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

November 22, 2011

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ARMENIA: LETTER OF INTENT

Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Yerevan, November 22, 2011

Dear Ms. Lagarde:

1. **Armenia continues its path of stabilization and recovery**. Growth is picking up in 2011, although the construction sector, a key growth driver prior to the crisis, remains strained. With timely policy rate hikes, budgetary spending restraint, a recovery of the agriculture sector in Armenia, and favorable global food and fuel price developments, inflation has come down sharply from high levels reached in February and March. Public finances are improving, and the financial sector is well capitalized and expanding rapidly. At the same time, our external current account deficit remains high, underscoring the need to sustain our efforts to address structural rigidities and improve the business environment, domestic competition, and competitiveness.

2. **Performance under our program, which is supported by arrangements under the Extended Fund and Extended Credit facilities (EFF/ECF), has been good**. The program is on track, with most continuous and quantitative performance criteria (PC) and indicative targets for end-June 2011 met. The end-June PC on net domestic assets (NDA) of the Central Bank of Armenia (CBA) was missed by a small margin, due to temporary factors (delays in donor budgetary support by a few days), while the end-June indicative target on social spending was also missed by a small amount, as targeting of social outlays was being improved in the first half of the year. The program did not incorporate an adjustor for shortfalls in programmed budget support, but such an adjustor will be added going forward. All but one of the structural benchmarks were met (one with a delay). All but one of the indicative targets for end-September 2011 were observed.

3. **This Letter of Intent (LOI) describes policies that we will implement for the remainder of 2011 and in 2012.** Our near-term policies will continue to be geared to containing pressures and limiting disruptions to the recovery. Our reform program aims at enhancing economic growth and poverty reduction, fiscal and debt sustainability, and further developing a sound financial system.

I. Recent Developments and Outlook

4. **Growth is strengthening and inflation is rapidly declining, as agriculture recovers from last year's sharp drop**. Growth has been led by the manufacturing, mining, and service sectors. Agriculture activity picked up significantly in the second and third quarters, suggesting return to a normal harvest season, even though very substantial structural

challenges remain in the sector. Despite some volatility, inflationary pressures from food have receded sharply, and headline inflation has come down from its peak of 11½ percent in March towards the target range (4 ± 1.5 percent). Credit has grown rapidly this year, suggesting increasing economic activity. For the year as a whole, the economy is expected to grow by 4.6 percent, with inflation expected to remain subdued through year end.

5. **Growth is expected to moderate to 4 percent in 2012, with inflation remaining within the target range**. The slowdown of the global economy is a risk. Due to base effects, inflation is expected to decline below the midpoint of the target band in the first half of 2012, before reaching just over 4½ percent by year-end. Growth should remain at around 4 percent per year over the medium-term. Fiscal consolidation will continue, helping to stabilize and gradually reduce public debt. With continued structural reforms, fiscal consolidation, and a flexible exchange rate, the sizeable external current account deficit should be reduced steadily through 2015.

II. THE PROGRAM FOR 2011–12

A. Fiscal Policy and Debt Sustainability

6. **We are continuing to reduce the fiscal deficit to ensure debt sustainability and help address external imbalances**. We will reduce the deficit to well below 4 percent of GDP this year, and we are targeting a deficit of 3.1 percent of GDP in 2012. We are aiming to improve the tax revenue-to-GDP ratio by 0.6 percentage points in 2012 and remain committed to saving at least half of tax revenue overperformance. If revenues fall short, we will strictly limit non-priority spending. The headline deficit is projected to reach 2.3 percent of GDP in 2013. A modest further consolidation thereafter would keep the debt to GDP ratio on a gradually declining path, and along with further revenue gains would balance the need to ensure a buffer against shocks with providing space for infrastructure and social spending needs.

7. **We have demonstrated our commitment to meeting program fiscal targets through strict expenditure management.** We very cautiously managed spending in the first half of 2011. We also made efficiency gains and better targeted delivery of pension outlays and family benefits. While strict expenditure control should ease in the second half of 2011, we project underspending and overperformance on the fiscal deficit for the year. Still, we expect to meet our social spending targets, and we are considering legislative amendments that will enable the full functioning of the integrated system of social protection services. Another important expenditure initiative—the interest rate subsidy and seed distribution program for the agricultural sector—worked well to moderate price pressures and support recovery in agriculture. Looking ahead, higher tax yields should allow us to ease spending constraints in key areas to protect socially vulnerable segments of the population.

