International Monetary Fund

Republic of Armenia
and the IMF

Press Release:
IMF Completes First Review Under Stand-By Arrangement with Armenia and Approves Increase in Financial Support to US$822.7 Million
June 22, 2009

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

June 5, 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.

ARMENIA: LETTER OF INTENT

June 5, 2009

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

Dear Mr. Strauss-Kahn:

After many years of strong macroeconomic performance, marked by rapid growth, significant poverty reduction, and low inflation, Armenia has been hit severely by the global economic crisis. The Government of the Republic of Armenia intends to build on the long-lasting partnership with the IMF, which has led to many successes, to strengthen its program with sound macroeconomic policies and structural reforms that would alleviate the impact of the crisis and pave the way to a prompt recovery.

As the crisis was unfolding, 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 was approved by the IMF Executive Board on March 6, 2009. The program supported by the Arrangement envisaged the return to a floating exchange rate on March 3, which has been successful in restoring confidence. The consequences of the dram depreciation on the financial system have been limited and the exchange rate has remained stable without large interventions by the Central Bank of Armenia.

However, the economic outlook has continued to deteriorate, and a larger contraction of economic activity is now expected for 2009. Balance of payments inflows have continued to decline, increasing external financing needs. On the fiscal side, tax revenues have fallen significantly, leading to a delay of budgeted government spending that compounds the drop in private sector demand.

The Government of Armenia requests the completion of the first review under the Stand-By Arrangement. Moreover, we request additional resources under the Stand-By Arrangement in the amount of SDR 165.6 million (180 percent of quota or about $258 million) to cover the increased financing needs in 2009 and 2010. The objectives of the program remain unchanged: to help Armenia adjust to the changed outlook, restore confidence, and protect the poor. But these additional balance of payments resources are necessary to prevent excessive domestic adjustment, and thus preserve economic and financial stability and continued implementation of our budget while maintaining adequate social expenditure.

In addition, we request waivers for the non-observance of the end-March performance criteria on net banking system credit to the government and the program fiscal balance. These targets were missed due to the large unexpected decline in tax revenues, which we are redressing through a strengthening of our tax administration reform program. Furthermore, to adapt the conditionality to the current situation, we request the elimination of the indicative target on base money and the conversion of the end-June structural performance criterion (approval of a plan to increase the resources of the Deposit Guarantee Fund) to a structural benchmark. We also request the modification of end-June 2009, end-September 2009, and end-December 2009 quantitative performance criteria.

The attached Memorandum of Economic and Financial Policies outlines our policies for 2009 and 2010, which have been updated and revised to address the more challenging economic and financial situation. 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 any other measure that may become necessary for this purpose. The Government will consult with the Fund on the adoption of additional 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 end of the arrangement, and as long as Armenia has outstanding financial obligations to the Fund, 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. 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 I. ARMENIA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

(June 5, 2009)

I. RECENT DEVELOPMENTS AND OUTLOOK FOR 2009-10

1. **The economic outlook has deteriorated dramatically for Armenia.** The global economic crisis has caused a swift turnaround in our economic prospects. After many years of rapid growth, Armenia is faced with a large contraction of economic activity on the back of declining external inflows and plummeting domestic demand. Falling remittances and rising unemployment are depressing household incomes and causing poverty to rise. In the first quarter of 2009, real GDP fell by 6.1 percent on an annual basis, and the contraction is expected to reach almost 10 percent for the year as a whole, with the construction sector and mining sector bearing the brunt of the crisis. Growth could resume, albeit moderately, in 2010, provided that the expected global recovery materializes.

2. **In this context, Armenia's external position is weakening.** Exports are suffering both from the drop in external demand and from falling international commodity prices, and remittances are declining rapidly. This means that despite a fall in imports, the current account deficit is likely to worsen after reaching an estimated 11 percent of GDP in 2008, and the slowdown of capital inflows will add to financing pressures.

