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GEORGIA

April 2017

REQUEST FOR EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND CANCELLATION OF STAND-BY ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR GEORGIA

In the context of the request for an extended arrangement under the Extended Fund Facility and cancellation of Stand-By Arrangement, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on April 12, 2017, following discussions that ended on March 1, 2017, with the officials of Georgia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on March 23, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Alternate Executive Director** for Georgia.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Georgia*
Memorandum of Economic and Financial Policies by the authorities of Georgia*
Technical Memorandum of Understanding*
*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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April 12, 2017

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IMF Executive Board Approves US$285.3 million Extended Arrangement Under the Extended Fund Facility for Georgia

On April 12, 2017, the Executive Board of the International Monetary Fund (IMF) approved a three-year extended arrangement under the Extended Fund Facility (EFF) for Georgia for an amount of SDR 210.4 million (about $285.3 million or 100 percent of quota) to support the authorities' economic reform program.

The EFF-supported program will help Georgia reduce economic vulnerabilities, pursue well-coordinated policies, and promote economic growth. The program includes ambitious structural reforms to generate higher and more inclusive growth, focusing on: improving education; investing in infrastructure; making the public administration more efficient; and improving further the business environment to boost the private sector as a growth engine.

The Executive Board's approval allows for an immediate disbursement of SDR30 million (or about US$40.7 million). The remaining amount will be phased over the duration of the program, subject to six semi-annual reviews.

Following the Executive Board discussion, Mr Tao Zhang, Deputy Managing Director and Acting Chair, said:

"The Georgian authorities have adopted an economic program aimed at promoting growth while maintaining macroeconomic stability. Georgia faces several economic challenges, including a narrow production base, external and fiscal imbalances, and subdued economic growth with high unemployment. This situation has been exacerbated by low growth in major trading partners largely resulting from lower oil prices. The authorities' program supported by the Extended Fund Facility will help address these challenges by reducing fiscal deficits while shifting public spending toward investment, accelerating structural reforms, strengthening the monetary policy framework, and enhancing financial sector supervision, safety nets, and bank resolution frameworks.

"The central bank will continue to strengthen its ability to meet inflation targets. While the financial sector has shown resilience to depreciation, the central bank is introducing macroprudential instruments to address currency mismatches, concentration risks, and systemically important banks. The authorities have also announced a comprehensive set of de-dollarization measures. The introduction of deposit insurance will help strengthen the financial safety net.

"Fiscal policy will aim to reduce the deficit gradually through measures to raise revenue and cut current expenditures, while spending on infrastructure investment will rise, supporting growth. Efforts will be made to increase efficiency in public healthcare while maintaining adequate healthcare coverage, especially for the most vulnerable. Control and disclosure of fiscal risks are being strengthened.

"Structural reforms are critical for the success of the program, enabling higher inclusive growth and economic diversification. The reform effort will focus on capital market development, pension reform, a PPP framework, public financial management, private sector governance and competition, and education reform.

"Risks to program implementation are significant, but should be mitigated by the authorities' determined commitment to the policy package and the broad political support for the program."

ANNEX

Recent Economic Developments and Outlook

As in other countries in the region, growth in Georgia remained subdued in 2016, reaching 2.7 percent, due to a decline in trading partners' growth since late 2014. Inflation was also low, despite cuts in the policy rate, staying well below the 5 percent inflation target. The current account deficit widened slightly to 12.4 percent of GDP due to a worsening of the trade balance, and it continued to be financed by FDI. External debt, mostly concessional, grew close to 110 percent of GDP, in part due to currency depreciation.

The fiscal deficit reached 4.1 percent of GDP in 2016, higher than the originally budgeted deficit of 3.0 percent of GDP. Current spending overruns and higher budget lending were only partially offset by higher-than-envisaged excise and corporate profit tax revenues.

The exchange rate was volatile in 2016, prompting the National Bank of Georgia (NBG) to both sell and purchase foreign reserves to avoid excessive exchange rate volatility. Georgia's banking sector, while highly dollarized, has remained resilient, with a minor increase in non-performing loans. The sector continued to report adequate capital, liquidity and profitability in 2016. Credit grew 12 percent (at constant exchange rate).

Real GDP growth is projected at 3.5 percent in 2017, and inflation is projected to remain above the NBG's target (4 percent) in 2017 due to the lagged effects of exchange rate depreciation, higher commodity prices, and the excise tax increases, until it converges to the NBG target by 2018. Georgia's economic outlook is subject to risks from the uncertain regional and global economic outlook.

Program Summary

Following parliamentary elections in October 2016, Georgia's government has united around a program aimed at promoting higher and more inclusive growth while maintaining macroeconomic stability.

The authorities' reform program, supported by the EFF, aims to strengthen financial stability, reduce external imbalances, enhance fiscal credibility, increase infrastructure investment, and undertake structural reforms. In particular, the program envisages:

- ***Fiscal consolidation over the medium term*** anchored on limiting debt to the current level, ***while shifting spending from current toward capital investment*** to address infrastructure bottlenecks.

- ***Structural reforms aimed at promoting savings, private sector investment, and improved competitiveness***.

- ***Unlocking bilateral and multilateral support*** to help finance infrastructure investment and build foreign exchange reserves over the program period.

Program policies

Fiscal Consolidation while Creating Space for Investment: The authorities' program aims to reduce current spending as well as increase revenues to create space for public investment. The cuts include better management of the wage bill, efficiency gains in current spending, and new spending controls on local governments. Efforts to increase efficiency in public healthcare are designed not to undermine adequate healthcare coverage, especially for the most vulnerable. On the revenue side, the government has increased taxes to offset revenue losses from the corporate income tax reform and partly finance additional capital spending. The authorities are committed to take additional measures, if needed, to meet the fiscal target.

Enhancing the Inflation Targeting Framework and Continued Exchange Rate Flexibility: The NBG remains committed to price stability, and to exchange rate flexibility. Inflation will be monitored regularly, with a view to ensuring consistency with the NBG's medium-term inflation targets. The NBG will continue allowing the exchange rate to adjust with market conditions. The program will also aim to build up international reserves. The NBG will continue improving liquidity management and strengthening monetary policy, including by improving its communication.

Strengthening the financial sector: The authorities have reaffirmed the independence of the NBG in conducting its financial stability mandate. In line with the IMF's Financial Sector Assessment Program (FSAP) recommendations, the NBG will introduce limits on loan-to-value and payment-to-income ratios for mortgages, with more stringent limits on loans denominated in foreign currency. The program will also, in the near term, strengthen safety nets and the resolution framework, and, in the medium term, enhance the lender of last resort framework.

Structural reforms: Structural reforms will promote job creation, economic diversification, and more inclusive growth. Capital market development, together with pension reform, will mobilize domestic savings and support private sector investment. Education reform will increase productivity and adapt skills to labor market demands. Enhancing governance and competition will help advance the economy toward emerging market status.

Georgia: Selected Economic Indicators

	2012	2013	2014	2015	2016	2017
National accounts and prices	(annual percentage change; unless otherwise indicated)					
Real GDP	6.4	3.4	4.6	2.9	2.7	3.5
Nominal GDP (in billions of laris)	26.2	26.8	29.2	31.8	33.7	36.2
Nominal GDP (in billions of U.S. dollars)	15.8	16.1	16.5	14.0	14.2	13.7
GDP per capita (in thousands of U.S. dollars)	4.1	4.3	4.4	3.8	3.8	3.7
GDP deflator, period average	1.1	-0.8	3.8	5.9	3.2	4.0
CPI, Period average	-0.9	-0.5	3.1	4.0	2.1	5.7
CPI, End-of-period	-1.4	2.4	2.0	4.9	1.8	5.4
Investment and saving	(in percent of GDP)					
Gross national saving	17.3	19.0	19.2	20.1	19.4	20.5
Investment	28.9	24.8	29.8	32.1	31.8	33.4
Public	7.5	5.1	5.0	5.6	5.1	5.8
Private	21.4	19.7	24.9	26.5	26.7	27.7
Consolidated government operations	(in percent of GDP)					
Revenue and grants	28.8	27.5	28.0	28.1	28.6	29.3
o.w. Tax revenue	25.4	24.7	25.1	25.1	26.0	26.2
Expenditures	31.8	30.1	31.0	31.9	32.7	33.4
Current expenditures	23.1	24.3	25.4	24.9	26.2	25.3
Capital spending and net lending	8.7	5.9	5.6	7.0	6.5	8.0
Net Lending/Borrowing (GFSM 2001)	…	…	-1.9	-1.3	-1.6	-1.4
Augmented Net lending/ borrowing (Program definition) [1/]	…	…	-2.7	-2.7	-3.0	-3.7
Public debt		34.7	35.6	41.4	44.9	45.5
o.w. Foreign-currency denominated	27.6	27.2	26.8	32.5	35.5	35.9
Money and credit	(annual percentage change; unless indicated)					
Credit to the private sector	12.8	19.5	23.3	22.1	19.6	10.5
In constant exchange rate	12.9	13.5	16.9	4.3	12.0	12.0
Broad money	11.4	24.4	13.8	19.2	20.4	10.1
Broad money (incl. fx deposits)	15.6	25.5	15.5	23.4	19.1	8.6
In constant exchange rate	12.6	19.7	10.3	5.1	13.3	11.3
Deposit dollarization (in percent of total)	60.4	55.7	57.1	66.8	69.9	69.0
Credit dollarization (in percent of total)	67.1	61.7	59.7	63.1	64.6	61.5
External sector	(in percent of GDP; unless otherwise indicated)					
Current account balance	-11.7	-5.8	-10.6	-12.0	-12.4	-12.9
Gross international reserves (in billions of US$)	2.9	2.8	2.7	2.5	2.8	3.1
In percent of IMF Composite measure (floating)	…	…	95.4	83.6	87.6	92.5
Gross external debt	82.8	82.0	83.3	107.8	111.8	119.3
Gross external debt, excl. intercompany loans	66.0	65.6	64.9	86.2	87.8	91.7
Laris per U.S. dollar (period average)	1.65	1.66	1.77	2.27	2.37	…
REER (period average; CPI based, 2010=100)	111.3	107.0	109.0	104.0	107.5	…

Sources: Georgian authorities; and Fund staff estimates.

1/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.

INTERNATIONAL MONETARY FUND

GEORGIA

March 27, 2017

REQUEST FOR EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND CANCELLATION OF STAND-BY ARRANGEMENT

KEY ISSUES

Context. Georgia is recovering from an adverse external shock (a decline in trading partners' growth since late 2014), although at a slower pace than previously envisaged. The economy has shown resilience to the external shock, with real GDP growth averaging 2.8 percent in 2015–16, the highest among its main trading partners, except for China and Turkey. The exchange rate was allowed to adjust, and the dollarized banking sector has weathered the significant depreciation vis-à-vis the dollar. With depreciation of major trading partner currencies, external competitiveness has not improved, however. Hence, external imbalances remain elevated and reserves below adequate levels. Following the October 2016 parliamentary elections that gave the ruling party a constitutional majority, the new government has united around a policy agenda centered on bolstering growth.

Program request and objectives. The external shock unveiled structural weaknesses (narrow production base, high under– and unemployment, and skill mismatches) that result in an inherently weak external position and weigh negatively on growth. The authorities have formulated a comprehensive program to preserve macro and financial stability and advance structural reforms to bolster growth. To support their efforts, they request the cancellation of the Stand-by arrangement (SBA) and a three-year Extended Fund Facility (EFF) with cumulative access of SDR 210.4 million (100 percent of quota). In particular,

- The program envisages fiscal consolidation over the medium term anchored on limiting debt to the current level, while shifting spending from current towards capital investment to address infrastructure bottlenecks.
- The program supports ambitious structural reforms to generate higher and more inclusive growth, focusing on: improving education; investing in road infrastructure; making the public administration more efficient; and improving further the business environment to boost the private sector role as a growth engine.

- Decisive implementation of the program will help unlock support from bilateral and multilateral creditors. Over the program period, total external support is expected to reach about $750 million.

Approved By:
Juha Kähkönen and Petya Koeva Brooks

Discussions were held in Tbilisi during February 15–March 1, 2017, with Prime Minister Kvirikashvili, Finance Minister Kumsishvili, Economy and Sustainable Development Minister Gakharia, NBG Governor Gvenetadze, other senior officials and representatives of the private sector, civil society and the diplomatic community. The team comprised Ms. Vera Martin (head), Mr. Ljungman, Mr. Sola (MCD), Ms. Suphaphiphat (SPR), and Ms. Mazraani (FAD). Mr. Painchaud (Resident Representative) and Ms. Sharashidze (local economist) assisted the mission. Mr. Botel (OED) participated in the policy discussions. Mr. Almalik provided research assistance and Ms. Toshmuhamedova provided assistance in preparing the report.

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CONTEXT

1. **Difficulties in delivering an appropriate policy response to the weakened external environment derailed the 2014–17 Stand-By Arrangement (SBA).** The first review was completed in December 2014. Thereafter, fiscal slippages, the proposed withdrawal of financial supervision from the National Bank of Georgia (NBG), and the expansion of contingent liabilities prevented further progress.

2. **The new government, through ambitious reforms, wants to leverage Georgia's geographic position to become a transit and tourism hub in the region.** Following Parliamentary elections in October 2016—giving the incumbent party a constitutional majority—the government has united around a program aimed at promoting growth while maintaining macroeconomic stability. The external shock at end-2014—lower growth in major trading partners, largely resulting from lower oil prices—unveiled structural weaknesses (a narrow production base and significant skill mismatches) that result in slow growth, large external imbalances and balance of payment needs, and prevent Georgia from reaching its growth potential (Annex I). In response, the authorities aim to strengthen macroeconomic and financial stability, strengthen fiscal credibility, increase infrastructure investment, and undertake structural reforms to make the private sector the engine for growth. Several important structural reforms are being initiated to remove growth bottlenecks.

3. **The authorities request a new program to help implement their economic vision.** To reflect a strong focus on structural reforms, the authorities request an arrangement under the Extended Fund Facility. They have already demonstrated their commitment to fiscal discipline by adopting a budget with tax increases and cuts in current expenditure, reversed legislation establishing a financial supervisory agency outside of the NBG, and drafted a law on public private partnerships (PPPs) to limit contingent liabilities.

RECENT ECONOMIC DEVELOPMENTS

4. **Economic activity remained subdued in 2016.** Growth reached 2.7 percent in 2016, supported by consumption demand (Figure 1). Weak activity, low inflation expectations, and low global oil and food prices kept end-year inflation at 1.8 percent, below the 5-percent target. The current account deficit widened slightly to 12.4 percent of GDP due to a worsening of the trade balance (Figure 2), although it continued to be largely financed by foreign direct investment. As of end-September 2016, external debt (mostly concessional) reached 108 percent of GDP, the increase was mostly explained by the depreciation.

5. **The fiscal deficit widened in 2016 because of higher current expenditure.** The cash fiscal deficit, including net budget lending, reached 4.1 percent of GDP (Figure 3, Tables 3a-b), above the SBA program's target (3.0 percent of GDP). The overruns occurred in health (after introducing universal healthcare), defense, tourism, and local government (0.9 percent of GDP) and budget lending (0.4 percent of GDP), while excise and corporate profit taxes over-performed.

6. The NBG started normalizing monetary policy as inflationary pressures abated in 2016. The NBG lowered its policy rate from 8.0 percent to 6.5 percent in 2016 as inflation was below the target. However, in January 2017, inflation expectations picked up and the NBG raised its policy rate by 25 basis points and signaled its intention to increase rates depending on inflation expectations.

7. The lari is assessed to be somewhat overvalued. Although the NBG intervened to avoid excessive volatility, the lari depreciated by 4 percent against the dollar in 2016 (cumulatively, 27 percent since end-2014). The lari appreciated, however, marginally in nominal and real effective terms in 2016, due to depreciation among trading partners' currencies, which limited gains in competitiveness. The lari is estimated to be overvalued based on the exchange rate assessment (EBA-lite approach). Based on two approaches, the lari is considered overvalued by 10–12 percent. The current account (CA) method suggests a CA gap of -3 percent of GDP, an overvaluation of the REER of 11.6 percent. This gap is mainly explained by residuals due to structural factors like still underdeveloped financial system that is unable to deploy household savings efficiently, and a weak education system. This highlights the relevance of structural reforms to enhance external competitiveness and raise net private savings. Over the medium term, planned fiscal consolidation and reserves accumulation should also help narrow the CA gap. The external sustainability approach suggests an overvaluation of 10.3 percent assuming a desired NIIP of -60 percent of GDP. The REER method suggests an undervaluation of 1 percent. These estimates are subject to uncertainties and are sensitive to the underlying assumptions.

8. The banking sector remains resilient. Banks continued to report profits and adequate capital and liquidity (Figure 4). Despite high loan dollarization (65 percent at end-year) and depreciation against the U.S. dollar, non-performing loans (NPLs) increased only marginally from 2.7 to 3.5 percent partly because of the banks' stringent lending standards, high profitability and proactive restructuring. However, an increase in watch loans could indicate limited capacity to absorb further depreciation and result in higher NPLs. Credit to the private sector grew by 12 percent (at constant exchange rates). To reduce FX credit risks, the authorities announced measures to reduce credit dollarization in late 2016 (Box 1). The two largest banks (Bank of Georgia and TBC Bank) each bought smaller banks, increasing concentration in the system—they now represent 63 percent of total banking assets. While still limited in size (4.5 percent of GDP), the non-banking sector is growing fast and is loosely regulated and supervised.

Box 1. Georgia: Announced De-Dollarization Measures

As part of a comprehensive plan to help de-dollarize the economy, the Government and NBG have adopted a 10-point plan focused on increasing long-term lari funding; reducing FX credit risk; and promoting pricing in lari.

A. Increasing long-term lari funding

1. To facilitate maturity transformation, the NBG will broaden the list of eligible collateral to access NBG liquidity facilities.
2. The NBG will introduce Basel III Liquidity Coverage Ratio with preferential treatment of local currency (FSAP recommendation).
3. The joint strategy for developing domestic capital markets aims at promoting long-term corporate financing.
4. The authorities will develop the yield curve by: a) creating liquid benchmark, with a pre-announced auction calendar; and b) establishing market dealers to promote liquid secondary markets.
5. The pension reform will enhance the role of pension funds as institutional investors, increasing the demand for long-term lari instruments and help promote access to long-term lari funding.

B. Reducing FX credit risks

6. To limit currency risks for unhedged borrowers, loans under GEL100,000 can only be issued in local currency starting January 2017.
7. The NBG offers a program to convert households' FX mortgages below $40,000, issued before January 1, 2015.
8. The NBG will formalize limits on loan-to-value and payment-to-income ratios to limit FX-induced credit risks (FSAP recommendation).

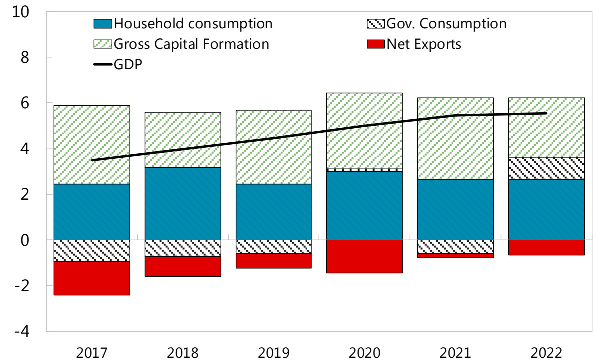
C. Promoting pricing in lari

9. Starting July 2017, all prices must be quoted solely in lari.
10. To promote settlements in lari, the authorities and commercial banks will establish an escrow account for real estate transactions in lari.

OUTLOOK AND RISKS

9. GDP growth is projected to increase gradually. Real GDP growth is projected at 3.5 percent in 2017, supported by consumption and investment. Inflation was 5.5 percent in February and is projected to remain above the NBG's target (4 percent) in 2017 due to the lagged effects of exchange rate depreciation, higher commodity prices, and the excise tax increases. Conditional on the NBG's path for the policy rate and once the effects of the excise increases fade out, inflation is projected to decline rapidly, and only converge to its 3 percent target by end-2018. Credit to the private sector will continue to increase in real terms. Real GDP growth will gradually increase to 5.5 percent by 2020 supported by structural reforms and investment. Potential real GDP growth is currently estimated at around 4 percent. Structural reforms are projected to add about 1 percentage point to economic growth over the medium term.[1] The current account deficit is projected to improve to 9.2 percent of GDP by 2022 as structural reforms and trade integration improve competitiveness and export growth. FDI will finance 90 percent of the current account deficit, on average. Gross international reserves are projected to increase, reaching close to 110 percent of the Fund's ARA metric by 2020.

GDP by Demand Components - Constant 2010 prices
(Contribtution to Growth, in percent)



10. The authorities were more positive about the GDP growth outlook. They argued that the corporate tax reform would increase private sector investment as corporates reinvest retained earnings. They also believed that trade integration initiatives, arterial road infrastructure and structural reforms would accelerate export growth. Staff agreed that these measures could be growth enhancing, but caution against being overly optimistic on growth in the short term.

11. The outlook is subject to risks (Annex II). The projected economic improvement hinges on an improved regional environment, policies geared at macroeconomic and financial stability, and structural reforms that create favorable conditions for private investment, productivity growth and export competitiveness. Regional and global economic uncertainty could result in slower regional recovery, hampering Georgia's economic outlook. On the domestic side, financial dollarization could intensify the effects of external shocks. Fiscal consolidation and the shift in public spending could prove too ambitious, which could hinder fiscal credibility. Large contingent liabilities could put pressure on the public sector balance sheet and call for a tighter fiscal stance.[2] Political backlash or/and reform fatigue could undermine structural reforms to enhance potential economic growth. On the upside, yields from structural reforms and/or trade integration could be higher than expected. The recently-signed Free Trade Agreement (FTA) with China and the Deep and Comprehensive FTA with the European Union could mobilize higher-than-envisaged investment and exports.

12. Debt will remain sustainable but vulnerable to large shocks. Under the program scenario, public debt stabilizes at 45 percent of GDP—after peaking at around 47 percent in 2019—and total external debt stabilizes at 92 percent of GDP. Higher economic growth and fiscal consolidation will contain public debt dynamics. Public debt is mostly concessional with long maturities and low effective interest rates, with a benign debt service profile. The debt level, however, is vulnerable to large macroeconomic shocks. A shock to GDP growth or a 30 percent depreciation would increase the public debt-to-GDP ratio between 5 and 10 percentage points, while a combined macro-fiscal shock would increase it by almost 25 percentage points. A 30 percent

[1] Based on cross country experience, the 5-year average impact of structural reforms on TFP growth for emerging markets is about 2 percentage point (http://www.imf.org/external/np/pp/eng/2015/101315.pdf).

[2] The authorities estimate liabilities of public corporations at 17 percent of GDP as of end-2015 and the net present value of power-purchase agreements at around 15 percent of GDP as of end-2016.

depreciation would increase the external debt–to–GDP ratio by more than 30 percentage points, up to 124 percent of GDP (Tables 12-13, Figures 5-6).

PROGRAM OBJECTIVES AND POLICIES

13. The program will help reduce economic vulnerabilities and support inclusive growth. The program's monetary and fiscal policies, together with the strengthening of policy frameworks, will help increase resilience and build up external buffers, while structural reforms will help reduce external vulnerabilities by promoting productivity and competitiveness. The program will help strengthen monitoring of contingent liabilities arising from PPPs and state-owned enterprises (SOEs). The resilience of the financial sector will be further strengthened through regulatory and supervisory measures and enhanced financial safety nets. The authorities' *Four Point Reform Plan* centers on a wide range of reforms to generate higher and more inclusive economic growth.

A. Fiscal Consolidation while Creating Space for Investment

14. Consistent with the 2017 budget, the augmented cash fiscal deficit of the general government is projected at 3.7 percent of GDP under the program.[3] The authorities plan a reduction in current spending (0.8 percent of GDP), reversing previous years' increases. The cuts include a reduction in the wage bill (staff count and bonuses), cuts in administrative expenditures, efficiency gains in healthcare spending, and new spending controls on local governments. The budget also increases capital spending (0.7 percent of GDP) and lending to SOEs for capital projects (0.8 percent of GDP). On the revenue side, the government has increased taxes to offset revenue losses from the corporate income tax reform and also the increase in capital spending and budget lending (see Table).[4] The authorities have amended the law on local government finance, allowing the state to impose spending cuts on local governments to adhere with the Liberty Act limits on the general government deficit. The authorities are committed to take additional measures, if needed, to meet the fiscal target (MEFP, ¶8), which will improve fiscal credibility.

15. The authorities are committed to identify additional measures to meet medium-term fiscal targets (Tables 3c-d, MEFP, ¶10). The authorities are committed to reducing the augmented fiscal deficit to 2.8 percent of GDP by 2020, while also increasing infrastructure investment. The operating balance will improve by 3.4 percentage points of GDP by 2020 while capital investment (including net budget lending) will increase by 2.9 percentage points of GDP. Although measures have been identified for 2018–20, the authorities and staff agreed on the need for additional fiscal measures (0.4 and 0.5 percent of GDP in 2019 and 2020, respectively) (see table). Additional

[3] This is equivalent to 4.1 percent of GDP according to the previous program definition. The quantitative performance criterion will be on the augmented fiscal deficit on a cash basis, which equals net lending/borrowing of the general government minus budget lending (following GFSM 2001 categorization).

[4] The authorities are harmonizing legislation with the EU by charging VAT on advance payments and are abolishing the "golden list" of taxpayers allowed to delay VAT payments on imports. These measures would only have a one-time revenue impact in 2017.

measures may be needed in 2018 if the loss from the corporate tax reform proves to be higher, or gains from excise increase or current expenditure cuts become lower than projected.

Georgia. Medium-Term Fiscal Measures (2017–20)*

(In percent of GDP)

	2017	2018	2019	2020	Cumul.
Legislated in 2017 Budget	**1.4**	**-0.6**			**0.8**
Revenue Measures	**0.7**	**-0.6**			**0.1**
Tobacco excise	0.6				0.6
Vehicle and fuel excises	0.9				0.9
Gambling taxes and fees	0.1				0.1
Advance payments and golden list (**)	0.4	-0.4			0.0
10% of LEPL revenues transferred to budget	0.1				0.1
CIT reform	-1.5	-0.2			-1.7
Current Expenditure Measures	**0.8**				**1.1**
Central governmment					
Wage bill cuts	0.4				0.4
Administrative costs savings	0.1				0.1
Efficiency in healthcare	0.2				0.2
End agroland program	0.1				0.1
Other	-0.4				-0.4
Local governments	0.4				0.4
Planned Medium-term Measures		**1.0**	**0.8**	**0.7**	**2.6**
Tobacco excise		0.3	0.3	0.3	0.9
No CIT reform extension (insurance, financial) in 2019			(**)		0.0
Wage bill reform		0.2	0.2	0.1	0.5
Freeze goods and services, subsidies, other expense in real terms		0.6	0.3	0.1	1.1
Reform healthcare programs		0.1	0.1	0.3	0.6
Pension reform		-0.2	-0.2		-0.4
Total Identified Measures	**1.4**	**0.4**	**0.8**	**0.7**	**3.4**
o/w: use to increase capital spending	0.7	0.7	0.9	0.5	2.7
o/w: use to increase budget lending	0.8	-0.7	0.0	-0.1	0.1
Measures to be identified	0.0	0.0	0.4	0.5	
Overall balance (GFSM1986 definition)	-4.1	-3.8	-3.5	-3.1	
Augmented net lending/borrowing (program definition)	-3.7	-3.5	-3.2	-2.8	

Source: National Authorities and Fund staff estimates.

(*) The measures' impact is shown relative to the previous year.

(**) This measure prevents the CIT revenue from falling further.

16. The program envisages ambitious medium-term fiscal plans that call for successful implementation of fiscal structural reforms.

- *Wage bill reform*. A comprehensive and well-structured civil service strategy is needed to achieve additional savings of 0.5 percent of GDP in 2018–20. The expected implementation of the law on civil service (July 2017) will categorize staff in grade structures. The authorities will also adopt a remuneration law for public civil service (structural benchmark, end-December 2017), helping determine pay levels, bonuses and supplements by grade structures and reduce disparities across ministries.

- *Social spending.* Together with the World Bank, the authorities have developed measures to increase cost efficiency in public healthcare, including reducing the overlap between public and private health insurance, strengthening sanctions on hospitals that violate rules, and introducing selective contracting with hospitals. The authorities also plan to make healthcare coverage more targeted by introducing copays for higher-income households, while increasing drug coverage for the most vulnerable. Staff welcomed the initiative to improve the quality of spending (with savings estimated at 0.2 percent of GDP in 2017 and 0.6 percent of GDP in 2018–20), but argued that this should not come at the expense of undermining adequate healthcare coverage. The planned pension reform is welcome as it will over time increase replacement rates. The proposal to introduce rule-based indexation for basic pensions would reduce uncertainty.
- *Public investment.* The program envisages a more gradual increase in investment than the authorities' initial plans. The program will also strengthen the role of the Ministry of Finance in defining investment priorities, including by improving project appraisal, strengthening multi-year investment planning, and introducing a competitive and transparent framework for PPPs. The authorities are piloting guidelines for project appraisal and roll-out to all ministries will require time. Staff stressed that, where applicable, these guidelines should also be used to evaluate public-private partnerships.
- *Revenue measures.* Staff highlighted the need to prepare contingency measures for 2017–18 in case plans fall short and/or the authorities want to accelerate investment further. Potential measures include introducing a modern property tax and a motor vehicle circulation tax. A temporary VAT increase could also be considered.

17. The authorities recognize the need to disclose and manage fiscal risks more comprehensively (MEFP, ¶13). The authorities have made progress in reporting fiscal risks, with the 2017 Fiscal Risk Statement (FRS) covering SOEs and Power-Purchase Agreement (PPA) liabilities. The 2018 FRS will expand the coverage of SOEs including any quasi-fiscal activities, and PPPs (structural benchmark, end-December 2017). A new PPP law will be submitted to Parliament in 2017, strengthening public oversight of fiscal risks (structural benchmark, end-December 2017). Pending approval of the law, the authorities will refrain from signing any PPPs and Purchasing Power Agreement (PPAs), except for a limited number in the energy sector subject to a comprehensive fiscal risk assessment of liabilities (MEFP, ¶9). Staff urged the authorities to give a strong role to the Ministry of Finance in reviewing value for money and budget affordability; ensuring a competitive tender process; and reporting PPP liabilities in line with international accounting standards. The program will limit the Partnership Fund's new borrowing (performance criterion) as well as impose a ceiling on its cash deficit (performance criterion).