8. **In 2012, we will implement a set of revenue measures to increase our low tax-to-GDP ratio**. The measures will involve a range of actions, including changes to the corporate income tax (including thin capitalization provisions), increased personal income taxes and

social contributions from high-income taxpayers, higher excises on alcoholic beverages (including to harmonize excises on domestic and imported products), higher presumptive taxes on tobacco and casinos, a new excise tax on motor oil, and administrative measures and improvements (e.g., improved enforcement of the new regime for fuel taxation). We were not able to obtain support for automatic indexation of excises (Structural benchmark, August 2011), but we will secure an increase of most excises in 2012 in excess of inflation, so as to generate revenue gains. This includes adjustment of the specific tax on luxury and sport utility vehicles.

9. **A key tax policy measure for 2012 is overhauling the fiscal regime for the mining sector** (Structural benchmark, December 2011). This includes a redesigned mining royalty in line with international best practices, complemented by a strict limit of the fiscal stability clause in the new mining code to tax rates and a set period of 5 years and a transfer pricing rule for the mining sector. Following further study and technical assistance, we will adopt broad transfer pricing legislation for all sectors for implementation in 2013. This will allow the tax authority to adjust prices between related parties, including interest charged on related party loans, to reflect market or arm's length prices. More broadly, we are finalizing a detailed strategy paper to lay our tax reform objectives and implementation plan for 2012–15. The strategy builds on recent IMF TA and will cover the initial changes in 2012 and our plans to address exemptions and tax expenditures (including in the agriculture sector), further reforms for mining, and plans for other taxes.

10. **We have made further progress in tax administration.** We have made tax reporting and payment less frequent, and reduced the number of forms needed. We have extended the e-filing system to over 6,100 taxpayers, and we are expecting to operate electronic processing of tax returns and automated invoice processing by end-2011. All VAT taxpayers must file electronically starting January 2012. We have started to implement a risk-based management approach in VAT refund processing. The system was introduced somewhat later than expected, due to the time required for testing the software system. We have also put in place the key elements for risk-based tax audits (legislation, software, etc.), a long-standing objective, and we will start these in 2012. We have improved the quality of taxpayer services through new taxpayer call and service centers, and we are exploring the concept of a tax ombudsman to improve the accountability and fairness of the tax system for small businesses. The tax appeals committee under the government is working well, and we have recently published a booklet on clarifications of the legislation and regulations. Finally, we have made progress in collecting taxes from large taxpayers (LTPs). LTP collections in terms of total domestic revenues are continuing to increase. This reflects, in part, changes in the criteria for selection of LTPs, and an increase of the number of designated LTPs by 100.

11. **Notwithstanding this progress, we will enhance our tax administration reform efforts**. We are making progress to establish within the taxpayer registry the capacity to identify VAT liability for each taxpayer. This capacity requires the addition of a VAT payer identification number to the tax identification number. The registry and the risk-based management audit and refund approaches should help us to begin to make progress with the

large stock of outstanding VAT credits. We will issue a White Paper detailing the measures and costs of addressing mixed cash and accrual accounting and refunding or setting off against future VAT liability excess VAT credits drawing on IMF TA (Structural benchmark, March 2012). Full-fledged implementation of these reforms is strongly dependent on the availability of additional budget resources. We will renew an agreement between the Ministry of Finance and the State Revenue Committee (SRC) on information sharing to strengthen our assessment of tax expenditures and revenue developments and our capacity for tax policy and revenue administration.

12. **We are assessing options to deal with Nairit, a chemical company and Armenia's largest industrial enterprise**. While Nairit has encountered financial difficulties, we believe that it has potential to attain profitability and export markets, particularly in the CIS region and Asia, with new ownership, management, and modernization. We have applied for concessional financing from the EurAsEC Anti-Crisis Fund of up to $400 million. However, recognizing the complexity and risks of this operation, we will move cautiously to find a private-sector led solution that minimizes exposure of the government and use of public funds, and will assume liabilities (including guarantees) only in consultation with the Fund and the World Bank. In case we are unable to find a relevant private-party solution, we would look forward to IFI assistance in handling Nairit's large scope of concerns (including environmental and safety issues).