3. **At the same time, government financing needs are increasing.** Tax revenues fell by 15 percent in the first four months of 2009, compared with the same period in 2008. Despite postponement of non-essential expenditures, we were not able to meet the end-March fiscal targets under our IMF stand-by arrangement (SBA). Even with painful expenditure cuts, the fiscal deficit is expected to widen significantly for the year as a whole.

4. **Encouragingly, pressures on the exchange rate have waned.** On March 3, 2009, the Central Bank of Armenia (CBA) announced that it would return to a floating exchange rate and that it would stop intervening in the foreign exchange market except to smooth excessive volatility. At the same time, the CBA raised the policy rate by 100 basis points. As a result, the dram depreciated by 22 percent vis-à-vis the U.S. dollar and has been fairly stable since, despite limited intervention by the CBA. Bank deposits have remained stable, confirming the depositors' confidence in the banking system. In fact, banks are well capitalized, and have easily absorbed the balance sheet losses arising from the impact of the depreciation. International reserves have been strengthened by the provision of IMF resources. The conversion of dram deposits into foreign currency deposits, which had been intense prior to the depreciation, has stopped.

5. **Despite the recent cuts in the policy rate, inflation is expected to remain low and credit conditions in the economy to remain tight.** Year-on-year inflation increased to

slightly over 3 percent in April from 1 percent in March—largely driven by increases in utility prices and some pass-through of the exchange rate depreciation—but is expected to remain low on the back of falling domestic demand. In the absence of significant pressures either on the exchange rate or inflation, the CBA started reducing its policy rate in April. Nonetheless, dram liquidity remains scarce, and banks have significantly cut back lending to the private sector, further dampening economic activity.

II. The Program for 2009 and 2010

6. **The policies in our program have been updated and revised to reflect the more challenging outlook.** The objectives of the program remain unchanged: namely, to help Armenia adjust to the changed external outlook, maintain confidence, and protect the poor. However, the sharp contraction in economic activity, widening fiscal deficit, and difficult conditions in credit markets require a robust policy response which will allow Armenia to return to high growth, a strong balance of payments, and continued progress in poverty reduction.

7. **To this end, we intend to pursue the policies outlined below in the monetary and financial, fiscal, and structural areas.** In particular, monetary and exchange rate policies are geared toward enabling the economy to adjust to the external shock and boosting confidence. Fiscal policies are likewise aimed at softening the impact of the economic downturn, ensuring medium-term fiscal sustainability, and protecting social services. And structural reforms are targeted at increasing the flexibility of the economy, and laying the basis for renewed growth and macroeconomic stability.

A. Monetary, Exchange Rate, and Financial Sector Policies

8. **We are committed to maintaining a flexible exchange rate regime.** The CBA will continue its current policy of intervening only to contain excessive volatility of the exchange rate, and will not resist movements that are in line with fundamentals. The CBA will avoid giving the market any perception of resuming targeting an exchange target level or range which could hinder the interplay of demand and supply. To introduce two-way risks in the foreign exchange market, we intend to rely on a coherent intervention strategy to achieve consistent and transparent outcomes. To this end, the CBA will adopt an intervention policy in accordance with the objectives of smoothing excessive movements of exchange rates and rebuilding foreign currency reserves (structural benchmark for end-June 2009). To enhance the transparency of its operations, the CBA commits to only conduct foreign exchange interventions with banks or government entities. Furthermore, to ensure proper exchange rate risk management, the CBA will consider tightening prudential measures regarding foreign currency exposures, both direct and indirect, including imposing limits on banks' open foreign exchange positions

9. **With inflation pressures receding rapidly, the focus of monetary policy has now shifted.** At the time of the depreciation, monetary policy was geared towards supporting the

return to a flexible exchange rate regime. As the inflationary pressures triggered by the depreciation of the dram and the subsequent increases in utility prices are expected to subside in the face of extremely weak domestic demand, the CBA has been able to lower interest rates, providing some support to economic growth. Consistent with its primary objective of price stability and in line with its inflation forecasts, the CBA will continue to ease policy.

