INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/79

GEORGIA

April 2021

EIGHTH REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT—PRESS RELEASE; AND STAFF REPORT

In the context of the Staff Report for the Eighth Review Under the Extended Fund Facility Arrangement, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on April 9, 2021 on a lapse-of-time basis, following discussions that ended on March 29, 2021 with the officials of Georgia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on March 31, 2021.

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

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Washington, D.C.

PR21/106

IMF Executive Board Completes the Eighth Review under the Extended Fund Facility for Georgia

FOR IMMEDIATE RELEASE

- *The completion of the eighth review concludes the EFF supported program which has helped strengthen the economy's resilience to shocks, as underscored by Georgia's ability to successfully navigate the fallout from the COVID-19 pandemic.*
- *The Georgian economy is expected to resume growth from the second quarter of 2021 onwards and output is projected to expand by 3.5 percent this year.*
- *Continued prudent macroeconomic policies and implementation of structural reforms would help ensure a durable and inclusive recovery.*

Washington, DC – April 12, 2021: On April 9, the Executive Board of the International Monetary Fund (IMF) completed on a lapse of time basis[1] the Eighth Review of Georgia's economic reform program supported by a four-year extended arrangement under the Extended Fund Facility (EFF). This is the last review under the arrangement and its completion will release SDR 78 million (about $111 million), bringing total disbursements to SDR 484 million (about $687 million).

Repeated restrictions on movement and economic activity took a toll on economic growth with output contracting by 6.2 percent in 2020. The authorities' policy response helped limit the human toll of the pandemic and rightly focused on protecting the vulnerable. After successfully navigating the second wave of COVID-19 and commencing vaccinations, Georgia is at a potential turning point in overcoming the fallout of the pandemic. The next steps are to decisively bring COVID-19 under control, secure the recovery, and maintain macroeconomic policy discipline in a challenging environment. Under the baseline, a strong recovery is expected to commence in the second quarter of 2021 and output is expected to expand by 3.5 percent for the year.

The 2021 budget appropriately provides additional targeted support to vulnerable households and businesses to help cope with the pandemic. If more fiscal support is needed due to a new wave of the pandemic, reprioritizing spending should be the first line of defense. Increased public debt and sizable contingent liabilities make strict adherence to the fiscal rule especially important to preserve credibility. Proactive monitoring of fiscal risks remains essential, and advancing state owned enterprise reform would help control and mitigate those risks.

Due to consecutive shocks related to concerns over travel restrictions in the second half of 2019, the outbreak of the pandemic in early 2020, and recent spillovers of trading partner currency volatility, the lari has come under repeated bouts of pressure. The NBG remains appropriately focused on achieving its inflation target which is a cornerstone of Georgia's macroeconomic policy framework. The most recent policy rate increase responds to elevated inflation expectations following a somewhat prolonged period of inflation exceeding its target.

[1] The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

Further increases in the policy rate may be needed if external pressures persist. Overall, the inflation targeting framework, combined with the floating exchange rate regime, continues to serve Georgia well and foreign exchange intervention should remain aimed at preventing disorderly market conditions.

The financial sector remained profitable in 2020 and the banking system managed to maintain sufficient capital buffers to withstand the COVID-19 shock, reflecting the effectiveness of the supervisory regime before the crisis. Looking ahead, supervisors should aim to calibrate policies that balance the need to support the recovery and to proactively deal with the increase in non-performing loans. The new bank resolution framework will further strengthen financial resilience.

In addition to prudent macroeconomic policies, advancing the structural reform agenda will be essential to sustain a durable and inclusive recovery. The near-term priorities are operationalizing the insolvency framework to deal with the aftermath of the COVID-19 shock, and education reform.

Georgia: Selected Economic and Financial Indicators, 2018-2022

	2018	2019	2020	2020	2021	2022
	Actual		Country Report 20/322 1/	Prelimi-nary	Projections	
National accounts and prices	(annual percentage change; unless otherwise indicated)					
Real GDP	4.8	5.0	-5.1	-6.2	3.5	5.8
Nominal GDP (in billion of laris)	44.6	49.3	49.9	49.4	53.3	59.3
Nominal GDP (in billion of U.S. dollars)	17.6	17.5	16.2	15.9	16.2	18.1
GDP per capita (in thousand of U.S. dollars)	4.7	4.7	4.4	4.3	4.4	4.9
GDP deflator, period average	4.3	4.9	5.2	6.9	5.2	3.8
CPI, Period average	2.6	4.9	5.2	5.2	3.8	2.7
CPI, End-of-period	1.5	7.0	3.5	2.4	5.0	2.4
Investment and saving	(in percent of GDP)					
Gross national saving	21.4	24.2	16.6	14.6	13.2	16.5
Investment	28.1	29.3	26.4	26.9	24.1	24.4
Public	6.4	8.0	8.1	8.6	7.9	6.9
Private	21.7	21.3	18.3	18.4	16.2	17.5
Consolidated government operations	(in percent of GDP)					
Revenue and grants	26.4	27.1	24.9	25.1	25.2	25.7
o.w. Tax revenue	23.4	23.7	21.8	22.2	22.6	23.1
Expenditures	29.2	29.6	34.2	34.9	33.3	30.1
Current expenditures	21.3	21.4	25.9	26.2	25.2	22.9
Capital spending and budget lending	7.9	8.2	8.3	8.7	8.1	7.2
Net Lending/Borrowing (GFSM 2001)	-0.8	-1.8	-8.8	-9.2	-7.4	-3.7
Augmented Net lending / borrowing (Program definition)[2/]	-2.3	-2.1	-9.0	-9.3	-7.6	-4.0
General government debt[3/]	38.9	40.4	56.3	60.0	60.8	58.2
o.w. Foreign-currency denominated	31.6	32.0	44.3	47.5	49.6	45.5
Money and credit	(in percent; unless otherwise indicated)					
Credit to the private sector	19.9	20.7	17.1	22.4	6.4	8.3
In constant exchange rate	17.7	16.1	10.0	9.0	5.5	8.6
Broad money	13.9	17.6	14.3	24.6	16.9	16.6
In constant exchange rate (estimate)	15.1	14.3	8.8	14.4	15.8	17.6
Broad money (excl. fx deposits)	15.9	18.8	14.3	18.8	17.7	18.4
Deposit dollarization (percent of total)	63.1	64.0	64.1	67.5	67.0	66.2
Credit dollarization (percent of total)	57.1	55.4	56.9	55.7	55.0	54.9
Credit to the private sector (percent of GDP)	57.4	62.8	72.6	76.6	75.5	73.5
External sector	(in percent of GDP; unless otherwise indicated)					
Current account balance	-6.8	-5.1	-9.8	-12.3	-10.9	-7.9
Trade balance	-23.4	-21.3	-17.1	-19.8	-18.9	-18.0
Terms of trade (percent change)	-5.1	2.9	4.8	5.2	-9.2	1.7
Gross international reserves (in billions of US$)	3.3	3.5	3.6	3.9	3.6	4.0
In percent of IMF Composite measure (floating)	95.3	98.2	105.4	111.0	97.8	98.9
Gross external debt	101.0	105.6	127.0	124.8	133.9	126.2
Gross external debt, excl. intercompany loans	82.9	86.9	103.8	104.1	110.3	103.9
Laris per U.S. dollar (period average)	2.53	2.82	…	3.11	…	…
Laris per euro (period average)	2.99	3.15	…	3.55	…	…
REER (period average; CPI based, 2010=100)	106.2	100.5	…	97.5	…	…

Sources: Georgian authorities; and Fund staff estimates.

1/ Please refer to this link for details https://www.imf.org/en/Publications/CR/Issues/2020/12/18/Georgia-Seventh-Review-Under-the-Extended-Fund-Facility-Arrangement-and-Request-for-49973

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

3/ Excludes domestic legacy debt of 1.2 percent of GDP.

INTERNATIONAL MONETARY FUND

GEORGIA

March 31, 2021

EIGHTH REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT

EXECUTIVE SUMMARY

Context. Georgia has emerged from its second lockdown that was imposed in November 2020 following a sharp increase in COVID-19 cases. Vaccinations commenced in March 2021 and the country is now entering a critical stage in overcoming the pandemic. The lockdowns drove a contraction of around 6.2 percent of GDP in 2020, and a recovery is expected to take hold in the second quarter of 2021.

Program status. This is the final review of the EFF arrangement, which remains broadly on track. All end-December quantitative performance criteria and indicative targets have been met. All but one of the remaining structural benchmarks have been met and the remaining one should be completed by end-April. Completion of this review will make SDR 78 million (about $111 million) available to Georgia, bringing total disbursements under the EFF arrangement to SDR 484 million (about $687 million).

Program policies. The 2021 budget implies a mildly contractionary fiscal stance while continuing to provide support to households and businesses, which should help limit the impact of the crisis on the population and support the economic recovery. The medium-term fiscal path is anchored by the fiscal rule which calls for the fiscal deficit to reach 3 percent of GDP and public debt to be below 60 percent of GDP by 2023.

The National Bank of Georgia raised the policy rate by 50 basis points on March 17th and remains committed to ensuring that inflation expectations remain firmly anchored. Exchange rate flexibility has helped cushion the economy against the shock of the pandemic, while disorderly foreign exchange market conditions that could prove disruptive to financial stability have been avoided. Proactive monitoring of financial risks, prudent provisioning, and maintaining supportive measures with respect to capital requirements until the economy is clearly recovering should allow the banking system to support the recovery while avoiding the build-up of vulnerabilities.

Decisive implementation of structural reforms is critical to limit economic scarring from the pandemic. Mobilizing investment, advancing education reform, fully implementing the new insolvency framework, developing local capital markets, and judiciary reforms would further improve the business environment and support private sector–led growth.

Approved By
Subir Lall (MCD) and Craig Beaumont (SPR)

An IMF team consisting of S. Lall (head), S. Khan, S. Saksonovs (all MCD), A. Lagerborg (FAD), M. Leika (MCM), Y. Zhao (SPR), S. Cakir (Resident Representative) and N. Sharashidze (Local Economist) held discussions with the Georgian authorities by videoconference during March 24 – 29, 2021. K. Danelia and T. Pecherkina assisted in the preparation of this report. Discussions were led on the authorities' side by Governor K. Gvenetadze, Finance Minister I. Matchavariani, and other senior officials. Mr. Zedginidze (OED) participated in the discussions.

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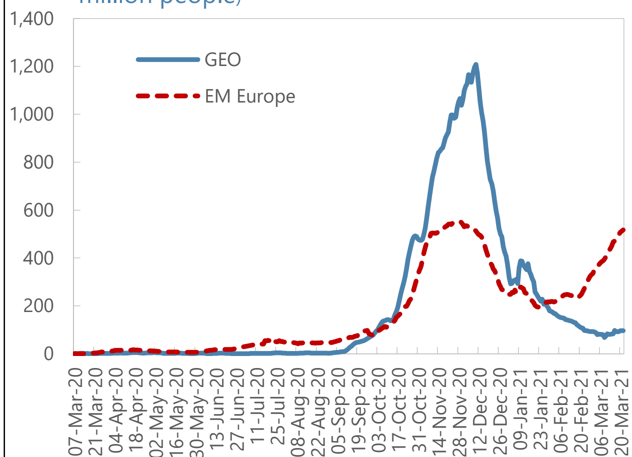
APPENDIX

RECENT ECONOMIC DEVELOPMENTS

1. **Georgia is emerging from its second lockdown with daily COVID-19 cases plateauing at levels last seen prior to the surge.** All the restrictions introduced in end-November have been gradually removed except for the nightly curfew. The number of new cases has fallen from a peak of over 1,200 per million to 96 as of end-March, less than a fifth of the average of emerging European countries[1] (Text Figure). Vaccinations of medical personnel began on March 15th and of people over the age of 65 on March 25th. The new government[2] remains committed to securing sufficient vaccine supplies both through the COVAX initiative as well as through bilateral negotiations with suppliers.

Daily COVID-19 Cases
(7-day moving average of new cases per one million people)



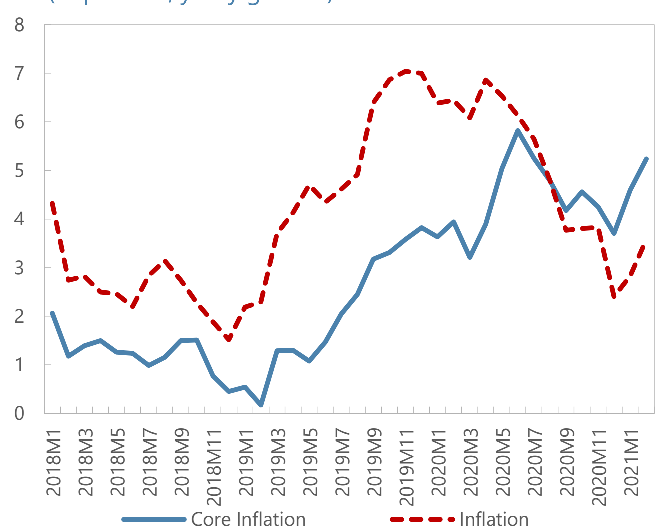
Source: European Centre for Disease Prevention and Control, and IMF staff calculations.

2. **The second lockdown has delayed the recovery of economic activity (Tables 1-4).**

- Renewed restrictions on movement and other measures led to a decline in GDP of 6.8 percent (y-o-y) in the fourth quarter of 2020. Real GDP contracted by 6.2 percent in 2020, with the decline largely driven by net exports reflecting the collapse of tourism revenues by 83 percent last year.

- A temporary subsidy on utility costs (due to expire in March) brought headline inflation down to 2.4 percent (y-o-y) in December 2020. Since then inflation recovered to 3.6 percent (y-o-y) in February 2021 with core inflation somewhat higher at 5.2 percent. The increase in inflation reflects higher energy and input costs as well as the pass-

Inflation
(In percent, y-o-y growth)



Source: National authorities, and IMF staff cailculations.

[1] These include: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Montenegro, North Macedonia, Poland, Romania and Serbia.

[2] Prime Minister Gakharia resigned on February 18th over political differences with other leaders from his party, and a new government headed by PM Garibashvili of the same party took office on February 22nd. The main opposition parties have refused to participate in the parliament The authorities have reaffirmed the continuity of economic policies.

through from depreciation in nominal effective terms since January 2021.

- The current account deficit for 2020 is now estimated at 12.3 percent of GDP, double the size of the 2019 deficit in dollar terms. The increase in the deficit was driven by the decline in the tourism revenue by 83 percent (y-o-y). This was partially offset by an improvement in the trade balance due to broad-based import compression and robust growth in net remittances (by 28 percent y-o-y) as travel restrictions may have shifted some informal remittances to formal channels.

- The financial account surplus is estimated at 5.5 percent of GDP, slightly lower than the 2019 level in dollar terms. A significant deterioration in net FDI (by 40 percent y-o-y) and net portfolio outflows have been partially offset by donor financing (for example, project loans to the government increased by 39 percent y-o-y).

- The lari had depreciated by 5.6 and 7.4 percent (y-o-y) in nominal and real effective terms, respectively, as of end-December 2020. Its 14 percent depreciation against the dollar was offset by an appreciation against the Turkish lira and the Russian ruble. Since January 2021, the lari depreciated by an additional 2.2 percent against the dollar through March 26th.

Text Table 1. Georgia: Budget Execution, 2019-2020
(GEL millions)

	2019		2020		Difference	
	GEL mls	% of GDP	GEL mls	% of GDP	GEL mls	pp of GDP
Revenues and grants	13,350	27.1	12,422	25.1	-928	-2.0
Taxes	11,860	24.1	10,979	22.2	-881	-1.9
of which: COVID-19 tax relief	0	0.0	-362	-0.7	-362	-0.7
of which: VAT refunds	-615	-1.2	-1,040	-2.1	-425	-0.9
Other revenues	1,067	2.2	1,038	2.1	-30	-0.1
Grants	422	0.9	405	0.8	-17	0.0
Primary current spending	9,907	20.1	12,190	24.7	2,283	4.6
of which: COVID-19 fiscal measures	0	0.0	1,504	3.0	1,504	3.0
Interest expense	611	1.2	769	1.6	158	0.3
Net acquisition of non-financial assets	3,739	7.6	4,022	8.1	283	0.5
Capital spending	3,945	8.0	4,229	8.6	284	0.6
of which: COVID-19 health equipment	0	0.0	73	0.1	73	0.1
Privatization	-206	-0.4	-208	-0.4	-2	0.0
Net budget lending	111	0.2	57	0.1	-54	-0.1
Augmented deficit	-1,019	-2.1	-4,617	-9.3	-3,598	-7.3

Source: National authorities and IMF staff estimates.

3. **The cost of COVID-19 support measures and declining revenues substantially increased the budget deficit in 2020 (Text Table 1).** The augmented deficit reached 9.3 percent of GDP, well below the adjusted program ceiling of 10.1 percent of GDP.[3] Revenues declined not only due to the

[3] The target ceiling (GEL 4,300 million) was adjusted up due to higher VAT refunds (GEL 440 million), project loan disbursements (GEL 249 million) and COVID-19 related healthcare spending (GEL 67 million), and down due to sales of non-financial assets (GEL -58 million).

recession but also because of income and property tax relief measures announced by the government. Fiscal support provided to individuals and businesses in response to the COVID-19 pandemic amounted to 3.8 percent of GDP in spending and revenue measures[4], one of the highest levels in the Caucuses and Central Asia (CCA) region. Capital spending was maintained at historically high levels of 8.6 percent of GDP, with the increase driven by spending on highway construction. The authorities almost doubled VAT refunds from 615 million GEL in 2019 to 1,040 million GEL in 2020, and implemented automatic VAT refunds in October 2020, which should help provide liquidity to the private sector.

4. **The 2021 budget provides further support to the economy, although most measures are scheduled to expire by mid-year.** The adopted budget for 2021 envisages a deficit of GEL 4,082 million (7.6 percent of GDP, **end-December 2020 SB**) implying a mildly contractionary fiscal stance. The budget includes 7.9 percent of GDP in capital spending and 2.3 percent of GDP in targeted and temporary fiscal support to households and businesses (Text Table 2). This support includes subsidies announced in December for utility costs starting January 1st, 2021 for households with low consumption and for food producers, which was financed by the reprioritization of spending. The budget also includes 0.6 percent of GDP in new spending on education reform (0.2 percent on teacher salaries and 0.4 percent on infrastructure).

Text Table 2. Georgia: COVID-19 One-Off Fiscal Measures in 2021

Support Beneficiary	Description	GEL million	percent of GDP
	Revenue measures	**270**	**0.5**
Employment Support	Income tax relief for businesses who retain workers.	225	0.4
Firms	Property tax exemption for the tourism sector.	45	0.1
	Expenditure measures	**977**	**1.8**
	Goods and Services	**252**	**0.5**
Health	Healthcare-related (e.g. medical supplies, hospitalization, quarantine)	225	0.4
	Micrograntsand subsidizing basic food products	27	0.1
	Subsidies	**110**	**0.2**
Households	Subsidies for utility billds to households with low consumption	60	0.1
	Subsidies to food producers for electricity tariff hikes.	50	0.1
	Social benefits	**530**	**1.0**
Health	Healthcare-related (e.g. testing and treatment costs).	225	0.4
Households	Compensation for private sector employees who lose jobs.	150	0.3
	Direct transfers to vulnerable families (incl. with 3+ children)	73	0.1
Households	Direct transfers to people with severe disbilities.	27	0.1
	Subsidies to households for electricity tariff hikes.	55	0.1
	Grants	**85**	**0.2**
SMEs	Credit guarantee scheme	50	0.1
Households	Interest rate subsidies on mortgages (below GEL200,000, issued in 2020	35	0.1
	Total COVID-19 Fiscal Measures	**1,247**	**2.3**

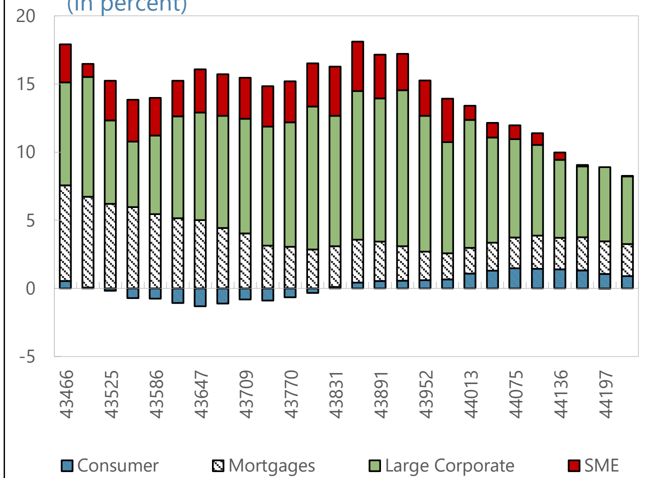
Source: National authorities and IMF staff estimates.

