 2007, and grants and non-tax revenues increased as well. This allowed us to increase expenditure from 17.1 percent of GDP to 22.4 percent of GDP (including the gas subsidy)[1] over the same period, while government debt was reduced from 32.4 percent of GDP to 17.4 percent of GDP.

7. The monetary framework was strengthened with the adoption of an implicit inflation targeting regime in 2006. Moreover, by committing to a preannounced three-year target in 2008, the Central Bank of Armenia (CBA) took an important step toward full-fledged inflation-targeting. Together with a flexible exchange rate, the new framework contributed to our success in maintaining moderate inflation, providing an anchor to inflation expectations in the face of significant external shocks. Monetary policy implementation was greatly enhanced by a more extensive use of indirect instruments, particularly open market operations, which helped improve liquidity management and fostered the development of the money market.

8. Our tax policy during the program period was focused on reducing the scope of tax exemptions. We limited access to the simplified tax regime, with the final objective of eliminating it, and reduced the number of goods exempt from VAT at the border. Presumptive taxes were indexed to the CPI. Additionally, we completed and submitted to Parliament the general part of the tax code. Tax administration reform concentrated on strengthening IT capacity, limiting the interaction between taxpayers and tax officials by eliminating recording commissions, and introducing risk-based audit selection systems. Moreover, we have recently adopted a comprehensive and ambitious medium-term tax reform plan.

9. Structural reforms have improved the financial sector infrastructure and the regulatory and supervisory framework, promoting private sector activity and financial deepening. As a result, financial intermediation almost doubled in relation to GDP since end-2006.

- Key weaknesses in banks' corporate governance were addressed early on in the program, improving accountability and confidence in the banking system. Market transparency, creditor rights, and consumer protection were enhanced through new

[1] The budget figures do not include the gas subsidy.

legislation and the establishment of a credit registry at the CBA as well as a private credit bureau. Financial institutions were strengthened through increased minimum capital requirements, the implementation of the first pillar of Basel II Accord provisions, investments in banks' risk management capacity, and the entry of reputable international commercial banks. Most recently, we adopted legislation on asset securitization and mortgage-backed securities to promote the development of the mortgage market, on Anti-Money Laundering and Combating the Financing of Terrorism, on the disclosure of financial terms of consumer loans and bank deposits, and on the establishment of financial ombudsperson services.

- Financial sector regulation and supervision was strengthened markedly through consolidation and introduction of risk-based supervision, and the recent move to a functional or process-oriented structure, separating the main functions of (i) prudential requirements, (ii) market conduct, and (iii) consumer protection.

- With a view to containing activities in the informal economy and strengthening monetary policy effectiveness, we introduced several measures limiting cash operations and the use of foreign currency. These include improved regulation and supervision of foreign exchange offices, introduction of mandatory point of sales outlets at larger retail establishments, acceptance of credit cards transaction receipts for tax verification purposes, and legislation on cash transaction limits and the electronic payment of salaries.

- In the insurance sector, we adopted legislation fully compliant with the standards of the International Association of Insurance Supervisors. We also implemented by-laws and regulations to improve accounting, auditing, and financial reporting; solvency and reserves; reinsurance; oversight of insurance companies; and procedures for the liquidation of insurance companies. An insurance registry at the CBA was established and is now operational.

- Progress has been achieved in money and capital market development with the adoption of a new securities market law corresponding to the standards of the International Organization of Securities Commissions, the conversion of the Armenian stock exchange (Armex) from a self-regulatory body into a joint stock company, and the takeover of Armex and the central depository by Nasdaq-OMX.

10. The second phase of public sector reform was completed in August 2007. To improve the efficiency and the accountability of the public sector, we introduced new management structures; improved procedures of human resource management and development in civil service; regulated and decentralized service delivery; encouraged public participation in decision-making; and improved communication with the public. Moreover, we have finalized a strategy for the third phase of reforms, which will focus on streamlining the civil service. We have made progress on the development of a new anti-corruption strategy that identifies

specific objectives and performance indicators, with an action plan expected to be finalized in November 2008.

11. Following the reforms initiated in 2000, our efforts to restructure the energy sector have continued. Efficiency gains, lower distribution losses, and improved collection have led to further financial consolidation of privatized companies, contributing to contain tariff adjustments and reducing the need for government support. At the same time, the reliability of electricity, gas, water, and irrigation flows has improved. Plans for the replacement of the nuclear power plant, to be decommissioned in 2016, are under way.

II. PROGRAM OBJECTIVES AND STRATEGY FOR 2009–11

12. The new program builds on our past achievements and our strategy to implement the SDP. Armenia has achieved remarkable results in terms of growth and poverty reduction by opening up its economy, removing barriers to competition, and following sound macroeconomic policies. The challenge before us is how to consolidate these gains. While stability is necessary for growth, it is only by boosting the productive potential of the economy that we can make growth sustainable. The new program addresses the unfinished structural reform agenda to fully equip policy frameworks and institutions for the next challenges facing the Armenian economy.

13. With the past program, we have achieved important results in many areas, but we are aware that additional efforts are needed in several other areas. As we prepare for the transition to full-fledged inflation targeting, the fiscal framework needs to be refined to be more attuned to the needs of stabilization policy and to facilitate the formulation of appropriate policy responses to key fiscal risks. Reforms aimed at enhancing productivity and improving the business climate are necessary to boost the competitiveness of Armenian companies and encourage the emersion of the underground economic activities. In this context, reforms in tax policy and administration are particularly important. Despite our past efforts, the tax revenue-to-GDP ratio in Armenia still remains low, limiting the use of resources for productivity-enhancing and poverty-reducing expenditures. We will continue our efforts to deepen financial intermediation, which remains low by international standards.