10. **However, the economic crisis and the increased preference for foreign currency have reduced the effectiveness of monetary policy.** Credit to the private sector has effectively dried up as banks tighten their credit standards and find fewer attractive lending opportunities. In addition, many banks, having experienced a shift toward foreign currency deposits, are trying to reduce the currency mismatch by extending foreign currency loans. On the other hand, borrowers, whose revenues are mostly in local currency, are reluctant to increase their own exchange rate exposure.

11. **Therefore, we intend to take steps to unlock the frozen credit market and strengthen the transmission of monetary policy**. In the short term, while maintaining sufficient short-term repo lending, we will endeavor to provide longer-term dram liquidity to facilitate banks' liquidity management by:

- (i) gradually introducing additional repo maturities of up to one year, including a 3-month repo (structural benchmark for end June 2009);
- (ii) offering foreign exchange swaps as part of regular monetary instruments; and
- (iii) continuing to carry out outright purchase operations of government securities to the extent that these accommodate structural liquidity injections.

12. **In the medium term, we will continue to develop the securities market as laid out in our capital market development program presented in the Memorandum of Economic and Financial Policies of March 2, 2009.** We will increase the issuance of government securities in line with market demand and consistent with the memorandum of understanding between the CBA and the MoF, with a view to extending maturities. In addition, we will amend Article 11 of the "Law on the Central Bank of the Republic of Armenia" to ensure a gradual recapitalization of the CBA with marketable interest-bearing securities (structural benchmark for end September 2009). Finally, to support dedollarization of deposits, we are tightening the enforcement of the prohibition of payments in foreign currency.

13. **We are also preparing to undertake exceptional credit easing operations.** The CBA will use resources from the World Bank, KfW, and part of the resources from the Russian government to extend long-term domestic currency loans to banks for on-lending to small and medium enterprises (SMEs). We are also planning the creation of a secondary mortgage operator in partnership with the private sector. The new entity will raise financing

through the issuance of domestic currency bonds and provide long-term dram loans to banks, collateralized on their mortgage portfolio cash flows.

14. **We will continue to closely monitor the banking sector**, particularly in light of the increase in nonperforming loans caused by the economic contraction and, to a lesser degree, by the depreciation. We will continue to conduct stress tests on each individual bank, focusing particularly on market, credit, and liquidity risk. The latest stress tests indicated that, even after the balance sheet losses owing to the depreciation, the banking system remains highly capitalized and liquid. In any case, we remain vigilant and ready to take steps to promptly address any potential vulnerabilities in the system.

15. **Existing legislation confers on the CBA comprehensive powers for intervening and resolving banks**. The CBA has strengthened its capacity to address banking crises by expanding the range of eligible collateral for emergency liquidity assistance. The CBA has also formalized a mechanism to support the recapitalization of banks through a subordinated debt facility matching bank shareholders' capital injections. The CBA also introduced a temporary loan facility to facilitate mergers and acquisitions. The CBA is securing public resources for this purpose. The CBA is considering requesting Fund technical assistance to further strengthen contingency planning and crisis preparedness.

16. **Enhancing the efficacy of the Deposit Guarantee Fund (DGF) will strengthen our banking system safety net**. The CBA and the DGF, with the support of technical assistance financed by KfW, will introduce a mechanism to periodically review the appropriate level of coverage of the deposit insurance for both dram and foreign currency deposits, including the possibility of equalizing their coverage. We are finalizing a plan to increase the resources of the DGF (structural benchmark for end June 2009). We are considering requesting technical assistance from the Fund on the possible adoption of risk-adjusted deposit insurance premia.