18. Fiscal and budgetary frameworks should be strengthened (MEFP, ¶14). The authorities have committed to reviewing their fiscal rule's framework to provide fiscal policy flexibility while ensuring sustainability.[5] Staff also discussed the fiscal transparency reforms recommended in the 2016 Fiscal Transparency Evaluation: including legal entities of public law (LEPL) revenue from fees and associated expenditure in government finance statistics; transparent classification and reporting of budget lending, equity injections and subsidies to SOEs; improved reporting of tax expenditures; and a requirement that the Supreme Audit Institution audit the government's annual financial statements according to international standards (INTOSAI). The authorities will prepare guidelines for approving budget lending operations that require a reasonable expectation of commercial returns (structural benchmark, end-December 2017). The authorities responded that reporting LEPL's revenues and expenditures on a gross basis would require amendments to the Liberty Act, but committed to a comprehensive review of government finance statistics to identify gaps with international statistical standards. Staff recommended the Supreme Audit Institution to do a complete audit of financial statements, but they argued that government accounts should be compliant with IPSAS ahead of such exercise.

19. The authorities will continue to strengthen revenue administration (MEFP, ¶11). The authorities have improved revenue administration with IMF technical assistance (abolishing the alternative audit program, introducing single taxpayer accounts, writing off uncollectable tax liabilities, and piloting risk-based automated refunds). With a three-year TA plan, the current medium-term reform agenda focuses on: full risk-based automation of VAT refunds; addressing the large stock of VAT refunds; improving tax compliance; and reorganizing the Georgia Revenue Service. The government has committed to designing an action plan to address the stock of outstanding VAT refunds in an orderly manner over time (structural benchmark, end-September 2017).

B. Enhancing the Inflation Targeting Framework and Continued Exchange Rate Flexibility

20. The NBG remains committed to containing inflation, and to exchange rate flexibility.

- Staff agrees with the monetary policy stance (MEFP, ¶16). To signal commitment to the inflation targeting regime, the program includes an Inflation Consultation Clause (ICC). Inflation will be monitored through dual consultation bands around a central point based on the projected 12-month inflation path, consistent with NBG's inflation targets.
- The flexible exchange rate regime has served Georgia well, facilitating adjustment to external shocks (MEFP, ¶17). With a performance criterion on net international reserves, the program will seek to build up gross reserves to nearly 110 percent of the IMF composite measure of reserve adequacy for floating exchange rate regimes, which is warranted due to additional risks from dollarization. The NBG will continue allowing the exchange rate to adjust with market conditions

[5] Among others, the fiscal rule could clarify that it is binding to fiscal outcomes, not only to fiscal plans; limit scope for deviations; require a plan to converge to the fiscal rule if deviations materialize; and rescind the requirement that tax increases have to be approved by referendum.

and limiting interventions to smoothing disorderly exchange rate volatility and/or building up reserves if need arises.

21. Under the program, the NBG will continue improving liquidity management and provision (MEFP, ¶18).

- The NBG introduced a one-month liquidity facility in December 2016. Given the increasing demand for liquidity (Box 2), the NBG has also broadened the list of eligible collateral, with haircuts based on the risk and liquidity profile, to enhance confidence and facilitate maturity transformation.
- To improve liquidity forecasting, the Ministry of Finance and the NBG committed to signing a memorandum of understanding on information sharing for liquidity forecasting (structural benchmark, end-June 2017). The government will also submit to Parliament legal amendments in 2017 to allow for derivatives and repo transactions.
- The monetary policy transmission will be further enhanced by pre-announcing a multi-year issuance plan for government benchmark bonds (structural benchmark, end-December 2017) and by creating a framework for primary dealers. These reforms will foster the development of a liquid market for government securities, ensure larger amount of high quality collateral for refinancing operations and allow corporations to better manage liquidity risk.

22. Monetary policy will be strengthened by improving NBG's communication (MEFP, ¶19). In April 2016, the NBG started quarterly press conferences after the Monetary Policy Committee meetings and now publishes the forecast for the policy rate path in its monetary policy report. The NBG communication will be further strengthened by issuing guidelines for monetary policy operations. Staff agrees with the NBG's focus on communication and transparency and encouraged the NBG to keep publishing the outcome of monetary and exchange rate operations in a timely manner.

Box 2. Georgia: Refinancing Loans in Georgia

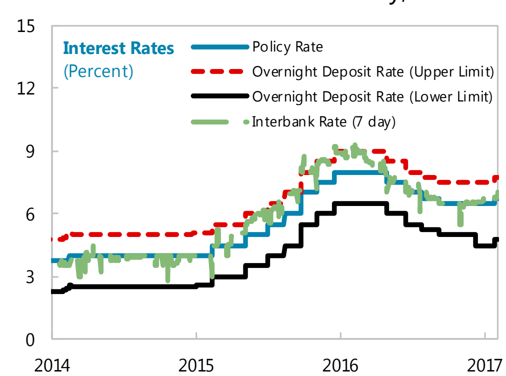
The monetary policy regime in Georgia is inflation targeting. Accordingly, the NBG announces a target for inflation and sets its policy interest rate to steer actual inflation towards the target in the medium term. Monetary policy is conducted through the policy rate, which is the price commercial banks pay or are paid, for base money.[1/] Monetary policy is operated by adjusting the *price* of money, not by controlling the *quantity* of money.

To obtain base money, commercial banks turn to the NBG though refinancing loans (open market operations), or, in exceptional cases, standing facilities. Commercial banks' confidence that the NBG will always supply the cash that banks' customers are demanding at the prevailing interest rate is crucial for the trust and stability of the banking system.

Several factors determine the nominal volumes of refinancing loans: (i) currency in circulation will increase as the economy grows; (ii) changes in commercial banks' reserves at the NBG; (iii) changes in the balance on the government's account in the NBG; (iv) NBG issuing or redeeming Certificates of Deposits (CDs)—the instrument to withdraw liquidity; and finally (v) NBG's foreign exchange auctions —there is a corresponding increase (purchase of foreign currency) or reduction (sale of foreign currency) in base money.

(million GEL)	2013	2014	2015	2016
Increase in NBG Refinancing Loans	**9**	**313**	**355**	**688**
1. Increase in Currency in Circulation	433	111	42	496
2. Increase in Required and Excess Reserves	111	209	-258	-21
3. Increase in Gov't Deposits at NBG	-113	-9	81	313
5. Issuance of NBG CDs	122	-184	-147	-156
6. FX Purchase/Sale by NBG	-544	186	637	56

If more refinancing loans than what is demanded were offered, market interest rates would fall below the policy rate, and monetary policy would be looser than the NBG's intention. Conversely, if insufficient refinancing were offered, interest rates would rise above the policy rate. A good litmus test of whether too much or too little refinancing is provided by the NBG is to compare the interbank rate with the policy rate. During 2015, the interbank rate was above the policy rate. Since then, it has been close to the policy rate implying that refinancing loans were in line with demand in 2016.



Overall, refinancing loans has improved the efficiency of the NBG's monetary policy and allowed commercial banks to start long-term mortgage lending with adjustable interest rate linked to the one of the refinancing loans.

1/ Base money is defined as currency in circulation plus commercial banks' deposits at the NBG

C. Strengthening Financial Sector Policies to Increase Financial Resilience and Promote Intermediation

23. The program supports the authorities' efforts to strengthen the independence of the NBG in conducting its financial stability mandate. Parliament has approved legislative amendments that invalidate the effects of the law establishing a financial supervision agency outside of the central bank (prior action, MEFP ¶20).

24. The NBG is strengthening the banking regulatory and supervisory frameworks (MEFP, ¶21). In line with FSAP recommendations, the NBG is introducing limits on loan-to-value and payment-to-income ratios for mortgages, with more stringent limits on loans denominated in foreign currency. To ensure that banks have sufficient liquidity buffers, NBG is also introducing liquidity coverage ratio limits, with preferential treatment of domestic currency liabilities (structural benchmark, end-September 2017). These measures complement the differentiated reserve requirement for domestic and foreign currency deposits and the higher risk weights attached to foreign currency loans in the calculation of capital adequacy ratios. Minimum capital requirements will be increased gradually to GEL50 million by 2019 (structural benchmark, end-June 2017), up from the current GEL12 million. The NBG will also introduce additional capital requirements for systemically important banks (structural benchmark, end-December 2017), and introduce Basel Pillar III disclosure requirements. The authorities plan to submit legislation giving the NBG oversight power for credit information bureaus (structural benchmark, December 2017). With TA support, the central bank plans to publish a self-standing financial stability report with forward-looking analysis.

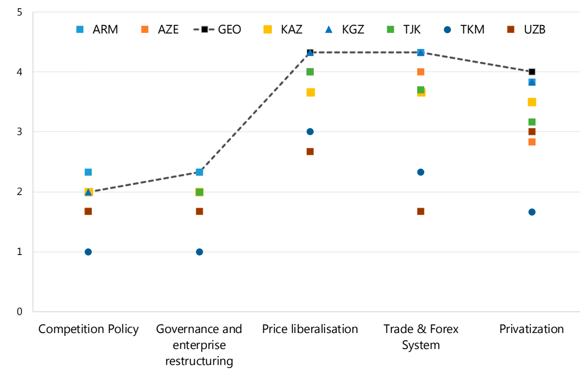
25. The program will also strengthen safety nets and the resolution framework in the short term, to later put efforts on enhancing the lender of last resort framework (MEFP, ¶22). The authorities will submit legislation to Parliament introducing a deposit guarantee scheme (structural benchmark end-June 2017), meeting a requirement under the Association Agreement with the EU. To harmonize Georgian legislation with best international practice, the government is submitting legislation that empowers the NBG to appoint a temporary administration for a bank at the early stages of financial difficulties (structural benchmark, end-September 2017). The authorities will also strengthen the capacity of the NBG to act as a lender of last resort and the resolution framework minimizing risks to financial stability and public sector exposure to losses (MEFP, ¶22).

26. The program will support the NBG in expanding its oversight to the non-banking sector. Although the NBG identifies on its web site and imposes supervisory regulation on large non-deposit taking institutions—so called Qualified Credit Institutions—small non-bank credit institutions are loosely regulated and monitored. Staff agreed with the NBG on enhancing scrutiny and control over nonbanks, since financial stability risks could emerge, potentially putting a dent on the confidence in the financial system and potentially having a large social impact. The recently introduced ban on extending loans in foreign currency below the equivalent of GEL100,000 will help limit risks for these institutions.

D. Using the Momentum to Implement Ambitious Structural Reforms

27. While Georgia's is among the most reformed economy in the CCA, further structural reforms are needed to promote higher and more inclusive growth (MEFP, ¶25-30). Structural reforms will promote job creation, economic diversification and more inclusive and sustainable growth. They are crucial for reducing external imbalances, increasing resilience to shocks, and promoting private sector development. The authorities' Four Point Reform Plan appropriately centers on policies to generate higher sustainable and more inclusive economic growth. The ambitious structural reform agenda focuses on improving education; investing in roads infrastructure to leverage Georgia's position to become a transit and tourism hub; making the public administration more efficient; and improving the business environment to boost the private sector role as a growth engine.

Georgia: Transition Indicators in the Caucasus and Central Asia, 2016



Source: EBRD

28. Encouraging investment will play a crucial role in improving productivity and competitiveness and reducing current account deficits. Mobilizing FDI in export-oriented sectors is instrumental for improving competitiveness, reducing external vulnerabilities, and generating balanced growth. Authorities' efforts toward further trade integration will also help attract investment. Continuing to improve the business climate, especially addressing insolvency and enforcing contracts (Table 5), will also help attract higher FDI. The energy sector and road infrastructure could benefit from the new PPP framework.

29. Capital market development, together with the pension reform, will mobilize savings and support private sector investment.

- As an initial step, the publication of the multi-year calendar of government bond issuances will help develop benchmark bonds along the yield curve. The Georgian Stock Exchange is also working, in cooperation with the NBG, to upgrade trading infrastructure. With TA support, changes in taxation of financial instruments will ensure a level-playing field for investment. With help from the EBRD, the authorities plan to introduce derivatives.
- Regarding the pension reform, the Government has committed to submit to Parliament legislation to introduce a second pension pillar (structural benchmark, end-December 2017). The pension fund is projected to collect GEL200-300 million per year, creating demand for long-term lari instruments. Staff highlighted the importance of having clarity on the investment strategy and the accountability of the pension fund.
- With the NBG's decision to broaden the list of eligible collateral for liquidity facilities (including corporate bonds), the financial sector will increasingly demand corporate securities.

30. Education reform is key to development and inclusive growth. High growth in the past decade has not led to significant improvements in poverty, inequality, or unemployment. High unemployment and extensive underutilization of labor contribute to widespread poverty. The latest Global Competitiveness Report identified the lack of a qualified labor force as the biggest obstacle for doing business in Georgia. Advancing education reform is essential to increase productivity and adapt skills to labor market demands. In the absence of a comprehensive reform, high unemployment and skills mismatch will create a drag on growth. The authorities are planning to reform the education system, with the help of the World Bank, by setting curriculum standards, adopting a new teacher policy framework, and introducing vocational training and adult learning. Social indicators also report a rural-urban divide that will require active policies to reduce inequality. Improving road infrastructure could support tourism, a labor intensive sector, and create jobs.

31. Enhancing governance and competition will help advance the economy toward emerging market status. The authorities plan to introduce International Financial Reporting Standards (IFRS) for corporations and revamp the insolvency law to ensure an adequate restructuring framework for viable business. The reform of the land cadaster is important to protect property rights, ease land transactions, and provide collateral for borrowing, especially in the agricultural sector.

PROGRAM MODALITIES

E. Access, Phasing, and Conditionality

32. The authorities' program will be support by a three-year EFF arrangement with access of SDR 210.4 million (100 percent of quota, about $285 million). The authorities are expected to have protracted balance of payments (BOP) needs that are driven by the large current account deficit and low domestic savings, coupled with the need to build up reserve buffers to protect against external shocks. Such needs will subside over the medium term as the structural reform agenda is implemented. The overall external financing package, estimated at $754 million for the three-year program period, would allow reserves to accumulate to around 110 percent of the IMF ARA metric in 2020, compared to 88 percent in 2016. The program is expected to catalyze budget support from the European Union (EU), the World Bank, the Asian Development Bank (ADB), and *Agence Française de Développement* (AFD). As a result, the program is fully financed for the next 12 months, with good prospects for further financing to materialize after that. The proposed Fund financing, fully devoted to address the BOP need, will cover the residual gap of 26 percent of total financing needs.

Georgia: Program Financing

(Millions of U.S. Dollars)

	2017	2018	2019	2020
Financing Gap	257	222	184	91
Identified financing	257	222	184	91
IMF	69	27	34	41
Prospective purchases	81	81	81	41
Repurchases	-12	-54	-47	0
Official creditors	188	195	150	50
World Bank	100	100	100	50
EU	26	45	0	0
Others	62	50	50	0
Memorandum items:				
Gross international reserves	3,061	3,376	3,799	4,249
in percent of IMF Composite measure	92	96	102	109
EFF in percent of total financing	27	12	18	45

Source: IMF Fund estimates.

33. The proposed program will be phased uniformly (Table 11). To balance between the authorities' commitment to the arrangement and addressing financing needs, the program envisages phasing disbursements equally over seven installments, starting from the Board approval.

34. Program monitoring will be guided by semi-annual reviews, continuous performance criteria (PCs), an inflation consultation clause, indicative targets, and structural benchmarks (Appendix I).

- Quantitative PCs include a ceiling on the augmented cash deficit of the general government, a floor on the net international reserves (NIR), ceilings on the cash deficit of the Partnership Fund and on the new borrowing of the Partnership Fund; as well as continuous PCs on the flow of external debt arrears and on new public guarantees. To support the shift in expenditure composition, the program also includes an indicative ceiling on current primary spending. Since the fiscal target is defined on a cash basis, an indicative target is suggested on the accumulation of general government domestic expenditure arrears.
- Monetary conditionality will be embedded in the inflation consultation clause, which is set symmetrically around the projected 12- month percentage change in the headline inflation, consistent with the NBG's inflation target.
- Structural benchmarks in the short term will strengthen financial regulatory and supervisory frameworks, crisis management frameworks as guided by the 2014 FSAP recommendations; introduce a PPP framework and guidelines for budget lending operations, both aiming at limiting fiscal risks; and initiate pension and capital market reforms.

F. Capacity to Repay the Fund and Risks to the Program

35. Georgia is expected to meet its obligations to the Fund. Georgia's debt profile remains under low scrutiny under the Emerging Market Debt Sustainability Analysis (EM DSA) framework and Georgia has a strong track record in repayments to the Fund as indicated in timely repurchases to date. Exposure to the Fund will peak at 1.6 percent of GDP in 2020, before declining to 1.3 percent of GDP by 2022. Debt service to the Fund will average below 1 percent of GIR, about 0.3 of total exports during 2017–22 (see Table 9). The repayment of the EFF arrangement will begin in 2021 and will result in averaged debt service obligations of SDR 31.6 million, slightly above 1 percent of GIR, in 2023–28.

36. Risks to the program are significant, but manageable. Sustained weak domestic demand, in the context of fiscal consolidation and subdued global growth, could weaken the growth outlook. In such an environment, reform fatigue could set in and support for the program could decline. While fiscal policy has been calibrated to allow space for productive public investment, such formulation hinges on minimizing fiscal risks. The government stands ready to adopt fiscal measures, if needed, to meet the fiscal targets (MEFP, ¶8). The authorities' ownership and proposed conditionality under the program mitigate those risks and provide safeguards.

37. Georgia owes external arrears to Kazakhstan and Turkmenistan that are deemed away under the policy on arrears to official bilateral creditors. The underlying Paris Club Agreement is adequately representative and the authorities are making best efforts to resolve arrears.

38. The 2014 safeguard assessment found a robust framework with strong control mechanisms at the central bank. The central bank is found to have a strong track record. The NBG has implemented all but one non-priority recommendation from the last assessment—incorporating in the NBG Law specific provisions on the Audit Committee and the Chief Internal Auditor, to be addressed at the next amendment of the law. No significant changes have occurred since 2014. The NBG's 2015 financial statements were prepared and audited in accordance with international standards and are published on the bank's website. Monitoring of safeguards developments at the NBG will continue under the program.

STAFF APPRAISAL

39. The authorities' initial response to the external shock in late 2014 was not fully successful. The exchange rate was allowed to adjust to market conditions, acting as a buffer against the external shock. The government was late in recognizing the impact of the shock on the Georgian economy, which delayed an appropriate policy response and resulted in fiscal slippages. The NBG appropriately focused on bringing inflation back to its target. The external shock increased public and external vulnerabilities and unveiled structural weaknesses. Potential output growth has likely fallen, unemployment and underemployment remain high, and Georgia has been unable to successfully capitalize on its access to European markets due to a narrow production base.

40. The new government has formulated a coherent plan to ensure macro and financial stability and raise inclusive growth. The authorities recognize the need to redirect policies and reform efforts to boost investment and productivity and enhance inclusive growth and socio-economic conditions. They have already taken encouraging steps in implementing their economic vision by adopting a budget with tax increases and cuts in current expenditure, reversing the law establishing a financial supervisory agency outside of the NBG, and drafting a law on public private partnerships (PPPs) to limit contingent liabilities.

41. The 2017 budget is a credible start to fiscal consolidation, and should be implemented strictly to reinstate fiscal credibility. The measures under the 2017 budget provide a welcome shift in public spending toward investment, and will reverse the upward trend in current spending of past years. Revenue measures will help offset losses associated with changes in the corporate income tax and finance about half of the increase in public investment, with the rest being financed by reduced current spending. Savings in administrative costs are supported by measures limiting budget allocation changes and overruns by local government. Given the risks associated with implementing changes in the composition of revenues and spending, additional measures may be needed to deliver the fiscal target.

42. Medium-term fiscal consolidation will require institutional fiscal reforms. The program supports the increase in public investment—predominantly financed on a concessional basis by international financial institutions (IFIs). However, additional deficit-reducing measures will be needed starting in 2019. The government needs to start preparations for: credible and long-lasting policies reducing the government's wage bill (civil service reform); further enhancing the efficiency of the public administration; improving targeting of social programs; and reducing subsidies and equity injections to SOEs over time. Revenue measures may also be necessary and should be aimed toward non-distortionary taxes. The authorities' commitment to review the fiscal rule is welcome.

43. **Fiscal risks need to be better contained.** Contingent liabilities through PPPs, PPAs, and SOEs have been rising and are a source of concern. The stock of unpaid VAT refunds needs to be addressed with FAD TA support. A framework consistent with best practices is needed for budget lending operations. The authorities' commitments to adopt a PPP law and to continue expanding the annual FRS are welcome. Furthermore, strengthening the role of the MOF in public investment and PPP management is crucial when scaling up investment. The authorities should limit and closely monitor the Partnership Fund's balance sheet.

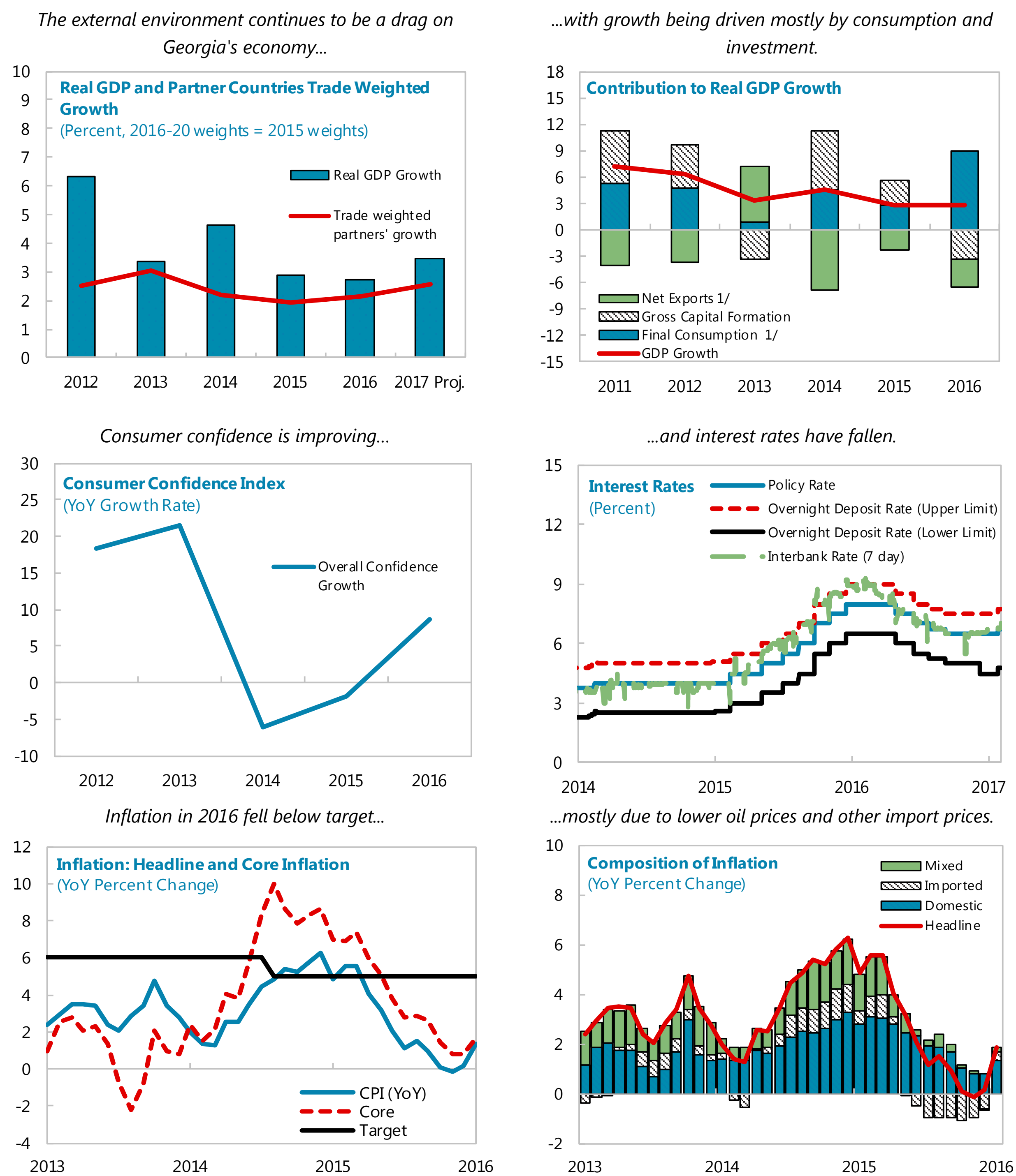
44. **Monetary policy should continue to focus on price stability, supported by the flexible exchange rate and efforts to strengthen the transmission mechanism.** The NBG's monetary policy stance is appropriate. The inflation targeting framework, combined with the floating exchange rate regime, has served Georgia well. Foreign exchange intervention need to continue being limited to smoothing excessive exchange rate volatility and, if needed, to build up international reserves. The de-dollarization measures—prepared jointly by the Government and the NBG—will help strengthen the monetary policy transmission mechanism and reduce financial sector vulnerabilities. Improvements in lari liquidity facilities, together with NBG's plans to broaden the collateral pool and improve transparency and communication, will improve further the IT framework.

45. **The program will help strengthen banking regulation and supervision, financial safety nets, and the bank resolution framework.** Maintaining financial supervision under the NBG mandate is welcome. The NBG's commitments to: introduce macro-prudential limits on mortgages; raise banks' minimum capital requirement; introduce capital buffers for systemically important banks; gain oversight of credit information bureaus; and introduce Basel Pillar III disclosure requirements are welcome. The introduction of liquidity coverage ratios in 2017 will also help strengthen banking sector resilience against liquidity risks. Introducing deposit insurance and legislative changes to define specific rules for banks' temporary administration regimes will increase financial sector resilience to shocks. The program will support the authorities' efforts to expand NBG's oversight to nonbanking institutions and develop the banking resolution framework, ensuring that the NBG has sufficient authority to play its role as a lender of last resort.

46. **The authorities' broad structural reform agenda (the *Four Point Reform Plan*) will help support more inclusive growth.** In addition to strengthening tax administration and fiscal risk management, a funded pension system will support fiscal sustainability and develop domestic capital markets. The deposit insurance will enhance confidence in the banking system and promote savings. Further trade integration initiatives will also help attract investment. Infrastructure development should be complemented with investment in human capital. Education reform requires: increasing the quality of education; revamping education tools and career advancement; and introducing effective vocational training and adult learning.

47. Staff supports the authorities request for the approval of the 3-year Extended Arrangement under the Extended Fund Facility and the cancellation of the SBA arrangement. The authorities are united around a policy agenda centered on inclusive growth. The program will provide a strong policy anchor for appropriate macroeconomic policies and structural reforms, which has gained momentum following Parliamentary elections. The implementation of the authorities' policies and reforms requires timely and continued support from the international community. Given an ambitious structural reform agenda and time that will be needed to build up reserve buffers to protect against external shocks, staff views that the Extended Fund Facility is an appropriate arrangement. While risks to the program are significant, they are considered manageable as the authorities' ownership and the proposed conditionality under the program mitigates those risks and provide safeguards.

Figure 1. Georgia: Real Sector and Inflation Developments

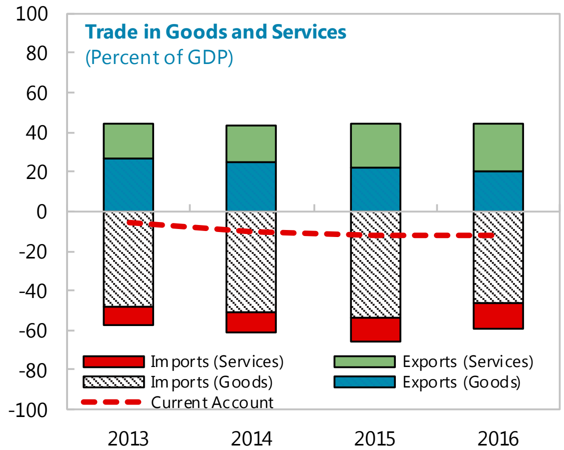


Sources: National authorities; ISET Policy Institute; and IMF staff estimates.

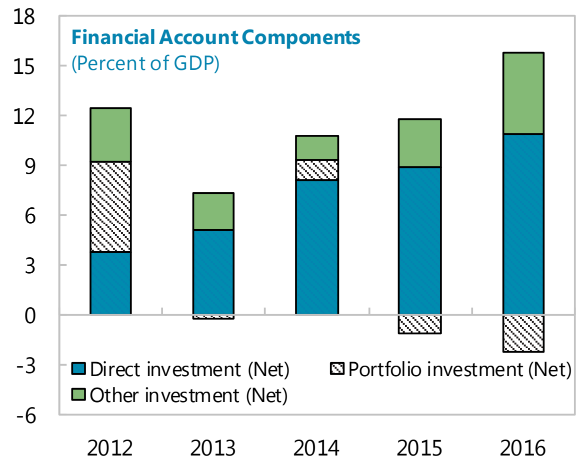
1/ Net Exports and Government Consumption data exclude the Hepatitis C vaccines.

Figure 2. Georgia: External Sector Developments

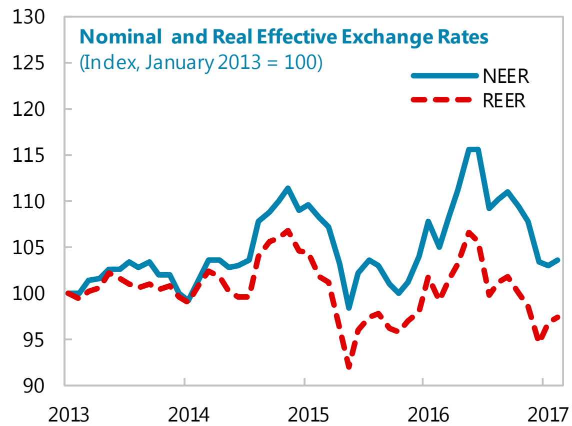
The current account deficit is still large, mostly driven by the trade balance...