B. Monetary and Exchange Rate Policy

13. **Our monetary policy will continue to aim at price stability**. As inflationary pressures are subsiding at a faster pace than expected, we reduced the CBA policy rate by 50 basis points in September, after keeping the rate steady at 8½ percent since April. Under our baseline projection, the output gap is expected to close, and inflation should return to the target band in the second half of 2011. Thus, further policy action is unlikely to be needed. We will, however, remain vigilant against both upside and downside risks to the economy. Should a faster fiscal consolidation and further deterioration in the global economy increase deflationary pressures, we will stand ready to cut the policy rate further.

14. **We will allow greater exchange rate flexibility going forward**. The foreign exchange market has been broadly stable in 2011, and our interventions in the market will continue to aim at smoothing unusually large movements, while not resisting fundamental trends. We also aim to build international reserves as a buffer against exogenous shocks and in view of forthcoming repayments of crisis-related support. We intend to once again lock in strong performance on reserves by significantly increasing our program targets for the remainder of 2011, in comparison with targets set at the time of the Second Review, including by $16 million for end December. We have set ambitious yet achievable targets for 2012.

15. **We are enhancing our inflation-targeting framework**. To this end, we are strengthening our capacity for model building and forecasting to help guide policy decisions. We are also improving monetary and financial operations to increase the influence of the

policy rate. Since April, we have stepped up liquidity management in dram markets, and as a result, market rates have been moving broadly in line with the policy rate. We will aim to reduce the volatility of interbank rates by conducting more frequent fine-tuning operations. In addition, we will provide more information on future liquidity conditions to market participants by publishing liquidity forecasts. We are also standardizing our standing facilities and supporting efforts of NASDAQ OMX Armenia to develop term interbank instruments that will provide higher flexibility and security than the current interbank repo transactions. These are expected to involve provision of collateral for trades by participants, and not transaction guarantees by the CBA.

C. Financial Sector Stability and Development

16. **We will continue to safeguard the stability of the banking system, especially in light of rapid growth of loan portfolios**. With the credit-to-GDP ratio remaining low, we anticipate credit to grow faster than the economy in the coming years. In addition, with deposits remaining highly dollarized and with banks continuing to enjoy access to relatively cheap funding from abroad, we anticipate that foreign exchange lending will continue to predominate. We have raised risk weights and provisioning for foreign currency loans and Armenian banks have remained well-capitalized. To further strengthen the resilience of the banking system, we will initiate a study on the possible impact of introducing liquidity coverage ratios by major currencies and will prepare a report for discussion during the forthcoming FSAP Update and next review missions. The report will study the feasibility of such coverage ratios, the most effective design, and the timing for enforcement. These ratios are currently imposed on total assets and liabilities of each bank, currency composition notwithstanding. We will take further steps to curb foreign exchange-induced credit risk, if the enhanced stress-testing methodology finds it necessary. The FSAP Update will help shape financial stability policy to increase the resilience of the banking sector.

17. **We will further improve our tools to monitor risks in the banking system**. With a view to facilitating a more forward-looking assessment of risks to financial stability, we are enhancing our stress testing methodology to incorporate real sector variables and possible contagion effects from interbank transactions and capture the potential impacts of exchange rate movements on default probabilities. We will share the key elements of the new methodology with banks, so that they can improve their risk management tools.

D. Structural Reforms

18. **We remain committed to our reform agenda aimed at improving the business environment.** We have made key legislative changes, most notably to the laws on inspections and competition and have pursued implementation of a comprehensive action plan covering areas assessed under the World Bank's "Doing Business" rankings.

- The new law on inspections involves a reorientation for inspection agencies to risk-based oversight, for example, in tax, labor, fire and safety, and sanitary inspections, as well as greater transparency in planning and reporting. A key aim is to clarify rules and procedures and reduce direct contacts with inspection agency staff, thereby limiting opportunities for corruption.

- The changes to the competition law give greater power and tools to the competition committee to address abuse of market power and influence. In 2011, the committee has initiated a number of cases of abuse of dominance in highly concentrated markets, including in telecommunications, energy, and food processing and marketing.

