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March 6, 2009

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

March 2, 2009

The following item is a Letter of Intent of the government of Republic of Armenia, which describes the policies that Republic of Armenia intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Republic of Armenia, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

ATTACHMENT I. ARMENIA: LETTER OF INTENT

March 2, 2009

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

Dear Mr. Strauss-Kahn:

The Government of the Republic of Armenia has made significant progress on economic and structural reforms in recent years, with impressive gains in growth and poverty reduction in a context of low inflation. The IMF has accompanied these efforts, and we have successfully implemented a sequence of arrangements under the Poverty Reduction and Growth Facility (PRGF). A new low-access PRGF arrangement was approved by the IMF's Executive Board on November 17, 2008 to support Armenia's macroeconomic and reform objectives for the 2008-11 period.

Since last fall, the global outlook has deteriorated substantially, with sharp downturns experienced by Armenia's key trade partners. As a result, Armenia's balance of payments inflows have contracted dramatically and capital outflows have picked up, putting significant pressure on the exchange rate and significantly reducing our international reserves. This situation has placed the financial sector in a vulnerable position.

To help address this situation, the Government of Armenia requests a Stand-By Arrangement in the amount of SDR 368 million (400 percent of quota or $544 million) for the period March 2009 through June 2011. These resources should help us to ensure economic and financial stability by stabilizing the international reserves position and the banking system, and allowing for a sound implementation of our budget while protecting the poor. In support of these objectives, we have committed to a set of policies outlined in the attached Memorandum of Economic and Financial Policies. We will continue to implement the structural reforms that underpinned our PRGF-supported program and will be crucial to strengthening our medium-term public finance position. However, given the changed outlook and financing needs, we request cancellation of the PRGF arrangement.

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 arrangement, and while Armenia has outstanding financial obligations to the Fund from purchases and 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 quarterly review under the proposed arrangement by June 2009. Finally, we grant our permission for the publication on the IMF's website of the staff report and this letter.

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

ATTACHMENT II. ARMENIA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

(March 2, 2009)

I. RECENT MACROECONOMIC PERFORMANCE AND OUTLOOK FOR 2009-10

1. **Armenia is now facing significant challenges following a long period of macroeconomic success and stability.** Under the PRGF arrangement that covered the period 2005–08, prudent macroeconomic policies and structural reforms contributed to double digit GDP growth, low inflation, and a significant reduction in poverty rates. Despite a widening external current account deficit, international reserves continued to increase, owing to large foreign exchange inflows and dedollarization, and external debt remained low. The overall fiscal deficit was contained, and additional revenues arising from improvements in tax administration could be used to finance poverty-reducing expenditures. Government debt remained stable. The monetary framework was strengthened, contributing, with a flexible exchange rate, to maintaining low inflation.

2. **In the first three quarters of 2008,** growth remained strong, with GDP increasing by 10.4 percent through September. Driven by international prices and strong domestic demand, inflation rose to a high of 11.5 percent in August, and the current account deficit continued to worsen. In response to these signs of overheating, monetary policy was progressively tightened.

3. **The economic outlook changed abruptly as the global financial crisis deepened in October.** Owing to its relative international isolation, the financial sector was not directly affected. However, the mining sector and exports were severely hit by the sharp drop in international commodity prices, with many mines stopping operations. In addition, remittances and capital inflows slowed considerably, which had a major impact on the construction sector. As a consequence, growth came to a halt, with annual GDP growth falling to 6.8 percent for the year as a whole, and the external current account deficit rising to an estimated 12.6 percent of GDP. In the wake of falling international prices and rapidly slowing domestic demand, inflation fell to 4 percent in January 2009.

4. **Out of concerns for the impact of a crisis in confidence on financial stability, the Central Bank of Armenia (CBA) intervened repeatedly to stabilize the exchange rate in the last part of 2008 and in early 2009.** With expectations for a depreciation of the dram gaining strength, the CBA faced strong pressures, leading to a rapid decline in international reserves. With a significant amount of deposits being converted to foreign currency, and overall deposits declining slightly, banks came under pressure to reduce lending. In this context, and in line with the changed inflation outlook, the CBA eased monetary policy, cutting the policy rate from 7.75 in November 2008 to 6.75 percent in February 2009.

