



GEORGIA

June 2018

2018 ARTICLE IV CONSULTATION, SECOND REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT, AND REQUEST FOR MODIFICATION OF A QUANTITATIVE PERFORMANCE CRITERION—PRESS RELEASES; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR GEORGIA

In the context of the 2018 Article IV Consultation, Second Review Under the extended Fund Facility Arrangement, and Request for Modification of a Quantitative Performance Criterion, the following documents have been released and are included in this package:

- **Press Releases** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its June 27, 2018 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 27, 2018, following discussions that ended on April 16, 2018 with the officials of Georgia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 14, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the 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, as well as
Selected Issues

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.

Copies of this report are available to the public from
International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: <http://www.imf.org>
Price: \$18.00 per printed copy

International Monetary Fund
Washington, D.C.



INTERNATIONAL MONETARY FUND



Press Release No. 18/266 FOR
IMMEDIATE RELEASE
June 28, 2018

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2018 Article IV Consultation with Georgia

On June 27, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Georgia.

Since the global financial crisis, macroeconomic performance in Georgia has been positive. Growth was higher than that in most peers, policy frameworks have been strengthened with inflation well-anchored and fiscal deficits broadly well-managed, the banking sector has remained stable—despite a large exchange rate depreciation—and foreign reserves have increased. After two years of sluggish growth, following the 2014 regional slowdown, growth has picked up and the external position strengthened. Supported by external demand and buoyant consumption, real GDP grew 5 percent in 2017. Annual inflation reached 6.7 percent at the end of 2017, and fell to 2.5 percent in April 2018 as the impact of one-off shocks (increase in excises) dissipated. Supported by revenue measures, the strengthened recovery, and the reduction in current spending, the fiscal position in 2017 remained stable while allowing a considerable ramp up in public investment. Rapid growth in exports, tourism, and remittances narrowed the current account deficit to 8.7 percent of GDP. FDI reached 10.5 percent of GDP in 2017. External debt, mostly concessional, remains elevated, at 96 percent of GDP in 2017, excluding intercompany loans.

The near-term outlook has improved moderately and the output gap is expected to close gradually in 2019–20. Over the medium to long term growth is expected to accelerate moderately and external vulnerabilities to decrease, thanks to the dividends from structural reforms. Risks to the outlook are balanced. Upside risks arise from stronger domestic and external demand, which, in the presence of structural bottlenecks, could result in demand pressures and require policy tightening. A larger-than-anticipated impact from structural reforms could also increase growth in the outer years. However, Georgia remains vulnerable to regional

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

developments and market volatility in main trading partners. Weaker growth in key advanced economies and a retreat from cross-border integration could undermine efforts to diversify exports.

The favorable macroeconomic environment offers Georgia an opportunity to advance reforms to increase resilience to external shocks and to promote higher and more inclusive growth, while preserving macroeconomic stability. The authorities are committed to fiscal sustainability, which—in the context of limited room to raise extra revenue—will be achieved by containing current spending while creating room for higher public investments. In the medium run, the need to ramp up spending to implement the education reform will be compensated by lower capital spending. To limit fiscal risks, the authorities have taken decisive steps to extend the coverage and the reporting of fiscal risk and to address issues with the VAT refund system. The authorities will continue to improve the monetary and financial frameworks by strengthening the crisis management system, supporting the development of capital markets, and actively providing incentives to de-dollarize. The authorities are committed to ambitious structural reforms to promote private sector-led activity through improvement of business environment, economic diversification, and job creation.

Executive Board Assessment²

Executive Directors agreed with the thrust of the staff appraisal. They commended Georgia's strong economic performance under the EFF program supported by favorable external conditions and prudent economic policies, which has enhanced confidence and improved growth. Directors noted that while the macroeconomic outlook is generally positive and risks are balanced, Georgia remains vulnerable to external shocks, including market volatility in major trading partners. They noted that continued commitment to sound policies and further progress in structural reforms will be necessary to preserve the gains made, address remaining vulnerabilities, and foster stronger and more inclusive growth.

Directors welcomed the authorities' commitment to prudent fiscal policies to preserve fiscal sustainability and strengthen fiscal credibility. They supported continued efforts to rein in current spending and improve revenue administration to create space for higher public investment, refund VAT credits, and narrow the fiscal deficit. Directors welcomed the progress made in the coverage and reporting of fiscal risks, which remain high, and arise mainly from state-owned enterprises and power purchase agreements. They encouraged further efforts to improve transparency and strengthen mechanisms to better monitor and control these risks. Directors also supported measures to revamp the fiscal rule framework to improve fiscal governance and accountability.

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Directors considered that monetary policy is appropriately focused on price stability, supported by exchange rate flexibility and interventions that help smooth excessive volatility and build reserves. They supported strengthening the inflation targeting framework through efforts to improve liquidity management and communication. Directors commended the central bank for strengthening the financial supervision and regulatory framework, including by implementing FSAP recommendations. Given concerns about indebtedness, they supported efforts to contain credit to households by tightening prudential financial policies. Directors welcomed the gradual de-dollarization of the economy as a sign of increased credibility in monetary policy and progress in anchoring inflation expectations. They noted the need to bring the crisis management framework in line with best international practices, and stressed the importance of improving crisis management procedures, including implementing the emergency liquidity assistance and banking resolution frameworks.

Directors encouraged the authorities to take advantage of the current economic rebound to undertake reforms that will increase Georgia's economic resilience to external shocks and promote higher, more inclusive, and private sector-led growth. In this context, they emphasized the need to prioritize growth-enhancing measures, particularly to improve infrastructure, education, labor market policies, and competitiveness. Directors welcomed Georgia's efforts to improve the business environment and diversify export markets, including through free trade agreements. They noted that mobilizing foreign direct investment in export-oriented sectors is instrumental for enhancing competitiveness and supporting growth.

It is expected that the next Article IV consultation with Georgia will be held in accordance with the Executive Board decision on consultation cycles for members with Fund arrangements.

Georgia: Selected Economic and Financial Indicators, 2015–19

	2015	2016	2017	2017	2018	2018	2019
	Actual		CR 17/361 ^{1/}	Prel.	CR 17/361 ^{1/}	Projections	
National accounts and prices (annual percentage change; unless otherwise indicated)							
Real GDP	2.9	2.8	4.3	5.0	4.2	4.8	4.8
Nominal GDP (in billion of laris)	31.8	34.0	37.3	38.0	40.1	41.4	44.8
Nominal GDP (in billion of U.S. dollars)	14.0	14.4	15.0	15.2	16.3	16.9	18.3
GDP per capita (in thousand of U.S. dollars)	3.8	3.9	4.1	4.1	4.4	4.5	4.9
GDP deflator, period average	5.9	4.2	5.4	6.5	3.4	3.8	3.3
CPI, Period average	4.0	2.1	5.8	6.0	2.8	2.8	2.9
CPI, End-of-period	4.9	1.8	5.6	6.7	3.2	2.7	3.0
Investment and saving (in percent of GDP)							
Gross national saving	19.5	19.9	20.6	23.2	22.5	25.5	26.0
Investment	31.5	32.7	31.0	31.9	33.1	34.7	35.2
Public	5.6	5.0	5.8	6.1	6.5	6.8	7.4
Private	25.9	27.7	25.2	25.8	26.6	27.9	27.7
Consolidated government operations (in percent of GDP)							
Revenue and grants	28.1	28.3	28.9	29.0	28.6	27.9	27.3
o.w. Tax revenue	25.1	25.7	25.9	26.0	25.6	25.0	24.7
Expenditures	32.0	32.5	33.0	32.7	32.0	31.1	31.0
Current expenditures	25.0	26.0	24.7	24.2	24.0	23.1	22.5
Capital spending and budget lending	7.0	6.5	8.3	8.5	8.1	7.9	8.5
Net Lending/Borrowing (GFSM 2001)	-1.3	-1.6	-1.1	-0.5	-1.5	-1.6	-1.5
Augmented Net lending / borrowing (Program definition) ^{2/}	-2.7	-3.0	-3.6	-2.9	-3.0	-2.8	-2.6
Public debt	41.4	44.4	42.3	44.9	42.7	42.8	43.5
o.w. NBG debt to the IMF	...	...	0.5	0.6	1.0	0.5	1.0
o.w. Foreign-currency denominated	32.5	35.1	33.1	35.6	34.0	33.2	33.1
Money and credit (in percent; unless otherwise indicated)							
Credit to the private sector (annual percentage change)	22.1	19.6	10.1	17.6	14.3	14.1	10.6
In constant exchange rate	4.3	12.0	15.5	20.1	14.3	18.0	10.7
Broad money (annual percentage change)	19.2	20.4	9.8	14.8	15.0	12.6	11.0
Broad money (incl. fx deposits, annual percentage change)	23.4	19.1	7.9	13.7	13.4	10.5	10.0
In constant exchange rate	5.1	13.3	14.7	16.9	15.0	16.2	11.1
Deposit dollarization (in percent of total)	66.8	69.9	64.8	63.7	64.1	59.7	57.5
Credit dollarization (in percent of total)	63.1	64.6	54.7	56.1	54.1	50.7	48.3
Credit to GDP	49.2	54.9	55.3	57.8	58.5	60.6	61.9
External sector (in percent of GDP; unless otherwise indicated)							
Current account balance	-12.0	-12.8	-10.4	-8.7	-10.6	-9.2	-9.2
Trade balance	-28.1	-26.9	-25.8	-25.3	-26.4	-27.2	-27.1
Terms of trade (ratio)	100.0	98.9	99.1	96.1	99.3	94.3	94.5
Gross international reserves (in billions of US\$)	2.5	2.8	3.2	3.0	3.4	3.3	3.6
In percent of IMF Composite measure (floating)	89.9	90.9	93.3	90.1	95.2	93.3	98.8
Gross external debt	107.6	109.3	106.9	112.8	106.4	107.9	107.9
Gross external debt, excl. intercompany loans	86.1	91.8	87.4	95.6	86.5	90.9	90.6
Laris per U.S. dollar (period average)	2.27	2.37	2.5	2.51	...	...	...
Laris per euro (period average)	2.52	2.62	2.8	2.83	...	...	...
REER (period average; CPI based, 2010=100)	104.0	107.5	...	...	...	...	...

Sources: Georgian authorities; and Fund staff estimates.

1/ Please refer to this link for details <http://www.imf.org/en/Publications/CR/Issues/2017/12/07/Georgia-First-Review-under-the-Extended-Fund-Facility-and-Request-for-Modification-of-45448>.

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



INTERNATIONAL MONETARY FUND



Press Release No. 18/263
FOR IMMEDIATE RELEASE
June 27, 2018

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2018 Article IV Consultation and Completes Second Review of Georgia's Extended Fund Facility

On June 27, 2018, the Executive Board of the International Monetary Fund (IMF) approved the completion of the second review of the three-year Extended Fund Facility (EFF) arrangement for Georgia. The EFF was approved on April 12, 2017 for an of SDR 210.4 million (about US\$285 million or 100 percent of quota at the time of approval of the arrangement)) to support the authorities' economic reform program ([Press Release 17/130](#)).

The Executive Board's approval allows for an immediate purchase of SDR30 million (or about US\$ 42.25 million). The remaining amount will be phased over the duration of the program, subject to four semi-annual reviews.

The Executive Board today also concluded the 2018 Article IV Consultation with Georgia. A respective press release will be issued separately.

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

Georgia has made notable progress under the IMF-supported program. All end-December quantitative performance criteria were met, most with significant margins, while most structural benchmarks have been implemented.

Economic growth has been stronger than initially envisaged, inflation has declined, the fiscal and external positions have improved, and public debt continues to decline. Important progress has also been made in implementing the structural reform agenda. Although risks to the outlook are balanced, Georgia remains vulnerable to external shocks, including from market volatility in major trading partners. Prudent macroeconomic policies and implementation of structural reforms are critical to address remaining vulnerabilities and promote higher and more inclusive growth.

Fiscal policy will remain slightly contractionary in 2018. Tight control of current spending and higher fiscal revenues, supported by improved economic activity, will be used to refund

additional VAT credits, increase capital spending, and narrow the fiscal deficit. Reforms should continue to strengthen revenue administration, monitor and contain fiscal risks, and improve the fiscal rule.

The monetary policy stance remains adequate. The inflation targeting framework, supported by the floating exchange rate regime, has served Georgia well, and efforts to strengthen the framework should advance. The central bank should continue close monitoring of price and wage pressures, and monetary and financial conditions, to support an adequate monetary stance.

Financial sector reforms under the program have strengthened financial supervision and regulation. However, Georgia's crisis management framework needs to be brought in line with best international practices, including by improving crisis management procedures and the frameworks for bank resolution and emergency liquidity assistance.

Growth-enhancing structural reforms have been initiated and should be accelerated to foster private sector-led activity over the medium term. Advancing reforms to scale up infrastructure spending and improve education and competitiveness are key to promote sustainable and inclusive growth.

Georgia: Selected Economic and Financial Indicators, 2015–19

	2015	2016	2017	2017	2018	2018	2019
	Actual		CR 17/361 ^{1/}	Prel.	CR 17/361 ^{1/}	Projections	
(annual percentage change; unless otherwise indicated)							
National accounts and prices							
Real GDP	2.9	2.8	4.3	5.0	4.2	4.8	4.8
Nominal GDP (in billion of laris)	31.8	34.0	37.3	38.0	40.1	41.4	44.8
Nominal GDP (in billion of U.S. dollars)	14.0	14.4	15.0	15.2	16.3	16.9	18.3
GDP per capita (in thousand of U.S. dollars)	3.8	3.9	4.1	4.1	4.4	4.5	4.9
GDP deflator, period average	5.9	4.2	5.4	6.5	3.4	3.8	3.3
CPI, Period average	4.0	2.1	5.8	6.0	2.8	2.8	2.9
CPI, End-of-period	4.9	1.8	5.6	6.7	3.2	2.7	3.0
Investment and saving							
(in percent of GDP)							
Gross national saving	19.5	19.9	20.6	23.2	22.5	25.5	26.0
Investment	31.5	32.7	31.0	31.9	33.1	34.7	35.2
Public	5.6	5.0	5.8	6.1	6.5	6.8	7.4
Private	25.9	27.7	25.2	25.8	26.6	27.9	27.7
Consolidated government operations							
(in percent of GDP)							
Revenue and grants	28.1	28.3	28.9	29.0	28.6	27.9	27.3
o.w. Tax revenue	25.1	25.7	25.9	26.0	25.6	25.0	24.7
Expenditures	32.0	32.5	33.0	32.7	32.0	31.1	31.0
Current expenditures	25.0	26.0	24.7	24.2	24.0	23.1	22.5
Capital spending and budget lending	7.0	6.5	8.3	8.5	8.1	7.9	8.5
Net Lending/Borrowing (GFSM 2001)	-1.3	-1.6	-1.1	-0.5	-1.5	-1.6	-1.5
Augmented Net lending / borrowing							
(Program definition) ^{2/}	-2.7	-3.0	-3.6	-2.9	-3.0	-2.8	-2.6
Public debt	41.4	44.4	42.3	44.9	42.7	42.8	43.5
o.w. NBG debt to the IMF	...	...	0.5	0.6	1.0	0.5	1.0
o.w. Foreign-currency denominated	32.5	35.1	33.1	35.6	34.0	33.2	33.1
Money and credit							
(in percent; unless otherwise indicated)							
Credit to the private sector (annual percentage change)	22.1	19.6	10.1	17.6	14.3	14.1	10.6
In constant exchange rate	4.3	12.0	15.5	20.1	14.3	18.0	10.7
Broad money (annual percentage change)	19.2	20.4	9.8	14.8	15.0	12.6	11.0
Broad money (incl. fx deposits, annual percentage change)	23.4	19.1	7.9	13.7	13.4	10.5	10.0
In constant exchange rate	5.1	13.3	14.7	16.9	15.0	16.2	11.1
Deposit dollarization (in percent of total)	66.8	69.9	64.8	63.7	64.1	59.7	57.5
Credit dollarization (in percent of total)	63.1	64.6	54.7	56.1	54.1	50.7	48.3
Credit to GDP	49.2	54.9	55.3	57.8	58.5	60.6	61.9
External sector							
(in percent of GDP; unless otherwise indicated)							
Current account balance	-12.0	-12.8	-10.4	-8.7	-10.6	-9.2	-9.2
Trade balance	-28.1	-26.9	-25.8	-25.3	-26.4	-27.2	-27.1
Terms of trade (ratio)	100.0	98.9	99.1	96.1	99.3	94.3	94.5
Gross international reserves (in billions of US\$)	2.5	2.8	3.2	3.0	3.4	3.3	3.6
In percent of IMF Composite measure (floating)	89.9	90.9	93.3	90.1	95.2	93.3	98.8
Gross external debt	107.6	109.3	106.9	112.8	106.4	107.9	107.9
Gross external debt, excl. intercompany loans	86.1	91.8	87.4	95.6	86.5	90.9	90.6
Laris per U.S. dollar (period average)	2.27	2.37	2.5	2.51	...	...	...
Laris per euro (period average)	2.52	2.62	2.8	2.83	...	...	...
REER (period average; CPI based, 2010=100)	104.0	107.5	...	...	...	...	...

Sources: Georgian authorities; and Fund staff estimates.

1/ Staff report for the second review.

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



GEORGIA

June 14, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION, SECOND REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT, AND REQUEST FOR MODIFICATION OF A QUANTITATIVE PERFORMANCE CRITERION

KEY ISSUES

Context. Georgia continues to make progress in addressing macroeconomic imbalances, supported by its Extended Fund Facility (EFF) arrangement. Since the 2016 Article IV consultation, growth has picked up, the fiscal deficit has been contained, the banking sector has been stable, and the external position has strengthened. However, structural challenges hinder growth, calling for maintaining the reform momentum.

Article IV Discussions. The focus was on policies to enhance the economy's resilience and promote higher and more inclusive growth, particularly strengthening policy frameworks and undertaking structural reforms to enhance education, infrastructure, and external competitiveness.

- Public finances have improved, with revenue measures taken to compensate for losses associated with the 2016 corporate income tax reform. Higher-than-projected revenues and contained current spending have provided space for investment. Challenges ahead include addressing the stock of VAT credits, revamping the fiscal framework, and reducing fiscal risks.
- Monetary policy remains adequately focused on price stability. The flexible exchange rate remains a key shock absorber, with interventions only limited to reduce excessive volatility and to build buffers.
- Reforms under the program have supported financial resilience. Further efforts are needed to bring crisis management in line with international best practices.
- Growth-enhancing structural reforms have been initiated and should be accelerated to promote sustainable and inclusive growth, with a focus on fostering private sector-led activity over the medium term.

Program discussions. The 36-month EFF with access of SDR 210.4 million (100 percent of quota) is broadly on track. All end-December quantitative performance criteria were met, most with significant margins. Most structural benchmarks have been implemented. Completion of the review will make available SDR 30 million (about \$43 million). The authorities are committed to the 2018 fiscal policy targets. The monetary policy stance is appropriate to bring inflation toward the end-December target. Efforts to adopt and implement structure reforms are being stepped up.

Approved By
Juha Kähkönen (MCD)
and Rupa Duttagupta
(SPR)

Discussions were held in Tbilisi during April 2–16, 2018. The staff team comprised Mercedes Vera Martin (head), Sergio Rodriguez, Sergio Sola (all MCD), Klaus Hellwig (FAD), Francois Painchaud (resident representative), Nia Sharashidze (Tbilisi office), Nujin Suphaphiphat (SPR), and Umang Rawat (MCM). Support was provided by Khatuna Danelia (Tbilisi office), Mansour Almalik, Branden Laumann, and Madina Toshmuhamedova (HQ, all MCD). The team met with Governor Gvenetadze, Minister of Finance Bakhtadze, and Minister of Economy Kumsishvili, senior officials, private sector participants, and representatives of the donor community. Mr. Botel (OED) participated in the discussions.

CONTENTS

CONTEXT	4
RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS	5
PROGRAM PERFORMANCE	7
OUTLOOK AND RISKS	7
ARTICLE IV POLICY DISCUSSIONS	8
A. Preserving Medium-Term Fiscal Sustainability	8
B. Strengthening Monetary and Financial Frameworks	13
C. Enhancing External Stability to Increase Resilience to External Shocks	16
D. Structural Reforms to Support Higher and More Inclusive Growth	16
DISCUSSIONS FOR SECOND REVIEW UNDER EXTENDED FUND FACILITY	19
A. Policy Discussions	19
B. Program Modalities	21
STAFF APPRAISAL	22
BOXES	
1. Achievements and Challenges in Revenue Mobilization	10
2. Strengthening Georgia’s Fiscal Framework	12
3. Reforms to Build Financial Sector Resilience, 2017–18	14

FIGURES

1. Real Sector and Inflation Developments	24
2. External Sector Developments	25
3. International Investment Position (IIP)	26
4. Fiscal Sector Developments	27
5. Financial Sector Developments	28
6. Macro-Financial Developments	30
7. Macro-Structural Challenges	31
8. Public Sector Debt Sustainability Analysis (DSA)	32
9. Public Debt Sustainability Analysis—Composition of Public Debt and Alternative Scenarios	33
10. External Debt Sustainability: Bound Tests	34

TABLES

1. Selected Economic and Financial Indicators, 2015–23	35
2. Summary Balance of Payments, 2015–23	36
3a. General Government Operations, GFSM 2001, 2015–23 (In millions of GEL)	37
3b. General Government Operations, GFSM 2001, 2015–23 (In percent of GDP)	38
4. Monetary Survey 2015–19	39
5. Selected Monetary and Financial Soundness Indicators, 2015–March 2018	40
6. External Vulnerability Indicators, 2015–23	40
7. Gross External Requirement, 2017–23	41
8. Indicators of Fund Credit, 2015–23	42
9. Schedule of Reviews and Available Purchases	43
10. External Debt Sustainability Framework, 2014–23	44

ANNEXES

I. Status of Staff Recommendations Made in the 2016 Article IV Consultation	45
II. Risk Assessment Matrix	46
III. External Sector Assessment	48

APPENDIX

I. Letter of Intent	52
Attachment I. Memorandum of Economic and Financial Policies (MEFP)	54
Attachment II. Technical Memorandum of Understanding (TMU)	71

CONTEXT

1. The Georgian economy proved relatively resilient to the 2014 external shock. Georgia has enjoyed macroeconomic stability and economic growth despite the global financial crisis and the 2014 regional shock—lower growth in major trading partners, largely resulting from lower oil prices. Since 2010, growth in Georgia has been higher than the average of some of its peers.

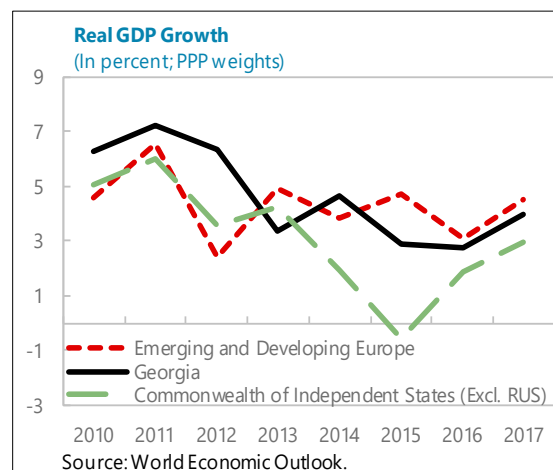
2. The resilience of the economy reflects generally strong policy efforts. Many of the 2016 Article IV recommendations were implemented (Annex I). Fiscal deficits have been effectively

managed. The 2017 budget incorporated tax increases and cuts in current spending to generate space for public investment. Monetary policy remained focused on price stability, with inflation well-anchored. The banking sector has remained stable, partly thanks to strengthened prudential regulation and supervision. Structural reforms have been initiated to remove growth bottlenecks and support the private sector as an engine for growth.

3. Nevertheless, growth has decelerated in recent years and is still not inclusive enough.

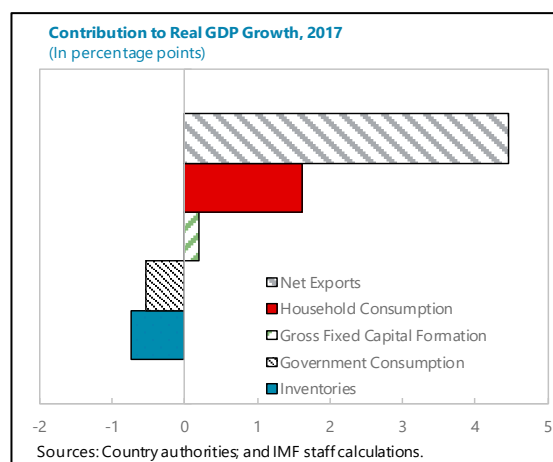
Average annual growth has slowed from 9.7 percent (2003–07) to 5.6 percent (2010–14) and 3.6 percent (2015–17). The deceleration has been driven by slower external demand and weaker total factor productivity growth. The slower growth has allowed extreme poverty and inequality to be reduced by only a small margin. Poverty is higher in rural areas and more prevalent among the elderly.

4. The current economic rebound provides an opportunity to undertake reforms that increase Georgia’s resilience to external shocks and promote higher and more inclusive growth. Recently, growth has picked up driven by a rebound in external demand and domestic consumption. The external position has strengthened due to rapid growth in exports, tourism, and remittances. However, the external shock since late 2014 exposed structural bottlenecks (poor infrastructure, limited production base, and significant skill mismatches) that led to external imbalances, balance-of-payments (BOP) needs, and low growth. Structural reforms are needed to increase productivity and reduce protracted BOP needs. The authorities’ vision for achieving higher and more inclusive growth, embedded in their Four-Point Reform Plan, would (1) improve infrastructure and connectivity to leverage Georgia’s location as a transit and tourism hub; (2) reform education to promote skills development, labor productivity, and job creation; (3) improve governance and the efficiency of government; and (4) enhance the role of the private sector as an engine for growth. The political setting has been reform friendly as the government benefits from a constitutional majority in Parliament. The Extended Fund Facility (EFF) arrangement supports the authorities’ home-grown reforms.



RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

5. Georgia's economy performed well in 2017 (Figures 1–6, Tables 1–8). Real GDP grew 5 percent in 2017 (compared to 2.8 percent in 2016), supported by external demand and buoyant consumption. Annual inflation reached 6.7 percent at the end of 2017, and fell to 2.5 percent in April 2018 as the impact of an increase in excises dissipated. Rapid growth in exports, tourism, and remittances narrowed the current account deficit to 8.7 percent of GDP (compared to 12.8 percent in 2016), largely supported by strong external demand.¹ Flows of net foreign direct investment (FDI) reached 10.5 percent of GDP in 2017, in part driven by high reinvested earnings. The exchange rate, both in nominal and real effective terms, was broadly stable at end-2017. Gross international reserves increased by \$283 million to \$3 billion (3.3 months of imports).



6. Monetary policy was tightened to address inflationary pressures. The National Bank of Georgia (NBG) increased the policy rate three times in 2017—each time by 25 basis points (bps), which ultimately boosted the rate to 7.25 percent, where it has remained. Interbank interest rates increased in tandem with the policy rate thanks to the use of certificates of deposits, refinancing loans, and other open market operations.

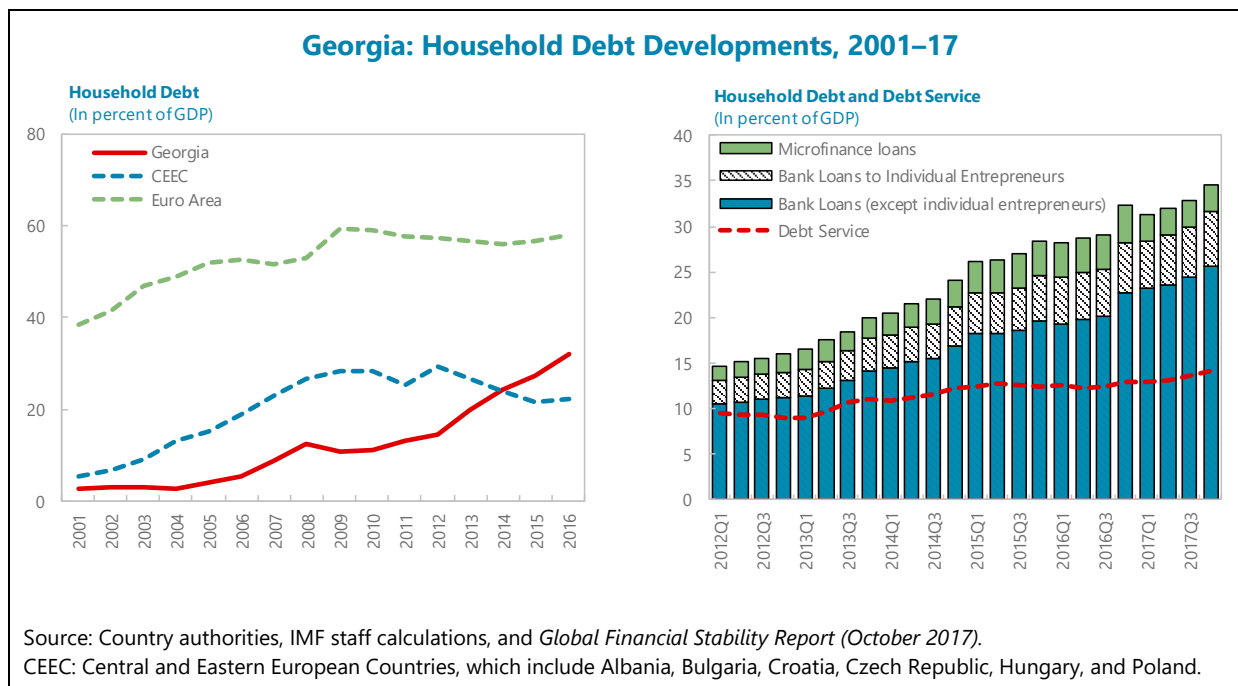
7. Supported by revenue measures and a strengthening recovery, the fiscal position remained stable in 2017. The augmented fiscal deficit (net lending/borrowing minus budget lending) reached 2.9 percent of GDP, compared to 3 percent of GDP in 2016. Revenues increased by 0.7 percentage points of GDP, due to cyclical gains and an increase in excise rates. Losses from corporate income tax reform (1.1 percentage points of GDP as the CIT changed from a profit to a dividend-distribution tax) and the compensating gains from higher excise rates (0.7 percentage points of GDP) were both lower than expected in 2017. While current spending was contained in real terms, capital spending and net budget lending increased by 2 percentage points of GDP, boosting infrastructure investment. The structural primary deficit (adjusted for cyclical revenues, grants, and privatization receipts) fell by 0.4 percent of potential GDP, indicating a mildly contractionary policy stance. Public debt stayed close to 45 percent of GDP and remains sustainable (Figures 8–9).²

8. Credit to the private sector has supported economic activity, but households' indebtedness is rapidly increasing. In March 2018, credit to the private sector (at constant exchange rates) grew by some 20 percent yoy, driven by credit to households, particularly mortgage lending. Consumer lending continued to grow in 2017, and household debt reached 34 percent of GDP at end-2017. Although starting from a low base, household debt doubled in the last five years.

¹ Export volume growth reached about 20 percent in 2017.

² Public debt does not include the stock of unrefunded VAT credits, estimated at 4.7 percent of GDP in 2017.

Debt service, however, has increased at a lower rate. Credit to corporations remained stable as a ratio of GDP (at 25 percent). As of March 2018, deposits (at constant exchange rates) grew about 20 percent yoy. Lending and deposit rates in lari have remained broadly stable, while lending and deposit rates in FX have declined modestly.



9. The banking sector remains well capitalized, liquid, and profitable. The capital adequacy ratio remains close to 20 percent. The average liquidity ratio declined slightly from 41 percent in January 2017 to 37 percent in January 2018. Nonperforming loans (NPLs) declined to 2.9 percent of total loans (January 2018), from 3.8 percent a year ago. Profitability remained strong, with return on equity (assets) close to 20 percent (3 percent). The central bank has strengthened regulations on capital and liquidity requirements, and its financial stability framework, supervision, and financial safety nets (see Box 3).

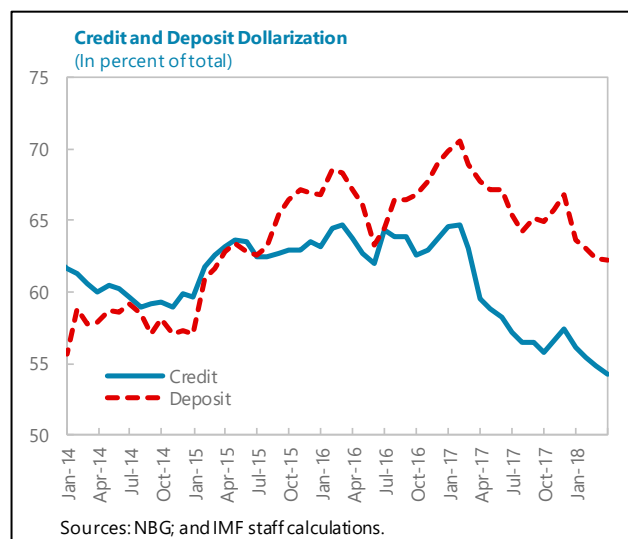
10. Dollarization has declined significantly, but remains elevated. In late 2016, the authorities took measures to help de-dollarize the economy. They focused on increasing long-term lari funding, providing incentives to reduce foreign currency lending, and promoting pricing in lari.³ The larization measures—together with higher economic confidence, prudent macroeconomic policies, and enhanced macroprudential tools— have yielded positive results. Since December 2016, dollarization fell by about 10 and 8 percentage points for loans and deposits, respectively, reaching 55 percent for loans and 63 percent for deposits in March 2018.⁴

³ The authorities introduced the Basel III liquidity coverage ratio with preferential treatment for local currency, prohibited loans in foreign currency under GEL100,000 to eliminate FX lending in non-banks, introduced a mortgage conversion program, and differentiated loan-to-value and payment-to-income ratios for loans to limit FX-induced credit risks, and mandated prices to be quoted only in lari.

⁴ Loan dollarization for the household sector declined by 15 percentage points, to 43 percent, during this period.

PROGRAM PERFORMANCE

11. Quantitative targets for end-December 2017 were met (MEFP, Tables 1–2). Inflation remained within the inner band of the consultation clause (5–7 percent). Quantitative performance criteria were met with significant margins: the fiscal deficit was 0.5 percent of GDP lower than the program ceiling; net international reserves (NIR) were \$100 million higher than the adjusted program floor, partly driven by lower-than-projected government FX conversion and higher-than-expected interest on reserves; and the Partnership Fund (PF) ran a small surplus. The indicative target on current primary spending was missed by a small margin (0.3 percent) due to higher donor disbursements.