14. Continuation of sound macroeconomic policies and effective implementation of structural reforms would support real growth rates of at least 8 percent on average over the next three years. The underlying fiscal balance, which better measures the fiscal impact on domestic demand by excluding grants and external interest payments, is projected to be below 2 percent of GDP during 2010-11, after an initial improvement in 2009. Hence, fiscal policy will contribute to achieve sustainable growth while maintaining macroeconomic stability. Tax collection improvements will be underpinned by tax reforms, and will allow additional spending for infrastructure, pension reform, and poverty reduction. These policies are expected to achieve a further reduction in the poverty rate, a key objective of the SDP. The external current account deficit will decline only gradually to about 8 percent of GDP in

2011, reflecting strong demand for imported capital and intermediate goods needed to support growth. External debt ratios are projected to decline to about 9 percent of GDP.

15. Macroeconomic stability will remain the main objective of fiscal policy, as it is key to sustain and broaden economic growth, and further reduce poverty. In light of rising inflation, the fiscal stance will be tightened to mitigate demand pressures. Furthermore, the Ministry of Finance (MoF) will strengthen the fiscal framework to enhance fiscal policy credibility by analyzing and disclosing fiscal risks and associated policy responses, and by improving economic modeling and projection capacity. We will also enhance our capacity to assess and implement investment projects; this will allow us to carry out high-return projects with partly non-concessional financing.

16. Price stability will remain the main focus of monetary policy. During the program period, the CBA will complete the transition to full-fledged inflation targeting (IT) in the context of a flexible exchange rate regime by strengthening the policy transmission mechanism. Monetary policy implementation will benefit from the expansion of open market operations in the context of closer coordination with MoF on debt and liquidity management. Structural measures aimed at developing the interbank and foreign exchange markets will help improve the effectiveness of monetary policy instruments.

17. Strengthening tax policy and administration is a top priority over the next three years. Removing remaining weaknesses in this area is crucial to improve the business environment and boost competitiveness. The tax policy framework will be streamlined and simplified to make it easy to comply with and administer. The establishment of a VAT threshold with a simple regime for small businesses below the threshold is a step in this direction. Tax administration reform aims at increasing voluntary compliance and establishing a self-assessment system in which the direct interaction between taxpayers and tax officials is eliminated to reduce corruption risks. Similarly, customs reforms will focus on establishing risk-based processes to minimize the interaction between customs officials and importers.

18. Financial sector reforms in the period ahead will focus on further deepening financial intermediation and broadening the range of financial services available in Armenia, while at the same time safeguarding financial sector stability. We will also adopt an extensive package of capital market development measures in collaboration with Nasdaq-OMX.

III. The New Program for 2008-09

A. Fiscal Policy

19. The fiscal deficit for 2008, defined according to GFSM 2001, is expected to be limited to 1.4 percent of GDP, significantly lower than the 2.6 percent of GDP targeted in the

budget (including the gas subsidy)[2], thanks to tax revenue overperformance and slow expenditure execution. Tax revenues have performed well on account of rapid import growth, better enforcement at customs, and strong VAT performance. However, the attempt to achieve ambitious targets led to a significant increase in tax credits. Tax revenues are expected to reach AMD 603 billion of GDP in 2008. Grants, on the other hand, were lower than expected, in part due to the delay in the disbursement of $50 million from the Millennium Challenge Account.

20. For 2009, a budget deficit of 1 percent of GDP strikes the right balance between the need to contain demand pressures and that to provide resources for high-priority and poverty-reducing projects. Tax revenues would reach AMD 700 billion, reflecting the positive impact of tax reforms, and the tax revenue ratio would rise from 16.4 percent of GDP projected for 2008 to 16.8 percent of GDP in 2009. Grants and non-tax revenues are projected to increase by 0.4 percent of GDP. Expenditure is expected to reach AMD 919 billion, or 22.1 percent of GDP, up from 21.6 percent of GDP in 2008, as a result of increased spending on pensions and infrastructure. The underlying balance would improve to -1.7 percent of GDP in 2009 from -1.9 percent of GDP in 2008. A potential risk to achieving the deficit target is represented by the large amount of outstanding tax credits (AMD 121 billion as of August 1, 2008) associated with weak tax-audit capacity. We are committed to analyzing and fixing the systemic problems underlying these tax credits to ensure that any risks to the target are mitigated.

B. Monetary and Exchange Rate Policies

21. Monetary conditions will continue to be tightened to achieve the CBA inflation target. Inflationary pressures from high food and energy import prices in a context of strong domestic demand have caused inflation to exceed the inflation target range of 4 ± 1.5 percent. We will continue with our strategy of gradually increasing the repo rate, and we stand ready to increase it at a faster pace if inflationary pressures persist. Money supply growth will be contained for the remainder of the year, supported by lower foreign exchange market intervention, a lower-than-projected budget deficit, and increased net issuance of treasury bills. The government intends to increase the stock of treasury bills by AMD 25 billion, in close coordination with the CBA. The monetary program seeks to limit reserve money growth to around 18.5 percent and envisages a broadly stable level of foreign reserves relative to 2007. Barring further external shocks, we are confident that these measures will help bring inflation back to the target range in 2009.

22. The transition to full-fledged IT will be completed during the program period. The institutional prerequisites are largely in place. A 2007 review of our strategy and organizational framework, conducted with the support of IMF technical assistance,

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[2] See footnote 1.

concluded that most of the key elements for successful IT are present in Armenia, including the independence of the CBA, appropriate internal organization and sufficient capacity of the CBA, a quarterly inflation projection model as one of the inputs in the monetary policy decision-making process, and a well-developed communication strategy. Since 2006, the CBA has issued quarterly inflation reports and published the minutes of its monthly board meetings on monetary policy. We have also moved from an end-year to a continuous inflation target.