[4] The cost was lower than the budgeted amount of 4.1 percent of GDP due to lower-than-expected demand from SMEs for the credit guarantee scheme.

5. The National Bank of Georgia (NBG) increased the policy rate in March citing concerns about exchange rate pass-through and inflation expectations. After lowering interest rates by a cumulative 100 basis points since the start of the pandemic, the NBG had kept the policy rate on hold from September 2020 until March 17th, 2021 before raising it by 50 basis points.

6. Credit growth has been resilient and bank capitalization remains broadly adequate notwithstanding an increase in non-performing assets and restructured loans. As of end-February 2021 credit growth (at constant exchange rates) was 8.3 percent (y-o-y), down from a peak of 18.1 percent in February 2020, driven by large corporate and to a lesser extent mortgage borrowing.[5] All of the growth was due to lari denominated loans. Growth in foreign currency loans of around 1 percent (y-o-y) fell to its lowest levels since mid-2017. System-wide regulatory capital ratios declined to 17.6 percent as of end-2020 from 19.5 percent in 2019 **(Table 5)**, but the sector finished the year with a small profit. Non-performing loans (NPLs) remained broadly unchanged (at 2 percent) since the COVID-19 outbreak; at the same time, impaired assets (or NPLs under NBG definition) have almost doubled as a share of total loans from a low of 4.4 percent in 2020Q1 to 8.2 percent in 2020Q4. The main contributing factor to asset quality deterioration was lari volatility, while the impact of the COVID-19 lockdown and loan moratoria led to a sharp increase in the amount of restructured loans, which reached 18 percent in Q4 2020.

Decomposition of Credit Growth
(In percent)



Source: NBG, and IMF staff calculations.

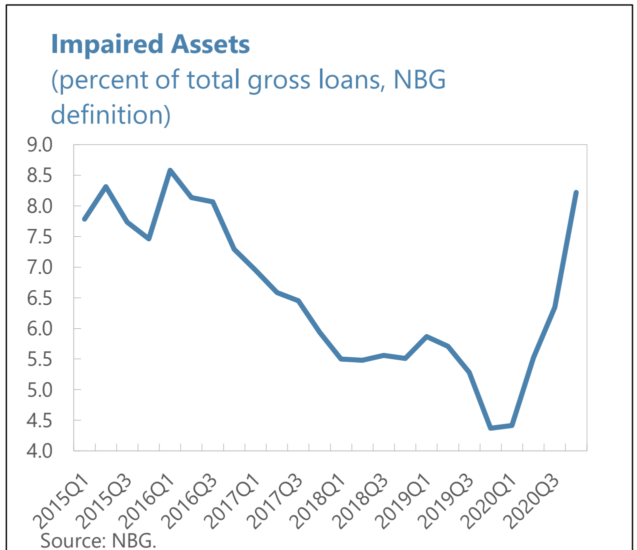
7. The NBG continued foreign exchange market interventions in early 2021 to avoid disorderly market conditions. After back to back shocks of concerns over travel restrictions in the second half of 2019, and the outbreak of the pandemic in early 2020, the lari has repeatedly come under bouts of pressure. A period of relative stability since the introduction of the second lockdown and lower than expected interventions helped bring net international reserves (at program exchange rates) by end-December 2020 to $1,335 million, $435 million above the adjusted target.[6] Gross international reserves reached $3,911 million at end-2020, $405 million above 2019 level, reflecting $1.3 billion in donor assistance. The NBG sold an additional $160 million in January-March 2021.

8. Program implementation is strong. Inflation remained within the inner bands of the inflation consultation clause (ICC). All end-December quantitative performance criteria (QPC) and indicative targets (IT) were met. The authorities met all structural benchmarks (SB) except the one on

[5] Gross issuance of new loans declined in 2020 by around 13 percent. The increase in the overall stock of credit is driven by lower repayments due to longer loan maturities and repayment moratoria in effect for much of 2020.

[6] The NIR target was adjusted down by $201 million due to lower than expected inflows from foreign loans and grants.

the regulatory framework for insolvency professionals and initiating the licensing of insolvency professionals **(end-March 2020, SB)**. The framework for insolvency professionals has been issued, but the actual licensing has not yet begun and is expected to start in April 2021.

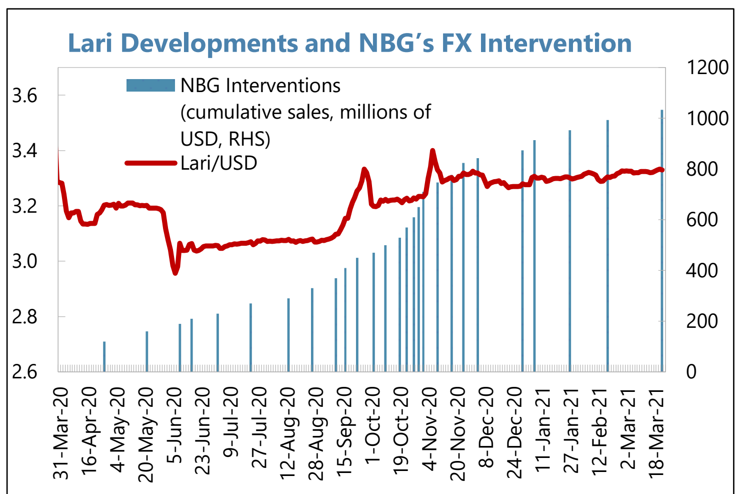


Source: NBG.

OUTLOOK AND RISKS

9. Near-term growth prospects remain subdued, and the medium-term recovery will not bring GDP back to levels projected prior to the pandemic within the projection horizon (scarring). Growth in 2021 is projected at 3.5 percent, somewhat weaker than projected at the time of the seventh review. The revision reflects: (i) the impact of carry-over from the fourth quarter of 2020; (ii) an expected slower recovery of tourism revenues; and, (iii) weaker domestic demand due to an uncertain vaccination timeline and voluntary social distancing. Over the medium term, growth is expected to recover to 5¼ percent, supported by infrastructure spending, along with a gradual recovery in tourism and external demand. The level of real output expected in 2024 is now around 11 percent lower compared to the pre-pandemic projection for that year. This scarring reflects the structure of the economy (e.g. the tourism sector cannot increase capacity quickly to compensate for the lost time) and dislocations in the labor market, which may suppress demand over the medium-term.

10. Staff projects a balance of payments (BOP) gap of $0.7 billion in 2021. The current account deficit is expected to narrow from 12.3 percent of GDP in 2020 to 10.9 percent of GDP in 2021, mostly driven by the gradual recovery in tourism and goods exports. The financial account surplus is projected to slightly decrease to 4.4 percent of GDP in 2021, as FDI recovers and other net inflows return to their historical trends. Overall, the BOP gap in 2021 is partially driven by a continued weakness in tourism receipts, with tourism revenue in 2021 projected at only 26 percent of its 2019 level. The gap is expected to be closed with IMF and donor financing.



Source: NBG, Haver, and IMF staff calculations.

11. The baseline scenario envisages declining inflation and a gradual improvement in the current account. Inflation is expected to pick up as the impact of utility subsidies expires and to be higher than the NBG's target this year. By 2022, the impact of the still negative output gap should outweigh the impact of higher energy prices and input costs and, assuming the exchange rate remains stable in nominal effective terms, inflation should decline before eventually converging to the three percent target from below. The current account balance is projected to gradually improve over the medium term, although it is expected to return to the 2019 level only by around 2026, partly due to the protracted recovery in tourism. Meanwhile, as the economic outlook improves domestically and abroad, FDI inflows are projected to gradually increase, which—together with robust other inflows—should enable the NBG to maintain reserves at close to 100 percent of the assessment of reserve adequacy (ARA) metric. External debt is expected to decline to 2019 levels by 2026 (Table 6). Public debt remains sustainable; however, it is largely denominated in foreign currency and risks related to gross financing needs have increased (Annex I).

12. Risks surrounding the outlook are balanced (Annex II). The emergence of new COVID-19 variants in Georgia or elsewhere could derail the recovery by requiring additional lockdowns and reducing external demand. Difficulties with vaccine procurement could slow the recovery. Continued political uncertainty given the lack of participation of main opposition parties in the Parliament, and election-related social unrest could exacerbate lari volatility, reverse the declining trend in inflation, and reduce demand in the short term. Disorderly depreciation of the lari may threaten financial stability given high dollarization of the economy and the upward trend in NPLs. On the upside, if the efforts to control COVID-19 are successful, the recovery could be stronger than expected due to pent-up demand and large fiscal support this year.

13. Authorities' views. The authorities broadly agreed with the outlook and the characterization of risks. They noted that the most recent inflation data suggests upside risks to inflation projections, underscoring the need for vigilance. They saw continued adverse external developments (including the recent impact of financial turmoil in Turkey) as the main source of risks in the near future.

POLICY DISCUSSIONS

A. Fiscal Policy: Providing Support to Recovery While Complying with the Fiscal Rule

14. The authorities and staff agreed that the 2021 budget remains appropriate at the current juncture. The budget provides continued support to the economy, through temporary and targeted fiscal support measures and elevated capital spending, while also beginning the necessary convergence towards the fiscal rule. This implies a mildly contractionary fiscal stance (MEFP ¶8). Fiscal support should not be withdrawn too quickly, which could weaken the economic recovery. Staff agreed with the authorities' decision to refinance the Eurobond due in April 2021, given still relatively benign global financial conditions and the need to preserve buffers for downside risks (MEFP ¶17). With gross government debt hovering around 60 percent of GDP (the limit prescribed by the fiscal rule), and anticipated substantial external borrowing to finance the balance of payments gap, the authorities expect to repay domestic debt (0.5 percent of GDP) in 2021 and draw down deposits. Over the medium-term, however, domestic issuance should increase to support local bond market development and reduce the share of foreign exchange (FX) denominated liabilities.

15. Spending reprioritization should be the first line of defense against the materialization of downside risks. The authorities and staff agreed that there is little scope to increase the fiscal deficit in 2021 given the need to maintain the credibility of the fiscal rule. An increase in the deficit would necessitate an even more abrupt fiscal adjustment in 2022-23. Staff suggested that there is scope to extend more targeted measures (e.g. targeted cash transfers to vulnerable households) at a cost of 0.5 percent of GDP by cutting capital spending. Staff advised against extending less targeted measures such as income tax exemptions and utility subsidies. The authorities agreed that there should be some spending reprioritization in a downside scenario and noted that current spending should also be subject to reprioritization. Staff and the authorities agreed that accelerating VAT refunds is another promising way to provide support to the economy, especially if tax revenues overperform. The authorities reaffirmed their commitment to reduce the stock of VAT credits, including by continuing automatic refunds.

16. The authorities' reaffirmed their commitment towards medium-term fiscal consolidation in compliance with the fiscal rule. Georgia's fiscal rule imposes ceilings on the fiscal deficit (3 percent of GDP) and government debt to be achieved by 2023, three years after the activation of the exit clause due to the pandemic. The authorities agreed that this will be achieved by an unwinding of the COVID-19 support measures (both on the revenue and expenditure side) and reducing capital spending in the medium run as major infrastructure projects are completed (MEFP ¶10). However, incorporating SOEs as part of the general government fiscal reporting, set to begin in 2021, could add around 0.8 percent of GDP to debt, further reducing fiscal space. In this context the authorities and staff agreed that mobilizing revenues, including by improving tax administration and assessing and streamlining VAT expenditures, will be important to create space for higher public investment and current spending pressures. The authorities are considering postponing the education spending floor (6 percent of GDP starting in 2022) due to reduced fiscal space.

17. Staff welcomed the authorities' efforts to improve transparency and mitigation of fiscal risks and strengthen tax administration.

- To reduce future risks from power purchase agreements (PPAs), the authorities extended the feed-in premium scheme to cover all renewable energy projects and not just those based on hydropower. This will ensure technology neutrality. The authorities agreed to avoid engaging the public sector in any energy investment without an independent technical evaluation that supports commercial viability and ensuring that it is fiscally sustainable (MEFP ¶12-13).

- The authorities have limited the operations of the Partnership Fund (PF) in line with their program commitments and committed to continue this after the expiration of the program (MEFP ¶14). Staff called for the joint-stock company structure of the PF to be dismantled.

- The 2020 Fiscal Risk Statement has been improved in line with recommendations of IMF technical assistance (TA) **(end-December 2020 SB)**. The report now summarizes the reclassification of state-owned enterprises (SOE), assesses the gross financing requirements of major SOEs, estimates quasi-fiscal activities, and coverage has been expanded to 90 percent of SOEs. Staff welcomes the authorities' commitment to continue to enhance the risk analysis (MEFP ¶15).

- A comprehensive strategy for SOE reform has been developed jointly with IMF TA, in line with end-March commitments. The authorities are also committed to developing a new governance framework covering establishing commercial objectives, performance management, and principles for competitive neutrality among other things. Staff urged the authorities to advance their SOE governance reform plans and the authorities agreed to explore options for implementation (MEFP ¶16).

- Staff welcomed the authorities' progress in reducing the outstanding stock of unrefunded VAT credits and their commitment to continue automatic refunding of new VAT credits, implemented in November 2020, that will help prevent the stock from increasing (MEFP ¶19-20).

- The Georgia Revenue Service (GRS) has made significant improvements in tax administration. The GRS has been enhancing its risk-based approach to better identify non-compliant cases. The GRS is also implementing an audit case management system, for which a pilot has been completed and GRS is starting to train its auditors. The system will be fully operational by May 2021, which should improve productivity and timeliness of audits (MEFP ¶21).

B. Monetary and Exchange Rate Policies: Anchoring Inflation Expectations

18. Monetary policy faces a trade-off between supporting the economy and ensuring inflation remains well controlled (MEFP ¶24). Most of the drivers of current inflation are transient, but survey-based inflation expectations remain elevated. The authorities and staff agreed that a tight monetary policy stance limits the risk that inflation expectations internalize the dynamic of lari depreciation and associated inflation. Continued adverse external developments may necessitate further policy rate increases. Monetary easing to support the economic recovery can be reconsidered provided inflation pressures remain subdued and inflation expectations firmly anchored. The NBG expressed readiness to tighten further if exchange rate pressures intensify and pointed to supportive fiscal policy as an additional factor supporting the need for tight monetary policy stance in the near term.

19. Exchange rate flexibility facilitated macroeconomic adjustment, but high dollarization presents a challenge. Georgia's external position in 2020 was broadly in line with the level implied by fundamentals and desirable policies. However, external vulnerabilities have increased relative to 2019 given the anticipated slow recovery of tourism and the build-up of external debt (Annex III). Gross international reserves are expected to decline from 111 to 98 percent of the ARA metric in 2021 mainly due to lower donor support. The authorities and staff agreed that external buffers are critical to sustain confidence, which is needed for macroeconomic and financial stability. FX sales should be used judiciously if needed to prevent disorderly market conditions (MEFP ¶25 – 27). The authorities agreed with the external sector assessment. The authorities and staff agreed that high levels of loan and deposit dollarization, although common in many emerging markets, continue to present a challenge for the implementation of monetary policy and financial stability. The authorities are considering ways to provide incentives for borrowing and saving in the local currency.

C. Financial Sector Policies: Dealing with the Aftermath of COVID-19

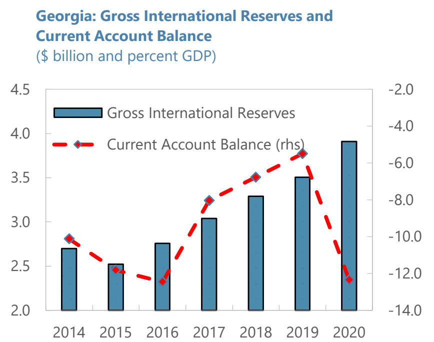
20. The NBG is actively monitoring the increase in non-performing loans and encouraging banks to promptly recognize losses (MEFP ¶28). The NBG developed standardized scenarios and methodology to assess credit losses expected from the delayed COVID-19 recovery. These guidelines also aim at avoiding delays in recognizing potential losses due to the loan moratoria as well as the ongoing loan restructuring. The buffers built in March 2020 from preemptive provisioning are still expected to be sufficient to account for the deterioration in asset quality due to the pandemic, although the gap between the share of NPLs and share of loan loss reserves is beginning to widen. Staff called for additional measures to deal with rising NPLs such as developing markets for distressed assets over the medium term or requiring NPLs to be written off (or fully provisioned without taking into account the value of collateral) automatically after a certain period (such as two years). NBG noted that: (i) most market participants continue to view the COVID-19 shock as temporary and hence are more inclined to restructure loans; (ii) the NBG is more conservative as it accounts all impaired assets as NPLs (as opposed to the international practice of 90 days past due); and, (iii) the impact of the crisis should also be mitigated by the abundant funding liquidity for banks.

21. The authorities and staff agreed that pandemic-related policies should not be withdrawn too soon. Banks will be given a two-year period to rebuild their capital buffers and the timeline to start this process will depend on the outlook for profitability and be agreed in consultation with the industry. Staff also called to limit distributions to shareholders before the full impact of a slower recovery from the COVID-19 crisis and from loan portfolio impairments due to FX volatility is observed and provisioned for (MEFP ¶30). The authorities agreed to this, but noted that banks are keen to restart paying out dividends and have aggressive loan portfolio growth targets which are almost two times higher than Staff projections.

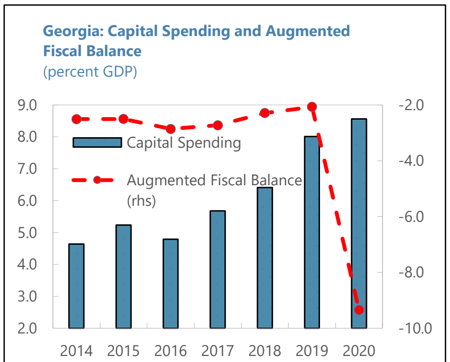
22. Staff welcomed the additional measures to strengthen financial resilience and discussed future reforms. The implementing regulations of banking resolution framework have been completed (**end-December 2020 SB)**. The NBG is working on further measures to develop local capital markets such as the legislation on securities' holding and covered bonds (MEFP ¶33). Developing the FX swap market could help banks bridge the gap between constraints on dollar lending and the population's desire to save in dollars, and at least partially address problems leading to a rapid FX loan portfolio quality deterioration. These issues will be further discussed in the ongoing IMF/World Bank Financial Sector Assessment Program (FSAP). The authorities and staff agreed that the recommendations of the ongoing FSAP, once reviewed and finalized, will provide an important direction for further reforms.

Box 1. Achievements Under the EFF Program

The objectives of the original program were fiscal consolidation and comprehensive financial sector and structural reforms. The authorities requested the Extended Fund Facility in 2017 to help deal with the aftermath of the decline in trading partners' growth after the 2014 regional shock. The program envisaged a shift in public spending from current to capital. To strengthen the resilience of the economy the authorities committed to enhancing the monitoring and transparency of fiscal risks, strengthening banking regulation and supervision, as well as enhancing financial safety nets and resolution framework. The structural reform agenda focused on tax administration improvements, mobilizing domestic savings through a funded pension system, infrastructure development and education reform. The program was extended in December 2019 and augmented in 2020 to help Georgia deal with the COVID-19 shock. The pandemic radically altered the macroeconomic framework. However, Georgia was in a stronger position to meet the shock owing to the policy measures enhancing resilience that were implemented under the program.



Source: NBG, and IMF staff calculations.



Source: NBG, and IMF staff calculations.

Under the program, the current account deficit declined, and the authorities managed to accumulate reserves. The average current account deficit fell from 11.5 percent of GDP (2014 to 2016) to 6.8 percent of GDP (2017-2019) partly reflecting growing tourism revenues. Even as the COVID-19 shock brought the current account deficit back to its 2016 level, gross international reserves increased, reaching almost $4 billion. This reflected the government's strategy of external borrowing to increase buffers.

The authorities were successful in achieving fiscal consolidation and rebalancing until the COVID-19 shock. The average augmented fiscal deficit was 2.4 percent of GDP between 2017 and 2019, compared to 2.6 percent of GDP between 2014 and 2016. At the same time, average capital spending increased from 4.9 percent of GDP (in 2014 to 2016) to 6.7 percent of GDP (2017 to 2019). The authorities also provide substantial support to the economy to deal with the COVID-19 outbreak.

The authorities significantly strengthened tax administration, improved control and increased transparency of fiscal risks. The government addressed the backlog of VAT refunds and put in place an automatic system, which should support the private sector. The authorities improved their published fiscal risk statement, expanding its coverage and deepening the analysis of risks stemming from PPAs and SOEs. Careful analysis of risks associated with PPAs prompted a more cautious approach to initiating new ones.