- Under the Doing Business action plan, electronic systems have been introduced in business registration, tax filing and compliance, customs declaration, legal proceedings, and contract enforcement. Procedures for certificates of origin for exports and custom formulation for imports have been eased, and registration of property titles streamlined. These actions have reduced transaction costs and increased transparency. A new investor protection law was introduced in June 2011 aiming at strengthening the rights of shareholders and preventing conflict of interest in any transaction.

19. **We will continue our business environment reforms in 2011–12**. We will implement a new Doing Business action plan that covers 50 actions, including simplifying tax payments by SMEs, allowing electronic customs payments by small and medium-sized importers via the SRC's website, further improving customs valuation procedures, and reducing the costs of company registration and the number of procedures for resolving contractual disputes. A broader Investment Climate Reform Action Plan is under consideration and will cover corporate governance and commercial dispute resolution. Another important initiative is the "Regulatory Guillotine," which aims at significantly reducing Armenia's 26 thousand regulations over the next 18 months. The project will involve cooperation with the private sector, focus on areas of public interaction with regulators, and aim to ensure revenue neutrality for the state budget. Finally, the competition committee will continue to step up anti-competitive enforcement efforts under its newly enhanced legal framework in 2012.

III. CONCLUSION

20. **Given our strong program implementation, we request the completion of the Third Review of the EFF/ECF program and the associated disbursement of SDR 36.2 million.** We also request a waiver for nonobservance of the end-June 2011 PC on NDA of the CBA and modification of the end-December PCs for NIR and NDA and revision of the NDA PC to include a symmetrical adjustor on external financing. In addition, we request the establishment of PCs for end-June 2012.

21. **We are requesting further Fund financing under the ECF to meet our external budgetary payment obligations**. The program had envisaged that Fund support for external budgetary payments would come to an end in 2011. However, in light of the strength of the program, in particular the important measures to increase tax revenues, and given our difficult financing situation, we request that SDR 27 million be provided for external

budgetary payments in 2012. To make clear our intentions to exit from such support, the 2012 amount is less than the funding provided in 2011. We are in contact with donors and partners to seek additional financing, including to close the remaining gap in 2013.

22. **We will maintain a close policy dialogue with the Fund and stand ready to take additional measures, as appropriate, to ensure the achievement of our social and economic objectives under the EFF/ECF program**. We will continue to consult with the Fund on the adoption of measures, and in advance of revisions of the policies contained in the LOI, in accordance with the Fund's policies on such consultation. We will also provide the Fund with information it requests for monitoring progress during program implementation. The program's quantitative performance criteria and indicative targets, as described in the attached Technical Memorandum of Understanding, and structural benchmarks are set out in Tables 1 and 2. The Fourth Review is expected to be completed on or after March 30, 2012. The Fifth Review is expected to be completed on or after September 30, 2012.

23. **We authorize the IMF to publish this Letter of Intent and its attachments, as well as the accompanying staff report.**

Very truly yours,

/s/
Tigran Sargsyan
Prime Minister
Republic of Armenia

/s/
Vache Gabrielyan
Minister of Finance
Republic of Armenia

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

Table 1. Armenia: Quantitative Targets for 2010–12 1/

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

	2010	2011											2012			
	Dec.	Mar. 2/			Jun.			Sep. 2/			Dec.		Mar. 2/	Jun.	Sep. 2/	Dec. 2/
	Act.	Country Report No. 10/350	Adj. Prog.	Act.	Country Report No. 11/178	Adj. Prog.	Prel.	Country Report No. 11/178	Adj. Prog.	Prel.	Country Report No. 11/178	Prog.	Prog.	Prog.	Prog.	Prog.
Performance Criteria																
Net official international reserves (floor, in millions of U.S. dollars)	892	831	748	833	795	761	800	769	766	878	819	835	785	802	812	764
Net domestic assets of the CBA (ceiling)	54	99	98	85	109	108	**118**	143	141	98	155	187	187	186	197	248
Program fiscal balance (floor) 3/	-124	-34	-34	-3	-50	-67	-29	-99	-108	-58	-187	-187	-22	-37	-64	-167
External public debt arrears (continuous criterion)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Indicative Targets																
Reserve money (ceiling)	508	515	520	506	522	527	520	538	543	**571**	563	596	578	594	614	658
Average concessionality of newly contracted debt (floor, in percent)	32										30	30				30
Social spending of the government (floor) 5/	31	9	9	**7**	18	18	**15**	27	27	27	36	36	8	15	28	37
Memorandum items:																
Budget support grants	…	…		0	16		3	16		12	31	33	0	6	6	10
o.w. EU MFA grant	…	10		0	8		0	8		8	19	19	0	0	0	0
Budget support loans	37	22		0	25		10	35		35	67	67	0	26	26	33
o.w. non-IMF loans	0	22		0	14		10	24		24	45	45	0	17	17	17
Project financing	72	6		10	24		16	42		36	61	58	23	46	70	93
KFW and IBRD loan disbursements	2	1		0	1		0	2		0	10	9	1	2	2	3