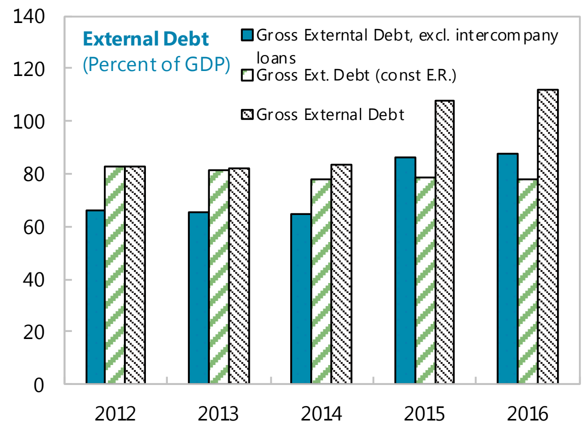
...and remains mostly financed by FDI



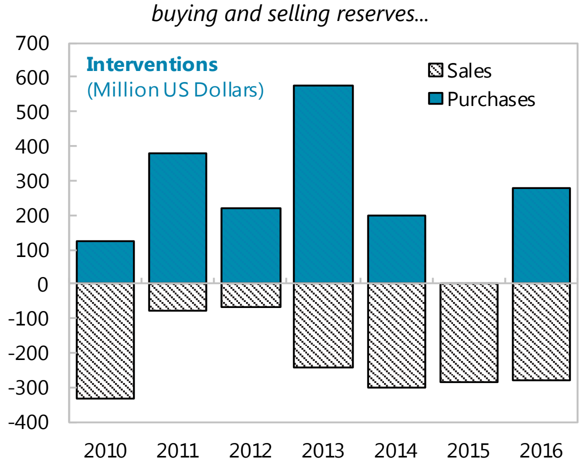
The lari has been volatile and has recently depreciated...



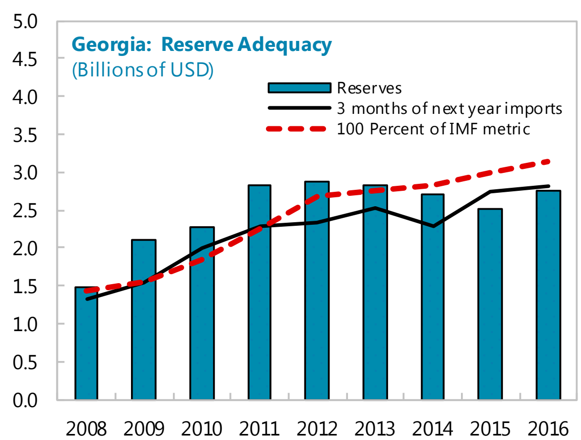
...increasing Georgia's external vulnerabilities further.



The NBG smoothed volatility on the FX market by both buying and selling reserves...



...and reserve coverage has remained short of the Fund's ARA metric in 2016.



Sources: National authorities; and IMF staff estimates.

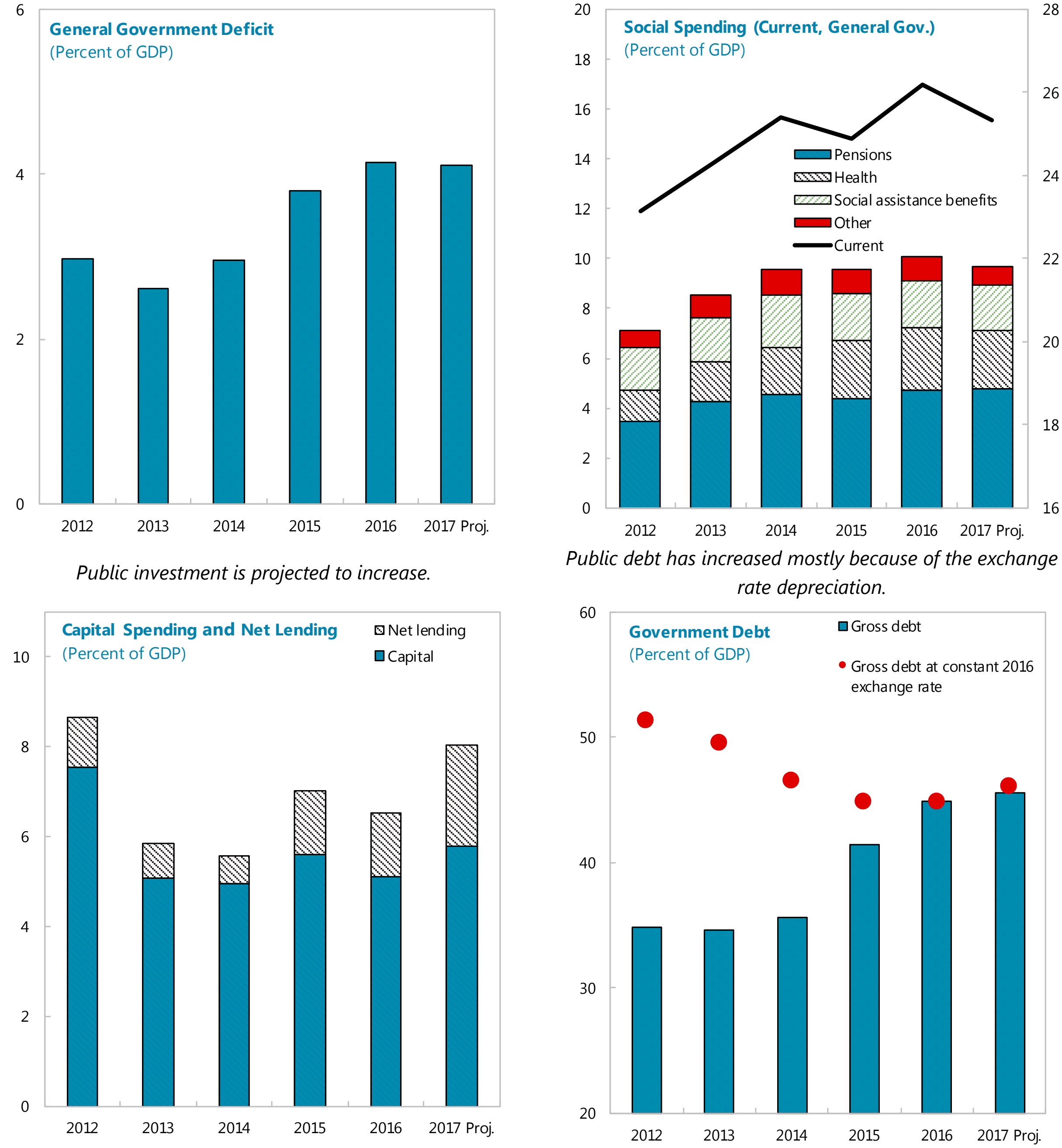
Figure 3. Georgia: Fiscal Sector Developments

Spending pressures increased the 2015 and 2016 deficits above the 3 percent targets.

Current spending has been increasing, driven mostly by social spending (health, pensions, and education).

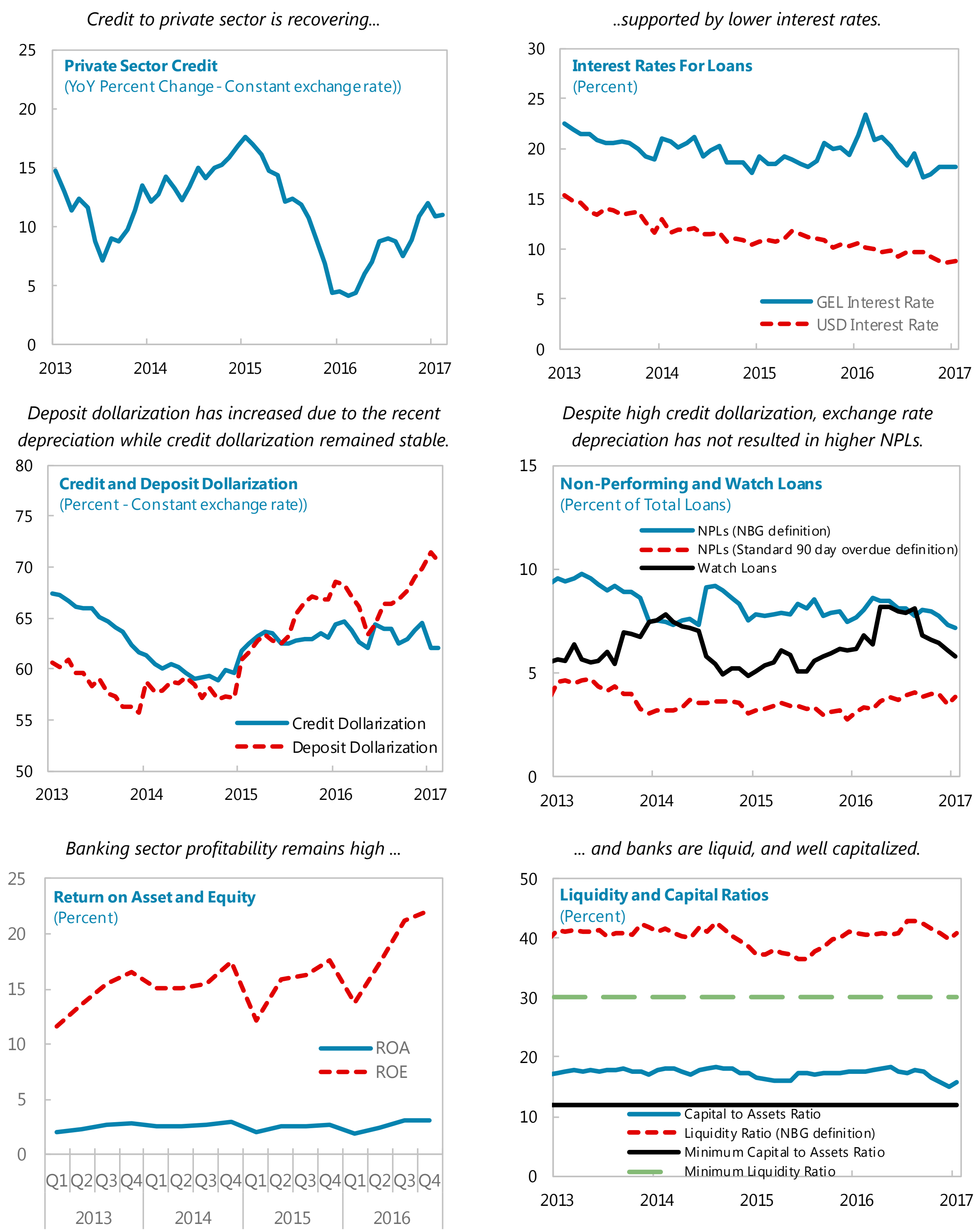
Public investment is projected to increase.

Public debt has increased mostly because of the exchange rate depreciation.



Sources: National authorities; and IMF staff estimates.

Figure 4. Georgia: Financial Sector Developments



Sources: National authorities; CEIC; and IMF staff estimates.

Table 1. Georgia: Selected Economic and Financial Indicators, 2014–22

	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Actual		Prel.	Projections					
National accounts and prices	(annual percentage change; unless otherwise indicated)								
Real GDP	4.6	2.9	2.7	3.5	4.0	4.5	5.0	5.5	5.5
Nominal GDP (in billion of laris)	29.2	31.8	33.7	36.2	38.8	41.7	45.1	49.0	53.3
Nominal GDP (in billion of U.S. dollars)	16.5	14.0	14.2	13.7	14.9	16.0	17.3	18.8	20.4
GDP per capita (in thousand of U.S. dollars)	4.4	3.8	3.8	3.7	4.0	4.3	4.7	5.1	5.6
GDP deflator, period average	3.8	5.9	3.2	4.0	3.0	3.0	3.0	3.0	3.0
CPI, Period average	3.1	4.0	2.1	5.7	2.4	3.0	3.0	3.0	3.0
CPI, End-of-period	2.0	4.9	1.8	5.4	3.0	3.0	3.0	3.0	3.0
Investment and saving	(in percent of GDP)								
Gross national saving	19.2	20.1	19.4	20.5	22.4	24.1	24.9	26.3	27.1
Investment	29.8	32.1	31.8	33.4	34.9	35.6	35.9	36.6	36.3
Public	5.0	5.6	5.1	5.8	6.4	7.3	7.8	8.1	8.2
Private	24.9	26.5	26.7	27.7	28.4	28.3	28.1	28.5	28.1
Consolidated government operations	(in percent of GDP)								
Revenue and grants	28.0	28.1	28.6	29.3	28.6	28.5	28.6	28.6	28.6
o.w. Tax revenue	25.1	25.1	26.0	26.2	25.8	25.9	26.1	26.4	26.5
Expenditures	31.0	31.9	32.7	33.4	32.4	32.4	32.2	32.1	32.0
Current expenditures	25.4	24.9	26.2	25.3	24.3	23.5	22.8	22.5	22.4
Capital spending and net lending	5.6	7.0	6.5	8.0	8.1	8.9	9.4	9.6	9.5
Overall balance	-2.9	-3.8	-4.1	-4.1	-3.8	-3.5	-3.1	-2.8	-2.5
Net Lending/Borrowing (GFSM 2001)	-1.9	-1.3	-1.6	-1.4	-1.8	-1.5	-1.3	-1.1	-1.0
Augmented Net lending / borrowing (Program definition)[1]	-2.7	-2.7	-3.0	-3.7	-3.5	-3.2	-2.8	-2.5	-2.3
Public debt	35.6	41.4	44.9	45.5	46.7	47.2	46.9	46.2	45.1
o.w. NBG debt to the IMF	...	... .	...	0.6	1.1	1.5	1.6	1.5	1.2
o.w. Foreign-currency denominated	26.8	32.5	35.5	35.9	37.3	37.8	37.8	37.8	37.3
Money and credit	(in percent; unless otherwise indicated)								
Credit to the private sector (annual percentage change)	23.3	22.1	19.6	10.5	11.2	10.7	10.6	10.9	11.0
In constant exchange rate	16.9	4.3	12.0	12.0	11.2	10.7	10.6	10.9	11.0
Broad money (annual percentage change)	13.8	19.2	20.4	10.1	14.5	14.9	14.0	13.3	12.5
Broad money (incl. fx deposits, annual percentage change)	15.5	23.4	19.1	8.6	13.0	13.6	12.9	12.3	12.0
In constant exchange rate	10.3	5.1	13.3	11.3	14.6	15.0	14.0	13.3	12.5
Deposit dollarization (in percent of total)	57.1	66.8	69.9	69.0	68.1	67.0	66.6	65.6	65.2
Credit dollarization (in percent of total)	59.7	63.1	64.6	61.5	60.0	59.0	58.0	57.0	56.0
External sector	(in percent of GDP; unless otherwise indicated)								
Current account balance	-10.6	-12.0	-12.4	-12.9	-12.5	-11.5	-11.0	-10.3	-9.2
Trade balance	-25.9	-31.1	-44.4	-44.4	-40.3	-36.9	-36.0	-29.0	-27.9
Terms of trade (ratio)	101.6	106.2	102.0	101.2	101.9	102.1	103.3	104.5	105.6
Gross international reserves (in billions of US$)	2.7	2.5	2.8	3.1	3.4	3.8	4.2	4.9	5.6
In percent of IMF Composite measure (floating)	95.4	83.6	87.6	92.5	96.3	102.3	108.5	116.4	125.1
Gross external debt	83.3	107.8	111.8	119.3	118.6	119.9	120.2	121.3	122.3
Gross external debt, excl. intercompany loans	64.9	86.2	87.8	91.7	90.4	91.1	90.8	91.7	92.6
Laris per U.S. dollar (period average)	1.77	2.27	2.37	...	...	...	...	...	...
Laris per euro (period average)	2.34	2.52	2.62	...	...	...	...	...	...
REER (period average; CPI based, 2010=100)	109.0	104.0	107.5	...	...	...	...	...	...

Sources: Georgian authorities; and Fund staff estimates.

Table 2. Georgia: Summary Balance of Payments, 2014–22

(In millions of U.S. dollars)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Actual		Prel.	Projections					
	(in millions of U.S. dollars)								
Current account balance	-1,756	-1,680	-1,764	-1,775	-1,849	-1,836	-1,905	-1,940	-1,879
Trade balance	-4,271	-4,356	-6,321	-6,098	-5,982	-5,893	-6,218	-5,444	-5,686
Exports	4,073	3,099	2,903	3,226	3,395	3,575	3,910	4,283	4,699
Imports 1/	-8,344	-7,455	-9,224	-9,324	-9,377	-9,469	-10,128	-9,727	-10,385
Services	1,288	1,441	1,596	1,789	1,940	2,122	2,344	2,600	2,847
Services: credit	3,018	3,133	3,356	3,693	3,955	4,254	4,615	5,026	5,457
Services: debit	-1,730	-1,692	-1,760	-1,905	-2,014	-2,132	-2,271	-2,427	-2,609
Income	-207	-312	-729	-547	-564	-501	-554	-555	-595
Of which : interest payments	-409	-490	-505	-532	-568	-609	-651	-678	-747
Transfers 1/	1,434	1,547	3,689	3,081	2,756	2,437	2,522	1,460	1,555
Of which : remittances credit	761	588	597	638	683	731	782	837	895
Capital account	110	63	62	61	60	59	57	56	55
General government	106	59	60	59	58	57	55	54	53
Financial account	1,783	1,505	1,941	1,762	1,882	2,017	2,207	2,498	2,533
Direct investment (net) 2/	1,343	1,255	1,564	1,408	1,493	1,582	1,794	1,851	1,991
Portfolio investment (net)	209	-154	-311	-80	-80	-80	-79	-83	-88
Equity	218	5	1	1	1	1	1	2	2
Debt securities	-9	-158	-312	-81	-81	-81	-81	-85	-89
Loans (net)	441	745	881	444	429	445	530	761	697
Short-term loans (net)	6	109	105	40	40	43	45	48	53
Medium and long-term loans (net)	511	763	757	427	410	429	512	739	675
Public 3/	491	366	312	219	332	315	395	579	563
Private	20	397	445	208	78	114	117	159	112
Bank	-36	91	281	215	18	27	1	72	34
Non-bank	56	306	164	-7	60	87	116	87	78
Other loans (net)	-76	-127	19	-23	-21	-26	-27	-26	-31
Public 3/	0	0	0	0	0	0	0	0	0
Private 4/	-76	-127	19	-23	-21	-26	-27	-26	-31
Others (net)	-72	-320	-193	-10	40	69	-37	-30	-67
Errors and omissions5/	-79	-88	4	0	0	0	0	0	0
Overall balance	58	-199	243	48	93	239	359	615	710
Financing	-58	199	-243	-304	-315	-423	-450	-612	-693
Gross International Reserves (-increase)	33	99	-245	-304	-315	-423	-450	-612	-693
Use of Fund Resources6/	-136	-73	-14	...	...	...	...	...	...
Financing gap	...	...	...	257	222	184	91	-3	-17
Proposed use of Fund Resources	...	...	...	69	27	34	41	-3	-17
Proposed IMF EFF	...	...	...	81	81	81	41	0	0
Repayment 7/	...	...	...	-12	-54	-47	0	-3	-17
Official creditors	...	...	...	188	195	150	50	0	0
World Bank	...	...	...	100	100	100	50	0	0
EU	...	...	...	26	45	0	0	0	0
Others	...	...	...	62	50	50	0	0	0
Memorandum items:				(In percent of GDP)					
Current account balance	-10.6	-12.0	-12.4	-12.9	-12.5	-11.5	-11.0	-10.3	-9.2
Trade balance	-25.9	-31.1	-44.4	-44.4	-40.3	-36.9	-36.0	-29.0	-27.9
Trade balance excluding medicines		-27.9	-26.0	-29.9	-29.5	-29.4	-36.0	-29.0	-27.9
Financial account	10.8	10.8	13.6	12.8	12.7	12.6	12.8	13.3	12.4
Foreign direct investment (net, in billion of US$)	1.3	1.3	1.6	1.4	1.5	1.6	1.8	1.9	2.0
In percent of GDP	8.1	9.0	11.0	10.3	10.1	9.9	10.4	9.9	9.8
External financing requirement	-15.5	-17.9	-18.0	-20.2	-19.6	-18.4	-17.9	-16.5	-15.3
Gross international reserves (in billions of USD)	2,699	2,521	2,756	3,061	3,376	3,799	4,249	4,860	5,553
in months of next year GNFS imports	4	3	3	3	3	4	4	4	5
in percent of short-term debt at remaining maturity	90	76	76	83	86	92	98	104	109
in percent of broad money and non-resident deposits	38	37	37	38	37	36	36	37	37
in percent of IMF Composite measure (floating)	95	84	88	92	96	102	109	116	125
Reserve cover (percent) 8/	46.3	40.0	40.0	43.9	46.8	50.2	52.8	56.9	61.7

Sources: National Bank of Georgia, Ministry of Finance; and IMF staff estimates.

1/ Including hepatitis C vaccines that covers by grants during 2015-19

2/ About US$110 million FDI was reclassified as bank's portfolio investment in 2014.

3/ Including general government and monetary authorities

4/ Including currency and deposits from banks and other financial instruments

5/ Including rescheduled debts and arrears clearance in 2013-15

6/ Repayment for exisitn Fund resources from 2017 onwards will be recorded as a part of financing gap.

7/ Including repayment of exisiting Fund resources

8/ Gross international reserves in percent of total short-term liabilities plus the current account deficit.

Table 3a. Georgia: General Government Operations, 2014–22

(In millions of GEL)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Actual		Prel.			Projections			
Revenues and Grants	8,164	8,923	9,623	10,608	11,075	11,889	12,886	14,033	15,221
Taxes	7,324	7,971	8,750	9,504	9,997	10,804	11,795	12,923	14,119
Direct taxes	3,076	3,498	3,924	3,666	3,847	4,129	4,524	4,975	5,445
Taxes on income	1,977	2,182	2,479	2,681	2,870	3,088	3,340	3,628	3,945
Taxes on profits	829	1,025	1,056	594	580	637	747	873	984
Other Taxes (incl. property)	270	291	388	390	396	404	437	475	516
Indirect taxes	4,248	4,473	4,826	5,838	6,150	6,675	7,271	7,947	8,674
VAT	3,334	3,533	3,686	4,137	4,268	4,591	4,966	5,395	5,866
Excises	819	871	1,070	1,621	1,806	2,006	2,226	2,468	2,725
Custom duties	95	69	70	80	77	78	79	85	83
Other revenues	561	634	592	725	697	704	710	730	750
Grants	279	319	282	380	381	381	381	381	351
Expenditures	9,023	10,128	11,016	12,097	12,563	13,519	14,524	15,753	17,037
Current expenditures	7,399	7,904	8,817	9,181	9,439	9,795	10,290	11,039	11,963
Compensation of employees	1,522	1,602	1,753	1,687	1,735	1,780	1,886	2,028	2,205
Goods and services	1,144	1,203	1,394	1,451	1,460	1,460	1,547	1,663	1,809
Subsidies and grants	638	755	784	880	840	860	915	977	1,053
Social expenses	2,791	3,037	3,394	3,503	3,695	3,914	4,040	4,329	4,707
Other expenses	1,056	978	1,090	1,148	1,175	1,209	1,279	1,387	1,506
Interest	248	330	403	513	534	573	623	655	683
Capital spending and net lending	1,624	2,224	2,199	2,915	3,124	3,724	4,234	4,714	5,074
Capital	1,444	1,776	1,718	2,094	2,500	3,050	3,530	3,990	4,350
Net lending	180	447	481	822	624	674	704	724	724
Primary balance	-611	-874	-990	-976	-954	-887	-776	-718	-650
Overall balance before adjustment	-859	-1,204	-1,393	-1,488	-1,488	-1,631	-1,639	-1,720	-1,817
Unidentified measures	0	0	0	0	0	170	240	347	484
Overall balance	-859	-1,204	-1,393	-1,488	-1,488	-1,460	-1,399	-1,373	-1,333
Financing	859	1,204	1,393	1,488	1,488	1,460	1,399	1,373	1,333
Domestic	246	184	277	286	105	230	108	-264	-204
T-bill issuance (net)	573	333	380	331	188	305	183	64	19
Amortization [1]	-39	-44	-49	-45	-45	-45	-45	-45	-45
Use of deposits	-287	-105	-54	0	-38	-30	-30	-283	-178
External	497	665	747	1,042	1,234	1,090	1,161	1,507	1,437
Borrowing	997	1,047	1,079	1,471	1,889	1,839	1,878	3,582	2,296
Amortization	-499	-382	-332	-429	-655	-748	-717	-2,075	-858
Privatization receipts	116	355	369	160	150	140	130	130	100
Memorandum items:									
Overall balance, national definition	-533	-381	-511	-476	-684	-787	-775	-836	-963
Public debt [2]	10,375	13,161	15,113	16,482	18,099	19,695	21,140	22,661	24,045
End-year government deposits [3]	814	919	973	973	1,011	1,041	1,071	1,354	1,532
Cyclically adjusted primary balance	-698	-907	-955	-929	-924	-897	-867	-944	-1,030
Structural primary balance [4]	-738	-1,037	-1,053	-1,066	-1,066	-1,039	-1,008	-1,083	-1,157
Fiscal deficit excluding grants	1,139	1,523	1,674	1,868	1,869	1,841	1,780	1,753	1,684

Sources: Ministry of Finance; and Fund staff estimates.

[1] Includes Bond for NBG and open market operations.

[2] Includes general government debt and NBG obligations to the Fund.

[3] Includes Treasury single account, Revenue reserve account, local government deposits, and long-term deposits at commercial banks

[4] Equals cyclically adjusted primary balance less budget grants and one-offs.

Table 3b. Georgia: General Government Operations, 2014–22

(Percent of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Actual		Prel.	Projections					
Revenues and Grants	28.0	28.1	28.6	29.3	28.6	28.5	28.6	28.6	28.6
Taxes	25.1	25.1	26.0	26.2	25.8	25.9	26.1	26.4	26.5
Direct taxes	10.6	11.0	11.7	10.1	9.9	9.9	10.0	10.1	10.2
Taxes on income	6.8	6.9	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Taxes on profits	2.8	3.2	3.1	1.6	1.5	1.5	1.7	1.8	1.8
Other Taxes (incl. property)	0.9	0.9	1.2	1.1	1.0	1.0	1.0	1.0	1.0
Indirect taxes	14.6	14.1	14.3	16.1	15.9	16.0	16.1	16.2	16.3
VAT	11.4	11.1	11.0	11.4	11.0	11.0	11.0	11.0	11.0
Excises	2.8	2.7	3.2	4.5	4.7	4.8	4.9	5.0	5.1
Custom duties	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other revenues	1.9	2.0	1.8	2.0	1.8	1.7	1.6	1.5	1.4
Grants	1.0	1.0	0.8	1.0	1.0	0.9	0.8	0.8	0.7
Expenditures	31.0	31.9	32.7	33.4	32.4	32.4	32.2	32.1	32.0
Current expenditures	25.4	24.9	26.2	25.3	24.3	23.5	22.8	22.5	22.4
Compensation of employees	5.2	5.0	5.2	4.7	4.5	4.3	4.2	4.1	4.1
Goods and services	3.9	3.8	4.1	4.0	3.8	3.5	3.4	3.4	3.4
Subsidies and grants	2.2	2.4	2.3	2.4	2.2	2.1	2.0	2.0	2.0
Social expenses	9.6	9.6	10.1	9.7	9.5	9.4	9.0	8.8	8.8
Other expenses	3.6	3.1	3.2	3.2	3.0	2.9	2.8	2.8	2.8
Of which : arrears clearance and provisions	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Interest	0.9	1.0	1.2	1.4	1.4	1.4	1.4	1.3	1.3
Capital spending and net lending	5.6	7.0	6.5	8.0	8.1	8.9	9.4	9.6	9.5
Capital	5.0	5.6	5.1	5.8	6.4	7.3	7.8	8.1	8.2
Net lending	0.6	1.4	1.4	2.3	1.6	1.6	1.6	1.5	1.4
Primary balance	-2.1	-2.8	-2.9	-2.7	-2.5	-2.1	-1.7	-1.5	-1.2
Overall balance before adjustment	-2.9	-3.8	-4.1	-4.1	-3.8	-3.9	-3.6	-3.5	-3.4
Unidentified measures	0.0	0.0	0.0	0.0	0.0	0.4	0.5	0.7	0.9
Overall balance	-2.9	-3.8	-4.1	-4.1	-3.8	-3.5	-3.1	-2.8	-2.5
Financing	2.9	3.8	4.1	4.1	3.8	3.5	3.1	2.8	2.5
Domestic	0.8	0.6	0.8	0.8	0.3	0.6	0.2	-0.5	-0.4
T-bill issuance (net)	2.0	1.0	1.1	0.9	0.5	0.7	0.4	0.1	0.0
Amortization [1]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Use of deposits	-1.0	-0.3	-0.2	0.0	-0.1	-0.1	-0.1	-0.6	-0.3
External	1.7	2.1	2.2	2.9	3.2	2.6	2.6	3.1	2.7
Borrowing	3.4	3.3	3.2	4.1	4.9	4.4	4.2	7.3	4.3
Amortization	-1.7	-1.2	-1.0	-1.2	-1.7	-1.8	-1.6	-4.2	-1.6
Privatization receipts	0.4	1.1	1.1	0.4	0.4	0.3	0.3	0.3	0.2
Memorandum items:									
Overall balance, national definition	-1.8	-1.2	-1.5	-1.3	-1.8	-1.9	-1.7	-1.7	-1.8
Public debt [2]	35.6	41.4	44.9	45.5	46.7	47.2	46.9	46.2	45.1
End-year government deposits [3]	2.8	2.9	2.9	2.7	2.6	2.5	2.4	2.8	2.9
Cyclically adjusted primary balance	-2.4	-2.9	-2.8	-2.6	-2.4	-2.2	-1.9	-1.9	-1.9
Structural primary balance [4]	-2.5	-3.3	-3.1	-2.9	-2.7	-2.5	-2.2	-2.2	-2.2
Fiscal deficit excluding grants	3.9	4.8	5.0	5.2	4.8	4.4	3.9	3.6	3.2

Sources: Ministry of Finance; and Fund staff estimates.

[1] Includes Bond for NBG and open market operations.

[2] Includes general government debt and NBG obligations to the Fund.

[3] Includes Treasury single account, Revenue reserve account, local government deposits, and long-term deposits at commercial banks

[4] Equals cyclically adjusted primary balance less budget grants and one-offs.