23. We are committed to maintaining a flexible exchange rate regime. While increased intervention has been necessary in the face of large-scale and volatile capital inflows and heightened uncertainty in the course of 2008, foreign exchange interventions will be used only as an instrument to smooth out exchange rate volatility without targeting the level of the exchange rate.

24. The CBA will sign a memorandum of understanding with the MoF regulating the issuance of government securities (performance criterion). As soon as an agreement is reached, the CBA will discontinue issuing its own securities and will instead focus on conducting repo operations. The treasury will recommence issuing short-term T- bills. Debt issuance will be closely coordinated between the MoF and CBA to take account of both budget financing and liquidity management needs, and the MoF will commit to avoid using cut-off yields at its auctions, except to reject clearly speculative bids that lie outside the normal range of bidding. Over the medium term, the CBA intends to increase its holdings of treasury securities in order to strengthen its capacity to conduct reverse repo operations.

25. At the same time, we recognize that the monetary transmission mechanism is still weak. We will therefore continue following an IT "lite" regime in the period ahead, while paying close attention to monetary aggregates. We aim at strengthening the monetary transmission mechanism by further improving our operational framework and fostering financial deepening and interbank money market development. To improve the functioning of the interbank market, the CBA is considering the introduction of an electronic trading platform. To improve bank liquidity management, we also consider introducing an overnight credit facility, and lengthening the reference period for reserve requirements from two weeks to four weeks against the background of high monthly volatility of government spending.

C. Structural Reforms

Fiscal reforms

26. We are improving our fiscal framework. The State Law on Debt Management, which introduces a ceiling on the amount of total debt (equal to 60 percent of GDP) and limits on the size of deficits if debt is above 50 percent of GDP, has been approved. Starting in 2009, we intend to improve the Medium Term Economic Framework by including a section on debt management that will help align policy decisions over the medium term (next three years)

with their long-term fiscal implications. We plan to complete the specific part of the tax code by June 2009.

27. We plan to introduce several changes in tax policy. On VAT, a new streamlined system for small traders and a registration threshold of AMD 58.35 million will become effective on January 2009. We are also considering the introduction of an annual business license for microbusinesses. We have amended the general presumptive tax regime by moving trade fairs to the general VAT and income tax regimes. We plan to abolish all presumptive tax regimes, and bring all sectors currently subject to presumptive taxation within the regular tax regimes (excise tax, customs duties, profit tax, and VAT) during the program period. In order for us to prepare the necessary changes, we will strengthen our administrative capacity, especially in the areas of auditing, professional recruitment and training, and risk analysis. A timetable for the implementation of these changes will be set during the first program review. We intend to reform the system of VAT refunds following best international practices. We will clear the backlog of refund claims, introduce risk-management approaches and a refund forecasting system, and amend the law to strengthen penalties for false claims and pay interest on late refunds arising from claims filed after December 31, 2009 (performance criterion). Importantly, we will process all VAT refund claims filed after December 31, 2008 within the 90-day statutory period.

28. We are reorganizing the tax administration:

- We are adopting a function-based organizational structure and will merge the four specialist inspectorates by January 1, 2009. Moreover, we plan to close a number of regional inspectorates that are not cost effective by end-2008 and further consolidate regional inspectorates by June 2009 (structural benchmark).

- We are merging the State Customs Service with the State Tax Service to achieve efficiency gains. These gains will mainly concern administrative support functions and information systems, while the core functions of customs and tax administration will not be integrated owing to their different nature. The merger, which has created a new organization named State Revenue Committee (SRC), is expected to be completed by January 2009.

29. We plan to introduce a funded pension pillar on January 1, 2010. We have completed a White paper including estimates of the costs of this reform and started developing an action plan for implementation. Drafting of the legislation introducing a unified tax has started already, and submission to parliament is expected by mid-2009. The SRC, which will assume the task of collecting contributions, has already started preparations. In the context of the Medium Term Economic Framework, we intend to produce an analytical report on medium-term fiscal risks, including those associated with the introduction of the funded pillar, which would also include the cost of the increase in basic pensions over the next few years (structural benchmark).

Financial sector

30. We will continue moving forward with banking sector reforms:

- To complement the recently-adopted legislation on consumer protection, we are preparing an extensive campaign to educate consumers about financial terms, products, and services.

- To increase the availability of credit and foster financial intermediation, we plan to introduce a consistent credit scoring system; enhance credit analysis; and further improve consumer rights protection, as stipulated in the recently approved law "On Circulation of Loan Information and On Activities of Credit Bureaus."

- To foster the development of commercial banks' risk management capacity, the CBA will develop guidelines and a new system of risk assessment for banks, taking best international practices as a basis. Moreover, the CBA is considering the introduction of an assessment of banks' risk management systems as part of its regular supervisory activity.

31. To further develop the securities market:

- We plan to implement a comprehensive program of securities market development, as laid out in our capital market development action plan. We have designed a new public debt management strategy that foresees an increase of domestic debt issuance over the medium term, bringing the stock of domestic debt to 7 percent of GDP by 2020. Benchmark bonds in 4 maturities will be issued for that purpose. To increase the stock of government securities available for open market operations, we will amend Article 11 of the "Law on the Central Bank of the Republic of Armenia" by mid-2009 (structural benchmark, June 2009) to allow a gradual recapitalization of the CBA with marketable securities.