Comprehensive financial sector reform helped ensure resilience even during the COVID-19 shock. Building on the recommendations of the 2015 FSAP, the authorities implemented critical elements of the Basel III framework. They put in place a bank resolution framework and a deposit insurance agency.

The authorities implemented a pension reform, which should improve social safety nets and mobilize domestic savings. A rules-based mechanism to index basic pensions helps sustain real incomes of the pensioners while respecting fiscal sustainability. The establishment of the independent Pensions Agency, which is now accumulating assets should help mobilize savings in local currency.

D. Structural Reforms: Supporting the Recovery and Limiting Scarring

23. The authorities have resumed education reform (MEFP ¶37). Reforming teacher qualification framework is one of the key pillars of the reform. The authorities have updated a decree on teacher career advancement to establish a new approach that should help ensure career progression of the most qualified teachers and help attract and retain talented staff. More comprehensive steps are needed, however, for example, building on the progress with remote learning that accelerated during the pandemic.

24. A new insolvency framework should help deal with the aftermath of the COVID-19 shock (MEFP ¶38). The new law establishes timely and efficient insolvency processes, and effective rehabilitation framework in line with best international standards. More efficient insolvency procedures should help deal with the expected increase in corporate insolvencies in the aftermath of the COVID-19 shock. The law also introduces a new profession of insolvency practitioners who need to be licensed (see ¶8). The authorities should also consider other steps to improve the business environment, including through enhancing transparency and efficiency of the judiciary, strengthening governance and promoting rule of law.

25. Enhancing regional connectivity through infrastructure projects and free trade agreements should help solidify Georgia's position as a logistics hub. Highway construction continued despite the COVID-19 pandemic. The authorities have initiated a feasibility study on a Free Trade Agreement (FTA) with the Republic of Korea and remain committed to gradually expand an array of FTAs from which Georgia benefits (MEFP ¶39).

PROGRAM ISSUES AND FINANCING

26. Financing assurances are in place for the Eighth Review and the capacity to repay the Fund remains adequate. Adequate financing for the remainder of the program is assured (Table 7). Total external debt service remains elevated over the medium term, but debt service to the IMF appears to be manageable, even under downside scenarios. The full drawing under the program would imply repayments to the IMF at 0.5 percent of GDP or 2.6 percent of GIR in 2026 (Table 8).

27. The Eighth Review is the last review of the program and no new conditionality was proposed. The program was broadly successful in meeting its original objectives (Box 1) and contributed to the resilience of the Georgian economy in the face of the COVID-19 shock. Importantly, it also generated a track record of successful reforms and catalyzed significant assistance from other donors. The attached MEFP documents the latest outturns for inflation, QPCs and ITs and the structural benchmarks achieved (MEFP Tables 1-3). It also signals the authorities' continued commitment to key elements of the program.

28. Post-Program Monitoring (PPM) is not proposed at this time as the authorities have expressed strong interest in a follow-up program. Following the disbursement for the Eighth Review, the stock of outstanding credit will reach 229 percent of quota (Table 8). However, given that the authorities have expressed the desire to negotiate a follow-up program and this is expected within six months of the completion of this review, a PPM is not proposed at this time.

STAFF APPRAISAL

29. After successfully bringing the second wave of COVID-19 under control, Georgia is at a critical stage in restoring macroeconomic stability and securing the recovery. The back-to-back shocks of concerns over travel restrictions in the second half of 2019 and the outbreak of the COVID-19 pandemic have depleted the available policy space. The authorities' policy response helped limit the human toll of the pandemic and rightly focused on protecting vulnerable populations. The next policy steps should be focused on decisively bringing COVID-19 under control, securing the recovery and maintaining macroeconomic policy discipline in a challenging external and domestic environment.

30. Repeated restrictions on movement and economic activity took a toll on economic growth and potential. Following a stronger than expected contraction in 2020 of 6.2 percent, real output is now expected to increase by 3.5 percent in 2021. A strong recovery is expected starting in the second quarter of 2021 with the output gap closing by 2024. However, output is not expected to return to its pre-pandemic projected levels within the projection horizon.

31. Fiscal policy should remain anchored by the need to begin fiscal consolidation to comply with the fiscal rule by 2023. The 2021 budget appropriately provides additional targeted support to vulnerable households and businesses to help cope with the pandemic. If downside risks materialize and additional fiscal support is needed, the authorities should seek to reprioritize spending e.g. by reducing capital spending, instead of increasing the deficit. Increased public debt and sizable contingent liabilities make strict adherence to the fiscal rule especially important to preserve fiscal credibility. The authorities should continue to monitor fiscal risks by expanding the Fiscal Risk Statement and focus now on the SOE governance reform, which will help control and mitigate those risks.

32. The NBG remains rightly focused on achieving its inflation target. The most recent policy rate increase was justified as inflation expectations remained elevated following a prolonged period of inflation remaining above the target. Further increases in the policy rate should not be ruled out if depreciation pressures on the lari persist. Provided inflation pressures remain subdued and inflation expectations are firmly anchored, the NBG could consider policy rate cuts to support growth. Exchange rate flexibility has served Georgia well. The external sector assessment suggests that Georgia's external position in 2020 was broadly in line with the level implied by fundamentals and desirable policies; however, external vulnerabilities increased relative to 2019 in view of the slow recovery of tourism and the build-up of external debt stock. Hence, the NBG should continue to judiciously use interventions to prevent disorderly conditions on the foreign exchange market.

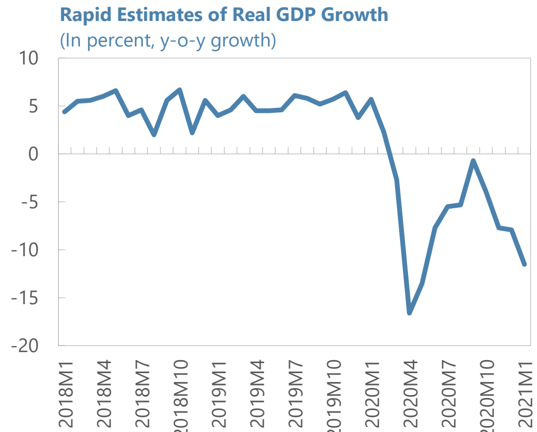
33. Financial sector policies should aim to facilitate the recovery and proactively deal with the increase in non-performing loans. Financial sector remained profitable in 2020 and majority of the banks remain adequately capitalized, reflecting intense supervision before the crisis. Banks have been assessing the quality of loan portfolios after the expiration of loan repayment moratoria using uniform standards developed by the NBG. The NBG is rightly focused on ensuring that losses are promptly recognized, but solvent enterprises and households are not denied financing due to temporary liquidity difficulties. The timeline for restoring pre-pandemic capital buffers, lifting moratoria for shareholder payouts should be adopted in consultation with the financial sector and based on banks' capital position, timely recognition of loan losses, and adequate provisioning. Staff welcomes full implementation of the bank resolution framework, which will further strengthen financial resilience to downside risks.

34. Structural reforms will be essential to sustain a durable and inclusive recovery. The near-term priorities are operationalizing the insolvency framework, which should help to deal with the aftermath of the shock, and education reform. A comprehensive education reform should help address the problem of skills mismatches and limit scarring by eventually increasing job creation, productivity and wages in the aftermath of the pandemic.

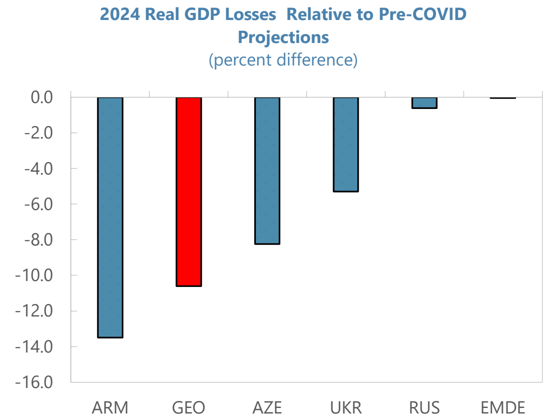
35. Staff supports the authorities' request for the completion of the Eighth Review. This is the final review of the program, which has helped enhance Georgia's resilience to shocks, as demonstrated in the last year due to the COVID-19 pandemic. Steps already taken and the authorities' policy commitments for the near term should help lay the foundations for a durable and inclusive recovery. Staff recommends that the next Article IV Consultation be completed on the 12-month cycle in accordance with the Decision on Article IV Consultation Cycles (Decision No. 14747- (10/96)).

Figure 1. Georgia: Real Sector Developments

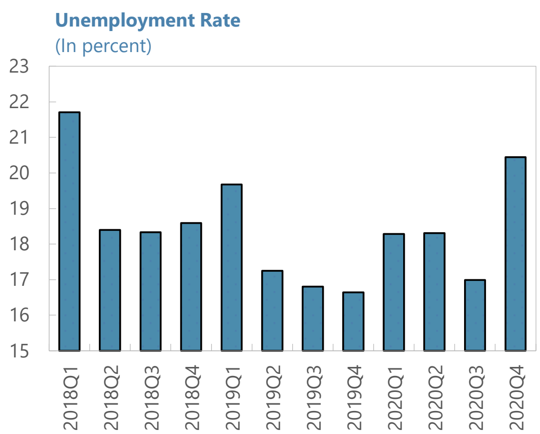
The second lockdown halted the recovery.



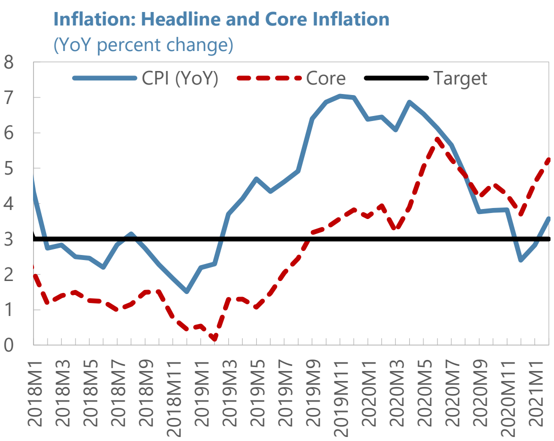
Cumulative output losses are now around 11 percent.



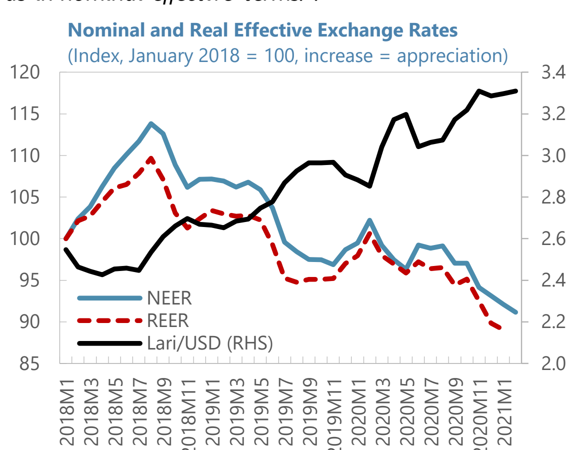
Recalculated unemployment rates[1] reached a three-year high.



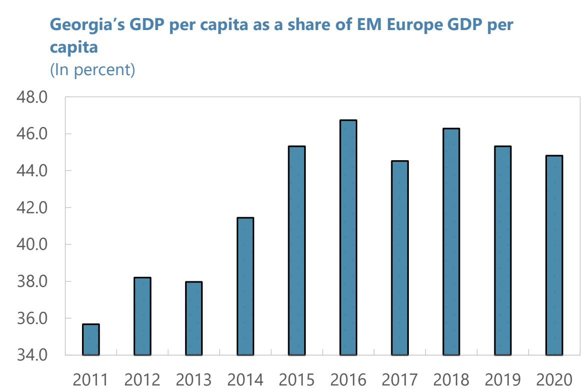
Headline inflation was subdued due to the subsidy on utilities, while core inflation accelerated…



…reflecting depreciation against the US dollar as well as in nominal effective terms. .



COVID-19 set back Georgia's convergence to EM Europe GDP per capita…

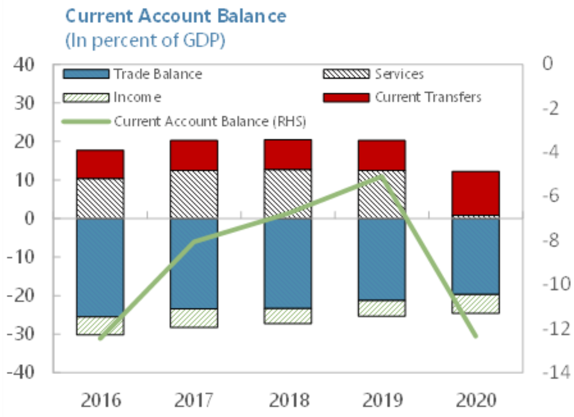


1/ Unemployment rates are recalculated according to the new standards adopted by International Labour Organization (ILO) at the 20th International Conference of Labour Statisticians. This resulted in an increase in unemployment rate of around 4 percentage points.

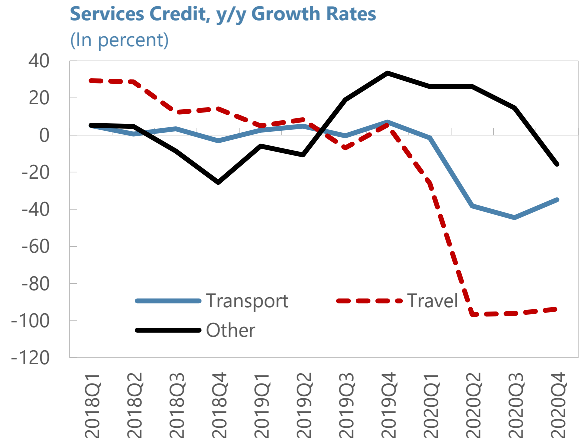
Source: National authorities, Haver, GEOStat, and IMF staff calculations.

Figure 2. Georgia: External Sector Developments

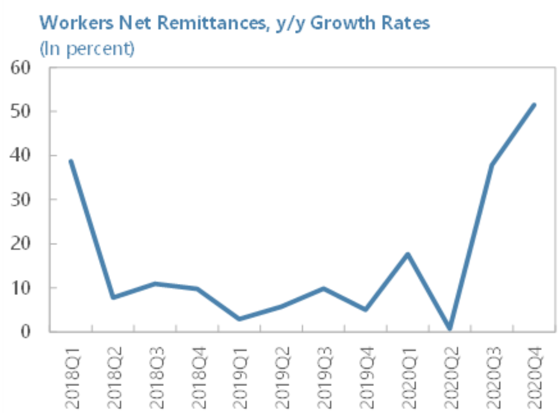
Current account deficit is estimated to have widened...



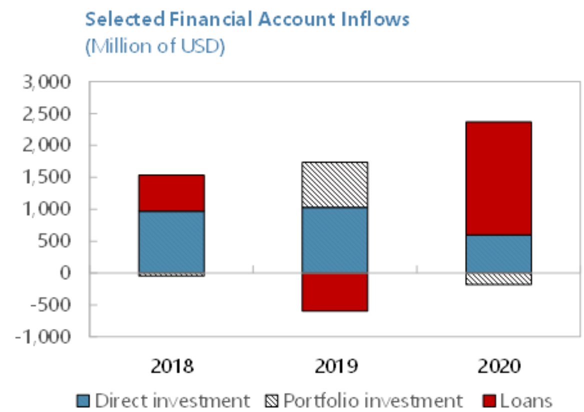
...largely due to significant reductions in tourism receipts.



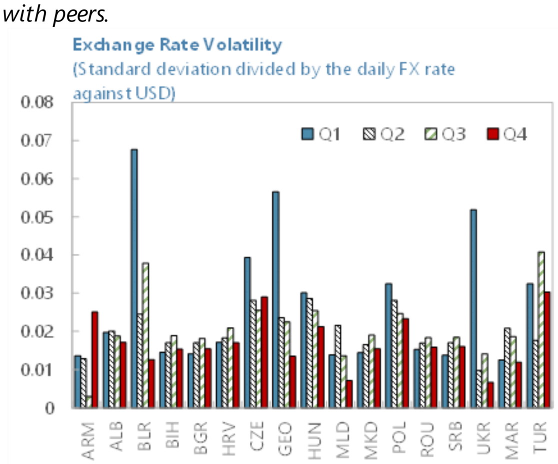
Remittances increased, as travel restrictions may have shifted some informal remittances to formal channels.



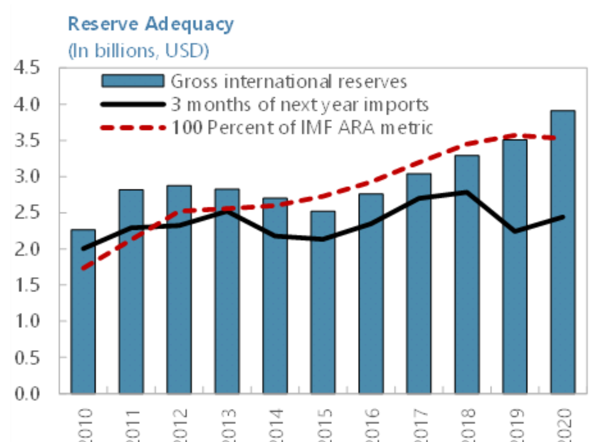
Financial account inflows remained robust but more reliant on debt financing.



Exchange rate volatility declined in 2020H2 owing to donor financing and NBG interventions and was in line with peers.



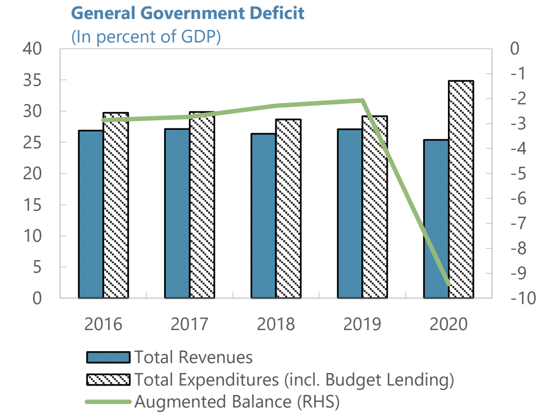
Reserve coverage reached an all-time high, supported by IMF and donor financing.



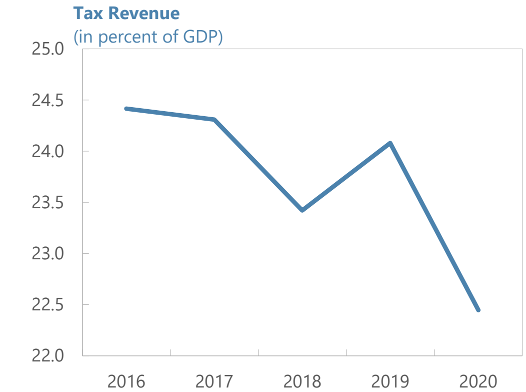
Source: National authorities, Haver, GeoStat, and IMF staff calculations.

Figure 3. Georgia: Fiscal Sector Developments

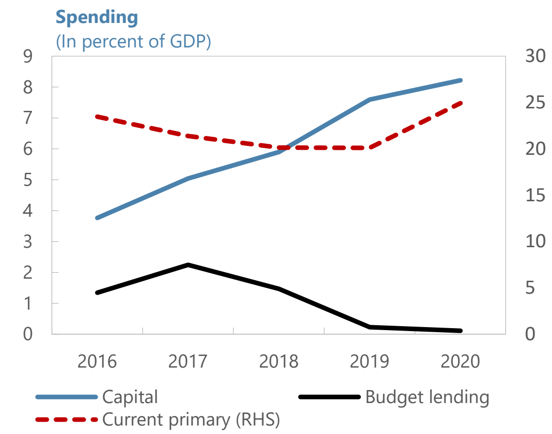
COVID-19 outbreak dramatically increased the general government deficit



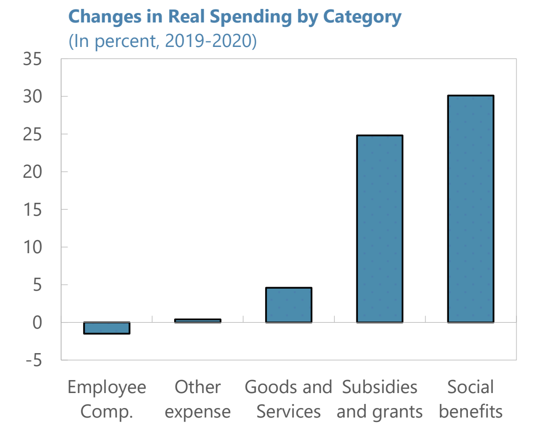
COVID-19 outbreak resulted in loss of revenues of around 2 percent of GDP…



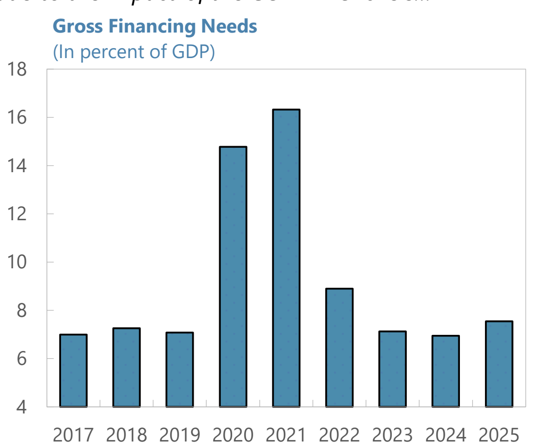
…along with an almost 5 percent of GDP increase in current spending…



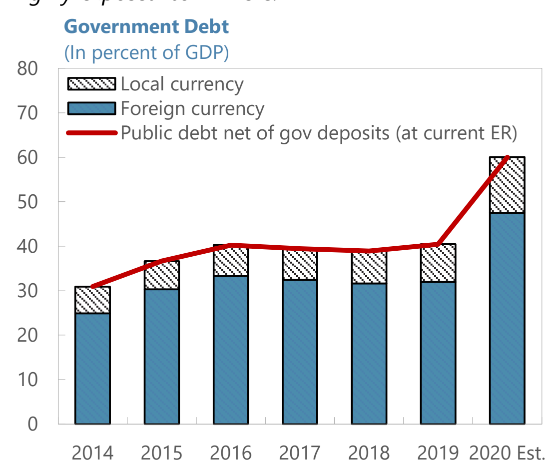
…concentrated on social benefits and subsidies and grants to deal with the pandemic.