B. Fiscal Policy

17. **We remain committed to fiscal discipline, which is necessary to maintain a sustainable fiscal position in the medium term.** Our program under the stand-by arrangement targeted a deficit of around 3 percent of GDP for 2009. As automatic stabilizers on the expenditure side are limited, greater discretionary expenditure is needed to avoid deepening the economic contraction. Therefore, we intend to keep spending in nominal terms in line with the stand-by arrangement, representing an increase as a percent of GDP relative to the program due to the fall in nominal GDP. On this basis, we expect a deficit of about 6.5 percent of GDP. Gradual adjustment will proceed in 2010, and to this end we will increase tax revenue by 0.4 percent of GDP and reduce expenditure by 0.6 percent of GDP, targeting a deficit of 5.8 percent of GDP for 2010.

18. **Refocused and better-targeted public spending will be a key element of our response to the crisis.** On current spending, we intend to continue critical maintenance and

operating expenditures, which will help strengthen public services and provide a positive economic impact. In addition, we are committed to preserving social spending and protecting the poor. Despite the pressures on overall expenditure, we commit to safeguard social spending by keeping the level of expenditure on social allowances and pensions at least as high as in the 2009 budget, which would imply an increase in social spending by 1½ percent of GDP. In addition:

- In close collaboration with the World Bank, we will develop a strategy to further strengthen the targeting of social safety nets (structural benchmark for end December 2009), and expect to achieve sizable savings in these areas, which will be directed to providing assistance to the newly-unemployed and strengthening the family benefit program.

- We will increase spending on infrastructure projects such as road rehabilitation—a critical element of our countercyclical response—which will generate employment, notably for the poor.

19. **We expect external sources to fund additional capital spending and credit lines for SMEs.** We anticipate the disbursement of a $500 million loan from Russia by mid-2009, which will be spent on critical projects, consistent with our capacity to implement these projects. The loan will primarily finance new housing projects in the earthquake-affected zone (Gyumri,Vanadzor, and Spitak), thus resettling the remaining 6,000 families left without permanent housing since the catastrophic 1988 earthquake. The loan will also finance SME lending via the banking system, helping offset the credit freeze, and fund identified infrastructure projects. These measures will provide much-needed stimulus to our economy, help accelerate the path to recovery, and address critical social needs.

20. **We intend to increase domestic financing moderately, to address financing needs in addition to supporting financial intermediation.** We plan to increase financing from issuing government securities in both 2009 and 2010, subject to market demand. Given the limited appetite currently for longer-maturity securities, we expect that some of these may be purchased by the CBA in the secondary market. Moderate net issuance of government securities is not expected to crowd out the private sector. We will limit the use of government cash deposits to finance the budget, as we recognize the need to have a minimum buffer for cash flow management of at least AMD 30 billion by end 2009.

C. Fiscal structural reforms

21. **Our tax administration reform program is a critical element of our response to the crisis and underpins our effort to strengthen fiscal sustainability**. In the first quarter, we reduced the stock of tax credits from AMD 154.4 billion to AMD 147 billion, and will further reduce it in the course of 2009, which will also provide stimulus during the downturn. 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 also 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 (to be monitored on a continuous basis);
- (ii) Reducing to zero the stock of VAT refund claims that were not processed within the statutory 90-day processing deadline;
- (iii) implementing risk-based auditing for VAT refunds; and
- (iv) submitting legislation to parliament to (a) strengthen penalties for overstated VAT refund claims effective January 2010, and (b) 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 end September 2009).

22. **We have also accelerated tax administration reforms in additional areas.** In particular: (i) tax return filing commissions have been liquidated and mailboxes installed in tax inspectorates for receiving tax returns; (ii) the new structure and functions of the regional inspectorates have been created; (iii) based on actual performance indicators, we are developing a system for the assessment of tax inspectorates and structural units' performance, and will continue the consolidation of tax inspectorates after assessing the results of the first round of consolidation; (iv) we are preparing the requirements to perform risk-based audits; and (v) we are introducing electronic filing of taxes.