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU.

2/ Indicative target.

3/ Below-the-line overall balance excluding net lending and project financing until March 2011. Below-the-line overall balance excluding net lending from June 2011.

4/ Assessed on a calendar year basis.

5/ Defined as 100 percent of the budgeted amount of the family benefit program and lump-sum financial aid.

Table 2. Armenia: Structural Benchmarks Under the EFF/ECF Arrangement

Item	Measure	Proposed Time Frame (End of Period)	Outcome	Comment
Tax administration				
1	Issue a government decree stipulating that clarifications and interpretations of laws, regulations, and procedures on taxes, duties, and mandatory fees should be approved by the Ministry of Finance. These clarifications and interpretations will become normative acts to be published and applied consistently across all taxpayers effective September 1, 2010.	July 2010	Met	
2	Set up a Tax Appeals Council under the Government to deal with legal and procedural disputes of taxpayers.	September 2010	Met with delay	
3	Develop manuals in tourism, real estate, transport, and sectors using cash register machines for tax audits for usage starting January 2011.	December 2010	Met	
4	Simplify the reporting system by reducing the frequency of reporting to tax authorities and considerably streamline tax forms for VAT, profits tax, and personal income tax.	December 2010	Met	
5	Adopt a government decree establishing a mechanism for implementing a fully functional risk management approach in VAT refund processing.	December 2010	Met	
6	Implement a fully functional risk-based management approach in VAT refund processing.	June 2011	Met with delay	
7	Establish the capacity to identify whether the taxpayer has VAT liability by adding a VAT payer identification number to the tax identification number.	December 2011		Replaces previous SB ("Set up a taxpayer registry")
8	Issue a White Paper detailing the measures and costs to address of addressing mixed cash and accrual accounting and refunding or setting off against future VAT liability excess VAT credits.	March 2012		New
Tax policy				
9	Introduce legislative changes that provide for annual automatic indexation of excises for inflation.	August 2011	Not met	
10	Increase the tax rate structure for up-market luxury vehicles and SUVs for 2012 and adjust the specific tax on cars annually for inflation.	December 2011		
11	Approve a Tax Strategy paper that lays out the tax reform objectives and implementation plan for 2012–15.	December 2011		
12	Overhaul fiscal regime for the mining sector	December 2011		New
	a. Strictly limit the fiscal stability clause in the new mining code to tax rates and to a set period of 5 years.			
	b. Introduce and collect resource rents in terms of a variable royalty regime with the sliding rate depending on the EBIT to sales value.			
	c. Clarification of deductibility of contributions for mine rehabilitation and mine site clean-up.			
Social policy				
13	Submit amendments to existing laws to parliament to enable the full functioning of an integrated system for the provision of social protection services.	December 2011		
Fiscal and debt sustainability				
14	Approve a medium-term expenditure framework (2011–13), including a medium-term debt management strategy.	August 2010	Met	
Monetary sector				
15	Approve terms and conditions for deposit auction to enable the CBA to absorb liquidity with greater flexibility.	September 2011	Met	
16	Publish the CBA's liquidity forecast that provides projected amount of dram liquidity before CBA's actions with indication of separate components such as currency outside the CBA, net foreign assets, government transactions excluding treasury bill issuances, and treasury bill issuances for liquidity management purposes.	December 2011		
Financial sector				
17	Issue prudential regulations to specifically address currency-induced credit risk, including increased loan-loss provisioning requirements and higher risk weights in capital requirements for foreign currency loans.	June 2010	Met	
18	Formalize the Committee for Financial Stability in an MOU to set the modalities for main policy makers to coordinate their policies and responses in case of an imminent critical situation in the banking sector.	September 2010	Met	
19	Issue prudential regulation requiring banks to prepare their contingency plans for liquidity and solvency support.	December 2010	Met	