Gross financing needs are expected to peak in 2020-21 due to the impact of the COVID-19 crisis…



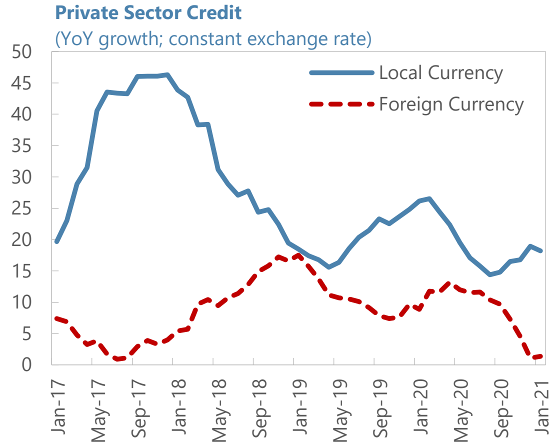
…triggering an increase in public debt which remains highly exposed to FX risks.



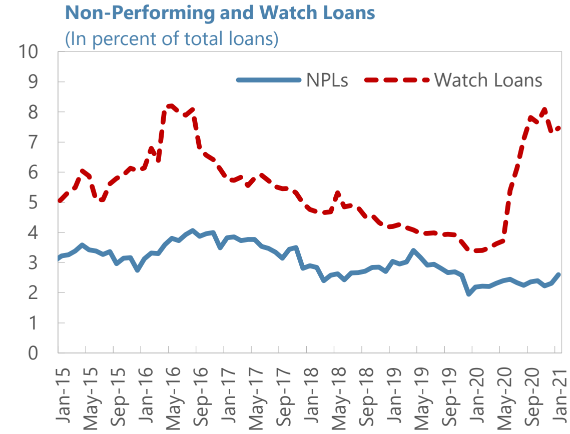
Source: National authorities, and IMF staff estimates.

Figure 4. Georgia: Financial Sector Developments

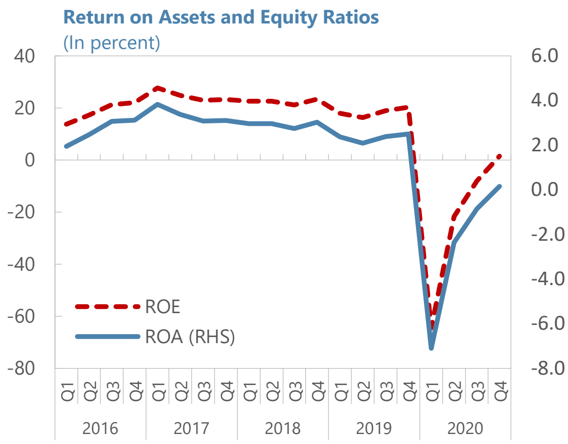
Private sector credit growth remained robust on account of local currency credit.



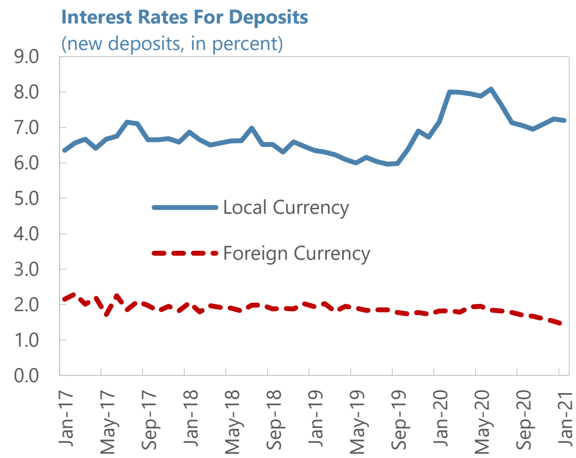
Watch loans have been rising, but NPLs so far remained subdued, reflecting repayment moratoria.



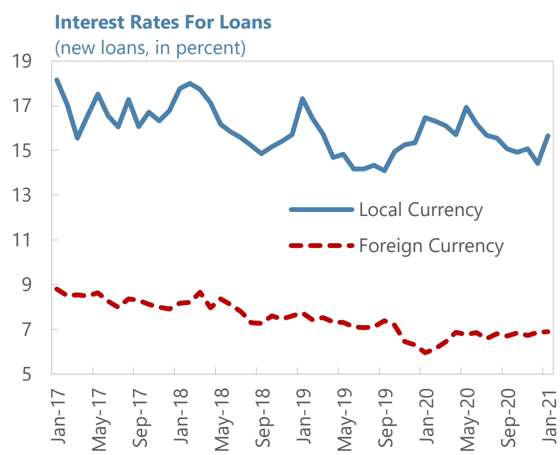
Profitability sharply deteriorated due to loan loss provisions, though it recovered by the end of the year.



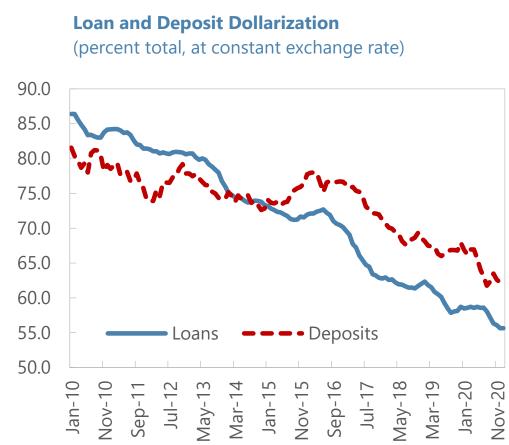
Interest rates on local currency deposits declined after the initial COVID-19 spike and remain below the policy rate.



Interest rates on loans remain broadly unchanged.



Loan and deposit dollarization declined somewhat in the aftermath of the COVID-19 shock.



Source: National Bank of Georgia, and IMF staff calculations.

Table 1. Georgia: Selected Economic and Financial Indicators, 2019–26

	2019	2020	2020	2021	2021	2022	2023	2024	2025	2026
	Actual	EFF 7th Review	Est.	EFF 7th Review	Projections					
National accounts and prices 1/	(annual percentage change; unless otherwise indicated)									
Real GDP	5.0	**-5.1**	-6.2	**4.3**	3.5	5.8	5.5	5.2	5.2	5.2
Output Gap	-0.6	**-2.7**	-3.9	**-2.5**	-2.8	-1.3	-0.3	0.0	0.0	0.0
Nominal GDP (in billion of laris)	49.3	**49.9**	49.4	**53.9**	53.3	59.3	63.9	69.6	75.2	81.6
Nominal GDP (in billion of U.S. dollars)	17.5	**16.2**	15.9	**17.0**	16.2	18.1	19.6	21.4	23.2	25.1
GDP per capita (in thousand of U.S. dollars)	4.7	**4.4**	4.3	**4.6**	4.4	4.9	5.3	5.8	6.2	6.8
GDP deflator, period average	4.9	**5.2**	6.9	**3.8**	5.2	3.8	3.0	3.0	3.0	3.0
CPI, Period average	4.9	**5.2**	5.2	**2.5**	3.8	2.7	2.7	3.0	3.0	3.0
CPI, End-of-period	7.0	**3.5**	2.4	**3.0**	5.0	2.4	3.0	3.0	3.0	3.0
Core CPI, End-of-period	3.8	**...**	3.7	**...**	...	...	...	...	...	...
Investment and saving	(in percent of GDP)									
Gross national saving	24.2	**16.6**	14.6	**15.1**	13.2	16.5	17.5	18.4	18.9	18.7
Investment	29.3	**26.4**	26.9	**23.6**	24.1	24.4	24.0	24.3	24.7	24.4
Public	8.0	**8.1**	8.6	**7.9**	7.9	6.9	5.9	5.7	5.3	5.1
Private	21.3	**18.3**	18.4	**15.7**	16.2	17.5	18.2	18.6	19.4	19.3
Consolidated government operations	(in percent of GDP)									
Revenue and grants	27.1	**24.9**	25.1	**24.9**	25.2	25.7	26.1	26.2	26.2	26.2
o.w. Tax revenue	23.7	**21.8**	22.2	**22.3**	22.6	23.1	23.5	23.7	23.7	23.8
Expenditures	29.6	**34.2**	34.9	**32.9**	33.3	30.1	29.1	29.0	28.8	28.6
Current expenditures	21.4	**25.9**	26.2	**24.9**	25.2	22.9	22.9	23.0	23.2	23.3
Capital spending and budget lending	8.2	**8.3**	8.7	**8.0**	8.1	7.2	6.2	5.9	5.6	5.3
Net Lending/Borrowing (GFSM 2001)	-1.8	**-8.8**	-9.2	**-7.4**	-7.4	-3.7	-2.3	-2.1	-2.0	-2.0
Augmented Net lending / borrowing (Program definition) 2/	-2.1	**-9.0**	-9.3	**-7.5**	-7.6	-4.0	-2.6	-2.4	-2.3	-2.3
General government debt 3/	40.4	**56.3**	60.0	**59.1**	60.8	58.2	56.7	54.6	52.9	51.3
o.w. Foreign-currency denominated	32.0	**44.3**	47.5	**48.0**	49.6	45.5	43.2	40.7	38.3	36.0
General government debt net of government deposits 3/	37.5	**49.6**	53.6	**55.1**	57.5	55.4	53.8	51.8	50.1	48.5
Money and credit	(annual percentage change; unless otherwise indicated)									
Credit to the private sector	20.7	**17.1**	22.4	**6.5**	6.4	8.3	8.3	8.1	8.1	8.2
In constant exchange rate	16.1	**10.0**	9.0	**6.0**	5.5	8.6	8.4	8.2	8.2	8.2
Broad money	17.6	**14.3**	24.6	**16.5**	16.9	16.6	9.3	10.4	9.6	11.1
In constant exchange rate (estimate)	14.3	**8.8**	14.4	**14.9**	15.8	17.6	9.5	10.5	9.7	11.1
Broad money (excl. fx deposits)	18.8	**14.3**	18.8	**17.7**	17.7	18.4	10.5	11.6	10.7	12.2
Deposit dollarization (percent of total)	64.0	**64.1**	67.5	**63.4**	67.0	66.2	65.5	64.8	64.2	63.6
Credit dollarization (percent of total)	55.4	**56.9**	55.7	**56.7**	55.0	54.9	53.9	52.9	51.9	50.9
Credit to the private sector (percent of GDP)	62.8	**72.6**	76.6	**71.5**	75.5	73.5	73.8	73.4	73.4	73.1
External sector	(in percent of GDP; unless otherwise indicated)									
Current account balance (in billions of US$)	-0.9	**-1.6**	-2.0	**-1.4**	-1.8	-1.4	-1.3	-1.3	-1.3	-1.4
Current account balance	-5.1	**-9.8**	-12.3	**-8.5**	-10.9	-7.9	-6.5	-5.9	-5.8	-5.7
Trade balance	-21.3	**-17.1**	-19.8	**-16.8**	-18.9	-18.0	-17.4	-16.9	-16.3	-15.6
Terms of trade (percent change)	2.9	**4.8**	5.2	**-0.5**	-9.2	1.7	1.6	1.9	1.4	0.3
Gross international reserves (in billions of US$)	3.5	**3.6**	3.9	**3.4**	3.6	4.0	4.2	4.5	4.6	4.8
In percent of IMF Composite measure (floating)	98.2	**105.4**	111.0	**95.4**	97.8	98.9	99.9	100.0	100.8	102.0
Gross external debt	105.6	**127.0**	124.8	**129.0**	133.9	126.2	123.1	118.0	113.6	107.9
Gross external debt, excl. intercompany loans	86.9	**103.8**	104.1	**106.5**	110.3	103.9	99.9	95.2	91.0	85.5
Laris per U.S. dollar (period average)	2.82	**...**	3.11	**...**	...	...	...	...	...	
Laris per euro (period average)	3.15	**...**	3.55	**...**	...	...	...	...	...	
REER (period average; CPI based, Jan 2010=100)	100.5	**...**	97.5	**...**	...	...	...	...	...	

Sources: Georgian authorities; and Fund staff estimates.

1/ National accounts numbers include the impact of GDP rebasing, which increased GDP levels while leaving growth rates unchanged.

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

3/ Excludes domestic legacy debt amounting to 1.2 percent of GDP.

Table 2. Georgia: Balance of Payments, 2019-26

	2019	2020	2020	2021	2021	2022	2023	2024	2025	2026
		EFF 7th		EFF 7th						
	Actual	Review	Proj.	Review			Projections			
					(in millions of U.S. dollars)					
Current account balance	-891	**-1,588**	-1,962	**-1,444**	-1,766	-1,435	-1,282	-1,252	-1,342	-1,426
Trade balance	-3,726	**-2,759**	-3,141	**-2,853**	-3,056	-3,262	-3,412	-3,612	-3,763	-3,917
Exports	4,990	**4,225**	4,375	**4,593**	4,783	4,925	5,413	5,946	6,301	6,600
Imports	-8,716	**-6,985**	-7,515	**-7,446**	-7,840	-8,186	-8,826	-9,558	-10,064	-10,517
Services	2,169	**79**	135	**430**	347	841	1,313	1,634	1,758	2,125
Services: credit	4,586	**1,634**	1,583	**1,993**	2,273	2,858	4,088	5,517	6,242	7,136
Services: debit	-2,418	**-1,555**	-1,449	**-1,563**	-1,926	-2,017	-2,775	-3,883	-4,484	-5,011
Income	-706	**-310**	-765	**-489**	-843	-849	-1,063	-1,249	-1,388	-1,552
Of which : interest payments	-607	**-597**	-565	**-582**	-582	-646	-683	-727	-772	-823
Transfers	1,373	**1,402**	1,809	**1,469**	1,786	1,835	1,881	1,975	2,052	1,917
Of which : remittances (net)	915	**951**	1,167	**1,018**	1,201	1,237	1,274	1,312	1,352	1,406
Capital account	48	**40**	38	**40**	40	39	38	38	37	36
General government	42	**40**	25	**40**	40	39	38	38	37	36
Financial account	972	**415**	877	**372**	719	1,706	1,529	1,428	1,464	1,548
Direct investment (net)	986	**611**	594	**575**	735	862	1,028	1,258	1,492	1,547
Portfolio investment (net)	707	**176**	-173	**-87**	-87	300	206	240	271	255
Equity	-50	**-10**	-15	**0**	0	0	0	0	0	0
Debt securities	758	**186**	-158	**-87**	-87	300	206	240	271	255
Loans (net)	-137	**276**	230	**507**	486	416	383	271	242	283
Short-term loans (net)	42	**53**	131	**-23**	-24	4	2	4	5	6
Public	-1	**-4**	-5	**-4**	-5	-5	-5	-5	-5	-5
Private	43	**57**	136	**-20**	-19	9	7	9	10	11
Medium and long-term loans (net)	-178	**222**	99	**530**	510	412	381	267	238	277
Public 1/	91	**247**	220	**219**	214	217	197	148	166	262
Private	-269	**-25**	-121	**311**	296	196	184	119	72	16
Bank	-73	**161**	118	**422**	403	334	322	273	243	29
Non-bank	-196	**-186**	-239	**-112**	-108	-138	-138	-154	-171	-14
Others (net) 2/	-585	**-648**	227	**-623**	-415	128	-88	-341	-541	-537
Errors and omissions	-53	**-36**	9	**0**	0	0	0	0	0	0
Overall balance	76	**-1,169**	-1,038	**-1,032**	-1,007	310	285	214	159	158
Financing	-324	**-136**	-179	**202**	261	-310	-285	-214	-159	-158
Gross International Reserves (-increase)	-202	**-136**	-315	**202**	261	-310	-285	-214	-159	-158
Rescheduled debts and arrears clearance	-121	**0**	136	**0**	0	0	0	0	0	0
Financing gap	248	**1,305**	1,217	**830**	746	0	0	0	0	0
Use of Fund Resources	35	**310**	315	**106**	106	0	0	0	0	0
Proposed IMF EFF	83	**310**	315	**109**	109	0	0	0	0	0
Repayment 3/	-48	**0**	0	**-4**	-4	0	0	0	0	0
Official creditors	212	**992**	903	**722**	641	0	0	0	0	0
Memorandum items:					(in percent of GDP)					
Current account balance	-5.1	**-9.8**	-12.3	**-8.5**	-10.9	-7.9	-6.5	-5.9	-5.8	-5.7
Trade balance	-21.3	**-17.1**	-19.8	**-16.8**	-18.9	-18.0	-17.4	-16.9	-16.3	-15.6
Financial account	5.6	**2.6**	5.5	**2.2**	4.4	9.4	7.8	6.7	6.3	6.2
Foreign direct investment (net)	5.6	**3.8**	3.7	**3.4**	4.5	4.8	5.2	5.9	6.4	6.2
External financing requirement	28.9	**33.3**	37.5	**26.5**	33.5	27.5	23.8	21.2	19.5	16.7
Gross international reserves (in million of USD)	3,506	**3,642**	3,911	**3,440**	3,650	3,959	4,244	4,458	4,617	4,775
in months of next year GNFS imports	4.7	**4.9**	4.8	**4.2**	4.3	4.1	3.8	3.7	3.8	3.2
in percent of short-term debt at remaining maturity	90	**99**	110	**90**	98	96	95	93	92	96
in percent of broad money and non-resident deposits	34	**38**	36	**33**	29	27	26	25	24	22
in percent of IMF Composite measure (floating)	98	**105**	111	**95**	98	99	100	100	101	102
in percent of short-term external debt (remaining maturity)	90	**99**	110	**90**	98	96	95	93	92	96
Reserve cover (percent) 4/	54.2	**50.9**	53.0	**48.0**	50.4	54.3	55.9	55.7	53.9	53.6

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 exisitng Fund resources over 2017-20 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, GFSM2001 2019–26
(in millions of GEL)