5. **As a result of the commodity price shock and our attempt to preserve financial stability, we missed most of the end-December targets under the PRGF arrangement.** Due to unexpectedly large foreign currency sales, both the end-2008 targets for international reserves and net domestic assets of the CBA were missed. In addition, the target on net banking system credit to the government, as well as that on the underlying fiscal balance, were also missed. Other targets under the program were respected.

6. **The short-term economic outlook presents enormous challenges.** Difficulties in many sectors, including mining and construction, are affecting growth prospects and weakening the labor market. GDP growth in 2009 is projected to fall considerably with respect to 2008, and unemployment is expected to increase. Depressed international commodity prices, falling remittances, and weaker capital inflows are putting pressure on the balance of payments, despite falling domestic demand. The redollarization of the financial system presents risks for financial stability and challenges for monetary policy. We are expecting a gradual recovery in 2010, but this is highly dependent on global economic developments, and downside risks are prevalent. A strong policy response is needed to restore confidence, stop the loss of international reserves, and maintain macroeconomic stability.

II. THE PROGRAM FOR 2009

7. **The policies outlined below are designed to tackle the economic and financial challenges now confronting Armenia.** These policies, which would form the basis for a new 28-month stand-by arrangement from the Fund, are aimed at preserving economic and financial stability, while mitigating the impact of the global crisis and economic downturn on the poor. Central to this strategy is the return to a flexible exchange rate regime supported by appropriate monetary policies. We are also vigilant to possible distress in the financial sector, and will respond rapidly should more targeted measures be needed. A sound fiscal policy will underpin our commitment to macroeconomic stability, while ensuring that growth-promoting public investment moves forward. In addition, we want to preserve the impressive gains Armenia has made in reducing poverty in recent years. To this end, we will ensure that the level of social services is maintained, and that programs to protect the poor are expanded as needed. We will continue our ambitious structural reform program aimed at strengthening public finances, boosting productivity, and increasing the resilience of the economy.

8. **We will establish a high-level committee to monitor developments in the economy and coordinate the policy response of the authorities to the ongoing economic challenges.** This committee will be chaired by the Prime Minister, and will include representatives from the Ministry of Finance, Ministry of Economy, the CBA, and the State Revenue Committee.

A. Monetary, Exchange Rate, and Financial Sector Policies

9. **We are committed to return to a flexible exchange rate regime in the immediate future.** Since the deepening of the global financial crisis in October 2008, intervention has been necessary to prevent a crisis of confidence that was threatening the stability of the financial system. However, we recognize that the maintenance of a soft peg has led to a large loss of international reserves and significant redollarization without stemming expectations of a dram depreciation. This, in turn, has undermined the credibility of our inflation-targeting framework and the effectiveness of monetary policy, which we are committed to restoring. Since October 2008, our exchange rate misalignment has increased significantly, owing to the worsening economic outlook and the currency depreciation experienced by many of our trade partners. We expect the exchange rate to move to a value in line with its fundamentals when we return to a floating regime. When normal market functioning is restored, our exchange rate policy will be a managed float with no predetermined path. We are committed to intervening only to smooth excessive market volatility and to increase international reserves.

10. **Monetary policy will be geared towards supporting the return to a flexible exchange rate regime.** As outlined below, we will take any emergency measures necessary to address banks' liquidity shortages in order to avoid any risks of bank runs. The CBA will raise policy interest rates at the time we return to a flexible regime. This will support demand for dram-denominated assets, fight capital outflows, mitigate any inflationary pressures stemming from depreciation, and restore confidence in the financial sector. Throughout this transition period, we will conduct an open and transparent communication campaign to explain to the public the reasons behind the depreciation and any additional measures needed to preserve financial stability.

11. **Strengthening financial stability will be a critical part of the program:**

- To ensure a timely and consistent policy response, the CBA will prepare a comprehensive and actionable contingency plan for the financial sector. This plan will contain the explicit policy responses to all likely developments, including liquidity shortages in the banking sector, with responsibilities of various parties clearly defined. The CBA will consult with the government as needed on the preparation of this contingency plan.

- We recognize that the banking system will be adversely affected by the depreciation of the dram and will take all appropriate measures to ensure that banks remain able to meet all liabilities as they fall due. The CBA stands ready to provide liquidity to banks on a temporary basis in exchange for adequate collateral. The CBA will on a temporary basis accept a wider range of collateral, including pledged fixed assets, bank shares, and high quality bank loans if necessary.