12. All structural benchmarks (SBs) but one were met (MEFP, Tables 3–4). The Ministry of Finance (MoF) published a calendar for government benchmark bonds for 2018; submitted a budget consistent with the parameters under the EFF arrangement; adopted a law for public civil service; restructured the Georgia Revenue Service (GRS) headquarters into a function-based organization; and issued guidelines for new budget lending operations requiring reasonable expectation of commercial returns. The authorities also submitted to Parliament by end-2017 a second-pillar pension reform, a public-private partnership (PPP) law, and proposed legislation giving the National Bank of Georgia (NBG) oversight over credit bureaus. The 2018 Fiscal Risk Statement (FRS) disclosed associated with PPPs and power purchasing agreements (PPAs), reported quasi-fiscal activity, and analyzed contingent liabilities associated with state-owned enterprises (SOEs). Needing further discussions, the steering committee at the MoF delayed proposing legal amendments to implement the action plan to reduce outstanding VAT liabilities to May 2018 (rather than March). The NBG adopted a regulation on additional capital for domestic systemically important banks, to be fully effective by 2020.

OUTLOOK AND RISKS

13. The macroeconomic outlook is generally positive. Supported by external demand and domestic consumption, GDP growth is projected at 4.8 percent in 2018—0.6 percentage points higher than at the first review. Inflation, at 2.5 percent in April, is projected below the target of 3 percent at end-2018. GDP growth is projected to increase slightly over the medium term, to 5.2 percent, provided that structural reforms are implemented. Robust growth and fiscal consolidation will keep public debt firmly below 45 percent of GDP (Figures 8–9) if fiscal risks do not materialize (see ¶19). The current account deficit is projected to narrow to about 7.5 percent of GDP in the medium term, and will remain mostly financed by FDI. Reserve coverage, projected at

93 percent of the ARA matrix by end-2018, will increase to 105 percent by 2020. However, external debt is projected to remain elevated, underscoring the remaining vulnerabilities (Figure 10, Table 10).

14. Risks to the outlook are balanced (Annex II). Upside risks arise from stronger domestic and external demand, which, in the presence of structural bottlenecks, could result in demand pressures and require policy tightening. A larger-than-anticipated impact from structural reforms could also increase growth in the outer years. While risks from correspondent banking relationships have receded, Georgia remains vulnerable to regional developments and market volatility in main trading partners. Weaker growth in key trading partners could affect the pace of export recovery, and a retreat from cross-border integration could undermine efforts to diversify exports. Complacency, political fatigue in delivering structural reforms, or deviations from fiscal discipline could reduce medium-term growth prospects.

15. The authorities shared staff's views on the outlook and risks, and reiterated their plans to advance structural reforms and maintain fiscal discipline. The authorities expressed concerns about possible adverse spillovers from regional market volatility, which could undermine the positive economic outlook and the pace of reforms. Staff and the authorities agreed that, as a small open economy, Georgia remains vulnerable to external shocks despite its improved resilience.

ARTICLE IV POLICY DISCUSSIONS

The favorable global growth environment offers Georgia an opportunity to advance reforms to increase resilience to external shocks and promote higher and more inclusive growth. Discussions focused on policies to (1) preserve fiscal sustainability while addressing bottlenecks to growth; (2) strengthen monetary and financial policy frameworks; (3) improve external stability; and (4) implement structural reforms to promote private sector-led activity through economic diversification and job creation.

A. Preserving Medium-Term Fiscal Sustainability

16. Fiscal policy will remain slightly contractionary in 2018. The augmented fiscal deficit in 2018 is projected at 2.8 percent of GDP, 0.2 percent of GDP lower than in the budget. The higher revenues in 2017 and a strengthening recovery will result in additional revenues (GEL 300 million, 0.7 percentage points of GDP). The bulk of these would be used to double repayments of outstanding VAT liabilities (to GEL400 million for the year) and reduce the deficit (GEL56 million), with the remainder steered toward additional capital spending.

17. Fiscal policy is projected to remain broadly neutral over the medium term and consistent with anchoring public debt below 45 percent of GDP. The authorities expressed their commitment to prudent fiscal policies. Continued fiscal consolidation hinges on sustained revenue performance and tight control on current spending. These efforts will allow for spending, mainly to address key road infrastructure needs and investment in education. Under the baseline projections, additional fiscal measures (0.8 percent of GDP in 2019) are needed to ensure such consolidation over the medium term.

18. The authorities recognized the need to address structural bottlenecks by scaling up infrastructure and improving education. Additional public investment in infrastructure and education are needed to reduce structural bottlenecks and increase potential growth. To make room for capital spending, the authorities are containing real current spending. In the near term, the focus on additional spending will be on infrastructure for which projects have been identified. Public investment should prioritize productive and well-managed projects. Strengthening public investment management will help improve efficiency of public and PPP investments.⁵ Over the medium term, the focus will shift spending to support education reform, which requires preparation. The authorities and staff agreed that education reform should be fiscally sustainable, with a focus on identifying efficiency gains and compensating measures. To the extent the additional capital spending cannot be covered by cuts in current spending, tax increases would be needed. With the Economic Liberty Act constraining options for permanently mobilizing more revenues, tax increases would need to be temporary (Box 1).

19. Fiscal risks remain significant. Staff welcomes the improved coverage and reporting of fiscal risks in the 2017 FRS. The main fiscal risks arise from contingent liabilities associated with SOEs and PPAs.⁶ According to the 2017 FRS, half of the SOEs are considered high-risk, total liabilities of high-risk SOEs stood at 12.8 percent of GDP in 2016, and one SOE is currently unable to service its debt to the government.⁷ The authorities also plan to strengthen SOE monitoring by requiring financial reporting of the largest SOEs to be IFRS compliant by October 2019. The authorities agreed on the need for legal and/or regulatory changes to institutionalize, standardize, and centralize supervisory powers on SOEs. Staff stressed that the institutional framework should provide the MoF and the Ministry of Economy and Sustainable Development (MoE) explicit authority to oversee SOEs and limit fiscal risks. Further, according to the authorities' calculation, the net fiscal exposure to PPAs amounts to 3.6 percent of GDP under current export/import electricity prices (net present value terms).⁸ Under the domestic electricity pricing mechanism, the cost of PPAs to state-owned electricity companies would be limited, since guaranteed prices will be fully passed on to end-users. However, losses would arise from exporting surplus electricity if export prices are below the guaranteed prices. Moreover, staff and the authorities agree that public finances are exposed to regulatory risks, which could materialize if electricity tariffs are not adjusted to fully reflect guarantee prices under PPAs (see ¶135 below).

⁵ A PIMA FAD TA mission took place in May 2018, providing recommendations on strengthening the public investment management framework.

⁶ PPAs have been signed between ESCO, the state-owned company responsible for matching supply and demand in the electricity market, and private electricity generators. One PPA, the Nenskra project, involves the government directly as well.

⁷ High-risk SOEs are those that are receiving fiscal support or failed to meet at least two out of three criteria related to creditworthiness, profitability, and liquidity. The state budget has serviced debt amounting to GEL34 million on behalf of this SOE. The payment has been guaranteed by property and equipment.

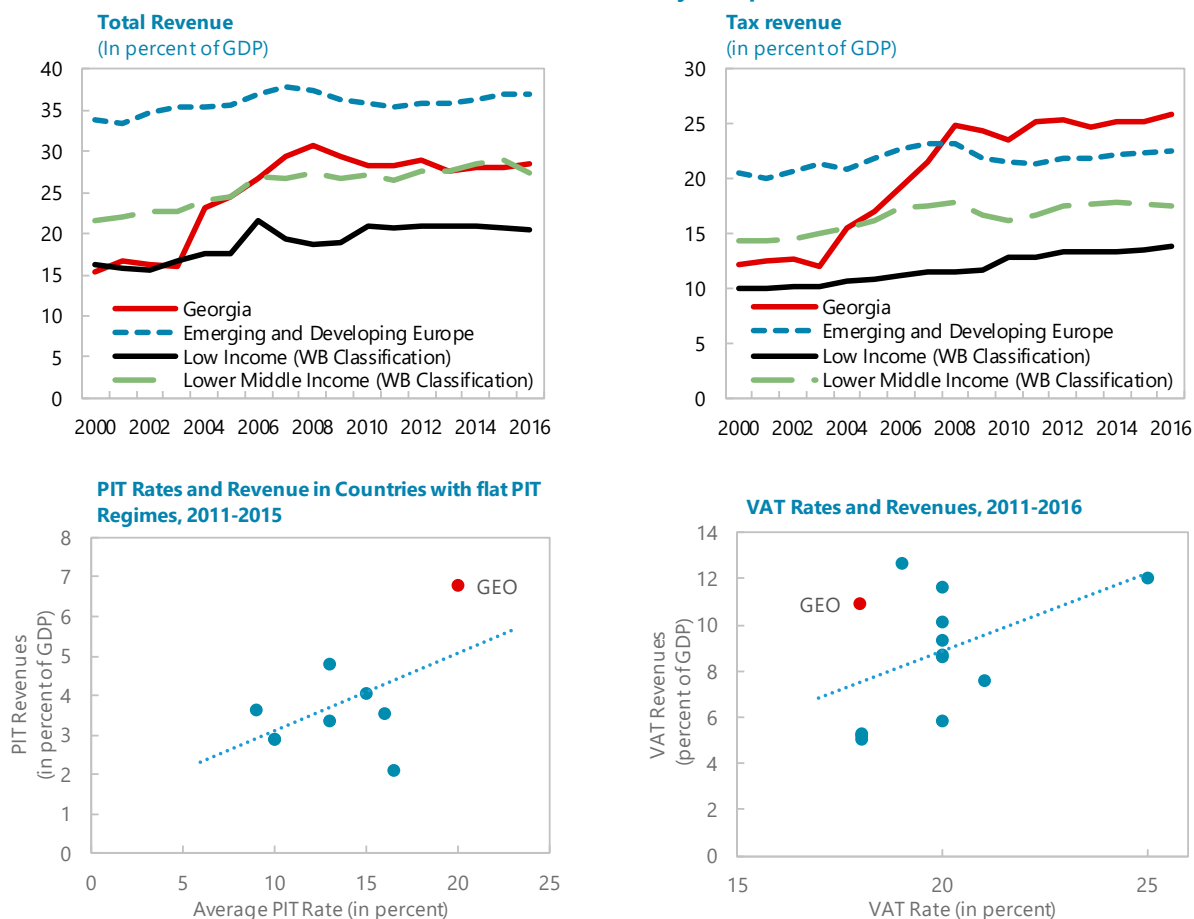
⁸ The net fiscal exposure of PPAs has been calculated as the difference between the present value of ESCO's expected payments under the PPAs and the present value of payments on alternative sources of supply, namely imports.

Box 1. Achievements and Challenges in Revenue Mobilization

After the 2003 Rose Revolution, Georgia recorded one of the largest revenue increases for any non-commodity exporter. Tax revenues increased from 12 percent of GDP in 2003 to 22 percent of GDP in 2007. This success was made possible by the new government’s strong reform mandate, which led to an all-out fight against corruption, thereby reducing theft of public resources and improving government effectiveness in delivering public services. These positive developments fostered a new culture of compliance, an effort that was complemented with policy changes: (1) the 2005 tax code reduced the number of taxes from 21 to 7, eliminated most exemptions, and reduced and unified rates to a flat tax; (2) the tax base was broadened by shutting down unlicensed vendors and making electronic cash registers mandatory for most businesses; and (3) a zero-tolerance policy on corruption in the tax administration was introduced that improved the collection efficiency. In addition, a 2004 amnesty allowed taxpayers to declare all previously undeclared assets at the cost of a small fine.

Since 2008, tax revenues have plateaued at around 25 percent of GDP. While the tax revenue ratio is higher than in most peers, Georgia does not collect social security contributions, so that total revenues are significantly below the average in Emerging and Developing Europe. With the 2011 Economic Liberty Act requiring a referendum for any permanent increase in central government taxes, except excises, mobilizing additional revenues has become challenging. In addition, the 2017 corporate income tax reform led to an estimated revenue loss of 1.1 percent of GDP. The compensating increase in excise rates on tobacco and imported vehicles yielded less in revenues than expected, due to shifts in consumption and increased smuggling, which highlights the limited potential for additional revenue from this source.

Revenue Mobilization: Cross Country Comparison, 2000–16



Sources: Country authorities; *World Economic Outlook*; and IMF staff calculations.

Box 1. Achievements and Challenges in Revenue Mobilization (concluded)

To support revenue mobilization and enhance the business environment, the authorities are undertaking an ambitious program to further improve tax administration. Reforms include the following measures:

- Improving taxpayer services: Georgia is already a strong performer in taxpayer services, with simple online filing procedures, service centers, and accessible and independent dispute resolution mechanisms.^{1/} The authorities are planning additional improvements by streamlining the documentation requirements for taxpayers.
- Modernizing the Georgia Revenue Service (GRS): A new organizational structure, with a clear separation between headquarter functions and operational tasks, has been put in place. Further steps include an improved taxpayer register; deploying modern risk management tools to detect fraud and increase compliance; and developing a system to track the performance of GRS units. FAD TA also recommends the creation of a large taxpayer office.
- Modernizing the tax code: Reforms include improvements to timely return filing—a presumed zero-liability where no return is filed will be removed. The overly rigid penalty regime will be revised to become more proportionate, reflecting the reality of varying degrees of culpability.
- Easing access to information: Modern tax administration relies increasingly on data analysis to identify and manage compliance risks. The authorities have committed to providing GRS with automated access risk-relevant data from other government agencies, including on real estate, corporate ownership, construction permits, and suspicious financial transactions. In staff's view, Georgia also needs to require automatic reporting of bank information to GRS; maintaining high bank secrecy for tax purposes is at odds with international norms and promotes tax evasion.
- SME tax reform: The authorities have submitted a new tax reform initiative to parliament. The reform would (1) lower the turnover tax rate for small businesses to 1 percent (from 3 percent) while removing tax exemptions on salaries; (2) give entrepreneurs with a turnover between GEL100,000 and 500,000 the option to pay the turnover tax instead of the income tax on profits, which would reduce the compliance burden on entrepreneurs; and (3) expand existing requirements for using cash registers to small businesses and require businesses to account for all transactions. In case all medium-sized firms choose to move to the turnover tax regime, the reform would have a small fiscal cost in the short term, but could improve compliance by existing taxpayers and reduce the cost of formalizing businesses that, so far, operate in the shadow economy.

1/ See IMF Country Report No. 16/283.

20. The fiscal rule needs to be strengthened to prevent procyclicality and promote fiscal transparency and accountability (Box 2). The authorities agreed with staff that a strong fiscal framework should be anchored by a robust fiscal rule, and that the current fiscal rule can be improved. Staff therefore welcomed the authorities' plan to revamp the fiscal rule in line with the Fiscal Affairs Department (FAD) recommendations, noting that this was an opportune time to consider revamping the fiscal rule as the authorities implement GFSM2014 in fiscal reports. In designing the new fiscal rule, the authorities plan to increase accountability toward compliance to the fiscal rule; and maintain the current deficit and debt ceiling, with strengthened definitions of fiscal aggregates, escape clauses, and the corrective mechanism.

21. Staff welcomed the authorities' plans to advance other fiscal structural reforms. With technical assistance (TA) from FAD, the GRS has embarked on an ambitious reform program aimed at

improving the business climate and tax compliance (Box 1). The reforms also address flaws in the current VAT refund system under which a continued accumulation of new VAT credits deprives businesses of working capital. For 2018, the authorities have committed to reducing the stock of VAT credits by refunding GEL400 million, from GEL225 million in 2017.

Box 2. Strengthening Georgia's Fiscal Framework 1/

The current fiscal rule has served Georgia well, but it could be strengthened. As outlined in the Economic Liberty Act, the fiscal rule included the following elements: (1) a ceiling on state debt (60 percent of GDP); (2) a ceiling on the consolidated general government deficit (3 percent of GDP); and (3) a ceiling on general government expenditures (30 percent of GDP). The debt and deficit ceilings have been adhered to, whereas the expenditure plans have marginally exceeded the ceiling in two budgets (2014 and 2015), though by a small margin. Also, the constitution requires any permanent increase in state taxes to be subject to a referendum, except for excises. The requirement reduces fiscal flexibility and could lead to excessive reliance on excises or administrative fees. Areas for improvement include replacing the expenditure rule with nominal ceilings embedded in the MTBF, shifting focus to fiscal outturns rather than plans, defining fiscal aggregates and escape clauses, and enhancing transparency and monitoring.

To reduce procyclicality, the expenditure rule could be replaced in favor of a nominal expenditure ceiling as part of an enhanced and more binding MTBF. Specified in percent of GDP, the current expenditure rule is procyclical by design, and it has no direct link with the overall objective of fiscal sustainability. The rule could also discourage public investment, since current expenditures are difficult to adjust, and it interferes with transparent accounting as it delays including fiscal activities of SOEs and legal enterprises of public law (LEPLs) into the general government accounts. Since the MTBF sets out a four-year path for expenditures in nominal terms on a rolling basis, making the second-year target binding for the subsequent budget would establish an expenditure ceiling while reducing the risk of procyclicality.

The fiscal rule should cover all general government operations. Revising the fiscal policy framework should therefore go together with enhanced accounting practices in line with GFSM 2014 standards. Notably, revenues and expenditures by legal entities of public law (LEPLs) and quasi-fiscal operations by SOEs are currently not included in the general government accounts. Moreover, prior to the recently issued budget lending guidelines (December 2017 SB), transfers to cover the losses of SOEs were recorded as equity injections, which are deficit neutral, rather than expenditures.

A revised fiscal rule should provide more clarity on escape clauses. The fiscal rule allows for a budget to breach the fiscal rule if (1) the current-year budget is consistent with the fiscal rule, or (2) in case of a recession or national security emergency. However, the framework does not provide a definition of a recession, nor a process for determining such exceptional circumstances. Well-defined escape clauses can reduce the potential procyclicality of the deficit rule while preserving its simplicity. A ceiling on headline deficits allows governments to increase spending during expansions, and enforces expenditure cuts when revenues decline in recessions. In Georgia, the risk of such procyclical behavior is reduced by the escape clause for recessions. Moreover, a nominal ceiling on expenditures would help avoid procyclical expansions.

Credibility of the fiscal rule should be enhanced through independent oversight. Budget execution reports could helpfully discuss compliance with the fiscal rule. An independent evaluation of assumptions underlying the budget, as well as monitoring of compliance, would further strengthen the rule's credibility. To improve oversight, the fiscal rule should include a mechanism for independent verification that includes, at minimum, the ability to assess macro and fiscal forecasts and compliance. The verifying institution should be legally and operationally independent and have full access to relevant information.

1/ For details, see "Georgia: Technical Assistance Report-Enhancing the Fiscal Rules", at

<http://www.imf.org/en/Publications/CR/Issues/2018/06/01/Georgia-Technical-Assistance-Report-Enhancing-the-Fiscal-Rules-45911>

B. Strengthening Monetary and Financial Frameworks

22. The monetary stance remains adequate. While financial conditions are assessed to be slightly loose, reflecting easy global monetary and liquidity conditions, and the estimated neutral real interest rate (2 percent) is higher than the real policy rate (1.6 percent), there is no evidence of price and wage pressures.⁹ With subdued core inflation, the authorities and staff agreed that the current policy rate remains appropriate for now. Absent price pressures, the central bank plans to reduce the interest rate in the second half of 2018, and headline inflation is projected to remain below, but close to, the target of 3 percent by the end of 2018. However, the NBG is closely monitoring domestic financial conditions and price pressures, including from higher global oil prices. If price pressures materialize, the NBG stands ready to postpone lowering the policy rate, or to tighten further the policy rate.

23. The NBG will continue strengthening its IT framework. The inflation targeting regime helps anchor inflation expectations and remains appropriate for Georgia, particularly given improved macroeconomic policy frameworks, stronger credibility of the NBG, and fiscal consolidation. The NBG has successfully managed short-term interest rates, with interbank rates hovering around the policy rate. Liquidity management has improved with the new one-month liquidity facility. The NBG has also improved communication by organizing regular press briefings upon completion of Monetary Policy Committee (MPC) meetings—which have helped provide guidance on the future trajectory of monetary policy rates. A new manual for monetary operations, with support from IMF TA, will clarify the operational aspects in conducting monetary policy. Going forward, staff supports NBG’s plans to enhance further communication, including on exchange rate policy.

24. The authorities are stepping up efforts to tighten prudential financial policies to contain credit to households on concerns about indebtedness. The NBG has established a cap on loans to households without verifiable income (25 percent of banks’ regulatory capital), awaiting upcoming legislation to promote responsible lending. Considering the rapid growth in household indebtedness, especially in the low-income segment, staff supported these measures as they would contain household credit growth. Staff also expressed a strong preference for tighter macroprudential measures that incorporate households’ capacity to repay, rather than using administrative prudential measures that could limit further FX lending across the board. Hence, staff proposed targeted and market-based prudential measures that would encourage prudent pricing of FX risks—such as those that increase higher capital and/or provisioning for FX loans and establish lending limits on FX loans, based on payment-to-income (PTI) and loan-to-value (LTV) ratios, and a higher premium on dollar deposits for the deposit insurance scheme. Staff agreed with the NBG on the need to further disseminate information related to risks of FX borrowing and supported enhancing financial education.

25. While the banking sector has proven resilient, further efforts are needed to bring the crisis management framework in line with best international practices. In 2015, the highly concentrated banking sector proved resilient to the lari depreciation thanks to strong prudential

⁹ See accompanying selected issues paper titled “Assessing the Monetary Policy Stance in Georgia”.

regulation and supervision. The NBG has strengthened prudential regulation and supervision, and integrated analysis of macro-financial interlinkages to support policy decisions (Box 3). Despite recent improvements to enhance crisis preparedness (including the introduction of deposit insurance, the creation of a clear definition of a “problem bank,” and the improvement of temporary bank administration) the authorities agreed with the staff on the need to improve emergency liquidity assistance (ELA) and bank resolution for systemic institutions. In line with the 2014 FSAP recommendations, the role of the public stakeholders will need to be clarified in the context of these reforms.

Box 3. Reforms to Build Financial Sector Resilience, 2017–18

As the financial supervisor, the NBG has stepped up efforts since the last Article IV Consultation to strengthen prudential regulation and supervision, broaden financial oversight, and undertake institutional changes to incorporate macroprudential policy into the financial policy toolkit.

The NBG has strengthened prudential regulation on capital and liquidity requirements:

Capital buffers. Additional buffers will help mitigate systemic, cyclical, and FX-induced credit risks. Three banks have been identified as systemically important banks (SIBs), with additional capital requirements of 1.5– 2.5 percentage points to be phased in by 2021. The *countercyclical capital buffer*, effective in December 2017, can limit procyclicality in credit growth that is triggered by, among other elements, deviations from the long-term trend in the credit-to-GDP ratio and indicators of the financial sector’s cyclical position. In addition, the *risk-based capital buffer* on retail loans, effective after November 30, 2017, anchors risk-weights on payment-to-income (PTI) and loan-to-value (LTV) ratios for consumer loans and mortgages— with higher requirements for FX loans (Table 2). Risk weights on newly issued consumer loans with low credit standards have increased on average from 75 to 135 percent, which, as of now, has cumulatively resulted in about 0.3 percentage points of additional capital.

Calibrating Risk-Weight Capital Requirements on Loan-to-Value and Payment-to-Income Ratios				
<i>(In percent)</i>				
		Loan-to-Value (LTV) Ratio ^{1/}		
		In line with requirements	Deviation from requirements	Unsecured consumer loan
Payment-to-income ratio (PTI) ^{2/}	In line with requirements	75	100	75
	Deviation from requirements	100	100 for loans secured by real estate 150, otherwise	150

Source: National Bank of Georgia.
^{1/} LTV ranges from 80 to 90 percent for Lari-denominated loans; and 75 to 85 percent for FX loans.
^{2/} PTI ranges from 30 to 50 percent for hedged borrowers; and 25 to 45 percent for unhedged borrowers depending on the monthly net income.

In addition, new General Risk Assessment Program (GRAPE) guidelines help integrate stress tests with pillar 2 of the Basel framework. Capital requirements under pillar 2 covers buffers related to credit, liquidity, market, operating, business model, and profitability risks. They also consider the macroeconomic environment, group structure, and corporate governance. Stress tests will serve as a key tool for risk-based capital requirements.

Liquidity buffers. The Basel III liquidity coverage ratio (LCR), effective September 2017, has strengthened the stability of funding. Banks have adjusted their balance sheets by reducing deposit concentration and increasing the share of non-withdrawable certificates of deposits, especially for non-resident and FX deposits.

Box 3. Reforms to Build Financial Sector Resilience, 2017–18 (concluded)

To incentivize de-dollarization, the lari LCR can fall to 75 percent if the overall LCR remains above 100 percent. The Basel III net stable funding ratio will be introduced in 2019, helping improve liquidity management over a one-year horizon. Further, differentiated reserve requirements by currency aim to incentivize de-dollarization in addition to mitigating liquidity risks.

The NBG has also strengthened its financial stability framework, supervision, and financial safety nets.

The NBG now has oversight over non-bank lenders, such as microfinance institutions and bank holding companies on a consolidated level. Legal amendments (December 2017) granted NBG oversight power to credit information bureaus and all other unregulated lenders, under the umbrella of consumer protection in financial-related activities.

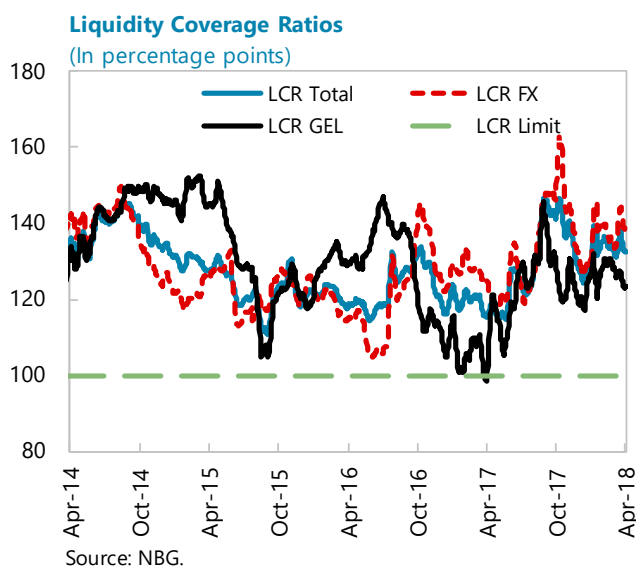
Deposit insurance and temporary administration provide for more effective banking resolution. The deposit insurance became effective January 2018, covering 90 percent of total deposit accounts (GEL 5,000 insured amount). Amendments to the Organic Law give NBG the authority to resolve a bank through a temporary administration.

The NBG is taking steps to develop a responsible lending framework, protect consumers, and improve financial literacy. The NBG has amended regulations on product disclosure requirements and effective interest rates calculations. Programs are underway to enhance financial education and sensitize households on risks associated with financial imprudence, over-indebtedness, and FX borrowing. To address increasing household indebtedness, the NBG will be launching a responsible lending framework to restrict issuance of loans without detailed assessment of the customer's creditworthiness. In addition, limits will be introduced on PTI and LTV, and the corresponding changes will be implemented to expand those regulations to non-banks.

Institutional changes have assisted in improving transparency and integrating macro-financial analysis to broader policy making.

The operational framework of the Financial Stability Committee (FSC) has been strengthened, enhancing transparency and communication. The FSC meets once a quarter to analyze systemic risks, assess the cyclical position of the financial sector, and make decisions on countercyclical capital buffer and other macroprudential tools. These decisions are communicated via a press release. Twice per year, FSC meetings are followed by a press conference.

A financial stability analysis department was also created in 2017, responsible for macro-financial analyses. With IMF support, the NBG has started developing a macro-financial model, incorporating interlinkages between the real economy and the financial system to analyze financial and macroeconomic risks scenarios, conducting macro-stress tests, and providing analytical support for macro-prudential policy. It has published macroeconomic risk scenarios to assist financial institutions' transition to IFRS 9 accounting rules, which will drive more forward-looking provisioning. The model will also serve as a tool for a renewed financial stability report, which is planned for 2019.



C. Enhancing External Stability to Increase Resilience to External Shocks

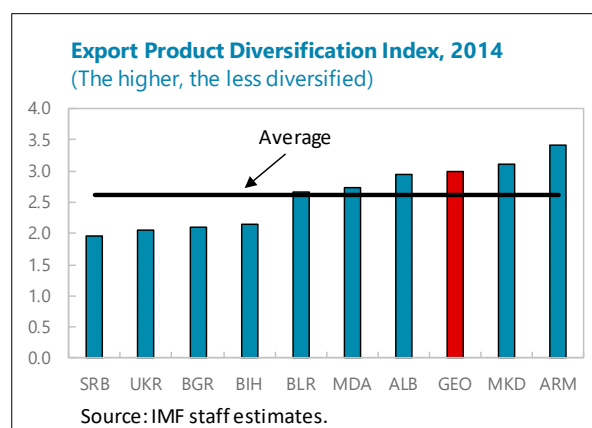
26. Georgia’s external position is broadly in line with fundamentals and desirable policy settings, but subject to vulnerabilities (Annex III). The current account deficit improved significantly, adjusting from 12.8 percent of GDP in 2016 to 8.7 percent of GDP in 2017. The large negative net international investment position (NIIP, estimated at 150 percent of GDP in 2017, Figure 3) poses a vulnerability, although its composition (tilted toward a high share of FDI liabilities, 115 percent of GDP in 2017) is a mitigating factor. External debt (at 96 percent of GDP in 2017, excluding intercompany loans) increased since the last Article IV consultation (92 percent of GDP in 2016), mainly due to bank borrowing and multilateral financing. Public external debt remains anchored around 35 percent of GDP. The authorities agreed that external debt remains vulnerable to large macroeconomic shocks, especially to exchange rate depreciation (Figure 10, Table 11). Efforts to increase reserves and export competitiveness, develop domestic capital markets, and attract foreign investment, coupled with prudent fiscal policy, support external stability.

27. Consistent with the IT framework, the NBG remains committed to the floating exchange rate regime. FX interventions are limited to smoothing out excessive exchange rate volatility and/or building reserves. Staff and the authorities agreed on the need to accumulate reserves as guided by the IMF reserve adequacy metric and considering large external financing requirements. The staff and the authorities agreed on the need to deepen forex market; which will further enhance the role of the exchange rate as a shock absorber.

D. Structural Reforms to Support Higher and More Inclusive Growth

28. The authorities agreed that slower growth and limited inclusiveness reflect structural impediments to growth (Figure 7).

- **Infrastructure.** Infrastructure gaps prevent Georgia from becoming a transit hub and major tourist destination, and firms identify transport as a major business concern. The European Bank of Reconstruction and Development, in its 2017 Transition Report, estimates Georgia’s infrastructure investment needs at about 10 percent of its GDP per year for 2018–22, mainly in transportation and energy.
- **External competitiveness and economic diversification.** Despite strides in trade integration, Georgia's limited production structure results in high export concentration in primary products (metals, wine, and nuts). Product export diversification has not improved since the early 2000s and has been below its peers.¹⁰



¹⁰ Peers are selected based on population size, income, and geographical location. They include Albania, Armenia, Belarus, Bosnia and Herzegovina, Bulgaria, Kosovo, Macedonia, FYR, Moldova, Serbia, and Ukraine.

The current export mix limits the country potential to upgrade its export basket to higher value-added products.

- **Education and labor market efficiency.** Georgia ranks poorly relative to its peers in terms of quality of education and employment, with high employment in (low productivity) agriculture. Georgia's robust growth in the last decade has not been accompanied by job creation, unemployment has remained high, and the youth, especially women, remain outside the labor force. A large share of Georgia's higher-educated youth population is unemployed due to a mismatch between the skills obtained in the education system and those demanded in the labor market. Business surveys indicate that labor skills have increasingly become an obstacle to growth and competitiveness.
- **Despite remarkable progress, the business environment can be further improved.** According to the World Bank Doing Business indicators, Georgia is well positioned in ease of doing business, starting a business, registering property, protecting minority investors, and enforcing contracts. Areas for improvement include resolving insolvency and trading across borders. In addition, the latest Global Competitiveness Indices highlight that Georgia could improve innovation and business sophistication.

29. The authorities and staff agreed on the need to prioritize structural reforms to improve infrastructure, competitiveness, and education. The authorities noted that their Four-Point Reform Plan is designed to address structural bottlenecks to growth. It aims to improve infrastructure, education, and government efficiency, and promote private-sector activity. Staff underscored the opportunity to accelerate efforts to close structural gaps with comparator countries in line with the Plan (Figure 7). In improving road infrastructure, the authorities aim to supplement public investment with private investment under the new PPP framework. On education, the authorities are already modernizing vocational training, but substantive reforms are needed to improve input and output quality at all levels of education. Infrastructure and education reforms, complemented by reforms that make conducting business easier and that improve the efficiency in the labor market, would enhance productivity and competitiveness, and potential growth. Under the assumptions that all investment is employed productively and that the sustainability of public finances is preserved, staff estimates suggest that implementing a comprehensive structural reform package could accelerate growth by 0.7 percentage points annually, driven by increased investment and productivity, to raise GDP by 5 percent in the long run.¹¹

30. Reforming education and strengthening labor market policies will be critical to achieve robust and inclusive growth.¹² Advancing education reform is essential to adapt skills to labor market demands and to increase productivity. Staff agreed with the authorities that, in the absence of a comprehensive reform, unemployment and skills mismatch will create a drag on growth.

¹¹ See accompanying Selected Issues Paper (SIP) "Assessing the Growth Impact of Macroeconomic and Structural Reforms in Georgia". The reform package considers a fiscal policy package which intends to incentivize private investment, a scaling-up of public investment, improvement in government's efficiency, and an education reform. Simulations suggest that the reform package is beneficial to the economy, with the education reform having sizable effects on productivity over the long run.

¹² See accompanying SIP "Georgia's Labor Market and Education System".

Education reform should entail (1) raising the quality of early childhood education, (2) improving learning outcomes, (3) enhancing vocational and on-the-job training and supporting lifelong learning, (4) strengthening science and technology, and (5) bolstering education sector management. Labor market policy should aim to (1) provide more information on labor market needs, (2) enhance labor matching services, and (3) encourage a greater participation of women in the labor force. Education reform and labor market policies, however, should be fiscally sustainable (¶18 above).

31. Efforts are needed to promote export product diversification. Compared to peers, Georgia fares well in terms of export market diversification, thanks to free trade agreements. However, Georgia’s export product diversification is relatively low due to its narrow production base. A product space analysis shows that weaknesses in Georgia’s productive factors, including limited skills and technological know-how constrain the country’s potential to upgrade its exports to higher value-added products. The analysis also suggests that Georgia could diversify to exports in dairy products, meat, furniture, and metals. Mobilizing FDI in export-oriented sectors is instrumental to enhancing competitiveness, reducing external vulnerabilities, and generating balanced growth. Increasing productivity, promoting innovation, and better institutions can help expand Georgia’s current capacity to diversify its exportable products.¹³

32. Institutional reforms are also needed to enhance the role of the private sector as the driver of strong and sustained growth. The authorities are working with donors on a judiciary reform that would lead to a modern, efficient, and transparent judiciary system, which would help improve the business environment and mobilize investment. The authorities are also working on an insolvency law, which would make the economy more efficient by permitting a timely and adequate exit of companies as well as strengthening the rehabilitation framework for viable companies. Staff also highlighted the need to level the economic playing field. This would help prevent high market concentration—for example, in banking and health services—from translating into noncompetitive practices that could limit entry of new market participants and investment.

