**International Monetary Fund**

Republic of Armenia
and the IMF

# **Republic of Armenia:** Letter of Intent, and Technical Memorandum of Understanding

**Press Release**:
IMF Executive Board Completes Fourth Reviews Under EFF/ECF Arrangement for Armenia and Approves US$50.7 Million Disbursement
June 15, 2012

May 31, 2012

The following item is a Letter of Intent of the government of the Republic of Armenia, which describes the policies that the 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 the 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.

Country's Policy Intentions Documents

## Armenia: Letter of Intent

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

Yerevan, May 31, 2012

Dear Madam Lagarde:

1. **Armenia is continuing its path of recovery and stabilization**. Growth picked up to 4.6 percent in 2011, with strong performance in industry, services, and agriculture. Construction remains in a slump. Inflation has come down from high levels in early 2011 with appropriate policies, a recovery in agriculture, and favorable global price developments. Fiscal consolidation was larger than expected in 2011, reflecting higher-than-expected grants, administrative improvements and efficiency gains, delays in project implementation, and spending restraint. The lower fiscal deficit contributed to a sizable reduction of the external current account deficit, which however remains high. The financial sector is well capitalized and sound, and credit has continued to expand rapidly, particularly in foreign currency (FX). In 2012, weaker global conditions are expected to reduce growth to 3.8 percent, just below potential. A further slowing of the global economy and spillovers from Europe are downside risks for economic activity. Over the medium term, fiscal and external consolidation will continue, supporting both economic growth close to potential, as well as stabilization and gradual reduction of public debt. Inflation should remain within the target range. Further structural reforms are planned to strengthen the business environment and competitiveness and boost private investment. Structural reforms, along with prudent macroeconomic management, should keep growth at around 4 percent per year over the medium term.

2. **Our program, supported by Extended Fund and Extended Credit (EFF/ECF) arrangements, remains on track**. All continuous and quantitative performance criteria (PCs) and most indicative targets (ITs) for end-December 2011 were met. All but one of the structural benchmarks were implemented, with one partly implemented and progress made on the outstanding measure. Preliminary indications are that most of the end-March 2012 ITs were also met; the ceiling on reserve money and the floor on social spending appear to have been missed by very small margins. This Letter of Intent (LOI) describes policies for the remainder of 2012. These continue to aim at containing pressures, limiting disruptions to the recovery, enhancing growth and poverty reduction, strengthening fiscal and debt sustainability, and further developing a sound financial system. We anticipate broad policy continuity following the parliamentary elections in May.

## THE PROGRAM FOR 2012

### Fiscal Policy and Debt Sustainability

3. **We have further reduced the fiscal deficit to help ensure debt sustainability and address external imbalances**. The fiscal deficit in 2011 was significantly lower than targeted under the program due to lower spending on goods and services, efforts to verify social allowance and pension recipients, lower spending on capital investment co-financing, and higher grants. For 2012, fiscal policies aim to increase tax revenues, while directing additional resources for growth and poverty reduction. We have implemented a major tax package aimed at improving the tax revenue-to-GDP ratio by 0.6 percentage points in 2012, based on IMF technical assistance. Measures adopted this year include: changes to the corporate income tax (thin capitalization provisions); increased income taxes and social contributions from high-income taxpayers; higher excises on alcoholic beverages; higher presumptive taxes on tobacco and casinos; and new excise taxes on motor oil and luxury cars. Importantly, we overhauled the fiscal regime for mining (structural benchmark) and increased the tax rate on non-metallic minerals. Grants are expected to be significantly lower in 2012. On the expenditure side, implementation of large capital projects will be stepped up, while social allowances and pensions will be increased, and benefits for the core civil service improved. As temporary factors helped contribute to the below-program deficit outturn in 2011, the fiscal deficit will be somewhat higher in 2012 in line with the program. Renewed consolidation in 2013–15 (with deficits of 2.6, 2.3 and 2.0 percent of GDP, respectively) is aimed to stabilize the public debt ratio; additional revenue gains of 0.4 percent per year will help mitigate the need for further spending cuts. We remain committed to saving at least half of tax revenue overperformance

4. **We will continue efforts to raise additional revenues through tax policy changes.** A tax strategy paper was finalized in December 2011 (structural benchmark) to help guide our actions. A key initiative for 2012 is preparation and submission of legislative proposals to adopt OECD guidelines for transfer pricing for implementation in 2013 (Structural Benchmark, November 2012), with support from the IFC. To support the medium-term revenue targets, we are considering a range of measures, including options for conversion of fees on extraction of non-metallic minerals to a royalty regime.