- Having established a rating system for enterprises, the CBA will continue to produce ratings for companies that are potential candidates for initial public offerings at Nasdaq-OMX. The rating system developed at the CBA will be handed over eventually to the private sector.

32. Regarding insurance sector reforms:

- We plan to finalize the classification of insurance companies' assets.

- We will introduce a new minimum capital requirement of AMD 500 million for newly established insurance companies in January 2009. Over time, we plan to increase this requirement to AMD 1 billion for non-life insurance companies and AMD 1.5 billion for life insurance companies.

- We will introduce legislation on the introduction of mandatory third-party liability auto insurance by January 2010. This will provide a major push for insurance market development in Armenia and is expected to attract new reputable market entrants.

Other structural reforms

33. We intend to continue our efforts to improve governance and reduce corruption. We plan to finalize the new anti-corruption strategy action plan by November 2008, and we are strongly committed to continue its implementation over the program period. We intend to implement the third phase of public sector reform, which is expected to improve performance and ethical standards in the civil service.

34. We have approved a five year strategy to develop Armenia into a center for excellence of doing business and investments. The 2008 action plan approved by the Government and the decision of the Prime Minister to address impediments to the SME sector are major first steps in this direction. The reforms will accelerate in 2009, targeting improvements of the Doing Business indicators significantly.

IV. Program Monitoring

35. Progress in implementing the program will be monitored through quantitative performance criteria and indicative targets set forth in Table 1 as well as structural performance criteria and benchmarks as listed in Table 2. The Technical Memorandum of Understanding (TMU) attached to this Memorandum defines the quantitative targets of Table 1, and specifies reporting requirements. Semiannual performance criteria will be monitored under two reviews. The quantitative targets include targets for the underlying fiscal balance (excluding grants and external interest payments, and including any new subsidies) and limits on contracting/guaranteeing external debt (see Table 1). Monetary aggregates will continue to be used as indicative targets during the transition to full-fledged IT. Once the transition has taken place, a defined set of monetary indicators will be used to assess compliance with the inflation target.

Table 1. Armenia: Quantitative Targets, 2008–09 1/
(End of period ceilings on stocks, unless otherwise specified)

	2007	2008		2009			
	Dec.	Jun.	Dec.	Mar.	Jun.	Sep.	Dec.
	Act.	Act.	Prog. 2/	Prog. 5/	Prog. 2/	Prog. 5/	Prog. 2/
	(In billions of drams)						
Net domestic assets of the CBA 3/	-95.5	-8.0	19.9	10.4	31.7	52.8	73.0
Net banking system credit to the general government	-54.0	-78.2	-50.8	-48.5	-29.9	-16.0	-36.8
Underlying fiscal balance on a cash basis (floor) 4/	-93.6	-11.0	-68.6	-5.2	-36.4	-54.4	-72.0
Reserve money 5/	427.1	412.7	506.4	471.3	502.6	540.0	595.8
	(In millions of dollars)						
Contracting or guaranteeing of new nonconcessional external debt 4/ 6/	0	0	0	50	50	50	50
External arrears (continuous criterion)	0	0	0	0	0	0	0
Net official international reserves (floor)	1403.7	1330.8	1517.9	1440.3	1469.5	1516.8	1610.0

1/ All items as defined in EBS/05/153 and its subsequent amendments, with the exception of the underlying balance, wich is defined as the overall balance excluding grants and external interest payments.
2/ Performance criterion.
3/ At program exchange rates (357 dram per dollar in 2007 and 304.2 dram per dollar in 2008 and 2009).
4/ Cumulative flow from the beginning of the calendar year until the end of the month indicated.
5/ Indicative target.
6/ Includes debt with maturity of more than a year as well as obligations with maturity of one year or less, excluding normal import-related credit and sales of treasury bills to nonresidents.

Table 2. Proposed Structural Conditionality for 2009

Item	Measure	Proposed Time Frame (End of Period)	Type of Conditionality
1	Strengthen domestic debt market by signing an agreement between the Ministry of Finance (MoF) and Central Bank (CBA) on the coordination of government securities auctions, including (i) the discontinuation of CBA security issuance; (ii) a commitment to avoid using cut-off yields at its auctions, except to reject clearly speculative bids that lie outside the normal range of bidding.	December 2008	Performance Criterion
2	Restructure the tax administration organization by (i) implementing a modern function-based structure; (ii) merging the four specialist inspectorates into a single large taxpayer inspectorate (LTI); and (iii) closing at least 10 tax inspectorates that are not cost-effective.	December 2008	Structural Benchmark
3	Further reduce the number of tax inspectorates by at least 20.	June 2009	Structural Benchmark
4	Improve the recapitalization mechanism for the central bank by amending Article 11 of the “Law on the Central Bank of the Republic of Armenia” to allow a gradual recapitalization of the CBA with marketable securities.	June 2009	Structural Benchmark
5	Introduce best practices in VAT refund processing to exporters by (i) clearing the stock of late refund claims, while meeting the statutory 90-day processing deadline for all claims filed in 2009; (ii) implementing risk-management approaches (i.e. taxpayers with good compliance histories to get fast-track refunds, while risky cases face pre-refund audits); (iii) implementing a forecasting system to anticipate refund levels so that funds are available to pay legitimate refund claims as they occur; and (iv) submitting legislation to parliament to strengthen penalties for false refund claims and pay interest on legitimate refunds not paid on time (interest will apply only to new claims filed after December 31, 2009). Interest will be paid out of VAT revenues.	December 2009	Performance Criterion
6	Strengthen the fiscal framework by producing a yearly analytical report identifying fiscal challenges and risks over the short- and medium-term, and potential fiscal policy responses to them.	December 2009	Structural Benchmark

REPUBLIC OF ARMENIA: TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum defines the benchmarks, performance criteria, indicative targets, adjustors, and reporting modalities referred to in the Memorandum of Economic and Financial Policies (MEFP).