33. Capital market development and initiatives to promote domestic savings would mobilize savings and support private sector-led growth. Low savings reflect not only low living standards but a lack of investment vehicles. A more developed capital market—supported by enhanced transparency, reduced transaction costs, and additional investment vehicles—would help mobilize savings and financing. To develop the domestic capital market, the authorities are preparing a framework for establishing investment funds and primary dealers, and expanding financial instruments (derivatives and securitization). The central bank is also upgrading the market infrastructure to facilitate the settlement of transactions for Georgian securities. Advancing the capital market reform would complement the Pillar II pension reform and the new PPP law to mobilize financing for investment.¹⁴ Finally, in coordination with development partners, the authorities are exploring modalities to promote financing for small and medium enterprises (SMEs).

¹³ See accompanying SIP “Georgia’s Path to Economic Diversification”.

¹⁴ The pension reform is currently discussed in Parliament. To enhance the prospective benefits from the reform, staff has argued for strengthening the composition of the pension agency’s supervisory board, ensuring the independence of the investment board, and devising enforcement.

Access to finance appears to be an important constraint for private sector-led activity, with about one-fifth of companies considering access to finance a significant obstacle to business operations.¹⁵ Staff highlighted the importance of targeted and market-based initiatives with any public financial support incorporated transparently in the budget, and that can be easily dismantled in the future.

DISCUSSIONS FOR SECOND REVIEW UNDER EXTENDED FUND FACILITY

The authorities expressed their firm intention to implement their 2018 fiscal policy commitments. The monetary policy stance was assessed as appropriate to bring inflation toward the target by the end of 2018. Efforts to adopt and implement structural reforms are being stepped up (including pension reform, PPP law, insolvency law, crisis management framework, and revenue administration).

A. Policy Discussions

Fiscal Policy

34. The program envisages an end-December deficit ceiling of GEL1,150 million (2.8 percent of GDP) in 2018. Compared to the first review, higher revenues will be used to refund additional VAT credits (0.5 percent of GDP), increase capital spending (0.1 percent of GDP; ₾16), and narrow the deficit by a small amount. Staff supports the authorities' plans to double repayments related to VAT refunds in 2018, to GEL400 million, compared to the level envisaged under the budget (TMU, ₾14).

	2016		2017		2018		
	Actual	1st Review	Actual	Difference	1st Review	Projected	Difference
Total revenue	9,623	10,760	11,051	291	11,470	11,571	101
Tax revenue	8,750	9,634	9,909	275	10,260	10,360	100
Other revenue	592	758	838	80	800	800	0
Grants	282	368	304	-64	410	411	2
Total expenditure	10,168	11,174	11,248	74	12,061	12,231	170
Current spending	8,817	9,180	9,194	15	9,590	9,585	-4
Net acquisition of nonfinancial assets	1,351	1,995	2,054	60	2,472	2,646	174
Budget lending	481	913	915	2	614	480	-134
Augmented net lending / borrowing 2/	-1,025	-1,328	-1,113	215	-1,206	-1,140	65
Memorandum items							
Primary current spending	8,414	8,684	8,713	28	9,030	9,032	2
Operational balance 3/	806	1,580	1,857	277	1,880	1,986	106
Public debt (percent of GDP)	44.4	42.3	44.9	2.6	42.7	42.8	0.1
Nominal GDP	34,028	37,260	38,042	782	40,148	41,410	1,262

Sources: Ministry of Finance; and Fund staff estimates.
1/ GFSM 2001
2/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing minus budget lending.
3/ Total revenues minus current spending.

¹⁵ For details, see "Neighborhood SME Financing: Georgia", European Investment Bank (February 2016); and "Recommendations for Georgia's SME Development Strategy, 2016-20". Project Report Working Group on SME Development Strategy, OECD (March 2016).

35. The authorities are advancing reforms to strengthen revenue administration (MEFP, ¶111). Georgia's Revenue Service (GRS) headquarters were restructured into a functions-based organization (**SB, February 2018**). The new structure is organized into core units, which will help improve filing compliance and audit capacity. The authorities will also submit to parliament a revised penalty regime with penalties that will vary with the degree of culpability (**new SB, December 2018**). To strengthen risk-based analysis, the authorities will provide the GRS with access to third-party information from relevant government agencies, including the National Agency of Public Registry and municipalities.

36. The authorities plan to address the backlog of VAT credits (MEFP, ¶111). They expressed their intention to reduce the stock of VAT credits eligible for a cash refund by at least 50 percent by end-2021, but expressed concerns about the impact on the deficit. The new specialized VAT unit focusing on reviewing and auditing VAT claims (**SB, June 2018**) will support the streamlining of the refund process. For newly declared VAT credits, the authorities plan to introduce a new electronic risk-assessment system and to automatically refund—if requested by tax payers and if there are no outstanding tax liabilities—VAT credits on 90 percent of the declarations with the lowest risk score (**new SB, June 2019**). The declarations with the highest risk scores (10 percent) will be reviewed and, if necessary, audited by the new VAT unit.

37. To safeguard fiscal sustainability, the authorities are taking action to contain fiscal risks and improve the fiscal rule (MEFP, ¶112–13). The 2019 FRS will expand the analysis of fiscal risks stemming from SOEs, PPPs, and PPAs (**new SB, December 2018**). For PPAs, the FRS will disclose the annual aggregate exposure during the projects' life span, while for SOEs two-year financial projections will be presented. Following the newly approved PPP law, the government will issue secondary legislation to limit direct negotiations and unsolicited tenders in line with FAD TA recommendations (**new SB, December 2018**). The law envisages protecting the gatekeeper role of the MoF. The authorities are assessing the legal and/or regulatory changes needed to centralize the supervisory powers on SOEs under the MOESD and MoF. They are also committed to strengthening the Public Investment Management Framework (PIMF). The authorities will also submit to parliament a new fiscal rule framework (**new SB, December 2018**).

38. Staff welcomed the authorities' plan to upgrade fiscal reporting (MEFP, ¶113). The authorities will upgrade the public finances presentation from GFSM2001 to GFSM2014. For the 2019 budget, the authorities will apply the guidelines for new budget lending operations requiring reasonable expectation of commercial returns—if the commercial return test is not met, equity injections will be treated as subsidies or transfers. In addition, the MoF plans to fully incorporate LEPLs' revenues and expenditures in the 2019 state budget.

Monetary and Exchange Rate Policy

39. The NBG envisages further strengthening of the monetary and exchange rate policies (MEFP, ¶114–17). The inflation targeting framework helps safeguard price stability, and staff agreed with the NBG on the need to sustain efforts to enhance liquidity management and the transmission mechanism. The flexible exchange rate regime helps protect the economy against external shocks, and the authorities remain committed to building up international reserves. The favorable external

position allowed for higher reserve accumulation in 2017. Reflecting this, the authorities agreed to increase the NIR target for end-June 2018 to \$1.49 billion, and to establish the target for end-December 2018 at \$1.55 billion.

Financial Sector Policy

40. Financial sector reforms are progressing (MEFP ¶118–26). The authorities met their commitments for the second review (MEFP Table 3). In addition, with help from MCM TA, the central bank introduced regulation and started supervision of non-bank financial institutions. The prudential regulation framework for microfinance institutions (MFIs) will be finalized by June 2018 and the non-prudential regulation to other lenders will become effective in January 2019. To strengthen asset valuation, the NBG will introduce regulations on banks' real estate appraisal of collateral in line with international valuation standards (**SB, June 2018**) and on banks' corporate governance in line with Basel principles (**SB, September 2018**), and leverage ratios based on Basel Principles and relevant EU regulations (**SB, September 2018**). To strengthen the crisis management framework, the authorities will submit to Parliament legal amendments to establish the emergency liquidity assistance and bank resolution frameworks (**new SB, May 2019**). The NBG is also preparing guidelines to assess household credit worthiness.

Structural Policies

41. The authorities underscored the need to implement a comprehensive structural reform agenda to support robust and inclusive growth (MEFP, ¶127–34). The reforms aim at scaling infrastructure and improving education, the business environment, foreign trade relations, and land reform. Successful implementation of the reform program will help boost long-term growth, diversify the economy, strengthen the external position, create jobs, and reduce poverty.

42. The authorities are taking actions to advance reforms. An independent pension agency is being created (**SB, June 2018**), although parliamentary discussions may delay this somewhat. The government will also submit to Parliament legislation (prepared in consultation with the IMF) that would establish a rule-based mechanism to index basic pensions (**new SB, February 2019**). The Business House, to be established in 2019, will create a one-stop shop for businesses. The authorities also plan to introduce IFRS for corporations to standardize financial reporting and promote a deeper domestic capital market, and submit to Parliament a new insolvency law (April 2019) to support restructuring of viable non-financial corporations.¹⁶

B. Program Modalities

43. The authorities and staff agreed on modifying targets for one quantitative performance criterion and updating conditionality in support of the program's objectives (MEFP, Tables 1–4). It is proposed to increase the floor on the NIR target to \$1.49 billion by end-June 2018 and to establish the end-December target at \$1.55 billion. **New SBs** are proposed for **end-December 2018** on (1) expanding the 2019 FRS; (2) adopting a decree to implement the PPP

¹⁶ The IMF provided technical assistance on the insolvency law reform in May 2018.

law; (3) submitting to Parliament a revised penalty regime for taxpayers; and (4) submitting to Parliament a new fiscal rule framework. In addition, new SBs are proposed for 2019 on (1) submitting to Parliament a proposal for a rule-based mechanism to index basic pensions (**end-February 2019**); (2) submitting to parliament legal amendments to strengthen the crisis management framework (**end-May 2019**); and (3) refunding automatically 90 percent of the validated VAT refund requests, upon request and after offsetting against existing tax liabilities (**end-June 2019**).

44. Financing assurances are in place for the second review. The program is fully financed for the next 12 months, with support from the European Union and Agence Française de Développement. Good financing prospects are in place for the remainder of the program.

45. Georgia's capacity to repay remains adequate. Georgia's debt profile continues to warrant low scrutiny under the Emerging Market Debt Sustainability Analysis. Debt service to the IMF will remain manageable. Repayments to the IMF would peak at 0.4 percent of GDP or 1.9 percent of gross reserves in 2018, reflecting obligations under the previous Stand-by arrangement (Table 8).

46. Risks to the program are manageable. While the improved growth outlook may reduce short-term fiscal and external risks, it could lead to complacency in the implementation of the structural reform agenda. The authorities' strong commitment and ownership of the program provide mitigate these risks.

47. The NBG continues to maintain a strong safeguards framework (MEFP, ¶35). With the approval of the NBG Organic Law by Parliament in December 2017, the NBG has implemented the Fund's safeguards recommendations.

48. Negotiations of arrears with Turkmenistan continue. Arrears to Turkmenistan predate the program and were covered under the Paris Club Agreement. The authorities continue negotiations on penalties.

STAFF APPRAISAL

49. The improved macroeconomic environment provides an opportunity to cement macroeconomic and financial stability, and to advance structural reforms to achieve higher and more inclusive growth. External demand and domestic consumption have supported Georgia's growth momentum, but risks to the outlook remain. Inflation has declined toward the NBG target, the external position has strengthened, and the fiscal position has improved. The banking sector remains liquid, profitable, and well capitalized. Maintaining the growth momentum requires prudent macroeconomic policies, strengthened financial sector resilience, and comprehensive structural reforms to remove obstacles to growth—poor infrastructure, limited production base, and significant skill mismatches.

50. To maintain fiscal prudence while creating space for investment in infrastructure and human capital, current spending needs to be contained, revenue administration improved, and fiscal risks managed. The 2018 budget appropriately supports fiscal consolidation. Going forward, given the limited scope for increasing tax rates on a permanent basis, financing additional public

investment requires a multi-pronged approach involving containing current spending, improving revenue administration, and strengthening public investment management. Also, advancing institutional fiscal reforms—including revamping the fiscal rule and expanding the monitoring of fiscal risks—is key to improving fiscal efficiency and accountability.

51. Monetary policy remains rightly focused on price stability, supported by exchange rate flexibility. The monetary policy stance is appropriate, and close monitoring of price and wage pressures, as well as developments in monetary and financial conditions, should continue. The inflation targeting framework, combined with the floating exchange rate regime, has served Georgia well. Foreign exchange interventions should remain limited to smooth excessive exchange rate volatility and to build reserves. Steps to strengthen liquidity management and improve communication will help further improve the monetary policy framework and support exchange rate flexibility. The gradual de-dollarization of the economy signals increased credibility of the authorities' monetary policy framework and progress on anchoring inflation expectations.

52. Building on reforms to strengthen financial resilience, further efforts are needed to bring the crisis management framework in line with international best practices. The authorities have already taken significant steps to increase the resilience of the financial sector. The central bank has expanded the perimeter of regulation and supervision, and gained powers to supervise banks on a consolidated basis. Measures to encourage responsible lending by financial institutions will help contain household indebtedness, especially for low-income households with non-verifiable income. Concerns about dollarization should be addressed with targeted and market-based prudential measures that help internalize FX risks. The authorities have established deposit insurance, requested banks to prepare contingency plans, and introduced an early intervention mechanism. Going forward, consideration should be given for establishing a crisis management framework, including an emergency liquidity assistance, that could guide the decision-making process in times of systemic stress.

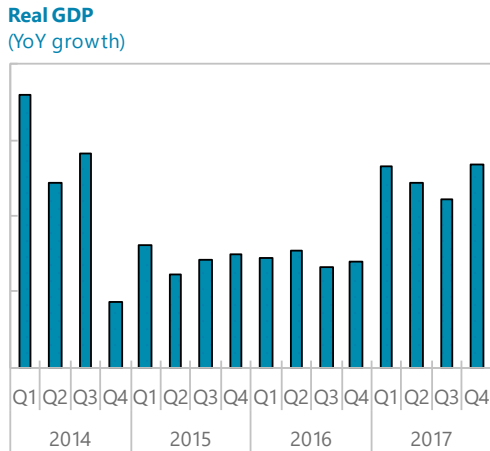
53. Structural reforms should focus on improving infrastructure, competitiveness, and education. Implementing the authorities' structural agenda is essential for Georgia to achieve higher and more inclusive growth. In line with the authorities' Four-Point reform plan, reforms should focus on improving infrastructure, competitiveness, and education. Strong implementation of the new PPP framework will help mobilize private investment. Improving the business climate will increase productivity and competitiveness, and strengthen the external position. The new insolvency law for non-financial corporations and the Business House are good steps in this direction. The authorities are modernizing vocational training, but major further reforms are needed to improve education at all levels.

54. Staff supports the authorities' request for the completion of the Second Review under the Extended Fund Facility and the modification of a quantitative performance criterion. Strong implementation of macroeconomic policies and structural reforms provides confidence that the program will meet its objectives. Staff supports modifying the end-June 2018 NIR target, and establishing the end-December 2018 quantitative performance criteria.

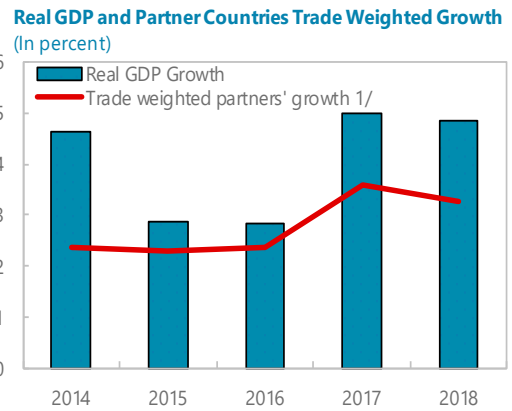
55. Staff recommends that the Article IV Consultation with Georgia takes place on the 24-month cycle, in accordance with Decision No. 14747-(10/96) on consultation cycles.

Figure 1. Georgia: Real Sector and Inflation Developments

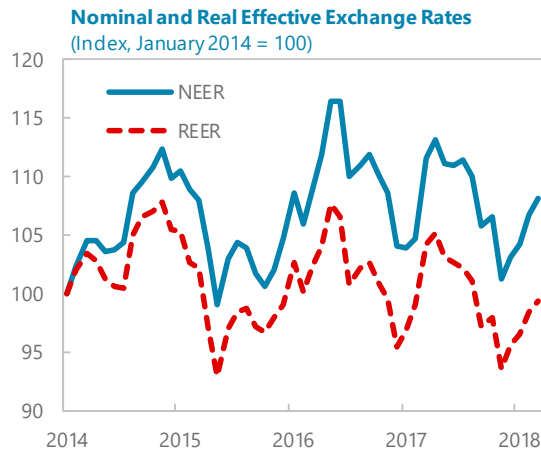
Growth has accelerated ...



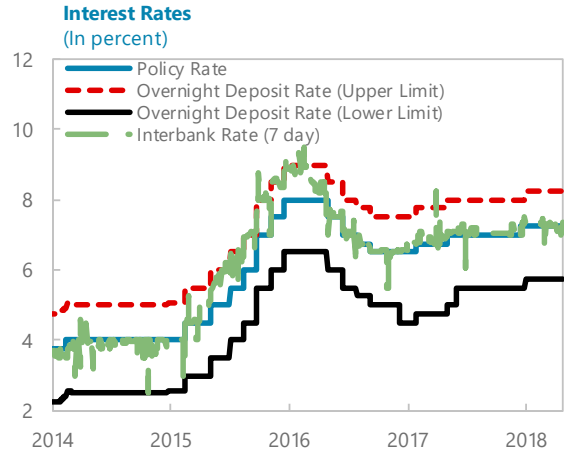
... supported by the recovery of the external environment.



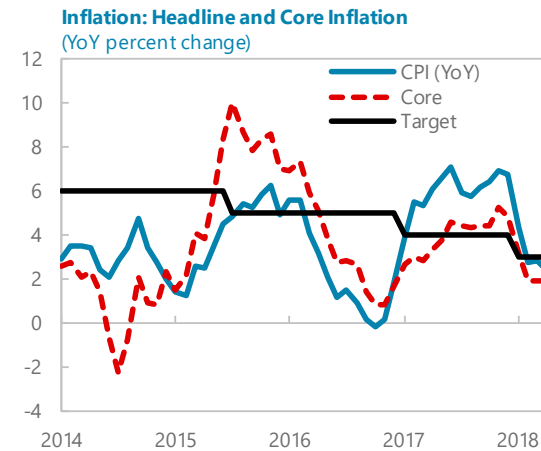
The lari started appreciating since the end of 2017.



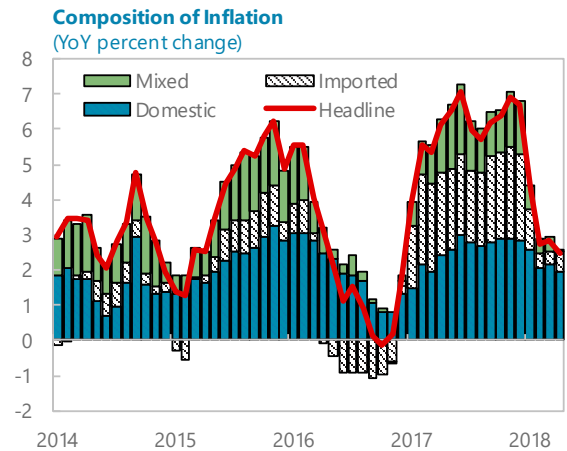
The NBG increased the policy rate to 7.25 percent in 2017, ...



... which helped keep inflation below target, ...



... also thanks to lower imported inflation since early 2018.

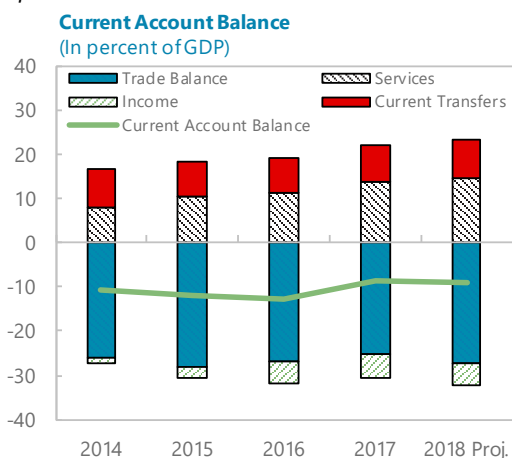


Sources: National authorities; and IMF staff calculations.

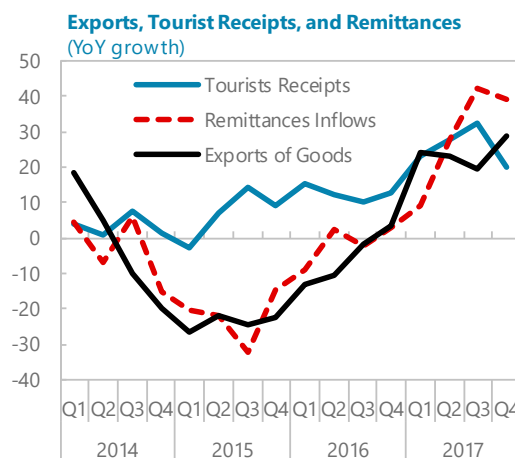
1/ Partner countries' growth is computed using trade-weighted real GDP growth of the largest 20 trading partner countries.

Figure 2. Georgia: External Sector Developments

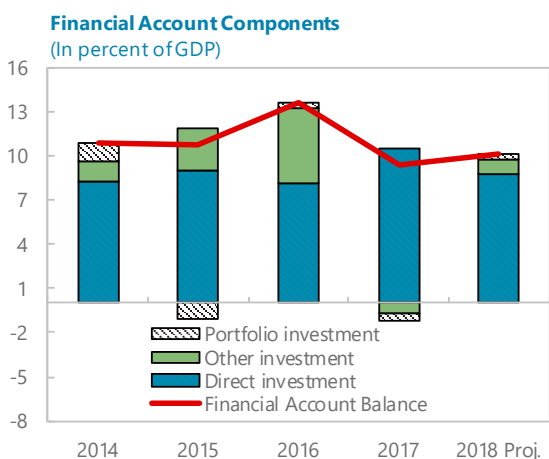
The current account deficit remains high, but it improved in 2017...



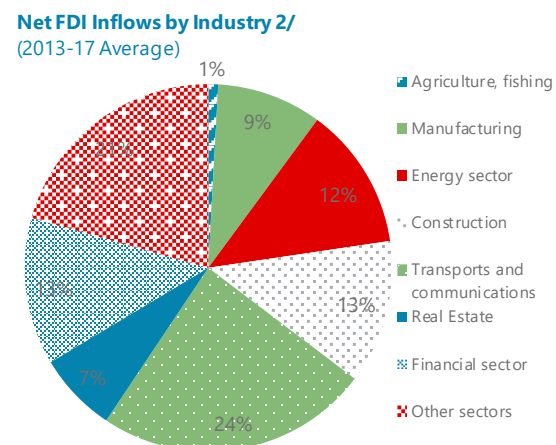
... thanks to exports, tourism, and remittances.



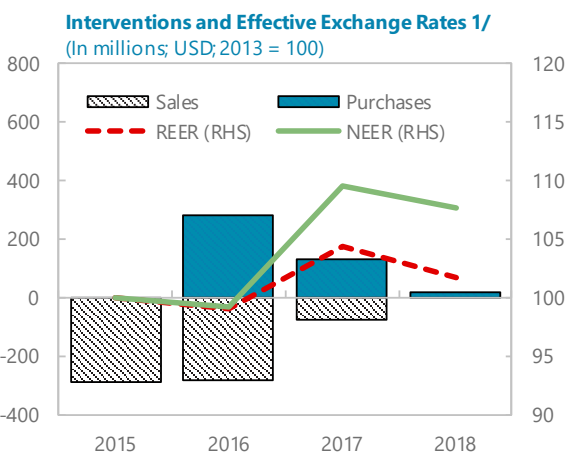
Direct investment remained the dominant source of financial inflows in 2017, ...



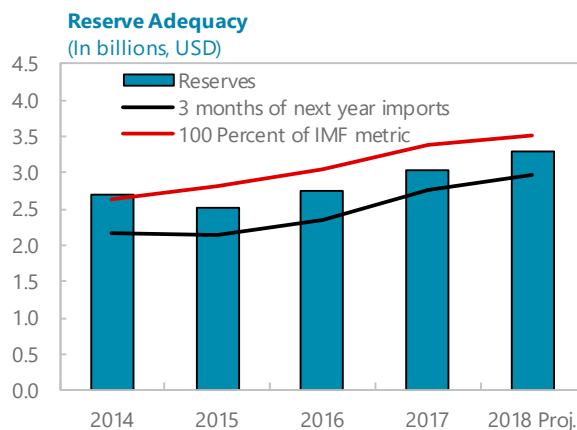
... and was concentrated in transport and energy sectors.



NBG's intervention is mostly two-sided.



Despite increasing, reserves remained low.



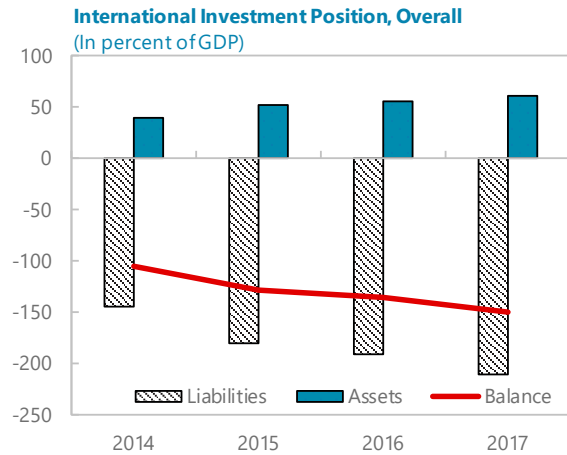
Sources: National authorities; GEOSTAT; and IMF staff estimates.

1/ Interventions for 2018 are as of April.

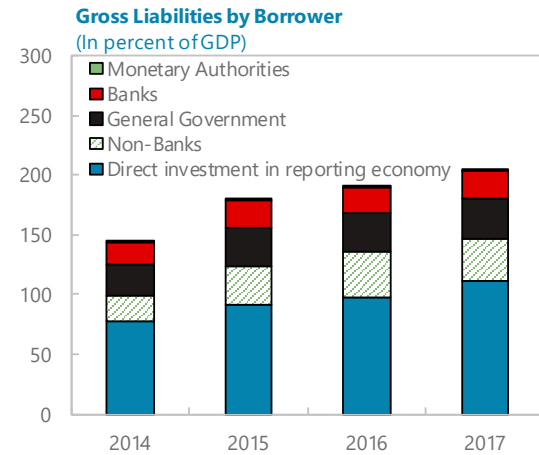
2/ 2017 data is preliminary.

Figure 3. Georgia: International Investment Position (IIP)

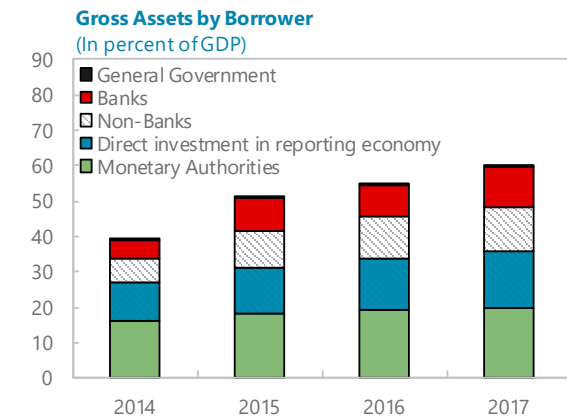
Net IIP continued to deteriorate in 2017, ...



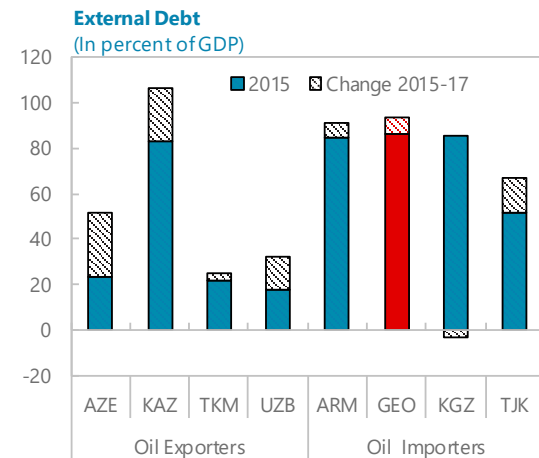
... mostly due to higher FDI, ...



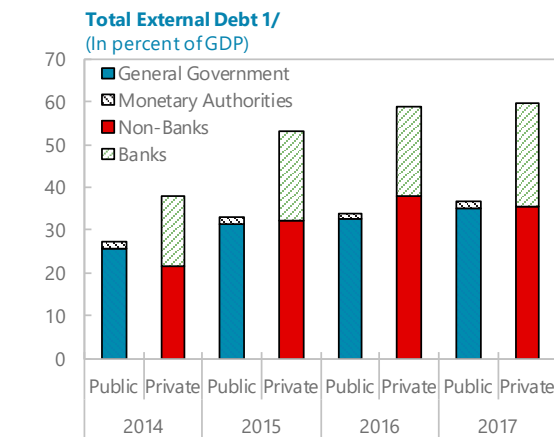
...while foreign assets increased especially in the banking and non-banking sectors.



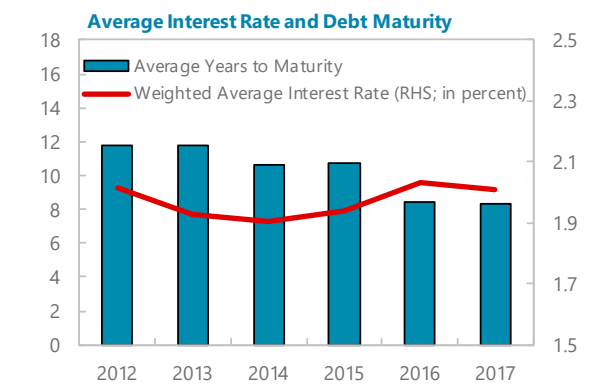
Georgia's external debt has slightly increased, in line with other oil importers in the Caucasus.



External debt dynamics are driven by the private sector.



External public debt long maturity and low interest rates.

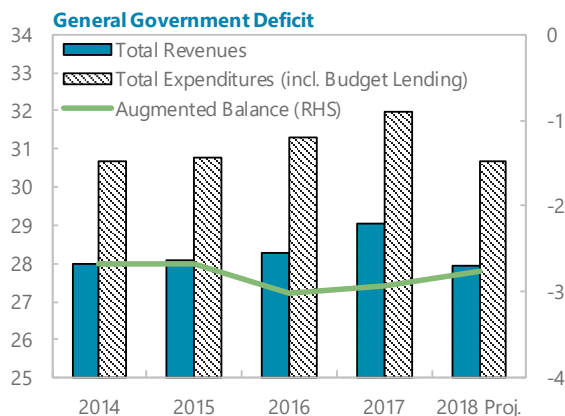


Sources: National authorities; World Economic Outlook; and IMF staff estimates.

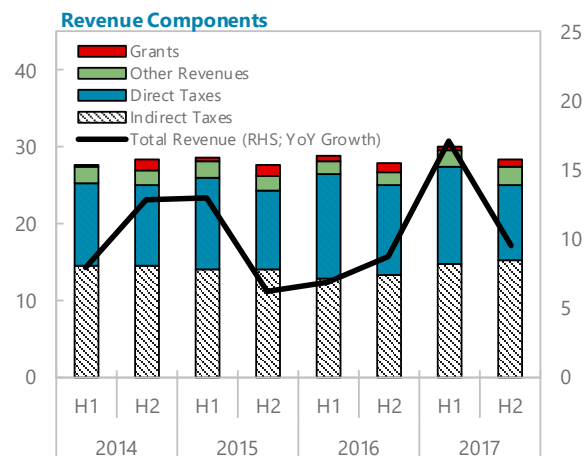
1/ Excludes intercompany lending.

Figure 4. Georgia: Fiscal Sector Developments
(In percent of GDP)

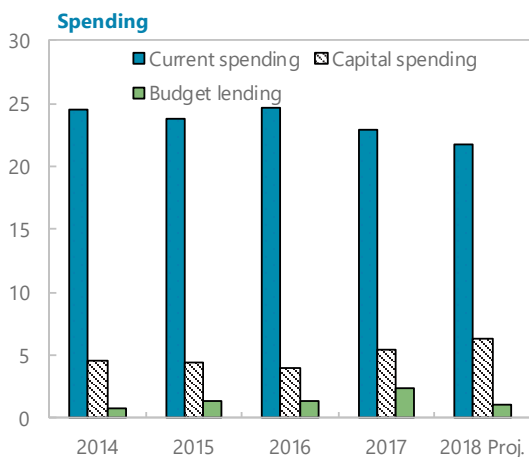
The augmented fiscal balance has improved since 2016, ...



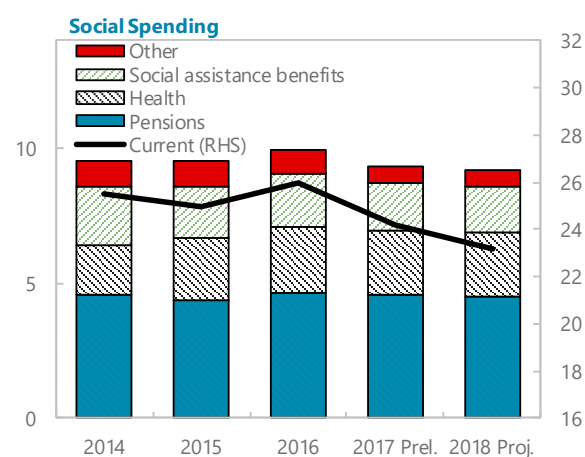
... driven by strong revenue performance ...



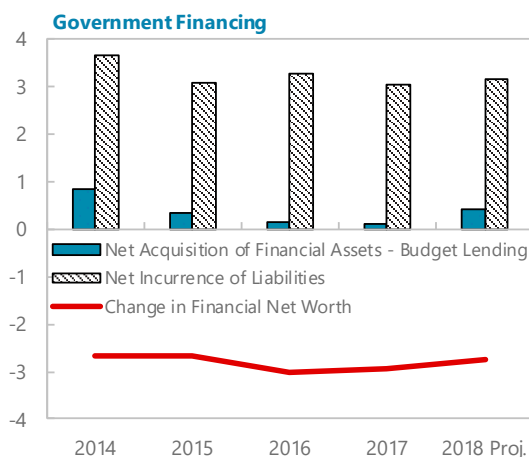
... and contained current spending. Public investment is expanding.



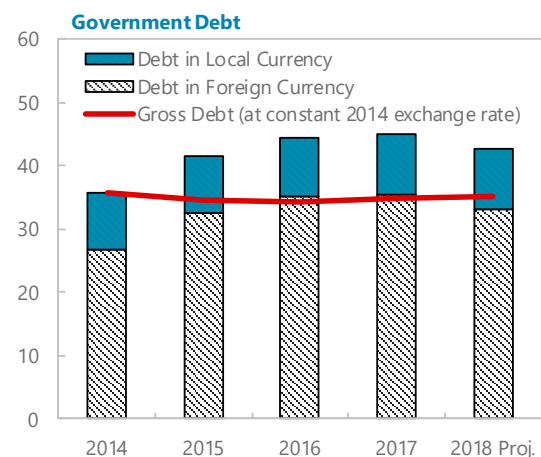
Social spending remains an important component of current spending.