- Should circumstances warrant it, the coverage of the Deposit Guarantee Fund will be increased. In addition, the authorities will approve a plan to increase the resources of the Deposit Guarantee Fund (performance criterion for end-June 2009).

- Bank supervision will be enhanced with more intensive on-site and off-site surveillance and monitoring. If financial conditions in any banks appear to be deteriorating, we will agree with bank management and shareholders on a restructuring plan to resolve the difficulties. In the first instance, we would expect the banks' shareholders to recapitalize the bank to adequate levels. However, we will also set out a framework for using public resources if this approach proves to be inadequate. In exceptional cases, we will provide banks with long-term funds. In order to protect taxpayers' interests, the banks will issue subordinated debt, with an option to convert such debt into bank equity. We will also tighten prudential standards, particularly regarding foreign currency exposures, and will progressively work to reduce banks' net open positions.

12. **As market conditions stabilize, we will return to our inflation-targeting framework.** In the short term, increased dollarization will hamper the implementation of monetary policy. Therefore, it will be particularly important to further strengthen the monetary transmission mechanism, pursue more active liquidity management, and foster the development of the money market. To enhance monetary operations and debt management, the Ministry of Finance (MoF) and CBA will closely coordinate their liquidity forecasting and MoF debt issuance to take account of both budget financing and liquidity management needs. Furthermore, the CBA will continue to conduct repo operations, and will not go back to issuing its own securities. At the same time, the treasury will maintain its issuance of short-term T- bills, including three-month and six-month T-bills, consistent with the recent memorandum of understanding between the CBA and the MoF. The CBA also plans to increase its holdings of treasury securities over the medium term in order to strengthen its capacity to conduct reverse repo operations.

B. Fiscal Policy

13. **Fiscal policy will support macroeconomic stability, while allowing for continued public investment and protection of social services.** To this end, we intend to limit the overall fiscal deficit in 2009 to around 3 percent of GDP, excluding nonprogrammed externally-financed investment projects (see below). The deterioration in the deficit target relative to the 1 percent of GDP budget objective is due to the fact that revenue is projected to be significantly lower than the projection in the budget, reflecting the contraction in economic activity, particularly the downturn in revenue-generating sectors such as mining. As discussed below, the revenue shortfall will be offset in part by restrained spending and some tax policy measures.

14. **On spending, we plan to restrict non-priority expenditure, while protecting social outlays and allowing for higher investment as foreign financing materializes.** To this end, we expect substantial savings on nonessential spending and areas where execution has been slow. At the same time, we intend to boost spending on social protection programs, and are in discussions with partners, notably the World Bank, on how to strengthen these programs.

15. **Our aim is to restrict spending financed by domestic resources and instead rely on external financing to fund the increase in capital spending.** We expect additional resources to become available from external donors and partners on top of what is currently projected by the IMF. While much of these resources are only partially concessional, they would allow us to finance more public investment projects, and potentially set up credit lines for small and medium enterprises. To this end, we propose to spend up to $200 million from those additional resources on public investment in 2009, with which would allow us to increase our deficit target accordingly. We are committed to maintaining transparency in the use of such resources by channeling any additional spending through the budget. We will also limit the use of government cash deposits to finance the budget, as we recognize the need to have a cushion for cash-flow management purposes, and possibly for future needs.

16. **We are implementing some changes to tax policy.** Given the weak revenue outlook and the difficult conditions facing Armenian firms with respect to trading partners, we plan to raise temporarily customs tariffs for some goods. We recognize the distortionary impact of such a policy, and the negative impact on the poor. However, the changes in tariff rates are within our commitments to the WTO, and will be limited to a certain number of goods for which Armenian substitutes exist. In terms of revenue impact, we expect this measure to generate an additional AMD 10 billion in receipts in 2009. In addition, we have recently raised presumptive taxes on tobacco products, we plan to raise excise taxes on imported alcoholic beverages, and are considering raising presumptive taxes on petroleum products. Looking forward, we maintain our objective of abolishing presumptive taxation for tobacco and fuel, and to this end, we will submit legislation to parliament by December 2009 to bring petroleum and tobacco products within the regular tax regimes (excise tax, customs duties, profit tax, and VAT), effective January 1, 2011.