I. QUANTITATIVE TARGETS

1. The program targets a minimum level of **net official international reserves (NIR)** of the Central Bank of Armenia (CBA). The stock of such reserves will be calculated as the difference between total official gross international reserves (excluding reserve money denominated in foreign currencies) and official gross reserve liabilities. Total gross official international reserves are defined as the CBA's holdings of monetary gold (excluding amounts pledged as collateral or in swaps), holdings of Special Drawing Rights (SDRs), any reserve position in 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. Gross reserves are reported separate from the balance on the government's Special Privatization Account (SPA) and the Millennium Challenge Account (MCA) and exclude capital subscriptions in foreign financial institutions and illiquid foreign assets. Official reserve liabilities shall be defined as outstanding liabilities to the IMF, and convertible currency liabilities of the CBA to nonresidents with an original maturity of up to and including one year. NIR is monitored in U.S. dollars, and, for program monitoring purposes, assets and liabilities in currencies other than the U.S. dollar shall be converted into dollar-equivalent values using the exchange rates as specified in Table 1.

2. The program targets a maximum level of **net domestic assets (NDA)** of the CBA. For program purposes, NDA is defined as reserve money minus NIR, minus reserve money denominated in foreign currencies, and plus medium- and long-term liabilities (i.e. liabilities with a maturity of one year or more) of the CBA. To evaluate program targets, the dram-equivalent values of NIR, medium- and long-term liabilities, and reserve money in U.S. dollar are calculated at the program exchange rate of dram 304.22 per U.S. dollar. The dram-equivalent value of reserve money in Euro is calculated at the program exchange rate specified in Table 1. NDA is composed of net CBA credit to the general government; outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money (exclusive of accrued interest), and other items net.

3. The program's ceiling on **reserve money** is an indicative target. Reserve money is defined as the sum of currency issued, required and excess reserves, and current and time deposit accounts of certain resident agents.[1]

4. **The stock of net credit from the CBA to the government** includes the CBA's holdings of treasury bills and treasury bonds less all types of government deposits with the CBA (including the deposits in the Treasury Single Account, deposits of donor-financed project implementation units, the Lincy foundation, and balances of proceeds from the sale of humanitarian assistance). Treasury bonds are valued at the purchase price and excluding accrued interest and treasury bills are valued at the purchase price plus the implicit accrued interest.

5. **Net credit from commercial banks to the government** includes: (1) gross commercial bank credit to the central government less government deposits with commercial banks (including the counterpart funds of certain government on lending to the economy financed by the Lincy Foundation and the World Bank); and (2) bank holdings of treasury bonds (valued at the purchase price and excluding accrued interest) and treasury bills (valued at the purchase price plus the implicit accrued interest). **Net credit of the banking system to the government** is the sum of net credit from the CBA and net credit from commercial banks to the central government.

6. **External debt ceilings** apply to all forms of new nonconcessional medium- and long-term external debt[2] with original maturities of more than one year, which are contracted or guaranteed by the government or the CBA or any other agency acting on behalf of the government. It does include debt with maturity of one year or less. Excluded from the limits are changes in indebtedness resulting from refinancing credits or rescheduling operations, sales of treasury bills or treasury bonds to nonresidents (provided the sales go through the regular auction mechanism and involve no exchange rate guarantees), concessional loans, and credits extended by the IMF.[3] Except for normal import-related credits, there is a zero limit on short-term external debt (obligations with original maturities of up to one year) contracted or guaranteed by the government or the CBA or any other agency acting on behalf of the government. Transactions subject to debt ceilings shall be valued in the contracted

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[1] Liquidity absorbing transactions under reverse repurchase agreements, the CBA's deposit facility, foreign currency swaps, and securities issued by the CBA are netted out from claims on banks, i.e., they are excluded from the reserve money definition.

[2] The term "debt" shall have the meaning set forth in Section 9(a) of the Guidelines on performance criteria on external debt, as modified by the Executive Board Decision No. 12274-(00/85) of August 24, 2000.

[3] For program purposes, a loan is considered concessional if the grant element is at least 35 percent calculated using a discount factor based on the Commercial Interest Reference Rates (CIRRs) published by the OECD plus margins depending on the loan maturity. The margins are: 0.75 percent for repayment periods of less than 15 years, 1 percent for 15–19 years, 1.15 percent for 20–29 years, and 1.25 percent for 30 years or more. The average of the CIRRs over the last ten years will be used for loans with a maturity of at least 15 years and the average of the CIRRs for the preceding six months will be used for shorter maturities.

currencies and converted into U.S. dollars at the average monthly market exchange rate in the month when the commitment was contracted.

7. **External arrears** will consist of all overdue debt-service obligations (i.e., payments of principal and interest) arising in respect of public sector loans contracted or guaranteed including unpaid penalties or interest charges associated with these arrears.[4]

8. **The underlying balance of the central government on a cash basis** is defined as the negative of the sum of domestic banking system net financing, domestic nonbank net financing, external net financing to the government; plus external interest payments, less grants to the central government. Should a general subsidy be introduced off-budget, the underlying balance will be measured including the subsidy as part of government spending. **Net banking system credit to the government** equals the change during the period of net credit to the government. **Nonbank net 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);[5] (2) any other disbursement or transaction that increases nonbanks' claims on the central government plus withdrawals from the special privatization account or the treasury sub-account containing privatization proceeds in dram, less amortizations made by the central government to private resident nonbank agents; and less domestic net lending following the GFSM2001. **External net financing** equals total debt-increasing disbursements from non-residents to the central government less total amortizations from the central government to non-residents, and less external net lending following the GFSM2001. Grants equal total non-debt increasing disbursements from non-residents to the central government. External interest payments equal interest paid from the central government to non-residents. All foreign-currency denominated transactions are recorded in drams using the prevailing exchange rate at the time of the transaction.