Financing needs have been relatively stable.



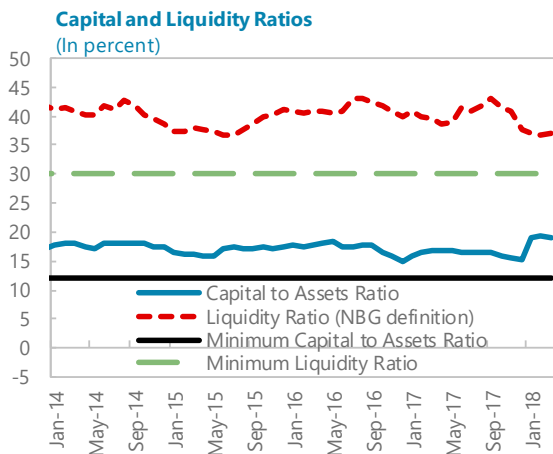
Public debt, below 45 percent of GDP is exposed to FX risks.



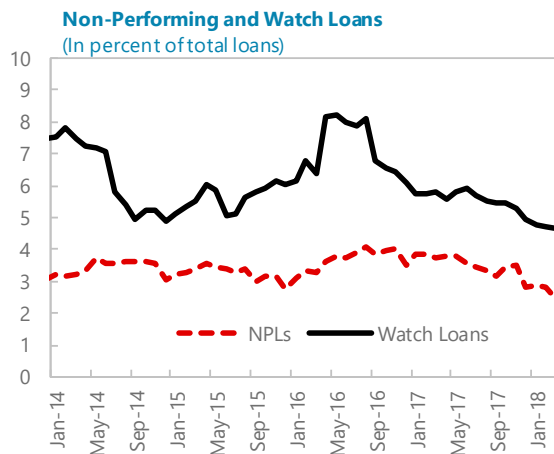
Sources: National authorities; and IMF staff estimates.

Figure 5. Georgia: Financial Sector Developments

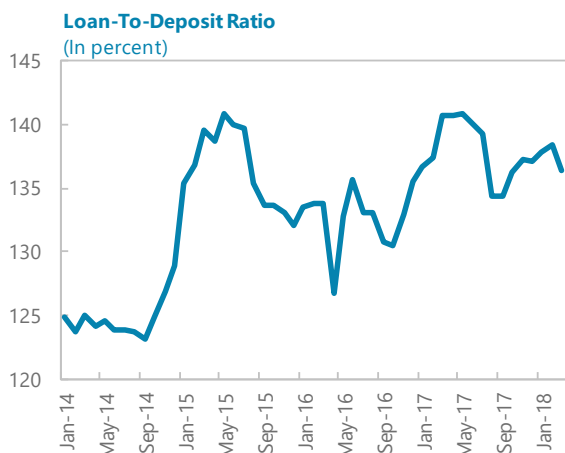
Banks are liquid and well capitalized, ...



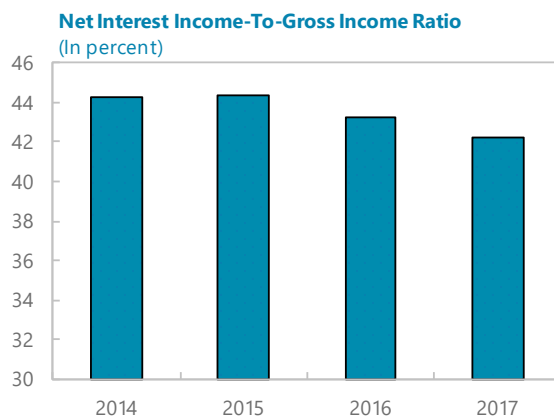
... and NPLs and watch loans are declining.



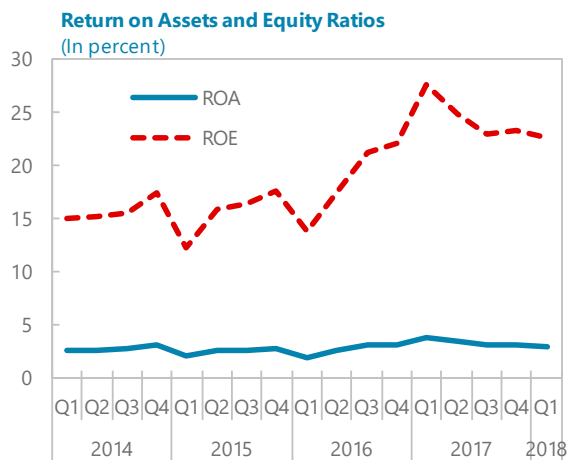
Supporting high profitability, ...



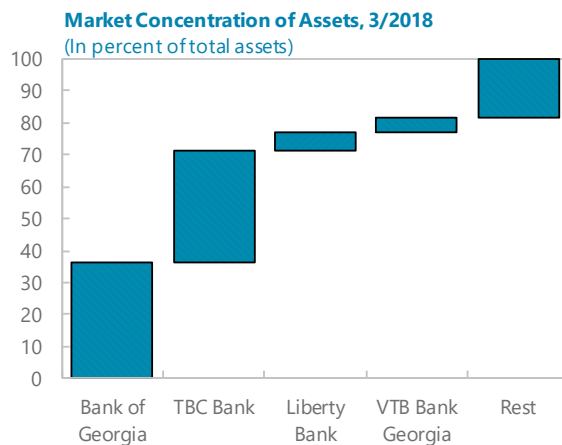
Although declining, financial performance continues to be strong, ...



... supporting high profitability, ...



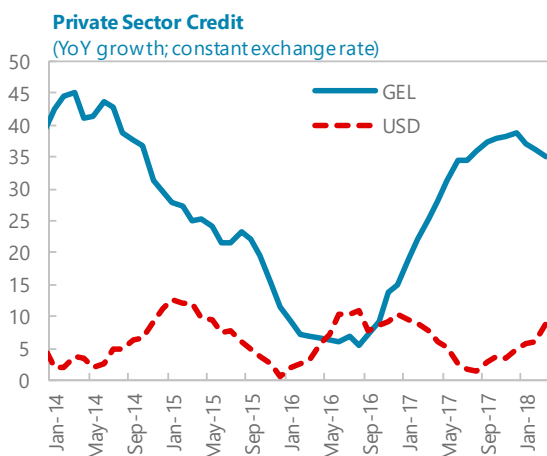
... in the context of a highly concentrated market.



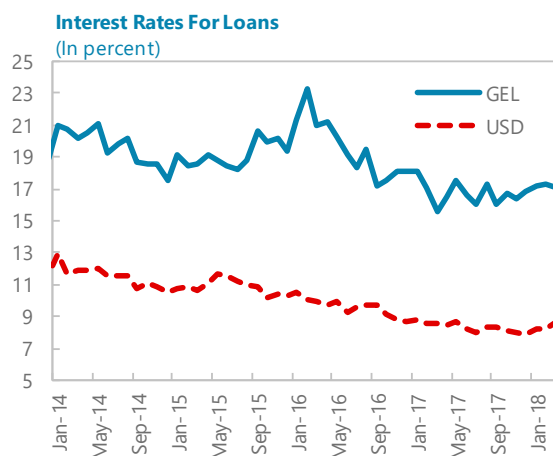
Sources: National Bank of Georgia; and IMF staff calculations.

Figure 5. Georgia: Financial Sector Developments (concluded)

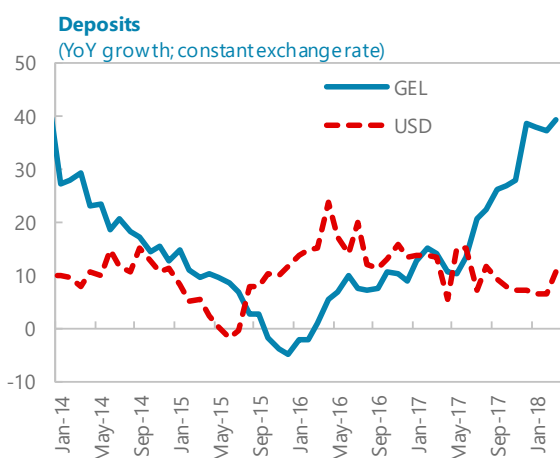
Credit to the private sector has accelerated since mid-2016, ...



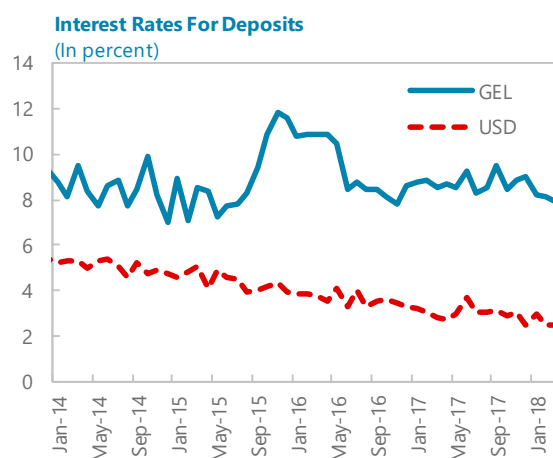
... and lending rates have remained broadly stable.



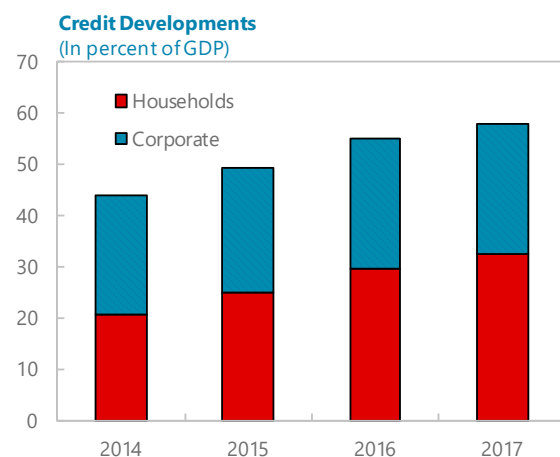
Domestic currency deposits continue to grow, ...



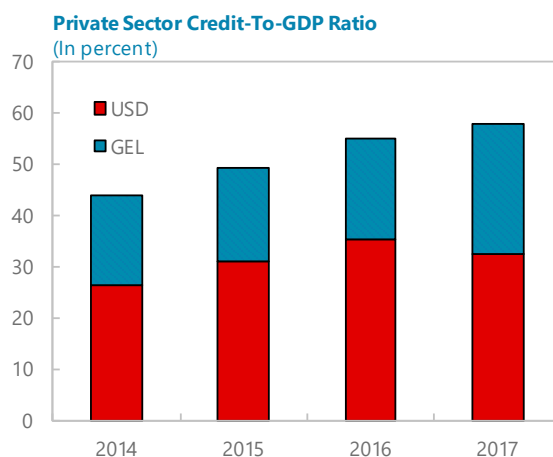
... while interest rates on deposits have remained flat.



Credit developments are driven by credit to households, ...



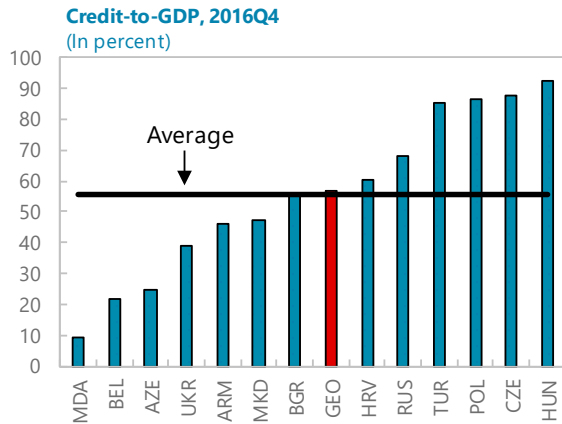
... with an increasing share of loans in local currency.



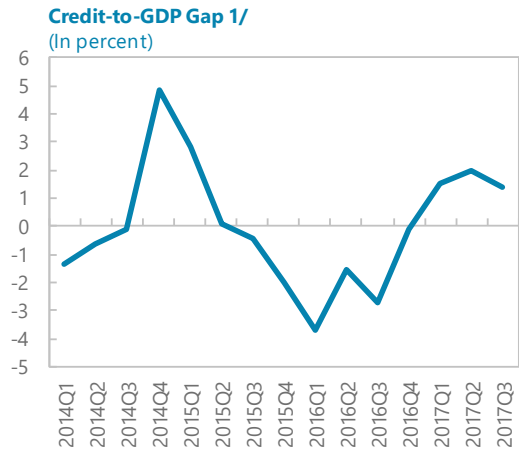
Sources: National Bank of Georgia; and IMF staff calculations.

Figure 6. Georgia: Macro-Financial Developments

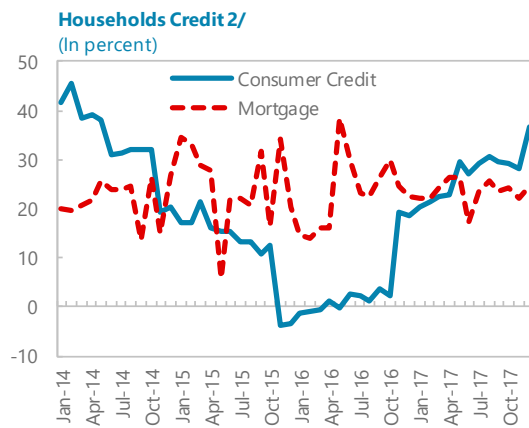
Georgia's credit to GDP is comparable to peers...



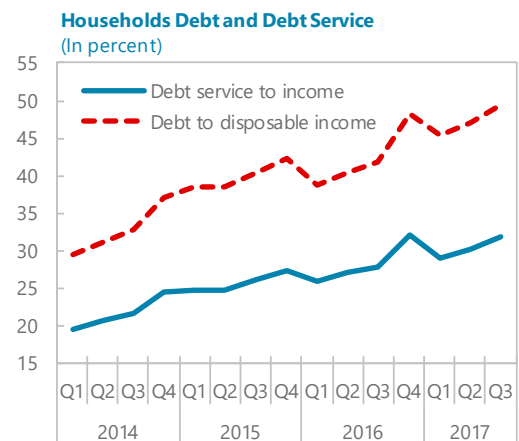
... and the credit gap is closing



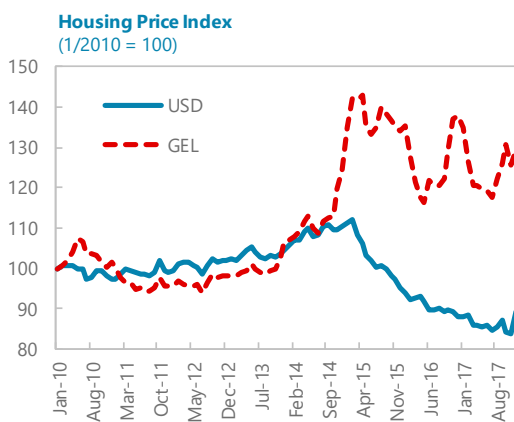
Household debt has been driven by consumer and mortgage loans.



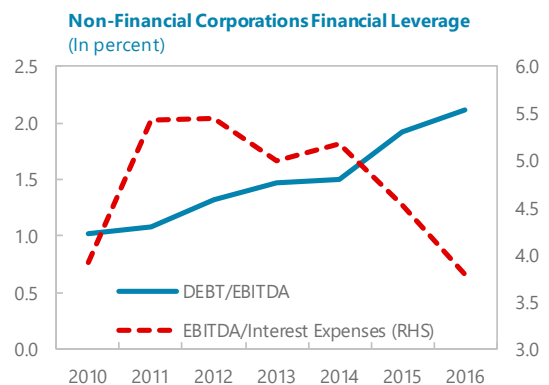
While household debt is increasing, debt service remains manageable.



There are no signs of pressures in the real estate market, ...



... neither of debt service pressures in the non-financial corporate sector.

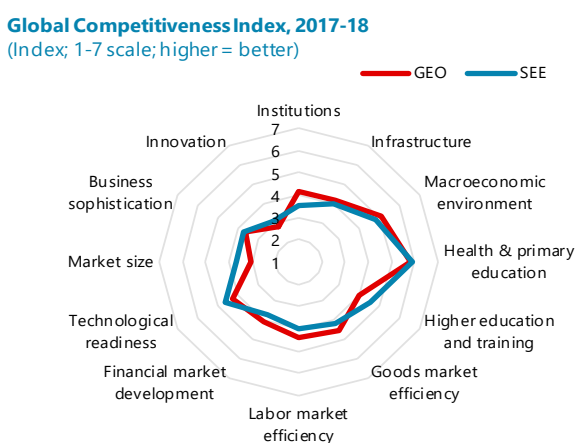
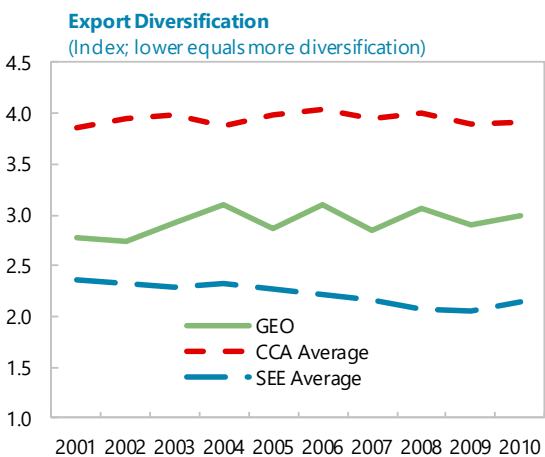
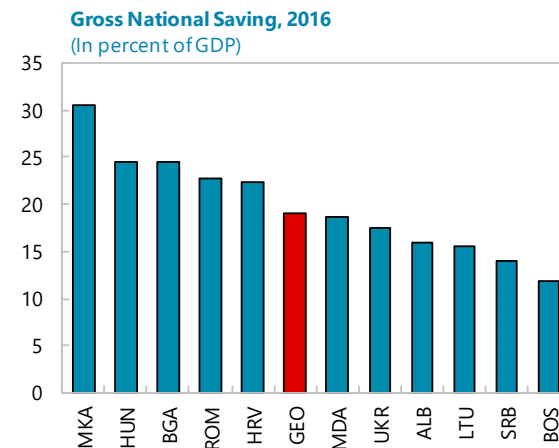
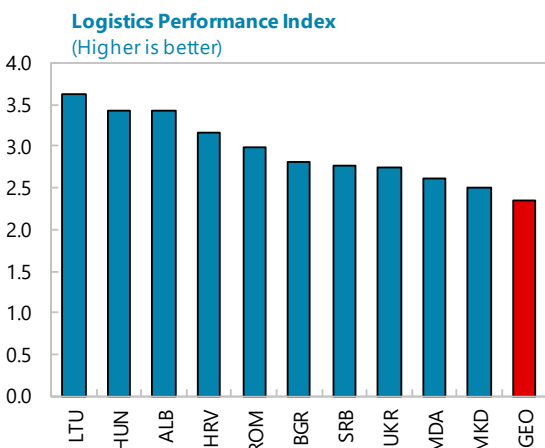
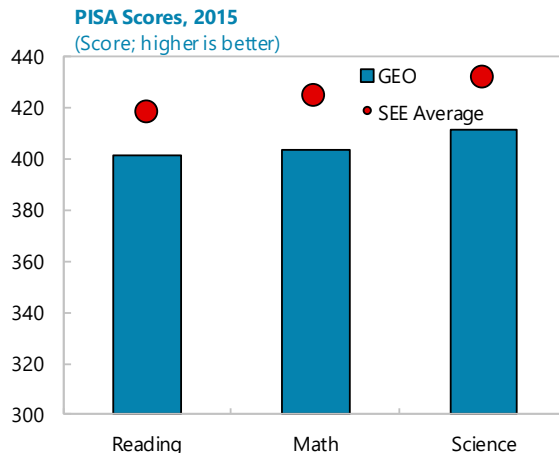
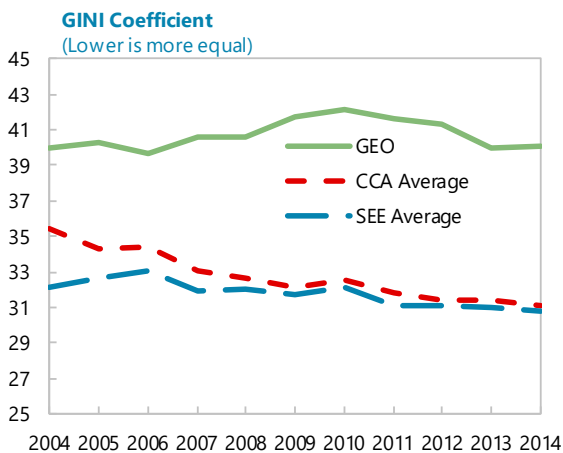


Sources: National Bank of Georgia; and IMF staff calculations.

1/ The Hodric-Prescott Filter was used to remove the cyclical components of credit-to-GDP time-series.

2/ In the fourth quarter of 2015, the NBG reclassified consumer loans from 'by product' to 'by aim.'

Figure 7. Georgia: Macro-Structural Challenges

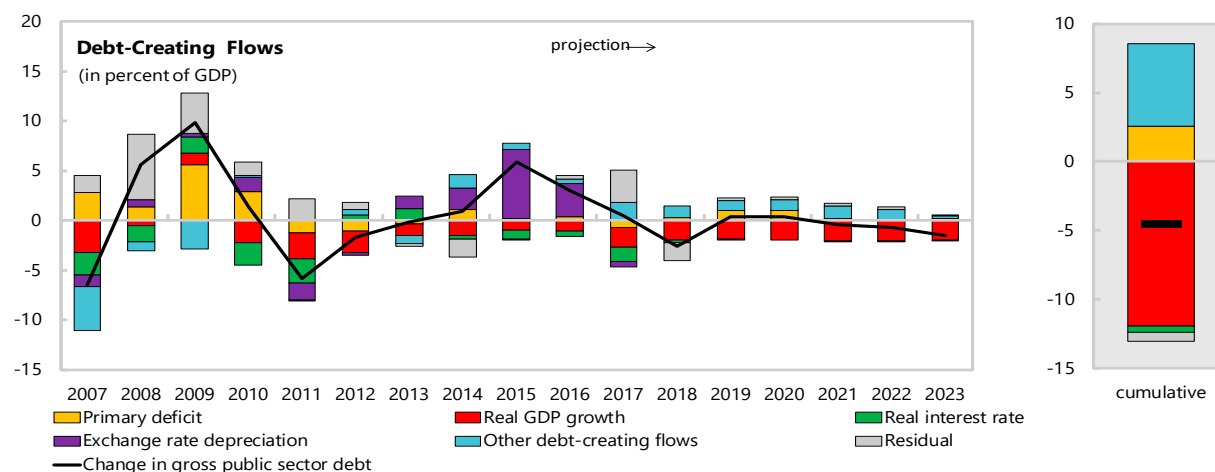


Sources: National Bank of Georgia; and IMF staff calculations.

Figure 8. Georgia: Public Sector Debt Sustainability Analysis (DSA)
(In percent of GDP; unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}										As of May 02, 2018	
	Actual			Projections								Sovereign Spreads
	2007-2015 ^{2/}	2016	2017	2018	2019	2020	2021	2022	2023	EMBIG (bp) ^{3/}	
Nominal gross public debt	35.9	44.4	44.9	42.3	42.6	43.0	42.5	41.8	40.3		217
Public gross financing needs	4.4	4.9	4.3	6.1	6.2	6.3	8.0	5.5	5.6		384
Real GDP growth (in percent)	4.7	2.8	5.0	4.8	4.8	5.0	5.2	5.2	5.2	Ratings	Foreign Local
Inflation (GDP deflator, in percent)	5.0	4.2	6.5	3.8	3.3	3.0	3.0	3.0	3.0	Moody's	Ba2 Ba2
Nominal GDP growth (in percent)	10.0	7.2	11.8	8.9	8.2	8.1	8.4	8.4	8.3	S&Ps	BB- BB-
Effective interest rate (in percent) ^{4/}	2.8	3.1	3.2	3.4	3.3	3.2	2.9	3.1	3.1	Fitch	BB- BB-

Contribution to Changes in Public Debt											
	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023		
Change in gross public sector debt	1.0	3.0	0.4	-2.6	0.3	0.4	-0.4	-0.7	-1.5	-4.5	
Identified debt-creating flows	-0.6	2.6	-2.8	-0.8	0.0	0.1	-0.7	-0.9	-1.6	-3.9	
Primary deficit	1.2	0.4	-0.7	0.3	1.0	1.0	0.2	0.0	0.2	2.6	-1.7
Primary (noninterest) revenue and grants	28.6	28.3	29.0	27.9	27.3	27.2	27.2	27.1	27.0	163.8	
Primary (noninterest) expenditure	29.9	28.7	28.3	28.2	28.3	28.2	27.4	27.2	27.2	166.4	
Automatic debt dynamics ^{5/}	-1.1	1.7	-3.9	-2.3	-1.9	-1.9	-2.2	-2.1	-2.0	-12.4	
Interest rate/growth differential ^{6/}	-2.2	-1.6	-3.4	-2.3	-1.9	-1.9	-2.2	-2.1	-2.0	-12.4	
Of which: real interest rate	-0.7	-0.5	-1.4	-0.3	-0.1	0.0	-0.1	0.0	-0.1	-0.5	
Of which: real GDP growth	-1.5	-1.1	-2.0	-2.0	-1.9	-2.0	-2.1	-2.0	-2.0	-11.9	
Exchange rate depreciation ^{7/}	1.1	3.3	-0.5	...	...	...	...	...	...	...
Other identified debt-creating flows	-0.7	0.5	1.8	1.2	1.0	1.0	1.3	1.1	0.3	5.9	
GG: Privatization and Drawdown of d	-1.5	-0.9	-0.6	0.1	-0.1	0.0	0.4	0.2	-0.6	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
GG: Net acquisition of financial asset	0.8	1.4	2.4	1.2	1.1	1.0	0.9	0.9	0.9	5.9	
Residual, including asset changes ^{8/}	1.6	0.4	3.3	-1.8	0.3	0.3	0.2	0.2	0.1	-0.7	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

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

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+g\pi)]$ 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).

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

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

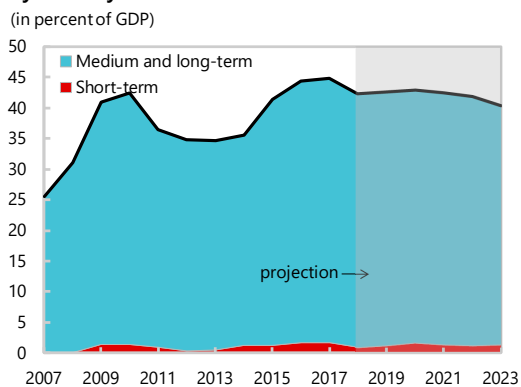
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ 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.

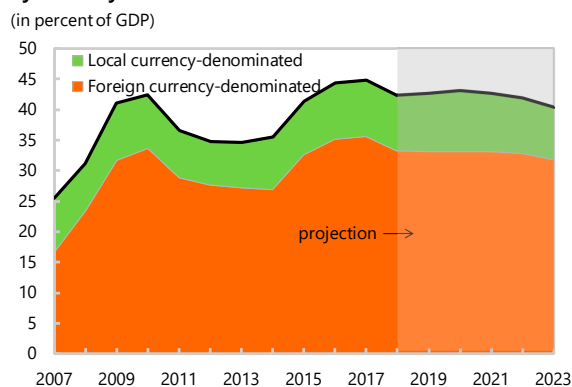
Figure 9. Georgia: Public Debt Sustainability Analysis—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity



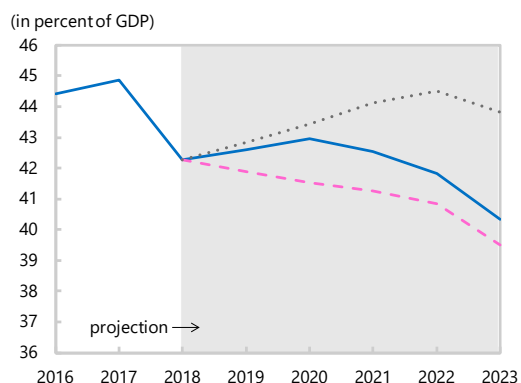
By Currency



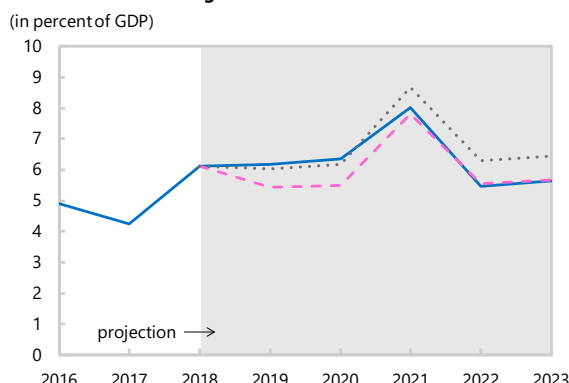
Alternative Scenarios

— Baseline Historical - - - Constant Primary Balance

Gross Nominal Public Debt



Public Gross Financing Needs

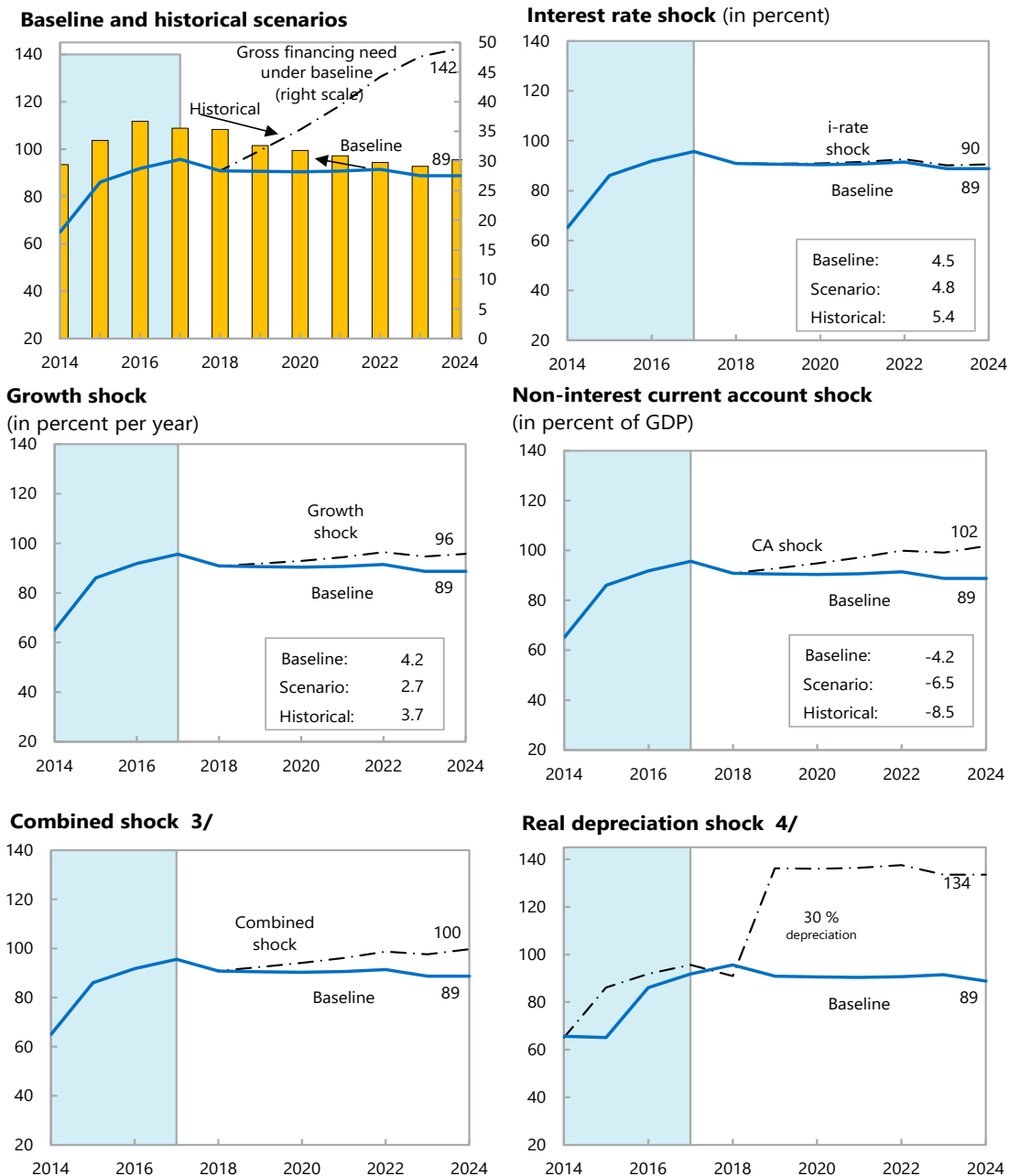


Underlying Assumptions
(in percent)

	2018	2019	2020	2021	2022	2023
Baseline Scenario						
Real GDP growth	4.8	4.8	5.0	5.2	5.2	5.2
Inflation	3.8	3.3	3.0	3.0	3.0	3.0
Primary Balance	-0.3	-1.0	-1.0	-0.2	0.0	-0.2
Effective interest rate	3.4	3.3	3.2	2.9	3.1	3.1
Constant Primary Balance Scenario						
Real GDP growth	4.8	4.8	5.0	5.2	5.2	5.2
Inflation	3.8	3.3	3.0	3.0	3.0	3.0
Primary Balance	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Effective interest rate	3.4	3.3	3.2	2.9	3.1	3.1
Historical Scenario						
Real GDP growth	4.8	3.7	3.7	3.7	3.7	3.7
Inflation	3.8	3.3	3.0	3.0	3.0	3.0
Primary Balance	-0.3	-0.8	-0.8	-0.8	-0.8	-0.8
Effective interest rate	3.4	3.3	3.0	2.5	2.5	2.3

Source: IMF staff.

Figure 10. Georgia: External Debt Sustainability: Bound Tests 1/ 2/
(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 2018.