	2019	2020	2020	2021	2021	2022	2023	2024	2025	2026
	Actual	**EFF 7th Review**	Est.	**EFF 7th Review**				Projections		
Revenue	13,350	**12,448**	12,422	**13,421**	13,419	15,220	16,672	18,248	19,668	21,338
Taxes	11,860	**10,872**	10,979	**12,045**	12,064	13,682	15,042	16,505	17,813	19,386
Taxes on Income, profits and capital gains	4,349	**4,148**	4,246	**4,580**	4,610	5,394	5,834	6,371	6,937	7,528
Payable by individuals	3,483	**3,222**	3,327	**3,649**	3,677	4,387	4,747	5,167	5,584	6,059
Payable by corporations	866	**926**	919	**931**	933	1,008	1,087	1,203	1,353	1,469
Taxes on property	474	**400**	434	**415**	451	552	595	647	700	759
Taxes on goods and services	6,746	**6,379**	6,457	**6,930**	6,986	7,885	8,602	9,396	10,156	11,021
General taxes on goods and services (VAT)	5,239	**4,884**	4,837	**5,356**	5,338	6,053	6,626	7,246	7,833	8,499
Excises	1,507	**1,495**	1,619	**1,574**	1,648	1,832	1,976	2,150	2,324	2,522
Taxes on international trade	79	**74**	74	**78**	82	85	92	100	108	117
Other taxes 1/	212	**-129**	-232	**42**	-65	-46	95	-9	-88	-39
Grants	422	**496**	405	**276**	285	348	347	347	346	347
Other revenue	1,067	**1,080**	1,038	**1,100**	1,070	1,190	1,283	1,396	1,509	1,605
Total Expenditure	14,257	**16,837**	16,981	**17,393**	17,389	17,399	18,159	19,705	21,191	23,002
Expense	10,518	**12,932**	12,960	**13,407**	13,433	13,549	14,659	16,009	17,444	18,992
Compensation of employees	1,785	**1,850**	1,851	**1,955**	1,955	2,136	2,279	2,480	2,681	2,909
Use of goods and services	1,659	**1,825**	1,881	**2,070**	2,070	1,932	2,038	2,218	2,398	2,602
Interest	611	**801**	769	**933**	933	859	987	1,093	1,277	1,297
External	324	**386**	337	**388**	394	281	283	283	290	298
Domestic	287	**415**	433	**545**	539	578	704	810	988	999
Subsidies	990	**1,190**	1,452	**1,285**	1,325	1,171	1,235	1,344	1,452	1,711
Grants	126	**275**	237	**170**	177	89	96	104	113	122
Social benefits	4,198	**5,776**	5,575	**5,573**	5,571	5,604	6,127	6,706	7,292	7,930
Other expense 2/	1,150	**1,215**	1,196	**1,422**	1,402	1,759	1,897	2,064	2,231	2,421
Net acquisition of nonfinancial assets	3,739	**3,905**	4,022	**3,986**	3,956	3,850	3,500	3,696	3,747	4,010
Increase (capital spending)	3,945	**4,055**	4,229	**4,236**	4,206	4,100	3,750	3,950	4,000	4,150
Decrease (privatization proceeds)	-206	**-150**	-208	**-250**	-250	-250	-250	-254	-253	-140
Net lending / borrowing before adjustment	-907	**-4,389**	-4,559	**-3,972**	-3,970	-2,179	-1,487	-1,457	-1,523	-1,665
Unidentified measures	0	**0**	0	**0**	0	0	0	0	0	0
Net lending / borrowing	-908	**-4,389**	-4,559	**-3,972**	-3,970	-2,179	-1,487	-1,457	-1,523	-1,665
Change in net financial worth, transactions	-908	**-4,389**	-4,559	**-3,972**	-3,970	-2,179	-1,487	-1,457	-1,523	-1,665
Net acquisition of financial assets ("+": increase in assets)	456	**1,976**	1,773	**-1,105**	-1,383	139	371	303	374	403
Domestic	456	**1,976**	1,773	**-1,105**	-1,383	139	371	303	374	403
Budget lending	111	**80**	57	**91**	91	185	185	185	221	200
Deposits (NBG and commercial banks)	346	**1,896**	1,736	**-1,196**	-1,474	-46	95	118	153	203
Financial privatization	0	**0**	-21	**0**	0	0	0	0	0	0
Net incurrence of liabilities ("+": increase in liabilities)	1,364	**6,365**	6,332	**2,867**	2,587	2,318	1,858	1,760	1,897	2,068
Domestic	898	**1,809**	1,970	**-75**	-244	1,560	1,110	1,060	1,360	1,460
Securities other than shares	898	**1,215**	1,970	**-75**	-244	1,560	1,110	1,060	1,360	1,460
Loans	0	**594**	0	**0**	0	0	0	0	0	0
Foreign	467	**4,556**	4,362	**2,942**	2,831	758	748	700	537	608
Loans	467	**4,556**	4,362	**2,942**	2,831	758	748	700	537	608
Memorandum items:										
Nominal GDP	49,253	**49,897**	49,407	**53,924**	53,315	59,270	63,925	69,561	75,187	81,588
Government debt 4/	19,916	**28,106**	29,654	**31,862**	32,390	34,491	36,257	37,978	39,804	41,872
End-year government deposits	1,454	**3,350**	3,190	**2,154**	1,716	1,670	1,856	1,974	2,126	2,330
Operating balance	2,831	**-485**	-538	**14**	-14	1,671	2,013	2,239	2,224	2,345
Net lending / borrowing (excluding privatization)	-1,114	**-4,539**	-4,767	**-4,222**	-4,220	-2,429	-1,737	-1,711	-1,776	-1,805
Augmented Net lending / borrowing (Program definition) 3/	-1,019	**-4,469**	-4,617	**-4,063**	-4,061	-2,364	-1,672	-1,642	-1,744	-1,865
Cyclically-adjusted primary balance (Program definition)	-329	**-3,345**	-3,367	**-2,800**	-2,754	-1,310	-637	-549	-467	-567

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes cash outflows due to tax credit refunds.
2/ Includes wages and salaries in the education sector.
3/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.
4/ Excludes domestic legacy debt amounting to 1.2 percent of GDP.

Table 3b. Georgia: General Government Operations, GFSM2001 2019–26
(percent GDP)

	2019	2020	2020	2021	2021	2022	2023	2024	2025	2026
		EFF 7th		EFF 7th						
	Actual	Review	Est.	Review			Projections			
Revenue	27.1	**24.9**	25.1	**24.9**	25.2	25.7	26.1	26.2	26.2	26.2
Taxes	24.1	**21.8**	22.2	**22.3**	22.6	23.1	23.5	23.7	23.7	23.8
Taxes on Income, profits and capital gains	8.8	**8.3**	8.6	**8.5**	8.6	9.1	9.1	9.2	9.2	9.2
Payable by individuals	7.1	**6.5**	6.7	**6.8**	6.9	7.4	7.4	7.4	7.4	7.4
Payable by corporations	1.8	**1.9**	1.9	**1.7**	1.7	1.7	1.7	1.7	1.8	1.8
Taxes on property	1.0	**0.8**	0.9	**0.8**	0.8	0.9	0.9	0.9	0.9	0.9
Taxes on goods and services	13.7	**12.8**	13.1	**12.9**	13.1	13.3	13.5	13.5	13.5	13.5
General taxes on goods and services (VAT)	10.6	**9.8**	9.8	**9.9**	10.0	10.2	10.4	10.4	10.4	10.4
Excises	3.1	**3.0**	3.3	**2.9**	3.1	3.1	3.1	3.1	3.1	3.1
Taxes on international trade	0.2	**0.1**	0.2	**0.1**	0.2	0.1	0.1	0.1	0.1	0.1
Other taxes 1/	0.4	**-0.3**	-0.5	**0.1**	-0.1	-0.1	0.1	0.2	-0.1	0.0
Grants	0.9	**1.0**	0.8	**0.5**	0.5	0.6	0.5	0.5	0.5	0.4
Other revenue	2.2	**2.2**	2.1	**2.0**	2.0	2.0	2.0	2.0	2.0	2.0
Total Expenditure	28.9	**33.7**	34.4	**32.3**	32.6	29.4	28.4	28.3	28.2	28.2
Expense	21.4	**25.9**	26.2	**24.9**	25.2	22.9	22.9	23.0	23.2	23.3
Compensation of employees	3.6	**3.7**	3.7	**3.6**	3.7	3.6	3.6	3.6	3.6	3.6
Use of goods and services	3.4	**3.7**	3.8	**3.8**	3.9	3.3	3.2	3.2	3.2	3.2
Interest	1.2	**1.6**	1.6	**1.7**	1.7	1.4	1.5	1.6	1.7	1.6
External	0.7	**0.8**	0.7	**0.7**	0.7	0.5	0.4	0.4	0.4	0.4
Domestic	0.6	**0.8**	0.9	**1.0**	1.0	1.0	1.1	1.2	1.3	1.2
Subsidies	2.0	**2.4**	2.9	**2.4**	2.5	2.0	1.9	1.9	1.9	2.1
Grants	0.3	**0.6**	0.5	**0.3**	0.3	0.2	0.2	0.2	0.2	0.2
Social benefits	8.5	**11.6**	11.3	**10.3**	10.4	9.5	9.6	9.6	9.7	9.7
Other expense 2/	2.3	**2.4**	2.4	**2.6**	2.6	3.0	3.0	3.0	3.0	3.0
Net acquisition of nonfinancial assets	7.6	**7.8**	8.1	**7.4**	7.4	6.5	5.5	5.3	5.0	4.9
Increase (capital spending)	8.0	**8.1**	8.6	**7.9**	7.9	6.9	5.9	5.7	5.3	5.1
Decrease (privatization proceeds)	-0.4	**-0.3**	-0.4	**-0.5**	-0.5	-0.4	-0.4	-0.4	-0.3	-0.2
Net lending / borrowing before adjustment	-1.8	**-8.8**	-9.2	**-7.4**	-7.4	-3.7	-2.3	-2.1	-2.0	-2.0
Unidentified measures	0.0	**0.0**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0
Net lending / borrowing	-1.8	**-8.8**	-9.2	**-7.4**	-7.4	-3.7	-2.3	-2.1	-2.0	-2.0
Change in net financial worth, transactions	-1.8	**-8.8**	-9.2	**-7.4**	-7.4	-3.7	-2.3	-2.1	-2.0	-2.0
Net acquisition of financial assets ("+": increase in assets)	0.9	**4.0**	3.6	**-2.0**	-2.6	0.2	0.6	0.4	0.5	0.5
Domestic	0.9	**4.0**	3.6	**-2.0**	-2.6	0.2	0.6	0.4	0.5	0.5
Budget lending	0.2	**0.2**	0.1	**0.2**	0.2	0.3	0.3	0.3	0.3	0.2
Deposits (NBG and commercial banks)	0.7	**3.8**	3.5	**-2.2**	-2.8	-0.1	0.1	0.2	0.2	0.2
Financial privatization	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)	2.8	**12.8**	12.8	**5.3**	4.9	3.9	2.9	2.5	2.5	2.5
Domestic	1.8	**3.6**	4.0	**-0.1**	-0.5	2.6	1.7	1.5	1.8	1.8
Securities other than shares	1.8	**2.4**	4.0	**-0.1**	-0.5	2.6	1.7	1.5	1.8	1.8
Loans	0.0	**1.2**	0.0	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.9	**9.1**	8.8	**5.5**	5.3	1.3	1.2	1.0	0.7	0.7
Loans	0.9	**9.1**	8.8	**5.5**	5.3	1.3	1.2	1.0	0.7	0.7
Memorandum items:										
Nominal GDP (in millions of GEL)	49,253	**49,897**	49,407	**53,924**	53,315	59,270	63,925	69,561	75,187	81,588
General government debt 4/	40.4	**56.3**	60.0	**59.1**	60.8	58.2	56.7	54.6	52.9	51.3
End-year government deposits	3.0	**6.7**	6.5	**4.0**	3.2	2.8	2.9	2.8	2.8	2.9
Operating balance (before adjustment)	5.7	**-1.0**	-1.1	**0.0**	0.0	2.8	3.1	3.2	3.0	2.9
Net lending / borrowing (excluding privatization)	-2.3	**-9.1**	-9.6	**-7.8**	-7.9	-4.1	-2.7	-2.5	-2.4	-2.2
Augmented Net lending / borrowing (Program definition) 3/	-2.1	**-9.0**	-9.3	**-7.5**	-7.6	-4.0	-2.6	-2.4	-2.3	-2.3
Cyclically-adjusted primary balance (Program definition)	-0.7	**-6.7**	-6.8	**-5.2**	-5.2	-2.2	-1.0	-0.8	-0.6	-0.7

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes cash outflows due to tax credit refunds.
2/ Includes wages and salaries in the education sector.
3/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.
4/ Excludes domestic legacy debt amounting to 1.2 percent of GDP.

Table 4. Georgia: Monetary Survey, 2019-21

	2019	2020		2021	
				Projections	
		June	Dec	June	Dec
Central Bank			(In billions of lari)		
Net foreign assets	8.8	9.7	10.9	10.1	9.7
Gross international reserves	10.1	11.0	12.8	12.4	12.0
Foreign liabilities	1.3	1.4	1.9	2.4	2.4
Of which : use of Fund resources	0.7	0.8	1.2	1.7	1.7
Net domestic assets	0.2	-0.2	-0.1	0.5	2.3
Net claims on central government	-0.4	-0.3	-0.1	0.3	0.7
Claims on general government (incl. T-bills)	1.0	1.2	1.4	1.3	1.2
Nontradable govt. debt	0.2	0.2	0.2	0.2	0.2
Debt securities (tradable)	0.8	1.0	1.2	1.1	1.0
Deposits	1.5	1.5	1.5	1.0	0.5
Net claims on banks (excl. reserves)	3.1	2.8	3.2	3.4	4.8
Bank refinancing (incl. swap lines)	3.1	2.8	3.2	3.5	4.9
Certificates of deposits and bonds	0.1	0.1	0.1	0.1	0.1
Other items, net	-2.5	-2.7	-3.2	-3.2	-3.2
Reserve Money	8.9	9.5	10.8	10.6	12.0
Banking System			(In billions of lari)		
Net foreign assets	-0.4	-1.0	0.9	-2.8	-2.6
NBG	8.8	9.7	10.9	10.1	9.7
Commercial banks	-9.1	-10.7	-10.0	-12.9	-12.3
Net domestic assets	24.7	26.6	29.4	33.8	38.1
Domestic credit	33.3	36.2	40.2	41.9	43.9
Net claims on central government	1.6	2.0	1.5	2.1	2.7
Of which : government deposits at NBG	1.5	1.5	1.5	1.0	0.5
Of which : T-bills at commercial banks	0.8	1.6	2.8	2.5	2.3
Claims on Other Sectors	31.7	34.2	38.7	39.8	41.2
Other items, net	-8.6	-9.6	-10.7	-8.1	-5.8
Broad money (M3)	24.4	25.6	30.4	31.0	35.5
Lari Broad money (M2)	11.5	12.1	13.7	13.0	16.1
Currency held by the public	3.2	3.5	3.7	3.8	4.3
Lari resident deposits	8.3	8.6	9.9	9.1	11.7
Resident foreign exchange deposits	12.9	13.5	16.7	18.0	19.3
Sources of funds of commercial banks	39.8	42.9	49.7	51.2	57.5
Resident deposits	22.0	24.2	29.7	28.7	33.6
Non-resident deposits	5.0	5.3	5.6	6.1	6.5
Other resident liabilities	3.7	3.4	3.9	4.9	5.6
Other foreign liabilities	9.1	10.1	10.4	11.5	11.9
Uses of funds of commercial banks	39.8	42.9	49.7	51.2	57.5
Claims on Central Bank	5.7	6.1	7.1	5.4	7.6
Credit to the Private Sector	31.7	34.2	38.7	39.8	41.2
National currency	14.1	14.7	17.1	17.9	18.5
Foreign currency	17.6	19.5	21.5	21.9	22.6
Other foreign assets	5.0	4.6	6.1	4.6	6.1
Other items, net	-2.6	-2.0	-2.2	1.4	2.7
			(In percent of GDP)		
Broad money (M3)	49.5	51.8	61.5	58.1	66.6
Lari Broad money (M2)	23.3	24.4	27.6	24.3	30.1
Currency held by the public	6.6	7.0	7.6	7.1	8.1
Non-resident deposits (percent of total deposits)	18.5	18.0	16.0	17.4	16.1
Credit to the Economy	64.4	69.2	78.3	74.7	77.2
Nominal GDP (billions of lari)	49.3		49.4		53.3
			(year-on-year growth)		
Reserve Money	13.4	5.1	20.8	11.8	11.4
Broad money (M3)	17.6	14.4	24.6	21.1	16.9
NBG Claims on Banks	61.3	102.5	2.3	24.0	51.4
Credit to the Economy (Percent change, year on year)	19.7	19.0	22.0	16.5	6.4

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

Table 5. Georgia: Financial Soundness Indicators, 2018–20

	2018	2019	2020			
		Dec	Mar	Jun	Sep	Dec
Capital Adequacy						
Capital to risk-weighted assets 1/	18.4	19.5	17.0	18.0	17.6	17.6
Nonperforming loans net of provisions to capital	6.4	5.2	7.8	7.6	7.9	7.3
Leverage ratio 2/	18.5	19.0	16.2	16.6	16.3	16.3
Asset Quality						
Nonperforming to total gross loans 3/	2.7	1.9	2.2	2.4	2.3	2.3
Nonperforming to total gross loans 4/	5.5	4.4	4.4	5.5	6.3	8.2
Substandard and restructured loans to total gross loans 5/	15.3	12.9	27.0	20.5	26.9	34.5
Specific provisions to total loans	2.5	1.9	2.1	2.6	2.6	3.2
Sectoral distribution of loans to total loans						
Residents	97.4	97.4	95.4	96.1	96.3	96.4
Deposit-takers	0.0	0.1	0.1	0.1	0.1	0.2
Other financial corporations	0.7	0.0	0.6	0.0	0.0	0.0
Nonfinancial corporations	46.3	49.8	46.3	46.2	46.2	47.1
Other domestic sectors 6/	50.5	47.5	48.4	49.7	49.9	49.1
Non-residents	2.6	2.6	4.6	3.9	3.7	3.6
Earnings and Profitability						
Return on assets (ROA)	3.0	2.5	-7.1	-2.4	-0.9	0.2
Return on equity (ROE)	23.3	20.3	-64.4	-21.7	-8.1	1.4
Interest margin to gross income	61.0	58.1	56.5	58.1	58.8	58.4
Non-interest expenses to gross income	49.6	52.9	55.0	56.5	55.4	54.3
Liquidity						
Liquid assets to total liabilities ratio	21.6	19.6	20.0	21.4	21.5	21.1
Liquid assets to total short-term liabilities 7/	27.1	24.2	24.0	25.6	25.6	25.2
Loan-to-deposit ratio (in percent) 8/	115.6	121.7	121.5	113.2	110.9	110.6
Foreign Currency Position and Dollarization						
Deposit dollarization (residents)	62.1	64.0	66.3	61.4	61.6	61.4
Loans in foreign exchange to total loans	57.1	55.2	58.9	57.3	57.5	55.7
Net foreign assets to total assets	-18.3	-18.9	-19.3	-22.1	-19.4	-17.6
Net open foreign exchange position to regulatory capital	9.8	-1.4	1.8	-2.6	1.0	3.1
Borrowed funds from abroad-to-GDP ratio 9/	16.2	19.1	17.2	17.7	18.9	18.0
Other						
Loans collateralized by real estate to total loans	62.0	64.9	65.5	65.7	65.5	53.5
Memorandum items						
Georgia EMBIG Sovereign Spread	252	157	241	680	495	407
Georgia EMBIG Sovereign Yield	5.4	3.2	3.5	7.0	5.1	4.2

Source: National authorities and IMF staff calculations.

1/ Basel III definition.

2/ Defined as the ratio of total capital to total liabilities; an increase in the ratio indicates an improvement.

3/ IMF definition for NPLs: includes loans in doubtful and loss categories (categories overdue 90 days or more).

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

5/ Includes watch, non-standard, doubtful, bad, and restructured loans.

6/ Includes households and individual entrepreneurs.

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

8/ Loans and deposits from the banking sector.

9/ Borrowed funds include subordinated debt.

Table 6. Georgia: External Vulnerability Indicators, 2019–26

	2019	2020	2021	2022	2023	2024	2025	2026
		Prel.			Projections			
Value of exports of goods and services, percent change	7.2	-37.8	18.4	10.3	22.1	20.6	9.4	9.5
Value of imports of goods and services, percent change	3.1	-19.5	8.9	4.5	13.7	15.9	8.2	6.7
Terms of trade (deterioration -)	2.9	5.2	-9.2	1.7	1.6	1.9	1.4	0.3
Current account balance (percent of GDP)	-5.1	-12.3	-10.9	-7.9	-6.5	-5.9	-5.8	-5.7
Capital and financial account (percent of GDP)	7.0	11.4	8.7	9.6	8.0	6.9	6.5	6.3
External public debt (percent of GDP)	34.5	49.3	54.3	49.6	46.7	43.5	40.7	38.0
(in percent of exports of goods and services)	63.0	131.5	124.5	115.4	96.4	81.0	75.1	69.5
Debt service on external public debt								
(in percent of exports of goods and services)	4.8	7.2	6.3	6.5	5.7	5.3	4.9	3.9
External debt (percent of GDP) 1/	86.9	104.1	110.3	103.9	99.9	95.2	91.0	85.5
(in percent of exports of goods and services)	158.6	277.8	252.9	241.9	206.3	177.4	168.0	156.3
Debt service on MLT external debt								
(in percent of exports of goods and services)	19.3	27.7	20.0	19.5	17.7	16.4	16.1	14.9

Source: Fund staff estimates and projections.

1/ Excluding intercompany loans.