17. **In 2009, we intend to address two long-standing problems in the tax area:**

- The large amount of outstanding tax credits (AMD 154.4 billion at end-December 2008) is associated with ad-hoc collection practices in earlier periods, including requests for advance tax payments. Halting these practices and offsetting advance payments against future tax liabilities will provide an important stimulus during the recession. Therefore, we will not accumulate additional tax credits during 2009, and, more generally, we are committed to analyzing and fixing the systemic problems underlying these tax credits in the context of our comprehensive tax administration reform. We have included in the program a quantitative indicative target on the stock of tax credits.

- We remain committed to introducing best practices in VAT refund processing to exporters by: (i) meeting the statutory 90-day processing deadline for all VAT refund claims filed in 2009, (ii) clearing the stock of late refund claims, (iii) implementing risk management approaches (i.e. taxpayers with good compliance histories to get fast-track refunds, while risky cases face pre-refund audits); (iv) implementing a forecasting system to anticipate refund levels so that funds are available to pay legitimate refund claims as they occur; and (v) submitting legislation to parliament to strengthen penalties for false refund claims and pay interest on legitimate late refunds arising from claims filed after December 2009, with interest to be paid out of VAT revenues (structural benchmark for December 2009). We have already significantly reduced the stock of refund claims and plan to completely eliminate it over the next few months.

C. Structural Reforms

Public finances

18. **We remain committed to our ambitious tax administration reform agenda.** To this end, we restructured the tax administration organization by adopting a function-based organizational structure, merging the four specialist inspectorates into a single large taxpayer inspectorate, and closing 11 tax inspectorates, all of which became effective in February 2009. We expect these changes to generate savings and enhance cost-effectiveness, while securing a sustainable revenue base. Going forward, we intend to continue consolidating the regional tax inspectorates. We have also completed the merger of the State Customs Service with the State Tax Service into a new organization named State Revenue Committee (SRC). The merger is expected to generate efficiency gains through information sharing and administrative support functions, such as human resources and IT, while the core functions of customs and tax administration will not be integrated.

19. **On other fiscal reforms,** we plan to introduce a funded pension pillar on January 1, 2010. We intend to revise our estimates of the costs of this reform, as well as those associated with the planned increase in basic pensions, taking into consideration the weakening economic environment. Legislation on the new pension system, including on the unification of income tax and social contributions, will be submitted to parliament by mid-2009. The SRC will assume the task of collecting and reconciling individual contributions. In the context of the Medium Term Expenditure Framework (MTEF), we intend to produce an analytical report on medium-term fiscal risks, including those arising from the introduction of the funded pillar and the costs associated with the planned increase in basic and average pensions over the next few years. To further improve our fiscal framework, we intend to improve the MTEF by including a section on debt management, which will help align policy

decisions over the medium term, with their long-term fiscal implications. Finally, we plan to complete the specific part of the unified tax code by June 2009.

Financial sector

20. We remain committed to the financial sector reforms outlined in the Memorandum of Economic and Financial Policies underpinning our November 2008 PRGF request. In the current crisis, our focus is on ensuring financial stability, including through the adoption of the measures discussed above. Nonetheless, we will continue to implement our reform agenda, including:

- Foster the development of commercial banks' risk management capacity, and integrate an assessment of banks' risk management systems into the CBA's regular supervisory activity.
- Enhance credit availability and improve financial intermediation;
- Launch our campaign to educate consumers about financial terms, products, and services; and
- Further develop the securities market as laid out in our capital market development action plan. 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" to allow a gradual recapitalization of the CBA with marketable interest-bearing securities (structural benchmark for end-September 2009).

Other structural reforms

21. **Despite the difficult economic climate, we will continue our wide-ranging structural reform agenda outlined in our Sustainable Development Program.** This agenda is aimed at deepening productivity-enhancing structural reforms, and improving governance. A key area will be continued efforts to strengthen the business environment. The tax administration reforms outlined above will help in this regard, and we will continue our fight against corruption.

III. PROGRAM FINANCING

22. **Armenia faces significant financing needs during the program period.** Our estimates suggest that a large financing gap in 2009 is likely, due to a significant reduction in export earnings, private transfers, and private capital inflows. The decline in export earnings reflects the sharp drop in base metals prices and weakening external demand, while the steep drop in private transfers and capital inflows is particularly associated with the sharp contraction of the Russian economy, from which the majority of both remittances and FDI originate.