Table 1. Georgia: Selected Economic and Financial Indicators, 2015–23

	2015	2016	2017	2017	2018	2018	2019	2020	2021	2022	2023
	Actual		EFF 1st Review	Prel.	EFF 1st Review			Projections			
National accounts and prices (annual percentage change; unless otherwise indicated)											
Real GDP	2.9	2.8	4.3	5.0	4.2	4.8	4.8	5.0	5.2	5.2	5.2
Nominal GDP (in billion of laris)	31.8	34.0	37.3	38.0	40.1	41.4	44.8	48.4	52.5	56.9	61.6
Nominal GDP (in billion of U.S. dollars)	14.0	14.4	15.0	15.2	16.3	16.9	18.3	19.8	21.5	23.3	25.2
GDP per capita (in thousand of U.S. dollars)	3.8	3.9	4.1	4.1	4.4	4.5	4.9	5.3	5.8	6.3	6.9
GDP deflator, period average	5.9	4.2	5.4	6.5	3.4	3.8	3.3	3.0	3.0	3.0	3.0
CPI, Period average	4.0	2.1	5.8	6.0	2.8	2.8	2.9	3.0	3.0	3.0	3.0
CPI, End-of-period	4.9	1.8	5.6	6.7	3.2	2.7	3.0	3.0	3.0	3.0	3.0
Investment and saving (in percent of GDP)											
Gross national saving	19.5	19.9	20.6	23.2	22.5	25.5	26.0	26.7	27.2	27.4	26.9
Investment	31.5	32.7	31.0	31.9	33.1	34.7	35.2	35.5	35.6	35.2	34.5
Public	5.6	5.0	5.8	6.1	6.5	6.8	7.4	8.1	8.2	8.0	8.0
Private	25.9	27.7	25.2	25.8	26.6	27.9	27.7	27.4	27.4	27.3	26.5
Consolidated government operations (in percent of GDP)											
Revenue and grants	28.1	28.3	28.9	29.0	28.6	27.9	27.3	27.2	27.2	27.1	27.0
o.w. Tax revenue	25.1	25.7	25.9	26.0	25.6	25.0	24.7	24.8	25.0	25.0	25.0
Expenditures	32.0	32.5	33.0	32.7	32.0	31.1	31.0	30.8	29.9	29.7	29.3
Current expenditures	25.0	26.0	24.7	24.2	24.0	23.1	22.5	21.7	20.8	20.8	20.5
Capital spending and budget lending	7.0	6.5	8.3	8.5	8.1	7.9	8.5	9.1	9.1	8.9	8.8
Net Lending/Borrowing (GFSM 2001)	-1.3	-1.6	-1.1	-0.5	-1.5	-1.6	-1.5	-1.5	-1.5	-1.4	-1.3
Augmented Net lending / borrowing (Program definition) 1/	-2.7	-3.0	-3.6	-2.9	-3.0	-2.8	-2.6	-2.5	-2.4	-2.3	-2.2
Public debt	41.4	44.4	42.3	44.9	42.7	42.8	43.5	44.0	43.6	42.8	41.2
o.w. NBG debt to the IMF	...	...	0.5	0.6	1.0	0.5	1.0	1.1	1.0	0.9	0.7
o.w. Foreign-currency denominated	32.5	35.1	33.1	35.6	34.0	33.2	33.1	33.1	33.1	32.8	31.6
Money and credit (in percent; unless otherwise indicated)											
Credit to the private sector (annual percentage change)	22.1	19.6	10.1	17.6	14.3	14.1	10.6	10.5	9.0	8.4	8.3
In constant exchange rate	4.3	12.0	15.5	20.1	14.3	18.0	10.7	10.5	9.0	8.4	8.3
Broad money (annual percentage change)	19.2	20.4	9.8	14.8	15.0	12.6	11.0	10.4	9.8	9.3	9.3
Broad money (incl. fx deposits, annual percentage change)	23.4	19.1	7.9	13.7	13.4	10.5	10.0	9.7	9.2	9.2	9.2
In constant exchange rate	5.1	13.3	14.7	16.9	15.0	16.2	11.1	10.4	9.8	9.3	9.3
Deposit dollarization (in percent of total)	66.8	69.9	64.8	63.7	64.1	59.7	57.5	55.1	54.0	52.6	50.8
Credit dollarization (in percent of total)	63.1	64.6	54.7	56.1	54.1	50.7	48.3	47.4	46.5	45.6	44.7
Credit to GDP	49.2	54.9	55.3	57.8	58.5	60.6	61.9	63.3	63.6	63.6	63.6
External sector (in percent of GDP; unless otherwise indicated)											
Current account balance	-12.0	-12.8	-10.4	-8.7	-10.6	-9.2	-9.2	-8.8	-8.4	-7.8	-7.5
Trade balance	-28.1	-26.9	-25.8	-25.3	-26.4	-27.2	-27.1	-27.2	-26.8	-26.3	-25.9
Terms of trade (ratio)	100.0	98.9	99.1	96.1	99.3	94.3	94.5	94.7	95.0	95.9	96.7
Gross international reserves (in billions of US\$)	2.5	2.8	3.2	3.0	3.4	3.3	3.6	4.0	4.3	4.8	5.3
In percent of IMF Composite measure (floating)	89.9	90.9	93.3	90.1	95.2	93.3	98.8	105.2	110.2	118.7	126.2
Gross external debt	107.6	109.3	106.9	112.8	106.4	107.9	107.9	108.1	108.7	109.8	108.5
Gross external debt, excl. intercompany loans	86.1	91.8	87.4	95.6	86.5	90.9	90.6	90.4	90.7	91.5	88.8
Laris per U.S. dollar (period average)	2.27	2.37	2.5	2.51	...	...	...	...	...	...	...
Laris per euro (period average)	2.52	2.62	2.8	2.83	...	...	...	...	...	...	...
REER (period average; CPI based, 2010=100)	104.0	107.5	...	...	...	...	...	...	...	...	...

Sources: Georgian authorities; and Fund staff estimates.

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

Table 2. Georgia: Summary Balance of Payments, 2015–23

	2015	2016	2017	2017	2018	2018	2019	2020	2021	2022	2023
	Actual		EFF 1st Review	Prel.	EFF 1st Review			Projections			
(in millions of U.S. dollars)											
Current account balance	-1,681	-1,840	-1,563	-1,316	-1,729	-1,555	-1,681	-1,738	-1,796	-1,827	-1,899
Trade balance	-3,935	-3,869	-3,881	-3,841	-4,292	-4,582	-4,968	-5,391	-5,769	-6,134	-6,535
Exports	3,099	2,931	3,495	3,630	3,810	4,205	4,516	4,831	5,222	5,622	5,885
Imports	-7,034	-6,800	-7,376	-7,471	-8,102	-8,786	-9,484	-10,221	-10,991	-11,756	-12,420
Services	1,458	1,620	1,966	2,069	2,174	2,494	2,743	3,037	3,333	3,612	4,011
Services: credit	3,133	3,351	3,874	4,026	4,253	4,709	5,089	5,535	6,002	6,477	7,053
Services: debit	-1,675	-1,731	-1,908	-1,957	-2,079	-2,216	-2,346	-2,499	-2,669	-2,865	-3,042
Income	-323	-714	-834	-816	-848	-880	-960	-991	-1,076	-1,136	-1,145
Of which: interest payments	-490	-519	-503	-506	-561	-546	-579	-620	-642	-709	-621
Transfers	1,120	1,122	1,186	1,271	1,237	1,413	1,504	1,608	1,716	1,831	1,770
Of which: remittances credit	588	579	653	750	699	903	966	1,034	1,106	1,189	1,264
Capital account	64	58	86	109	60	82	81	80	78	77	75
General government	59	54	61	83	60	82	80	78	77	75	74
Financial account	1,506	1,950	1,575	1,299	1,761	1,531	1,797	1,936	2,065	2,264	2,326
Direct investment (net)	1,267	1,177	1,377	1,594	1,459	1,480	1,678	1,826	1,993	2,197	2,400
Portfolio investment (net)	-154	41	36	-71	50	50	50	50	50	50	50
Equity	5	-15	-40	-53	0	0	0	0	0	0	0
Debt securities	-158	56	75	-18	50	50	50	50	50	50	50
Loans (net)	724	1,004	380	355	551	458	465	519	612	635	551
Short-term loans (net)	-4	269	24	17	35	18	15	17	17	19	21
Public	3	2	2	3	2	3	3	3	3	3	3
Private	-6	267	22	15	33	15	13	14	15	16	19
Medium and long-term loans (net)	728	735	356	338	515	440	450	502	595	617	530
Public 1/	345	281	217	238	358	276	316	400	555	574	461
Private	382	453	140	100	157	164	134	102	40	42	69
Bank	103	239	105	194	76	138	115	82	65	46	64
Non-bank	279	215	34	-95	81	26	18	19	-25	-4	5
Others (net) 2/	-331	-272	-217	-579	-298	-457	-396	-459	-590	-618	-675
Errors and omissions	-88	27	7	-65	0	0	0	0	0	0	0
Overall balance	-199	194	106	26	93	58	197	278	347	513	502
Financing	199	-194	-369	-212	-255	-253	-330	-371	-343	-495	-468
Gross International Reserves (-increase)	99	-245	-384	-242	-251	-248	-330	-371	-343	-495	-468
Use of Fund Resources 3/	-73	-14	...	...	...	...	...	...	...	...	...
Rescheduled debts and arrears clearance	173	64	15	30	-5	-5	0	0	0	0	0
Financing gap	...	...	264	192	163	195	133	93	-4	-18	-33
Proposed use of Fund Resources	...	...	70	71	28	29	37	45	-4	-18	-33
Proposed IMF EFF	...	...	83	84	85	87	88	45	0	0	0
Repayment 3/	...	...	-13	-13	-56	-58	-51	0	-4	-18	-33
Official creditors	...	...	193	121	135	166	96	48	0	0	0
World Bank	...	...	107	106	0	0	0	0	0	0	0
EU	...	...	15	15	18	44	0	0	0	0	0
AFD	...	...	72	0	117	122	96	48	0	0	0
Memorandum items:											
					(In percent of GDP)						
Current account balance	-12.0	-12.8	-10.4	-8.7	-10.6	-9.2	-9.2	-8.8	-8.4	-7.8	-7.5
Trade balance	-28.1	-26.9	-25.8	-25.3	-26.4	-27.2	-27.1	-27.2	-26.8	-26.3	-25.9
Financial account	10.8	13.6	10.5	8.6	10.8	9.1	9.8	9.8	9.6	9.7	9.2
Foreign direct investment (net)	9.1	8.2	9.2	10.5	9.0	8.8	9.1	9.2	9.3	9.4	9.5
External financing requirement	36.4	38.5	35.6	36.1	35.8	34.3	33.6	32.9	32.0	31.1	30.3
Gross international reserves (in billions of USD)	2,521	2,756	3,167	3,039	3,418	3,288	3,618	3,989	4,332	4,827	5,295
in months of next year GNFS imports	3.5	3.5	3.7	3.3	3.8	3.3	3.4	3.5	3.6	3.7	3.9
in percent of short-term debt at remaining maturity	75	71	82	73	83	78	81	84	85	89	91
in percent of broad money and non-resident deposits	37	37	37	36	35	32	32	32	32	33	33
in percent of IMF Composite measure (floating)	90	91	93	90	95	93	99	105	110	119	126
Reserve cover (percent) 4/	40.4	38.6	45.7	43.0	46.1	43.6	45.7	47.5	48.6	51.1	52.6

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

1/ Including general government and monetary authorities

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

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

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

Table 3a. Georgia: General Government Operations, GFSM 2001, 2015–23
(In millions of GEL)

	2015	2016	2017	2017	2018	2018	2019	2020	2021	2022	2023
	Actual		EFF 1st Review	Prel.	EFF 1st Review			Projections			
Revenue	8,923	9,623	10,760	11,051	11,470	11,572	12,226	13,168	14,307	15,447	16,672
Taxes	7,971	8,750	9,634	9,909	10,260	10,360	11,091	12,007	13,131	14,239	15,437
Taxes on income, profits, and capital gains	3,207	3,535	3,625	3,675	3,712	3,869	4,138	4,461	4,820	5,209	5,631
Payable by individuals	2,182	2,479	2,910	2,919	3,112	3,157	3,377	3,650	3,956	4,287	4,645
Payable by corporations	1,025	1,056	715	757	600	712	761	811	863	922	986
Taxes on property	264	363	395	394	426	430	448	484	525	569	616
Taxes on goods and services	4,404	4,756	5,456	5,573	5,869	5,935	6,354	6,868	7,443	8,066	8,739
General taxes on goods and services (VAT)	3,533	3,686	4,046	4,123	4,419	4,532	4,868	5,262	5,703	6,179	6,695
Excises	871	1,070	1,410	1,451	1,450	1,403	1,486	1,606	1,741	1,886	2,044
Taxes on international trade	69	70	69	72	64	70	75	81	87	93	99
Other taxes 1/	26	25	89	195	190	56	74	113	256	302	352
Grants	319	282	368	304	410	411	313	313	304	308	308
Other revenue	634	592	758	838	800	800	823	848	873	899	926
Total Expenditure	9,325	10,168	11,174	11,248	12,061	12,231	13,262	14,282	15,100	16,237	17,501
Expense	7,904	8,817	9,180	9,194	9,590	9,585	10,065	10,498	10,932	11,818	12,642
Compensation of employees	1,602	1,753	1,675	1,649	1,710	1,710	1,759	1,812	1,866	2,022	2,191
Use of goods and services	1,203	1,394	1,450	1,536	1,505	1,505	1,548	1,595	1,642	1,780	1,928
Interest	330	403	495	482	560	554	595	635	709	778	721
External	174	195	221	238	265	284	269	286	308	332	356
Domestic	156	208	274	244	294	270	327	349	401	446	366
Subsidies	671	701	830	871	855	857	881	908	935	1,013	1,098
Grants	84	82	80	64	80	80	82	85	87	95	103
Social benefits	3,037	3,394	3,550	3,544	3,730	3,730	4,016	4,245	4,436	4,807	5,208
Other expense	978	1,090	1,100	1,050	1,150	1,150	1,183	1,219	1,255	1,322	1,393
Net acquisition of nonfinancial assets	1,421	1,351	1,995	2,054	2,472	2,646	3,197	3,784	4,168	4,419	4,859
Increase (capital spending)	1,776	1,718	2,180	2,314	2,622	2,796	3,337	3,914	4,298	4,539	4,909
Decrease (privatization proceeds)	-355	-367	-185	-260	-150	-150	-140	-130	-130	-120	-50
Net lending / borrowing before adjustment	-402	-545	-415	-197	-592	-660	-1,036	-1,114	-792	-790	-830
Unidentified measures	0	0	0	0	0	0	344	407	0	0	0
Net lending / borrowing	-402	-545	-415	-198	-592	-660	-691	-707	-792	-790	-830
Change in net financial worth, transactions	-402	-545	-415	-198	-592	-660	-691	-707	-792	-790	-830
Net acquisition of financial assets ("+" : increase in assets)	552	533	825	954	599	651	578	622	823	754	233
Domestic	552	533	825	954	599	651	578	622	823	754	233
Budget lending	447	481	913	915	614	480	474	504	464	524	530
Deposits (NBG and commercial banks)	105	54	-88	39	-15	171	104	118	359	230	-297
Financial privatization	0	-2	0	0	0	0	0	0	0	0	0
Net incurrence of liabilities ("+" : increase in liabilities)	954	1,078	1,240	1,152	1,190	1,311	1,269	1,330	1,615	1,544	1,063
Domestic	288	331	255	354	113	368	387	234	269	186	20
Securities other than shares	297	345	295	354	153	368	387	234	269	186	20
Loans	-9	-14	-10	0	-10	0	0	0	0	0	0
Foreign	666	747	984	798	1,078	943	882	1,096	1,346	1,358	1,043
Loans	666	747	984	798	1,078	943	882	1,096	1,346	1,358	1,043
Memorandum items:											
Nominal GDP	31,756	34,028	37,260	38,042	40,148	41,410	44,825	48,448	52,506	56,896	61,643
Public debt	13,161	15,113	15,757	17,066	17,145	17,508	19,100	20,815	22,330	23,795	24,863
End-year government deposits	919	973	885	1,012	870	1,183	1,287	1,405	1,764	1,995	1,698
Operating balance	1,019	806	1,580	1,857	1,880	1,986	2,161	2,670	3,376	3,629	4,029
Net lending / borrowing (excluding privatization)	-757	-912	-600	-457	-742	-810	-1,176	-1,244	-922	-910	-880
Augmented Net lending / borrowing (Program definition) 2/	-849	-1,025	-1,328	-1,113	-1,206	-1,140	-1,165	-1,211	-1,256	-1,314	-1,360
Cyclically-adjusted primary balance (Program definition)	-537	-557	-810	-594	-776	-580	-565	-573	-561	-550	-649

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes cash outflows due to tax credit refunds.

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

Table 3b. Georgia: General Government Operations, GFSM 2001, 2015–23
(In percent of GDP)

	2015	2016	2017	2017	2018	2018	2019	2020	2021	2022	2023
	Actual		EFF 1st Review	Prel.	EFF 1st Review		Projections				
Revenue	28.1	28.3	28.9	29.0	28.6	27.9	27.3	27.2	27.2	27.1	27.0
Taxes	25.1	25.7	25.9	26.0	25.6	25.0	24.7	24.8	25.0	25.0	25.0
Taxes on income, profits, and capital gains	10.1	10.4	9.7	9.7	9.2	9.3	9.2	9.2	9.2	9.2	9.1
Payable by individuals	6.9	7.3	7.8	7.7	7.8	7.6	7.5	7.5	7.5	7.5	7.5
Payable by corporations	3.2	3.1	1.9	2.0	1.5	1.7	1.7	1.7	1.6	1.6	1.6
Taxes on property	0.8	1.1	1.1	1.0	1.1	1.0	1.0	1.0	1.0	1.0	1.0
Taxes on goods and services	13.9	14.0	14.6	14.7	14.6	14.3	14.2	14.2	14.2	14.2	14.2
General taxes on goods and services (VAT)	11.1	10.8	10.9	10.8	11.0	10.9	10.9	10.9	10.9	10.9	10.9
Excises	2.7	3.1	3.8	3.8	3.6	3.4	3.3	3.3	3.3	3.3	3.3
Taxes on international trade	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other taxes 1/	0.1	0.1	0.2	0.5	0.5	0.1	0.2	0.2	0.5	0.5	0.6
Grants	1.0	0.8	1.0	0.8	1.0	1.0	0.7	0.6	0.6	0.5	0.5
Other revenue	2.0	1.7	2.0	2.2	2.0	1.9	1.8	1.7	1.7	1.6	1.5
Total Expenditure	29.4	29.9	30.0	29.6	30.0	29.5	29.6	29.5	28.8	28.5	28.4
Expense	24.9	25.9	24.6	24.2	23.9	23.1	22.5	21.7	20.8	20.8	20.5
Compensation of employees	5.0	5.2	4.5	4.3	4.3	4.1	3.9	3.7	3.6	3.6	3.6
Use of goods and services	3.8	4.1	3.9	4.0	3.7	3.6	3.5	3.3	3.1	3.1	3.1
Interest	1.0	1.2	1.3	1.3	1.4	1.3	1.3	1.3	1.4	1.4	1.2
External	0.5	0.6	0.6	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6
Domestic	0.5	0.6	0.7	0.6	0.7	0.7	0.7	0.7	0.8	0.8	0.6
Subsidies	2.1	2.1	2.2	2.3	2.1	2.1	2.0	1.9	1.8	1.8	1.8
Grants	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social benefits	9.6	10.0	9.5	9.3	9.3	9.0	9.0	8.8	8.4	8.4	8.4
Other expense	3.1	3.2	3.0	2.8	2.9	2.8	2.6	2.5	2.4	2.3	2.3
Net acquisition of nonfinancial assets	4.5	4.0	5.4	5.4	6.2	6.4	7.1	7.8	7.9	7.8	7.9
Increase (capital spending)	5.6	5.0	5.8	6.1	6.5	6.8	7.4	8.1	8.2	8.0	8.0
Decrease (privatization proceeds)	-1.1	-1.1	-0.5	-0.7	-0.4	-0.4	-0.3	-0.3	-0.2	-0.2	-0.1
Net lending / borrowing before adjustment	-1.3	-1.6	-1.1	-0.5	-1.5	-1.6	-2.3	-2.3	-1.5	-1.4	-1.3
Unidentified measures	0.0	0.0	0.0	0.0	0.0	0.0	0.8	0.8	0.0	0.0	0.0
Net lending / borrowing	-1.3	-1.6	-1.1	-0.5	-1.5	-1.6	-1.5	-1.5	-1.5	-1.4	-1.3
Change in net financial worth, transactions	-1.3	-1.6	-1.1	-0.5	-1.5	-1.6	-1.5	-1.5	-1.5	-1.4	-1.3
Net acquisition of financial assets ("+" : increase in assets)	1.7	1.6	2.2	2.5	1.5	1.6	1.3	1.3	1.6	1.3	0.4
Domestic	1.7	1.6	2.2	2.5	1.5	1.6	1.3	1.3	1.6	1.3	0.4
Budget lending	1.4	1.4	2.5	2.4	1.5	1.2	1.1	1.0	0.9	0.9	0.9
Deposits (NBG and commercial banks)	0.3	0.2	-0.2	0.1	0.0	0.4	0.2	0.2	0.7	0.4	-0.5
Financial privatization	0.0	0.0	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)	3.0	3.2	3.3	3.0	3.0	3.2	2.8	2.7	3.1	2.7	1.7
Domestic	0.9	1.0	0.7	0.9	0.3	0.9	0.9	0.5	0.5	0.3	0.0
Securities other than shares	0.9	1.0	0.8	0.9	0.4	0.9	0.9	0.5	0.5	0.3	0.0
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	2.1	2.2	2.6	2.1	2.7	2.3	2.0	2.3	2.6	2.4	1.7
Loans	2.1	2.2	2.6	2.1	2.7	2.3	2.0	2.3	2.6	2.4	1.7
Memorandum items:											
Nominal GDP	31,756	34,028	37,260	38,042	40,148	41,410	44,825	48,448	52,506	56,896	61,643
Public debt	41.4	44.4	42.3	44.9	42.7	42.3	42.6	43.0	42.5	41.8	40.3
End-year government deposits	2.9	2.9	2.4	2.7	2.2	2.9	2.9	2.9	3.4	3.5	2.8
Operating balance (before adjustment)	3.2	2.4	4.2	4.9	4.7	4.8	4.8	5.5	6.4	6.4	6.5
Net lending / borrowing (excluding privatization)	-2.4	-2.7	-1.6	-1.2	-1.8	-2.0	-2.6	-2.6	-1.8	-1.6	-1.4
Augmented Net lending / borrowing (Program definition) 2/	-2.7	-3.0	-3.6	-2.9	-3.0	-2.8	-2.6	-2.5	-2.4	-2.3	-2.2
Cyclically-adjusted primary balance (Program definition)	-1.7	-1.6	-2.2	-1.6	-1.9	-1.4	-1.3	-1.2	-1.1	-1.0	-1.1

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes cash outflows due to tax credit refunds.

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

Table 4. Georgia: Monetary Survey 2015–19

	2015		2016		2017		2018		2019	
	June	Dec	June	Dec	June	Dec	June	Dec	June	Dec
Central Bank	(In billions of lari)									
Net foreign assets	3.5	3.7	3.8	3.6	4.0	3.8	3.8	3.2	4.4	
Gross international reserves	6.0	6.7	7.3	7.1	7.9	7.5	8.0	7.3	8.8	
Other foreign assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Foreign currency liabilities	-2.5	-3.0	-3.5	-3.5	-3.9	-3.7	-4.2	-4.1	-4.4	
<i>Of which</i> : use of Fund resources	0.0	0.0	0.0	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4	
<i>Of which</i> : compulsory reserves in USD	-1.7	-2.3	-2.8	-2.6	-2.8	-2.5	-3.0	-2.8	-3.2	
Net domestic assets	-0.6	-0.9	-0.4	-0.3	-0.3	-0.2	0.3	0.7	0.2	
Net claims on general government	-0.4	0.0	-0.5	-0.9	-0.5	-0.3	-0.2	-0.2	-0.1	
Claims on general government (incl. T-bills)	0.5	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.7	
Nontradable govt. debt	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	
Securitized debt (marketable)	0.1	0.2	0.1	0.2	0.2	0.2	0.3	0.3	0.4	
Deposits	-0.9	-0.5	-1.0	-1.4	-1.0	-0.8	-0.8	-0.8	-0.8	
Claims on rest of economy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Claims on banks	0.7	0.2	1.6	1.8	1.7	1.4	1.8	2.2	1.5	
Bank refinancing	1.1	0.4	1.8	1.8	1.8	1.5	1.9	2.3	1.6	
Certificates of deposits and bonds	-0.4	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	
Other items, net	-0.9	-1.0	-1.4	-1.2	-1.5	-1.3	-1.3	-1.3	-1.3	
Banking System	(In billions of lari)									
Net foreign assets	1.0	0.8	1.9	1.8	1.0	0.4	0.3	-0.5	0.6	
NBG	5.2	6.1	6.6	6.1	6.8	6.3	6.8	6.0	7.6	
Commercial banks	-4.3	-5.2	-4.7	-4.3	-5.8	-5.9	-6.4	-6.5	-6.9	
Net domestic assets	12.4	12.5	14.2	13.8	17.4	17.0	20.4	19.9	22.4	
Domestic credit	16.4	17.2	19.6	19.7	22.9	22.7	26.3	26.0	29.4	
Net claims on general government	0.7	1.0	0.9	0.6	0.9	0.9	1.2	1.3	1.7	
<i>Of which</i> : government deposits at NBG	-0.9	-0.5	-1.0	-1.4	-1.0	-0.8	-0.8	-0.8	-0.8	
<i>Of which</i> : T-bills at commercial banks	1.6	1.7	2.0	2.1	2.4	2.5	2.8	2.9	3.2	
Private credit	15.6	16.2	18.7	19.1	22.0	21.9	25.1	24.7	27.8	
Other items, net	-4.0	-4.6	-5.4	-6.0	-5.5	-5.7	-5.9	-6.1	-7.0	
Broad money (M3)	13.3	13.3	16.1	15.6	18.4	17.4	20.7	19.5	23.0	
(Broad money, percent change year on year)	19.2	13.3	20.4	16.6	14.8	11.9	12.6	11.8	11.0	
Lari Broad money (M2)	5.7	6.0	6.5	6.9	8.4	8.6	10.2	9.8	11.7	
Currency held by the public	2.0	2.0	2.4	2.3	2.7	2.6	3.1	2.9	3.4	
Lari resident deposits	3.8	4.0	4.1	4.6	5.7	5.9	7.1	6.8	8.3	
Resident foreign exchange deposits	7.6	7.3	9.6	8.6	10.0	8.9	10.6	9.7	11.3	
Sources of funds of commercial banks	18.7	19.0	21.7	21.3	25.9	24.7	28.1	27.0	30.5	
Resident deposits	11.4	11.3	13.7	13.2	15.7	14.8	17.7	16.5	19.6	
Non-resident deposits	3.1	3.1	3.5	3.6	3.8	3.7	3.8	3.9	4.0	
Other foreign liabilities	4.2	4.6	4.5	4.5	6.3	6.2	6.6	6.6	6.9	
Uses of funds of commercial banks	18.7	19.0	21.7	21.3	25.9	24.7	28.1	27.0	30.5	
Reserves	4.9	4.8	6.3	6.2	6.9	6.3	6.8	6.6	7.1	
Domestic credit	16.7	17.2	20.1	20.6	23.4	23.1	26.5	26.2	29.5	
Lari domestic credit	6.9	6.8	8.0	9.7	11.0	11.5	13.8	14.0	16.1	
Fx domestic credit	9.9	10.4	12.1	11.0	12.3	11.6	12.7	12.2	13.4	
Other foreign assets	0.6	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.5	
Other items, net	-3.0	-3.1	-4.7	-5.5	-4.4	-4.6	-5.2	-5.9	-6.1	
Memorandum items:	(Percent of GDP, unless otherwise indicated)									
Broad money (M3)	42.0	40.6	47.2	43.2	48.4	43.8	50.1	45.2	51.4	
Lari Broad money (M2)	18.1	18.4	19.1	19.2	22.1	21.6	24.6	22.6	26.2	
Currency held by the public	6.2	6.1	7.0	6.5	7.1	6.6	7.4	6.8	7.6	
Non-resident deposits (percent of total deposits)	17.1	16.2	16.6	17.7	16.6	16.6	14.6	15.7	13.9	
Private credit (Percent change, year on year)	22.1	11.5	19.6	18.5	17.6	14.2	14.1	12.8	10.6	
Private credit	49.2	49.1	54.9	53.1	57.8	55.0	60.6	57.4	61.9	
Nominal GDP (billions of lari)	31.8	32.9	34.0	36.0	38.0	39.7	41.4	43.1	44.8	

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

Table 5. Georgia: Selected Monetary and Financial Soundness Indicators, 2015–March 2018

	2015	2016	2017	Mar 2018
Deposit dollarization (residents, in percent)	66.8	69.9	63.7	62.2
Loan-to-deposit ratio (in percent) 1/	103.9	103.6	107.0	107.6
Credit-to-GDP ratio (in percent)	49.2	54.9	57.8	56.5
Capital adequacy ratio (in percent) 2/	17.5	15.0	15.2	19.0
Capital adequacy ratio (in percent) 3/	26.0	23.2	22.5	...
Liquidity ratio (in percent) 4/	41.2	39.7	37.8	37.1
Nonperforming loans (in percent of total loans) 5/	7.5	7.3	6.0	5.6
Nonperforming loans (in percent of total loans) 6/	2.7	3.5	2.8	2.4
Loans collateralized by real estate (in percent of total loans)	54.8	59.2	59.0	58.7
Loans in foreign exchange (in percent of total loans)	64.3	65.4	57.1	55.2
Specific provisions (in percent of total loans)	3.7	3.6	2.8	2.7
Net foreign assets (in percent of total assets)	-13.1	-15.0	-14.9	-15.7
Net open foreign exchange position (in percent of regulatory capital)	-0.6	4.4	4.2	1.2
Return on equity (cumulative through the year, annualized) 7/	15.4	19.2	20.7	20.6
Borrowed funds from abroad-to-GDP ratio 8/	14.1	15.3	16.5	14.2

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

1/ Loans and deposits from the banking sector.

2/ 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.

3/ Basel I definition. This ratio has discontinued end of 2017.

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

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

6/ IMF definition.

7/ Pre tax.

8/ Borrowed funds include Subordinated Debt.

Table 6. Georgia: External Vulnerability Indicators, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
	Actual		Prel.			Projections			
Value of exports of goods and services, percent change	-12.1	0.8	21.9	16.4	7.8	7.9	8.3	7.8	6.9
Value of imports of goods and services, percent change	-13.5	-2.0	10.5	16.7	7.5	7.5	7.4	7.0	5.7
Terms of trade (deterioration -)	31.0	-1.1	-2.8	-1.9	0.2	0.2	0.3	0.9	0.9
Current account balance (percent of GDP)	-12.0	-12.8	-8.7	-9.2	-9.2	-8.8	-8.4	-7.8	-7.5
Capital and financial account (percent of GDP)	11.2	14.0	10.0	10.5	10.8	10.4	10.0	10.1	9.5
External public debt (percent of GDP)	32.8	33.4	36.1	35.5	35.5	35.7	35.7	35.6	34.6
(in percent of exports of goods and services)	73.6	76.4	71.4	67.2	67.9	68.3	68.4	68.5	67.4
Debt service on external public debt									
(in percent of exports of goods and services)	4.3	3.9	3.7	4.4	4.5	4.1	3.9	4.1	3.5
External debt (percent of GDP) ¹	86.1	91.8	95.6	90.9	90.6	90.4	90.7	91.5	88.8
(in percent of exports of goods and services)	193.3	210.2	189.3	172.0	173.0	172.9	173.6	176.0	173.1
Debt service on MLT external debt									
(in percent of exports of goods and services)	21.4	20.7	20.2	18.8	18.2	17.5	16.8	16.9	15.6
Gross international reserves									
in millions of USD	2,521	2,756	3,039	3,288	3,618	3,989	4,332	4,827	5,295
in months of next year's imports of goods and services	3.5	3.5	3.3	3.3	3.4	3.5	3.6	3.7	4.1
in percent of external debt	20.9	20.9	21.0	21.4	21.8	22.3	22.2	22.7	23.6
in percent of short-term external debt (remaining maturity)	75	71	73	78	81	84	85	89	91

Source: Fund staff estimates and projections.

¹ Excluding intercompany loans.

Table 7. Georgia: Gross External Requirement, 2017–23
(In millions of USD)

	2017	2018	2019	2020	2021	2022	2023
	Actual			Projections			
Total financing requirement	3,105	3,128	3,234	3,437	3,674	3,818	3,961
Current account deficit	1,316	1,555	1,681	1,738	1,796	1,827	1,899
Medium and long-term debt	1,139	1,166	1,207	1,290	1,338	1,423	1,437
Private	974	948	943	991	1,018	1,097	1,129
Banks	341	422	399	423	433	493	520
Corporates	632	526	545	568	586	604	609
Public	165	218	264	300	320	326	307
Others (net)	650	407	346	409	540	568	625
Total financing sources	3,197	3,186	3,431	3,715	4,021	4,331	4,462
Capital transfers	109	82	81	80	78	77	75
Direct investment, net	1,594	1,480	1,678	1,826	1,993	2,197	2,400
Medium and long-term debt	1,477	1,607	1,657	1,792	1,932	2,040	1,966
Private	1,073	1,112	1,077	1,092	1,058	1,140	1,198
Banks	536	559	514	505	498	539	584
Corporates	538	553	563	587	560	600	614
Public (only project loans)	404	495	580	700	874	900	767
Short-term debt (net)	17	18	15	17	17	19	21
Increase in gross reserves	242	248	330	371	343	495	468
Rescheduled debt and arrears clearance	-30	5	0	0	0	0	1
Errors and omissions	-65	0	0	0	0	0	0
Total financing needs	186	195	133	93	-4	-18	-33
Official financing	192	195	133	93	-4	-18	-33
IMF	71	29	37	45	-4	-18	-33
Prospective purchases	84	87	88	45	0	0	0
Repurchases	-13	-58	-51	0	-4	-18	-33
Official creditors	121	166	96	48	0	0	0
World Bank	106	0	0	0	0	0	0
EU	15	44	0	0	0	0	0
Others	0	122	96	48	0	0	0
Memorandum items:							
Gross international reserves	3,039	3,288	3,618	3,989	4,332	4,827	5,295
in months of next year GNFS imports	3	3	3	4	4	4	4
in percent of short-term debt at remaining maturity	73	78	81	84	85	89	91
in percent of IMF Composite measure (floating)	90	93	99	105	110	119	126
EFF in percent of total official financing	37	15	28	48	...	...	...