Table 3c. Georgia: General Government Operations, GFSM 2001, 2014–22

(In millions of GEL)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Actual		Prel.	Projections					
Revenue	8,164	8,923	9,623	10,608	11,075	11,889	12,886	14,033	15,221
Taxes	7,324	7,971	8,750	9,504	9,997	10,804	11,795	12,923	14,119
Taxes on income, profits, and capital gains	2,805	3,207	3,535	3,276	3,450	3,725	4,087	4,501	4,929
Payable by individuals	1,977	2,182	2,479	2,681	2,870	3,088	3,340	3,628	3,945
Payable by corporations	829	1,025	1,056	594	580	637	747	873	984
Taxes on property	246	264	363	365	373	380	411	446	486
Taxes on goods and services	4,153	4,404	4,756	5,758	6,074	6,597	7,192	7,863	8,591
General taxes on goods and services (VAT)	3,334	3,533	3,686	4,137	4,268	4,591	4,966	5,395	5,866
Excises	819	871	1,070	1,621	1,806	2,006	2,226	2,468	2,725
Taxes on international trade	95	69	70	80	77	78	79	85	83
Other taxes	24	26	25	25	24	24	26	28	31
Grants	279	319	282	380	381	381	381	381	351
Other revenue	561	634	592	725	697	704	710	730	750
Total Expenditure	8,728	9,325	10,168	11,115	11,789	12,705	13,690	14,899	16,213
Expense	7,399	7,904	8,817	9,181	9,439	9,795	10,290	11,039	11,963
Compensation of employees	1,522	1,602	1,753	1,687	1,735	1,780	1,886	2,028	2,205
Use of goods and services	1,144	1,203	1,394	1,451	1,460	1,460	1,547	1,663	1,809
Interest	248	330	403	513	534	573	623	655	683
External	139	174	195	247	255	278	300	324	353
Domestic	109	156	208	265	279	295	323	330	330
Subsidies	626	671	701	802	755	770	815	877	953
Grants	12	84	82	77	85	90	100	100	100
Social benefits	2,791	3,037	3,394	3,503	3,695	3,914	4,040	4,329	4,707
Other expense	1,056	978	1,090	1,148	1,175	1,209	1,279	1,387	1,506
o/w arrears	30	21	31	30	30	30	30	30	30
Net acquisition of nonfinancial assets	1,329	1,421	1,351	1,934	2,350	2,910	3,400	3,860	4,250
Increase	1,444	1,776	1,718	2,094	2,500	3,050	3,530	3,990	4,350
Decrease (privatization proceeds)	-115	-355	-367	-160	-150	-140	-130	-130	-100
Net lending / borrowing before adjustment	-564	-402	-545	-506	-714	-817	-805	-866	-993
Unidentified measures	0	0	0	0	0	170	240	347	484
Net lending / borrowing	-564	-402	-545	-507	-714	-646	-565	-518	-509
Change in net financial worth, transactions	-564	-402	-545	-507	-714	-646	-565	-518	-509
Net acquisition of financial assets ("+": increase in assets)	467	552	533	822	662	704	734	1,007	902
Domestic	467	552	533	822	662	704	734	1,007	902
Budget lending	217	447	481	822	624	674	704	724	724
Deposits (NBG and commercial banks)	287	105	54	0	38	30	30	283	178
Financial privatization	-1	0	-2	0	0	0	0	0	0
Net incurrence of liabilities ("+": increase in liabilities)	1,031	954	1,078	1,328	1,376	1,350	1,299	1,525	1,411
Domestic	533	289	331	286	143	260	138	19	-26
Securities other than shares	538	298	345	296	153	270	148	29	-16
Loans	-4	-9	-14	-10	-10	-10	-10	-10	-10
Foreign	497	665	747	1,042	1,234	1,090	1,161	1,507	1,437
Loans	497	665	747	1,042	1,234	1,090	1,161	1,507	1,437
Memorandum items:									
Nominal GDP	29,150	31,756	33,664	36,227	38,782	41,717	45,120	49,019	53,304
Public debt	10,375	13,161	15,113	16,482	18,099	19,695	21,140	22,661	24,045
End-year government deposits	814	919	973	973	1,011	1,041	1,071	1,354	1,532
Operating balance	765	1,019	806	1,427	1,636	2,093	2,595	2,994	3,257
Net lending / borrowing (excluding privatization)	-679	-757	-912	-666	-864	-957	-935	-996	-1,093
Augmented Net lending / borrowing (Program definition) 1/	-781	-849	-1,025	-1,328	-1,338	-1,491	-1,509	-1,590	-1,717
Cyclically-adjusted primary balance (Program definition)	-584	-551	-587	-769	-774	-757	-737	-814	-930

Sources: Ministry of Finance; and Fund staff estimates.

1/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.

Table 3d. Georgia: General Government Operations, GFSM 2001, 2014–22

(Percent of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Actual		Prel.	Projections					
Revenue	28.0	28.1	28.6	29.3	28.6	28.5	28.6	28.6	28.6
Taxes	25.1	25.1	26.0	26.2	25.8	25.9	26.1	26.4	26.5
Taxes on income, profits, and capital gains	9.6	10.1	10.5	9.0	8.9	8.9	9.1	9.2	9.2
Payable by individuals	6.8	6.9	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Payable by corporations	2.8	3.2	3.1	1.6	1.5	1.5	1.7	1.8	1.8
Taxes on property	0.8	0.8	1.1	1.0	1.0	0.9	0.9	0.9	0.9
Taxes on goods and services	14.2	13.9	14.1	15.9	15.7	15.8	15.9	16.0	16.1
General taxes on goods and services (VAT)	11.4	11.1	11.0	11.4	11.0	11.0	11.0	11.0	11.0
Excises	2.8	2.7	3.2	4.5	4.7	4.8	4.9	5.0	5.1
Taxes on international trade	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other taxes	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Grants	1.0	1.0	0.8	1.0	1.0	0.9	0.8	0.8	0.7
Other revenue	1.9	2.0	1.8	2.0	1.8	1.7	1.6	1.5	1.4
Total Expenditure	29.9	29.4	30.2	30.7	30.4	30.5	30.3	30.4	30.4
Expense	25.4	24.9	26.2	25.3	24.3	23.5	22.8	22.5	22.4
Compensation of employees	5.2	5.0	5.2	4.7	4.5	4.3	4.2	4.1	4.1
Use of goods and services	3.9	3.8	4.1	4.0	3.8	3.5	3.4	3.4	3.4
Interest	0.9	1.0	1.2	1.4	1.4	1.4	1.4	1.3	1.3
External	0.5	0.5	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Domestic	0.4	0.5	0.6	0.7	0.7	0.7	0.7	0.7	0.6
Subsidies	2.1	2.1	2.1	2.2	1.9	1.8	1.8	1.8	1.8
Grants	0.0	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social benefits	9.6	9.6	10.1	9.7	9.5	9.4	9.0	8.8	8.8
Other expense	3.6	3.1	3.2	3.2	3.0	2.9	2.8	2.8	2.8
o/w arrears	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net acquisition of nonfinancial assets	4.6	4.5	4.0	5.3	6.1	7.0	7.5	7.9	8.0
Increase	5.0	5.6	5.1	5.8	6.4	7.3	7.8	8.1	8.2
Decrease (privatization proceeds)	-0.4	-1.1	-1.1	-0.4	-0.4	-0.3	-0.3	-0.3	-0.2
Net lending / borrowing before adjustment	-1.9	-1.3	-1.6	-1.4	-1.8	-2.0	-1.8	-1.8	-1.9
Unidentified measures	0.0	0.0	0.0	0.0	0.0	0.4	0.5	0.7	0.9
Net lending / borrowing	-1.9	-1.3	-1.6	-1.4	-1.8	-1.5	-1.3	-1.1	-1.0
Change in net financial worth, transactions	-1.9	-1.3	-1.6	-1.4	-1.8	-1.5	-1.3	-1.1	-1.0
Net acquisition of financial assets ("+": increase in assets)	1.6	1.7	1.6	2.3	1.7	1.7	1.6	2.1	1.7
Domestic	1.6	1.7	1.6	2.3	1.7	1.7	1.6	2.1	1.7
Budget lending	0.7	1.4	1.4	2.3	1.6	1.6	1.6	1.5	1.4
Deposits (NBG and commercial banks)	1.0	0.3	0.2	0.0	0.1	0.1	0.1	0.6	0.3
Financial privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities ("+": increase in liabilities)	3.5	3.0	3.2	3.7	3.5	3.2	2.9	3.1	2.6
Domestic	1.8	0.9	1.0	0.8	0.4	0.6	0.3	0.0	0.0
Securities other than shares	1.8	0.9	1.0	0.8	0.4	0.6	0.3	0.1	0.0
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	1.7	2.1	2.2	2.9	3.2	2.6	2.6	3.1	2.7
Loans	1.7	2.1	2.2	2.9	3.2	2.6	2.6	3.1	2.7
Memorandum items:									
Nominal GDP	29,150	31,756	33,664	36,227	38,782	41,717	45,120	49,019	53,304
Public debt	35.6	41.4	44.9	45.5	46.7	47.2	46.9	46.2	45.1
End-year government deposits	2.8	2.9	2.9	2.7	2.6	2.5	2.4	2.8	2.9
Operating balance (before adjustment)	2.6	3.2	2.4	3.9	4.2	5.0	5.8	6.1	6.1
Net lending / borrowing (excluding privatization)	-2.3	-2.4	-2.7	-1.8	-2.2	-2.3	-2.1	-2.0	-2.1
Augmented Net lending / borrowing (Program definition) 1/	-2.7	-2.7	-3.0	-3.7	-3.5	-3.2	-2.8	-2.5	-2.3
Cyclically-adjusted primary balance (Program definition)	-2.0	-1.7	-1.7	-2.1	-2.0	-1.8	-1.6	-1.7	-1.7

Sources: Ministry of Finance; and Fund staff estimates.

1/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.

Table 4. Georgia: Monetary Survey, 2013–17

	2013	2014	2015	2016		2017	
	Dec. Act.	Dec. Act.	Dec. Act.	June Act.	Dec Prel.	June Proj.	Dec Proj.
Central Bank	(In billions of lari)						
Net foreign assets	3.2	3.2	3.5	3.7	3.8	3.5	3.8
Gross international reserves	4.9	5.0	6.0	6.7	7.3	7.4	8.0
Other foreign assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign currency liabilities	-1.7	-1.8	-2.5	-3.0	-3.5	-3.9	-4.1
Of which : use of Fund resources	-0.2	-0.1	0.0	0.0	0.0	-0.4	-0.5
Of which : compulsory reserves in USD	-1.0	-1.2	-1.7	-2.3	-2.8	-2.8	-3.0
Net domestic assets	-0.3	-0.1	-0.6	-0.9	-0.4	-0.1	-0.1
Net claims on general government	0.0	-0.1	-0.4	0.0	-0.5	-0.4	-0.3
Claims on general government (incl. T-bills)	0.5	0.5	0.5	0.5	0.5	0.6	0.7
Nontradable govt. debt	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Securitized debt (marketable)	0.0	0.1	0.1	0.2	0.1	0.2	0.3
Deposits	-0.5	-0.6	-0.9	-0.5	-1.0	-1.0	-1.0
Claims on rest of economy	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on banks	-0.3	0.2	0.7	0.2	1.6	1.7	1.6
Bank refinancing	0.4	0.7	1.1	0.4	1.8	2.5	2.0
Certificates of deposits and bonds	-0.7	-0.5	-0.4	-0.2	-0.2	-0.8	-0.4
Other items, net	-0.1	-0.2	-0.9	-1.0	-1.4	-1.4	-1.4
Banking System	(In billions of lari)						
Net foreign assets	1.0	0.6	1.0	0.8	1.9	1.6	1.7
NBG	4.2	4.4	5.2	6.1	6.6	6.3	6.8
Commercial banks	-3.2	-3.8	-4.3	-5.2	-4.7	-4.7	-5.1
Net domestic assets	8.8	10.6	12.4	12.5	14.2	15.0	16.0
Domestic credit	11.0	13.5	16.4	17.2	19.6	20.6	21.9
Net claims on general government	0.6	0.7	0.7	1.0	0.9	0.9	1.2
Of which : government deposits at NBG	-0.5	-0.6	-0.9	-0.5	-1.0	-1.0	-1.0
Of which : T-bills at commercial banks	0.7	1.3	1.6	1.7	2.0	2.1	2.3
Private credit	10.4	12.8	15.6	16.2	18.7	19.7	20.7
Other items, net	-2.1	-2.9	-4.0	-4.6	-5.4	-5.7	-5.9
Broad money (M3)	9.8	11.2	13.3	13.3	16.1	16.6	17.7
(Broad money, percent change year on year)	24.4	13.8	19.2	13.3	20.4	24.3	10.1
Lari Broad money (M2)	5.4	5.9	5.7	6.0	6.5	6.7	7.4
Currency held by the public	1.9	1.9	2.0	2.0	2.4	2.5	2.8
Lari resident deposits	3.5	4.0	3.8	4.0	4.1	4.2	4.6
Resident foreign exchange deposits	4.4	5.3	7.6	7.3	9.6	9.9	10.3
Sources of funds of commercial banks	12.7	14.5	18.7	19.0	21.7	22.2	23.4
Resident deposits	7.9	9.2	11.4	11.3	13.7	14.1	14.9
Non-resident deposits	1.7	2.1	3.1	3.1	3.5	3.5	3.6
Other foreign liabilities	3.1	3.1	4.2	4.6	4.5	4.5	5.0
Uses of funds of commercial banks	12.7	14.5	18.7	19.0	21.7	22.2	23.7
Reserves	3.4	3.5	4.9	4.8	6.3	6.2	6.5
Domestic credit	10.9	13.6	16.7	17.2	20.1	21.0	22.2
Lari domestic credit	4.5	5.9	6.9	6.8	8.0	8.9	9.5
Fx domestic credit	6.4	7.6	9.9	10.4	12.1	12.1	12.7
Other foreign assets	0.2	0.3	0.6	0.5	0.4	0.4	0.4
Other items, net	-1.5	-2.5	-3.0	-3.1	-4.7	-5.1	-4.9
Memorandum items:	(Percent of GDP, unless otherwise indicated)						
Broad money (M3)	36.6	38.4	42.0	40.8	47.7	47.5	48.8
Lari Broad money (M2)	20.2	20.3	18.1	18.5	19.3	19.1	20.5
Currency held by the public	7.0	6.6	6.2	6.1	7.0	7.1	7.8
Non-resident deposits (percent of total deposits)	15.5	16.2	17.1	16.2	16.6	15.8	15.4
Private credit (Percent change, year on year)	19.5	23.3	22.1	11.5	19.6	21.9	10.5
Private credit	38.7	43.9	49.2	49.4	55.5	56.4	57.0
Nominal GDP (billions of lari)	26.8	29.2	31.8	32.7	33.7	34.9	36.2

Sources: National Bank of Georgia; and Fund staff estimates.

Table 5: Selected Monetary and Financial Soundness Indicators, 2008–16

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Deposit dollarization (residents, in percent)	72.6	68.8	65.0	58.6	60.4	55.7	57.1	66.8	69.9
Loan-to-deposit ratio (in percent)	155.9	124.2	107.6	105.3	106.7	102.9	105.3	103.9	103.6
Credit-to-GDP ratio (in percent)	31.7	29.0	29.9	31.7	33.2	38.7	43.9	49.2	55.5
Capital adequacy ratio (in percent) 1/	13.9	19.1	17.4	17.1	17.0	17.2	17.4	17.5	15.0
Capital adequacy ratio (in percent) 2/	24.0	25.6	23.6	25.6	25.3	25.2	25.5	26.0	23.2
Liquidity ratio (in percent) 3/	28.3	39.1	38.7	37.3	39.8	41.8	38.7	41.2	39.7
Nonperforming loans (in percent of total loans) 4/	12.8	17.9	12.5	8.6	9.3	7.5	7.6	7.5	7.3
Nonperforming loans (in percent of total loans) 5/	4.1	6.3	5.4	4.6	3.7	3.1	3.1	2.7	3.5
Loans collateralized by real estate (in percent of total loans)	43.6	55.5	47.5	53.4	50.6	52.5	51.2	54.8	59.2
Loans in foreign exchange (in percent of total loans)	72.8	76.9	74.0	68.8	67.5	62.1	60.4	64.3	65.4
Specific provisions (in percent of total loans)	6.0	9.7	6.5	4.6	4.6	3.8	3.6	3.7	3.6
Net foreign assets (in percent of total assets)	-19.6	-14.9	-8.2	-13.7	-19.7	-17.4	-17.7	-13.2	-15.0
Net open foreign exchange position (in percent of regulatory capital)	1.7	1.8	8.1	5.9	3.3	2.1	2.0	-0.6	4.4
Return on equity (cumulative through the year, annualized) 6/	-12.4	-4.3	9.6	17.3	5.8	14.6	14.8	15.4	19.2
Borrowed funds from abroad-to-GDP ratio 7/	12.7	11.6	12.2	9.4	11.4	11.1	11.7	14.1	15.3

Sources: National Bank of Georgia; and Fund staff estimates.

1/ National definition. Risk weight to forex loans was reduced from 200 to 175 percent in September 2008, and to 150 percent in August 2009, and raised to 175 percent in January 2011.

2/ Basel I definition.

3/ Ratio of liquid assets to 6-month and shorter maturity liabilities.

4/ National definition: NPLs are defined as loans in substandard, doubtful, and loss loan categories.

5/ IMF definition.

6/ Pre tax.

7/ Borrowed funds include Subordinated Debt.

Table 6. Georgia: Selected Competitiveness and Structural Indicators[1]

	Georgia		Best Performer[2]				Distance[3]	
	2010	**2014**		**2010**		**2014**	**2010**	**2014**
EBRD transition indicators	78.5	78.5		100.0		98.2	21.5	19.7
Large scale privatisation	100.0	100.0		100.0		100.0	0.0	0.0
Small scale privatisation	83.5	83.5		100.0		100.0	16.5	16.5
Governance and enterprise restructuring	49.8	49.8		100.0		100.0	50.2	50.2
Price liberalisation	100.0	100.0		100.0		100.0	0.0	0.0
Trade & Forex system	100.0	100.0		100.0		100.0	0.0	0.0
Competition Policy	37.5	37.5		100.0		100.0	62.5	62.5
Transparency International	**2010**	**2016**		**2010**		**2016**	**2010**	**2016**
Corruption Index	32.9	58.8	POLAND	51.2	POLAND	65.0	18.3	6.3
	2014	**2017**		**2014**		**2017**	**2014**	**2017**
World Bank Doing Business Indicator[4]	84.5	89.8	GEORGIA	84.5	LATVIA	90.4	0.0	0.6
Starting a business	95.1	94.4	ARMENIA	95.2	AZERBAIJAN	96.8	0.1	2.3
Dealing with construction permits	100.0	90.4	GEORGIA	100.0	GEORGIA	94.8	0.0	4.3
Registering property	100.0	95.9	GEORGIA	100.0	LITHUANIA	98.4	0.0	2.5
Getting credit	93.3	85.0	GEORGIA	93.3	GEORGIA	85.0	0.0	0.0
Protecting minority investors	73.1	74.0	GEORGIA	73.1	KAZAKHSTAN	96.0	0.0	22.0
Paying taxes	85.7	83.2	KAZAKHSTAN	89.6	LATVIA	90.3	3.9	7.1
Trading across borders	86.7	100.0	LITHUANIA	89.9	POLAND	100.0	3.2	0.0
Enforcing contracts	79.7	70.9	BELARUS	87.8	LITHUANIA	92.0	8.0	21.1
Resolving insolvency	39.2	30.6	POLAND	73.0	POLAND	81.3	33.8	50.8

Sources: EBRD; Transparency International; World Bank; and IMF staff calculations.

[1] For comparability, all indices normalized so that they range from 0 (worst) to 100 (best).

[2] Sample countries include: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Poland, Romania, Serbia, Tajikistan, Turkey, Ukrain, and Uzbekistan

[3] Distance of Georgia from best performer for each index.

[4] As pointed out in an independent evaluation of the Doing Business survey (see www.worldbank.org/ieg/doingbusiness), care should be exercised when interpreting these indicators given subjective interpretation, limited coverage of business constraints, and a small number of informants which tend to overstate the indicators' coverage and explanatory power.

Table 7. Georgia: External Vulnerability Indicators, 2014–22

	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Actual		Prel.	Projections					
Value of exports of goods and services, percent change	-1.6	-12.1	0.4	10.6	6.2	6.5	8.9	9.2	9.1
Value of imports of goods and services, percent change	8.4	-9.2	20.1	2.2	1.4	1.8	6.9	-2.0	6.9
Terms of trade (deterioration -)	2.3	4.5	-4.0	-0.7	0.6	0.2	1.2	1.1	1.1
Current account balance (percent of GDP)	-10.6	-12.0	-12.4	-12.9	-12.5	-11.5	-11.0	-10.3	-9.2
Capital and financial account (percent of GDP)	11.5	11.2	14.1	14.7	14.4	13.9	13.4	13.6	12.7
External public debt (percent of GDP)	27.2	32.9	33.7	38.6	39.5	39.8	39.6	39.6	39.1
(in percent of exports of goods and services)	63.3	73.8	76.6	76.6	79.8	81.3	80.3	79.8	78.5
Debt service on external public debt									
(in percent of exports of goods and services)	6.1	4.3	3.8	3.7	4.7	5.0	4.5	4.3	4.6
External debt (percent of GDP)[1]	64.9	86.2	87.8	91.7	90.4	91.1	90.8	91.7	92.6
(in percent of exports of goods and services)	151.2	193.7	199.4	181.8	182.6	185.9	184.1	184.9	186.1
Debt service on MLT external debt									
(in percent of exports of goods and services)	20.3	21.4	20.0	21.3	22.0	21.5	20.6	19.0	19.0
Gross international reserves									
in millions of USD	2,699	2,521	2,756	3,061	3,376	3,799	4,249	4,860	5,553
in months of next year's imports of goods and services	3.5	2.8	2.9	3.2	3.5	3.7	4.2	4.5	4.8
in percent of external debt	25.2	20.9	22.1	24.3	25.2	26.1	27.1	28.2	29.4
in percent of short-term external debt (remaining maturity)	90	76	76	83	86	92	98	104	109

Source: Fund staff estimates and projections.

[1] Excluding intercompany loans.

Table 8: Georgia: Gross External Requirement, 2017–22

(Millions of U.S. Dollars)

	2017	2018	2019	2020	2021	2022
			proj.			
Total financing requirement	2,882	2,972	2,969	3,231	3,243	3,317
Current account deficit	1,775	1,849	1,836	1,905	1,940	1,879
Medium and long-term debt	993	1,062	1,096	1,181	1,164	1,253
Private	843	865	857	907	871	936
Banks	302	347	321	350	298	345
Corporates	541	518	536	557	574	591
Public	150	197	239	274	292	316
Others (net)	114	60	37	144	139	186
Total financing sources	2,929	3,064	3,208	3,590	3,858	4,027
Capital transfers	61	60	59	57	56	55
Direct investment, net	1,408	1,493	1,582	1,794	1,851	1,991
Medium and long-term debt	1,420	1,472	1,525	1,693	1,902	1,928
Private	1,051	944	971	1,024	1,031	1,049
Banks	517	365	348	351	369	379
Corporates	535	579	622	673	661	669
Public (only project loans)	369	528	554	669	872	879
Short-term debt (net)	40	40	43	45	48	53
Increase in gross reserves	304	315	423	450	612	693
Errors and omissions	0	0	0	0	0	0
Total financing needs	257	222	184	91	-3	-17
Official financing	257	222	184	91	-3	-17
IMF	69	27	34	41	-3	-17
Prospective purchases	81	81	81	41	0	0
Repurchases	-12	-54	-47	0	-3	-17
Official creditors	188	195	150	50	0	0
World Bank	100	100	100	50	0	0
EU	26	45	0	0	0	0
Others	62	50	50	0	0	0
Memorandum items:						
Gross international reserves	3,061	3,376	3,799	4,249	4,860	5,553
in months of next year GNFS imports	3	3	4	4	4	5
in percent of short-term debt at remaining maturity	83	86	92	98	104	109
in percent of IMF Composite measure (floating)	92	96	102	109	116	125
EFF in percent of total official financing	27	12	18	45	…	…

Sources: National Bank of Georgia, Ministry of Finance; and IMF staff estimates.

Table 9. Georgia: Indicators of Fund Credit, 2014–22

(In millions of SDR)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Actual			Projections					
Existing Fund credit									
Stock 1/	146.2	94.0	84.2	75.0	35.0	0.0	0.0	0.0	0.0
ECF 2/	29.4	14.0	4.2	0.0	0.0	0.0	0.0	0.0	0.0
SBA	116.8	80.0	80.0	75.0	35.0	0.0	0.0	0.0	0.0
Obligations	168.3	53.2	10.7	10.2	40.9	35.4	0.0	0.0	0.0
ECF 2/	18.2	15.4	9.8	4.2	0.0	0.0	0.0	0.0	0.0
SBA	150.1	37.8	0.8	6.0	40.9	35.4	0.0	0.0	0.0
Principal (repurchases)	148.6	36.8	0.0	5.0	40.0	35.0	0.0	0.0	0.0
Interest charges	1.6	1.0	0.8	1.0	0.9	0.4	0.0	0.0	0.0
Prospective purchases under the EFF									
Disbursements	0.0	0.0	0.0	60.0	60.0	60.0	30.4	0.0	0.0
Stock 1/	0.0	0.0	0.0	60.0	120.0	180.0	210.4	207.9	195.4
Obligations 3/	0.0	0.0	0.0	0.5	1.3	2.2	2.8	5.4	15.3
Principal (repurchases)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.5	12.5
Interest charges	0.0	0.0	0.0	0.5	1.3	2.2	2.8	2.9	2.8
Stock of existing and prospective Fund credit 1/	146.2	94.0	84.2	135.0	155.0	180.0	210.4	207.9	195.4
In percent of quota 4/	97.3	62.5	40.0	64.2	73.7	85.5	100.0	98.8	92.9
In percent of GDP	1.3	0.9	0.8	1.3	1.4	1.5	1.6	1.5	1.3
In percent of exports of goods and nonfactor services	3.1	2.1	1.9	2.6	2.8	3.1	3.3	3.0	2.6
In percent of gross reserves	8.2	5.2	4.2	6.0	6.2	6.4	6.7	5.8	4.8
In percent of public external debt	4.9	2.9	2.4	3.4	3.6	3.8	4.2	3.8	3.3
Obligations to the Fund from existing and prospective Fund credit	168.3	53.2	10.7	10.8	42.2	37.5	2.9	5.4	15.3
In percent of quota	112.0	35.4	5.1	5.1	20.1	17.8	1.4	2.6	7.3
In percent of GDP	1.5	0.5	0.1	0.1	0.4	0.3	0.0	0.0	0.1
In percent of exports of goods and nonfactor services	3.6	1.2	0.2	0.2	0.8	0.6	0.0	0.1	0.2
In percent of gross reserves	9.5	3.0	0.5	0.5	1.7	1.3	0.1	0.1	0.4
In percent of public external debt service	58.9	27.5	6.3	5.7	16.4	12.9	1.0	1.8	4.5

Source: Fund staff estimates and projections.

1/ End of period.
2/ Following the Low Income Countries (LIC) reforms, effective January 7 2010, the PRGF arrangements were renamed Extended Credit Facility (ECF) Arrangements. ECF interest is based on 0 percent through end December 2018.
3/ Repayment schedule based on repurchase obligations and GRA charges. Includes service charges.
4/ Quota increased to SDR 210.4 million in February, 2016.

Table 10. Georgia: Proposed Schedule of Reviews and Available Purchase

Availability Date	Condition	Amount of Purchase (SDR millions)	Amount of Purchase (Percent of quota)
12-Apr-17	Approve the 36-month EFF	30	14.3
27-Oct-17	Complete the first review based on end-June 2017 performance criteria and other relevant performance criteria	30	14.3
13-Apr-18	Complete the second review based on end-December 2017 performance criteria and other relevant performance criteria	30	14.3
26-Oct-18	Complete the third review based on end-June 2018 performance criteria and other relevant performance criteria	30	14.3
12-Apr-19	Complete the fourth review based on end-December 2018 performance criteria and other relevant performance criteria	30	14.3
25-Oct-19	Complete the fifth review based on end-June 2019 performance criteria and other relevant performance criteria	30	14.3
20-Mar-20	Complete the sixth review based on end-December 2019 performance criteria and other relevant performance criteria	30.4	14.4
Total available		210.4	100

Source: Fund staff estimates and projections.

Table 11. Georgia: Public Sector Debt Sustainability Analysis (DSA)

(Percent of GDP unless otherwise indicated)

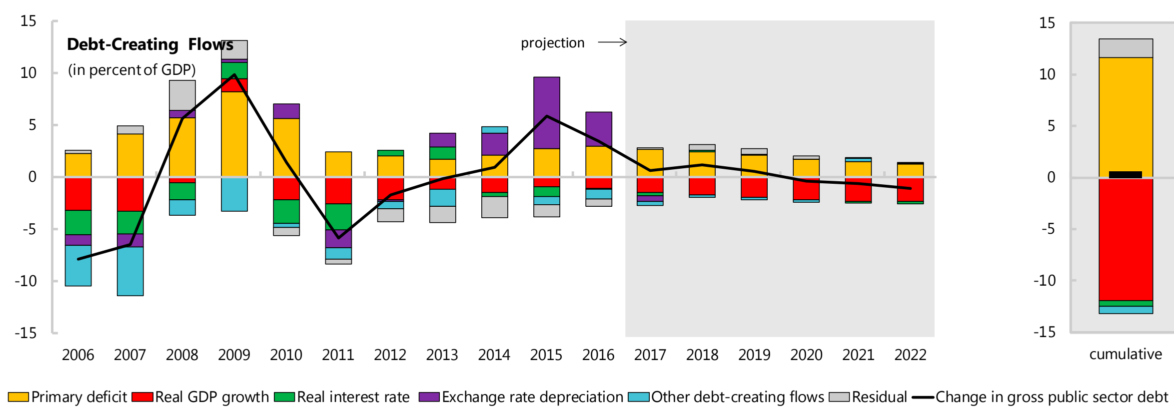
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2006-2014 [2]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	34.9	41.4	44.9	45.5	46.7	47.2	46.9	46.2	45.1
Public gross financing needs	6.8	6.7	7.5	7.9	7.7	7.8	7.0	9.3	6.6
Real GDP growth (in percent)	5.4	2.9	2.7	3.5	4.0	4.5	5.0	5.5	5.5
Inflation (GDP deflator, in percent)	5.3	5.9	3.2	4.0	3.0	3.0	3.0	3.0	3.0
Nominal GDP growth (in percent)	11.1	8.9	6.0	7.6	7.1	7.6	8.2	8.6	8.7
Effective interest rate (in percent) [3]	2.7	3.2	3.1	3.3	3.3	3.2	3.2	2.9	2.7

As of December 30, 2016		
Sovereign Spreads		
EMBIG (bp)		338
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	Ba3	Ba3
S&Ps	BB-	BB-
Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [8]
Change in gross public sector debt	-0.5	5.9	3.4	0.6	1.2	0.5	-0.4	-0.6	-1.1	0.2	
Identified debt-creating flows	-0.4	7.0	4.2	0.5	0.6	0.0	-0.7	-0.7	-1.2	-1.6	
Primary deficit	3.8	2.8	2.9	2.7	2.5	2.1	1.7	1.5	1.2	11.7	-2.4
Primary (noninterest) revenue and grants	28.5	28.1	28.6	29.3	28.6	28.5	28.6	28.6	28.6	172.1	
Primary (noninterest) expenditure	32.3	30.9	31.5	32.0	31.0	30.6	30.3	30.1	29.8	183.8	
Automatic debt dynamics [4]	-2.4	5.0	2.2	-1.8	-1.6	-1.9	-2.2	-2.5	-2.6	-12.5	
Interest rate/growth differential [5]	-2.6	-1.9	-1.2	-1.8	-1.6	-1.9	-2.2	-2.5	-2.6	-12.5	
Of which: real interest rate	-0.9	-0.9	-0.1	-0.3	0.1	0.0	0.0	-0.1	-0.2	-0.5	
Of which: real GDP growth	-1.7	-0.9	-1.1	-1.5	-1.7	-1.9	-2.2	-2.4	-2.4	-12.0	
Exchange rate depreciation [6]	0.2	6.9	3.3	...	...	...	...	...	...	...	
Other identified debt-creating flows	-1.9	-0.8	-0.9	-0.4	-0.3	-0.3	-0.2	0.3	0.1	-0.8	
GG: Privatization and Drawdown of deposits (negative)	-1.9	-0.8	-0.9	-0.4	-0.3	-0.3	-0.2	0.3	0.1	-0.8	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [7]	0.0	-1.1	-0.7	0.1	0.6	0.6	0.3	0.1	0.1	1.8	



Source: IMF staff.

