
IMF Approves New Poverty Reduction Programme For Armenia

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Armenia's fourth poverty reduction programme with the IMF keeps the focus on strengthening of the macroeconomic policy framework and tax sector reform.

Building on Past Success

The now approved new loan arrangement follows the completion of Armenia's third PRGF-supported reform programme in May (see Armenia: 22 May 2008:). As in the last review of the completed programme, the International Monetary Fund (IMF) now reiterated that Armenia's progress with its structural reforms and its responsible macroeconomic policies have allowed for rapid economic growth rates and reduction in poverty. Inflation initially remained low even in the face of high GDP growth rates, while it has recently accelerated as rising international food and fuel price have been combined with growing demand side pressures. However, IMF notes that, nevertheless, inflation in Armenia still remains relatively low in peer comparison with other countries of the Commonwealth of Independent States (CIS).

Global Insight Perspective Significance: The Executive Board of the IMF has approved a new three-year assistance programme under the Poverty Reduction and Growth Facility (PRGF) for Armenia.

Implications The arrangement supports the government's economic reform programme until 2011 with a loan of 9.2 million Special Drawing Rights (SDR, some \$13US.6 million, with 1.31 million SDR available for withdrawal immediately.

Outlook Especially given the deteriorating global financial and economic outlook, and considering that Armenia's external deficit remains wide, it remains important that the Armenian authorities make further progress with structural reforms. The focus of the new IMF programme remains strengthening the fiscal and monetary policy frameworks and deepening of structural reforms, the ultimate goal being to support growth potential by improved productivity and competitiveness.

Risks and Challenges Persist

Further, the international lender notes that, while the deteriorated global growth outlook has increased uncertainty also regarding development and prospects of the Armenian economy, the country remains in a strong position to weather the global turmoil. Indeed, the IMF expects that the expected gradual deceleration of Armenian growth will lead to a moderation of inflation, while it may also help in containing the widened current-account deficit. Looking forward, the IMF sees the medium-term outlook as favourable, given attractive investment opportunities, even if risks remain.

The IMF also reiterated that keeping to responsible macroeconomic policies remains the key for continued stability, given the sizeable imbalances in the economy. The international lender urges strengthening of the macroeconomic policy frameworks. In particular, it states that the floating

exchange rate regime remains the most appropriate approach for Armenia, while the monetary authorities are urged to complete their journey to fully-fledged inflation targeting. In addition, the effectiveness of fiscal policy as a tool for managing demand needs to be increased by strengthening the capacity for policy analysis, which allows for improvement of the budgetary process and increases credibility of fiscal policy.

The Fund also stresses the need to complete the important tax policy and administration reforms. Reforms in these areas would strengthen the business environment and improve competitiveness and productivity.

Outlook and Implications

Given Armenia's so far relatively convincing reform progress, the approval of the new IMF lending facility was expected. As announced earlier, the new development programme is worth less than the previous arrangement which had totalled 23 million SDR (see Armenia: 18 September 2008:). This is because Armenia has been able to increase its income level.

Before the intensification of the current international financial crisis and marked weakening of global growth prospects, we were increasingly concerned about the risk of overheating of the Armenian economy, while acknowledging the good reform progress. With the gloomier global outlook, the inflow of foreign exchange is likely to moderate, and the resulting cooling economic momentum will aid in suppressing inflation. Moreover, cost-side price pressures are also easing with the falling global commodity prices. We also believe that, with growth slowing, cooling domestic demand and the resultant moderation in import growth will lead to easing of the current account deficit. However, as the IMF notes, medium-term prospects remain subject to uncertainty.

While noting Armenia's progress in tax reforms, the IMF has repeatedly stressed the importance of continued focus in strengthening tax collection and administration further. With the rapid deterioration in the global growth outlook and the uncertainty related to investment inflows, this remains as important as ever. With external financial and economic conditions weak, the risks related to finding financing for the wide current account gap have increased. Thus, it remains crucial to support Armenia's attractiveness for foreign investment by improving the operational environment by completing the reforms in the fiscal sector.