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

Table 8. Georgia: Indicators of Fund Credit, 2015–23
(In millions of SDR)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
	Actual			Projections					
Existing Fund credit									
Stock 1/	94.0	84.2	135.0	95.0	60.0	60.0	57.5	47.5	37.5
SBA and EFF	80.0	80.0	135.0	95.0	60.0	60.0	57.5	47.5	37.5
Obligations	53.2	10.7	10.9	42.2	36.7	1.2	3.7	11.1	10.9
SBA and EFF	37.8	0.8	6.7	42.2	36.7	1.2	3.7	11.1	10.9
Principal (repurchases)	36.8	0.0	5.0	40.0	35.0	0.0	2.5	10.0	10.0
Interest charges	1.0	0.8	1.7	2.2	1.7	1.2	1.2	1.1	0.9
Prospective purchases									
Disbursements	0.0	0.0	0.0	60.0	60.0	30.4	0.0	0.0	0.0
Stock 1/	0.0	0.0	0.0	60.0	120.0	150.4	150.4	147.9	135.4
Obligations 2/	0.0	0.0	0.2	0.5	1.8	2.8	2.9	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	0.2	0.5	1.8	2.8	2.9	2.9	2.8
Stock of existing and prospective Fund credit 1/	94.0	84.2	135.0	155.0	180.0	210.4	207.9	195.4	172.9
In percent of quota 3/	62.5	40.0	64.2	73.7	85.5	100.0	98.8	92.9	82.2
In percent of GDP	0.9	0.8	1.2	1.3	1.4	1.6	1.4	1.2	1.0
In percent of exports of goods and nonfactor services	2.1	1.9	2.4	2.5	2.7	3.0	2.7	2.4	2.0
In percent of gross reserves	5.2	4.2	6.2	6.9	7.3	7.7	7.0	5.9	4.8
In percent of public external debt	2.9	2.4	3.4	3.8	4.0	4.4	4.0	3.5	2.9
Obligations to the Fund from existing and prospective Fund credit	53.2	10.7	11.0	42.7	38.5	4.0	6.6	16.5	26.2
In percent of quota	35.4	5.1	5.2	20.3	18.3	1.9	3.1	7.8	12.5
In percent of GDP	0.5	0.1	0.1	0.4	0.3	0.0	0.0	0.1	0.2
In percent of exports of goods and nonfactor services	1.2	0.2	0.2	0.7	0.6	0.1	0.1	0.2	0.3
In percent of gross reserves	3.0	0.5	0.5	1.9	1.6	0.1	0.2	0.5	0.7
In percent of public external debt service	27.5	6.1	5.4	15.8	13.0	1.4	2.2	4.9	8.4

Source: Fund staff estimates and projections.

1/ End of period.

2/ Repayment schedule based on repurchase obligations and GRA charges. Includes service charges.

3/ Quota increased to SDR 210.4 million in February, 2016.

Table 9. Georgia: Schedule of Reviews and Available Purchases

Availability Date	Condition	Amount of Purchase	
		(SDR millions)	(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 10. Georgia: External Debt Sustainability Framework, 2014–23
(In percent of GDP; unless otherwise indicated)

	Actual				Projections							Debt-stabilizing non-interest current account 6/ -5.2	
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023			
Baseline: External debt	65.1	86.1	91.8	95.6	90.9	90.6	90.4	90.7	91.5	88.8			
Change in external debt	-0.6	21.0	5.8	3.8	-4.8	-0.3	-0.2	0.3	0.8	-2.7	0.0		
Identified external debt-creating flows (4+8+9)	1.0	14.7	2.4	-4.8	-2.6	-3.6	-4.1	-4.7	-5.4	-5.6	0.0		
Current account deficit, excluding interest payments	7.5	7.6	8.1	4.9	5.8	5.0	4.6	4.4	3.6	3.9	5.2		
Deficit in balance of goods and services	18.1	17.7	15.6	11.2	12.3	11.9	11.6	11.1	10.1	9.6			
Exports	42.9	44.5	43.7	50.7	52.3	51.5	51.4	51.4	51.6	50.7			
Imports	61.0	62.2	59.3	61.8	64.6	63.4	62.9	62.4	61.7	60.3			
Net non-debt creating capital inflows (negative)	-8.3	-9.0	-8.1	-9.3	-8.5	-8.6	-8.7	-8.7	-8.6	-8.5	-8.5		
Automatic debt dynamics 1/	1.8	16.2	2.4	-0.4	0.1	0.1	-0.1	-0.4	-0.3	-1.0	3.4		
Contribution from nominal interest rate	3.2	4.4	4.7	4.4	4.2	4.1	4.1	3.9	4.0	3.4	3.4		
Contribution from real GDP growth	-3.0	-2.2	-2.4	-4.3	-4.2	-4.0	-4.2	-4.4	-4.3	-4.4	0.0		
Contribution from price and exchange rate changes 2/	1.5	13.9	0.1	-0.4	...	...	...	...	...	...	0.0
Residual, incl. change in gross foreign assets (2-3) 3/	-1.5	6.3	3.3	8.6	-2.2	3.3	4.0	5.0	6.2	2.9	0.0		
External debt-to-exports ratio (in percent)	151.6	193.3	210.2	188.8	173.7	176.0	175.9	176.6	177.4	175.1			
Gross external financing need (in billions of US dollars) 4/	4.9	4.7	5.3	5.4	6.0	6.0	6.3	6.6	6.9	7.3			
in percent of GDP	29.4	33.4	36.7	35.5	10-Year	10-Year	35.3	32.6	31.8	30.9	29.8	29.1	
Scenario with key variables at their historical averages 5/					90.9	99.4	108.2	118.5	130.5	139.1	-6.4		
Key Macroeconomic Assumptions Underlying Baseline											For debt stabilization		
Real GDP growth (in percent)	4.6	2.9	2.8	5.0	3.7	3.1	4.8	4.8	5.0	5.2	5.2	0.0	
GDP deflator in US dollars (change in percent)	-2.2	-17.6	-0.1	0.4	1.0	11.8	6.2	3.8	3.0	3.0	3.0	0.0	
Nominal external interest rate (in percent)	5.1	5.8	5.6	5.0	5.4	0.7	4.9	4.9	4.8	4.7	4.8	4.0	3.8
Growth of exports (US dollar terms, in percent)	-1.6	-12.1	0.8	22.2	10.2	15.6	15.0	6.9	7.9	8.3	8.8	6.5	
Growth of imports (US dollar terms, in percent)	8.4	-13.5	-2.0	9.9	6.3	18.2	16.4	6.7	7.3	7.5	7.1	5.8	
Current account balance, excluding interest payments	-7.5	-7.6	-8.1	-4.9	-8.5	4.5	-5.8	-5.0	-4.6	-4.4	-3.6	-3.9	
Net non-debt creating capital inflows	8.3	9.0	8.1	9.3	7.3	2.2	8.5	8.6	8.7	8.7	8.6	8.5	

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.

Annex I. Status of Staff Recommendations Made in the 2016 Article IV Consultation

Since the 2016 Article IV Consultation, the authorities have implemented many of the recommended policies that emerged from that process. The authorities have implemented prudent macroeconomic policies, reaffirmed the independence of the National Bank of Georgia (NBG), taken steps to contain fiscal risks, and advanced structural reforms.

1. **Fiscal Policy:** Several policy recommendations have been adopted. The government remained committed to fiscal prudence. In 2017, the authorities introduced revenue and spending measures to compensate for projected revenue losses associated with the corporate income tax reform (the introduction of the Estonian dividend taxation system) and to create space for increasing capital spending. These measures included increases in fuel and tobacco excises and freezes in current spending in real terms. They were accompanied by civil service reform that helped streamline the wage bill. Based on recent IMF technical assistance, the government is considering ways to strengthen the fiscal rule. The latest fiscal risk statement included a comprehensive analysis of major SOEs, with detailed financial information, and incorporated a first assessment of fiscal risk exposures associated with PPAs in the energy sector. A new framework for managing PPPs and PPAs is also being developed.
2. **Financial Sector Policies:** The government overhauled the draft law proposing to separate financial supervision from the central bank. Moreover, the NBG has taken decisive steps to improve financial stability by strengthening prudential regulation for banks and introducing LTV and PTI for mortgage loans. The NBG has also created a new department responsible for macro-financial and macro-prudential analysis. To reduce dollarization, the authorities announced a conversion program for mortgages to reduce FX risks in the household sector, made lari pricing mandatory, banned foreign currency lending for all loans smaller than GEL100,000, and introduced LCRs with preferential treatment for lari-denominated liabilities. Nonbanking institutions and credit bureaus have come under the supervision of the NBG, with regulatory requirements under way.
3. **Monetary and Exchange Rate Policies:** The NBG remains committed to its inflation targeting regime with a flexible exchange rate. FX interventions are targeted toward smoothing excessive volatility and/or accumulating FX reserves. For liquidity management, the NBG has expanded instruments with one-month open market operations. The MoF started auctioning its deposits and issued a multiyear calendar for benchmark bonds.
4. **Structural Reforms:** The authorities have submitted to Parliament the pension reform establishing a funded pension pillar and a new framework for PPPs was approved by Parliament. Authorities are also in the process of revamping the insolvency law and formulating a comprehensive education reform. The deposit insurance agency was created in December 2017.

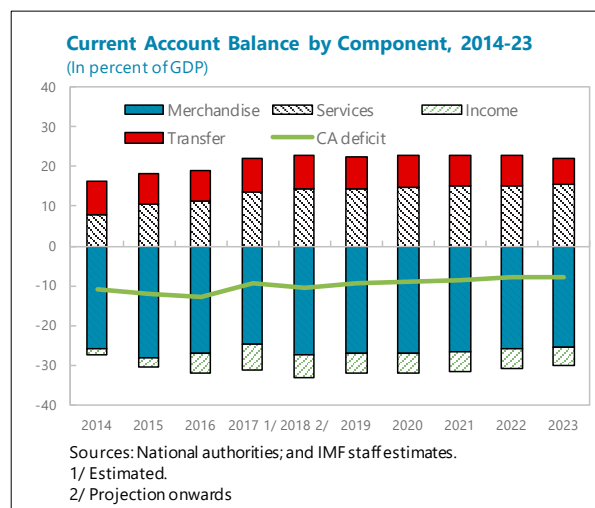
Source of Risks	Relative Likelihood/Time Horizon	Expected impact on the economy if risks materialize	Policy Response
<p>Weaker-than-expected global growth</p> <ul style="list-style-type: none"> • Structurally weak growth in key advanced economies. Low productivity growth (U.S., euro area, and Japan), high debt, and failure to fully address crisis legacies by undertaking structural reforms amidst persistently low inflation undermine medium-term growth. • Significant China slowdown and its spillovers. While ongoing efforts by the Chinese authorities to “de-risk” the financial system are welcome, an adjustment that moves too quickly and improper sequencing of actions may adversely affect near-term growth (low likelihood). Over the medium term, overly ambitious growth targets could lead to unsustainable policies, reducing fiscal space and further increasing financial imbalances. A sharp adjustment would weaken domestic demand, with adverse international spillovers, including a pullback in capital flows to EMs (medium likelihood). 	<p>High Medium Term</p> <p>Low/Medium Short to Medium Term</p>	<p>Medium</p> <p>Weaker global demand, including in other emerging economies, and potential slowdown to Georgia’s main trading partners’ growth would risk the envisaged economic recovery. Lower economic growth could reduce the buying-in on much-needed structural reforms for economic diversification and more inclusive e growth.</p>	<p>A flexible exchange rate should serve as a first line of defense.</p> <p>Accelerate structural reforms, including on education, to enhance confidence and improve competitiveness.</p> <p>Strengthen fiscal sustainability and financial stability to weather external shocks from a stronger policy position.</p> <p>Strengthen social safety nets to protect the most vulnerable segments of the population.</p>
<p>Cyber-attacks on interconnected financial systems and broader private and public institutions that trigger systemic financial instability or widely disrupt socio-economic activities.</p>	<p>Medium Short to Medium Term</p>	<p>Medium</p> <p>Georgia has adopted cybersecurity legislation, but its effectiveness could prove challenging depending on the nature of the attack.</p>	<p>Strengthen banking regulation and supervision to ensure that the system is prepared to address relevant risks, including from cyber-attacks.</p>
<p>Georgia-Specific Risks</p>			
<p>Financial risks. Reduced financial buffers, especially for unhedged borrowers, will limit the capacity to absorb further shocks. Risks could stem from the non-banking sector.</p>	<p>Medium</p>	<p>Medium</p>	<p>Use the flexible exchange rate as a first line of defense.</p> <p>Accelerate implementation of structural reforms to enhance confidence and improve competitiveness.</p>
<p>Fiscal risks. Materialization of contingent liabilities/fiscal risks could deteriorate public debt dynamics.</p>	<p>High</p>	<p>High</p>	<p>Strengthen fiscal sustainability and financial stability to weather external shocks from a stronger position.</p>
<p>Political risks. Political backlash or/and reform fatigue could undermine structural reforms.</p>	<p>Low</p>	<p>Medium</p>	

Annex III. External Sector Assessment

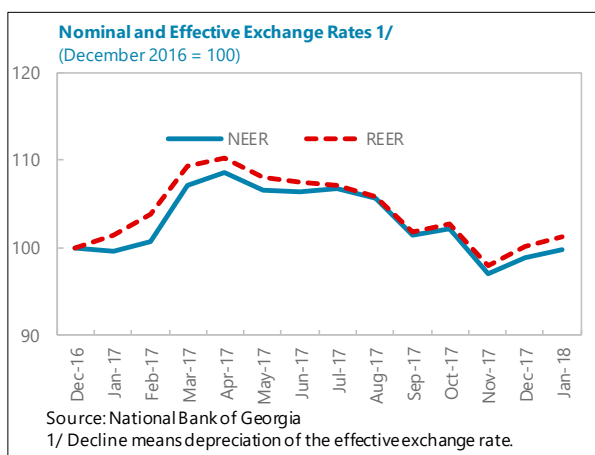
Georgia's external position in 2017 is assessed to be broadly consistent with fundamentals and desired policies. Compared to the assessment during the first review, the improvement reflects a narrowing of the current account deficit supported by a favorable external environment and a sound fiscal policy. Going forward, continued prudent fiscal policy, exchange rate flexibility, and structural reforms to diversify the economy and bolster competitiveness are needed to address structural imbalances.

Current Account and Real Exchange Rate

1. Georgia's current account (CA) deficit in 2017 improved markedly. The CA deficit—at 8.7 percent of GDP—is about 3 percentage points better than the 2014–16 average. The improvement reflected a lower trade deficit, strong tourism receipts, and robust remittances' growth. The improved trade deficit was supported by strong external demand, despite unfavorable terms of trade (a 3 percent decline year-over-year), and subdued import growth. Tourism receipts grew 30 percent year-over-year, driven by strong tourist arrivals. The income account deficit deteriorated to 5.4 percent of GDP in 2017 due to large profit repatriation from FDI.



2. Structural reform to promote export product diversification and further trade integration will help improve the current account balance. The improvement in the current account is partly cyclical, and structural reforms are key to addressing protracted BOP needs. Georgia's export product diversification is relatively low when compared to other comparator countries. Ongoing free trade agreements with the European Union, China, and Hong Kong SAR will help expand the country's export opportunities. Improving human capital and quality of institutions can help expand Georgia's production base to diversify export capacity. Over the medium term, the current account deficit is projected to narrow to 7.5 percent of GDP.



3. At the end of 2017, nominal and real effective exchange rates stabilized to around the levels seen at the end of 2016. Compared to end-2016, an improved current account balance in 2017 led to appreciation of nominal (NEER) and real (REER) effective exchange rates up until April 2017. This provided an opportunity to strengthen Georgia's FX reserves.

4. Georgia’s external position is assessed to be consistent with fundamentals and desired policies. Based on the IMF’s External Balance Assessment (EBA-lite) Methodology¹, the CA method suggests a current gap of -0.3 percent of GDP in 2017, down from -2 percent of GDP during the first review. The CA gap corresponds to a REER overvaluation of 0.6 percent (5.1 percent during the first review). The CA gap is mainly explained by residuals (-1.7 percent of GDP) and could be driven by structural factors not captured in the model, including a still underdeveloped financial system 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. On the other hand, the policy gap supports the narrowing of the CA gap, as macro policies in Georgia have improved significantly. Over the medium term, planned fiscal consolidation and reserve accumulation would continue to help narrow the CA gap.

Annex Table 1. Georgia: External Balance Assessment, 2017
(in percent)

	Second Review	First Review
CA-Projected	-8.7	-10.4
Cyclical Contributions (from model)	0.2	0.1
Additional temporary/statistical factors	0.0	0.0
Cyclically adjusted CA	-8.9	-10.5
CA-Norm	-8.4	-8.4
Additional adjustments to the norm	0.0	0.0
Cyclically adjusted CA Norm	-8.7	-8.5
CA-Gap	-0.3	-2.0
o/w Policy gap	1.5	1.5
Elasticity	-0.40	-0.40
REER Gap	0.6	5.1

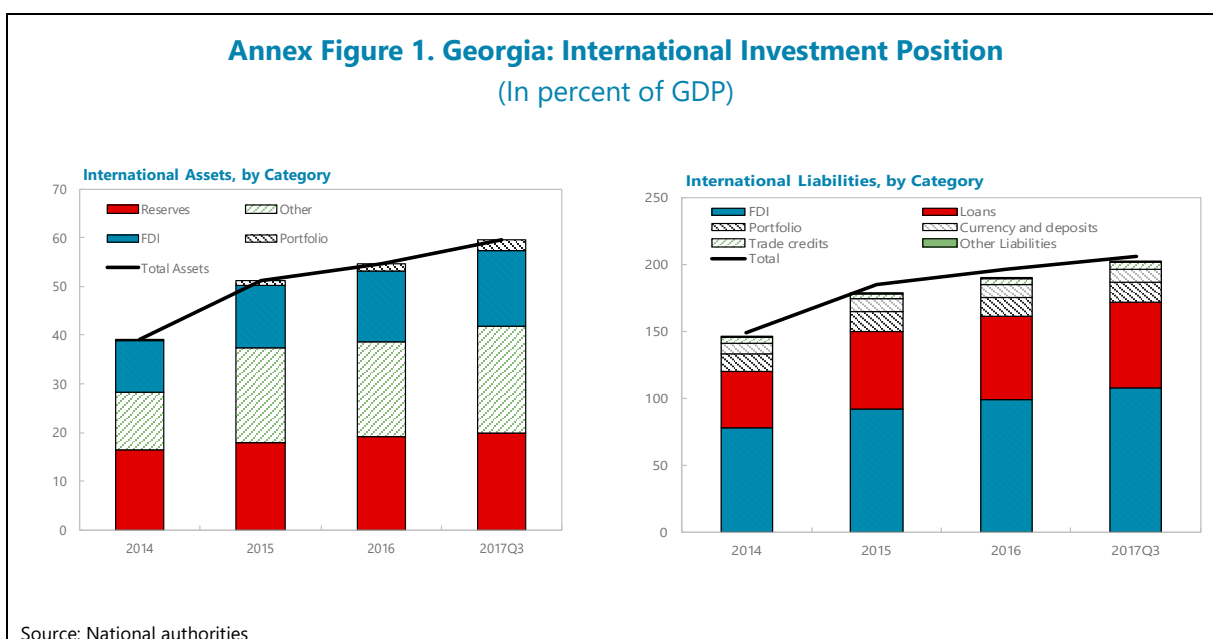
Source: IMF staff calculations.

5. The adjusted REER approach suggests an overvaluation of 5 percent. Given Georgia’s history of overvaluation, the IMF’s REER approach, which benchmarks the CPI-based real exchange rate against a country’s historical average, could be misguided. Instead, PPP-based real exchange rates would be a better indicator for a cross-country comparison. Following Rodrik (2008), a regression model with time fixed effect is used to estimate the relationship between GDP per capita and the PPP-based real exchange rate (adjusted for Balassa-Samuelson effect). Using annual data from 2000–17 for all countries, excluding commodity exporters and small states, a 10 percent increase in GDP per capita leads to a 3.5 percent appreciation of the real exchange rate. This implies a 5 percent overvaluation of the real exchange rate.

¹ <https://www.imf.org/external/np/pp/eng/2016/020516.pdf>

External Balance Sheets

6. Persistently high CA deficits have led to a large negative net IIP. As of end-2017, Georgia’s liabilities to non-residents exceeded its foreign assets by 150 percent of GDP. During 2014–17, gross foreign liabilities have increased by almost 70 percentage points of GDP, to 211 percent of GDP. Nonetheless, more than half of the increase is explained by FDI, which is deemed to be more stable, and less sensitive, to capital reversal in the event of crisis. As of December 2017, the stock of FDI increased by almost 40 percent to about 115 percent of GDP. The remaining contribution to increasing foreign liabilities can be explained by nonbank, general government, and bank loans. Going forward, NIIP is expected to deteriorate further but at a slower pace as the CA deficit will improve over the medium term.



7. The external sustainability approach suggests an overvaluation of 7.7 percent. Assuming a NIIP anchor of -60 percent of GDP, Georgia’s CA norm in 2023 would need to be -5.6 percent of GDP, compared with a projected CA deficit at 7.7 percent of GDP.² This would suggest a REER overvaluation of 5.4 percent. Nonetheless, it should be noted that this estimate is very sensitive to the assumed NIIP anchor. For example, anchoring the NIIP at -80 percent of GDP would result in the CA norm of -7.1 percent of GDP, or equivalent to a 1.7 percent overvaluation.

Capital and Financial Flows

8. FDI has been a major source of current account financing. At about 11 percent of GDP during 2014–17, FDI inflows have been concentrated in transports and communication, construction, and the real estate and energy sectors. While the completion of a large energy-related project in 2018 may slow down FDI in the near term, FDI inflow are expected to stabilize at about 10 percent of GDP in

² The benchmark of 60 percent of GDP follows Catao and Milesi-Ferretti (2014).

the medium term, as new projects have been identified and yields from structural reforms start to take place. Regarding other financing sources, the government has access to external loans, most of which are concessional with favorable interest rates, long maturity, and grace periods. Bank and nonbank sectors have also undertaken external loans and portfolio investment. In 2017, the Bank of Georgia issued a GEL-denominated bond internationally.

Reserves

9. Gross international reserves are below the IMF ARA metric, despite the recent increase.

Gross international reserves (GIR) increased by \$283 million to \$3 billion in 2017, partly reflecting the improvement in the current account balance. The GIR—at 90 percent of the ARA metric—was assessed to be below its adequate level for Georgia.³ To ensure an adequate buffer to external shocks, the authorities are committed to further reserve accumulation in the context of Georgia's IMF-supported program, while maintaining exchange rate flexibility. Consequently, GIR is projected to reach 125 percent of the ARA metric by 2023.

10. National Bank of Georgia (NBG)'s FX intervention has been two-sided. The NBG is committed to a floating exchange rate regime, with FX intervention not targeting any specific value of the exchange rate. However, to fulfil conditionality on the floor of NIR under the EFF program, as of April 2018 the authorities have purchased FX (\$20 million), taking advantage of the appreciating lari.

³ Based on the IMF's Guidance Note on the Assessment of Reserve Adequacy and Related Considerations, reserves in the range of 100-150 percent of the composite metric are considered broadly adequate for precautionary purposes. For further detail, see <http://www.imf.org/external/np/pp/eng/2014/121914.pdf>

Appendix I. Letter of Intent

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

Tbilisi, May 31, 2018

Dear Ms. Lagarde:

1. We remain committed to the policies detailed in our Letter of Intent and Memorandum of Economic and Financial Policies of March 27, 2017, updated on November 17, 2017. Our policy agenda is based upon the Government's Four Point Reform Plan, which focuses on: (i) reforming education to promote adequate skills development, labor productivity and job creation; (ii) accelerating core infrastructure 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 efficiency of the government; and (iv) enhancing the role of the private sector as an engine for growth. The central bank's reform plan aims at strengthening monetary policy and enhancing the supervisory and regulatory framework and financial safety nets. Together with this ambitious reform package, we are committed to preserve macroeconomic and financial stability, as pre-requisites for sustainable and more inclusive economic growth.

2. Robust economic growth provides an opportunity for steadfast implementation of our reform program. Growth in 2017 was 5.0 percent, higher than the 3.5 percent projected at the time of the program approval. As anticipated, inflation has declined significantly in early 2018. The current account deficit has narrowed to 8.7 percent of GDP in 2017, from 12.8 percent of GDP in 2016, driven by growth in exports, tourism and remittances, and subdued import growth, reflecting in part fiscal measures. Supported by revenue measures and a strengthening recovery in 2017, higher revenues and contained current spending allowed us to increase capital spending and net budget lending by 2 percentage points of GDP while containing the fiscal deficit.

3. We have hitherto met most of the conditionality under our IMF-supported program. We have met all end-December quantitative performance criteria, and inflation has remained within the inflation consultation clause (ICC). Most structural benchmarks through end-March have been adopted. We marginally missed the indicative target on net primary expenses for end-December.

4. We request the modification of a quantitative performance criterion and the completion of the Second Review under the Extended Fund Facility and the release of the related purchase.

Given the performance under the program so far, and the policies described in the enclosed Memorandum of Economic and Financial Policies (MEFP), we intend to purchase a further SDR 30 million from the Fund, bringing our drawings under this program to SDR 90 million. Our program will continue to be monitored through quantitative performance criteria, an indicative target, and an inflation consultation clause, both with end-June and end-December test dates, and continuous performance criteria. Consistent with our reform agenda, our program also envisages structural benchmarks. These are set out in Tables 1–3 of the Memorandum of Economic and Financial Policies (MEFP, Attachment I), and described with definitions in the attached Technical Memorandum of Understanding (TMU, Attachment II). Reviews will be conducted semi-annually. The Third Review will be based on end-June 2018 performance criteria and is expected to be completed on or after October 26, 2018. The Fourth Review will be based on end-December 2018 performance criteria and is expected to take place on or after April 12, 2019.

5. The attached MEFP, which updates and extends the previous ones, will enable us to achieve the objectives of our economic program. We will monitor progress continuously in consultation with the IMF, and we stand ready to take further measures if needed to reach our objectives. We will continue to consult with the IMF on the adoption of measures, and in advance of any revisions to policies included in this Letter of Intent in accordance with the IMF's policies on such consultation. We will also provide the IMF with the information it requests for monitoring program implementation. We authorize the IMF to publish this Letter of Intent and its attachments (including the MEFP and TMU), as well as the related Staff Report. 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 Economy and Sustainable Development

/s/

Mamuka Bakhtadze
Minister of Finance

/s/

Koba Gvenetadze
Governor of the National Bank of Georgia

Attachments:

1. Memorandum of Economic and Financial Policies (MEFP)
2. Technical Memorandum of Understanding (TMU)

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

1. This memorandum reports on recent economic developments and updates the economic and financial policy agenda of the National Bank of Georgia (NBG) and the Government of Georgia to address medium-term economic challenges.

Macroeconomic Framework

2. **Economic activity in 2017 exceeded our expectations, supported by our prudent policies and robust growth in our main trading partners.** At 5.0 percent, growth in 2017 was much higher than anticipated at the time of the program approval (3.5 percent). Our current account balance has strengthened considerably due to vigorous growth in exports, tourism receipts and remittances. Stronger confidence in the economy resulted in an unprecedented level of FDI (\$1.86 billion in 2017). As expected, inflation declined rapidly in early 2018, after being temporarily above the NBG's target in 2017 due to higher excise taxes and import prices. The strength of our current account allowed us to boost FX reserves above the program ceiling. The improved confidence in the Georgian economy and our larization measures have led to a decline in both deposit and loan dollarization. Continued reform implementation also resulted in Georgia ranking 9th in the World Bank's Doing Business Report and 5th in the Open Budget Survey. In March, Moody's upgraded our credit rating from Ba3 to Ba2, and Fitch Ratings improved the credit outlook from stable to positive.

3. **Decisive program implementation and the dynamism of our economy have led to positive revisions to our economic outlook.**

- We expect robust growth to continue in 2018 supported by a favorable external environment, domestic consumption, and public investment. We revised up our growth projection based on a more benign global outlook and remain vigilant about regional developments which could impact negatively our economy. Over the medium term, growth is expected to gradually increase due to the steadfast implementation of our structural reforms and continued growth in our main trading partners.
- Upward revisions to growth would translate into higher government revenues. This will allow us to accelerate infrastructure spending while slightly reducing our augmented fiscal deficits (see below).
- The current account is expected to marginally deteriorate in 2018 owing to accelerated capital spending and rising global fuel prices. The current account deficit is projected at 9.2 percent of GDP in 2018, before declining gradually to below 8 percent of GDP over the medium term. External financing will continue to rely mostly on FDI. The stronger external position will allow us to build international reserves over the medium term.

4. External competitiveness will be bolstered by the implementation of our reform agenda.

Ambitious structural reforms, continued implementation of the EU-Georgia Association Agreement, and our commitment to deepening trade relations with the rest of the world, will create new business opportunities and support economic diversification. Further improvements to the business environment, including through a more effective tax administration, will help mobilize FDI in tradable sectors, improve competitiveness, and reduce external vulnerabilities.

5. Risks to the medium-term outlook are balanced. Upside risks stem from stronger domestic and external demand. Materialization of these risks leading to an overheating of the economy may require tightening macro policies. Downside risks are mainly related to regional developments, retreat from cross-border integration, and weaker growth in advanced economies. Materialization of fiscal risks could also put pressures on the public-sector balance sheet and call for additional consolidation. Our first line of defense against these risks include our commitment to sound macroeconomic policies, a flexible exchange rate, and a well-capitalized and liquid banking system. Georgia's IMF-supported program provides an additional anchor to help us cope with negative shocks.

Economic Policies

A. Fiscal Policy

6. The 2017 augmented fiscal deficit was lower than programmed. The 2017 augmented deficit (TMU definition) was GEL1,113 million or 2.9 percent of GDP, well below the program ceiling of GEL1,335 million (performance criterion) or 3.6 percent of GDP. Our fiscal performance reflected lower-than-expected losses from changes to the corporate income tax and cyclical gains. Consistent with our commitment under the program, part of the revenue over-performance was used to accelerate capital spending and to refund a higher amount of VAT claims. Unfortunately, we marginally exceeded the indicative target on primary current expenses by GEL28 million related to donor-financed projects.

7. Fiscal prudence will continue in 2018. We remain committed to our end-June ceiling on the augmented deficit (GEL430 million) and aim for an augmented deficit of GEL1,150 in 2018 (performance criterion) or 2.8 percent of GDP. We will continue containing current primary spending (indicative target), by keeping it constant in real terms. To that end, we have introduced a new civil service law and a civil service remuneration law (structural benchmark, December 2017), to contain civil service costs, increase efficiency, and improve the link between performance and pay. Given our projected revenues, we aim to refund GEL400 million in value-added tax (VAT) credits, doubling the initial budget projection. Any additional refunds will be accommodated under the program through an adjustor (see Technical Memorandum of Understanding (TMU, ¶14). The augmented deficit ceiling incorporates higher capital spending in priority infrastructure with respect to the budget. In addition, we stand ready to adopt contingency measures, if needed, to keep the augmented deficit not above the 2018 program ceiling. In consultation with the IMF, we are committed to use revenue over-performance or additional savings in current spending toward high priority growth-enhancing net acquisition of non-financial assets, and any under-execution in investment towards a lower deficit.

8. We are committed to appropriately account for emerging fiscal pressures in the budget, so that debt remains anchored at safe levels over the medium term. We are committed to

medium-term fiscal consolidation and remain proactive to address fiscal pressures. In coordination with donors, we will design a comprehensive education reform (see paragraph 29 below) that will be incorporated in our multi-year budgetary framework (MTBF) once resource needs are evaluated. The main fiscal costs from implementing the education reform are expected to be incurred only once infrastructure projects are finalized, providing space for higher education spending. We are committed to seek efficiency gains in the sector and, if needed, identify permanent fiscal measures to ensure that the reform is deficit neutral. While the budgetary effect of Public-Private Partnerships (PPPs) and Purchasing Power Agreements (PPAs) is intrinsically uncertain, some contingent liabilities stemming from PPPs/PPAs have a greater likelihood of materializing. The immediate effect of such risk events would mostly be felt by public enterprises, but any cost would eventually be passed on to the budget through lower dividends, delayed debt service payments, or a need for capital injections. With the assistance of IMF TA, we will strengthen our scenario analysis to estimate plausible fiscal costs associated with these activities and, in anticipation of risks that could materialize in the medium to long term, will prudently consider the need for additional fiscal measures to build precautionary buffers.

9. We remain committed to medium-term fiscal consolidation while scaling-up public investment. We aim to reduce the augmented cash deficit of the general government to 2.5 percent of GDP by 2020 while significantly increasing capital spending. To achieve this, we will continue rationalizing primary current spending (from almost 25 percent of GDP in 2016 to 20.4 percent of GDP by 2020) by improving the efficiency of the public administration including through (i) containing the wage bill and administrative expenses; (ii) improving the targeting of subsidies and of social assistance programs; (iii) reducing transfers and privatizing loss-making state-owned enterprises (SOEs); and (iv) improving performance-based budgeting. To support the vulnerable population, the existing social safety net will be maintained and the basic public pension will be increased (see below). In addition, we do not plan to extend the dividend distribution model to financial institutions until 2023, which would limit the revenue loss (up to 0.5 percent of GDP). However, we will consider moving sooner the insurance sector to the dividend distribution model, in consultation with the Fund. To achieve our deficit target, we stand ready to identify additional measures, if needed, in coordination with the IMF, including on the revenue side within the scope of our fiscal framework.

10. We aim to reduce fiscal risks and remain committed to avoid domestic/external debt payment arrears.

- We will not (i) accumulate any general government's external debt payment arrears outside those under negotiation (performance criterion); (ii) accumulate net domestic expenditure arrears of the general government (indicative target); or (iii) issue new public guarantees (performance criterion), or comfort letters.
- The Partnership Fund (PF) 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 new guarantees. New net borrowing of the Partnership Fund will be limited to \$20 million at end-June and end-December 2018 (cumulative from the beginning of the EFF program, performance criterion). We remain committed to maintain a non-negative cash position at the Partnership Fund by end-June and end-December 2018 (performance criterion).

- We will refrain from initiating any Public-Private Partnerships (PPPs), including Power-Purchasing Agreements (PPAs), until our PPP framework is operationalized. We are committed to reassess and implement, if needed, additional fiscal adjustment based on our fiscal risk profile.
- Taking into consideration existing fall-winter period power deficit, and except for the PPAs described in the next bullet, PPAs currently under negotiation will be permitted to proceed (prior to the new PPP law) 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 MW650. This adds MW150 to the previous cumulative capacity as the Koromkheti Hydro Power Plant (HPP, see below) will not be pursued.
- Consistent with our program commitments, we evaluated two PPAs under negotiation that are outside of the terms mentioned above (the Namakhvani HPP Cascade Project and the Koromkheti HPP). We prepared a fiscal risk analysis for these projects. The risk assessment updated the analysis of gross exposure of all signed PPA projects and these two large projects; and analyzed the net risk exposure with different demand, price and exchange rate assumptions. The risk assessment also described and quantified other risk-sharing contractual obligations (including, for instance, termination risk or construction risk). Negotiations of the memorandum of understanding (MoU) associated with the Namakhvani HPP Cascade Project (MW433) are ongoing, but the government decided not to pursue the Koromkheti HPP (MW150).
- We will continue to exercise fiscal prudence by containing potential fiscal risks stemming from our proposed export credit agency (ECA). We will coordinate with the IMF on preparing the charter of the agency to ensure that the agency will (i) only provide guarantees and insurances related to export operations; (ii) be subject to insurance regulation and supervision; and (iii) not receive explicit government guarantees. ECA's capital will be constituted by a \$20-million equity injection by the Partnership Fund distributed over 3 years. A revolving fund for potential losses, totaling GEL50 million, will come from the state budget.
- We are also considering the possibility of creating a credit guarantee scheme (CGS) to support SMEs' access to finance. The CGS would be based on best international practices to limit fiscal risks. In particular, the CGS would be limited in size, targeted, easy to dismantle, transparently incorporated in the budget, and use market-based principles for its operations. We will work closely with our international partners, including the IMF, to elaborate a proposal.