1 Public sector is defined as general government.

2 Based on available data.

3 Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

4 Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

5 The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

6 The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

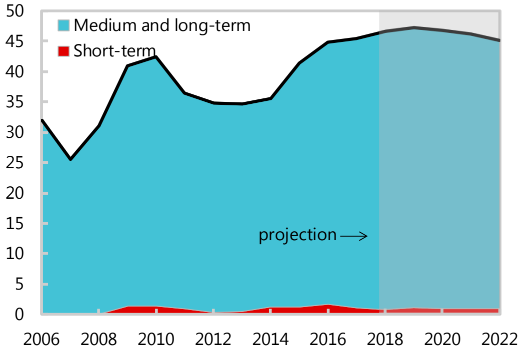
7 Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

8 Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

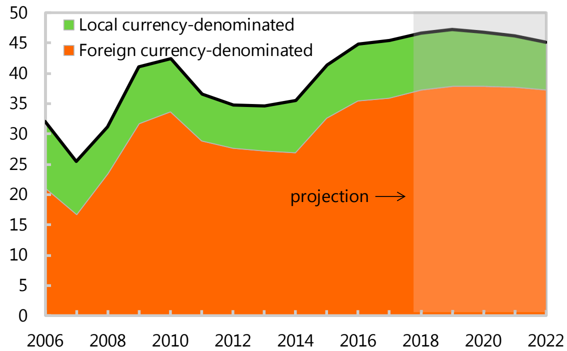
Figure 5. Georgia: Public Debt Sustainability Analysis - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



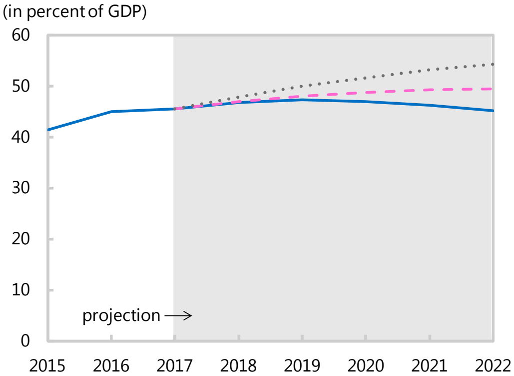
By Currency
(in percent of GDP)



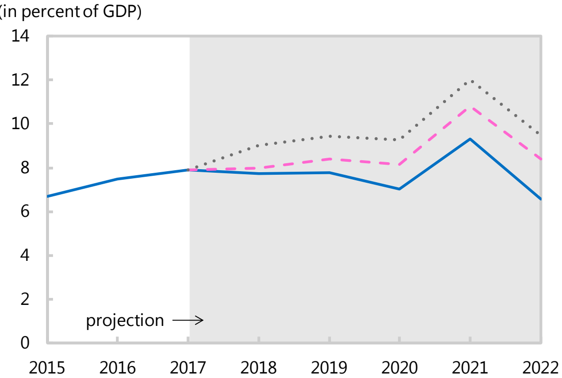
Alternative Scenarios

Baseline — Historical — Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	3.5	4.0	4.5	5.0	5.5	5.5
Inflation	4.0	3.0	3.0	3.0	3.0	3.0
Primary Balance	-2.7	-2.5	-2.1	-1.7	-1.5	-1.2
Effective interest rate	3.3	3.3	3.2	3.2	2.9	2.7
Constant Primary Balance Scenario						
Real GDP growth	3.5	4.0	4.5	5.0	5.5	5.5
Inflation	4.0	3.0	3.0	3.0	3.0	3.0
Primary Balance	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7
Effective interest rate	3.3	3.3	3.2	3.2	2.9	2.8

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	3.5	4.5	4.5	4.5	4.5	4.5
Inflation	4.0	3.0	3.0	3.0	3.0	3.0
Primary Balance	-2.7	-3.8	-3.8	-3.8	-3.8	-3.8
Effective interest rate	3.3	3.3	2.9	2.7	2.2	1.8

Source: IMF staff.

Table 12. Georgia: External Debt Sustainability Framework, 2012–22

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
Baseline: External debt	66.0	65.6	64.9	86.2	87.8			**91.7**	**90.4**	**91.1**	**90.8**	**91.7**	**92.6**	**-12.6**
Change in external debt	4.8	-0.4	-0.7	21.3	1.5			3.9	-1.3	0.8	-0.3	0.9	0.9	
Identified external debt-creating flows (4+8+9)	2.6	-0.6	1.0	14.7	0.1			-0.5	-1.0	-2.2	-3.6	-4.1	-5.2	
Current account deficit, excluding interest payments	8.7	2.7	7.4	7.5	7.8			8.0	7.7	6.7	6.3	5.8	4.6	
Deficit in balance of goods and services	19.7	12.9	18.1	20.8	33.2			31.4	27.2	23.6	22.4	15.2	13.9	
Exports	38.2	44.7	42.9	44.5	44.0			50.4	49.5	49.0	49.3	49.6	49.7	
Imports	57.8	57.6	61.0	65.4	77.2			81.8	76.7	72.6	71.8	64.7	63.7	
Net non-debt creating capital inflows (negative)	-3.7	-5.2	-8.2	-9.0	-11.0			-10.3	-10.1	-9.9	-10.4	-9.9	-9.8	
Automatic debt dynamics 1/	-2.4	1.9	1.8	16.2	3.2			1.8	1.4	1.0	0.5	0.0	-0.1	
Contribution from nominal interest rate	3.0	3.1	3.2	4.5	4.6			4.9	4.8	4.8	4.7	4.6	4.6	
Contribution from real GDP growth	-3.5	-2.2	-3.0	-2.2	-2.3			-3.2	-3.4	-3.7	-4.2	-4.6	-4.7	
Contribution from price and exchange rate changes 2/	-1.9	1.0	1.5	13.9	0.9			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.3	0.2	-1.7	6.6	1.5			4.4	-0.3	2.9	3.3	5.0	6.1	
External debt-to-exports ratio (in percent)	173.0	146.9	151.2	193.7	199.4			181.8	182.6	185.9	184.1	184.9	186.1	
Gross external financing need (in billions of US dollars) 4/	4.3	3.9	4.8	4.7	5.2			5.5	5.6	5.8	6.1	6.4	6.7	
in percent of GDP	27.4	24.2	29.3	33.7	36.3	10-Year	10-Year	39.9	37.9	36.5	35.5	33.9	32.6	
Scenario with key variables at their historical averages 5/								**91.7**	**94.9**	**100.5**	**106.4**	**114.1**	**123.0**	**-10.3**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	6.4	3.4	4.6	2.9	2.7	4.5	4.2	3.5	4.0	4.5	5.0	5.5	5.5	
GDP deflator in US dollars (change in percent)	3.2	-1.5	-2.2	-17.6	-1.1	2.5	12.8	-6.8	4.1	3.0	3.0	3.0	3.0	
Nominal external interest rate (in percent)	5.4	4.8	5.1	5.8	5.4	5.4	0.7	5.4	5.6	5.7	5.6	5.4	5.5	
Growth of exports (US dollar terms, in percent)	14.9	19.2	-1.6	-12.1	0.4	10.5	15.9	10.6	6.2	6.5	8.9	9.2	9.1	
Growth of imports (US dollar terms, in percent)	14.4	1.5	8.4	-9.2	20.1	11.3	19.6	2.2	1.4	1.8	6.9	-2.0	6.9	
Current account balance, excluding interest payments	-8.7	-2.7	-7.4	-7.5	-7.8	-9.7	5.2	-8.0	-7.7	-6.7	-6.3	-5.8	-4.6	
Net non-debt creating capital inflows	3.7	5.2	8.2	9.0	11.0	8.3	3.8	10.3	10.1	9.9	10.4	9.9	9.8	

Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

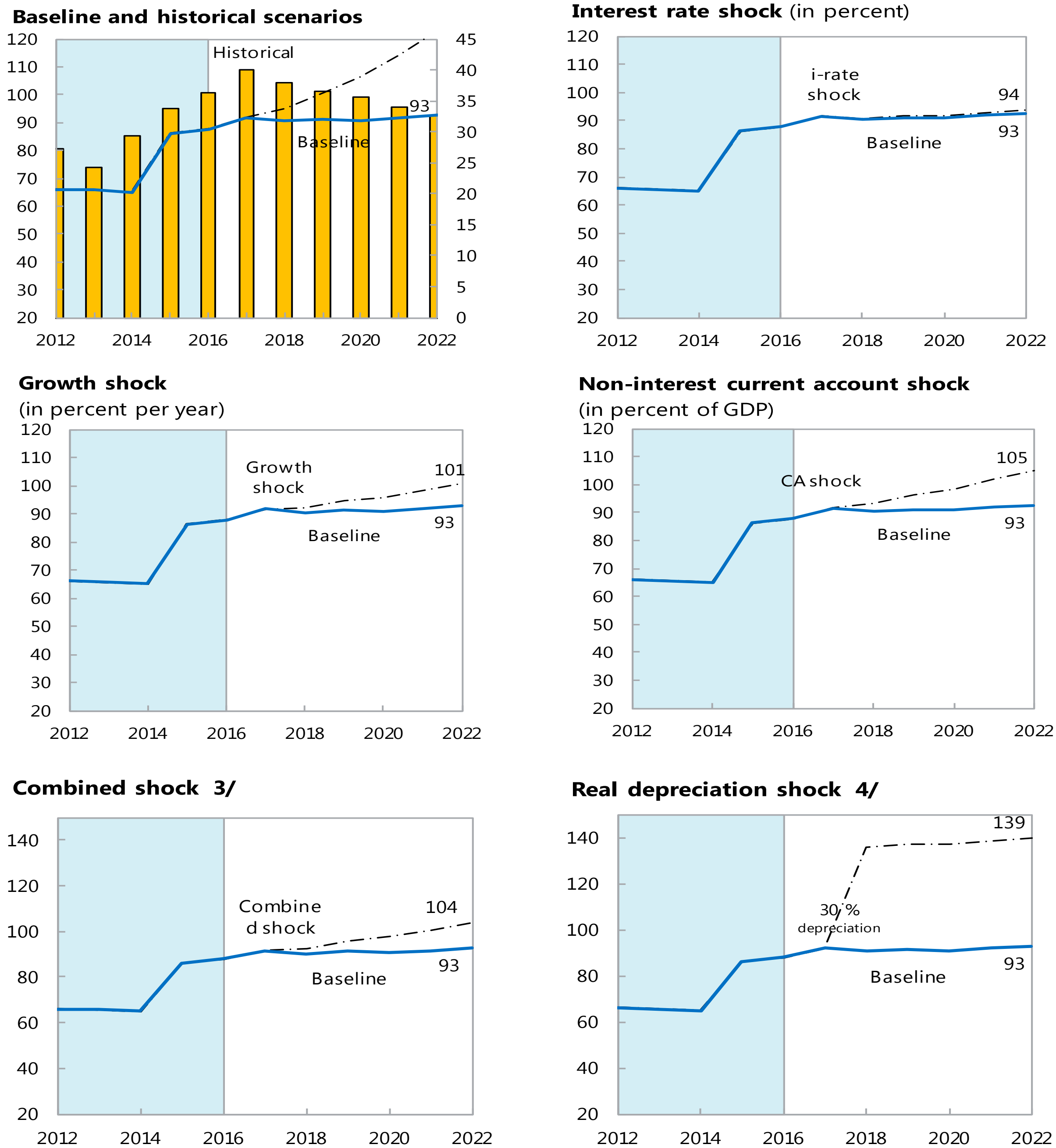
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 6. Georgia: External Debt Sustainability: Bound Tests

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2010.

Annex I. Georgia: Unlocking Growth Potential

As a small open economy with limited domestic market size, Georgia needs to integrate in the global economy to fully unlock its growth potential. Although its good institutions and location make it a natural gateway to access regional markets, Georgia is still characterized by high rural poverty and high unemployment. The authorities' reform agenda is aiming at addressing economic bottlenecks that prevent Georgia from fully reaping its growth potential.

Georgia's potential growth has been slowing down, highlighting several structural weaknesses. Estimates based on different econometric techniques show that potential growth until 2012 was around 6 percent, driven by capital accumulation and TFP growth and an improved business and regulatory environment. Georgia improved its ranking in the World Bank's Doing Business indicators from the 112th position (out of 175 countries) in 2006 to the 16th position (out of 185 countries) in 2017. As the growth dividend from those reforms reached decreasing returns, productivity declined, gradually reducing potential growth to 4 percent by 2015. However, there are many elements suggesting that Georgia has a large untapped potential. First, there is scope for increasing factors' productivity given that: (i) the production and export base is narrow (Figure 1); (ii) unemployment is high (Figure 2) and employment is concentrated in low-productivity sectors; and (iii) business environment can be further improved (Figure 2). Second, human capital can be increased, improving the labor market. Third, physical capital can be increased to fully exploit the country's comparative advantage as a platform for markets as well as a tourist destination.

The production base is relatively narrow. The structure of production has not changed dramatically over the last decade. Overall, the share of tradable products in GDP increased only marginally from 53 percent in 2004 to 55 percent in 2015. Among the tradable sectors, manufacturing and services (mostly financial and communications) each increased their shares in GDP from 9–10 percent in 2004 to 13 percent in 2015. This took place at the expense of the agricultural sector, whose weight in GDP declined from 13 percent in 2004 to 8 percent of GDP in 2015. The limited production structure is reflected in its export base. Georgia's exports are concentrated in a few products like metals, wine, mineral water and nuts, and remained broadly stable for the past 5 years (Figure 1). Given the extent of bio-diversity in Georgia, there is scope for diversifying agricultural exports. Access to new large markets (EU or China) could also increase market penetration. However, for Georgian products to be competitive, quality and standards will need to be improved, for instance through moving toward EU regulations.

Employment is concentrated in the agricultural sector, which produces low value added. About 45 percent of the employed are engaged in agriculture (including subsistence agriculture) and the sector accounts for less than 10 percent of total value added. Low productivity reflects fragmented land ownership, poor rural infrastructure (such as irrigation and drainage), and lack of knowledge, technology, and investments.

Despite remarkable progress, business environment can be further improved. According to the doing business indicators, Georgia ranks very well in terms of business-friendly regulations, but the Global Competitiveness Indices show that—despite the fact that in 2016 Georgia outperformed the other countries in the region—there is scope for improvement, especially in innovation and business sophistication (Figure 2). Spending on research and development is low, as is the access to technology. [1] In 2016, the Global Competitiveness Index ranked Georgia 123rd in terms of capacity for innovation and 112th in terms of business sophistication (out of 140 countries). A dynamic private sector also requires strong protection of property rights, a bankruptcy law to ensure an adequate restructuring framework for viable businesses, and well-functioning mechanisms for resolution of disputes. Also, many SMEs are not equipped to fully benefit from access to global markets due to lack of business and financial skills including accounting standards and scarce knowledge of regulations, procedures, markets, and products.

The education system needs to be reformed to increase the stock of human capital. According to the Global Competitiveness Report, an "inadequately educated workforce" is generally ranked as among the most problematic issues for businesses. The quality of education—as measured through standardized scores like those from the Program for International Student Assessment (PISA)—is low compared with other countries in the region and countries with similar level of development (Figure 2). Educational outcomes are suboptimal in rural areas, leading to high unemployment. Enrolment in universities is also low—less than 30 percent of Georgian students go on to university-level education, compared to more than 60 percent in Central and Eastern Europe and 70 percent in Western Europe—and vocational training needs strengthening to meet private sector's needs. As a result, there is considerable skill mismatch in the labor market, and businesses lament the lack of technical specialists in various fields, from agriculture to engineering.

Lack of infrastructure limits the development of Georgia's potential as a transit hub and as a tourist destination.

- Thanks to its geographical position, Georgia can play an important role in international transit trade. Transport services accounted for about 7 percent of GDP in 2015 but their shares have remained broadly stable over the past decade. Despite investments in roads and railways, the quality of infrastructure limits growth in the sector. Current capacity unables to handle more traffic. Moreover, the cost of shipping and logistical services is not competitive and Georgia has no logistical centers which meet modern requirements.

Tourism has been a dynamic export sector, but requires further investments. Tourism arrivals over the past decade have increased by 10 times, the share of tourism in Georgia's GDP increased from 4 percent in 2005 to 6 percent in 2015, and tourism receipts in 2015 reached 2 billion dollars (or 14 percent of GDP). Moreover, the share of tourism-related exports in services exports grew from 34 percent in 2005 to 65 percent in 2016 (based on 2016Q3) Despite this improvement, the duration

[1] For instance, in 2016 about 95 percent of enterprises reported having internet connection, but only 9.5 percent of them reported receiving orders via internet.

of stay of visitors is still short (slightly more than 2 nights in 2016) and, as a result, average spending by visitor in Georgia is between 3 to 4 times lower than that of tourists in Turkey or in the Euro area (Figure 2).

Visitors (Millions)

	2013	2014	2015	2016
24 Hours or more	2.1	2.2	2.3	2.7
Same-day visit	2.1	2.2	2.2	2.3
Transit	1.2	1.1	1.4	1.3
Total	5.4	5.5	5.9	6.4

Change from Pervious Year (Percent)

	2013	2014	2015	2016
24 Hours or more	15.4	7.9	2.4	19.0
Same-day visit	13.5	1.6	2.1	4.4
Transit	57.5	-6.3	25.7	-5.7
Total	21.8	2.3	7.0	7.6

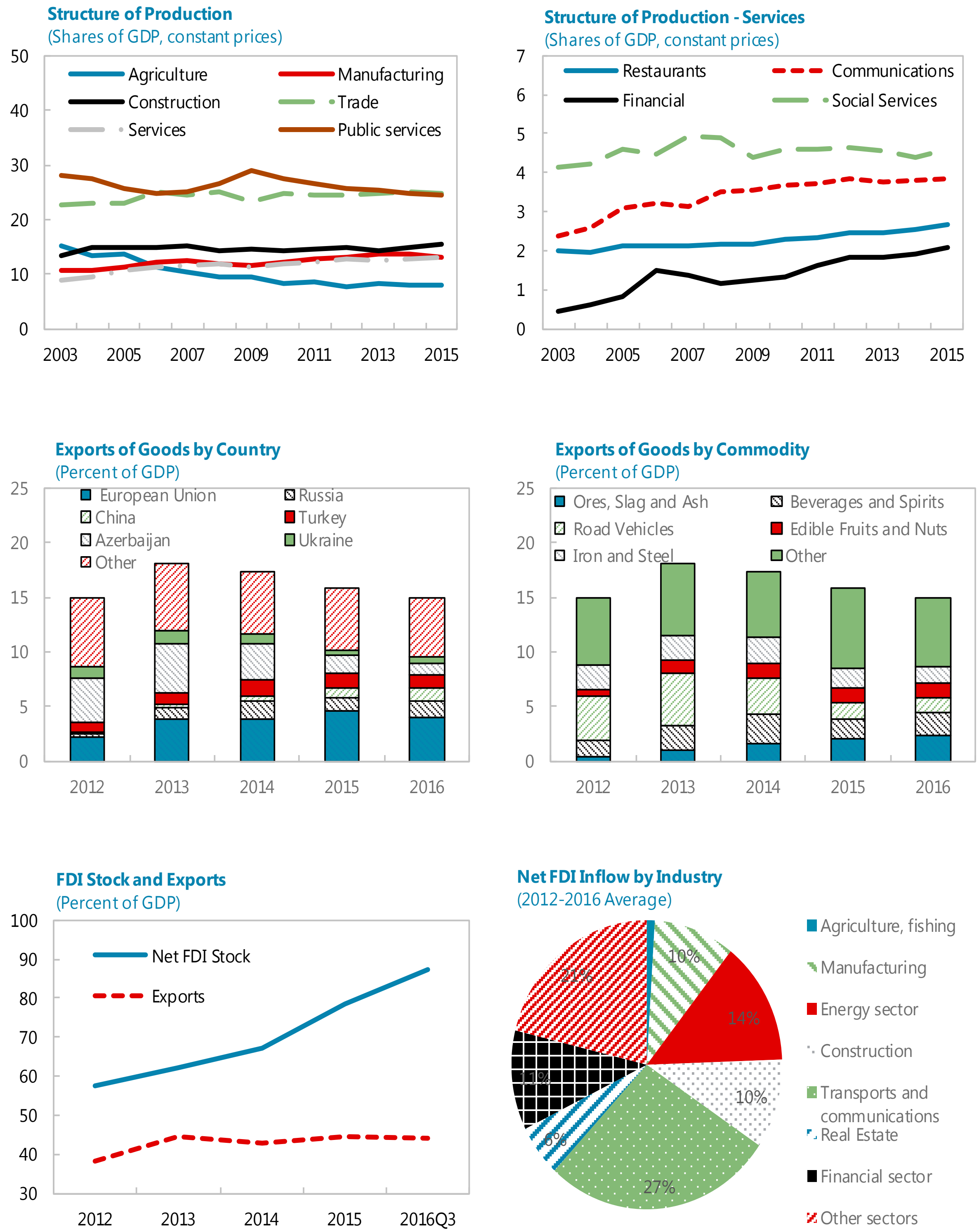
Source: Ministry of International Affairs of Georgia

Mobilizing FDI and domestic savings will help finance capital spending needs. FDI has traditionally been an important source of foreign funds for Georgia, but the sectoral allocation can be improved. On the other hand, domestic savings are low and need to be increased.

- Attracting FDI will still be crucial for Georgia. Over the past five years, FDI have been concentrated in transport, communication, energy, other services, construction and real estate. On the other hand, the manufacturing and agricultural sectors have received relatively small shares of total FDI, with the result that the performance of exports has been only weakly correlated with FDI inflows (Figure 1). Ensuring FDI inflows to sectors with high export potential will be crucial to ensure growth in foreign markets.
- Low savings is a reflection not only of low living standards but also of lack of investment vehicles. Corporates finance their investments either through bank loans or through retained earnings. However, SMEs list lack of access to capital as one of their major obstacles to business. Reforming capital markets and introducing mandatory pension scheme can create the right incentives to have new venues for financing long-term investments for both the supply and the demand side.

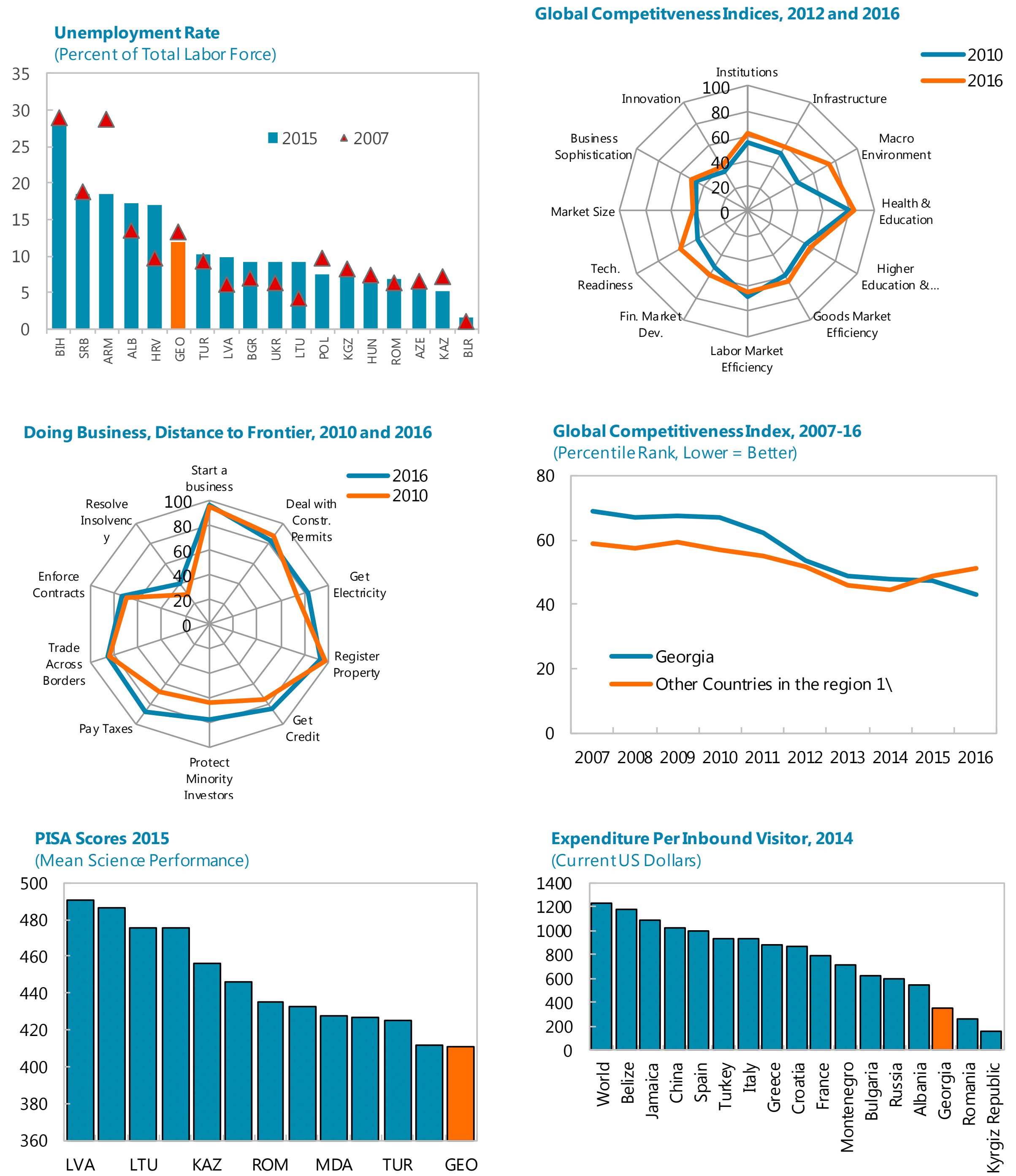
The authorities are taking steps to overcome economic bottlenecks and promote more inclusive economic growth. The government has a broad reform agenda covering many of the areas in which it identified impediments to growth. It will improve productivity in the agricultural sector by reforming the land cadaster which will facilitate transactions and secure property rights. It will support the private sector's competitiveness by: (i) setting up a Business House to provide public services to enterprises; (ii) introducing IFRS for corporations and (iii) reforming insolvency law. Also, by deepening trade relations with other countries, it will broaden Georgia's export markets. To increase the stock of human capital, the government has embarked on a comprehensive education reform which will set curriculum standards, and introduce a new framework for teachers, vocational training, and adult learning. Finally, to improve the stock of physical capital, the government aims at scaling-up infrastructure spending. In particular, it aims to complete the East-West highway and the South-North corridor by 2020 and to build ports, airports, and railways to transform Georgia into a transport and logistics hub connecting Europe with Asia.

Figure 1. Georgia: Structure of the Economy



Source: GEOSTAT, NBG, IMF Staff Calculations.

Figure 2. Georgia: Labor Market, Competitiveness and Education



Source: EWO, World Economic Forum, World Bank, OECD

1\ Regional Group of the Global Competitiveness Index includes: Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Kazakhstan, Kyrgyz Rep., Latvia, Lithuania, Moldova, Macedonia FYR, Romania, Russian Federation, Serbia, Tajikistan, Turkey, Ukraine

Annex II. Georgia: Risk Assessment Matrix[1]

Source of risk	Relative Likelihood/ Time Horizon	Expected impact on the economy if risk is realized
Global Shocks		
Retreat from cross-border integration. A fraying consensus about the benefits of globalization could lead to protectionism and economic isolationism, leading to reduced global and regional policy collaboration with negative consequences for trade, capital and labor flows, sentiment, and growth.	High **Short to Medium Term**	**Staff assessment:** High Rise in nationalism could be accompanied by protectionism which will reduce Georgia's exports and—possibly—capital inflows. Growth will be lower and lower external financing will put pressure on the lari. It could also jeopardize Georgia's plans to become a transit hub.
Financial conditions: • **Significant further strengthening of the US dollar and/or higher rates.** As investors reassess policy fundamentals, as term premia decompress, or if there is a more rapid Fed normalization, leveraged firms, lower-rated sovereigns and those with un-hedged dollar exposures could come under stress. Could also result in capital account pressures for some economies. • **Reduced financial services by correspondent banks ("de-risking").** Significant curtailment of cross-border financial services in emerging and developing economies.	High **Short Term** High **Short to Medium Term**	**Staff assessment:** Medium Higher lari volatility and depreciating pressures could negatively affect financial stability and generate balance sheet effects.
Weaker than expected global growth: • **Significant slowdown in other large EMs/frontier economies.** Turning of the domestic credit cycle in addition to lower trend productivity and potential growth generates disorderly household and corporate deleveraging, with potential spillbacks to advanced economies.	Medium **Short Term**	**Staff assessment:** Medium Weaker demand in other emerging economies and potential spillovers to Georgia's main trading partners would slow down the recovery.
Persistently lower energy prices. Production cuts by OPEC and other major producers may not materialize as agreed while other sources of supply could increase production.	Low **Short to Medium Term**	**Staff assessment:** High Worsening regional growth prospects will lower remittances and exports hampering Georgia's growth.
Georgia-Specific Shocks		
Financial risks. Reduced financial buffers, especially for unhedged borrowers, will limit the capacity to absorb further exchange rate depreciation. Risks could stem also from the non-banking sector.	**Staff assessment:** Medium	**Staff assessment:** High
Fiscal risks. The materialization of contingent liabilities, together with possible off balance sheet spending will increase the debt to GDP ratio further.	**Staff assessment:** High	**Staff assessment:** Medium
Political risks. Political backlash or/and reform fatigue could undermine structural reforms.	**Staff assessment:** Low	**Staff assessment:** Medium

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Appendix I. Letter of Intent

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

Tbilisi, March 27, 2017

Dear Ms. Lagarde:

1. The Georgian economy has shown resilience in the face of a challenging external environment. Since last quarter of 2014, the economy has faced significant external shocks that affected our main trading partners that slowed economic growth in Georgia. Despite this, economic growth averaged 2.8 percent in 2015–16, the highest among Georgia's main trading partners (excluding China). The exchange rate was allowed to play its role as a buffer against external shocks. The National Bank of Georgia (NBG) appropriately focused on bringing inflation toward its target while fiscal policy supported economic growth. Our social assistance programs have helped protect the most vulnerable. The banking system has shown resilience thanks to banks' prudent credit risk management and strong financial regulation and supervision.