Table 7. Georgia: Gross External Financing Requirement, 2019-26
(in millions of USD)

	2019	2020	2021	2022	2023	2024	2025	2026
				Projections				
Total financing requirement	2,056	3,061	3,166	1,975	2,246	2,589	2,938	3,002
Current account deficit	891	1,962	1,766	1,435	1,282	1,252	1,342	1,426
Medium and long-term debt	1,288	1,153	898	968	1,082	1,237	1,326	1,294
Private	1,003	847	579	592	667	748	827	862
Banks	713	450	183	175	228	286	344	558
Corporates	290	397	397	417	438	461	483	304
Public	285	306	319	376	416	489	499	432
Others (net)	-122	-53	502	-428	-118	101	271	282
Total financing sources	2,185	2,015	2,159	2,285	2,531	2,803	3,097	3,160
Capital transfers	48	38	40	39	38	38	37	36
Direct investment, net	986	594	735	862	1,028	1,258	1,492	1,547
Medium and long-term debt	1,110	1,252	1,408	1,380	1,463	1,504	1,563	1,571
Private	734	726	875	787	851	866	899	878
Banks	639	567	586	509	550	560	587	587
Corporates	95	159	289	279	300	307	312	290
Public (only project loans)	376	526	533	592	612	638	664	693
Short-term debt (net)	42	131	-24	4	2	4	5	6
Increase in gross reserves	202	315	-261	310	285	214	159	158
Rescheduled debt and arrears clearance	121	-136	0	0	0	0	0	0
Errors and omissions	-53	9	0	0	0	0	0	0
Total financing needs	247	1,217	746	0	0	0	0	0
Official financing	247	1,218	746	0	0	0	0	0
IMF	35	315	106	0	0	0	0	0
Prospective purchases	83	315	109	0	0	0	0	0
Repurchases	-48	0	-4	0	0	0	0	0
Official creditors	212	903	641	0	0	0	0	0
Memorandum items:								
Gross international reserves	3,506	3,911	3,650	3,959	4,244	4,458	4,617	4,775
in months of next year GNFS imports	5	5	4	4	4	4	4	3
in percent of short-term debt at remaining maturity	90	110	98	96	95	93	92	96
in percent of IMF Composite measure (floating)	98	111	98	99	100	100	101	102
EFF in percent of total official financing	14	26	14	…	…	…	…	…

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

Table 8. Georgia: Indicators of Fund Credit
(in millions of SDR)

	2020	2021	2022	2023	2024	2025	2026
	Actual	Projections					
Existing Fund credit							
Disbursements (EFF)	226.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	406.0	403.5	391.0	368.5	326.3	258.6	190.9
SBA and EFF	406.0	403.5	391.0	368.5	326.3	258.6	190.9
Obligations	4.2	5.9	16.9	26.6	46.1	71.0	70.3
SBA and EFF	4.2	5.9	16.9	26.6	46.1	71.0	70.3
Principal (repurchases)	0.0	2.5	12.5	22.5	42.3	67.7	67.7
Interest charges	4.2	3.4	4.4	4.1	3.8	3.3	2.6
Prospective purchases							
Disbursements	0.0	78.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	0.0	78.0	78.0	78.0	78.0	71.5	58.5
Obligations 2/	0.0	1.7	2.4	2.2	1.8	7.5	13.7
Principal (repurchases)	0.0	0.0	0.0	0.0	0.0	6.5	13.0
Interest charges	0.0	1.7	2.4	2.2	1.8	1.0	0.7
Stock of existing and prospective Fund credit 1/	406.0	481.5	469.0	446.5	404.3	330.1	249.4
In percent of quota 3/	193.0	228.8	222.9	212.2	192.1	156.9	118.5
In percent of GDP	3.6	4.3	3.8	3.3	2.8	2.1	1.5
In percent of exports of goods and nonfactor services	9.5	9.9	8.8	6.9	5.2	3.9	2.7
In percent of gross reserves	14.5	19.2	17.3	15.5	13.4	10.6	7.7
In percent of public external debt	7.2	8.0	7.6	7.2	6.4	5.2	3.9
in percent of total government revenues and grants	16.2	21.2	18.5	16.1	13.4	10.1	7.1
Obligations to the Fund from existing and prospective	4.2	7.6	19.2	28.8	47.9	78.4	84.0
In percent of quota	2.0	3.6	9.1	13.7	22.7	37.3	39.9
In percent of GDP	0.0	0.1	0.2	0.2	0.3	0.5	0.5
In percent of exports of goods and nonfactor services	0.1	0.2	0.4	0.4	0.6	0.9	0.9
In percent of gross reserves	0.2	0.3	0.7	1.0	1.6	2.5	2.6
In percent of public external debt service	1.4	2.5	5.6	7.9	11.7	19.1	23.2
in percent of total government revenues and grants	0.2	0.3	0.8	1.0	1.6	2.4	2.4

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
12-Apr-20	Complete the sixth review based on end-December 2019 performance criteria and other relevant performance criteria	147	70.0
25-Oct-20	Complete the seventh review based on end-June 2020 performance criteria and other relevant performance criteria	79	37.3
20-Mar-21	Complete the eighth review based on end-December 2020 performance criteria and other relevant performance criteria	78	37.2
Total available		484	230.0

Source: Fund staff estimates and projections.

Annex I. Public Debt Sustainability Assessment[1]

Georgia's public debt is assessed as sustainable, with fiscal consolidation and higher growth expected to put the public debt-to-GDP ratio on a downward path, after a sharp rise in 2020-21 due to the COVID-19 pandemic. The debt-to-GDP ratio is projected to peak at close to 61 percent of GDP in 2021 before complying with the 60 percent of GDP ceiling by 2023, prescribed by Georgia's fiscal rule. As part of efforts to enhance monitoring of fiscal risks under the EFF program, the authorities will incorporate SOEs into general government reporting in 2021, which will add to projected debt. Main risks to sustainability currently stem from the high share of foreign exchange denominated debt.

1. **Public debt-to-GDP increased sharply in 2020 after an extended period of stability.** Gross public debt stood at 40 percent of GDP at end-2019, having remained stable on average over 2016-19. Fiscal discipline, under the EFF arrangement, supported containing public debt and the buildup of government deposits. However, faced with the COVID-19 pandemic, debt increased by 20 percentage points of GDP in 2020. This sharp increase reflects: (i) a widening of the fiscal deficit, as the pandemic shock triggered a drop in GDP and revenues, coupled with a rise in spending, including to finance the government's fiscal relief package in response to COVID-19 (3.8 percent of GDP), accelerated VAT refunds, and elevated capital spending, (ii) an accumulation of government deposits (increase by 3.6 percent of GDP) to guard against downside risks, (iii) exchange rate depreciation, (iv) economic contraction (base effect); and (v) other residual debt-increasing factors.[2]

2. **Public debt remains sustainable over the medium term.** Under a realistic baseline medium-term fiscal path[3], the public debt-to-GDP ratio is expected to peak at close to 61 percent in 2021 before declining over the projection horizon, as one-off spending measures wane and growth resumes. In 2026, public debt is projected at 51 percent of GDP in gross terms and 48 percent of GDP measured net of government deposits, above previous program commitments (the earlier 45 percent of GDP program target for public debt net of deposits is no longer expected to be achieved)[4]. Gross financing needs are expected to average 6.7 percent of GDP over 2022-26.

3. **Public debt is projected to comply with Georgia's Liberty Act.** Georgia's fiscal rule imposes a 60 percent ceiling on gross general government debt to be attained by 2023 (within three years of the escape clause being triggered due to the pandemic). Georgia's public debt is currently projected at

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[1] Prepared by A. Lagerborg. The public sector throughout this analysis is defined as the general government (i.e. excludes NBG debt to the IMF).

[2] The government responded to the Covid-19 shock in 2020 with temporary fiscal support measures (tax relief and increased spending) in addition to stepping up VAT refunds and capital spending. Donor grants/loans and domestic borrowing accommodated a higher deficit and accumulation of deposits to weather against downside risks.

[3] The baseline assumptions on growth are in line with the WEO assumptions and a gradual recovery and fiscal consolidation following the Covid-19 shock. Primary balances in the medium term are in line with Georgia's own past fiscal track record. The REER is projected to adjust in 2021. A more protracted impact of the pandemic could weaken aggregate demand and GDP growth for longer, lower tax revenues and increase the deficit.

[4] Medium-term projections during the 7th Review also exceeded the past program target of 45 percent of GDP for public debt net of government deposits.

around 57 percent of GDP in 2023, close to but in compliance with the fiscal rule. Government deposits, projected at 2.9 percent of GDP, provide some additional cushion for adherence to the rule. However, the rule provides very little room for relaxing fiscal policy and stresses the urgency of commencing fiscal consolidation in 2021, to avoid a more abrupt consolidation path in 2022-23. Incorporating SOEs into general government reporting will add to projected debt starting in 2021 and further limit space within the fiscal rule's limits.

4. **Public debt remains sustainable in all standardized stress tests.** Public debt remains sustainable and below the high-risk thresholds in all standardized macro-fiscal stress tests, considering shocks to real GDP growth, the primary balance, real interest rate, and real exchange rate. While debt would not stabilize under the constant primary balance scenario, this scenario is not realistic, considering the unprecedented external shock related to the Covid-19 pandemic and the authorities' good past record of fiscal discipline. While debt levels breach the benchmark threshold under the combined macro-fiscal shock of low growth, inflation, a deteriorated primary balance, and high interest rates, such a scenario is unlikely as it would breach Georgia's fiscal rule, which imposes a ceiling on the deficit (3 percent) in addition to debt levels.

5. **However, stress tests highlight increased vulnerabilities to high gross financing needs and external financing requirements, partly due to a Eurobond maturing in 2021, and a high share of FX-denominated debt.** A $500-million sovereign Eurobond maturing on April 12, 2021 is expected to be refinanced; the Ministry of Finance has sent a Request for Proposal to numerous banks and has sufficient liquidity in the form of deposits to bridge any time gaps for the re-issuance. The authorities remain committed to deepening the local capital market and reducing the share of FX-denominated share over the medium term. Currently, 80 percent of the public debt is FX-denominated causing debt dynamics to be vulnerable to exchange rate depreciation. On the other hand, the government has been successful in securing debt of long-term maturity (representing over 97 percent of outstanding debt), reserves are adequate, the public debt service profile is relatively smooth (averaging 4.1 percent of GDP over 2022-26), and much of the external debt service is owed to international finance institutions at concessional terms, mitigating risks to debt sustainability.

6. **The public debt analysis does not incorporate contingent liabilities to the general government.** Key fiscal risks stem from power purchasing agreements and SOEs. Under the EFF arrangement, the authorities have taken important steps to strengthen the assessment, monitoring, and transparency of those risks, including by disclosing them in their annual Fiscal Risk Statement (FRS). The completion of a comprehensive sectorization exercise of SOEs in 2020, the first among Central Asia and Eastern European countries, revealed 183 enterprises to be incorporated into the general government sector starting in 2021. The 2020 FRS estimates that the hypothetical impact of this exercise on 2019 fiscal statistics would increase debt by 0.8 percent of GDP. The impact of incorporating these SOEs in public finance statistics is yet to be estimated for 2021-26. The authorities are also committed to a comprehensive governance reform of SOEs which will help reduce fiscal risks.

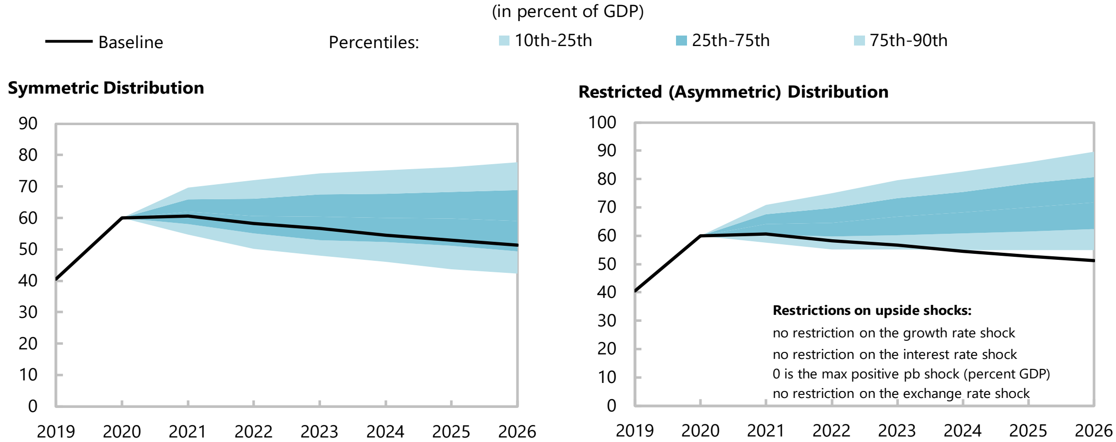
Figure 1. Georgia: Public DSA Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

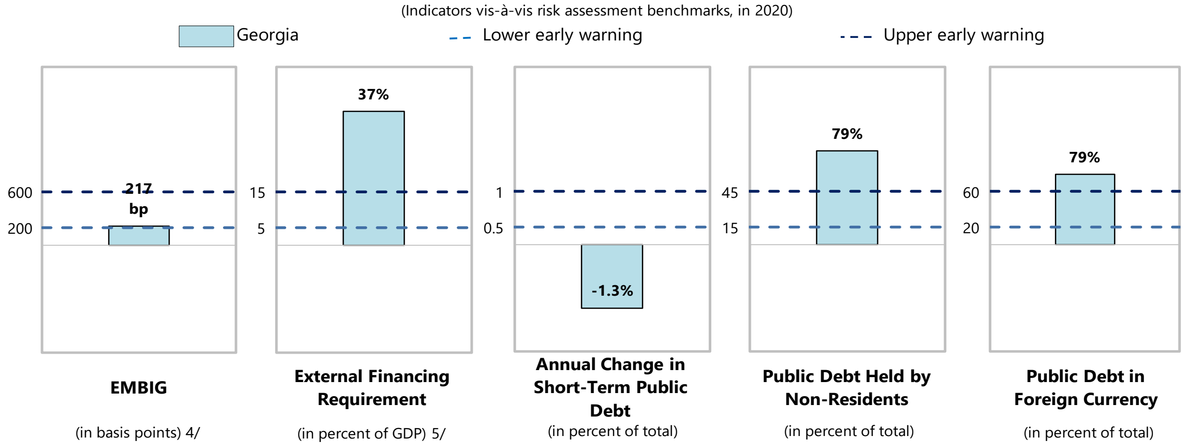
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, .

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

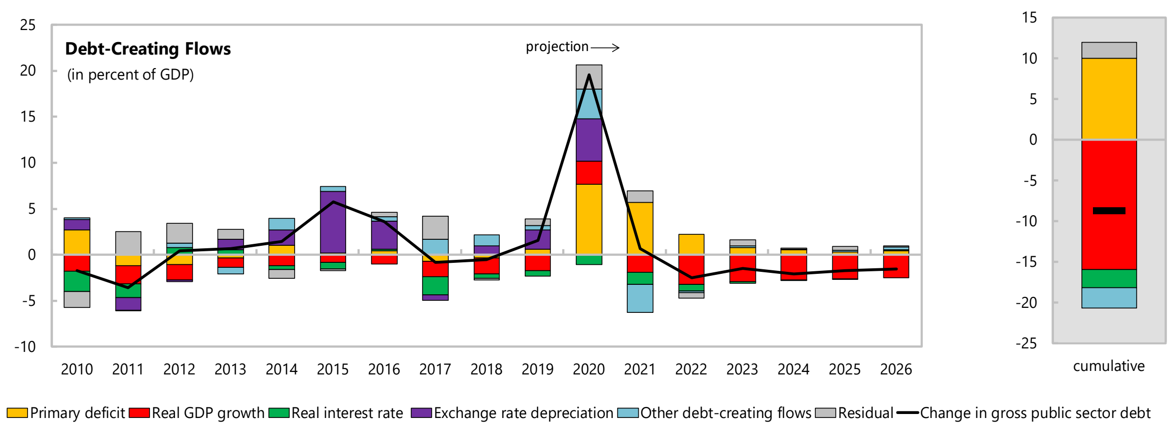
Figure 2. Georgia: Public DSA – Baseline Scenario
(in percent of GDP unless otherwise noted)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of March 11, 2021		
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026	Sovereign Spreads		
Nominal gross public debt	33.9	40.4	60.0	60.7	58.1	56.7	54.6	52.8	51.3	EMBIG (bp) 3/		193
Public gross financing needs	4.2	6.5	14.3	15.5	8.0	6.3	6.2	6.7	6.2	5Y CDS (bp)		n.a.
Real GDP growth (in percent)	4.8	5.0	-6.2	3.5	5.8	5.5	5.2	5.2	5.2	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	5.1	4.9	6.9	5.2	3.8	3.0	3.0	3.0	3.0	Moody's	Ba2	Ba2
Nominal GDP growth (in percent)	10.4	10.4	0.3	7.9	11.2	7.9	8.8	8.1	8.5	S&Ps	BB	BB
Effective interest rate (in percent) [4/]	3.4	3.5	3.9	3.0	2.7	2.8	3.0	3.1	3.3	Fitch	BB	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [10/]
Change in gross public sector debt	0.6	1.6	19.6	0.7	-2.5	-1.5	-2.1	-1.7	-1.5	-8.7	
Identified debt-creating flows	0.0	0.9	17.0	-0.6	-1.9	-2.1	-2.2	-2.1	-1.7	-10.7	
Primary deficit	0.1	0.6	7.7	5.7	2.2	0.8	0.5	0.3	0.5	10.0	-2.1
Primary (noninterest) revenue and grants	27.1	27.1	25.1	25.2	25.7	26.1	26.2	26.2	26.2	155.5	
Primary (noninterest) expenditure	27.1	27.7	32.8	30.9	27.9	26.9	26.8	26.5	26.6	165.5	
Automatic debt dynamics [5/]	-0.7	-0.3	6.1	-3.2	-3.9	-3.1	-2.8	-2.6	-2.5	-18.2	
Interest rate/growth differential [6/]	-2.1	-2.3	1.4	-3.2	-3.9	-3.1	-2.8	-2.6	-2.5	-18.2	
Of which: real interest rate	-0.6	-0.6	-1.1	-1.3	-0.7	-0.2	-0.1	0.0	0.1	-2.2	
Of which: real GDP growth	-1.4	-1.8	2.5	-1.9	-3.2	-2.9	-2.7	-2.6	-2.5	-16.0	
Exchange rate depreciation [7/]	1.4	2.1	4.6	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.6	0.5	3.2	-3.1	-0.2	0.2	0.1	0.2	0.3	-2.5	
GG: Privatization and Drawdown of deposits (negative)	-0.6	0.3	3.1	-3.2	-0.5	-0.1	-0.2	-0.1	0.1	-4.1	
GG: Net acquisition of financial assets: Budget lending [8/]	1.2	0.2	0.1	0.2	0.3	0.3	0.3	0.3	0.2	1.6	
Residual, including asset changes [9/]	0.6	0.7	2.6	1.2	-0.6	0.7	0.1	0.4	0.1	2.0	



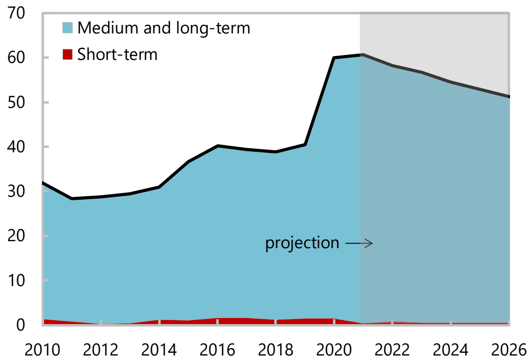
Source: IMF staff.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ EMBIG.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate;
a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes net budget lending.
9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
10/ 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 3. Georgia: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

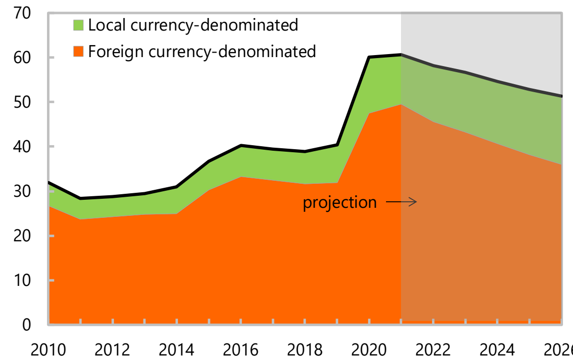
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

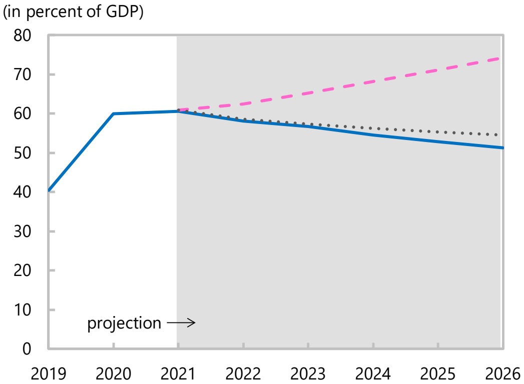


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

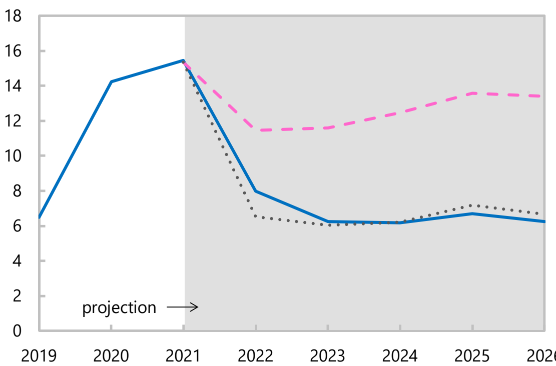
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