5. **We are also making further progress in tax administration reforms.** From January 2012, VAT taxpayers are required to file electronically, and new capacity within the taxpayer registry to identify VAT liabilities for each taxpayer (structural benchmark) will help support risk-based management audit and refund approaches and progress with the large stock of outstanding VAT credits. We issued a White Paper detailing measures and costs of addressing mixed cash and accrual accounting for VAT and refunding or offsetting excess VAT credits (structural benchmark). Following the recommendations in the White Paper and should sufficient additional funding be available, we will take actions to reduce the backlog of credit and ease restrictions on refunds of new credit. In addition, in line with our 2012–14 tax administration strategy, we will continue to decrease the number of field offices—by up

to 5 offices in the regions this year—as we expand service centers and extend e-filing. E-filing will be made available for all types of tax returns, and we are aiming that 40 percent of all tax returns be filed electronically by end-2012, from less than 10 percent now. To do so, a set of actions and incentives to promote enhanced e-filing will be developed by end-June, while a new tax administration IT program will help boost capacity. We are identifying specialized areas where additional capacity is needed (e.g., mining, financial services, transfer pricing). Finally, a new internal audit function is being introduced in the State Revenue Committee that is expected to begin work by July.

6. **We are continuing efforts to enhance social protection**. A key initiative is integration of the wide range of social services to enhance efficiency and service provision. While submission of legal amendments to parliament to enable the full functioning of integrated social services was delayed (structural benchmark), progress is being achieved. The delay reflected the need for further work after a pilot in 6 regions and the need for an inventory of services and an updated model for integration across ministries, agencies, and local governments. Legal changes should also facilitate information sharing across agencies, cooperation with NGOs, and new initiatives (e.g., at-risk teenagers). The aim now is Cabinet approval of a list and timetable of legal amendments (Structural benchmark, October 2012), and submission of the legal changes to parliament by mid 2013. While the delay is unfortunate, the required changes have proved to be significantly more complex than anticipated.

7. **We are accelerating our preparations for the introduction of pension reforms in 2014.** Substantial work lays ahead for successful transition to a funded pension system. We are working to lay out the regulatory framework in which the pension funds will operate, and establish adequate prudential norms based on an analysis of financial stability risks and recommendations from the recent FSAP Update mission. These will include specific rules for licensing of asset managers, investment policy regulations for pension portfolios, and rules governing consumer information. We will prepare approximately 35 separate decrees on pension reform issues in 2012–13. To help manage this process and keep the public informed, we have created a special fund for public relations and increasing awareness on the pension reforms. An action plan will be adopted, and information about performance will be publicized periodically. In addition, capacity to produce updated estimates of the fiscal costs of the reform (including the contingency costs of state guarantees) will be enhanced, with the first set of comprehensive estimates completed by year end (Structural benchmark, December 2012).

## Monetary and Exchange Rate Policy

8. **Monetary policy will continue to aim at price stability**. As inflationary pressures have moderated, and spillovers from the Eurozone and Russia have not materialized, we have kept the policy rate steady at 8 percent since September 2011. Under the baseline scenario, the output gap is expected to remain small, and headline inflation is likely to stay in the target range over the policy-relevant horizon. Thus, further policy action is unlikely to be needed.

We will, however, remain vigilant, in particular against downside risks. Should risks leading to deflationary pressures clearly materialize, we will stand ready to reduce the policy rate in line with our inflation-targeting framework.

9. **Our commitment to a flexible exchange rate has not changed.** Our interventions in the market will not resist fundamental trends, but rather be limited to smoothing unusually large movements while maintaining a strong international reserve position as a buffer against exogenous shocks. We are making additional efforts to ensure that our international reserves meet or exceed the levels targeted for 2012 at the time of the Third Review. We are also reviewing our reserve management guidelines in light of recent discussions with the IMF staff. We will establish enhanced guidelines in consultation with the IMF prior to the next review.