2. **But challenges remain to unveil fully Georgia's growth potential.** Adverse external shocks have increased fiscal and external vulnerabilities and unveiled the need to intensify structural reforms to bolster sustainable and more inclusive economic growth. Underdeveloped infrastructure and a narrow production base remain main weaknesses of the Georgian economy. Unemployment and underemployment, partly due to skill mismatches in the labor market, are constraints to making economic growth more inclusive, despite an expansion of our social programs. Rural poverty and inequalities remain a challenge. Financial dollarization makes the economy vulnerable to external shocks and hinders an effective conduct of economic policies. In response to the above mentioned challenges, we have an ambitious structural reform agenda aimed at boosting growth and improving competitiveness.

3. **The Georgian authorities are committed to implement a wide package of reforms centered on increasing growth and making it more inclusive.** To this end, the Government has initiated the Four Point Reform Plan, which focuses on the following strategic directions: (i) reforming education to promote adequate skills development, labor productivity and job creation; (ii) accelerating development of the core road infrastructure development to leverage Georgia's strategic geographic location as a transit and tourism hub as well as improving connectivity between regions; (iii) improving the governance and the efficiency of the government and, finally, (iv) enhancing the role of the private sector as an engine for growth by reducing economic distortions. Together with this ambitious reform package, we are committed to preserve macroeconomic and financial stability, as pre-requisites for sustainable economic growth. We believe that a Fund-supported program would further reassure our creditors of the credibility of our policies and thus facilitate the mobilization of donors' funding and foreign direct investment (FDI).

4. The enclosed Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU) provide comprehensive details of our reform agenda and program. In support of it, the Government of Georgia hereby requests a 36-month Extended Fund Facility in the cumulative amount of SDR 210.4 million (100 percent of quota). This access to IMF financing will help strengthening our foreign exchange reserves. We also request that the existing Stand-By Arrangement be canceled.

5. The Georgian authorities will consult with the IMF, at our own initiative or whenever the Managing Director of the IMF requests such a consultation, on the adoption of these measures and in advance of any revisions to the policies contained in our MEFP, in accordance with the IMF's policies on such consultations. We will provide IMF staff with data and information necessary for the purpose of monitoring the program.

6. The Government of Georgia authorizes the IMF to publish this letter, the attached MEFP and TMU, and the related staff report, including placement of these documents on the IMF website. These documents will also be posted on the official websites of the Georgian government after the approval by the IMF Board.

Very truly yours,

/s/
Dimitri Kumsishvili
First Deputy Prime Minister and
Minister of Finance

/s/
Giorgi Gakharia
Minister of Economy and Sustainable
Development

/s/
Koba Gvenetadze
Governor of the National Bank of Georgia

Attachment I. Memorandum of Economic and Financial Policies (MEFP)

1. This memorandum reports on recent economic developments and outlines the economic and financial policy agenda of the National Bank of Georgia (NBG) and the Government of Georgia to address the medium-term economic challenges that Georgia is facing, and that the IMF could support with a 36-month Extended Fund Facility (EFF). The policy agenda is based upon the Government's Four Point Plan and the Medium-Term Expenditure Framework (2017–20), as well as NBG's policies and reform plans.

2. The Government's Four Point Plan covers the following strategic directions:

- Education reform; supporting skills development through education reform targeted at bridging the gap between skills demand and supply.
- Infrastructure development to increase regional connectivity and utilize Georgia's potential as a transit country and a tourism country; specially in core road infrastructure that consists of the East-West highway, two south-north corridors crossing the highway in Tbilisi and Kutaisi; and the road connecting the biggest sea port cities (Poti and Batumi).
- Governance reforms; including having the general public more actively participating in decision making and improving the provision of government's services on the basis of the one-stop shop principle.
- Economic reforms to promote job creation by improving, among others, the business and investment environment.

MACROECONOMIC FRAMEWORK

3. We will implement the policy actions and reforms envisaged under the economic program. We expect this to give rise to a virtuous cycle of boosting confidence, improving growth and private sector vibrancy. We envisage the following macroeconomic scenario under the program:

- We expect economic growth to pick up in 2017 and to be higher than in main trading partners; driven by higher investment and consumption and a recovery in exports. As a result of important fiscal reforms and growth-enhancing measures, we believe that 4 percent economic growth is achievable in 2017. However, considering potential risks in the region and global uncertainty, the macroeconomic framework underpinning our program is based on purposely cautious assumptions, of 3.5 percent real GDP growth in 2017. Real GDP growth is projected to gradually accelerate over the medium term as a result of higher investment, the positive effects of structural reforms and an expected improved external environment.

- Headline CPI inflation is projected to converge to the NBG's 3 percent target by 2018, as the effects of the introduction of excises and the lagged effects of the depreciation dissipate. According to the NBG's latest projections, inflation throughout this period will remain within the bands of the inflation consultation clause (Table 1).

- The current account deficit is expected to adjust 1.6 percentage points of GDP over the medium term to 11 percent of GDP by 2020, supported by improving exports. External financing will rely mostly on FDI.

4. Our program will reduce vulnerabilities and improve external competitiveness. Ambitious structural reforms, together with the continued implementation of the EU-Georgia Association Agreement and free trade agreements with China and other countries, will support economic diversification. Improving further the business environment will help mobilize FDI in the tradable sectors, improve competitiveness, and reduce external vulnerabilities.

5. The program scenario is subject to downside exogenous risks, but the Georgian economy can withstand them. Regional and global economic uncertainty, and inward-looking policies in large economies could jeopardize Georgia's economic outlook and worsen our external imbalances. However, as a first line of defense, we have a well-capitalized and liquid banking system, and stand ready to further adjust policies as necessary. The Fund arrangement would provide an additional buffer to help us cope with negative shocks.

ECONOMIC POLICIES

Fiscal Policy

6. A key objective under the program is to maintain a sustainable fiscal position while providing fiscal space for capital investment. We will gradually reduce the augmented cash deficit of the general government (TMU definition) to 2.8 percent of GDP by 2020. Such target will ensure that our public debt remains around 45 percent of GDP and allow for some countercyclical policies in the future, if needed. We aim at reducing primary current spending (excluding budget lending activities) as a percent of GDP from 25 percent of GDP in 2016 to 21.4 percent of GDP by 2020 to substantially scale up public investment to address infrastructure bottlenecks. In this vein, we are committed to limit using any revenue over-performance or additional savings in current spending for capital spending and any under-execution in capital spending—because of normal implementation delays—towards a lower deficit.

7. The approved 2017 budget already incorporates significant measures to contain the augmented cash deficit of the general government and improve the quality of spending. The budget contains the administrative costs of the general government, reversing the upward trend on current spending of past years. We are committed to the augmented cash deficit of the general government envisaged in the budget (3.7 percent of GDP in 2017), keeping it below GEL1,335 million (performance criterion). We will strive to keep total primary current expenses of the general government below GEL8,685 million (indicative target), while increasing net acquisition of nonfinancial assets and net lending (to GEL2755 million). To this end, we have introduced significant measures, including:

- Revenue-enhancing measures: Fuel excise increase (GEL270 million, 0.7 percent of GDP); tobacco excise increase (GEL215 million, 0.6 percent of GDP); gambling fee and e-gambling tax increase (GEL50 million, 0.14 percent of GDP); and a vehicle excise increase (GEL45 million, 0.1 percent of GDP). As one-off measures, we also introduced taxation of advance payments and we will restrict preferences to tax payment due dates (effective July 2017) (GEL150 million, 0.4 percent of GDP).

- Expenditure-reducing measures: reduction of the wage bill at the central and local government levels (GEL190 million, 0.5 percent of GDP); cuts in goods and services (GEL50 million, 0.2 percent of GDP); improved efficiency of public healthcare provision and targeting of social programs in municipalities (GEL110 million, 0.3 percent of GDP); and end of the agro-land program (cumulative GEL50 million, 0.1 percent of GDP).

8. We will prepare contingency measures, if needed, to bring the augmented deficit of the general government below the program ceiling in 2017. We will not accumulate any general government's external debt payment arrears outside those under negotiation (performance criterion) and net domestic expenditure arrears of the general government (indicative target). If revenues and/or cuts in current spending fall short of the projected amounts under the program, we will consider contingency measures in consultation with the Fund, such as additional steps to contain administrative spending, including to local governments, so that the budget allocations are not surpassed, and limiting net lending. On the other hand, if the revenue collection exceeds the projected amounts in 2017, the gains could be used, in consultation with the Fund, for high priority growth-enhancing infrastructure projects.

9. We will aim to reduce fiscal risks.

- We will refrain from initiating any PPP or PPA agreements until the PPP law and institutional framework comes in place. We will not issue new public guarantees (performance criterion), or comfort letters. We are committed to reassess and implement, if needed, additional fiscal adjustment based on our fiscal risk profile.

- The Partnership Fund will continue to pursue only commercial objectives (providing minority equity or loan co-financing), will not run a cash deficit (performance criterion), or issue any guarantees. In addition, we will limit the borrowing of the Partnership Fund to $20 million in 2017 (performance criterion).

- Taking into consideration existing fall-winter period power deficit and with the exception of the PPAs described in the next bullet, partial PPAs currently under negotiation will be permitted to proceed only under the following terms:

- The guaranteed purchase period shall not be more than 8 months in each year;

  - The guaranteed purchase tariff shall not be more than US 6c kWh; and
  - The cumulative installed capacity of these projects under negotiations will not exceed MW500.
- Additionally, we have two PPAs under negotiation (the Namakhavani HPP Cascade Project and Koromkheti Hydro Project) —with cumulative capacity of MW600—outside of the terms mentioned above. These projects will only be allowed to proceed under the following conditions:
  - The government will not sign these projects before having conducted a thorough fiscal risk analysis for the projects itself and comprehensively for all fiscal risks, in consultation with the energy expert of the World Bank and the IMF.
  - In particular, the risk assessment will update the analysis of gross exposure of all signed PPA projects and these two large projects; and analyze the net risk exposure with different demand, price and exchange rate assumptions. The scenario analysis will be defined in coordination with the IMF.
  - For these two last projects, the risk assessment will describe and quantify other risk-sharing contractual obligations (including, for instance, termination risk or construction risk).

10. We are committed to increase capital spending while achieving medium-term fiscal consolidation. We are preparing measures to achieve our medium-term fiscal objectives and commit to formulating the 2018 budget consistent with our program (structural benchmark, December 2017). We will continue rationalizing current spending, mostly based on improving the efficiency of the public administration (including by containing the wage bill and administrative expenses, improving the targeting of subsidies and of social assistance programs; reducing transfers and privatizing loss-making state-owned enterprises (SOEs); and broadening the use of program budgeting. To ensure proper protection of the vulnerable population, the existing social safety net will be maintained. In addition, we have identified revenue measures over the medium term, namely further increases in cigarette excises in 2018–20 (0.3 percent of GDP annually), and we do not plan to extend the dividend distribution model to financial institutions and insurance companies in 2019, which would limit the revenue loss (up to 0.5 percent of GDP). In order to achieve our deficit target, we will identify additional contingency measures, if needed, including on the revenue side within the scope of our fiscal framework.

Structural Fiscal Policies

11. We will strengthen our revenue administration to secure full and equitable compliance by all taxpayers and improve taxpayer service delivery. We have been steadily modernizing the Georgia Revenue Services (GRS) with the help of the IMF since 2012. While an IMF TADAT assessment in mid-2016 showed a relatively sound tax administration, it also highlighted enduring weaknesses such as low filing compliance rates for all tax types, inadequate follow-up procedures for non-filers, gaps in data sources for risk analysis, weaknesses in operational planning and performance measurement, and the lack of an effective management information system.

In consultation with the IMF, we have developed a strategic plan for 2017–2020, to be implemented with the help of the 3-year IMF technical assistance.

We are in discussions with the IMF FAD on a three-year assistance program, which will include the deployment of resident revenue administration advisor. The proposed program includes a range of measures which will enhance the efficiency of revenue administration, including revising the organizational structure, improving risk and compliance management, managing arrears, and improving the accuracy and comprehensiveness of the taxpayer register. We will initially focus on the following steps:

- **Improve filing compliance**: We will implement a filing compliance program to improve filing rates and provide for early and effective action where returns are overdue. We will initially develop the program for the VAT, but the program will have the potential to manage compliance for all tax types.

- **VAT refunds:** We are committed to expand a risk-based automated system to check VAT refund claims, replacing the resource-intensive manual system currently in place. This will improve efficiency and allow resources to be directed towards auditing. With Fund TA support, we are committed to developing an action plan to address accumulated outstanding VAT refunds in an orderly manner over time (including analysis, refund, set-offs, and write-offs as appropriate) (structural benchmark, September 2017).

- **TAX Audits:** Building on significant progress during last years, we are committed to increase audit capacity, efficiency, and impact on compliance. To that end, we plan to use a risk-based case selection tool that draws on all available third-party information and incorporates risk rules to identify non-compliant cases that are likely to produce higher yields. We will better manage the audit scope and develop audit plans with a range of interventions that give a balanced coverage of tax types and focus the scope of audits on the largest risks. We will introduce an audit case management system to enhance audit timeliness and productivity, and will implement a systematic approach to terminating non-productive audits.

12. We are planning a reform of the civil service and remuneration systems of the general government. In the 2017 State Budget Law, we have limited compensation of employees and goods and services for most budget organizations, and subjected the increase of these line items during the year to approval by a government decree. As of March 2017, employment at the central level has been reduced, with savings totaling GEL35 million compared to the 2016 performance. We have also amended the *Organic Law on Self-government* to allow Parliament to limit local governments' spending to enable us to adhere to the limits on general government expenditure envisaged in the Liberty Act. A new Civil Service Law will be implemented in 2017, requiring classifying all employees into different grade structures. To support our efforts to optimize the wage bill over the medium-term while improving the link between pay and performance to ensure high-quality administration, we are further committed to:

- Adopt a **Remuneration Law for the civil service** (structural benchmark, December 2017). This Law will set salary ceilings for different grades of civil service (compensation grid) and consolidate bonuses and supplements into the salary structure. These ceilings will be set to ensure our wage bill will be reduced over the medium term consistent with the wage bill projections under the program.

13. We are committed to contain fiscal risks to safeguard fiscal sustainability. We understand that key sources of fiscal risk in Georgia, in addition to those associated with macroeconomic risks, are associated with state-owned enterprises (SOEs) and Public-Private Partnerships (PPPs), including power-purchasing agreements (PPAs) in the energy sector. At the same time, we recognize that PPPs and PPAs can play a pivotal role in the development of Georgia by attracting investment, including FDI. In this vein, improvements in the relevant legislation are required to reap the benefits of further PPPs and PPAs.

Hence, we are committed to:

- **Adopt a new PPP law and associated regulations**, with assistance from the World Bank (WB) the Asian Development Bank (ADB), the EBRD, and the IMF. We are committed to ensure that the law will include sound elements following best international practice: (i) a wide institutional and sectoral coverage of PPPs (including PPAs in the energy sector) and a clear definition focused on optimal risk sharing; (ii) a strong integration of PPP projects with the overall investment strategy and budget cycle; (iii) a strong role for the MoF in the approval process (using cost-benefit and VfM analysis), checking budget affordability, and assessing fiscal risks (Fiscal Risk Management Unit)); (iv) transparent and competitive procurement processes (e.g. prohibiting direct agreements); and (v) providing for transparent reporting, accounting, and auditing of all PPP arrangements, including a ceiling on government exposure from such partnerships. We will consult with the IMF in drafting of the law and plan to submit the PPP Law to Parliament in 2017 (structural benchmark, December 2017).

- **Widening the coverage of fiscal risks in the in the Fiscal Risk Statement (FRS) accompanying the 2018 budget.** Our 2017 FRS reported on PPA and SOE liabilities. In the 2018 Budget, the FRS will report more comprehensively all existing PPP-associated firm and contingent liabilities, include a quantitative reporting of quasi-fiscal relationships, and expand the analysis of contingent liabilities associated to SOEs (structural benchmark, December 2017). More specifically, we will expand the historical analysis of contingent liabilities associated to SOEs by up to five years, describe historical trends of the size of the SOE sector relative to the economy and have conclusive analysis of the factors driving the SOEs' aggregate and individual financial performance and position; identify and evaluate quasi-fiscal relationships; develop the methodology for sensitivity analysis and stress tests examining the impact of changes in key variables on SOE financial performance and fiscal risks.

- **Improve the Public Investment Management Framework (PIMF).** We will strengthen monitoring of public investment and the role of the MoF, by centralizing information at the MoF about public investment projects. This will help establish a unique project pipeline; support adequate project evaluations; help prioritize investments and identify their financing, and link them with the multi-annual budget process. The PIMF will cover PPP-type projects to ensure they are prioritized and assessed alongside traditionally-procured projects.

14. We believe that accurate and transparent public financial management is a cornerstone of fiscal stability. Accordingly, we are committed to:

- **Improve our fiscal rule to safeguard fiscal sustainability.** We will initiate a review of our fiscal framework, including our fiscal rules, with the aim of ensuring that they support our medium-term fiscal objectives toward sustainability while also granting flexibility in formulating fiscal policy over the economic cycle. We will consult with the Fund on this matter, including through technical assistance. Within the context of reviewing the fiscal rule, we will upgrade the presentation of public finances from GFSM 2001 to GFSM 2014 classification.

- **Issue guidelines for new budget lending operations,** requiring reasonable expectation of repayment (structural benchmark, December 2017).

- **Comply with international standards including by undertaking the necessary steps to incorporate LEPL own- revenue and expenditures** in government finance statistics.

- **Improve the quality of fiscal reports** by reconciling in the annual budget document revisions to the medium-term budget estimates and including LEPLs own revenues and expenditures in the budget documentation starting in the 2018 Budget.

Monetary Policy

15. We will reinforce NBG's independence given its pivotal role in safeguarding macroeconomic and financial stability. In 2014, the Parliament of Georgia approved changes to the *Organic Law of the NBG* transferring financial supervision responsibilities to an independent agency. As a prior action to this program, we have amended the law, reverting back to the original version assigning financial supervision responsibilities to the NBG.

16. We see the current inflation targeting framework as the most viable option for maintaining stable inflation and protecting the economy against external shocks. We have lowered our inflation target to 4 percent in 2017 and 3 percent from 2018 onwards. While we forecast inflation to be above the target during 2017 due to lagged effects of the exchange rate depreciation, rising world commodity prices, and one-off price increases resulting from higher excises, we project inflation to be below the target in 2018. As the deviation of inflation from the inflation target in 2017 is due to temporary factors, we will refrain from excessive tightening in order to avoid significant undershooting from the target in 2018 and to support economic recovery. To signal our commitment to the inflation targeting regime, we are including an Inflation Consultation Clause (ICC) in the EFF arrangement. Under the program, inflation developments will be monitored via dual consultation bands set symmetrically around the central point for headline CPI (Table 1). Should actual inflation be higher or lower than the inner consultation band of ± 2 percent, the NBG will consult with IMF staff on the reasons for the deviation and the policies to return to target. Should actual inflation be higher or lower than the outer consultation band of ± 3 percent, a consultation with the IMF Board will be triggered.

17. We will maintain the existing flexible exchange rate regime in line with the inflation targeting framework. We believe that a floating exchange rate helps the economy adjust against external shocks. Consequently, foreign exchange interventions will be limited to smoothing excessive exchange rate volatility without targeting a specific level or path for the exchange rate. The current level of gross international reserves is below the level recommended by the IMF-composite metric (ARA) and we will buildup international reserves throughout the program, which will be monitored by a floor on net international reserves (performance criterion).

18. We will continue strengthening the monetary policy transmission mechanism. We announced a plan to promote financial larization and encourage greater use of the lari in the economy (see below). To broaden the set of tools at our disposal, we have recently introduced a one-month monetary instrument. We have improved our lari liquidity facilities and broadened the eligible collateral pool to provide confidence in NBG's liquidity management framework, facilitating maturity transformation in the banking sector. We are committed to signing a memorandum of understanding on information sharing for liquidity forecasting purposes between the MoF and the NBG (structural benchmark, June 2017). We will also submit to Parliament legal amendments to allow for derivatives and repo transactions, including netting and close-out netting provisions in 2017. Finally, we have requested technical assistance from the IMF to continue strengthening the monetary policy framework.

19. Monetary policy will be strengthened by improving our communication strategy. To increase communication and transparency in the conduct of monetary policy, since April2016, the NBG has started regular quarterly press conferences after the MPC meetings and published the forecast of monetary policy rate path in its monetary policy report. We will continue with the quarterly publication of the monetary policy reports on a fixed pre-announced schedule and with associated press conferences. While being at the frontier of monetary policy making, with the introduction of forward guidance, we will further strengthen our communications by issuing Guidelines for Monetary Policy Operations. To this end, we have requested technical assistance from the IMF.

Financial Sector Policy

20. Our policies will support financial sector stability and the banking sector's ability to cope with shocks, while improving financial intermediation. We will prioritize on (i) further strengthening the supervisory and regulatory framework; (ii) improving the safety nets and the bank resolution framework, enhancing our crisis preparedness; (iii) stepping up efforts to incentivize the use of the domestic currency, aiming at reducing dollarization in the economy; and (iv) developing capital market and pension reforms.

21. We will continue strengthening financial regulation and supervision. Our banking system has remained resilient after the external shocks due, in large part, to good regulation and supervision by the NBG.

- In line with FSAP recommendations, we will (i) introduce, effective September 2017, liquidity coverage ratios (LCRs) for commercial banks, with preferential treatment for GEL deposits (structural benchmark, September 2017); (ii) introduce limits, with a preferential treatment for local currency, for loan-to-value and debt-service capacity ratios per borrower at bank and non-bank financial institutions; (iii) issue regulation to phase in, by 2020, additional capital requirements for systematically important banks (structural benchmark, December 2017); and (iv) submit to Parliament amendments giving to the NBG oversight power for credit information bureaus (structural benchmark, December 2017).

- We will also adopt regulations to increase the minimum regulatory capital for commercial banks to GEL 50 million to be phased in by 2019 (structural benchmark, June 2017) and introduce Basel's Pillar 3 disclosure requirements seeking to promote market discipline through regulatory disclosure requirements.

- Regarding banks belonging to holding companies, the NBG will expand explicitly its authority to set prudential limits on a consolidated basis and expand supervisory oversight of holding companies in line with international practices. Accordingly, we plan amendments to the *Organic Law of the NBG* by end-2017. Furthermore, the NBG and the State Insurance Supervision Agency are working together on developing a supervision framework for financial conglomerates.

- Finally, with IMF TA support, we plan to start publishing a self-standing financial stability report with forward-looking analysis.

22. We will strengthen financial safety nets while the banking sector is healthy. Consistent with FSAP recommendations (FSAP technical note on safety nets, bank resolution framework, and crisis preparedness and management arrangements), we will submit amendments to the NBG Organic Law that will give NBG the authority to resolve a bank through a temporary administration at an early stage of a bank's financial difficulty, facilitating the application of resolution tools, and reinforcing safeguards in the resolution process. The amendments will provide the authority to the NBG to define specific rules for temporary administration regimes by a normative act (structural benchmark, September 2017). With the support of the World Bank and ADB, we will submit to Parliament a law to introduce deposit insurance (structural benchmark, June 2017). Consistent with the FSAP recommendations, we plan to request the largest banks to develop recovery plans based on Financial Stability Board's principles and, with the help of the World Bank, strengthen the bank resolution framework in line with best international practices by revising the NBG law to define more clearly the NBG's resolution authority, including the set-up and control bridge banks and override shareholders' economic interests. We will strengthen our capacity to act as lender of last resort by submitting amendments to the NBG Organic Law that will remove the possibility to give unsecured lending, mandate a penalty rate for emergency liquidity assistance (ELA) and provide the NBG to request government assistance when providing ELA, following international best practices.

23. We will continue to implement our larization strategy to reduce foreign-exchange risks and improve the monetary policy transmission mechanism. We recently announced a comprehensive plan to increase the use of the lari consisting of measures to (i) increase long-term lari funding; (ii) reduce foreign-exchange credit risks; and (iii) promote pricing in lari. In particular, retail loans under GEL100,000 will only be allowed in local currency starting on January 1, 2017, all prices will need to be solely advertised in lari starting on July 1, 2017 and we will establish lari-denominated escrow accounts for real estate transactions. Looking forward, we will promote larization by encouraging the development of capital markets and giving a preferential treatment to lari in macro-prudential measures.

24. Capital market development and pension reform will support larization while reducing external vulnerabilities. The non-banking financial system is limited in Georgia, limiting competition for savings and their efficient use within the economy. Our capital market development strategy will focus initially on the bond market, for which the NBG, with participation of the Georgian Stock Exchange, is upgrading its post trade infrastructure to allow automated settlement of corporate bonds and equities in a centralized manner. To facilitate price discovery for private sector bonds, we will publish a multi-year calendar of government bonds to promote the developments benchmarks along the yield curve (structural benchmark, December 2017). We are committed to introducing a funded pension pillar in 2018, which will promote savings and create an institutional investor for long-term lari assets. With the assistance of the World Bank, we will submit a pension law to Parliament establishing a Pilar II pension system (structural benchmark, December 2017), to be followed by the establishment of an independent pension fund agency, with the aim of becoming effective in 2018. We will also help develop a primary dealer institute, improve the taxation of financial instruments (in line with IMF technical assistance), and introduce mandatory third-party vehicle insurance to support the development of the insurance sector.

Structural Reforms

25. Achieving more robust and inclusive growth will require implementing a comprehensive structural reform agenda. We are counting on our partners to support our reform program, including the World Bank (WB), the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the European Commission. Our reforms aim at scaling-up infrastructure spending, improving education and vocational training, the business environment, foreign trade relations, and land reform. We firmly believe that our reform program will boost long-term growth, diversify the economy, strengthen our external position, bring prosperity and employment to rural areas and reduce poverty. At the same time, targeted social assistance and health care will continue protect the most vulnerable.

26. Scaling-up infrastructure and spatial planning is key to Georgia's development. With the help of our international partners, we aim to finalize the East-West highway and the South-North corridor by 2020. Additional infrastructure projects, including ports, airports, and railways, will transform Georgia into a transport and logistics hub connecting Europe with Asia. We are also developing radial roads to better connect regions and urban and rural areas. To this end, we have brought procurement process for local governments up to international standards. Combined with the government's support for tourism development (including water and electricity infrastructure), Georgia will turn into a four-season touristic destination.

27. Job creation is a central element of our economic policies. Our planned education reform, including vocational training, is crucial to improve job creation, productivity and wages. In the most recent Global Competitiveness Report released by the World Bank, the lack of qualified labor force is reported as the most problematic factor for doing business in Georgia. At the same time, unemployment remains high, especially in rural areas. This suggests that the skills of our labor force are not well aligned with employers' demands. In line with our Four-Point Plan, we are committed to reforming the education system by, among other things, setting curriculum standards and a new teacher policy framework and introducing vocational training and adult learning. We will encourage the participation of employers in the design of curriculum to better prepare the young for labor market demands. Finally, we will provide support to job seekers with information and guidance on the selection of occupations, preparation and retraining.

28. We will continue improving the business environment. We have improved tax system and the taxation environment, promote savings and investments. We have improved our tax dispute resolution mechanism. In particular, bank accounts of taxpayers will no longer be garnished without a court ruling and tax audit timeframe will be regulated. We will establish a Business House by 2019 to provide public services to enterprises under a one-stop shop. We also plan to introduce IFRS for corporations and reform our insolvency law in order to ensure an adequate restructuring framework for viable businesses by 2018. In addition, we will widely apply Regulation Impact Assessments to analyze the possible negative impact of each major policy decision on businesses and protect them from undue costs.

29. Land registration will be pivotal for rural development and the expansion of the agricultural sector. Land cadasters are important to protect property rights, simplify land transactions and provide collateral for borrowing. The Law on the Special Rule for Systemic and Sporadic Registration of Land Parcels within the State Project and Improvement of Cadaster Data came into force on August 1, 2016 and will remain valid for 2 years. It greatly simplifies the land registration process and facilitates registration of agricultural land plots through the waiver of fees. We will assist citizens in the search of property ownership documents and dispute resolution through mediation.

30. Deepening trade relations with the rest of the world is one Georgia's key priority. As a small open, free trade agreements (FTA) will help Georgia mobilize FDI in tradable sectors to improve competitiveness, reduce external vulnerabilities, and help generate balanced growth. In addition to the Deep and Comprehensive Free Trade Area (DCFTA) with the EU, negotiations have been completed with the People's Republic of China on an FTA. Currently, FTA negotiations are in progress with Hong Kong, while negotiations with Turkey will be aimed at the extension of the current FTA. We remain committed to pursue other FTAs with priority countries.