B. Structural Fiscal Policies

11. We are strengthening our revenue administration to secure full compliance by all taxpayers and improve taxpayer services. Following the 2016 Tax Administration Diagnostic Assessment and follow-up IMF TA, we are implementing a 3-year plan that focuses on improving:

- **Organizational structure.** Georgia's Revenue Services (GRS) headquarter has been restructured into a function-based organization to modernize tax administration (structural benchmark, February 2018), with logical groupings of core functions – such as taxpayer service, returns filing and

payment, audit, appeals, arrears management, policy and interpretations and compliance management. The transfer of all core HQ functions from field offices to headquarters was completed in May 2018. We will continue building capacity of the GRS by adequately staffing the new departments in line with international best practices.

- **Improving VAT tax administration.**
 - Stock of unrefunded VAT credits. We are committed to eliminate the issue of unrefunded VAT credits and aim by end-2021 to reduce by at least 50 percent the outstanding stock of those VAT credits that are within the limitation period for audit. To achieve this, we established a steering committee with representatives from the MoF, GRS, and GTS that proposed in May 2018 the necessary legal amendments or ministerial decrees to facilitate the implementation of the action plan adopted in 2017. For the stock of existing credits, we are committed to risk-assess 100 percent of declarations within the next two years. A new specialized VAT unit in the GRS's audit department has already been created (structural benchmark, June 2018) to review VAT declarations and to audit or take other compliance action where necessary. We are committed to having it fully operational by June 2018.
 - Automatic risk assessment and risk based auditing. All new VAT declarations will be risk-assessed under the automated system starting January 2019. We improved our automatic risk-assessment system to check all VAT declarations and will have a fully automated system by end-2018. Under this system, those 90 percent of new declarations with the lowest risk score will not be subject to further manual review by GRS and be immediately eligible for a refund, if requested by taxpayers and if there are no outstanding tax liabilities (new structural benchmark, June 2019). This 90 percent target will be achieved within six months from the start of the automated repayment system. The 10 percent of declarations with the highest risk score will be reviewed by the specialized VAT unit in the Audit Department to determine the appropriate compliance action.
 - Automatic refunding of new VAT credits. From January 2020, to further automate the refund system, all risk-assessed new credits approved by the system will be either offset against existing liabilities or refunded to the taxpayer, without the need for an explicit request for refund. The VAT declaration form will be changed accordingly. The option to offset the stock of existing credits against new liabilities will remain unchanged, and taxpayers will retain the option to request a cash refund of those stocks through a separate form.
- **Compliance.** We received IMF TA on enhancing compliance risk analysis and improving data management for new risk models. We are committed to increase audit capacity, efficiency, and impact on compliance. With IMF TA, we plan to use risk-based audits to identify non-compliant cases that are likely to produce higher yields. We will better manage the audit scope and develop audit plans to give a balanced coverage of tax categories. We will have a pilot audit case management system in early 2019. Once fully implemented, this will enhance audit timeliness and productivity, and implement a systematic approach to terminate non-productive audits.
- **Filing compliance.** We established key performance indicators to help improve filing compliance. Initially developed for VAT, the program could expand to all tax categories. By end-2018 the GRS will also improve the taxpayer register, submit to Parliament legal amendments so that an unfiled

declaration is no longer deemed to be a nil declaration where the GRS requires a declaration, and set up an organizational unit that deals with filing default and late filing for all revenue types.

- **Penalty regime.** To have a more efficient and fair system, we will update our tax penalty regime. In consultation with the IMF, we will submit to Parliament a revised penalty regime with gradual tax-gear penalties depending on the degree of culpability (new structural benchmark, December 2018).
- **Automatic access to third-party information.** Risk analysis relies on data to be effective. It improves the effectiveness of a tax administration by allowing the targeting of resources towards greatest non-compliance. The GRS will be provided with automatic access to third-party information from appropriate government agencies, including information from: (i) the National Agency of Public Registry on real estate, rentals and leases, and on the Joint Stock Companies (JSC) partners and changes in company equity (tentatively by end-2018); (ii) municipalities, information on construction permits; and (iii) the Financial Monitoring Service on suspicious transactions as defined in the law on facilitating the prevention of illicit income legislation.

12. We are committed to contain fiscal risks to safeguard fiscal sustainability. We understand the importance of properly managing fiscal risks as an intrinsic part of prudent fiscal policy. We are carefully studying risks that could arise from state-owned enterprises (SOEs) and PPPs, including PPAs in the energy sector. At the same time, we recognize that PPPs and PPAs can play a pivotal role in Georgia's development 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.** We submitted a PPP Law to Parliament (structural benchmark, December 2017) that includes sound elements following best international practices (see previous MEFP for details), with assistance from the World Bank (WB), the Asian Development Bank (ADB), the EBRD, and the IMF. Parliament approved the new PPP law in May. We will consult with the IMF on secondary legislation, PPPs ceilings, and PPPs guidelines. The government decree implementing the PPP law will incorporate recommendations from the IMF, including on: (i) coverage, notably explicitly incorporating PPAs, to the coverage of the PPP law; (ii) definitions, specifically, of the principle of value for money (VfM); (iii) protecting the gatekeeper role of the MOF; (iv) a requirement for any PPPs agreed as a result of direct negotiations (except for those in the national security sector) to be fully transparent i.e. the PPP contract and its appendices to be published, including a summary of the project key financial indicators and the feasibility study, with PPP contracts in the energy sector above 100MW requiring an independent feasibility study; and (v) limiting the participation of public sector entities in institutional PPPs; (v) requirements regarding pre-feasibility studies and components thereof; and (vii) transparency of PPPs and the selection process. In consultation with the Fund, we will adopt the government decree implementing the PPP law (new structural benchmark, end-December 2018).
- **Continue strengthening the Fiscal Risk Statement (FRS) accompanying the budget.**
 - Our 2018 FRS reported fiscal risks on all existing PPP-associated liabilities; and expanded the analysis of SOE's contingent liabilities, including a quantitative reporting of quasi-fiscal operations (structural benchmark, end-December 2017). This analysis expanded the

historical financial analysis of SOEs to five years, described historical trends of the size of the SOE sector relative to the economy, provided analysis of the factors driving the financial performance and position of both key individual and overall SOEs, and identified and evaluated major quasi fiscal activities.

- The 2019 FRS will expand the analysis of fiscal risks stemming from PPPs and PPAs, and SOEs (new structural benchmark, December 2018). For PPPs and PPAs, the 2019 FRS will disclose: (i) in addition to the NPV, the total nominal value of the aggregate exposure per year for the complete lifespan of these projects, (ii) the aggregate total nominal exposure of the riskiest top 3/5/10 projects, by year for the period of the agreements, and their NPVs; and (iii) the total nominal net payments for the base case and alternative scenarios, and their NPVs. The 2019 FRS will also include financial baseline projections for major SOEs, covering the year of the FRS and the year after, which will be used as the basis for sensitivity analysis.
- For the MoF fiscal risks management unit, we commit to recruit new staff with practical corporate finance experience and intensify the training in corporate finance of its existing staff.
- **Strengthen the monitoring of SOEs.** Our legislation already envisages that the largest SOEs – first and second category SOEs as defined by legislation – will be IFRS-compliant by October 2019, underlying our efforts to strengthen the capacity of the MoF and the MOESD to effectively supervise SOEs. We will ensure that the MoF and the MOESD collect comprehensive data on SOEs, including performance information, transfers between the state and SOEs and among SOEs, borrowing, guarantees and any litigation, at least, on an annual basis. In parallel, by December 2018, we will assess the need for legal and/or regulatory changes to institutionalize, standardize and centralize the powers for supervision of SOEs under the MOESD and MOF, with the aim of supporting adequate financial performance and control of SOEs.
- **Improve the Public Investment Management Framework (PIMF).** We will strengthen MoF's role in public investment management. To this end, we created a dedicated public investment unit at the MoF, where information on public investment projects will be centralized. This unit will evaluate investment projects based on cost/benefit analysis and other relevant analyses. This will help establish a single project pipeline, support adequate project evaluations, help prioritize investment projects and identify their financing, and integrate them within our MTBF. The PIMF will cover PPP-type projects to ensure they are prioritized and assessed alongside traditionally-procured projects. In coordination with the IMF, we are committed to strengthen further our PIMF following IMF TA recommendations on Public Investment Management Assessment conducted in May 2018.

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

- **Improve our fiscal rule to safeguard fiscal sustainability.** With IMF support, we initiated a review of our fiscal framework, including of our fiscal rules, with the aim of ensuring that they support our medium-term fiscal objectives towards sustainability while also granting flexibility in formulating fiscal policy over the economic cycle. We will submit to parliament a revised fiscal framework following IMF recommendations included in the TA report of November 2017 (new structural

benchmark, December 2018). The revised fiscal rule will apply to fiscal outturns, clarify definitions of aggregates and escape clauses, and enhance coverage, communication, transparency, and oversight.

- **Guidelines for new budget lending operations.** We issued such guidelines, requiring reasonable expectation of repayment of budget lending operations (structural benchmark, December 2017), in consultation with the IMF. We will prepare the 2019 State Budget applying the GFS classification of equity injections and on-lending, per the reasonable commercial return test and, if not met, these equity injections will be treated as subsidies or transfers.
- **Improve the quality of fiscal reports.** We will explain revisions to the medium-term budget estimates in the annual budget document. We have included LEPLs' revenues and expenditures in the budget documentation starting in the 2018 state budget. To expand the institutional coverage of fiscal reports, we will assess existing LEPLs by end-2018 and create rules for classifying them as general government units or non-general government units, based on GFSM2014 standards. We will upgrade our public finances presentation from GFSM 2001 to GFSM 2014 classification in the context of the 2019 budget.
- **Comply with international accounting standards.** In our efforts to improve fiscal transparency, starting in 2021, we will produce an annual consolidated general government sector financial report based on International Public-Sector Accounting Standards (IPSAS) basis.

C. Monetary Policy

14. We are committed to our inflation targeting (IT) framework to maintain price stability.

After being temporarily above the NBG's inflation target in 2017 due to higher excise taxes and import prices, inflation has decreased significantly in early 2018 and is now close to the NBG's target of 3 percent. We will continue to abide by the Inflation Consultation Clause (ICC) under the program. As such, inflation developments will be monitored via dual consultation bands set symmetrically around the agreed forecast 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.

15. We will maintain a flexible exchange rate regime to protect the economy against external shocks.

Foreign exchange interventions will be limited to smoothing excessive exchange rate volatility and to strengthen our reserve position. While the current level of gross international reserves is still below the level recommended by the IMF-composite metric (ARA), we will accumulate international reserves throughout the program, which will be monitored by a floor on net international reserves (performance criterion). Positive external developments in 2017 allowed us to accumulate more reserves than envisaged under the end-December program floor. This has enabled us to strengthen our external buffers and we therefore increase the end-June 2018 NIR performance criterion by \$40 million to \$1,490 million, and to \$1,550 million by end-December 2018.

16. **We will continue strengthening the monetary policy transmission mechanism.** Improved confidence in the economy and our larization measures have led to a gradual decline in deposit and

loan dollarization, but dollarization remains elevated. Improved lari liquidity facilities have strengthened NBG's liquidity management, promoting maturity transformation in the banking sector. The interbank market is working well, and interbank interest rates are close to the policy rate. We will submit legal amendments to Parliament to support derivatives and repo transactions in line with best international practices, including netting and close-out netting provisions. We plan to strengthen lari liquidity management by extending open market operations to outright purchases of treasury securities by mid-2018.

17. Monetary policy will be enhanced by improving our communication toolkit. We have requested IMF TA to strengthen our communication. We will continue publishing our quarterly monetary policy reports on a fixed pre-announced schedule in par with associated meeting with experts. Every second monetary-policy meeting will also continue to be followed by a press conference. We will further strengthen our communications by issuing a manual for monetary policy operations in line with the recent IMF TA.

D. Financial Sector Policy

18. Our policies will strengthen financial sector stability. As noted in the previous MEFP, we took significant steps to enhance our financial stability policy framework, regulation and supervision, including: (i) operationalizing macroprudential policy; (ii) introducing new capital requirements within Basel III framework; (iii) allowing the NBG to supervise banking groups; (iv) empowering the NBG to ultimately supervise and regulate micro-financial institutions, and (v) improving consumer protection in operations related to the financial sector. This will support the banking sector's ability to cope with shocks and improve financial intermediation. We will further strengthen: (i) the supervisory and regulatory framework; (ii) the financial stability policy framework; and (iii) the safety nets and the bank resolution framework for crisis preparedness. We will also step-up efforts to incentivize the use of the domestic currency and support the development of the domestic capital market.

19. We made progress on strengthening the financial stability policy framework, regulation and supervision.

- We submitted to Parliament legal amendments giving to the NBG oversight power for credit information bureaus (structural benchmark, December 2017). Parliament approved amendments by end-2017.
- As one of the main components of the financial stability policy framework, we started operationalizing macroprudential policy, and introduced a countercyclical capital buffer. Its goal is to limit excessive credit growth, which could lead to the buildup of systemic risks.
- We strengthened the operational framework of the Financial Stability Committee (FSC). Its main tasks include evaluating and analyzing financial stability risks and implementing macroprudential policy. The FSC meets once a quarter according to the preannounced calendar, and after each meeting, a press release is published. The press release outlines current trends and challenges in the financial system, and the decisions of the committee. Moreover, twice a year committee meeting is followed by a press conference. We also updated the NBG webpage, which now outlines our financial stability policy, objectives and tools. Our enhanced communication strategy will strengthen financial stability.

- In the context of implementing IFRS-reporting standards, we introduced impairment guidelines to help the financial sector establish proper credit loss calculation system following IFRS 9. Also, to ensure IFRS 9 implementation, we started publishing macroeconomic forecasts and risk scenarios. Financial institutions can use these scenarios as an input for calculating the expected credit loss. A roadmap to transition to IFRS regulatory reporting will be prepared by June 2018. Ultimately, NBG aims to transfer banks' regulatory reporting to IFRS framework through EU standards (FINREP/COREP forms).
- In line with FSAP recommendations, we issued regulations to phase in by 2022 additional capital requirements for systematically important banks (structural benchmark, December 2017).
- To increase transparency of Pillar 2 capital requirements (under Basel III regulation), we published General Risk Assessment Program (GRAPE) guidelines describing the general principles of risk-based supervision and the rationale behind capital add-ons.
- To promote responsible lending practices, we prepared guidelines to enhance the assessment of households' credit worthiness. The guidelines are currently being discussed with the industry. We will conduct a thorough analysis of households' lending practices –both for banks and non-bank financial institutions – to better understand the potential impact of these guidelines on households' indebtedness.

20. We will continue strengthening financial regulation and supervision. Our banking system has remained resilient after the 2014 external shocks due, in large part, to good regulation and supervision by the NBG.

- The NBG and the State Insurance Supervision Agency are working together on developing a supervision framework for financial conglomerates. We drafted the law on supplementary supervision of financial conglomerates in accordance with the relevant EU directive.
- We will introduce regulations on: (i) leverage ratios based on Basel Principles and relevant EU regulations (structural benchmark, September 2018); (ii) credit information bureaus (with the support of WB TA) to set requirements and limits, issue guidelines and apply fines, protect consumers and limit business-continuity risks; (iii) bank's real estate appraisal of collateral in line with International Valuation Standards (structural benchmark, June 2018); (iv) corporate governance in line with Basel Principles (structural benchmark, September 2018); and (v) the net stable funding ratio in line with Basel III principles.
- With the help of IMF TA, we have initiated regulation, supervision and oversight of non-bank financial institutions, depending on the source of the funding. The prudential regulatory framework for MFI's will be ready by June 2018, and we will introduce non-prudential oversight to other lenders effective January 2019.

21. We will continue improving analytical tools for macro-financial analysis with the goal of strengthening financial stability through macroprudential policy. With the support of IMF TA, we are developing macro-financial model tailored our economy. The model incorporates interlinkages between the real economy and the financial system, analyzes financial and macroeconomic risks scenarios and main policy trade-offs, and conducts macro stress tests. The model will be the backbone for our macroprudential policy design and serve as an instrumental tool for our renewed Financial

Stability Report (FSR), which we plan to resume publishing in 2019. The FSR will include a forward-looking analysis of policies and risks.

22. We joined the Sustainable Banking Network (SBN) and thus expressed our willingness to support the sustainability of our financial system. We intend to raise awareness of sustainable finance. We are exploring best international practices and working to develop our roadmap to adopt sustainable finance principles. As a first step, we will publish the International Capital Market Association (ICMA) principles in Georgian and develop guidelines for green bonds and credits.

23. We are strengthening financial safety nets.

- We continue to cooperate with banks to strengthen their recovery plans. The deposit insurance agency became operational January 2018.
- Following international best practices, we will strengthen our capacity to act as lender of last resort by identifying legal amendments to prohibit unsecured lending by the NBG, to mandate a penalty rate for emergency liquidity assistance (ELA), and to clarify the role of the MoF to ensure an effective ELA framework. With TA support, we plan to revamp the banking resolution framework and to enhance crisis management, including clarifying the authorities' role and the decision-making process. Hence, we plan to revise the NBG law to state clearly the NBG's resolution authority. In this vein, we will submit to Parliament legislative changes to implement effective ELA and resolution frameworks in line with international best practices (new structural benchmark, May 2019).

24. We have taken steps to further enhance financial larization to reduce FX risks and improve monetary policy transmission mechanisms. We adopted a comprehensive plan in December 2016 (detailed in previous MEFP), which supported a decline in loan dollarization. Stronger confidence in the local currency has also led to a healthy decline in deposit dollarization. Accordingly, we will continue introducing larization measures, including prudential measures to help financial institutions continue internalizing FX-induced credit risks, promoting consumer protection practices, and expanding financial education so that households have a better understanding of the risks associated to FX borrowing.

25. Capital market development will support larization while reducing external vulnerabilities. The non-banking financial system is shallow in Georgia, limiting competition for savings and their efficient use within the economy.

- A law establishing investment funds will be submitted to Parliament by December 2018. In parallel, we are working on the legal and regulatory frameworks for other financial instruments, such as derivatives and securitization.
- We will upgrade our exchange infrastructure by having a single settlement system for all Georgian securities with two participating central security depositories (CSDs), one for commercial bonds and shares, and another one for government bonds. The new system will allow for delivery-versus-payments settlements in central bank money for all securities and full integration with the Georgian

Stock Exchange and OTC trading platforms. We expect the system to be fully operational by the end of 2018.

- We published a multi-year plan of government bond issuance to develop benchmarks along the yield curve (structural benchmark, December 2017) to facilitate price discovery for private-sector bonds. We will continue with this practice going forward.
- We will also support the creation of primary dealers, and the foreseen mandatory third-party vehicle insurance will help develop the insurance sector.
- We will align our legal framework in the securities market with EU directives, and strengthen the legal underpinnings of insolvency and securities holding frameworks.

E. Structural Reforms

26. Achieving more robust and inclusive growth will require advancing our 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), KfW Development Bank, Agence Française de Développement (AFD), and the European Commission. Our reforms aim at scaling-up infrastructure spending, and 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, create jobs and reduce poverty. At the same time, targeted social assistance and health care will continue to protect the most vulnerable.

27. Scaling-up infrastructure and spatial planning is key to Georgia's development. With 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 improve public investment efficiency and transparency, we have brought our public procurement process closer to international standards. Combined with the government's support for tourism development (including water and electricity infrastructure), Georgia will turn into a four-season tourist destination.

28. We are actively working on a comprehensive education reform to promote job creation. With the help of our partners, we will design a comprehensive education reform that will cover the following areas: (i) early childhood education; (ii) secondary education; (iii) vocational education and training; (iv) higher education; and (v) science and research. This reform is crucial to improve job creation, productivity and wages. The lack of qualified labor force is repeatedly reported as one of the most problematic factors for doing business in Georgia. At the same time, unemployment and underemployment remains high, suggesting skill mismatches in our labor force. This reform will entail, among other things, setting curriculum standards, a new teacher policy framework, and more effective 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 support job seekers with guidance on job selection, preparation and retraining.

29. 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 and the Asian Development Bank, we submitted to Parliament a law establishing a Pillar II pension system (structural benchmark, December 2017), to be followed by the creation of an independent pension agency (structural benchmark, July 2018). In parallel, we are committed to formulate a private pension savings system (Pillar 3) in 2018. Our basic public pension, which amounts to GEL180 per month, is marginally higher than the subsistence minimum. Hence, we will increase the basic monthly pension to GEL200 and GEL220 per month in 2019 and 2020, respectively. In consultation with the IMF, we will submit to Parliament legislation proposing a rule-based mechanism to index basic pensions (new structural benchmark, February 2019).

30. We will continue to improve the business environment. 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 to submit to Parliament a new insolvency law by April 2019, to support an adequate restructuring for viable non-financial corporations. An efficient VAT tax system will also improve the business environment. In addition, we will widely apply regulatory impact assessments to analyze the possible impact of major policy decisions and protect the economy from undue costs.

31. Land registration will be pivotal for rural and agricultural development. Land cadasters are important for protecting property rights, simplifying land transactions and providing collateral for borrowing. We have simplified land registration, especially for agricultural land plots, through a fee waiver program. We will assist citizens in searching for property ownership documents and facilitate dispute resolution through mediation. Currently, registered land plots amount to 1.8 million, where 25 percent of those were registered within the land reform launched on August 1, 2016.

32. Deepening trade relations with the rest of the world is one of Georgia's key priority. As a small open economy, free trade agreements (FTAs) will help Georgia mobilize FDI in tradable sectors to improve competitiveness, reduce external vulnerabilities, and generate balanced growth. Georgia has FTAs with the EU (Deep and Comprehensive Free Trade Area), the European Free Trade Association (EFTA), the People's Republic of China, Turkey and the Commonwealth of Independent States countries. FTA negotiations were concluded with Hong Kong Special Administrative Region and an agreement is expected to be signed by June 2018. At the same time, we are negotiating with Turkey an expansion of the current FTA. We remain committed to pursue other FTAs with priority countries, including the United States, India, and others.

33. 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. Unfortunately, due to technical issues related to the new census, we have not been able to start publishing quarterly unemployment figures in May 2017, but we will do so by September 2018. We will also broaden the coverage of employment statistics by publishing hours worked. In 2018, we will conduct a structure of earnings survey to have a detailed view of the earnings' structure by occupations and in terms of labor costs. We completed back-calculations for population figures to reconcile the differences between the 2014 and the 2002 census results. We plan to publish the new population data

by April 2018. We will also start publishing national accounts based on NACE 2 sectoral classification by November 2019. Along with the migration to NACE 2 classification, we will compute GDP-based on supply and use tables (capitalizing on the TA provided by the IMF) and publish quarterly GDP by expenditure in constant prices. This will provide a more detailed picture of the structural transformations in our economy. In May 2018 we will publish updated poverty figures and in the first half of the year we will start publishing quarterly statistics on inbound tourism which, among other things, will further strengthen balance of payments statistics.

F. Program Monitoring and Safeguards

34. 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 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.

35. The NBG continues to maintain a strong safeguards framework and internal controls environment. Since the last assessment and in line with IMF recommendations, we have submitted and Parliament has approved amendments to the NBG Organic Law on (i) Audit Committee's definition and mandate; (ii) specifying the Chief Internal Auditor eligibility criteria and grounds for dismissal and (iii) early appointment of external auditor for NBG. 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	Outturn	End Dec.	Outturn	End June	End Dec.
Inflation Consultation Bands for CPI (in percent)						
Central point	6	7.1	5	6.7	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

Source: IMF staff estimates

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets for end-December 2017 and 2018

(Unless otherwise indicated: cumulative from the beginning of the calendar year, millions of GEL)

	2017					2018		Proposed End- December Target
	End-December					End-June		
	Target	Revised Target	Adjusted Target	Outturn	Status	Target	Revised Target	
Performance Criteria								
Ceiling on augmented general government deficit (program definition)	1,335	1,335	1,350	1,113	Met	430	430	1,150
<i>In percent of GDP</i>	3.7	3.7	3.7	2.9		1.0	1.0	2.8
Floor on NIR of NBG ¹ (end-period stock, million of U.S. dollars)	1,350	1,390	1,314	1,416	Met	1,450	1,490	1,550
Ceiling on the accumulation of external debt arrears of the Public Sector (continuous criterion) (million of U.S. dollars)	0	0	...	0	Met	0	0	0
Ceiling on new public guarantees (continuous criterion)	0	0	...	0	Met	0	0	0
Ceiling on the cash deficit of the Partnership Fund	0	0	...	22	Met	0	0	0
Ceiling on the new net borrowing of the Partnership Fund (million of U.S. dollars, cumulative from the beginning of the EFF program)	20	20	...	0	Met	20	20	20
Indicative Targets								
Ceiling on the accumulation of net domestic expenditure arrears of the general	0	0	...	0	Met	0	0	0
Ceiling on Primary Current Expenditures of the General Government (in mn lari)	8,685	8,685	...	8,713	Not Met	4,675	4,675	9,035

Source: IMF Staff

Table 3a. Georgia: Structural Benchmarks

Measure	Date	Status
Financial Sector		
Financial Stability		
Introduction of LCR for commercial banks, with preferential treatment of GEL-deposits (MEFP ¶119)	End-September 2017	Met
Adoption of regulation on capital add-ons in CAR for systemically important banks, (MEFP ¶120)	End-December 2017	Met
Submit to Parliament legislation giving NBG oversight power over credit information bureaus, (MEFP ¶119)	End-December 2017	Met
Increase in minimum regulatory capital for commercial banks to GEL50 million, phased in by 2019 (MEFP ¶119)	End-June 2017	Met
Capital Markets Development		
Publication of a multi-year calendar for government benchmark bonds (MEFP ¶123)	End-December 2017	Met
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 ¶116)	End-June 2017	Met
Deposit insurance		
Submission to Parliament legislation establishing deposit insurance as of January 1, 2018 (MEFP ¶121)	End-June 2017	Met
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 ¶121)	End-September 2017	Met
Fiscal		
Submission to Parliament a 2018 budget consistent with the fiscal deficit in the Fund-supported program (MEFP ¶17)	End-December 2017	Met
Adopt a remuneration law for public civil service (MEFP ¶111)	End-December 2017	Met
Action plan to address accumulated outstanding VAT refunds in an orderly manner over time (including analysis, refund, set-offs, and write-offs) (MEFP ¶110)	End-September 2017	Met
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 ¶112)	End-December 2017	Met
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 ¶112)	End-December 2017	Met
Public Financial Management		
Issue guidelines for new budget lending operations requiring reasonable expectation of commercial returns (MEFP ¶113)	End-December 2017	Met
Pension Reform		
Submission of a pension law establishing a 2nd pillar pension system, and introducing indexation of basic public pensions (MEFP ¶127)	End-December 2017	Met
Source: IMF staff.		

Table 3b. Georgia: Structural Benchmarks, by Completion Date

Structural Benchmarks	Date	Status
Restructure the GRS headquarters into a function-based organization (MEFP ¶11).	Feb-18	Met
The steering committee will propose any necessary legal amendments or ministerial decrees to facilitate the implementation of the action plan to address outstanding VAT claims (MEFP ¶11).	Mar-18	Not met
Create a new specialized VAT unit focusing on validating VAT claims (MEFP ¶11).	Jun-18	In progress
Introduce regulation on bank's real estate appraisal in line with International Valuation Standards (MEFP ¶121).	Jun-18	In progress
Establishing an independent pension agency (MEFP ¶128).	Jun-18	Jul-18
Introduce regulation on leverage ratio based on Basel Principles and relevant EU regulation (MEFP ¶121).	Sep-18	In progress
Introduce regulation on banks corporate governance in line with Basel Principles (MEFP ¶121).	Sep-18	In progress
Proposed Structural Benchmarks		
The 2019 FRS will expand the analysis of fiscal risks stemming from PPPs and PPAs, and SOEs as described in the MEFP (MEFP ¶112)	Dec-18	
Adopt the government decree implementing the PPP law following the recommendations of the FAD TA report (MEFP ¶112)	Dec-18	
Submit to Parliament a revised penalty regime with gradual tax-geared penalties depending on the degree of culpability (MEFP ¶111)	Dec-18	
Submit to Parliament a new fiscal rule framework (MEFP ¶113)	Dec-18	
In consultation with the IMF, we will submit to Parliament legislation proposing a rule-based mechanism to index basic pensions (MEFP ¶130)	Feb-19	
Submit to Parliament legal amendments bringing the banking resolution framework, the role of the central bank as the lender of last resort, and crisis management in line with best international practice (MEFP ¶123)	May-19	
90 percent of the VAT refund requests approved by the system will be automatically refunded, upon request, after offsetting against existing tax liabilities (MEFP II 11)	Jun-19	
Source: IMF staff.		

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.

A. 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/>.

Table 1. Georgia: 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

B. 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.

C. 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 net 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-December 2017 and end-June 2018 (the next two test dates). They are monitored on a cumulative basis from the beginning of the calendar year (except for (i) the NIR target, which is monitored in term of stock levels and (ii) the new net borrowing by the Partnership Fund, which is monitored since program approval), while continuous performance criteria are monitored on a continuous basis.

D. 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 of the MEFP, 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.

E. 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 as the 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 \$60 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. Adjustor: The ceiling on the augmented cash deficit of the general government will be adjusted upward (higher deficit)/downward (lower deficit) by the amount of VAT credits refunded in cash above/below the program amounts (Table 2).

Table 2. Georgia: Projected Financing for Cash Deficit of the General Government (in millions of GEL, cumulative from the beginning of the calendar year)		
	June 30, 2018	December 31, 2018
Disbursements of foreign-financed project loans	673	1214
Receipts from sale of non-financial assets	69	150
VAT refunds	200	400

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.
- f. Separately for VAT and non-VAT tax credits, data for the previous month will be provided by the Georgia Revenue Service by the end of each month on:
 - Opening balance of tax credits (stock) and of new tax credits declared by taxpayers,
 - Tax credit balance adjustments made by GRS after desk check / audit,
 - Credit refunds paid in cash, offset against existing VAT liabilities, and offset against existing non-VAT liabilities,
 - Other flows,
 - Closing balance of tax credits (stock) and of tax credits older than three years (stock),
 - Number of claims for cash refund received,
 - Total amounts claimed for cash refund, and
 - Number of refunds made, number of refunds made automatically and total amounts refunded automatically.

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 program, **external payment arrears** will consist of all overdue debt service obligations (i.e. payments of principal or interest, considering 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

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 weeks 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 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

For 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).

Partnership Fund

Ceiling on the Cash Deficit of the Partnership Fund

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

¹ Arrears to Turkmenistan.

23. 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.

24. 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 Net Borrowing by the Partnership Fund

25. Definition: Net borrowing by the Partnership Fund is defined as contracted debt liabilities minus principal repayments.

26. Supporting Material: The Ministry of Finance will provide to the IMF detailed information on the Partnership Fund's quarterly revenue, expenditure, and amounts related to new contracted debt and principal repayments, within four weeks of the end of each quarter.

Net International Reserves

Floor on the Net International Reserves of the NBG

27. 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 \$1, 416 million as of December 31, 2017 (at program exchange rates).

28. 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 loans to the general government** are defined as disbursements of commercial loans and loans from bilateral and multilateral donors for budget support.

29. 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. Georgia: Projected Balance of Payment Support Financing (in millions of U.S. dollars, cumulative from the beginning of the calendar year)		
	June 30, 2018	December 31, 2018
Projected privatization revenue	0	0
Budget support grants from external donors and not related to project financing	6	45.7
Budget support loans, including bilateral and multilateral donors for budget support	130.8	166.4
Net issuance of the Eurobond from the general government	0	0
Disbursements of project loans and grants	114.1	306.8

30. 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

A. 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.

B. 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, adjusted present value, 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 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:

- 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 it 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.



GEORGIA

June 14, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION, SECOND REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT, AND REQUEST FOR MODIFICATION OF A QUANTITATIVE PERFORMANCE CRITERION— INFORMATIONAL ANNEX

Prepared By

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

CONTENTS

RELATIONS WITH THE FUND	2
RELATIONS WITH THE WORLD BANK GROUP	9
RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)	12
RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ADB)	15
RELATIONS WITH THE EUROPEAN INVESTMENT BANK (EIB)	17
STATISTICAL ISSUES	20

RELATIONS WITH THE FUND

(As of April 30, 2018)

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	335.38	159.40
Reserve Tranche Position	0.02	0.01

SDR Department

	SDR Million	Percent Allocation
Net Cumulative Allocation	143.96	100.00
Holdings	144.70	100.52

Outstanding Purchases and Loans

	SDR Million	Percent of Quota
Extended Fund Facility	60.00	28.52
Stand-By Arrangements	65.00	30.89

Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
EFF	April 12, 2017	April 11, 2020	210.40	60.00
Stand-By	July 30, 2014	April 11, 2017	100.00	80.00
Stand-By	Apr. 11, 2012	Apr. 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				
	2018	2019	2020	2021	2022
Principal	30.0	35.0		2.5	10.0
Charges/Interest	1.69	1.62	1.15	1.13	1.05
Total	31.69	36.62	1.15	3.63	11.05

Safeguard Assessments

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 recommendation from the last assessment. The NBG's 2017 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.

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. Since January 2016, the NBG sold \$280 million during periods of large depreciations of the lari against the dollar. During the same period, the NBG bought \$428 million at times when the lari strengthened against the dollar to accumulate international reserves.

The volumes bought or sold at the NBG's foreign exchange (FX) 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 FX market turnover, the size of these interventions on any given day may 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, for all payments between the government and enterprises and other legal entities, and for FX transactions with the NBG. Since 2013, FX 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 EFF was agreed to on April 12, 2017. The first review was completed on December 6, 2017.