9. The project implementation units, which carry out projects financed by the US-based Lincy Foundation, maintain accounts at the CBA. These grants are recorded in the fiscal accounts as external grants on the revenue side and as foreign-financed capital expenditure on the expenditure side. In addition, any loans extended by the US-based Lincy foundation to finance investments and 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.

10. Foreign currency proceeds from selling enterprises are deposited into the Special Privatization Account (SPA). The account 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

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[4] The public sector is 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.

[5] 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 SFSI.

entry in other items net. Any budgeted withdrawal from the SPA will be accounted for as privatization proceeds used to finance the budget and will be recorded below the line. Any unanticipated withdrawal from the SPA will be recorded below the line as privatization receipts; these withdrawals, however, will be replenished during the same fiscal year. Domestic currency proceeds from selling enterprises to residents are deposited in a sub-account of the treasury single account.

11. The program targets ceilings for the stock of **domestic arrears of the central government**. Domestic arrears are defined as follows. With respect to wages, social contributions (including for pensions), family allowances, and amortization and domestic interest payments, the stock of arrears is defined as all unpaid claims outstanding at the end of the month. This excludes technical arrears of up to AMD 0.5 billion that could arise because of minor delays in the execution of these expenditures. For all other expenditure categories, arrears are defined as the stock of unpaid claims, as verified by the recipient of the goods and services, which has been outstanding for more than 30 days as of the end of the month. However, at year-end all outstanding claims must be settled as required in the budget law.

II. Adjusters

12. The quantitative performance criteria and benchmarks under the program are subject to the following adjusters:

- **World Bank budget support:** the following targets will be adjusted by the full amount of lower than programmed World Bank direct budget support: NIR (downward), NDA of the CBA (upward), and net credit to the government (upward). The programmed amount is shown in Table 2 below.

- **KfW loan disbursements**: the target on the NDA of the CBA will be adjusted upward by the full amount of any non-programmed disbursement from KfW. The adjustment will be made at program exchange rates. The programmed amount is shown in Table 3 below.

- **Recapitalization of the CBA**: the target on the net credit of the banking system to the government will be adjusted upward by the full amount of the recapitalization of the CBA.

III. Structural Performance Criteria and Benchmarks

13. Strengthen domestic debt market by signing an agreement between the Ministry of Finance (MoF) and Central Bank (CBA) on the coordination of government securities auctions, including (i) the discontinuation of CBA security issuance; (ii) a commitment to avoid using cut-off yields at its auctions, except to reject clearly speculative bids that lie outside the normal range of bidding (performance criterion, December 2008). The agreement will specify the criterion to identify outlier bids (based on a deviation from the average yield either in terms of a multiple of standard deviations or in absolute basis points). See paragraph 24 of the MEFP.

14. Restructure the tax administration organization by (i) implementing a modern function-based structure; (ii) merging the four specialist inspectorates into a single large taxpayer inspectorate (LTI); and (iii) closing at least 10 tax inspectorates that are not cost-effective by end-2008 (structural benchmark, December 2008). Further reduce the number of tax inspectorates by at least 20 by June 2009 (structural benchmark, June 2009). See paragraph 28 of the MEFP.

15. Improve the recapitalization mechanism for the central bank by amending Article 11 of the "Law on the Central Bank of the Republic of Armenia" by mid-2009 (structural benchmark, June 2009) to allow a gradual recapitalization of the CBA with marketable securities. See paragraph 31 of the MEFP.

16. Introduce best practices in VAT refund processing to exporters by (i) clearing the stock of late refund claims, while meeting the statutory 90-day processing deadline for all claims filed in 2009; (ii) implementing risk-management approaches;[6] (iii) implementing a forecasting system to anticipate refund levels so that funds are available to pay legitimate refund claims as they occur; and (iv) submitting legislation to parliament to strengthen penalties for false refund claims and pay interest on legitimate refunds not paid on time (interest will apply only to new claims filed after December 31, 2009) (performance criterion, December 2009). See paragraph 27 of the MEFP.

17. Strengthen the fiscal framework by producing a yearly analytical report identifying fiscal challenges and risks over the short- and medium-term, and potential fiscal policy responses to them (structural benchmark, December 2009). See paragraph 29 of the MEFP.

[6] The implementation by the tax administration of a risk-management approach to administering VAT refunds will be evidenced by: (i) a documented risk-based audit strategy, plan, and methodology; (ii) regular risk assessments and maintenance of risk profiles for all exporters making VAT refund claims, using information in tax and customs databases and from third parties; (iii) payment of refunds within 14 days to exporters assessed as low-risk (i.e. those with sound compliance histories in relation to VAT and other taxes), supported by selective post-refund audits; and (iv) pre-refund audits within the statutory 90-day processing period to verify claims of exporters categorized as high-risk (i.e. those with a poor compliance history).