31. We are committed to strengthening our statistics as they serve as a precondition for strong economic policy-making. We are grateful for the technical assistance provided by the IMF in the areas of national accounts external sector statistics and financial and sectoral accounts. We will start publishing quarterly unemployment figures in May 2017 using our newly designed labor force survey (covering 6,000 households and following Eurostat methodology). We will also broaden the coverage of employment statistics by publishing hours worked. From 2018, we will start publishing national accounts based from the NACE 2 classification of sectors and—capitalizing on the TA provided by the IMF—compute GDP based on the supply. This will provide a more detailed picture of the structural transformations in our economy. Because of the migration to NACE 2 classification, we will be able to publish quarterly GDP by expenditure in constant prices in November 2019.

Program Monitoring and Safeguards

32. The program will be monitored through quantitative performance criteria, indicative targets, an inflation consultation clause and structural benchmarks. Semi-annual program reviews will be based on December and June test dates. All quantitative performance criteria and indicative targets are listed in Table 2, and prior actions and structural benchmarks are set out in Table 3. The Technical Memorandum of Understanding is also attached to describe the definitions of quantitative PCs and the inflation consultation clause as well as data provision requirements.

33. The NBG continues to maintain a strong safeguards framework and internal controls environment. No significant changes have occurred since the last assessment. As required by the safeguards policy, we will continue to engage independent external audit firms to conduct the audit of the NBG in accordance with International standards.

Table 1. Georgia: Inflation Consultation Targets and Bands for 2017–18

	2017		2018	
	End June	End Dec.	End June	End Dec.
Inflation Consultation Bands for CPI (in percent)				
Central point	6	5	3	3
Inner band, upper limit/lower limit	8/4	7/3	5/1	5/1
Outer band, upper limit/lower limit	9/3	8/2	6/0	6/0

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets for 2017
(Cumulative from the beginning of the calendar year; millions GEL; unless otherwise indicated)

	2017	
	End-June	End-Dec.
Performance Criteria		
Ceiling on augmented General Government deficit (in mn lari, cash basis) (MEFP ¶5)	-330	-1,335
In Percent of GDP	*-0.9*	*-3.7*
Floor on NIR of NBG[1] (End-period stock, in mn US$) (MEFP ¶17)	1,210	1,350
Ceiling on the accumulation of external debt arrears of the Public Sector (continuous criterion) (in mn US$) (MEFP ¶8)	0	0
Ceiling on new public guarantees (continuous criterion) (in mn lari) (MEFP ¶9)	0	0
Ceiling on the cash deficit of the Partnership Fund (in mn lari) (MEFP ¶9)	0	0
Ceiling on the new borrowing of the Partnership Fund (in mn US$) (MEFP ¶9)	20	20
Indicative Targets		
Ceiling on the accumulation of net domestic expenditure arrears of the General Government (in mn lari) (MEFP ¶8)	0	0
Ceiling on Primary Current Expenditures of the General Government (in mn lari) (MEFP ¶5)	…	8,685

[1] The NIR target is set at a program rate defined as the exchange rate on December 31, 2016, which for the GEL/US$ was 2.6468.

Table 3. Georgia: Prior Actions and Structural Benchmarks

Measure	Date
Prior Actions for Program	
Parliament to approve legislative amendments that invalidate the effects of the law establishing a financial stability agency outside of the central bank (MEFP ¶15)	
Financial Sector	
Financial Stability	
Introduction of LCR for commercial banks, with preferential treatment of GEL-deposits (MEFP ¶21)	End-September 2017
Adoption of regulation on capital add-ons in CAR for systemically important banks, (MEFP	End-December
Submit to Parliament legislation giving NBG oversight power over credit information bureaus, (MEFP ¶21)	End-December 2017
Increase in regulatory capital for commercial banks to GEL50 million, phased in by 2019 (MEFP ¶21)	End-June 2017
Capital Markets Development	
Publication of a multi-year calendar for government benchmark bonds (MEFP ¶24)	End-December
Monetary policy operations and communication	
Signing of a Memorandum of Understanding between the Ministry of Finance and the NBG on information sharing for liquidity forecasting purposes (MEFP ¶18)	End-June 2017
Deposit insurance	
Submission to Parliament legislation establishing deposit insurance as of January 1, 2018 (MEFP ¶22)	End-June 2017
Bank Resolution Framework	
Submit to Parliament amendments to NBG Law that will give it the authority to resolve a bank through a temporary administration at an early stage of a bank's financial difficulty, in line with good international practices as identified in the 2014 FSAP recommendations (MEFP ¶22)	End-September 2017
Fiscal	
Submission to Parliament a 2018 budget consistent with the fiscal deficit in the Fund-supported program (MEFP ¶10)	End-December 2017
Adopt a remuneration law for public civil service (MEFP ¶12)	End-December
Action plan to address accumulated outstanding VAT refunds in an orderly manner over time (including analysis, refund, set-offs, and write-offs) (MEFP ¶11)	End-September 2017
Public-Private Partnership and Fiscal Risk	
Submission of a public-private partnership law to Parliament, establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships (MEFP ¶13)	End-December 2017
Include all PPP and PPA liabilities, and expand the analysis of contingent liabilities from state-owned enterprises, reporting quasi-fiscal activity in the 2018 Annual Fiscal Risk Statement (MEFP ¶13)	End-December 2017
Public Financial Management	
Issue guidelines for new budget lending operations requiring reasonable expectation of commercial returns (MEFP ¶14)	End-December 2017
Pension Reform	
Submission of a pension law establishing a 2nd pillar pension system, and introducing indexation of public pensions (MEFP ¶24)	End-December 2017

Attachment II. Technical Memorandum of Understanding (TMU)

1. This Technical Memorandum of Understanding (TMU) defines the variables subject to quantitative targets (performance criteria, inflation consultation mechanism and indicative targets) and describes the reporting requirements used to monitor developments under the Extended Fund Facility and methods to be used in assessing the program performance with respect to these targets. To this effect, the authorities will provide the necessary data to the IMF as soon as it becomes available.

Program Assumptions

2. For the purposes of the program monitoring, all foreign currency-related assets will be valued in lari at program exchange rates as specified below. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross-rates as of December 31, 2016 published on the IMF web site http://www.imf.org/.

Program Exchange Rates		
	Currency Name	**Currency/US$**
SDR	Special Drawing Rights	0.7439
GEL	Georgian lari	2.6468
AUD	Australian dollar	0.7227
CAD	Canadian dollar	0.7419
EUR	Euro	1.0556

Institutional Definition

3. The **general government** is defined as comprising the central government and local governments, excluding Legal Entities of Public Law. The definition of the general government includes any new funds, or other special budgetary or extra-budgetary entities that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's Manual on Government Finance Statistics 2001 (GFSM 2001). The authorities will inform IMF staff on the creation of any such entities without delay. The general government coverage excludes state-owned companies and the Partnership Fund. The **public sector** consists of the general government, Legal Entities of Public Law and public financial and non-financial corporations, including the National Bank of Georgia.

4. Supporting material: The Treasury Department of the Ministry of Finance will provide to the IMF detailed information on monthly revenues of the general government within two weeks of the end of each month and monthly expenditures and arrears of the central government within four weeks of the end of each month. The Ministry of Finance will provide the stock of general government debt, broken down by currency and original maturity within one month from the end of each quarter. The Treasury will provide, on a daily basis, the cash balances in all the accounts of the general government as of the end of the previous business day.

Quantitative Program Targets

5. The program will be assessed through performance criteria and an indicative target (Tables 2 attached to the Letter of Intent). Performance criteria are set with respect to:

- a performance criterion (ceiling) on the augmented cash deficit of the general government;
- an indicative target (ceiling) on the primary current spending of the general government;
- a performance criterion (floor) on the net international reserves (NIR) of the NBG;
- a continuous performance criterion (ceiling) on the accumulation of external debt arrears by the general government;
- an indicative target (ceiling) on new domestic expenditure arrears by the general government;
- a performance criterion (ceiling) on the new guarantees issued by the public sector;
- a performance criterion (ceiling) on the cash deficit of the Partnership Fund;
- a performance criterion (ceiling) on new borrowing by the Partnership Fund.

In addition, the program will include a consultation clause on the 12-month rate of inflation.

6. Performance criteria and indicative targets have been set for end-June 2017, and end-December 2017 (the next two test dates). They are monitored on a cumulative basis from the beginning of the calendar year (with the exception of the NIR target, which is monitored in term of stock levels), while continuous performance criteria are monitored on a continuous basis.

Inflation Consultation Mechanism

7. Inflation consultation bands around the projected path for inflation are set for each test date under the program. Inflation is identified as the 12-month percentage change of the consumer price index (CPI) as measured and published by the National Statistics Office of Georgia (GEOSTAT).

8. If the observed year-on-year inflation for the test dates falls outside the outer bands specified in Table 1, the authorities will complete a consultation with the IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for the deviation; and (iii) the proposed policy response. When the consultation with the IMF Executive Board is triggered, access to Fund resources would be interrupted until the consultation takes place and the relevant program review is completed. In addition, if the observed year-on-year inflation falls outside the inner bands specified in Table 1 for the test dates, the authorities will complete a consultation with IMF staff on the reasons for the deviation and the proposed policy response.

Program Definitions, Adjustors, and Reporting Requirements

General Government

Ceiling on the augmented cash deficit of the general government

9. Definition: The **augmented cash balance of the general government** is defined as: revenues minus expense, minus net acquisition of non-financial assets (as defined by GFSM 2001) minus net budget lending (as defined below). A negative augmented cash balance is a deficit.

10. The **augmented cash balance of the general government** will be measured from the financing side at current exchange rates established by the NBG at the date of the transaction. Accordingly, augmented cash deficit of the general government will be measured by: i) net acquisition of financial assets (including changes in balances of the revenue reserve account), excluding net budget lending as defined by GFSM 2001; minus ii) net incurrence in domestic and foreign liabilities as defined in GFSM 2001.

11. Definition: Consistent with GFSM 2001, **net budget lending** is defined net acquisition of financial assets for policy purposes by the general government.

12. Adjustor: The ceiling on augmented cash deficit of the general government will be adjusted upward (higher deficit)/downward (lower deficit) by the cumulative total amount of foreign-financed project loan disbursements above/below the program amounts (Table 2), subject to a cap of $30 million per year.

13. Adjustor: The ceiling on the augmented cash deficit of the general government will be adjusted downward (lower deficit) by the cumulative amount of receipts from sale of non-financial assets above the program amounts (Table 2).

14. Supporting Material:

a. Data on domestic bank and nonbank financing will be provided to the IMF by the NBG and the Treasury Department of the Ministry of Finance within four weeks after the end of each month.

b. Data on external project financing as well as other external borrowing will be provided to the IMF monthly by the Ministry of Finance (specifying projects by creditor) within two weeks of the end of each month.

c. Data will be provided at actual exchange rates.

d. Data on receipts from sales of non-financial and financial assets of the general government will be provided by the Treasury Department of the Ministry of Finance to the IMF on a monthly basis within two weeks of the end of each month.

e. Data on securitized debt sold by the NBG, including the securities that have been purchased by nonbanks, will be reported by the NBG to the IMF on a monthly basis within two weeks of the end of each month.

Ceiling on the Current Primary Expenditures of the General Government

15. **Definition**: primary current expenditures is defined as expense (as defined by GFSM 2001) on a cash basis, minus interest payments.

16. **Supporting material:** Data for monitoring expenditures will come from the accounts of the general government covered under the ceiling on the augmented cash deficit of the general government (including autonomous regions). The Ministry of Finance is responsible for providing reporting according to the above definition. Data on expense and net acquisition of non-financial assets of the general government should be reported to the IMF within four weeks after the end of the quarter.

Continuous Performance Criterion on Accumulation of General Government External Debt Arrears

17. **Definition: Debt** is defined as set forth in point No. 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements (Decision No. 15688-(14/107) adopted on December 5, 2014. External debt is defined by the residency of the creditor.

18. For the purpose of the program, **external payment arrears** will consist of all overdue debt service obligations (i.e. payments of principal or interest, taking into account contractual grace periods) arising in respect of any debt contracted or guaranteed or assumed by the central government, or the NBG, or any agency acting on behalf of the general government. The ceiling on new external payments arrears shall apply on a continuous basis throughout the period of the arrangement. It shall not apply to external payments arrears arising from external debt being renegotiated with external creditors, and more specifically, to external payments arrears in respect to which a creditor has agreed that no payment needs to be made pending negotiations.[1]

[1] Arrears to Turkmenistan and Kazakhstan.

19. Supporting Material. The accounting of non-reschedulable external arrears by creditor (if any), with detailed explanations, will be transmitted on a monthly basis, within two week of the end of each month.

Continuous indicative target on Accumulation of General Government Domestic Expenditure Arrears

20. Definition: For program purposes, domestic expenditure arrears are defined as non-disputed (in or out-of-court) payment obligations whose execution term has expired and became overdue. They can arise on any expenditure item, including debt service, wages, pensions, and goods and services. Arrears will arise from non-debt liabilities that are not paid after 60 days of the contractual payment date or—if there is no contractual payment date—after 60 days of the receivable. Any wage, pension or other entitlement obligation of the general government that is not paid after a 30-day period from the date that they are due, is considered to be in arrears.

21. Supporting Material: The accounting of new domestic expenditure arrears (if any) will be transmitted within four weeks after the end of each month.

Guarantees

22. For the purpose of the program, a **guarantee** of a debt arises from any explicit legal obligation of the public sector to service such a debt in the event of nonpayment by the recipient (involving payments in cash or in kind), or from any implicit legal or contractual obligation to finance partially or in full any shortfall incurred by the debtor. For the purpose of the program, guarantees under PPAs are excluded.

Partnership Fund

Ceiling on the Cash Deficit of the Partnership Fund

23. Definition: The **cash deficit of the Partnership Fund** will be measured as its expenditures minus its revenues.

24. The Partnership Fund's revenues comprise the dividends from its assets and investments, the interest earnings from the loans it provides, the fees it charges for the services and guarantees it provides and any other income earned from its assets.

25. The Partnership Fund's expenditures comprise all current and capital expenditures. Current expenditures comprise compensation of employees, the purchase of goods and services, transfers to other entities, other account payables and domestic and external interest payments. Capital expenditures comprises the net acquisition of nonfinancial assets as defined under GFSM 2001. The Partnership Fund's purchase of financial assets (e.g. lending and equity participation) will not be considered part of its expenditures.

Ceiling on New Borrowing by the Partnership Fund

26. Definition: Borrowing by the Partnership Fund is defined as gross accumulation of financial liabilities.

27. Supporting Material: The Ministry of Finance will provide to the IMF detailed information on the Partnership Fund's quarterly revenue, expenditure and financial operations within four weeks of the end of each quarter.

Net International Reserves

Floor on the Net International Reserves of the NBG

28. Definition: Net international reserves (NIR) of the NBG in U.S. dollars are defined as foreign assets of the NBG minus the sum of foreign liabilities of the NBG, including all of Georgia's liabilities to the IMF. **Foreign assets of the NBG** include gold, gross foreign exchange reserves, Georgia's SDR holdings, and the reserve position in the IMF. Gross foreign exchange reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents, including cash holdings of foreign exchange that are readily available. Pledged or otherwise encumbered assets, including (but not limited to) assets used as collateral (or guarantee for third party external liabilities) are excluded from foreign assets. **Foreign liabilities of the NBG** shall be defined as the sum of Georgia's outstanding liabilities to the IMF (at face value), Georgia's SDR allocation, and any other liabilities of the NBG (including foreign currency deposits of financial institutions at the NBG and currency swaps and foreign exchange forward contracts with financial institutions), excluding the foreign exchange balances in the government's account with the NBG. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the NBG shall be valued at program exchange rates as described in paragraph 2 above. The stock of NIR amounted to US$1,330.2 million as of December 31st 2016 (at program exchange rates).

29. For the purpose of the program, **budget support grants to the general government** are defined as grants received by the general government for direct budget support from external donors and not related to project financing. **Budget support external to the general government** are defined as disbursements of commercial loans and loans from bilateral and multilateral donors for budget support.

30. Adjustors. For program purposes, the floor on NIR will be adjusted

Upward (downward) by the cumulative amount of any excess (shortfall) by any FX privatization revenue in foreign exchange above (below) the programmed amounts. Privatization receipts are defined in this context as the proceeds from sale, lease, or concessions of all or portions of entities and properties held by the public.

- Upward (downward) by the cumulative amount of any excess (shortfall) of budget support grants and loans compared to program amounts (Table 3).

- Upward/downward for any excess/shortfall related to net issuance of the Eurobond from the general government relative to program amounts (Table 3).
- Upward/downward by 75 percent for any excess/shortfall related to disbursements of the project loans and grants to the treasury single account at the NBG relative to the projected amounts (Table 3).

Table 3. Projected Balance of Payment Support Financing[1]
(in millions of U.S. dollars)

	June 30, 2017	December 31, 2017
Projected privatization revenue	0	0
Budget support grants from external donors and not related to project financing	3	49.3
Budget support loans, including bilateral and multilateral donors for budget support	13.7	188
Net issuance of the Eurobond from the general government	0	0
Disbursements of project loans and grants	116,2	227.7

31. Supporting material: Data on net international reserves (both at actual and program exchange rates); net foreign financing (balance of payment support loans, cash grants to the general government, amortization (excluding repayments to the IMF), interest payments on external debt by the Ministry of Finance and the NBG; and conversions for government imports will be provided to the IMF in a foreign exchange cash flow table (which includes details of inflows, outflows and net international reserves) on a weekly basis within three working days following the end of the week.

Appendix to the TMU: The Partnership Fund

Organization and operational structure

Legal Structure and Corporate Governance

The Partnership Fund (PF) is incorporated as a Joint Stock Company (JSC). Under civil law, JSCs are profit maximizing entities, organized with value creation as their main objective.

The PF is organized as a commercial financial institution. Its governance structure includes:

- An investment board, currently composed of internal members (CEO, CIO, portfolio officers) and can add external members (like experts and private sector representatives), which approves business cases and initiates projects;

- A risk management committee, composed of internal members (CFO, Chief Legal Officer, and Chief Accountant), which advises on project risks to be reflected in project implementation agreements;

- A supervisory board (i.e. board of directors), which approves projects (based on the feasibility studies, risk assessments, and business cases presented by the investment board and risk committee) and approves budget for project development needs. The supervisory board includes members of the government and is chaired by the Prime Minister; and

- In cases of equity participation in projects, the PF needs government approval.

Corporate mandate and portfolio management

Corporate Mandate

The corporate mandate of the PF is approved by the supervisory board and the government. The PF will provide project financing through equity participations, senior loan, quasi-equity through subordinated convertible debt, and performance bonds/guarantees. Investments will focus on the following sectors: energy, agriculture, manufacturing, and real estate. Under its corporate mandate, the PF is not allowed to provide financing to the service industry. The PF will charge market rates for services provided.

Portfolio Management Strategy

The PF’s portfolio management strategy has been developed. It sets portfolio limits, performance management objectives, and project evaluation guidelines, and will be based on the following principles:

- The PF will participate only in commercially viable projects; and

- The PF's performance will be monitored on the basis of the following evaluation criteria: IRR, APV, sharp ratio, and risk adjusted return.

Project Development Methodology

The PF will only participate in projects in which a corporate investor, with sufficient experience in industry, expresses its willingness to take an equity participation that represents at least 51 percent of the project's total equity. PF financing (debt plus equity plus guarantees) will not be allowed to exceed 100 percent of the equity of the private partner in the project. The PF will pursue only commercial objectives.

Reporting and Auditing

The PF will engage an internationally recognized auditing company to conduct semi-annual IFRS audits of its financial statements.

The PF will hire on a permanent basis the services of rating agencies, which will prepare regular ratings reports—there will no minimum rating requirement for the PF.

The PF's audited financial statements, as well as the ratings reports will be available on permanent basis to a broad audience.

Fiscal risks associated with the PF will be limited since:

- The PF projects don't create any kind of contingent liability for the sovereign balance sheet, as the government as no legal obligation to bail out the PF, should it become illiquid or insolvent;

- All liabilities of the PF are limited to its own balance sheet;

- The PF has its own revenue sources, namely: the dividends from its investments, the interest earnings from the loans its provides, the fees it charges on the guarantees it provides, and the proceeds of asset sales; and

- The PF may decide to borrow from credible financial institution with recourse to its balance sheet facility and without state guarantee.

INTERNATIONAL MONETARY FUND

GEORGIA

March 27, 2017

REQUEST FOR EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND CANCELLATION OF STAND-BY ARRANGEMENT—INFORMATIONAL ANNEX

Prepared By | Middle East and Central Asia Department (In Consultation with Other Departments)

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RELATIONS WITH THE FUND

(As of February 28, 2017)

Membership Status

Date of membership: May 5, 1992, Article VIII.

General Resources Account

	SDR million	Percent of Quota
Quota	210.40	100.00
Fund Holdings of Currency	290.40	138.02
Reserve Tranche Position	0.01	0.00

SDR Department

	SDR million	Percent Allocation
Net Cumulative Allocation	143.96	100.00
Holdings	143.76	99.86

Outstanding Purchases and Loans

	SDR million	Percent of Quota
Stand-By Arrangements	80.00	38.02
ECF Arrangements	4.20	2.00

Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-By	July 30, 2014	July 29, 2017	100.00	80.00
Stand-By	April 11, 2012	April 10, 2014	125.00	0.00
SCF	April 11, 2012	April 10, 2014	125.00	0.00

Projected Payments to the Fund

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2017	2018	2019	2020	2021
Principal	9.20	40.00	35.00		
Charges/Interest	0.78	0.85	0.34	0.01	0.01
Total	**9.98**	**40.85**	**35.34**	**0.01**	**0.01**

Safeguard Assessments

An update safeguards assessment concluded in November 2014 found that the National Bank of Georgia's (NBG) overall governance framework is broadly appropriate. The NBG continues to publish financial statements that comply with International Financial Reporting Standards. The assessment also found that the NBG had upgraded its core banking systems, thereby strengthening its internal controls, and the Fund's safeguards policy requirements for direct budget financing were in place. Most of the recommendations from the 2014 assessment have been implemented, including an independent evaluation of the internal audit function. The NBG continues to maintain a strong safeguards framework and internal controls environment and no significant changes have occurred since the last assessment.

Implementation of Multilateral Debt Relief Initiative (MDRI)

Not applicable.

Implementation of HIPC Initiative

Not applicable.

Exchange Arrangements

The de jure and de facto exchange rate arrangement of Georgia is floating. While the NBG intervenes in the foreign exchange market through foreign currency auctions with the objective of smoothing excess volatility, the NBG does not make any explicit or implicit commitment with respect to an exchange rate target or path. Between January 2016 and February 2017, the NBG sold a total of $280 million during periods of large depreciations of the lari against the US dollar. During the same period, the NBG bought $278 million at times when the lari strengthened against the dollar.

The volumes bought or sold at the NBG's foreign exchange auctions and the average exchange rates are posted on the NBG website immediately after each auction. Although FX interventions account for a small portion of annual foreign exchange market turnover, the size of these interventions on any given day can be substantial.

The exchange regime is free of restrictions and multiple currency practices. The government uses the official exchange rate for budget and tax accounting purposes as well as for all payments between the government and enterprises and other legal entities and for foreign exchange transactions with the NBG. Since 2013, foreign exchange transactions between the government and the NBG are priced with the market exchange rate of the day when the foreign exchange order is submitted to the NBG.

Program

A 36-month SBA was agreed on July 30, 2014. The first review was completed in December 2014.

Article IV Consultation

The 2016 Article IV consultation was concluded on July 11, 2016 (not published).

FSAP Participation

An FSAP mission visited Tbilisi between May 20 and June 3, 2014.

Technical Assistance

See Table 1 of this Annex.

Resident Representative

The eight resident representative, Mr. Francois Painchaud, took up his post on July 4, 2016.

Georgia: Technical Assistance Missions, 2013–17			
Subject	**Type of Mission**	**Timing**	**Counterpart**
Fiscal Affairs Department (FAD)			
Tax Administration	Expert	January 14–30, 2013	Ministry of Finance, Revenue Service
Tax Administration	Expert	March 18–29, 2013	Ministry of Finance, Revenue Service
Tax Administration	Expert	May 27–June 7, 2013	Ministry of Finance, Revenue Service
Public Financial Management	Expert Assistance	September 11–24, 2013	Ministry of Finance
Tax Administration	Follow-up assistance	September 25–October 8, 2013	Ministry of Finance, Revenue Service
Tax Administration and Policy	Advisory	May 28–June 10, 2014	Ministry of Finance, Revenue Service
Tax Administration	Expert	July 16–August 1, 2014	Ministry of Finance, Revenue Service
Tax Administration	Expert	November 12–25, 2014	Ministry of Finance, Revenue Service
Tax Administration	Expert	November 12–26, 2014	Ministry of Finance, Revenue Service
Tax Administration	Expert	November 25–December 3, 2014	Ministry of Finance, Revenue Service
Tax Policy	Advisory	March 9–17, 2015	Ministry of Finance
Public Financial Management	Expert	March 9–18, 2015	Ministry of Finance
Tax Administration	Expert	March 25–April 7, 2015	Ministry of Finance, Revenue Service
Tax Administration	Follow-up assistance	March 26–31, 2015	Ministry of Finance, Revenue Service
Tax Administration	Expert	March 26–April 8, 2015	Ministry of Finance, Revenue Service
Public Financial Management	Advisory	June 26–July 8, 2015	Ministry of Finance
Tax Administration	Expert	September 30–October 13, 2015	Ministry of Finance, Revenue Service
Tax Administration	Expert	October 5–7, 2015	Ministry of Finance, Revenue Service
Tax Administration	Advisory	October 14–27, 2015	Ministry of Finance, Revenue Service
Tax Administration	Expert	November 11–24. 2015	Ministry of Finance, Revenue Service
Public Financial Management	Expert	November 16–25, 2015	Ministry of Finance
Tax Administration	Expert	February 2–16, 2016	Ministry of Finance, Revenue Service
Tax Administration	Follow-up assistance	March 1–5, 2016	Ministry of Finance, Revenue Service
Tax Administration	Expert	March 16–29, 2016	Ministry of Finance, Revenue Service
Tax Administration	Expert	March 30–April 12, 2016	Ministry of Finance, Revenue Service
Tax Administration	Expert	April 6–19, 2016	Ministry of Finance, Revenue Service
Public Financial Management	Advisory	April 25–May 9, 2016	Ministry of Finance
Tax Administration	Advisory	May 25–June 7, 2016	Ministry of Finance, Revenue Service
Tax Policy	Advisory	May 31–June 13, 2016	Ministry of Finance
Tax Administration	Advisory	July 26–August 8, 2016	Ministry of Finance
Tax Administration	Advisory	July 18–August 10, 2016	Ministry of Finance
Public Financial Management	Advisory	October 26–November 12, 2016	Ministry of Finance
Tax Administration	Expert	October 27–November 9, 2016	Ministry of Finance
Tax Administration	Advisory	November 8–16, 2016	Ministry of Finance
Tax Administration	Expert	November 8–21, 2016	Ministry of Finance
Fiscal Transparency Evaluation	Advisory	December 6–19, 2016	Ministry of Finance
Tax Administration	Advisory	February 21–27, 2017	Ministry of Finance
Monetary and Capital Markets Department (MCM)			
Inflation Targeting	Advisory	February 16–27, 2015	National Bank of Georgia
Risk Management and Financial Reporting	Advisory	April 13–24, 2015	National Bank of Georgia
Monetary Policy and Financial Stability	Advisory	July 5–15, 2016	National Bank of Georgia
Liquidity Management	Advisory	September 27–30, 2016	National Bank of Georgia
Accounting for Financial Instruments	Advisory	January 30–February 3, 2017	National Bank of Georgia

Georgia: Technical Assistance Missions, 2013–17 (Concluded)			
Statistics Department (STA)			
National Accounts Statistics	Expert	January 14–25, 2013	Geostat
National Accounts Statistics	Expert	September 23–October 4, 2013	Geostat
National Accounts Statistics	Expert	January 12–23, 2015	Geostat
National Accounts Statistics	Expert	February 29–March 11, 2016	Geostat
Financial Sector Accounts	Advisory	October 24–November 4, 2016	National Bank of Georgia, and Geostat
External Sector Statistics	Advisory	October 31–November 11, 2016	National Bank of Georgia, and Geostat
Legal Department (LEG)			
Capital Markets Taxation	Advisory	October 17–28, 2016	National Bank of Georgia

RELATIONS WITH THE WORLD BANK GROUP

(As of March 7, 2017)

Georgia became a member of the International Bank for Reconstruction and Development (IBRD) in August 1992, the International Development Association (IDA) in August 1993, and a member of the International Finance Corporation (IFC) in June 1995. At the end of June 2014, Georgia graduated from the International Development Association (IDA), which was also the end of the IDA 16 Replenishment period. Since the end of June 2014, Georgia is an IBRD-only country.

IBRD in Georgia

The World Bank's lending operations in Georgia are consistent with the Country Partnership Strategy for FY14–17, endorsed by the World Bank's Board in May 2014. The Country Partnership Strategy FY14–17 envisages a new lending envelope of about $1.1 billion, about 30 percent more than under the previous Country Partnership Strategy ($823 million in FY10–13). As of March 7, 2017 IDA and IBRD have delivered twelve operations under the current Country Partnership Strategy amounting to $716.8 million. Plans are underway to deliver two DPOs of $100 million, which slipped from FY16.

As of March 2017, the IBRD/IDA investment portfolio comprised twelve investment projects under implementation with a total commitment of $739 million, of which $284 million or about 38 percent has been disbursed. About 55 percent of commitments are concentrated in the on-going East-West Highway and secondary roads projects, and 25 percent in urban development. The remaining 20 percent covers energy, land management and irrigation, and innovation ecosystems. There are two DPO series under implementation. The Programmatic Inclusive Growth DPO series target oversight of public institutions, improved budgeting, a framework for civil service reform, improved coverage and quality of social services, and strengthened monitoring of outcomes. The Private Sector Competitiveness DPO series target private sector competitiveness through second generation business environment reforms, financial sector deepening and diversification, and increasing firms' capacity to innovate and export.

Although the World Bank's investment portfolio is predominantly in infrastructure, the overall partnership is broader, with activities in many areas, complementary to the two DPOs.

The World Bank's ongoing support to the public administration sector includes a programmatic public financial management (including annual public expenditure reviews) and governance task that covers the FY15–17period, technical assistance on improving efficiency and transparency in public procurement, as well as another grant-funded project on the Supreme Audit Institution Capacity Development Fund (SAICDF). A programmatic poverty advisory and analytical engagement informs poverty and equity in the country, as well as strengthens statistical capacity.