ARMENIA: UPDATED TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum sets out the understandings between the Armenian authorities and the IMF staff regarding the definition of performance criteria and indicative targets, their adjusters, and data reporting requirements for the three-year EFF/ECF Arrangement as per the Letter of Intent dated November 22, 2011 (LOI).

2. For program monitoring purposes, all foreign currency-related assets, liabilities, and flows in the monetary accounts will be evaluated at program exchange rates. The program exchange rate of the Armenian dram to the U.S. dollar is set at 385 dram per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

I. Quantitative Targets

3. The program sets performance criteria and indicative targets for defined test dates (see Table 1 in the November 22, 2011 LOI). The program sets the following performance criteria:

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

The program sets the following indicative targets:

- Ceiling on reserve money;
- Floor on average concessionality of new debt; and
- Floor on social spending of the government.

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

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

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

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

5. **Reserve money** is defined as the sum of currency issued, required and excess reserves, and current and time deposit accounts of certain resident agents. Liquidity absorbing transactions under reverse repurchase agreements, foreign currency swaps, and securities issued by the CBA are excluded from the reserve money definition. The ceiling will be considered as met if the outcome is within AMD 5 billion of the indicative target sets in Table 1 attached to the Letter of Intent dated November 22, 2011.

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

7. **External public debt arrears** are 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.[1] The ceiling on external payment arrears is set at zero.

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

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

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

- **Net external financing** equals total debt-increasing disbursements from non-residents to the central government (including Fund net purchases credited directly to the government accounts at the CBA) less total amortization from the central government to non-residents. All foreign currency-denominated transactions are recorded in drams using the prevailing exchange rate at the time of the transaction.

9. External and domestic net lending, which are recorded as financing items, are *excluded* from the calculation of the program fiscal balance. This effectively treats net lending as an expenditure item when loans are made and as a revenue item when the loans are repaid.

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

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[1] The public sector is here defined following the *Government Financial Statistics Manual* (GFS 2001) and *System of National Accounts* (1993 SNA). It includes the general government and nonfinancial public enterprises (as defined in paragraph 12).

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

accounts as a financing item below the line and are thus excluded from net lending. Under previous Technical Memoranda of Understanding, these activities were excluded from the calculation of the program fiscal balance. This treatment reflected lags in receiving information from project implementation units and on project loans intermediated through the banking system. With the shift to semi-annual program reviews with the EFF/ECF arrangement and consolidation of the accounts of these units in the Treasury, there is no longer a need for such exclusion, and these activities are now fully accounted for in the program fiscal balance.

11. Foreign currency proceeds from selling enterprises are deposited into the Special Privatization Account (SPA). The SPA is held at the CBA and the proceeds are invested abroad together with the CBA's international reserves. These proceeds are included in the definition of the monetary accounts of the CBA as part of net foreign assets with a counter entry in other items net. Any 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 and are also treated as a financing item and recorded below the line.

12. The program sets an annual indicative floor of 30 percent on average concessionality of new debt on a contraction basis on debt with nonresidents with original maturities of one year or more contracted and guaranteed by the public sector.

- The grant element is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose for 2011 onwards are the currency specific commercial interest reference rates (CIRRs), published by OECD. For debt with a maturity of at least 15 years, the ten-year-average CIRR is used to calculate the PV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR is used. The margins for differing repayment periods (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more) are added to the ten-year and six-month CIRR averages.

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

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

13. The program sets a floor on **social spending of the government**. For the purposes of the program, social spending of the government is defined as 100 percent of the budgeted amount of the family benefit program and lump-sum financial aid.

II. Adjustors

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

- **KfW 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.

- **Budget support grants to the public sector** are defined as grants received by the general government for direct budget support from external donors and not related to project financing.