23. **We have introduced some tax policy changes aimed at increasing revenue, including raising the presumptive tax on tobacco.** In addition, we remain committed to abolishing the presumptive taxation for tobacco and fuel. To this end, we will submit legislation to parliament to bring all tobacco and petroleum products within the regular tax regimes (excises, custom duties, profit tax and VAT), effective January 2011 (structural benchmark for end December 2009).

24. **In addition**:

- We are continuing to progress on the introduction of the funded pension pillar. We will revise our estimates of the costs of this reform, as well as those associated with the planned increase in basic pensions, taking into account the deteriorating economic outlook. Legislation on the new pension system, including on the unification of income tax and social contributions, will be submitted to parliament shortly.
- 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 also intend to strengthen debt management.

- The special part of the unified tax code—which covers tax policy—has been drafted and is expected to be submitted to Parliament by September 2009.

D. Other structural reforms

25. **The government is also taking numerous structural measures to strengthen the business climate as part of its anti-crisis action plan**. In particular, we are in the process of creating one-stop shops in the corporate and service sectors, establishing free economic zones at Zvartnots international airport and in the city of Gyumri, and strengthening the Committee on the Protection of Economic Competition to improve domestic competition and reduce import monopolies. The business climate will be further strengthened by the tax administration reforms mentioned above and by our efforts to fight against corruption. Indeed, we are introducing legislative changes on prescribing targeted severe sanctions for senior state officials engaging in business activities. World Bank support in various areas (including regulatory changes, infrastructure development, competition policy, and customs reform) should contribute to enhancing competitiveness.

III. Program Financing

26. **Armenia faces larger than anticipated balance of payments financing needs over the next two years.** The steep contraction in export earnings and remittances, along with the projected reduction in FDI inflows has severely weakened the economy. Despite a larger than anticipated contraction in imports, projected financing gaps over the program period have increased relative to the original framework of the program by about $350 million for 2009-2010.

27. **The amount of resources available from donors is insufficient to cover these gaps.** The World Bank plans to provide $545 million in 2009-2012 with high upfront IDA budget support disbursements in 2009. The Asian Development Bank is likely to provide about $130 million in 2009-10, of which at least $70 million will be provided for direct budget support. A portion of these resources are new relative to the original program in 2009, and thus will help to address the increased balance of payments financing needs. In addition, we now anticipate budget support from the European Union in 2010. Finally, the expected Russian loan for project support will be used to provide on-lending to SMEs, infrastructure investment, and housing construction, although it is not intended for budget support. Given the magnitude of the external shock and the marked effect on Armenia's external and domestic economy, expected resources are insufficient to cover the widening financing gap.

28. **The financing needs are particularly acute in 2009 and 2010**. Absent additional Fund financing, Armenia has limited options to finance the remaining gap and would experience protracted weakness in the balance of payments, as domestic demand would have to contract by an unsustainably high amount. We anticipate limited financing needs in 2011.

IV. Program Monitoring

29. **Given the significant external financing needs, we would like to request an augmentation of the current Stand By Arrangement in the amount of 180 percent of quota** (SDR 165.6 million or about $258 million), which would increase Fund financing to SDR 533.6 million, about $830 million. This would result in increased access under the 28-month arrangement to 580 percent of quota. The requested funding would cover the remaining financing gap for 2009 and a large portion of the remaining balance of payments deficit in 2010 and 2011. The increased financing will be used to support international reserves as Armenia adjusts to the worsened economic outlook.