10. **We will continue our efforts to strengthen our inflation-targeting regime.** Drawing on recent IMF technical assistance, we will improve our monetary policy framework by stepping up our capacity for model building and forecasting and by increasing the effectiveness of the CBA's organizational structure for policy formulation. We are also strengthening monetary operations to increase the relevance of the policy rate to market rates by further reducing volatility of interbank rates. We have expanded monetary instruments and are providing enhanced information on future liquidity conditions to market participants. Using these tools, we will aim to maintain dram liquidity close to the aggregate demand of the banking system. In addition, to prevent unexpected liquidity flows from causing a wide swing of interbank rates, we will reduce the width of the interest rate corridor around the policy rate from the current level of 600 basis points to 300 basis points ideally by end 2012, but not later than June 2013. We will also take further steps to strengthen the interest rate transmission channel. To this end, we are supporting efforts of NASDAQ OMX Armenia to develop a term interbank trading platform, which is expected to start operating by mid-2012. We will also study measures to increase liquidity of government security markets, including the consolidation of issuances into fewer and larger benchmark issues.

## Financial Sector Stability and Development

11. **We will continue to safeguard the stability of the banking system, especially in light of rapid growth of loan portfolios, particularly in FX**. With deposits remaining highly dollarized and with banks continuing to tap external funding, FX lending is likely to continue to grow faster than dram lending. Following the crisis, the CBA has taken measures to have higher risk weights and provisioning for foreign currency-denominated assets in the calculation of prudential requirements and to create extra absorption buffers for excessive risks. As part of our continued monitoring of risks associated with FX lending, we will start requiring financial institutions to collect information on the currency mismatch of borrowers of large-sized loans (Structural benchmark, June 2012) and study the feasibility of expanding the coverage of smaller borrowers who must provide the information. In addition, to further strengthen the banking system resilience, we will introduce liquidity coverage ratios by major currencies. To minimize disruption we will begin with a coverage ratio lower than that

for domestic currency liabilities (Structural benchmark, June 2012, with effect from January 2013) and gradually increase the ratio over time.

12. **We will further enhance our regulatory and supervisory system in line with FSAP Update recommendations.** We will integrate the use of Basel II Pillar II powers in the supervisory toolkit to mitigate individual, institution-specific risks, including application of additional capital and other prudential requirements in case banks are not following appropriate risk-management practices. We will also amend regulations to require banks to immediately report changes to operations that would have a material adverse impact on the bank. In addition, we will clarify the division of responsibilities between the CBA and the government in crisis management by setting out in CBA rules that the Finance Ministry and the Deposit Guarantee Fund should participate in the Financial Stability Committee when financial institutions become insolvent and budget allocation and deposit payouts are needed.

**Structural Reforms**

13. **We are pursuing our structural reform agenda, focusing on the improvement of the business environment, governance and transparency.** We are implementing a new government action plan to implement more than 50 measures to improve the business environment and governance in 2012. Key measures include: simplifying tax payments for SMEs; facilitating trade across borders through the simplification of customs declarations and further improving customs valuation procedures; easing the submission and approval of construction permits; improving access to credit by strengthening collateral arrangements; reducing the costs of company registration by simplifying notary requirements; and reducing the number of procedures for resolving contractual disputes, including the liquidation of companies. Another important initiative is the "Regulatory Guillotine," which aims to review and significantly reduce the more than 25 thousand regulations on the books over the next two years, thereby improving the business environment, the efficiency of public administration, and governance. The project will be implemented in cooperation with donor agencies, civil society, and the private sector. The aim is to submit packets of legislative and regulatory changes in a first area (e.g., construction permitting, inspections, health and social regulations) by end-2012 (Structural benchmark, December 2012).

14. **The State Committee for the Protection of Economic Competition has continued to step up enforcement efforts against abuse of market dominance under its enhanced legal framework in 2012**. Actions so far in 2012 have focused on the fuel sector and pharmaceutical supplies within public procurement. Public information is being enhanced, and staff capacity strengthened, supported by twinning arrangements with two EU countries. Further changes to the legal framework will be proposed to parliament by end-October 2012 (Structural benchmark). These aim to: strengthen the definition and assessment of dominance, anticompetitive agreements, and price-related practices; and increase the amount of fines and introduce sanctions on individuals.

15. **We are continuing to assess options to deal with Nairit, the large synthetic rubber producer**. We have moved cautiously to find a private-sector led solution that

strictly minimizes government exposure and use of public funds. We are now working with a possible private investor, which will contract with a leading international engineering firm to assess the current state of Nairit's plant and equipment, the market for its products, possible modernization plans (including environmental impacts), and other options (including closure). We will only assume liabilities (including guarantees) in consultation with the Fund and the World Bank. In the event that we are unable to find a relevant private-party solution, we look forward to IFI assistance in handling Nairit's large scope of concerns (including workforce, environmental clean-up, and safety issues).