23. **In the current global climate there are limited available sources of financing.** Foreign direct investment is projected to slow considerably in line with the expected weakening of the Russian economy, the main source of such inflows. The bulk of official external financing included in the program will be provided by the World Bank.

24. **The resulting financing gap can only be partially financed from domestic adjustment.** The current account position is expected to adjust significantly under the program scenario, declining by close to $300 million relative to the program concluded with the Fund in November 2008. Nevertheless, absent Fund financing, official foreign exchange reserves would fall below the desirable minimum level, and cover less than 3 months of imports.

IV. PROGRAM MONITORING

25. **In the context of significant external financing needs associated with severe external shocks, we would like to request a 28-month Stand-By Arrangement in the amount of SDR 368 million.** The funding requested would cover the remaining projected balance of payments needs during 2009 and part of the projected financing gaps in 2010-11. The IMF financing would be utilized to assure financial stability and to maintain Armenia's gross international reserves at a level sufficient to cover about 3 months of imports of goods and services at the end of the program.

26. **The program will be monitored via quarterly performance criteria and structural benchmarks.** Progress in implementing the program will be monitored through quantitative criteria and indicative targets outlined in Table 1 as well as structural performance criteria and benchmarks as listed in Table 2. The structural measures discussed above that are not mentioned in Table 2 are part of the authorities' overall reform effort, but are not part of conditionality under this program. The first review of the program is expected to be completed on or after May 15, 2009, the second review on or after August 15, 2009, the third review on or after November 15, 2009, and the fourth review on or after February 15, 2010.

Table 1. Armenia: Quantitative Targets, 2009 1/
(End of period ceilings on stocks, unless otherwise specified)

	2007	2008		2009		
	Dec.	Jun.	Dec.	Mar.	Jun.	Sep.
	Act.	Act.	Prel.	Prog. 2/	Prog. 2/	Prog. 2/
				(in billions of dram)		
Net domestic assets of the CBA 3/	-96.2	-8.1	75.9	131.8	174.2	178.4
Net banking system credit to the government	-54.0	-78.2	-36.3	-23.6	-2.7	-1.8
Overall fiscal balance on a cash basis (floor) 4/	-69.4	15.9	-46.1	-24.0	-55.7	-73.6
Reserve money 5/	427.1	412.7	449.7	381.3	419.8	439.5
Stock of tax credits 5/	125.3	129.8	145.0	145.0	145.0	145.0
				(in millions of dollars)		
External arrears (continuous criterion)	0	0	0	0	0	0
Net official international reserves (floor)	1,350.1	1,279.6	1,084.7	0.0	0.0	0.0

1/ All items as defined in .
2/ Performance criterion.
3/ At program exchange rates.
4/ Overall balance before grants, and excluding external interest payments. Cumulative flow from the beginning of the calendar year until the end of the month indicated.
5/ Indicative target.

Table 2. Proposed Structural Conditionality for 2009

Measure	Proposed Time Frame (End of Period)	Type of Conditionality
Approve a plan to increase the resources of the Deposit Guarantee Fund (see MEFP ¶11).	June 2009	Performance Criterion
Submit to parliament an amendment to Article 11 of the "Law on the Central Bank of the Republic of Armenia" to allow a gradual recapitalization of the CBA with marketable interest bearing securities (see MEFP ¶20).	September 2009	Benchmark
Introduce best practices in VAT refund processing to exporters (see MEFP ¶17).	December 2009	Benchmark

ATTACHMENT III. 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 385 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.

1. 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]

2. The program targets a maximum level of **net credit of the banking system to the government, which is** the sum of net credit from the CBA and net credit from commercial banks to the central government.

3. **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.

4. **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).

5. **External payment arrears** will consist of all unpaid 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 obligations that are overdue beyond 30 days after the due date.[2]

6. **The program fiscal balance** is defined as the negative of the sum of domestic banking system net financing, domestic nonbank net financing, and external net financing to the government. Should a general subsidy be introduced off-budget, the overall 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

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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 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.

and excluding accrued interest for treasury bonds);[3] (2) any other disbursement or transaction that increases nonbanks' claims on the central government plus withdrawals from the special privatization account or the treasury sub-account containing privatization proceeds in dram, less amortizations made by the central government to private resident nonbank agents. **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. All foreign-currency denominated transactions are recorded in drams using the prevailing exchange rate at the time of the transaction.