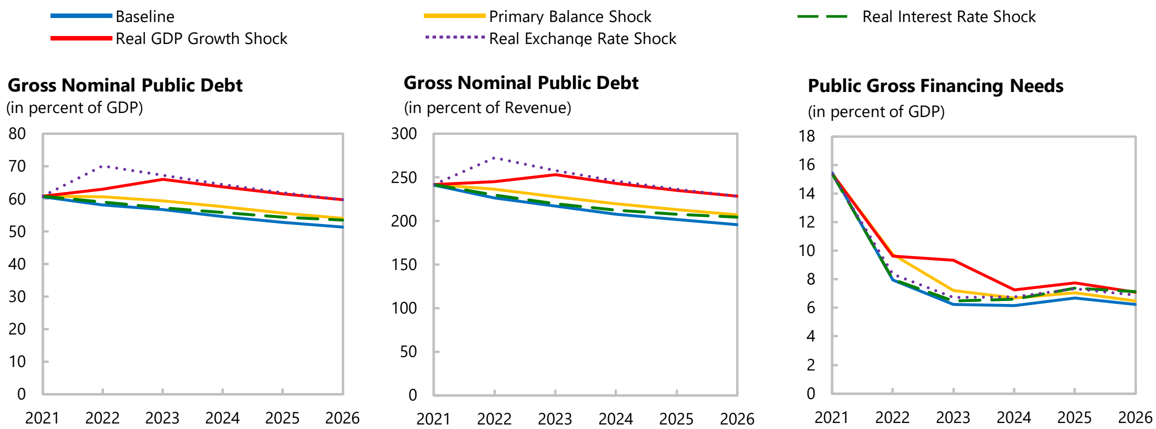
Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	3.5	5.8	5.5	5.2	5.2	5.2
Inflation	5.2	3.8	3.0	3.0	3.0	3.0
Primary Balance	-5.7	-2.2	-0.8	-0.5	-0.3	-0.5
Effective interest rate	3.0	2.7	2.8	3.0	3.1	3.3
Constant Primary Balance Scenario						
Real GDP growth	3.5	5.8	5.5	5.2	5.2	5.2
Inflation	5.2	3.8	3.0	3.0	3.0	3.0
Primary Balance	-5.7	-5.7	-5.7	-5.7	-5.7	-5.7
Effective interest rate	3.0	2.7	2.9	3.2	3.4	3.7

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	3.5	3.6	3.6	3.6	3.6	3.6
Inflation	5.2	3.8	3.0	3.0	3.0	3.0
Primary Balance	-5.7	-0.6	-0.6	-0.6	-0.6	-0.6
Effective interest rate	3.0	2.7	2.7	2.8	2.8	2.9

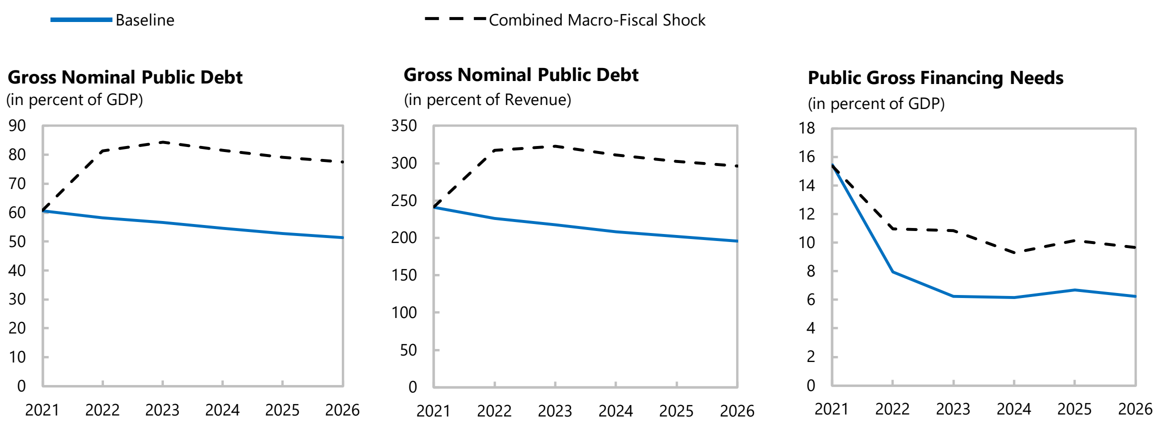
Source: IMF staff.

Figure 4. Georgia: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

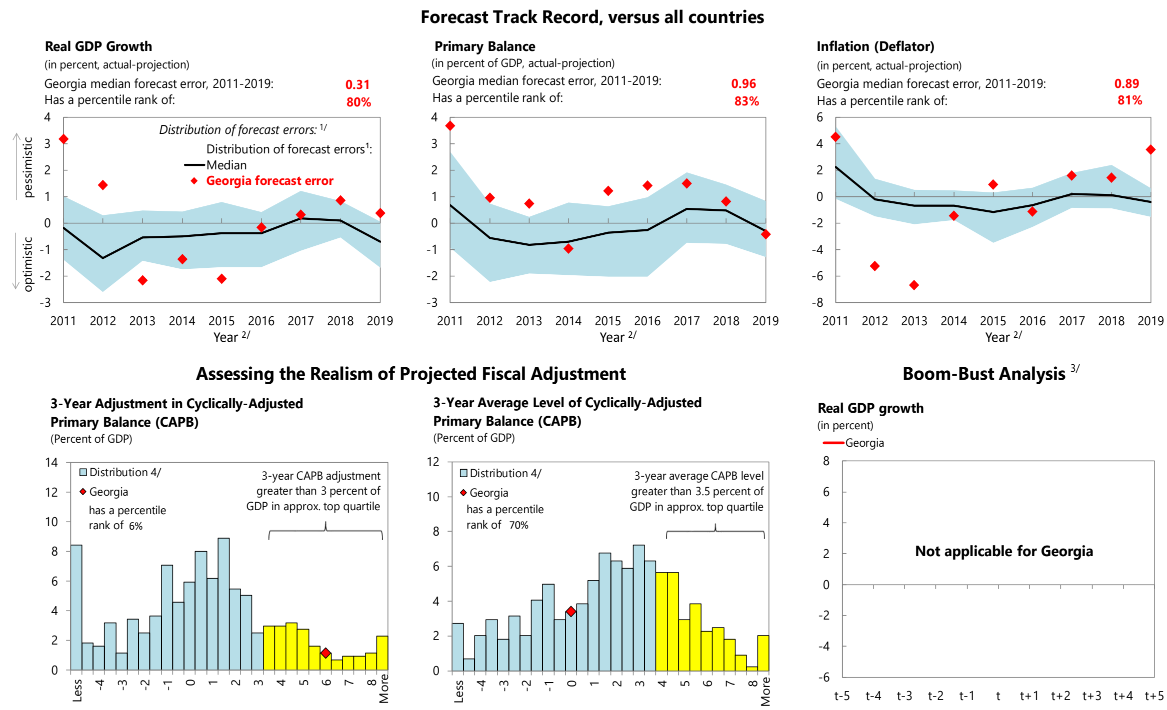
(in percent)

Primary Balance Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	3.5	5.8	5.5	5.2	5.2	5.2
Inflation	5.2	3.8	3.0	3.0	3.0	3.0
Primary balance	-5.7	-4.0	-1.5	-0.7	-0.4	-0.5
Effective interest rate	3.0	2.7	3.0	3.1	3.2	3.4
Real Interest Rate Shock						
Real GDP growth	3.5	5.8	5.5	5.2	5.2	5.2
Inflation	5.2	3.8	3.0	3.0	3.0	3.0
Primary balance	-5.7	-2.2	-0.8	-0.5	-0.3	-0.5
Effective interest rate	3.0	2.7	3.3	3.8	4.3	4.8
Combined Shock						
Real GDP growth	3.5	2.1	1.8	5.2	5.2	5.2
Inflation	5.2	2.9	2.1	3.0	3.0	3.0
Primary balance	-5.7	-4.0	-3.2	-0.7	-0.4	-0.5
Effective interest rate	3.0	3.0	3.0	3.6	4.0	4.6

Real GDP Growth Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	3.5	2.1	1.8	5.2	5.2	5.2
Inflation	5.2	2.9	2.1	3.0	3.0	3.0
Primary balance	-5.7	-3.6	-3.2	-0.5	-0.3	-0.5
Effective interest rate	3.0	2.7	2.9	3.2	3.3	3.5
Real Exchange Rate Shock						
Real GDP growth	3.5	5.8	5.5	5.2	5.2	5.2
Inflation	5.2	13.3	3.0	3.0	3.0	3.0
Primary balance	-5.7	-2.2	-0.8	-0.5	-0.3	-0.5
Effective interest rate	3.0	3.0	2.5	2.6	2.8	3.0

Source: IMF staff.

Figure 5. Georgia: Public DSA – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Georgia, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex II. Risk Assessment Matrix[1]

Source of Risks	Likelihood	Expected Impact on the Economy if Risks Materialize	Policy Response
Conjunctural Shocks and Scenarios			
Unexpected shifts in the Covid-19 pandemic. **Asynchronous progress.** Limited access to, and longer-than-expected deployment of, vaccines in some countries—combined with dwindling policy space—prompt a reassessment of their growth prospects (for some Emerging and Frontier Markets triggering capital outflows, depreciation and inflation pressures, and debt defaults).	Medium	**High** Capital outflows in context of high current account deficit would threaten external stability, likely resulting in lari depreciation and accelerating inflation.	Maintain commitment to exchange rate flexibility, but utilize foreign exchange reserves to prevent a disorderly depreciation that would jeopardize financial stability. Tighten monetary policy to keep inflation expectations anchored.
Prolonged pandemic. The disease proves harder to eradicate (e.g., due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them), requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable. For countries with policy space, prolonged support—while needed to cushion the economy—exacerbates stretched asset valuations, fueling financial vulnerabilities. For those with limited space, especially EMs, policy support is insufficient.	Medium	**High** Insufficient policy support during prolonged pandemic would likely increase poverty among vulnerable populations in informal employment. Lack of tourism recovery would reduce medium-term growth.	Extend targeted measures to support individuals and businesses by reprioritizing spending. To the extent that inflation expectations remain anchored utilize available monetary policy space to support demand.

[1] Prepared by S. Saksonovs. The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Source of Risks	Likelihood	Expected Impact on the Economy if Risks Materialize	Policy Response
Faster containment. Pandemic is contained faster than expected due to the rapid production and distribution of vaccines, boosting confidence and economic activity.	Medium	**High** Higher growth in trading partners would enable a faster recovery in Georgia.	Maintain prudent macroeconomic policies to build up buffers. Proceed with fiscal consolidation.
Widespread social discontent and political instability. Social tensions erupt as the pandemic and inadequate policy response cause socio-economic hardship (unemployment, poverty, and shortages and higher prices of essentials—often exacerbating pre-existing inequities), or due to unequal access to vaccines. Growing political polarization and instability weaken policymaking and confidence.	High	**High** Political polarization and social tensions could result in a disorderly lari depreciation. Social tensions would undermine the ability of the policymakers to set a new agenda for structural reform. They could also threaten external financing flows from international financial institutions (IFIs) on which Georgia relies.	Utilize foreign exchange reserves to prevent a disorderly depreciation that would jeopardize financial stability. Improve communication about economic policy – especially in terms of setting a medium-term reform agenda. Maintain commitment and ownership of reforms.
Structural Risks			
Accelerating de-globalization. Despite renewed efforts to reach multilateral solutions to existing tensions, geopolitical competition leads to further fragmentation. Reshoring and less trade reduce potential growth.	Medium	**Medium** Accelerating de-globalization would put the merits of Georgia's efforts to become a logistics hub in doubt. The country would need to find a new growth model that relies less on the external environment.	Allow the exchange rate to adjust to reflect the new fundamentals. Utilize monetary policy space to ensure that the output gap does not stay negative for too long. Extend targeted measures to

Source of Risks	Likelihood	Expected Impact on the Economy if Risks Materialize	Policy Response
			support individuals and businesses by reprioritizing spending.
Georgia-Specific Structural Risks			
Financial risks. As a result of one of the global shocks above, exchange rate could depreciate rapidly undermining confidence in the currency and increasing inflation expectations.	**Medium**	**High** Depreciation in a highly dollarized economy could hurt growth and threaten financial stability as households and firms struggle to repay loans. Higher inflation and depreciation expectations could result in a vicious cycle of loan conversions putting further pressure on the currency.	Maintain tight monetary policy to ensure confidence in the currency and keep inflation expectations anchored. Strengthen the resolution framework to ensure that financial stability challenges can be addressed. Adjust macroprudential measures to avoid an undue tightening of financial conditions.
Fiscal risks. Materialization of contingent liabilities/fiscal risks could put pressure on the deficit.	**Medium**	**High** The need to cover contingent liabilities could result in lower capital spending or lower current spending, which has already been significantly compressed.	Continue improving SOE governance and fiscal risk management practices. Utilize fiscal buffers accumulated due to capital markets development strategy.
Political risks. Political instability or/and reform fatigue could undermine efforts to undertake structural reforms.	**High**	**Medium** Policy uncertainty could undermine	Maintain macroeconomic policy discipline.

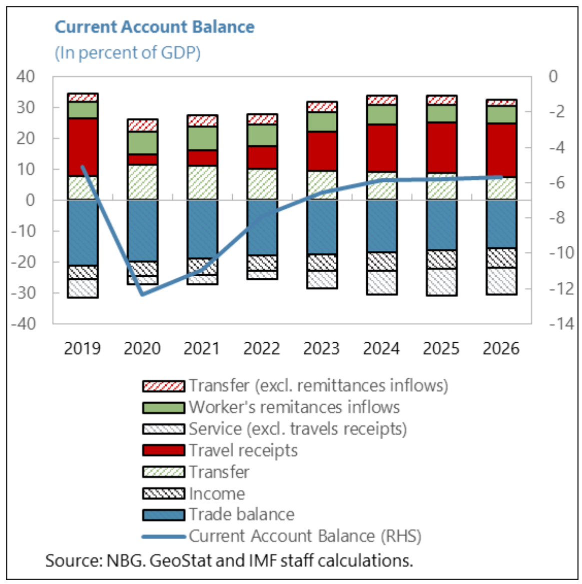
Source of Risks	Likelihood	Expected Impact on the Economy if Risks Materialize	Policy Response
		confidence and hurt growth.	Strengthen social safety nets to protect the most vulnerable segments of the population and ensure that growth is sufficiently inclusive.

Annex III. External Sector Assessment[1]

Georgia's external position in 2020 was broadly in line with the level implied by fundamentals and desirable policies. However, the COVID-19 shock dampened tourism revenues and widened the current account deficit significantly, and external vulnerabilities increased relative to 2019 in view of the slow recovery of tourism and the build-up of external debt stock. The Net International Investment Position widened in 2020, although it is deemed sustainable according to the external sustainability approach. Despite moderately lower inflows, the end-2020 gross international reserves coverage reached 111 percent of the ARA metric and the NIR target was met with a comfortable margin. This was mainly driven by the large donor financing in 2020 and because the capital outflows projected at the Seventh Review did not materialize. In the aftermath of the COVID-19 shock, the current account deficit is projected to gradually narrow to 5.7 percent of GDP by 2026. Continued prudent fiscal policy, exchange rate flexibility, and structural reforms implementation remain essential to safeguarding external sustainability over the medium term.

Current Account and Real Exchange Rate Developments

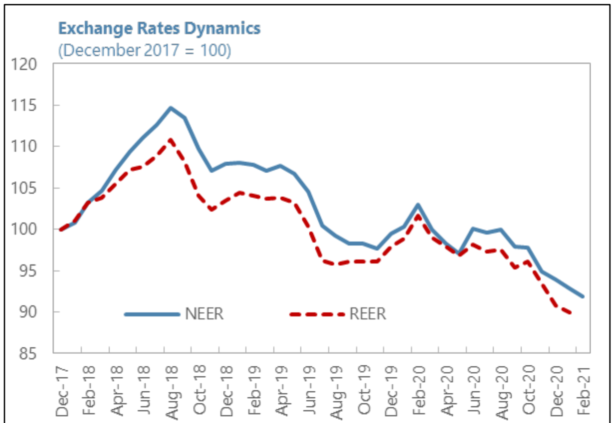
1. **The 2020 current account (CA) widened significantly due to the COVID-19 shock.** The 2020 CA deficit is now estimated at 12.3 percent of GDP, 7.2 percentage points higher than in 2019. Although the (merchandise) trade deficit in 2020 narrowed due to a large decline in imports, it was more than offset by the sharp deterioration in the services account, with the tourism revenue lower by 83 percent (y/y).



2. **The CA deficit is expected to narrow gradually in 2021 and beyond.** Partly driven by a gradual recovery in tourism revenue (by 56 percent y/y largely due to the low base in 2020), the CA deficit is projected to narrow to 10.9 percent of GDP in 2021. However, due to the potential scarring effect and the high uncertainties around the vaccine rollout in Georgia and worldwide, tourism revenue is expected to recover to the 2019 level only in 2024. Accordingly, the medium-term CA deficit is expected to decline to 5.7 percent of GDP, assuming a gradual recovery in exports and a timely implementation of structural reforms to diversify the economy and increase competitiveness.[2]

[1] Prepared by Yunhui Zhao.

[2] With Georgia's product diversification relatively low, export growth is projected to be mostly sustained by enhanced export market diversification.



Source: National Bank of Georgia and IMF staff calculations.
Note: An increase in the REER or the NEER means an appreciation of the currency.

3. **The lari depreciated sharply due to the COVID-19 shock.** In 2020, the lari depreciated by 5.6 percent and 7.4 percent in nominal and real effective terms, respectively. The lari depreciation was attributable to the adverse effect of the COVID shock starting from the initial outbreak stage in March-May 2020. The NBG's FX sales to curb inflationary expectations helped limit pressures on the FX market, although renewed depreciation pressures emerged in November 2020 when Georgia's COVID cases surged. With NBG's strong policy commitment and the expectation of the rollout of COVID vaccines domestically and abroad, the depreciation pressures have abated: for example, the NEER depreciated by 1.0 percent m/m in February 2021, much lower than the 3.0 percent m/m depreciation in November 2020.

4. **The CA approach does not suggest a significantly negative CA gap in 2020.** The CA approach of the IMF's External Balance Assessment (EBA-lite) methodology suggests a CA gap of -0.4 percent of GDP in 2020, compared with the positive gap of 2.8 percent of GDP in 2019 in the Sixth Review. Despite the CA deficit being significantly higher in 2020 than in previous years, an additional cyclical adjustment (4.6 percent of GDP) is made to account for the temporary impact of the pandemic on tourism and oil trade balance, in line with the updated EBA-lite template.[3] As a result, the CA approach implies an adjusted CA deficit of 7.9 percent of GDP, close to the CA norm and corresponding to an REER overvaluation of 1.2 percent (falling within the range of being "broadly in line", which has an upper bound of 2.7 percent of overvaluation for Georgia's REER). In addition, compared with policy gaps, economic fundamentals play a larger role in driving the CA gap. The CA approach suggests that Georgia external position in 2020 was broadly in line with the level implied by fundamentals and desirable policies. Furthermore, the REER approach actually suggests a positive CA gap of 2.4 percent of GDP and an REER undervaluation of 6.5 percent.[4] However, given the caveats of both approaches, the results should be interpreted with caution, and the authorities are still advised to sustain their reforms agenda to enhance external competitiveness and raise net private savings.

[3] The tourism adjustor equals 5.39 percent of GDP, and the oil trade balance adjustor equals -0.75 percent of GDP. The tourism adjustor accounts for medium-term scarring and is based on the comparison between the tourism revenue estimates/projections in 2020-2025 for Georgia in the current vintage and those in the January 2020 WEO, right before the pandemic. The tourism adjustor obtained using this method (5.39 percent of GDP) is close to the one obtained using an alternative method (5.37 percent of GDP) that builds on the WEO scenario and assumptions about the scarring effects.

[4] Although this approach is generally less accurate, it may be more suitable for a tourism-dependent economy like Georgia (*Methodological Note On EBA-lite*, IMF, February 2016, Paragraph 28).