- **Budget support loans to the public sector** are defined as disbursements of loans from bilateral and multilateral donors for budget support and Fund purchases credited directly to the government accounts at the CBA.

- **Project financing to the public sector** is defined as disbursements of loans from bilateral and multilateral donors for public sector projects.

- **The floor on NIR** will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants (excluding Fund disbursements to the government) compared to program amounts (Table 3). The floor on NIR will be adjusted downward for any external public debt amortization amounts in excess of program amounts.

- **The ceiling on NDA** will be adjusted downward (upward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants compared to program amounts (Table 3).

- **The floor on the program fiscal balance on a cash basis** will be adjusted upward (downward) by the cumulative total amount of the budget support grants received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $25 million in either direction. The floor on the program fiscal balance on a cash basis will also be adjusted downward (upward) by the cumulative total amount of the project financing received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $50 million in either direction.

III. Data Reporting

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA	CBA balance sheet	Summary	Daily	The following working day
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within seven days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks by chart of accounts at actual official exchange rates	Monthly	Within 25 days of the end of each month
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Daily	The following working day
	Foreign exchange market	Official exchange rates (buying and selling); daily trade volume, and weighted average exchange rate of the interbank, intrabank and Nasdaq-OMX	Daily	Within 1 day
	Foreign exchange market	CBA foreign exchange operations, (exchange rate, volume, 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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
				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
	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	Monthly	Within 21 days of

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		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		the end of each month. For project implementation units, within 21 days of the end of each month (preliminary data) and within 45 days of the end of each month (final data)
	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions	Monthly	Within 7 days of the end of each month
	Domestic expenditure arrears	All unpaid claims outstanding at the end of the month which includes wages, social contributions (including for pensions), family allowances, and amortization and domestic interest payments	Monthly	Within 45 days of the end of each month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month
	Treasury single account (TSA)	Detailed breakdown of central treasury account, including deposits at the central treasury, community budgets, off budget account, monetization account, state budget account and the Republic 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	Monthly	Within one month following the end of each quarter.

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		government; expenditure data will be provided according to both economic and functional classifications, consistent with the GFSM2001 methodology		
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
		Detailed balance of payments data	quarterly	Within 60 days of the end of each quarter
	CPI	By category	Monthly	Within 5 days of the end of each month
State Revenue Committee	Tax arrears	By type of tax	Monthly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)
		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)
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax inspectorate	Monthly	Within 45days after the end of each month
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty free recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions	Quarterly	Within 30 days of the end of each quarter

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

Table 1. Armenia: (Program) Exchange Rates of the CBA
(As of December 31, 2008 in U.S. 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
SDR	593.00	1.5403

Table 2. Armenia: KFW and IBRD SME Loan Disbursements, 2010-12 1/
(In millions of U.S. dollars)

Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11		Sep-11		Dec-11		Mar-12	Jun-12	Sep-12	Dec-12
Actual	Actual	Actual	Actual	Actual	Country Report No. 11/178	Prel.	Country Report No. 11/178	Prel.	Country Report No. 11/178	Prog.	Prog.	Prog.	Prog.	Prog.
0.0	0.0	5.0	5.0	0.0	2.0	0.0	4.0	0.7	25.8	23.8	2.0	4.0	6.0	8.0

1/ Cumulative from the end of the previous year.

Table 3. Armenia: External Disbursements to the Public Sector in 2010-12 1/
(In millions of U.S. dollars)

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11		Sep-11		Dec-11		Mar-12	Jun-12	Sep-12	Dec-12
	Actual	Actual	Actual	Actual	Actual	Country Report No. 11/178	Prel.	Country Report No. 11/178	Prel.	Country Report No. 11/178	Prog.	Prog.	Prog.	Prog.	Prog.
Project financing	63	107	145	193	26	62	42	109	93	158	152	60	121	181	241
Budget support loan	0	38	67	96	0	66	25	91	91	175	175	0	68	68	85
Budget support grant	…	…	…	…	0	41	7	41	32	82	86	0	15	15	27
of which: EU MFA	…	…	0	0	0	20	0	20	20	50	50	0	0	0	0
Total	63	145	212	289	26	168	74	240	216	414	413	60	204	264	353

1/ Cumulative from the end of the previous year.