IV. Data Reporting

18. The government will provide the IMF the information specified in the following table.

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA[7]	CBA balance sheet	Summary	Weekly	Each Friday
	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 and the consolidated balance sheet of commercial banks at program exchange rates; and 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	Weekly	Each Friday
		By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Monthly	Within 21 days of the end of each month
	Foreign exchange market	Official exchange rates (buying and selling) and volume of CBA interventions, including foreign exchange swaps; daily trade volume, number of trades, and weighted average exchange rate of Armex	Weekly	Each Friday
	Interest rates	Repo rate; interbank rate; by volume and maturity, T-bill rate, bond yield; and by maturity, deposit and lending rates; monthly weighted average interest rate on government bonds	Monthly	Within 7 days of the end of each month
	Interbank money market	Daily interbank repo volume and interest rate	Weekly	Each Friday
	CBA operations	Repo (reverse repo) operations; Lombard credits; and deposit facility	Monthly	Within 7 days of the end of each month
	Bank liquidity	Reserves and excess reserves	Biweekly	Within 10 days of the end of each biweekly period
	Banking data	Sectoral distribution of loans and deposits, dollarization of loans and deposits, loan maturities	Monthly	Within 25 days of the end of each month

[7] As defined in CBA resolution No. 201 (December 6, 1999).

	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Quarterly	Within 30 days of the end of each quarter
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
Ministry of Finance (MOF)	T-bill and coupon bond financing	By holders, i.e., CBA, resident banks, resident nonbanks, and nonresidents	Monthly	Within 7 days of each month
	T-bill and coupon bond financing	Auction data: date, original and remaining maturities, issuance volume, demand, allocation, minimum yield, cut-off yield, average yield	Weekly	Each Friday
	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 (preliminary data) and within 45 days of the end of each month (final data)
	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions	Monthly	Within 7 days of the end of each month
	Expenditure arrears	Government	Monthly	Within 45 days of the end of each month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month
	Treasury single account (TSA)	Detailed breakdown of central treasury account, including deposits at the central treasury, community budgets, off budget account, monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.	Monthly	Within 7 days of the end of each month
	Consolidated central government	State budget	Monthly	Within 30 days of the end of each month

	Consolidated general government	Central and local governments, and Non-Commercial Enterprises that belong within the general government (NCEs)	Quarterly	Within 60 days of the end of each quarter
	Consolidated general government	Central and local governments, and NCEs that belong within the general government	Annual	Within 180 days of the end of each year
	Budget execution	All cash receipts, cash expenditures, including domestic and external debt-service payments, external and domestic borrowing 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.
NSS	Balance of payments	Detailed export and import data	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
	GDP	Estimates	Monthly	Within 30 days of the end of each month
	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 month
		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	Monthly	Within 45 days of the end of each month
	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 30 days of the end of each month

	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty free recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving non-duty free recorded imports 5. Value of recorded imports where customs value was assessed using transaction prices, breaking out raw diamond imports; 6. Value of non-duty free recorded 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	Quarterly	Within 30 days of the end of each quarter

Table 1. Armenia: (Program) Exchange Rates of the CBA
(As of December 30, 2007 for dollars per currency rates.
Drams per currency rates are calculated using
the 304.22 drams per U.S. dollar rate)

Country	Drams Per Currency	Dollars Per Currency
Australian dollar	266.62	0.8764
Canadian dollar	310.90	1.0220
Swiss franc	268.22	0.8817
Danish krone	59.94	0.1970
Euro	446.96	1.4692
Pound sterling	608.27	1.9994
Japanese yen	2.71	0.0089
Norwegian krone	56.22	0.1848
Russian ruble	12.40	0.0408
Swedish krone	46.99	0.1545
U.S. dollar	304.22	1.0000
SDR	480.21	1.5785
Gold 1/		

1/ Per gram.

Table 2. Armenia: World Bank PRSC Lending 1/
(In billions of dram)

2009			
March	June	September	December
0.0	0.0	0.0	0.0

1/ Cumulative from December 2008, at program exchange rates.

Table 3. Armenia: KfW Loan Disbursements 1/
(In billions of dram)

2009			
March	June	September	December
0.03	0.06	0.09	0.13

1/ Cumulative from December 2008, at program exchange rates.

REPUBLIC OF ARMENIA: THREE-YEAR ARRANGEMENT UNDER THE POVERTY REDUCTION AND GROWTH FACILITY

Attached hereto is a letter from the Prime Minister, the Minister of Finance and the Chairman of the Central Bank of Armenia (the "CBA") dated September 16, 2008 (the "Letter"), with its attached Memorandum of Economic and Financial Policies (the "MEFP") and Technical Memorandum of Understanding (the "TMU"), requesting from the International Monetary Fund, as Trustee of the Poverty Reduction and Growth Facility and Exogenous Shocks Facility Trust (the "Trustee"), a three-year arrangement under the Poverty Reduction and Growth Facility, and setting forth:

(a) the objectives and policies of the program that the authorities of the Republic of Armenia intend to pursue during the three-year period of the arrangement;

(b) the objectives, policies and measures that the authorities of the Republic of Armenia intend to pursue during the first year of the arrangement; and

(c) understandings of the Republic of Armenia with the Trustee regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of the Republic of Armenia will pursue for the second and third years of the arrangement.

To support these objectives and policies, the Trustee grants the requested three-year arrangement in accordance with the following provisions, and subject to the provisions applying to assistance under the Poverty Reduction and Growth Facility and Exogenous Shocks Facility Trust.

1. (a) For a period of three years from the date on which the arrangement becomes effective, the Republic of Armenia will have the right to obtain loan disbursements from the Trustee in a total amount equivalent to SDR 9.2 million, subject to the availability of resources in the Poverty Reduction and Growth Facility and Exogenous Shocks Facility Trust.

(b) Disbursements under this arrangement shall not exceed the equivalent of SDR 3.93 million until the beginning of the second year of the arrangement and the equivalent of SDR 6.55 million until the beginning of the third year of the arrangement.