7. 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.

8. 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 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.

9. **The stock of tax credits** is defined as the sum of outstanding accumulated credit by the State Revenue Committee (SRC) of all types of tax revenues (VAT, profit tax, excises, income tax, presumptive payments, and others) resulting from advanced tax payments to be offset against future tax liabilities.

II. ADJUSTERS

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

- **Changes in reserve requirements**: The ceilings on the NDA of the CBA will be adjusted upward/downward by the amount of banks' reserves freed/seized by any

[3] Domestic nonbank holdings of treasury bills and treasury bonds are defined as total outstanding treasury bills and bonds less holdings by the banking system and the SFSI.

reduction/increase of the reserve requirement ratio on both domestic currency and foreign currency deposits relative to the baseline assumption as per the following formula: $\Delta NDA = \Delta rB$, where B denotes the level of the reservable deposits in the initial definition and Δr is the change in the reserve requirement ratio. The ceilings on the reserve money of the CBA will be adjusted upward/downward by the amount of banks' reserves freed/seized by any reduction/increase of the reserve requirement ratio relative to the baseline assumption as per the following formula: Δreserve money = ΔrB, where B denotes the level of the reservable foreign currency deposits in the initial definition and Δr is the change in the reserve requirement ratio.

- **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 2 below.

- **Other external financing**: The floor on the overall fiscal balance on a cash basis is subject to an automatic adjuster, based on deviations of external financing (defined as disbursements of loans from bilateral and multilateral agencies not explicitly mentioned above to government for budget or project support) from program projections (shown in Table 3 below). If external financing exceeds the program projections, the floor on the fiscal balance will be adjusted downward by the amount of the cumulative positive difference between actual and programmed external financing up to a maximum of $200 million (as in Table 4 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

11. Approve a plan to increase the resources of the Deposit Guarantee Fund (DGF) (performance criterion, end-June 2009).

12. Submit to parliament an amendment to Article 11 of the "Law on the Central Bank of the Republic of Armenia" to allow a gradual recapitalization of the CBA with marketable interest bearing securities (structural benchmark, end-September 2009). See paragraph 20 of the MEFP.

13. 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;[4] (iii) implementing a

[4] 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

(continued)

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), (structural benchmark, end December 2009). See paragraph 17 of the MEFP.

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

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA[5]	CBA balance sheet	Summary	Weekly	Last working day of the week
	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	Weekly	Last working day of the week
		By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Monthly	Within 25 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 Nasdaq-OMX	Weekly	Last working day of the week
	Foreign exchange market	CBA intervention	Daily	Within 1 day
	Interest rates	Repo rate	Monthly	Within 7 days of the end of each month
	Interbank money market	Daily interbank repo volume and interest rate	Weekly	Last working day of the week
	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	Monthly	Within 15 days of the end of each reference period

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

	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	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
	Transfers	Non-commercial transfers of individuals	Monthly	Within 30 of the end of each month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
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	Monthly	Within 7 days of the end of each

		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.		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	Detailed data on VAT refunds in	Monthly	Within 30 days of

	arrears	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.		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 31, 2008 for dollars per currency rates)

Country	Drams Per Currency	Dollars Per Currency
Australian dollar	266.57	0.6924
Canadian dollar	313.39	0.8140
Swiss franc	365.58	0.9496
Danish krone	73.26	0.1903
Euro	546.00	1.4182
Pound sterling	558.68	1.4511
Japanese yen	4.27	0.0111
Norwegian krone	55.20	0.1434
Russian ruble	13.13	0.0341
Swedish krone	18.21	0.0473
U.S. dollar	[...]	1.0000
SDR	593.00	1.5403

Table 2. Armenia: KfW Loan Disbursements 1/
(In billions of dram)

2009			
March	June	September	December
7.70	11.55	15.40	15.40

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

Table 3. Armenia: Other External Financing (Program) 1/
(in billions of drams)

2009			
March	June	September	December
19.83	41.00	71.10	100.80

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

Table 4. Armenia: Other External Financing (Additional) 1/

(in billions of drams)			
2009			
March	June	September	December
13.3	53.3	66.6	77.0

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