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

Georgia: Technical Assistance Missions, 2013–18 (As of May 2018)			
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

Georgia: Technical Assistance Missions, 2013–18 (continued) (As of May 2018)			
Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
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
RA-Gap	Advisory	February 20–27, 2017	Ministry of Finance, Revenue Service
Compliance Risk Management (Follow-up), Compliance program for VAT non-filers	Expert	March 9–22, 2017	Ministry of Finance
FTE (Follow-up)	Expert	March 20–31, 2017	Ministry of Finance
Tax Administration: Organization Structure	Expert	April 19–May 2, 2017	Ministry of Finance, Revenue Service
Tax Administration: VAT audit	Expert	April 19–May 2, 2017	Ministry of Finance, Revenue Service
Accounting Reform	Expert	May 15–26, 2017	Ministry of Finance, Revenue Service
Tax Administration (LTX installation)	Advisory	June 12–16, 2017	Ministry of Finance, Revenue Service
Data Sources and Mining for Tax Risk Analysis on CIT and DCIT	Expert	July 18–August 2, 2017	Ministry of Finance, Revenue Service
Data Mining for VAT Analysis	Expert	July 26–August 9, 2017	Ministry of Finance, Revenue Service
Fiscal Rules	Advisory	September 12–27, 2017	Ministry of Finance
Tax Administration	Advisory	September 18–26, 2017	Ministry of Finance, Revenue Service
Fiscal Risk Management	Expert	September 29–October 17, 2017	Ministry of Finance
Filing Compliance (Follow-up)	Expert	November 29–December 13, 2017	Ministry of Finance, Revenue Service
Tax Administration—Penalty, Fines and Interest Technical Assistance	Expert	January 16–29, 2018	Ministry of Finance, Revenue Service

Georgia: Technical Assistance Missions, 2013–18 (continued) (As of May 2018)			
Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Tax Administration	Advisory	January 17–30, 2018	Ministry of Finance, Revenue Service
PPPs and SOEs Fiscal Risks	Expert	April 26, May 11, 2018	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–April 24, 2015	National Bank of Georgia
Monetary Policy and Financial Stability	Advisory	July 5– July 15, 2016	National Bank of Georgia
Liquidity Management	Advisory	September 27–September 30, 2016	National Bank of Georgia
IFRS Accounting	Advisory	January 30–February 4, 2017	National Bank of Georgia
Bank and nonbank Supervision	Advisory	April 26–May 2, 2017	National Bank of Georgia
Macroprudential Policy Framework	Advisory	June 14–23, 2017	National Bank of Georgia
Development of Government Securities Market	Advisory	June 26–30, 2017	National Bank of Georgia, Ministry of Finance, Treasury
Development of Government Securities Market (Follow-up)	Expert	July 17–21, 2017	National Bank of Georgia, Ministry of Finance, Treasury
IFRS9 and Accounting Modernization	Advisory	September 20–October 3, 2017	National Bank of Georgia
Monetary and FX Operations/ELA	Advisory	December 3–15, 2017	National Bank of Georgia
Financial Stability Analysis	Expert	December 11–22, 2017	National Bank of Georgia
Centralized Risk Management	Expert	January 22–26, 2018	National Bank of Georgia
Financial Stability Analysis	Expert	March 22–31, 2018	National Bank of Georgia
Consolidated Supervision	Expert	April 10–20, 2018	National Bank of Georgia
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

Georgia: Technical Assistance Missions, 2013–18 (concluded) (As of May 2018)			
Subject	Type of mission	Timing	Counterpart
Statistics Department (STA)			
National Accounts	Expert	September 11–22, 2017	Geostat
Monetary and Financial Statistics	Advisory	September 18–29, 2017	National Bank of Georgia, and Geostat
Real Sector Prices Statistics	Expert	April 25–May 4, 2018	Geostat
Legal Department (LEG)			
Capital Markets Taxation	Advisory	October 17–28, 2016	National Bank of Georgia
Capital Markets Taxation	Advisory	May 16–May 29, 2017	National Bank of Georgia
Capital Markets Taxation	Advisory	November 8–20, 2017	National Bank of Georgia
Insolvency Law	Expert	December 16, 2017	Ministry of Finance

RELATIONS WITH THE WORLD BANK GROUP

(As of April 8, 2018)

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 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 have been consistent with the Country Partnership Strategy (CPS) for FY14–17, endorsed by the World Bank's Board in May 2014. The Country Partnership Strategy FY14–17 program delivered by IBRD/IDA under the CPS amounted to \$836.8 million.

The World Bank Group recently completed a Systematic Country Diagnostic, which informed the preparation of the new Country Partnership Framework (CPF) FY19–22. The new CPF was discussed by the Board of Directors on May 22, 2018. It proposes a strategic shift in focus from an infrastructure-heavy program to one that emphasizes expanding human capital. The proposed strategy relies upon three interconnected focus areas: (1) enhancing inclusive growth and competitiveness; (2) investing in human capital; (3) and building resilience.

As of April 2018, the IBRD/IDA portfolio comprised 11 investment projects under implementation with a total commitment of \$699 million, of which \$381 million (about 54 percent of the total) is undisbursed. About 60 percent of commitments are concentrated in the ongoing East-West Highway and secondary roads projects, and 18 percent in urban development. The remaining 22 percent covers energy, land management and irrigation, and innovation ecosystems. There are two DPO series under implementation. The Programmatic Inclusive Growth DPO series is targeted toward improving oversight of public institutions, improving budgeting, developing a framework for civil service reform, improving coverage and quality of social services, and strengthening monitoring of outcomes. The Private Sector Competitiveness DPO series is targeted toward enhancing private sector competitiveness through implementing second generation business environment reforms, deepening financial sector and diversification, and increasing firms' capacity to innovate and export. There is also an active program of five recipient-executed trust fund operations of about \$17.9 million.

Technical assistance as well as analytical and knowledge activities complement the Bank's investment portfolio. In the financial sector, an extensive program of technical assistance supports government priorities in several areas, including deposit insurance, financial inclusion, financial infrastructure, capital market development, responsible finance, and the insurance market. Ongoing support to fiscal and public financial management includes public expenditure reviews, assistance to improve public investment and fiscal risk/contingent liabilities management, Public Expenditures and Accountability Assessments (PEFAs) and assistance to implement the government's PFM strategy, improving public procurement efficiency and transparency, and support to the Supreme Audit Institution. A

programmatic advisory and analytical engagement on poverty and gender analyzes poverty and equity in the country, and strengthens statistical capacity. In social sectors, the Bank continues to support the health, education, and pension sectors in Georgia through technical assistance and potentially development policy lending in the future. In education, the Bank provides Programmatic Education Sector Support in the strategic areas identified as priorities in the sector strategy (Main Directions for Education and Science Development 2014-24 of the Ministry of Education and Science) to inform education sector policy dialogue in Georgia. The Bank is also providing advice on higher education finance reform.

Product	Expected Delivery
Development Policy Operation	2019
Integrated Regional Development	2019
Education Sector Improvement Program	2019
Improving Health Sector Efficiency	2019
<i>Recipient Executed Trust Funds</i>	<i>Closing</i>
Second regional and municipal infrastructure development project	December 2018
Empowering local communities and entrepreneurs	August 2018
IT audit development in the State Audit Office of Georgia	December 2018
Sustainable wastewater management project	June 2018
Improving pre-school education in Georgia through social accountability processes	January 2020
<i>Analytical Work</i>	
Potential development policy operation dialogue	June 2018
Programmatic poverty and gender advisory	May 2018
Missing girls in Georgia	December 2018
Georgia PFM implementation support	May 2019
Improving efficiency and transparency in public procurement	June 2019
Georgia customs valuation	August 2018
Financial sector deepening and inclusion	January 2020
Georgia financial advisory project	June 2020
Climate resilience of road network	June 2018
E-W Highway PS participation and monetization	June 2018
Operationalizing jobs agenda in Georgia	June 2018
Georgia Pension TA	June 2018
Advancing the DRM agenda in Georgia	June 2018
Forestry and mining dialogue	June 2018
Innovative financial solutions for Georgia's road sector	June 2018
TA to support reforms to higher education financing system in Georgia	July 2018
Georgia's energy efficiency and social equity	January 2019
Tbilisi urban regeneration and resilience phase 2	May 2019
National action plan for adapting to climate change impacts in the coastal zone	December 2018
Broadband for all roadmap	May 2019
Resilient building regulation and emergency preparedness	December 2019

IFC in Georgia

Georgia became an IFC member and shareholder in 1995. Since then, IFC has provided around \$1.84 billion in long-term financing, of which nearly \$940 million was mobilized from partners, in 59 projects in financial services, agribusiness, manufacturing, and infrastructure. In addition, IFC has supported more than \$385 million in trade through its trade finance program, and implemented a number of advisory projects focused on developing the private sector.

As of the end of April 2018, Georgia's committed portfolio totaled \$422 million (of which 97.9 percent has been disbursed), which represents the seventh largest committed exposure in ECA.

IFC's current strategy and operations in Georgia are guided by the joint World Bank Group Country Partnership Strategy for the fiscal years 2014–17. IFC's role within this framework is to contribute to improvements in Georgia's competitiveness and promote acceleration of private sector led job creation. IFC prioritizes investment and advisory services that (1) facilitate greater financial intermediation and increase access to finance; (2) develop infrastructure, which is critical for economic growth and diversification; (3) support expansion of competitive companies in agribusiness, value-added manufacturing, and services; and (4) 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 that 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 and real estate. In the power sector, IFC is committed to supporting Georgia in developing its vast hydro potential 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 MW550. 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 and provides advice on compliance with international 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 works with the government to promote sustainable private sector-driven growth in Georgia through regulatory reforms in agriculture, which will help Georgia reap the benefits from the Deep and Comprehensive Free Trade Area (DCFTA) with the EU— attracting and retaining investments in export sectors, and streamlining customs procedures.

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

(As of May 1, 2018)

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

In December 2016, the EBRD Board approved the 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 SMEs 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, 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 of May 2018, the EBRD's cumulative investments in Georgia reached EUR2.93 billion with 215 projects. Its outstanding portfolio stood at EUR781 million with 78 active projects. About 34 percent of the investment portfolio is in the power and energy sector, followed by 30 percent in the corporate sector. Additionally, 29 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 cumulative investments currently stands at around 90 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 2017 reached €271 million with 20 projects, a record number of investments for the Bank in Georgia. In 2017 EBRD marked special milestones with three unprecedented projects:

- Issued its Eurobond in lari and placed it at the London stock exchange. This was the first bond of this kind in the region. It has a maturity of 5 years, and it was issued under EBRD's GMTN. The bond will increase the visibility of the Georgian lari in international markets.
- Participated in the first secured corporate bond denominated in lari, a milestone transaction in Georgia and the Caucasus, by investing GEL 20 million in a bond subscription by JSC Evex Medical Corporation, the largest health care services provider in Georgia.
- Financed the acquisition of new low-floor electric buses to be used in a municipal fleet in Batumi, Georgia's third-largest city. This is the first ever project by the EBRD to introduce in one of its countries of operations the use of electric buses in a municipal fleet. The project benefits from the support of the EBRD-managed multi-donor Eastern Europe Energy Efficiency and Environment Partnership (E5P) Fund.

In the financial sector the EBRD extended a second DCFTA credit line to the Bank of Georgia, extending EUR43 million, as well as a first tranche of €43 million to TBC Bank to support local SMEs adapting to the EU Association Agreement and DCFTA requirements. The EU will provide interested SMEs 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 the following areas:

- The drafting of a new PPP Law
- Energy Efficiency (Residential Assessment and National Action Plan)
- Competition Agency
- De-dollarization
- Factoring and Leasing
- 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 at addressing key topics pertaining the business community. The Council works in coordination with key IFIs, donors, and the private sector on how best to enhance the activities of the private sector, increase 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 in 2017 were judiciary reform, pension reform, agricultural land, and the tourism budget.

The EBRD has a pipeline of new projects in 2018 in excess of €300 million. Key projects are Nenskra (which will be the largest new HPP in the region), DCFTA, WiB credit lines to TBC Bank (2nd tranche), and Procredit Bank. Some smaller projects in renewable energy, as well as in the manufacturing and services sectors, are also under development. EBRD may participate in financing infrastructure

projects in Georgia in line with the government's strategy and priorities, such as Anaklia Deep Sea Port and Kvesheti-Kobi Road projects.

EBRD investments will continue to focus on (1) strengthening the private sector, with particular attention to micro, small, and medium-sized enterprises and adaptation to DCFTA requirements with additional emphasis on inclusion; (2) supporting de-dollarization of the financial system; (3) developing local capital markets; (4) modernizing the energy sector with more renewable energy projects; and (5) promoting Georgia's regional and global economic integration. The EBRD also supports the government's priority of developing infrastructure and making growth more socially inclusive.

The EBRD will also focus on the following priorities:

- Putting strong emphasis on supporting Georgia's path toward the EU, while helping SMEs 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 connect the EBRD's clients with local consultants and international advisers who can support the transformation of their businesses to meet European standards.
- Investing in the development of the agribusiness sector and the modernization of the food distribution sector, supported by an intensive policy dialogue in food safety.
- Supporting 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.
- Supporting policy and regulatory developments in Georgia by providing further assistance on legal and judiciary reforms, including assistance on establishing the alternative Commercial Court system and support to train the judges.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ADB)

(As of May 2, 2018)

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 \$2.42 billion, with \$900 million from the concessional Ordinary Capital Resources (OCR) and \$1.41 billion from OCR, and \$114 million in co-financing. Non-sovereign loans total \$330 million as of the end of December 2017.

Cumulative disbursements to Georgia for lending financed by OCR, concessional OCR, and other special funds amounted to \$1.45 billion as of December 31, 2017, and the active sovereign loans portfolio is about \$1.38 billion. Effective from January 1, 2017, Georgia graduated from concessional OCR 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 financial crises on the country.

The two-phased Municipal Services Development Project, funded with \$70 million from concessional OCR 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.

In 2017, ADB approved \$80 million for the Secondary Road Improvement Project, which includes 50 kilometers of road rehabilitation to improve access for both residents and tourists in the Kharagauli district. ADB also approved the \$228 million Batumi Bypass Road Project to improve regional connectivity. It is ADB's first co-financed project in Georgia, and includes a new two-lane bypass road of 14.3 kilometers skirting Batumi, as well as performance-based maintenance contracts for 200 kilometers of international highways and secondary roads.

The Sustainable Urban Transport Investment Program, a 10-year MFF of \$300 million, runs until 2020. It supports the public transport network and the development of efficient transport systems in key urban areas. Under the MFF, five projects totaling \$257 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. It aims at delivering safe water and sanitation to major cities and regional towns across Georgia.

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 of December 31, 2017, cumulative OCR approvals for seven non-sovereign transactions totaled \$330 million. Total outstanding balances and undisbursed commitments to private sector transactions in Georgia were \$263.5 million, representing 2 percent of ADB's total non-sovereign portfolio as of December 31, 2017. In 2015, \$130 million in loans were approved for three financial institutions in Georgia to broaden micro and small enterprises and farmers' access to finance.

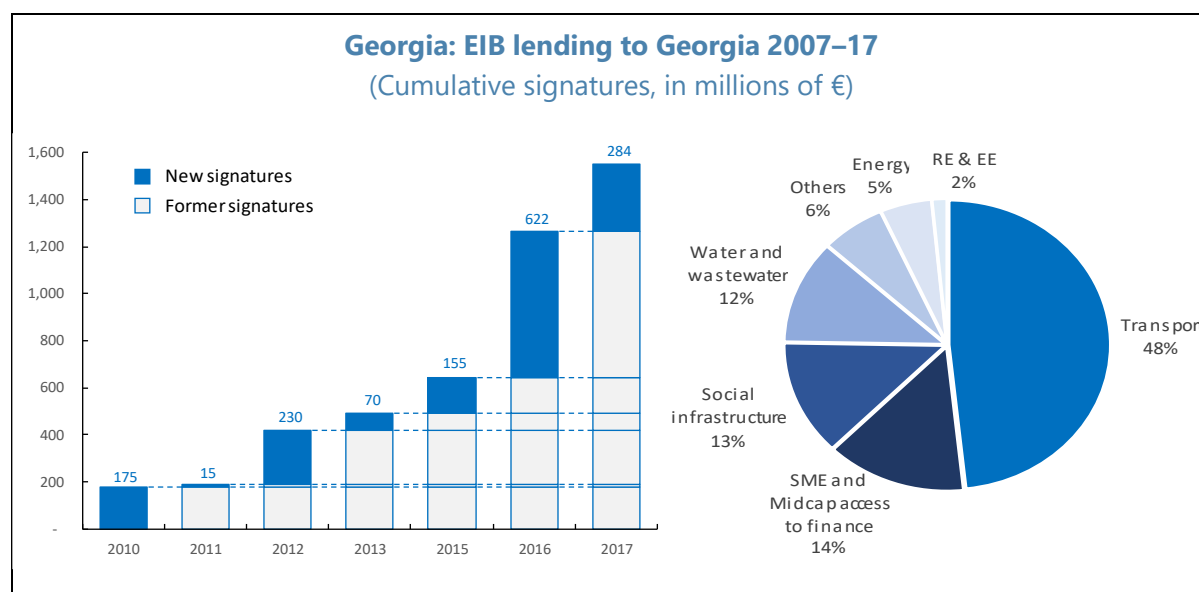
ADB's Trade Finance Program (TFP) fills market gaps by providing guarantees and loans through partner banks in support of trade. Since 2009, ADB's TFP has supported more than 12,000 small and medium-sized businesses across developing Asia—through over 16,500 transactions valued at over \$30 billion—in sectors ranging from commodities and capital goods to medical supplies and consumer goods. In 2017, the TFP supported around \$4.5 billion in trade through approximately 3,500 transactions. In Georgia, the TFP works with three banks and has supported \$115.96 million in trade between 67 transactions as of December 2017. In addition to filling market gaps, the TFP's objective is to mobilize private sector capital/involvement in developing Asia. In Georgia, 32.64 percent of the \$115.96 million in trade supported through the TFP was co-financed by the private sector.

RELATIONS WITH THE EUROPEAN INVESTMENT BANK (EIB)

(As of May 8, 2018)

The European Investment Bank (EIB) started its cooperation with Georgia more than 10 years ago, following the signature of the Framework Agreement governing EIB’s activities in Georgia on July 21, 2007. The goal is to support development in Georgia and promote closer integration with the European Union. The EIB finances projects in Georgia in line with the EU External Lending Mandate. The mandate provides the EIB with a guarantee covered by the EU Budget for projects in the areas of social and economic infrastructure, local private sector development (in particular SMEs), and climate change mitigation and adaptation. Through its lending activities in Georgia, the EIB supports the four key priority areas agreed at the Eastern Partnership Summit in Riga in 2015, namely (1) economic development and market opportunities; (2) strengthening institutions and good governance; (3) connectivity, energy efficiency, environment and climate change; and (4) mobility and people-to-people contacts.

Since 2007, the EIB has supported 21 operations in different sectors and at a steadily growing pace. Following the Association Agreement and the Deep and Comprehensive Free Trade Area’s (DCFTA) entry into force between Georgia and the EU in 2016, the EIB stepped up its support, effectively doubling its lending portfolio in the country to € 1.55 billion. As of the end of 2017, lending to the sovereign represented 85 percent of the EIB loan portfolio in Georgia.



Development of Social and Economic Infrastructure

- Transport.** The EIB has set up investment loans (Georgia East West Highway I and II projects for a total EIB financing of €249 million) and a framework loan (Georgia Transport Connectivity project, €500 million) to support transport infrastructure investments in Georgia. This will substantially

enhance Georgia's global connectivity to Europe and local mobility. The project implementation is supported by a technical assistance grant provided by the Neighborhood Investment Facility.

- **Environment / Water.** The EIB supports water infrastructure modernization through the provision of two loans of €40 million each. Those projects aim to finance the improvement of the water supply and wastewater infrastructure assets in over 50 cities around the country. Support for project implementation is also provided via the EU Neighborhoods Investment Facility (NIF) through Technical Assistance and Investment grants. The EIB is also financing the Kutaisi Waste Water project (€ 100 million loan) for improving wastewater collection and treatment. The project implementation is supported by a technical assistance grant provided by the Eastern Partnership Technical Assistance Trust Fund. An investment grant provided by the NIF shall enhance the climate mitigation effect of the project.
- **Municipal Infrastructure.** The EIB supports the upgrade of municipal infrastructure in several Georgian cities for improving service delivery for residents. After the 2015 floods, a first EIB framework loan (€100 million, signed in February 2016) was dedicated to emergencies and short-term priorities in Tbilisi, as well as to upgrade municipal and tourism infrastructure in selected municipalities. Upon the request of the Georgian Government, in December 2016 the EIB signed a second framework loan (€ 100 million) to finance municipal investments.
- **Renewable Energy.** The EIB supported Georgia's energy security and renewable energy potential through two loans: one for rehabilitation works for the Enguri and Vardnili HPPs (€23.5 million) and another one for the construction of high-voltage transmission lines (€80 million).
- **Energy Efficiency.** The government of Georgia is committed to increasing energy efficiency. A joint EIB-European Commission-other IFIs mission, which took place in 2017-18, has identified improving energy performance of existing buildings as one of the first areas of intervention.

Support for Private Sector Development

The EIB uses credit lines and direct investment loans to support the following: (1) EU based (or global) companies; (2) local sizable companies, including commercially managed public sector companies; and (3) mid-caps with strong development potential and/or added value to the local economy. So far, the EIB has provided 7 loans for SMEs credit lines (approximately €165 million) and a direct investment loan of € 21.5 million issued to Georgian Water and Power to support its water and wastewater infrastructure development program. Two more programs—DCFTA Initiative East and InnoFin—support SMEs' access to finance mostly by ensuring the availability of intermediated financing and by providing risk-sharing products and capacity-building.

- **DCFTA Initiative East.** The initiative (together with the NIF) supports Georgia's progress toward the removal of barriers and creation of the necessary conditions to align the SME sector with EU standards. Support under the Initiative includes (1) a \$4.2 million loan to Credo Bank to provide small loans to micro and small enterprises in urban and rural areas and (2) SME loan guarantees provided in 2017 to ProCredit (€2.4 million) and TBC Bank (€2.4 million) to improve access to finance for riskier SMEs.
- **Innofin.** Georgia joined the Horizon 2020 EU Framework Program for Research and Innovation in 2016. Under this umbrella, the InnoFin program offers financing tools (including portfolio

guarantees for SMEs and Mid-Caps) and advisory services to innovative enterprises in Georgia. To date, two Innovfin guarantee agreements were signed with ProCredit Bank JSC and TBC Bank, enabling them to provide respectively €60 million and €80 million in loans to innovative SMEs and small midcaps.

Supporting Georgian Counterparts in Project Preparation and Implementation

EIB also provides support in project preparation and implementation by blending its own lending and advisory capacity with the resources of other donors, notably the EU's Neighborhood Investment Facility (NIF) and the Eastern Partnership Technical Assistance Trust Fund (EPTATF).

- NIF was launched in 2008 to support EU neighboring countries in energy infrastructure projects, transport and environment, and development of the private sector. On top of the recent DCFTA Initiative East, the EU's NIF has so far provided almost €43 million of investment and technical assistance grants to support implementation of EIB-funded projects in Georgia.
- EPTATF was established in 2010 to enhance the quality and development impact of the Bank's operations in Eastern Partnership countries by supporting project preparation and implementation. EPTATF has allocated to Georgia €5 million out of €30.4 million operations approved by EPTATF so far. The priority sectors are (1) development of social and economic infrastructure; (2) climate change mitigation and adaptation; and (2) local private sector development, particularly support for SMEs.

STATISTICAL ISSUES

(As of May 15, 2018)

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 the 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 the 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 2018 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 2013-17, 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.

In April 2018, the IMF launched a two-year technical assistance project with GEOSTAT to develop a residential property price index and expand coverage of the PPI to include key services.

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*, in which Balance Sheet only comprises liabilities. Georgia is not reporting financial assets and holding gains and losses in assets and liabilities.

Monetary and Financial Statistics: The NBG compiles monetary data in line with the recommendations of the *Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG)*. 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)*. A 2016 technical assistance (TA) mission supported the NBG in expanding the scope to include also the other financial corporations (OFC) sector; producing financial accounts; and working towards the compilation of flow-based monetary statistics for the central bank and other depository corporations. Since early 2017, the NBG is regularly reporting to STA quarterly data on OFCs for publication in *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 monthly basis, but the NBG publishes core and encouraged financial soundness indicators (FSI) with quarterly frequency. Following a 2017 TA mission, the NBG improved from quarterly to monthly the frequency of FSI reporting to STA for dissemination on the IMF website.

External sector statistics: Over the past few years, GEOSTAT and NBG continued to enhance external sector statistics (ESS). The most significant accomplishments included: (i) amendment of the Law on Official Statistics for assuring the mandatory reporting of statistical data by all public and private entities; the amendments facilitate GEOSTAT to carry out its responsibilities; (ii) implementation of online survey of external economic activity (SEEA) that resulted in considerable improvements in coverage, quality, and timeliness of reporting; (iii) improved coverage and methodological soundness of international merchandise trade statistics (IMTS); (iv) improved quality of data reported to the IMF's Coordinated Direct Investment Survey (CDIS); and (v) enhanced cooperation with the NBG on producing ESS.

However, there are still areas for improvement. In particular, the accuracy of the data on trade in goods (e.g. consistency between the custom and balance of payments data) and foreign direct investment (FDI) should be enhanced. The revision and dissemination procedures should also be improved by streamlining the institutions involved and providing clear information (e.g. reasons for revisions and methods for estimations) to users. GEOSTAT and NBG made significant progress in implementing the 2016 mission's recommendations.

II. Data Standards and Quality

The country has subscribed to the SDDS since May 17, 2010.

Data ROSC was published on March 2012.

Georgia: Table of Common Indicators Required for Surveillance

(as of May 22, 2018)

	Date of latest observation	Date received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷	Memo Items: ⁸	
						Data Quality Methodological soundness ⁹	Data Quality – Accuracy and reliability ¹⁰
Exchange Rates	04/2018	01/05/2018	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	04/2018	07/05/2018	D	D	M		
Reserve/Base Money	04/2018	18/05/2018	D	D	M	O, O, LO, O	LO,O,O,O,O
Broad Money	04/2018	18/05/2018	D	D	M		
Central Bank Balance Sheet	04/2018	09/05/2018	D	D	M		
Consolidated Balance Sheet of the Banking System	04/2018	18/05/2018	M	M	M		
Interest Rates ²	04/2018	18/05/2018	M	M	M		
Consumer Price Index	0/2018	04/05/2018	M	M	M	O,LO,O,O	LO,O,LO,O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	31/03/18	02/04/18	M	M	M	O,O,LO,LO	O,O,O,O,O
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	31/03/18	02/04/18	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	31/12/17	08/02/18	Q	Q	Q		
External Current Account Balance	31/12/17	30/03/18	Q	Q	Q	O,O,O,O	LO, O, LO, O, LO
Exports and Imports of Goods and Services	30/03/18	25/04/18	Q	Q	Q		

Georgia: Table of Common Indicators Required for Surveillance (concluded)
(as of May 22, 2018)

GDP/GNP	31/12/17	21/03/18	Q	Q	Q	O,LO,LO,L O	LNO, O, LO, O, LO
Gross External Debt	31/12/17	30/03/18	Q	Q	Q		
International Investment Position ⁶	31/12/17	30/03/18	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 and domestic banks, 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 row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization 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 the Staff Representative on Georgia
Executive Board Meeting
June 27, 2018**

1. This statement provides information that has become available since the issuance of the staff report on June 14, 2018. This information does not change the trust of the staff appraisal.
2. On June 13, 2018, Prime Minister Kviratskhvilia announced his resignation. Following constitutional procedures, the government was dismissed.
3. On June 20, Parliament approved a new government led by Mamuka Bakhtadze, former Minister of Finance. Prime Minister Bakhtadze has provided assurances that the authorities remain committed to the policies detailed in the Letter of Intent of May 31, 2018 and the associated Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding.

**Statement by Mr. Doornbosch, Alternate Executive Director for Georgia,
and Mr. Botel, Senior Advisor to Executive Director for Georgia
June 27, 2018**

The Georgian authorities thank staff for the dedicated and constructive engagement during the mission, for the well-written report and an excellent set of SIPs. They agree with the thrust of the staff appraisal and look forward to continuing the fruitful dialogue and cooperation with the Fund. A new cabinet has been approved by the Parliament on June 20, 2018. The new Prime Minister has indicated that the continuation of the IMF program is the number one priority of the new government.

Through solid implementation of macroeconomic policies, against the backdrop of stronger economic activity in main trading partners and supported by the Extended Fund Facility (EFF), Georgia's growth and macroeconomic stability continues to consolidate. Growth has lately exceeded expectations and inflation has returned close to target. Fiscal overperformance and efforts to address structural weaknesses have helped boost confidence. Georgia's external position has strengthened and the banking sector remains liquid, profitable and well capitalized.

The authorities are well aware that safeguarding the macroeconomic stability and fostering sustainable and more inclusive growth require addressing structural challenges from a narrow production base, underdeveloped infrastructure, significant skill mismatches in the labor market, high financial dollarization, rural poverty and inequality. The coherent framework designed to address these challenges consists in the Government's Four Point Plan and the NBG's policies and reform plans. The Four Point Plan identifies the main strategic directions: (I) reforming education to promote adequate skills development, labor productivity growth, and job creation; (II) accelerating core infrastructure to leverage Georgia's strategic geographic location as a transit and tourism hub; (III) improving governance and efficiency of the government; and (IV) enhancing the role of the private sector as an engine for growth.

Macroeconomic outlook is positive.

Recent data show that growth maintains strong momentum. April's preliminary estimate of economic activity shows an advance of 6.5 percent. Inflation fell at the beginning of 2018 below but close to 3% target. Inflation is expected to stay around 2,5% for the remainder of the year and then to converge again toward the target inflation rate. While performance of the first months suggests that growth for the whole year may again surpass the baseline forecast of 4.8 percent, risks coming from external sector deterioration have also increased, primarily in relation to the significant depreciation of the Turkish Lira. Overall, the authorities consider that risks to the outlook remain relatively balanced.

Key objectives and components of program policies:

Fiscal policy remains committed to medium-term fiscal consolidation, while providing space for scaling-up public investment.

The 2017 augmented fiscal deficit was lower than programmed due to higher GDP growth and lower losses from the corporate income tax reform. In line with program commitments, revenue over-performance was used to accelerate capital spending and to refund a higher amount of VAT claims. The authorities will maintain their prudent and proactive conduct of fiscal policy in the future and plan to build precautionary buffers for identified fiscal risks. In addition, all new measures and reforms with significant fiscal impact (such as the envisaged comprehensive education reform) will be incorporated in the multi-year budgetary framework, together with any measures necessary to secure a neutral impact on the projected path of the deficit.

Given the authorities' firm commitment to fiscal consolidation, the fiscal space necessary for boosting public investment, to reduce infrastructure bottlenecks, will continue to be provided by reducing current spending, from 25 percent of GDP in 2016 to 20.4 percent in 2020. This will be achieved by improving the efficiency of public spending: containing the wage bill and administrative expenses; better targeting of subsidies and social assistance programs; privatizing loss-making SOEs; and improving performance-based budgeting. At the same time, to protect the most vulnerable population, the existing social safety net will be maintained and the basic public pension will be increased.

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

To enhance the efficiency of revenue administration, the authorities are implementing a 3-year plan based on the 2016 TADAT and the follow-up IMF TA. Georgia's Revenue Services (GRS) has already been restructured according to logical groupings of core functions, and is currently in the process of implementing staffing in line with international best practices. The plan will focus on improving VAT administration by implementing automatic risk assessment and risk-based auditing of VAT declarations, and automatic refund of new VAT credits, while gradually eliminating the accumulated stock of unrefunded VAT. Also by streamlining the process of filing compliance, revising the tax penalty regime to promote more efficiency and fairness, and by providing GRS with third-party information necessary for risk analysis.

Containing fiscal risks is crucial for fiscal sustainability. While carefully monitoring key fiscal risks associated with SOEs and Public-Private Partnerships (PPPs), including Power Purchasing Agreements (PPAs) in the energy sector, the authorities recognize the important role that PPPs and PPAs can play in attracting investment, including FDI. A new PPP law, compliant with best international practices, was approved by the Parliament in May 2018. The authorities devised concrete measures to widen and improve the coverage of the Fiscal Risks Statement accompanying the budget, and to strengthen the monitoring of SOEs. To improve the Public Investment Management Framework, the Ministry of Finance created a dedicated public investment unit, in charge of evaluating investment projects based on cost/benefit analysis.

The fiscal framework will be revised to prevent procyclicality and safeguard fiscal sustainability. A revised fiscal rule will apply to fiscal outturns rather than projections, clarify definitions of aggregates and escape clauses, and enhance coverage, communication, transparency and oversight.

The authorities appreciate and are encouraged by staff's analytical work presented in the SIPs, they clearly show that the government's fiscal package, augmented by the reforms aimed to increase government efficiency, will have significant positive effects on medium term growth.

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

Foreign exchange interventions will be limited to smoothing excessive volatility and strengthening the international reserves position. The level of gross international reserves, currently below the level recommended by the IMF's ARA metric, will be raised throughout the program.

The NBG continues their efforts to strengthen the monetary policy transmission mechanism. The liquidity management and provision will continue to be improved. One step forward has been the newly introduced one-month monetary instrument. The NBG will propose legal amendments to support derivatives and repo transactions in line with best international practices, and is planning to extend open market operations to outright purchases of treasury securities by mid-2018. The well-functioning of the interbank market is clearly reflected by the proximity of interbank and policy rates.

While gradually declining, due to the larization measures taken so far and improved confidence in the economy, dollarization remains relatively high. To further support de-dollarization the NBG has decided to widen the differential of Payment-to-Income and Loan-to-Value limits between local and foreign currency loans. In addition, the NBG has decreased the required reserves ratio for local currency liabilities from 7% to 5% and decreased the remuneration for Required Reserves in Foreign currency by additional 150 bps.

The NBG will continue to enhance communication by issuing a manual for monetary policy operations. Besides holding press conferences with every other monetary policy meeting, in 2017 the central bank started to hold press briefings in various regions of the country to further extend the reach of policy transparency and accountability.

Financial sector policies will further strengthen the supervisory and regulatory framework, improve the macroprudential tools, and develop financial safety nets.

Financial reforms have been steadily progressing in line with the program recommendations. Authorities' next priorities for strengthening financial regulation and supervision include: finalizing the prudential regulation framework for microfinance institutions and the non-prudential regulation to other lenders; developing a supervision framework for financial conglomerates; issuing regulations on leverage ratios, credit information bureaus, banks real estate appraisal of collateral, corporate governance; and the net stable funding ratio.

The analytical toolkit for macroprudential policy design will be substantially enhanced by the macro-financial model being developed by the NBG with IMF TA. It will provide input for the new version of the Financial Stability Report to be issued, starting in 2019. To overhaul the banking resolution framework and to enhance crisis management, the authorities will submit to the Parliament in 2019 legislative changes to implement emergency liquidity

assistance and resolution frameworks in line with international best practices. Building the institutional and informational infrastructures to foster capital market development is another priority.

Structural reforms will enhance the role of the private sector as an engine for growth.

Education reform is critical to foster job creation, improve productivity and reduce inequality, and is a top priority of the new cabinet. The lack of qualified labor is identified as the main difficulty for doing business in Georgia. Skill mismatches are the primary cause of high unemployment, especially in rural areas. Therefore, education reform, in cooperation with the World Bank, will focus on setting curriculum standards with the participation of employers and promote vocational training and adult learning. Staff's analysis in the SIPs evaluates that well-integrating the comprehensive education reform into the overall reform agenda will produce sizeable long-run effects on TFP and potential growth.

Scaling-up infrastructure and spatial planning to transform Georgia into a transportation, logistical and tourism hub connecting Europe and Asia is a key development strategy for the authorities. Developing radial roads to better connect regions and urban and rural areas together with government support for tourism development will help turn Georgia into a four-season tourist destination.

The authorities will continue to improve the business environment by, among other measures, introducing IFRS requirements for corporations, reforming the insolvency law and establishing a one-stop shop for public services to business, by 2019. Land registration will be supported 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, Georgia has the ambition to further integrate in the global economy to reach its growth potential. This ambition is reflected in the authorities' strong record of implementing the current program's policies and reforms. The new cabinet fully recognizes the need to remain vigilant, carefully monitor the risks, and resolutely continue the reform efforts to address structural obstacles to growth.