(c) During the period of the arrangement:

(i) the first disbursement, in an amount equivalent to SDR 1.31 million, will be available upon approval of the arrangement, at the request of the Republic of Armenia;

(ii) the second disbursement, in an amount equivalent to SDR 1.31 million, will be available on or after May 15, 2009, at the request of the Republic of Armenia and subject to paragraph 2 below;

(iii) the third disbursement, in an amount equivalent to SDR 1.31 million, will be available on or after November 15, 2009, at the request of the Republic of Armenia and subject to paragraph 2 below; and

(iv) the fourth disbursement, in an amount equivalent to SDR 1.31 million, will be available on or after May 15, 2010, at the request of the Republic of Armenia and subject to paragraph 2 below.

(d) The right of the Republic of Armenia to request disbursements during the remainder of the second year and the third year of this arrangement shall be subject to such phasing and conditions as shall be determined in the context of reviews under this arrangement.

2. the Republic of Armenia will not request

I. A. the second disbursement specified in paragraph 1(c)(ii) above:

(a) if the Managing Director of the Trustee finds that, with respect to the second disbursement specified in paragraph 1(c)(ii), the data as of December 31, 2008 indicate that:

(i) the ceiling on net domestic assets of the CBA; or

(ii) the ceiling on net banking system credit to the general government; or

(iii) the floor on underlying fiscal balance on a cash basis; or

(iv) the ceiling on contracting or guaranteeing of new nonconcessional external debt; or

(v) the floor on net official international reserves;

as specified in Table 1 of the MEFP and further specified in the TMU was not observed; or

(b) if, with respect to the second disbursement, the Managing Director of the Trustee finds that:

(i) by December 31, 2008, the Republic of Armenia has not carried its intentions to strengthen domestic debt market by signing an agreement between the Ministry of Finance and the CBA on the coordination of government securities auctions;

as specified in Table 2 of the MEFP and further specified in paragraph 13 of the TMU; or

(c) until the Trustee has determined that, with respect to the second disbursement, the first review of the Republic of Armenia's program scheduled for completion by June 30, 2009 and referred to in paragraph 3 of the MEFP has not been completed; or

I. B. the third disbursement specified in paragraph 1(c)(iii) above:

(a) if the Managing Director of the Trustee finds that, with respect to the third disbursement specified in paragraph 1(c)(iii), the data as of June 30, 2009 indicate that:

(i) the ceiling on net domestic assets of the CBA; or

(ii) the ceiling on net banking system credit to the general government; or

(iii) the floor on underlying fiscal balance on a cash basis; or

(iv) the ceiling on contracting or guaranteeing of new nonconcessional external debt; or

(v) the floor on net official international reserves;

as specified in Table 1 of the MEFP and further specified in the TMU was not observed; or

(b) until the Trustee has determined, with respect to the third disbursement, that the second review of the Republic of Armenia's program scheduled for completion by

November 30, 2009 and referred to in paragraph 3 of the MEFP has not been completed; or

I.C. the fourth disbursement specified in paragraph 1(c)(iv) above:

(a) if the Managing Director of the Trustee finds that, with respect to the fourth disbursement specified in paragraph 1(c)(iv), the data as of December 31, 2009 indicate that:

(i) the ceiling on net domestic assets of the CBA; or

(ii) the ceiling on net banking system credit to the general government; or

(iii) the floor on underlying fiscal balance on a cash basis; or

(iv) the ceiling on contracting or guaranteeing of new nonconcessional external debt; or

(v) the floor on net official international reserves;

as specified in Table 1 of the MEFP and further specified in the TMU was not observed; or

(b) if, with respect to the fourth disbursement, the Managing Director of the Trustee finds that:

(i) by December 31, 2009, the Republic of Armenia has not carried its intentions to introduce best practices in value-added tax refund processing to exports;

as specified in Table 2 of the MEFP and further specified in paragraph 16 of the TMU; or

(c) until the Trustee has determined, with respect to the fourth disbursement, that the third review of the Republic of Armenia's program scheduled for completion by June 30, 2010 and referred to in paragraph 3 of the MEFP has not been completed; or

II. A. any disbursement under this arrangement if at any time during the period of this arrangement

(a) The Republic of Armenia imposes or intensifies restrictions on payments and transfers for current international transactions, or

(b) The Republic of Armenia introduces or modifies multiple currency practices, or

(c) The Republic of Armenia concludes bilateral payments agreements that are inconsistent with Article VIII, or

(d) The Republic of Armenia imposes or intensifies import restrictions for balance of payments reasons, or

(e) any external payment arrear of the public sector is accumulated, as specified in Table 1 of the MEFP and further specified in the TMU.

3. When The Republic of Armenia is prevented from requesting disbursements under this arrangement because of paragraph 2 above, such disbursements may be made available only after consultation has taken place between the Trustee and the Republic of Armenia and understandings have been reached regarding the circumstances in which the Republic of Armenia may request the disbursements.

4. In accordance with paragraph 4 of the Letter, the Republic of Armenia will provide the Trustee with such information as the Trustee requests in connection with the progress of the Republic of Armenia in implementing the policies and reaching the objectives of the program supported by this arrangement.

5. In accordance with paragraph 4 of the Letter, during the period of this arrangement, the Republic of Armenia shall consult with the Trustee on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director of the Trustee requests such a consultation. Moreover, after the period of this arrangement and while the Republic of Armenia has outstanding financial obligations to the Trustee arising from loan disbursements under this arrangement, the Republic of Armenia will consult with the Trustee from time to time, at the initiative of the Government or whenever the Managing Director of the Trustee requests consultation, on the Republic of Armenia's economic and financial policies. These consultations may include correspondence and visits of officials of the Trustee to the Republic of Armenia or of representatives of Armenia to the Trustee.