The World Bank continues to support the health, education, and pension sectors in Georgia through technical assistance and development policy lending. In FY16, the World Bank has launched an analysis of financing options for health care, which includes potential efficiency savings. In education, the World Bank provides Programmatic Education Sector Support in the sector strategy priority areas (Main Directions for Education and Science Development 2014–2024 of the Ministry of Education and Science) to inform education sector policy dialogue in Georgia and to provide advisory support to the government in the implementation of the education related prior actions selected under the DPO.

In addition to the investment portfolio, there is an active program of four recipient-executed trust fund operations of about $17 million, of which about 83 percent is undisbursed.

Currently the World Bank is undertaking a Systematic Country Diagnostic, which will inform the next Country Partnership Framework. Lending and non-lending programs for FY18 and beyond will be agreed upon as part of the new Country Partnership Framework.

PRODUCT	TENTATIVE TIMING OF MISSION	EXPECTED DELIVERY
OPERATIONS		
Georgia Inclusive Growth DPO2	Periodic	April 2017
Private Sector Competitiveness DPO2	Periodic	April 2017
East-West highway Improvement Project Additional Financing	Periodic	July, 2017
RECIPIENT EXECUTED TRUST FUNDS		***Closing***
Second Regional and Municipal Infrastructure Development Project		December 2018
Empowering Local Communities and Entrepreneurs		February 2018
IT Audit Development in the State Audit Office of Georgia		December 2018
Sustainable Wastewater Management Project		June 2018
ANALYTICAL WORK		
Georgia Programmatic PFM Task		April 2017
Programmatic Education Sector Support		December 2017
Social Protection and Labor Technical Assistance		June 2017
Impact of Land Registration on Land valuation		February 2019
Advancing the DRM Agenda in Georgia		May 2017
Georgia Financial Advisory TA		June 2017
Georgia Country Social Analysis		April 2017
PER 2016		February 2017
Missing Girls in Georgia		December 2017
ASA to support UHC in Georgia		November 2017
Improving Effic & Transp in Public Proc		June 2019
Strengthening Sgbv Prevention Capacity		October 2017
Youth Policy TA		June 2017
Georgia: Forests Poverty Analysis		May 2017
GE: Climate Resilience of Road Network		June 2017
E-W Hwy Ps Participation & Monetization		June 2017
Georgia Trade Facilitation TA		March 2016
Georgia Pension TA		June 2017
Tbilisi Urban Regeneration & Resilience		July 2017
Georgia: Household Surveys on Forest Use, Poverty and Vulnerability to Natural Hazards		May 2017

IFC in Georgia

Georgia became a member of IFC in 1995. Since then, IFC has provided around $1.6 billion in long-term financing, of which $774 million was mobilized from partners, in 59 projects in financial services, agribusiness, manufacturing, and infrastructure. In addition, IFC has supported more than $331 million in trade through its trade finance program, and implemented a number of advisory projects focused on developing the private sector.

As of January 2017, Georgia is IFC's largest exposure in the South Caucasus, with a committed portfolio of about $454 million (5th largest in Europe and Central Asia).

IFC's current strategy and operations in Georgia are guided by the joint World Bank Group Country Partnership Strategy for the fiscal years 2014–2017. IFC's role within this framework is to contribute to improvements in Georgia's competitiveness and acceleration of private sector led job creation. IFC prioritizes investment and advisory services which: (i) facilitate greater financial intermediation and increase access to finance, (ii) develop infrastructure which is critical for economic growth and diversification, (iii) support expansion of competitive companies in agribusiness, value added manufacturing and services, and (iv) contribute to a better investment climate. Across all sectors, IFC works closely with government and private sector partners to mobilize additional financing and maximize its impact, and prioritizes projects that promote Foreign Direct Investment.

In the financial sector, where IFC has been programmatically engaged for many years, it prioritizes operations which contribute to the strengthening of the local financial institutions, increase access to finance for micro, small- and medium-sized enterprises and foster development of the local capital market. In infrastructure, IFC's focus is on power generation, transport and real estate. In the power sector, IFC is committed to support Georgia in developing its vast hydro potential in order to reduce winter electricity shortages and increase export potential. Over the past five years, IFC has provided debt and equity financing and PPP transaction advisory services for three large hydropower plants with an estimated capacity of over 550 MW. In transport, IFC prioritizes investment in port and airport infrastructure aimed at improving the country's international connectivity, developing transit potential and supporting the tourism sector. In real estate, IFC's increasing priority is to develop hotel infrastructure in the affordable segment, contributing to tourism sector development. In agriculture, IFC invests in competitive agro-producers, advises export-oriented firms on compliance with international food safety standards to enable their export to Europe, and contributes to improvements in food safety standards. In other sectors, IFC is exploring opportunities to support joint ventures in value added manufacturing and private healthcare.

In the investment climate, IFC/ World Bank Group aims to improve the investment climate in Georgia by increasing the efficiency of regulations in trade logistics and investment policy areas.

RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

(As of March 10, 2017)

Since 1994, the EBRD has been active in supporting Georgia's transformation towards a market economy. EBRD has been a critical partner in the development of the banking sector, renewable energy, private sector, including property, tourism and agribusiness, as well as micro, small and medium-sized enterprises.

In December 2016, the EBRD Board approved the new strategy for Georgia for the next four years. The new strategy will continue to support the following key sectors:

- The EBRD will continue to support private sector competitiveness through innovation, enhanced value added and convergence with the Deep and Comprehensive Free Trade Area (DCFTA) standards and obligations. The EBRD will continue supporting small and medium-sized enterprises and local private sector via the well-developed local banking sector. The focus of this support will be on areas with high potential, such as agriculture, hospitality and innovation. The EBRD plans to support work force training, focused on regional inclusion, youth and gender.

- In the financial sector, the EBRD's priority will be to deepen financial intermediation and develop local currency and capital markets to enable private sector access to finance.

- Another priority for the EBRD will be to expand markets through inter-regional connectivity, expanding Georgia's potential as a regional link through further modernization of the country's infrastructure. The EBRD will explore financing investments under private public partnerships, aiming to leverage Georgia's geographic advantage, being positioned between the South Caucasus, Central Asia and Europe.

- In addition, the new strategy includes enhanced focus on renewable energy, resource efficiency, and climate change adaptation to enhance competitiveness and resilience of the economy. The Bank will continue supporting the creation of renewable generation capacity in hydro's, wind and possibly solar, as well as building transmission lines to connect with regional markets. A special Energy Efficiency Action Plan will be developed to tackle excessive consumption.

As at March 2017, the EBRD's cumulative investments in Georgia reached €2.98 billion with 202 projects. Its outstanding portfolio stood at €720 million with 73 active projects. About 41 percent of the investment portfolio is in the power and energy sector, followed by 28 percent in the corporate sector, while 23 percent of the portfolio is in the financial institutions sector, and infrastructure sector investments account for 8 percent. The ratio of private sector projects in the portfolio currently stands at around 91 percent. The Bank gives preference to non-sovereign operations. Where sovereign guarantees are required, donor co-funding on a grant basis is sought.

The EBRD's overall investments in 2016 reached €248 million with 17 projects, which is twice the amount invested in 2015. The EBRD's activity was concentrated in the banking and private sectors with about €80.5 million investments into diverse private sector projects in healthcare sector (Aversi Clinic and Georgia Healthcare Group); agribusiness sector (Global Beer Georgia, Majid Al Futtaim Hypermarkets Georgia – Carrefour); telecommunications sector (Magticom); property and tourism sector (Fabrika hostel). In the power and energy sector, the EBRD signed its first Wind Farm in the Caucasus in Gori, which is already operational.

In the municipal and infrastructure sectors, the EBRD signed 3 projects with total sum of €40 million: i) modernization of bus transport fleet in Tbilisi; ii) purchase of solid waste collection vehicles; and iii) the Kobuleti water processing plant. In the transport sector the EBRD signed a sovereign loan to finance the construction of the Sadakhlo-Bagratashen bridge, the main border crossing point between Georgia and Armenia.

In the financial sector the EBRD partnered with Bank of Georgia, extending €48 million (1st tranche) to support local small and medium-sized enterprises adapting to the EU Association Agreement and DCFTA requirements. The EU will provide interested small and medium-sized enterprises with investment incentives of up to 15 percent, as well as technical assistance in the form of advisory services from international consultants and the EBRD's Advice for Small Businesses.

The EBRD has also been active in the policy dialogue in such areas as:

- The drafting of a new PPP Law;
- Energy Efficiency (Residential Assessment and National Action Plan);
- Competition Agency
- De-dollarization
- Derivatives framework
- Mining sector
- Road tolling
- Green City Framework, recently approved by the Board, supports cities in mitigating and adapting to climate change.

The EBRD also supports the Investors Council Secretariat, established in 2015. The Council is chaired by the prime minister, and aims ad addressing key topics pertaining the business community. The Council works in coordination with key IFIs, donors and the private sector on how to best to enhance the activities of the private sector, increase the investors' confidence, and encourage more investments. The UK's GGF has agreed to provide technical assistance funds to finance the operations of the Council. The key topics for the Council for 2017 are: Judiciary Reform; Pension Reform; Estonian Tax Model and Insolvency Law.

The EBRD has a pipeline of new projects in 2017 in excess of €300 million. Key projects are: Nenskra (to be largest new HPP in the region), DCFTA, WiB credit lines to TBC Bank, and some smaller projects in the manufacturing and services sectors.

EBRD investments will continue to focus on strengthening the private sector, with particular attention to micro, small and medium-sized enterprises; supporting de-dollarization of the financial system; developing local capital markets; modernizing the energy sector with more renewable energy projects; and promoting Georgia's regional and global economic integration. The EBRD is also in agreement with the government's priority to support infrastructure development and make growth more socially inclusive.

The EBRD will put additional emphasis on supporting Georgia's path towards the EU, while helping small and medium-sized enterprises to comply with the DCFTA requirements. A specially designed program, financed by the European Union and run by the EBRD's Small Business Support team, will continue to help to connect the EBRD's clients with local consultants and international advisers who can help transform their businesses to meet European standards.

The EBRD will continue to invest in the development of the agribusiness sector and the modernization of the food distribution sector, supported by an intensive policy dialogue in food safety.

The EBRD will continue to support the development of the property and tourism sector with direct investments, through on-lending via local partner banks as well as through the EBRD's know-how services and policy dialogue.

The EBRD will continue to support policy and regulatory developments in Georgia by providing further assistance on legal reforms, including improvements to the laws on secured transactions and insolvency, reform of concession laws, improved corporate governance, and judiciary reforms.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ADB)

(As of 9 March 2017)

The Asian Development Bank (ADB) and Georgia have a strong partnership since Georgia became a member of ADB in 2007. Approved sovereign loans to Georgia total about $2.1 billion, with $900 million from the concessional Asian Development Fund (ADF) and $885 million from ordinary capital resources (OCR). Non-sovereign loans are $330 million.

Cumulative disbursements to Georgia for lending financed by OCR, ADF, and other special funds amounted to $1.34 billion as of 31 December 2016, and the active sovereign loans portfolio is about $924 million. Effective from 1 January 2017 Georgia graduated from concessional ADF resources.

ADB has extended program support to the government totaling $500 million from 2008 to 2016 to facilitate structural reforms and mitigate the impact of global financial crises on the country.

The two-phased Municipal Services Development Project, funded with $70 million from ADF resources, supported the rehabilitation of roads, water supply, and sanitation systems, with more than 100 subprojects bringing potable water and improved roadways to communities across Georgia.

The Road Corridor Investment Program, a 10-year multi-tranche financing facility (MFF) of $500 million, will be implemented until 2019, supporting regional trade and connectivity. It includes the 33.6 kilometer Kobuleti Bypass, which diverts heavy vehicle traffic from popular tourist destinations, enhancing the quality of life and business environment in Kobuleti.

The Sustainable Urban Transport Investment Program, a 10-year MFF of $300 million, runs until 2020, supports the public transport network and the development of efficient transport systems in key urban areas. Under the MFF, four projects totaling $242 million have been mobilized to improve mass transit, essential road links, and coastal protection to date.

The Urban Services Improvement Investment Program, an 8-year MFF worth $500 million, will be implemented until 2019, aimed at delivering safe water and sanitation to major cities and regional towns across Georgia. The sixth and last tranche of the program in the amount of $99 million was approved in 2016 to finance the water supply and sanitation systems in the towns of Marneuli, Bolnisi, and Chiatura.

The Regional Power Transmission Enhancement Project approved in 2012 for $48 million was completed in December 2016. The project helped upgrade three power substations and build one new substation to enhance Georgia’s energy grid in Khorga, Ksani, Marneuli, and Menji.

As a catalyst for private investments, ADB provides direct financial assistance to the non-sovereign public sector and private sector in the form of direct loans, equity investments, guarantees, B loans, and trade finance. ADB has approved $330 million in non-sovereign financing for seven private sector transactions in Georgia. Total outstanding balances and commitments of ADB's private sector transactions in the country, as of 31 December 2016, was $236 million.

ADB's Trade Finance Program (TFP) fills market gaps by providing guarantees and loans through partner banks in support of trade. In Georgia, the TFP works with three banks and has supported $89.2 million in trade through 40 transactions. Another objective of the TFP is to mobilize private sector capital and involvement in developing Asia. In Georgia, 25 percent of the trade supported through the TFP was co-financed by the private sector.

STATISTICAL ISSUES

(As of March 15, 2017)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings but is broadly adequate for surveillance. There is some room for improving the compilation and dissemination of price, national accounts, and external sector statistics. Insufficient price and economic activity indicators to assess underlying inflation and output trends partly hamper the development of an effective inflation targeting framework. To support the authorities' effort to improve the compilation of macroeconomic statistics, the Fund has provided technical assistance (TA) (Annex I, Table 1.) The data module of the Report on the Observance of Standards and Codes (ROSC), published in March 2012, indicated that since the previous 2002 ROSC, the authorities have made significant institutional and methodological improvements in macroeconomic statistics. Georgia graduated to the IMF's Special Data Dissemination Standard (SDDS) on May 17, 2010, after participating in GDDS since 2006.
National Accounts: National accounts statistics follow the concepts and definitions of the *System of National Accounts 1993.* Annual and quarterly GDP estimates are compiled by both the production and expenditure approaches. Preliminary national accounts estimates in current prices by the production approach are available after 80 days and final estimates after 11 months. The 2012 data ROSC mission found serious source data deficiencies owing to: absence of an economic census; under-reporting in the business survey and household budget survey; shortcomings in the business register; and incomplete coverage of some activities (trade, other community, social and personal activities). Since 2012 Geostat has made progress in updating business register by using administrative sources (such as monthly and annual turnover data from the Revenue Service). The amendments to the Law on Statistics which made reporting compulsory led to significant improvement in business reporting. A better method is now used to benchmark quarterly national accounts (QNA) data to annual estimates. Implementation of NACE rev. 2 classification of economic activities by the end of 2017 will improve coverage of a number of sectors. Since 2015 GEOSTAT started publishing volume estimates of GDP by the expenditure approach. These are available at annual frequency and cover the period 2010-14. During the national accounts TA missions in 2013–15, actions on several issues were either initiated or partly implemented (benchmarking of QNA in current and constant prices, new methodology for estimating volume of taxes on products, compilation of unit values for imports). TA missions are also supporting GEOSTAT in improving statistics on the deflator of various components of aggregate demand. Although the authorities have made good progress in addressing some of these issues, there was scope for improving the constant price estimates and advancing the development of the system of supply and use tables.

Price Statistics: On price statistics, the scope of the consumer price index (CPI) is limited to urban areas. Owner-occupied housing is not covered by the CPI. The structure of the producer price index relies on output concept, and product based indices are compiled on the lowest level of the overall PPI. Export price indices are available at monthly frequency from 2014, while import price indices are available at monthly frequency from January 2017. Implementation of the agricultural price index survey ceased. The imputation methods for both CPI and PPI are based on broadly accepted methods ensuring coherent long term treatment of seasonal goods.
Government Finance Statistics: The Ministry of Finance is well advanced on a program of reform to their central and local government budget and accounting systems to fully adopt the *Government Finance Statistics Manual 2001 (GFSM 2001*) methodology and the International Public Sector Accounting Standards (IPSASs), including the staged introduction of accrual recording into transactions data, and an expansion in the range of items recorded in the balance sheet. The reform includes the implementation of accrual accounting by 2020. The authorities' commitment to the accounting reform strategy is set out in Decree 101 issued by the Minister of Finance on February 10, 2006. This decree approves the general strategy, but implementation of some of the individual steps in the transition plan will require amendments to the law of Georgia on the budget system (Budget System Law). Since 2008, the budget classification follows the *GFSM 2001*. However, there are deficiencies in the sectorization of Legal Entities of Public Law (LEPLs) and securities are not recorded at market value. The authorities report annual and monthly government finance statistics (GFS) compiled on a cash basis in the *GFSM 2001* framework for publication in the *GFS Yearbook* and *IFS*, respectively.
Monetary and Financial Statistics: The NBG compiles monetary data broadly in line with the recommendations of the *Monetary and Financial Statistics Manual 2000.* Data are compiled based on STA's Standardized Report Forms and reported to STA on a regular and timely basis for publication in the *International Financial Statistics (IFS)*.
Financial sector surveillance: Financial surveillance is conducted by the NBG which supervises both banks and other entities such as: credit unions, micro financial organizations, money remittance units and currency exchange bureaus. Data on depository corporations are available on a quarterly basis and the NBG publishes financial soundness indicators (core as well as additional) with the same frequency. Income and expense statements and balance sheets of the aggregate deposit taking institutions are available on a monthly basis
External sector statistics: The NBG began to take responsibility for the compilation of balance of payments statistics in January 2007. It received extensive technical assistance from STA, including the STA Resident Statistics Advisor who, stationed in Baku, undertook six peripatetic TA missions to Georgia during April 2007–October 2008. From 2014 balance of payments data are compiled broadly in accordance with the definitions set out in the sixth edition of the *Balance of Payments Manual* (*BPM6*) and data in BPM6 are available from 2000. However, along with the new revision, tables according to BPM5 are produced as well. The scope of the balance of payments statistics includes transactions of institutional units resident in Georgia with the rest of the world. However, data do not cover the territories of Abkhazian Autonomous Republic and Tskhinvali Region, a part of Georgian territory not controlled by the central authorities.

Source data used for compiling the balance of payments are generally adequate and timely. However, the accuracy of the data received from the enterprises survey should be improved. Moreover, foreign direct investment (FDI) data are subject to significant revisions. Data sources are subject to constant improvement. However, there is room for improvement on the international transactions reporting system (ITRS) and the private nonfinancial external debt compilation system. In particular, the quality of the ITRS data can be improved by conducting training activities with data reporters. The balance of payments compilers have plans for conducting such activities in the near future. The quality of the private nonfinancial external debt compilation system can be improved by increasing the coverage of data.	
II. Data Standards and Quality	
The country is a SDDS participant.	Data ROSC was published on March 2012.

Georgia: Table of Common Indicators Required for Surveillance (As of March 15, 2017)							
	Date of latest observation (For all dates in table, please use format dd/mm/yy)	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:[8] Data Quality – Methodological soundness[9]	Memo Items:[8] Data Quality – Accuracy and reliability[10]
Exchange Rates	15/03/17	15/03/17	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	28/02/17	07/03/17	D	D	M		
Reserve/Base Money	31/01/17	24/02/17	D	D	M	O, O, LO, O	LO,O,O,O,O
Broad Money	31/01/17	24/02/17	D	D	M		
Central Bank Balance Sheet	28/02/17	07/03/17	D	D	M		
Consolidated Balance Sheet of the Banking System	31/01/17	20/02/17	M	M	M		
Interest Rates[2]	28/02/17	01/03/17	D	D	D		
Consumer Price Index	28/02/17	02/03/17	M	M	M	O,LO,O,O	LO,O,LO,O,O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	31/01/17	27/02/17	M	M	M	O,O,LO,LO	O,O,O,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	31/01/17	27/02/17	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	30/09/16	30/12/16	Q	Q	Q		
External Current Account Balance	30/09/16	30/12/16	Q	Q	Q	O,O,O,O	LO, O, LO ,O, LO
Exports and Imports of Goods and Services	30/09/16	30/12/16	Q	Q	Q		
GDP/GNP	30/09/16	19/12/16	Q	Q	Q	O,LO,LO,LO	LNO, O, LO, O, LO
Gross External Debt	30/09/16	30/12/16	Q	Q	Q		
International Investment Position[6]	30/09/16	30/12/16	Q	Q	Q		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

[8] These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.

[9] This reflects the assessment provided in the data ROSC or the Substantive Update for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

[10] Same as footnote 9, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by Mr. Doornbosch, Alternate Executive Director for Georgia, and Mr. Botel, Senior Advisor to Executive Director for Georgia
April 12, 2017

The Georgian authorities thank staff for the dedicated and constructive engagement during the negotiation of the proposed program and a well- written report. The dialogue between staff and the authorities resulted in a clear diagnosis: with good institutions, a favorable location, and a proven commitment to reform, Georgia has significant potential for growth. However, a series of structural weaknesses still prevent the economy from reaching its full capacity and external imbalances from narrowing.

To tackle these challenges, the authorities have designed a policy and reform strategy aimed at promoting faster and more inclusive growth while maintaining macroeconomic stability. To support the implementation of their reform agenda, the Government of Georgia requests a 36-month Extended Fund Facility in the cumulative amount of SDR 210.4 million (100 percent of quota). The Fund financing will help addressing the balance of payments gap driven by persistent large current account deficits and the need to build up reserve buffers against external shocks. Given the much larger financing gap, the program is expected to unlock budget support from the European Union, the World Bank, the Asian Development Bank, and Agence Française de Développement.

The previous program, the 2014-2017 Stand-By Arrangement, could not be completed due to difficulties with achieving the fiscal targets, the expansion of contingent liabilities, and the proposed withdrawal of financial supervision from the National Bank of Georgia (NBG). However, the new government, in office after the Parliamentary elections of October 2016, has embarked on a comprehensive program of policy adjustments and reforms supported by a solid majority in Parliament. The authorities have already proven their commitment to a firm implementation of sound policies by: adopting a prudent 2017 budget with cuts in current spending and politically difficult tax increases; drafting a law on public-private partnerships to limit contingent liabilities; and reversing the legislation establishing financial supervisory agency outside the central bank (completed prior action).

Main challenges and the policy strategy

A series of adverse shocks propagated from the main trading partners have hit Georgia's economy since the last quarter of 2014, increasing the fiscal and external vulnerabilities and highlighting significant growth-hindering structural weaknesses. Main challenges include: narrow production base, underdeveloped infrastructure, un- and under-employment alongside skill mismatches in the labor market, financial dollarization, rural poverty and inequality. The reforms package designed to address these challenges is based on the Government's Four Point Plan and the Medium-Term Expenditure Framework (2017–20), as well as the

NBG's policies and reform plans. The Four Point Plan identifies the main strategic directions: (i) education reform enabling the supply of skills to adjust towards the labor market demand, supporting job creation and productivity growth; (ii) investing in core infrastructure to develop Georgia into a transit and tourism hub, and to increase regional connectivity; (iii) strengthening governance and inclusive decision making, and further improving public services by broadening the one-stop shop coverage; (iv) promoting jobs creation by further improving the business and investment environment and enhancing the role of private sector as a driver of growth.

Macroeconomic outlook

While the adverse external shocks have slowed down growth in Georgia, the economy proved to be resilient. Its average growth of 2.8 percent in 2015-16 has been higher than those of all trading partners, except China and Turkey. The economic growth is expected to pick up in 2017 driven by both domestic demand and a recovery in exports. The authorities believe that a growth rate of 4 percent is achievable in 2017 given the favorable effects expected from the fiscal reforms and the already implemented growth-friendly measures. However, given the significant risks and uncertainty generated by external factors, they agree with staff on basing the macroeconomic framework of the program on the prudent assumption of a 3.5 percent real GDP growth in 2017. Firm implementation of the reform program will result in a gradual acceleration of growth over the medium-term, convergence of the annual (yoy) headline CPI inflation to the NBG's 2018 target of 3 percent by year-end, and a downwards adjustment of the current account deficit to 11 percent by 2020.

Key objectives and components of program policies:

Fiscal policy will achieve medium-term fiscal consolidation while providing space for capital spending.

The augmented cash deficit of the general government will be gradually reduced to 2.8 percent of GDP by 2020, stabilizing the public debt around 45 percent of GDP. Increasing public investment to reduce infrastructure bottlenecks will be made possible by reducing primary current spending from 25 percent of GDP in 2016 to 21.4 percent in 2020. This will be achieved primarily by improving the efficiency of public spending: containing the wage bill and administrative expenses, better targeting subsidies and social assistance programs, privatizing loss-making SOEs.

The approved 2017 budget incorporates significant revenue-enhancing and expenditure-reducing measures to contain the cash deficit. Additional contingency measures will be identified, on both the spending and revenues sides of the budget, to secure the fulfillment of deficit targets in the short and medium-run, in case the collected revenues or cuts in current spending fall short of program projections.

Structural fiscal policies will enhance medium and long-run fiscal sustainability.

A strategic program to enhance the efficiency of revenue administration has been developed for 2017-2020. The program will initially focus on improving compliance by developing an action plan to address accumulated outstanding VAT in an orderly manner and increasing the tax audit capacity and efficiency.

The authorities are committed to reforms aimed at optimizing the wage bill and improving the link between pay and performance. Measures that were already implemented this year have contained the compensation of employees and spending on goods and services, reduced employment at the central level, and limited local governments' spending. In addition, the implementation of a new Civil Service Law classifying all employees into grade structures and the adoption of a Remuneration Law for the civil service which will set salary ceilings for all grades, are also planned for this year.

Containing fiscal risks is crucial for fiscal sustainability. While identifying key fiscal risks associated with SOEs and Public-Private Partnerships (PPPs), including Power Purchasing Agreements (PPAs) in the energy sector, the authorities also recognize the important role that PPPs and PPAs can play in attracting investment, including FDI. To minimize risks and maximizing benefits from PPPs and PPAs, the government is committed to adopting a new PPP law that is compliant with best international practices. They will widen the coverage of the Fiscal Risks Statement accompanying the budget to include quasi-fiscal relationships and contingent liabilities associated to SOEs and PPPs.

The fiscal framework will be revised to ensure that the fiscal rule allows flexibility for fiscal policy over the economic cycles, and transparency of public financial management will be increased.

Monetary policy will continue to operate within the framework of inflation targeting with exchange rate flexibility.

This framework remains the most viable option for pursuing stable inflation and increasing the economy's resilience to external shocks. NBG targets inflation at 4 percent in 2017 and at 3 percent from 2018 onwards. Inflation is forecasted to rise above the target in 2017, mainly a result of a hike in excises. With the effects of temporary factors ceasing in 2018, inflation will transitorily undershoot the target, and converge towards it by the year-end.

Foreign exchange interventions will be limited to smoothing excessive volatility of the exchange rate without targeting a specific level or path thereof. The level of gross international reserves, currently below the level recommended by the IMF's ARA metric, will be raised throughout the program.

The monetary policy transmission mechanism will be strengthened by promoting financial larization and greater use of the domestic currency in the economy. While operating already at the frontier of monetary policy by publishing forecasts of the monetary policy rate path, the NBG will further enhance communication by issuing guidelines for monetary policy operations.

The liquidity management and provision will continue to be improved. The NBG recently introduced a new one-month monetary instrument and has broadened the list of eligible collaterals to facilitate maturity transformation in the banking sector. The MoF and NBG are committed to sign a memorandum of understanding on information sharing for liquidity forecasting purposes.

Financial sector policies will safeguard financial stability, enhance banking sector's resilience to shocks, and improve financial intermediation.

The NBG will continue to strengthen financial regulation and supervision, in line with the 2014 FSAP recommendations. Further measures will be taken to enhance the resilience of the financial system to crises. To strengthen the financial safety net, a law will be submitted to the Parliament to introduce a deposit insurance scheme. The bank resolution framework will be strengthened by empowering the NBG to appoint a temporary administration for a bank at the early stages of financial difficulties and by requesting the largest banks to develop recovery plans based on Financial Stability Board's principles. Measures will be taken, following international best practices, to strengthen the NBG's capacity as a lender of last resort.

Authorities will firmly pursue their larization strategy to reduce the economy's vulnerability to exchange rate shocks and improve the monetary policy transmission mechanism. Measures will be taken to promote long-term lari funding and pricing in lari, and to reduce foreign-exchange credit risks. Larization will be further supported by capital market development, focused initially on the bond market. Reforming the pension system by introducing a second pension pillar in 2018 will create demand for long-term lari instruments.

Structural reforms will diversify the economy, increase productivity and competitiveness to boost long-term growth and reduce vulnerabilities to external shocks, reduce unemployment and poverty.

Transforming Georgia into a transportation, logistical, and tourism hub, connecting Europe and Asia is a key development strategy for the authorities. Scaling-up infrastructure, with focus on core cross-country road projects as well as radial roads to better connect regions, is therefore a top priority of the authorities' public investment policy.

Education reform is critical to foster job creation, improve productivity, and reduce inequality. The lack of qualified labor is identified as the main difficulty for doing business in Georgia and skill mismatches are the primary cause of high unemployment, especially in rural areas. Therefore, education reform will focus on setting curriculum standards with the participation of employers and promoting vocational training and adult learning.

The authorities will continue to improve the business environment by, among other measures, introducing IFRS for corporations and reforming the insolvency law by 2018, and establishing a one-stop shop for public services to business, as already exists for citizens, by 2019. Land registration will be promoted to protect property rights and foster development of rural areas and the agricultural sector. Deepening Georgia's trade relations with the rest of the world will help mobilize FDI in tradable sectors and diversify its economy to improve competitiveness, reduce vulnerability to external shocks, and sustain balanced growth.

Conclusion

With good institutions and favorably located at the cross-roads of regional markets but constrained by the small size of the domestic market, Georgia has the ambition to further integrate in the global economy to reach its growth potential.

However, freeing this potential from domestic constraints requires a comprehensive set of structural reforms together with adequate fiscal, monetary, and financial policies to maintain macroeconomic and financial stability. These demanding policy requirements are met by the program presented for approval by the authorities, who are committed to its full implementation. The program is both ambitious and prudent, with moderate short-run constraints building the foundations for longer-term sustainable benefits. The wide range of structural reforms involved and the time needed to build up reserve buffers qualifies Georgia for the Extended Fund Facility. The risks to the program are deemed to be manageable as it is built on the authorities' own reform agenda that is supported by a solid parliamentary majority. The proposed conditionality under the program mitigates further risks and provide safeguards.