30. **The program will continue to be monitored via quarterly performance criteria, indicative targets, and structural benchmarks.** The quantitative criteria and indicative targets are outlined in the attached Table 1, and the structural benchmarks are listed in Table 2. The structural measures discussed above that are not mentioned in Table 2 are part of the authorities' overall reform effort and will be considered in the context of program reviews, but is not part of conditionality under this program. The second review of the program is expected to be completed 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/

(in billions of drams, unless otherwise specified)

	2008	2009								
	Dec.	Mar.			Jun.		Sep.		Dec.	
		Country Report No. 09/140	Adj. Prog.	Prel.	Country Report No. 09/140	Prog.	Country Report No. 09/140	Prog.	Country Report No. 09/140	Prog.
Performance Criteria										
Net official international reserves (floor, in millions of dollars)	1,084.7	455.9		588.5	455.9	1,008.3	505.9	923.3	568.4	839.8
Net domestic assets of the CBA (ceiling) 2/	75.9	148.9	143.6	55.6	191.3	-117.8	195.5	-60.0	196.1	24.5
Net banking system credit to the government (ceiling)	-37.3	-23.6		**-10.6**	-2.7	-217.6	-1.8	-163.7	9.4	-118.6
Program fiscal balance (floor) /3	-73.1	-31.9	-29.9	**-36.6**	-73.3	-123.4	-102.2	-212.3	-142.8	-287.4
External arrears (continuous criterion)	0	0		0	0	0	0	0	0	0
Indicative Targets										
Reserve money (ceiling) 4/	449.7	381.3		**391.7**	419.8	…	439.5	…	464.1	…
Stock of tax credits (ceiling)	154.4	154.4		147.0	154.4	147.0	145.0	145.0	145.0	145.0

1/ All items as defined in the TMU. The figures in bold indicate when a target has not been met.
2/ At program exchange rates.
3/ Below-the-line overall balance excluding net lending.
4/ Indicative target up to end-March 2009.

Table 2. Armenia: Proposed Structural Benchmarks for the Second, Third, and Fourth Reviews

Item	Measure	Proposed Time Frame (End of Period)
	Financial sector	
1	Approve a plan to increase the resources of the Deposit Guarantee Fund.	June 2009
2	CBA to adopt a formal foreign exchange market intervention strategy consistent with IMF technical assistance.	June 2009
3	Start offering repo operations with a maturity of at least three months.	June 2009
4	Submit to parliament an amendment to Article 11 of the “Law on the Central Bank of the Republic of Armenia” to ensure a gradual recapitalization of the CBA with marketable interest bearing securities.	September 2009
	Tax administration	
5	Meet the statutory 90-day processing deadline for all VAT refund claims filed in 2009.	Continuous in 2009
6	Submit legislation to parliament to (a) strengthen penalties for overstated VAT refund claims effective January 2010, and (b) pay interest on all legitimate VAT refund claims filed after December 2009 and not refunded within 90 days, with interest to be paid out of VAT revenues.	September 2009
	Tax and social policy	
7	In close collaboration with the World Bank, develop a strategy to further strengthen the targeting of social safety nets.	December 2009
8	As part of the unified Tax Code, submit legislation to parliament to bring petroleum and tobacco products within the regular tax regimes (excise tax, customs duties, profit tax, and VAT), effective January 2011.	December 2009

ATTACHMENT II. ARMENIA: TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum defines the benchmarks, performance criteria, indicative targets, adjusters, 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; performance criterion)**. 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 the total outstanding liabilities of the government and the CBA to the IMF and convertible currency liabilities of the CBA to nonresidents with an original maturity of up to and including one year. 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 (performance criterion).** For program purposes, NDA is defined as reserve money minus NIR, minus reserve money denominated in foreign currencies, plus medium- and long-term liabilities (i.e. liabilities with a maturity of one year or more) of the CBA, plus the balance of outstanding Fund purchases credited directly to the government account at 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. 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]

3. **The program targets a maximum level of net banking system credit to the government (performance criterion), defined as** the sum of net credit from the CBA and net credit from commercial banks to the central government.

- **The stock of net credit from the CBA to the government,** which 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.

- **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).

4. **The program imposes a zero ceiling on external payment arrears (continuous performance criterion)** defined as 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]

5. **The program targets a minimum level of the program fiscal balance (performance criterion).** The fiscal balance is measured as the negative of the sum of net domestic banking system credit to the government, 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.

