Macro-financial assistance to Armenia

2009/0150(CNS) - 14/10/2009 - Legislative proposal

PURPOSE: to make available to Armenia macro-financial assistance in the form of a loan facility and a grant amounting to EUR 100 million.

PROPOSED ACT: Council Decision.

BACKGROUND: the global economic downturn and particularly the rapid deterioration of the Russian economy had a deep impact on the economic activity in Armenia which started to contract since the last quarter of 2008. After six years of double digit growth, the Armenian economy grew by 6.8% in 2008 down from 13.7% in 2007. In March 2009 the IMF approved a USD 540 million 28-month Stand-By Arrangement (SBA) to help Armenia to deal with the worsening economic environment and to ensure the smooth transition to the floating exchange rate regime. The economic situation in the first six months of 2009 worsened dramatically with the GDP contracting by 16.3% on a year-on-year basis. The economic contraction resulted in large additional government financing needs as revenues fell by 33% in the first five months of 2009. Even with significant budget cuts the fiscal deficit is projected to be around 6.5% of GDP in 2009 and is unlikely to be covered by financing sources identified originally by the IMF. As a result, in June 2009 the IMF Board approved the augmentation of access of Armenia to Fund resources under the SBA by about USD 250 million (180% of quota) requested by the Armenian authorities. Overall real GDP is forecasted to contract by 9.5% in 2009 representing a substantial deterioration of Armenia's economic outlook compared to projections anticipated at the time of the approval of the SBA, and the latest indications from July suggest that that economic downturn is even more severe than foreseen in the revised June assumptions.

IMPACT ASSESSMENT: macro-financial assistance will have an immediate impact on Armenia's balance of payments and will in this way contribute to the alleviation of financial constraints on the implementation of the authorities' economic programme and to financing the budget deficit. It will further support the general objectives of the stabilisation programme agreed with the IMF, which aims at achieving external adjustment, bolstering foreign reserves, maintaining confidence in the domestic currency and banking system and protecting the poor. Given the potential pressure that the easing of the fiscal policy creates on the balance of payments, part of the Macro-financial assistance will consist of grants. Project finance and/or technical assistance would not be suitable to address these macroeconomic objectives. EC assistance will also support the authorities' efforts to implement short and medium term policies identified in the EU-Armenian Action Plan.

CONTENT: the Community will make available to Armenia macro-financial assistance **EUR 100 million**. Given the deep impact of the economic crisis to the economy of Armenia and the country's eligibility to concessional (IDA) financing, the Community assistance will consist of a **grant (EUR 35 million) and a loan (EUR 65 million)**. Regarding the loan component the Commission shall be empowered to borrow up to EUR 65 million on the capital markets or from financial institutions. The assistance will be made available in two instalments. The maximum average loan maturity shall not exceed 15 years. The assistance will be managed by the Commission which shall agree with the authorities the specific economic policy and financial conditions attached to the payment of each instalment. Specific provisions on the prevention of fraud and other irregularities, consistent with the Financial Regulation, will be duly taken into account.

In view of the financing needs identified for 2010, it is important that the Community macro-financial assistance to Armenia is **disbursed over the period 2010-2011**.

The assistance will be fully consistent with the macroeconomic targets already set in Armenia's economic policy documents, such as the 2009 Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding agreed with the IMF. It will be also consistent with longer-term policy objectives contemplated in the EU-Armenia Action Plan adopted in November 2006. As regards specific economic policy conditions attached to the disbursement of the grant and loan instalments, the Commission intends to focus on a limited number of areas, including public finance management. Also, the Commission may consider targeting specific policies of particular importance, such as priorities identified in the context of the EU-Armenia Action Plan and the 2009 Progress Report, or measures deemed appropriate following the above mentioned Operational Assessment.

BUDGETARY IMPLICATIONS: the grant component of the assistance (EUR 35 million) would be financed from commitment appropriations in 2009 under budget line 01 03 02 (Macroeconomic assistance), with payments taking place at the earliest in 2010. In line with the Guarantee Fund Regulation the provisioning of a EUR 65 million loan disbursed in 2010 would intervene in 2012 and amount to a maximum of EUR 5.85 million.