## CONCLUSION

16. **Given strong program implementation, we request the completion of the Fourth Reviews of the EFF/ECF-supported program and the associated disbursement of SDR 33.5 million.** We also request the establishment of PCs for end-December 2012.

17. **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 program implementation. The program's quantitative PCs and ITs, as described in the attached Technical Memorandum of Understanding, and structural benchmarks are set out in Tables 1 and 2. The Fifth Review is expected to be completed on or after September 30, 2012. The Sixth Review is expected to be completed on or after March 30, 2013.

18. **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)

| | 2011 | | | | | | 2012 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Mar. 2/ | Jun. | Sep. 2/ | Dec. | | | Mar. 2/ | | | Jun. | Sep. 2/ | Dec. 2/ |
| | Act. | Act. | Act. | Prog. | Adj. Prog. | Prel. | Prog. | Adj. Prog. | Prel. | Prog. | Prog. | Prog. |
| **Performance Criteria** | | | | | | | | | | | | |
| Net official international reserves (floor, in millions of U.S. dollars) | 833 | 800 | 878 | 835 | 771 | 795 | 785 | 782 | 805 | 802 | 812 | 764 |
| Net domestic assets of the CBA (ceiling) | 85 | 118 | 98 | 187 | 215 | 201 | 187 | 195 | 190 | 186 | 197 | 248 |
| Program fiscal balance (floor) 3/ | -3 | -31 | -60 | -187 | -206 | -187 | -22 | -27 | -19 | -37 | -64 | -167 |
| External public debt arrears (continuous criterion) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Indicative Targets** | | | | | | | | | | | | |
| Reserve money (ceiling) | 506 | 520 | 571 | 596 | 601 | 671 | 578 | 583 | 590 | 594 | 614 | 658 |
| Average concessionality of newly contracted debt (floor, in percent) 4/ | | | | 30 | 30 | 34 | | | | | | 30 |
| Social spending of the government (floor) 5/ | 7 | 15 | 27 | 36 | 36 | 36 | 8 | 8 | 8 | 15 | 28 | 37 |
| **Memorandum items:** | | | | | | | | | | | | |
| Budget support grants | 0 | 3 | 12 | 31 | 28 | 28 | 33 | 28 | 28 | 39 | 39 | 43 |
| o.w. EU MFA grant | 0 | 0 | 8 | 19 | 19 | 19 | 19 | 19 | 19 | 19 | 19 | 19 |
| Budget support loans | 0 | 10 | 35 | 67 | 46 | 46 | 67 | 67 | 67 | 93 | 93 | 100 |
| o.w. non-IMF loans | 0 | 10 | 24 | 45 | 24 | 24 | 45 | 45 | 45 | 62 | 62 | 62 |
| Project financing | 10 | 16 | 30 | 58 | 44 | 44 | 23 | 23 | … | 46 | 70 | 93 |
| KFW and IBRD loan disbursements | 0 | 0 | 0 | 9 | 11 | 11 | 10 | 14 | … | 11 | 11 | 12 |

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU.

2/ Indicative target. December 2012 targets on net official international reserves, net domestic assets of the CBA, program fiscal balance, and external public debt arrears (Prog. Column) are proposed to the Executive Board as performance criteria.