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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 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.

- **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);[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 (including Fund net purchases credited directly to the government accounts at the CBA) 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.

6. 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 U.S.-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.

7. 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.

8. **The program targets a maximum level of stock of tax credits (indicative target)** 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

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[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.

payments, and others) resulting from advanced tax payments to be offset against future tax liabilities.

II. ADJUSTERS

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

- **Changes in reserve requirements**: The ceiling on the NDA of the CBA will be adjusted downward (upward) by the amount of banks' reserves freed (seized) by any reduction (increase) of the reserve requirement ratio on both domestic currency and foreign currency 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.

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

- **External financing to the public sector**, defined as disbursements of loans from bilateral and multilateral agencies for budget, project support, and the $500 million Russian loan (including Fund purchases credited directly to the government accounts at the CBA), with the exception of the KfW and World Bank disbursements mentioned above:

    - The floor on NIR will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of external financing in the form of budget support (excluding Fund disbursements to the government) or the Russian project loan compared to program amounts (Table 3).

    - The ceiling on NDA will be adjusted upward by the amount of any shortfall of external financing in the form of budget support or from the Russian loan compared to program amounts.

    - The ceiling on net banking sector credit to government will be adjusted upward by the cumulative amount of any shortfall of total external financing compared to programmed amounts (Table 3).

- The floor on the program fiscal balance on a cash basis will be adjusted downward by the cumulative amount of any excess of total external financing compared to programmed amounts (Table 3).

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

III. 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[4]	CBA balance sheet	Summary	Daily	The following working day
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within seven days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks by chart of accounts at actual official exchange rates	Monthly	Within 25 days of the end of each month
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Daily	The following working day
	Foreign exchange market	Official exchange rates (buying and selling); daily trade volume, and weighted average exchange rate of the interbank, intrabank and Nasdaq-OMX	Daily	Within 1 day
	Foreign exchange market	CBA foreign exchange operations, (exchange rate, volume, counterpart)	Daily	Within 1 day
	Foreign exchange market	Exchange rate (buying and selling)	Daily	Within 1 day
	Interest rates	Refinance rate	At least monthly	Within 1 days of the CBA Board decision
	Interbank money market	Daily interbank repo volume and interest rate and number of trades	Daily	Within 1 day
	CBA operations	Repo (reverse repo) operations, open market operations, Lombard credits, deposit facility, and foreign exchange swaps (volumes, maturity, yields, exchange rates)	Daily	Within 1 day
	Bank liquidity	Reserves and excess reserves, by currency	Monthly	Within 15 days of the end of each reference period

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

	Interest rates and flows of the funds attracted and allocated by commercial banks	By currency and maturity	Weekly	Last working day of the week
	T-bill and coupon bond financing, CBA securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Weekly	Last working day of the week
	Banking data	Sectoral distribution of loans and deposits; dollarization of loans and deposits; loan maturities; interbank rate, by volume and maturity; T-bill rate, bond yield; deposit and lending rates, by maturity; monthly weighted average interest rate on government bonds	Monthly	Within 25 days of the end of each month
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Monthly	Within 30 days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Monthly	Within 30 days of the end of each month
	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
	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 quarter (monthly data provided on a quarterly basis)

		For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	Tax credits	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	VAT refund claims in arrears	Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90 day statutory processing period. Number of refund applications processed per month.	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	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 and IBRD SME Loan Disbursements 1/
(In billions of dram)

2009			
March	June	September	December
2.39	2.39	33.63	36.01

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

Table 3. Armenia: External Financing to the Public Sector (Program) 1/ (in billions of drams)			
2009			
March	June	September	December
Project financing			
14.72	50.82	81.21	105.58
Budget support			
3.09	78.93	97.34	116.23
Russia			
	192.50	192.50	192.50
Total			
17.81	322.25	371.05	414.30

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