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 | Met | |
| 8 | Issue a White Paper detailing the measures and costs to address of | March 2012 | Met | |
| Tax policy | | | | |
| 9 | Introduce legislative changes that provide for annual automatic indexation of excises for inflation. | August 2011 | Not met | Annual automatic adjustment mechanism rejected by National Assembly; excises increased for 2012. |
| 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 | Partly met | Tax rates for luxury vehicles increased for 2012, but no annual adjustment mechanism. |
| 11 | Approve a Tax Strategy paper that lays out the tax reform objectives and implementation plan for 2012–15. | December 2011 | Met | |
| 12 | Overhaul fiscal regime for the mining sector | December 2011 | Met | |
| | a. Strictly limit the fiscal stability clause in the new mining code to tax rates and to a set period of 5 years. | | Met | |
| | b. Introduce and collect resource rents in terms of a variable royalty regime with the sliding rate depending on the EBIT to sales value. | | Met | |
| | c. Clarification of deductibility of contributions for mine rehabilitation and mine site clean-up. | | Met | New |
| 13 | Submit to Parliament legislative proposals to adopt OECD guidelines for transfer pricing for implementation in 2013. | November 2012 | | |
| Social policy | | | | |
| 14 | 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 | Not met (rephasing proposed) | Successful pilot project for integrated system in 6 regions revealed need for additional work on legislative and regulatory package. |
| 15 | Approval by Cabinet of list and timetable of required legal and regulatory amendments to enable the full functioning of the integrated system of social protection services | October 2012 | | New |
| Fiscal and debt sustainability | | | | |
| 16 | Approve a medium-term expenditure framework (2011–13), including a medium-term debt management strategy. | August 2010 | Met | |
| 17 | Complete first set of estimates of the fiscal cost of the pension reform. | December 2012 | | New |

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

| Item | Measure | Proposed Time | Outcome | Comment |
|---|---|---|---|---|
| Monetary sector | | | | |
| 18 | Approve terms and conditions for deposit auction to enable the CBA to absorb liquidity with greater flexibility. | September 2011 | Met | |
| 19 | 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 | Met | |
| Financial sector | | | | |
| 20 | 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 | |
| 21 | 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 | |
| 22 | Issue prudential regulation requiring banks to prepare their contingency plans for liquidity and solvency support. | December 2010 | Met | |
| 23 | Issue a regulation initiating collection and transmission by banks to the CBA of information on the currency mismatch of large borrowers. | June 2012 | | New |
| 24 | Issue a regulation introducing low-level liquidity coverage ratios by major currencies, effective January 2013. | June 2012 | | New |
| Regulatory and competition policy and enforcement | | | | |
| 25 | Submit to Parliament further changes to the legal framework for competition (fines and sanctions, definitions). | October 2012 | | New |
| 26 | Submit to Cabinet a packet of legislative and regulatory changes in at least one area under the Regulatory Guillotine initiative (from among construction permitting, inspections, health and social regulations, or another major regulatory reform area). | December 2012 | | New |

## 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 May 31, 2012 (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 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 LOI.

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 $\Delta r$ 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.<br>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;<br>2. Total value of non-duty free recorded imports;<br>3. Number of total transactions involving recorded imports;<br>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<br>5. Value of recorded imports where customs value was assessed using transaction prices, breaking out raw diamond imports;<br>6. Value of non-duty free recorded imports where customs value was assessed using transaction prices;<br>7. Number of transactions involving recorded imports where customs value was assessed using transaction prices;<br>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 [1]
(In millions of U.S. dollars)

| Dec-10 | Sep-11 | Dec-11 | | Mar-12 | | Jun-12 | | Sep-12 | | Dec-12 | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Actual | Actual | EBS/11/170 | Prog. | EBS/11/170 | Prog. | EBS/11/170 | Prog. | EBS/11/170 | Prog. | EBS/11/170 | Prog. |
| 5.0 | 0.7 | 25.8 | 27.7 | 2.0 | 7.9 | 4.0 | 9.9 | 6.0 | 11.9 | 8.0 | 13.9 |

1/ Cumulative from the end of the previous year.

Table 3. Armenia: External Disbursements to the Public Sector [1]
(In millions of U.S. dollars)

| | Dec-10 | Sep-11 | Dec-11 | | Mar-12 | | Jun-12 | | Sep-12 | | Dec-12 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Actual | Actual | EBS/11/170 | Prel. | EBS/11/170 | Prog. | EBS/11/170 | Prog. | EBS/11/170 | Prog. | EBS/11/170 | Prog. |
| Project financing | 193 | 78 | 158 | 116 | 60 | 60 | 121 | 121 | 181 | 181 | 241 | 241 |
| Budget support loan | 96 | 91 | 175 | 119 | 0 | 55 | 68 | 160 | 68 | 160 | 85 | 177 |
| Budget support grant | … | 32 | 82 | 73 | 0 | 0 | 15 | 0 | 15 | 0 | 27 | 26 |
| of which: EU MFA | 0 | 20 | 50 | 50 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total | 289 | 201 | 414 | 308 | 60 | 116 | 204 | 281 | 264 | 341 | 353 | 444 |

1/ Cumulative from the end of the previous year.