Annex Table 1. Georgia: EBA Model Estimates for 2020
(in Percent of GDP)

	CA model	REER model
CA-Actual	**-12.3**	
Cyclical contributions (from model) (-)	0.4	
COVID-19 adjustor (+) 1/	4.6	
Additional temporary/statistical factors (+)	0.0	
Natural disasters and conflicts (-)	-0.1	
Adjusted CA	**-7.9**	
CA Norm (from model) 2/	**-7.5**	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	**-7.5**	
CA Gap	**-0.4**	**2.4**
o/w Relative policy gap	2.0	
Elasticity	-0.37	
REER Gap (in percent)	**1.2**	**-6.5**

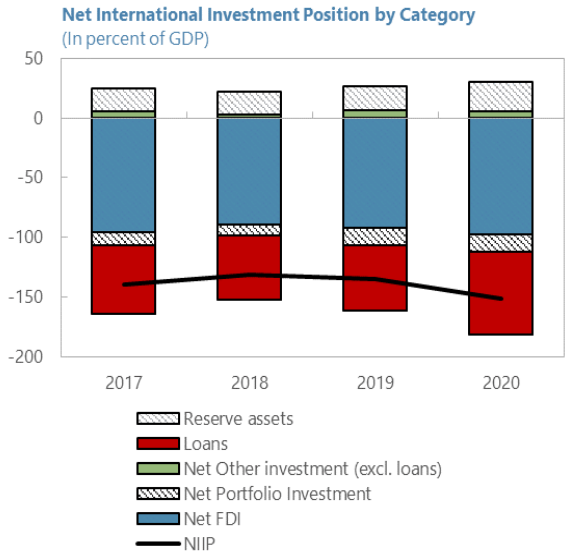
1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism (5.39 percent of GDP) and on oil trade balance (-0.75 percent of GDP).
2/ Cyclically adjusted, including multilateral consistency adjustments.

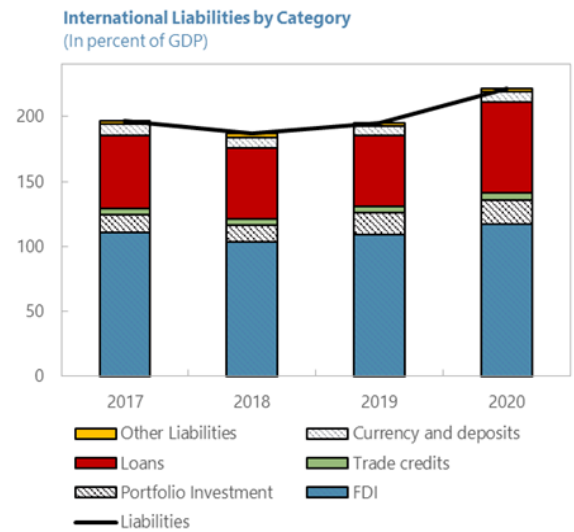
Source: IMF staff calculations.

External Balance Sheets

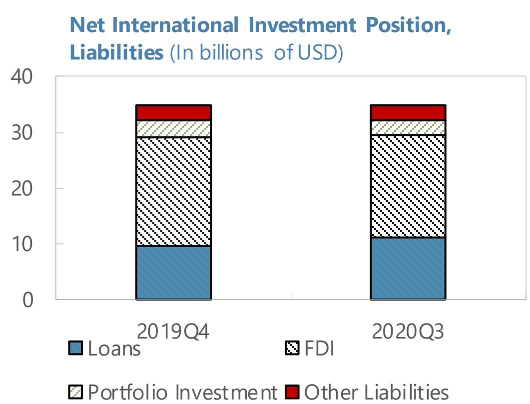
5. **Georgia's Net International Investment Position (NIIP) widened in 2020, and its external vulnerability increased relative to 2019.** Under the current baseline scenario, the EBA-lite external sustainability approach assesses that the NIIP (i.e., gross foreign liabilities minus gross foreign assets) does not deteriorate in net present value terms, that is, the NIIP is sustainable based on this definition. However, this definition of sustainability is relatively narrow, and potential vulnerabilities associated with the current level of the NIIP or the composition of the NIIP still need to be analyzed. By 2020 Q3,[5] Georgia's NIIP stood at 151.7 percent of GDP, with FDI and loans accounting respectively for about 52.9 percent and 31.3 percent of total liabilities. Relative to end-2019, the NIIP widened by 16.8 percent of GDP, mainly driven by higher loan disbursements (by 14.7 percent of GDP), higher net FDI inflows (by 4.9 percent of GDP), and a lower nominal USD-denominated GDP (the NIIP in dollar term actually improved by $11 million in 2020 Q3 relative to end-2019). FDI liabilities increased by 8.6 percent of GDP (relative to end-2019) to 117 percent of GDP. One potential mitigating factor is that an important contributor to the external debt stock build-up in 2020 was the increase in the government's concessional loans to IFIs (by around $1.2 billion); the private sector's external debt remained virtually unchanged in nominal terms.

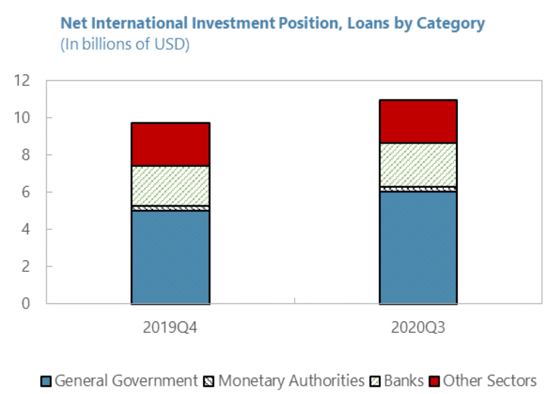
[5] The end-2020 data are not available yet. Since NIIP is a stock rather than flow variable, the comparison between 2020 Q3 and end-2019 is still informative.





Source: National Bank of Georgia and IMF staff calculations.





Source: National Bank of Georgia and IMF staff calculations.

Capital and Financial Flows

6. **The financial account balance in 2020 did not deteriorate, as the projected capital outflows did not materialize.** Financial account surplus is now estimated at 5.5 percent of GDP, slightly lower than that in 2019 and much higher than projected in the Seventh Review (by 2.9 percentage points). This reflects the fact that the projected capital outflows did not materialize (other net inflows were much higher), consistent with the lower-than-expected need for FX interventions by the NBG in 2020. Moreover, although the net FDI inflows and net portfolio inflows were much lower than 2019 (by 1.9 and 5.1 percent of GDP y/y, respectively), caused by the COVID

shock, the net loan inflows were also much higher (by 2.2 percent of GDP y/y), reflecting the large inflows of donor financing.

7. **Financial flows are expected to stabilize over the medium term.** The financial account surplus is projected to gradually decrease to about 6 percent of GDP over the medium term (after a temporary increase in 2022), consistent with a gradually improving current account balance. In the aftermath of the COVID-19 shock, portfolio inflows are expected to stabilize. As the economic outlook improves domestically and abroad, and boosted by improved competitiveness from structural reforms, FDI inflows are projected to gradually increase. The net loan inflows are expected to peak in 2021, as the COVID-related external borrowing gradually fades out. Over the medium term, the bulk of Georgian debt is expected to remain held by IFIs and related parties—mostly on concessional terms. External debt is also expected to remain dominated by medium and long-term debt.

Reserves

8. **Gross international reserves (GIR) reached 111 percent of the ARA metric at the end of 2020, and the end-2020 NIR target was met with a comfortable margin.** Despite moderately lower program and project loans/grants, the net international reserves (NIR) stood at $1,335m (program exchange rate) and GIR at $3,911m (market exchange rate) by end-2020, both higher than projected at the time of the Seventh Review. This is mainly driven by the lower-than-expected need for FX interventions by NBG. In view of the lower inflows and in line with past practice, the NIR target is revised down by $201m to $899m, which was met with a comfortable margin.

9. **The GIR in 2021 is expected to decrease relative to 2020, but to be slightly higher than projected in the Seventh Review due to the higher reserves at end-2020.** The protracted recovery in tourism and overall economic activities in 2021, as well as NBG's continued need for FX intervention, lead to a decrease in GIR relative to 2020. However, due to higher-than-expected reserves at end-2020 and the continued donor financing expected in 2021, staff project a slightly higher GIR coverage in 2021 (98 percent of the ARA metric).

10. **In conclusion, Georgia's external position in 2020 was assessed to be broadly in line with fundamentals and desired policy settings**. This assessment was based on an additional cyclical adjustment accounting for the temporary impact of the pandemic on tourism and oil trade balance. However, the external vulnerabilities increased, with the protracted recovery in tourism, a gradually narrowing CA deficit, the high NIIP, a build-up in external debt stock, and pressures on reserves. Hence, strong and prudent macroeconomic policies are needed to maintain and strengthen external sustainability over the medium term.

Appendix I. Letter of Intent

Tbilisi, March 30, 2021

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C.

Dear Ms. Georgieva:

1. **The battle to control the COVID-19 pandemic has entered a critical stage in Georgia.** The number of COVID-19 cases rose sharply in November 2020, which required introducing a second lockdown. Our robust public health response and far-reaching restrictions helped bring the number of cases down and we have been able to unwind all of the restrictions by March 2021 except for a nightly curfew. Most encouragingly, vaccinations, initially focused on medical personnel, have begun in the middle of March. We are working to quickly increase vaccine supplies both through the COVAX initiative and through bilateral negotiations with suppliers. We are closely monitoring COVID-19 cases in Georgia and globally, and stand ready to implement additional measures to limit the pandemic.

2. **The second lockdown has delayed the recovery.** A standstill in global travel and renewed domestic mobility restrictions resulted in real GDP growth of -6.2 percent in 2020, 1.1 percentage point below Seventh Review projections. We expect the economy to grow by 3.5 percent in 2021 as domestic demand recovers and the economy benefits from continued fiscal support envisaged in our 2021 budget. Inflation has accelerated to 3.6 percent (y/y) in February 2021 and is expected to increase further reflecting higher input costs, energy prices and exchange rate depreciation pass-through. Accordingly, the NBG increased the policy rate by 50 basis points in March to anchor inflation expectations.

3. **Our 2021 budget supports economic activity and jobs.** In 2020, we have spent 3.8 percent of GDP to accommodate increased healthcare costs and support households and businesses that have been most impacted by the pandemic. The 2021 budget extends key targeted support measures, including cash transfers to the population, at a total cost of 2.3 percent of GDP. Despite the lockdowns, we were able to increase public investment in 2020, especially in the regions, which helped support jobs and we intend to maintain high public investment in 2021 to continue key investment projects.

4. **The IMF's Extended Fund Facility (EFF) arrangement has helped safeguard macroeconomic stability and catalyze significant donor assistance.** We remain committed to the policies detailed in our Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) of March 27, 2017, updated most recently on December 1, 2020. These policies have helped us support the recovery and limit the economic scarring of the pandemic.

5. **Conditionality for the Eighth Review was met with one exception.** All of the end-December 2020 quantitative performance criteria (QPCs) and all but one structural benchmarks (SBs) were met.

The one structural benchmark not met concerns the implementation of the new insolvency law, where we have specified the requirements for the new profession of insolvency practitioners, but have not yet begun licensing. The new law enters in force on April 1st, 2021 and we expect to begin licensing in April.

6. **Given the positive performance under the program and the policies documented in the enclosed MEFP, we request the completion of this review, and the release of the related disbursement.** We intend to purchase SDR 78 million, which will bring total drawings under the arrangement to SDR 484 million. This is the last review of the program and therefore no further QPCs or structural benchmarks are set.

7. **The attached MEFP, updating the previous ones, documents the most recent achievements of our economic program during these unprecedented times and outlines our near-term priorities.** We will continue to closely engage with IMF staff on economic developments and our policies, including through our upcoming Article IV consultation. We authorize the IMF to publish this LOI and its attachments, and the related Staff Report. These documents will also be posted on the official websites of the Georgian government after the IMF's Executive Board approval.

Very truly yours,

/s/

Koba Gvenetadze
Governor of the National Bank of Georgia

/s/

Natia Turnava
Minister of Economy and Sustainable Development

/s/

Ivane Matchavariani
Minister of Finance

Attachments:

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

Attachment I. Memorandum of Economic and Financial Policies

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 economic challenges arising from the COVID-19 pandemic and over the medium-term.

Macroeconomic Framework

2. The second lockdown delayed economic recovery. Real GDP contracted by 6.2 percent in 2020, 1.1 percentage point lower compared to the Seventh Review projection. We also expect lower growth in 2021 – at 3.5 percent due to the impact of the second lockdown in January and February. Recovery is expected to resume in the second quarter of 2021 as vaccine coverage expands with local transmission brought to very low levels by the end-2021. Supported by infrastructure spending, medium-term growth remains unchanged at 5¼ percent and hinges strongly on advancing structural reforms to increase productivity and enhance private-sector led growth.

3. Inflation is expected to accelerate in 2021 reflecting higher commodity prices, higher production costs owing to pandemic restrictions and exchange rate pass-through. A subsidy on utilities for households has temporarily kept the headline number lower from December 2020 to February 2021, which will also create a base effect next year. In order to keep inflation expectations firmly anchored, the NBG has increased the policy rate by 50 basis points on March 17th. Inflation should decline to below the NBG's target in 2022 as the effect of the still negative output gap begins to dominate the effects of the cost-push factors. Inflation is expected to converge to target from below.

4. Macroeconomic policy discipline and donor support should ensure that reserves remain adequate over the medium term. The current account deficit has widened to 12.3 percent of GDP, 2.5 percentage points weaker than Seventh Review projection largely due to a weaker-than-expected income account and trade balance that were partially compensated by higher transfers. However, the financial account was stronger than expected as the expected capital outflows did not materialize. Accordingly, gross international reserves (GIR) reached 111 percent of the IMF's ARA metric. Over the medium-term, the current account deficit is expected to decline very gradually, reaching 2019 levels only by 2026. Resilient FDI inflows and higher portfolio flows, however, should enable the NBG to maintain reserves close to 100 percent of the ARA metric over the medium term.

5. Downside risks to the outlook remain significant. The race between the vaccination and the emergence of new and dangerous virus variants makes it difficult to predict the path to recovery in Georgia and our key trading partners. Continued shortages of vaccines could also slow the recovery. A protracted slowdown in major trading partners, along with intensified geopolitical tensions, could harm investment, dampen external demand —especially tourism— for longer. Our first line of defense against these considerable risks is our continued commitment to exchange rate flexibility, sound macroeconomic and financial policies, and gradual structural reforms.

Economic Policies

A. Fiscal Policy

6. **We met all end-December 2020 fiscal QPCs and indicative targets (IT).** The augmented fiscal deficit in 2020 reached GEL 4,617 million, against an adjusted ceiling of GEL 4,998[1] million, due to both higher-than-projected revenues and lower-than-projected current spending. Higher VAT refunds, project loan disbursements, and COVID-19 healthcare costs contributed positively to the adjustor. The IT on primary current expenditure was also met by a large margin, totaling GEL 12,190 million compared to an adjusted ceiling of 12,517.[2] In response to the COVID-19 pandemic, we provided temporary and targeted fiscal support to individuals and businesses totaling 3.8 percent of GDP. To further support the private sector, we refunded a record GEL 1,040 million (2.1 percent of GDP) of VAT claims.

7. **Despite the COVID-19 pandemic, we sustained capital spending in 2020 and intend to continue significant public investment in 2021.** Capital spending reached 8.6 percent of GDP in 2020, supporting major national infrastructure projects and elevated regional investment, exceeding the amended budget by GEL708 million. Investment execution was largely unaffected by the COVID-19 pandemic and local governments used the opportunity to reallocate jobs, primarily toward road infrastructure projects. Capital spending (including gross budget lending) will remain elevated at 8.4 percent of GDP in 2021 to support the economic recovery and give continuity to ongoing public infrastructure projects of strategic national importance.

8. **We have adopted the 2021 budget consistent with the policies agreed at the Seventh Review (end-December 2020 structural benchmark).** The adopted budget envisages an augmented deficit of GEL 4,082 million (7.7 percent of GDP), implying a mild contractionary stance. The budget includes 2.3 percent of GDP in temporary and targeted fiscal support measures in response to COVID-19 (as outlined in the Seventh Review MEFP ¶11). In December 2020, we also announced support to subsidize electricity tariff hikes coming into force on January 1, 2021, equivalent to the full amount of the tariff hike to low-energy consuming households and 50 percent of the tariff hike for food producers (costing GEL 105 million), to be accommodated through spending reprioritization.

9. **Our general government debt has reached 60 percent of GDP, at the limit prescribed in the Liberty Act under normal times.** Due to the exceptional circumstances caused by the pandemic and severe economic downturn, the debt limit is not binding for a three-year period until 2023. A sharp increase in debt in 2020 reflects pandemic-induced economic contraction and deficit increase (due to reduced revenues and increased expenditures associated with health costs and support provided to households and businesses), exchange rate depreciation and an accumulation of government deposits to guard against downside risks. The higher deficit in 2020 was financed mostly by donor and IMF

[1] The target ceiling (GEL 4,300 million) was adjusted upwards as a result of higher VAT refunds (GEL 440 million), project loan disbursements (GEL 249 million) and Covid-19 related healthcare spending (GEL 67 million), while sales of non-financial assets contributed negatively to the adjustor (GEL -58 million).

[2] The target ceiling (GEL 12,517 million) was adjusted upwards by Covid-19 health expenditures in excess of the TMU amounts.

financing. We are committed to reducing debt levels to comply with the fiscal rule. General government debt is expected to remain slightly above 60 percent of GDP in 2021, as we continue to provide support to counter the pandemic. In the medium term, we project the debt-to-GDP ratio to decline as temporary spending to deal with COVID-19 is reduced and economic growth resumes. Most of the debt is due to multilateral creditors, and risks are mitigated by long average maturities and low interest costs; debt is mostly vulnerable to FX risks. We are committed to deepen the local capital market and reduce the share of FX-denominated debt over the medium term.

10. We are committed to medium-term fiscal sustainability in compliance with our fiscal rule. We will bring the fiscal deficit under 3 percent of GDP and public debt under 60 percent of GDP by 2023, as prescribed by the Liberty Act. The recovery in revenues, as economic growth resumes, and the unwinding of temporary support measures would help reduce the budget deficit, while commitments toward higher education and infrastructure spending would require creating additional fiscal space within the current spending envelope and/or mobilizing revenues.

11. We are committed to expanding Georgia's power generation capacity in a fiscally sustainable manner. Reducing our reliance on electricity imports requires continued investment, but any public-sector involvement must safeguard medium-term debt sustainability. We have therefore amended Government Decree 403 to specify that not only hydropower energy generation, but also other renewable projects are to be promoted through a feed-in premium. This is a step in the right direction to ensure technology neutrality and limit fiscal risks, as quantities would not be guaranteed. We will also specify the criteria for cases when it may be necessary to deviate from the feed-in premium scheme and amend the Government Decree 403 accordingly. We will refrain from initiating additional Power Purchase Agreements (PPAs) that deviate from a feed-in premium until such criteria are clarified.

12. We are committed to limiting risks from PPAs. Taking into account the rising public debt and the need for fiscal consolidation, we will continue to refrain from (i) signing additional PPAs except for cases described in the previous paragraph until the liberalized energy market for electricity is fully operational and we clarify the potential realization of contingency liabilities to the budget from existing PPAs; and (ii) engaging the public sector in any energy investment without an independent technical evaluation that supports commercial viability and a consultation with the IMF on fiscal sustainability.

13. We are committed to reassessing and implementing, if needed, additional fiscal measures based on our fiscal risk profile. Under the current domestic electricity pricing regulated mechanism, the potential fiscal costs of PPAs would normally be avoided, since guaranteed prices would be fully passed on to end-users. Our baseline scenario forecasting electricity prices suggests that PPAs would imply marginal tariff increases in the foreseeable future. Risks stemming from PPAs will materialize if PPA prices are higher than price of electricity on the local market or export prices. These risks are analyzed in our Fiscal Risk Statement (FRS).

14. **We aim to contain fiscal risks and remain committed to avoiding domestic/external debt payment arrears.** We will not (i) accumulate any general government's external debt payment arrears outside those under negotiation; (ii) accumulate net domestic expenditure arrears of the general government; or (iii) issue new public guarantees, or comfort letters. Our public corporations will refrain from engaging in any new quasi-fiscal activities. The government will refrain from asking SOEs to engage in any new quasi-fiscal operations. We will continue to limit the operations of the Partnership Fund in line with previous program commitments.

15. **We have further enhanced our monitoring of fiscal risks.** We have expanded our fiscal risk statement (FRS) in line with FAD TA recommendations by expanding the fiscal risk analysis with coverage of over 90 percent of SOEs, summarizing the sectorization exercise, including an assessment of the gross financing requirements of major SOEs, and updating estimates of quasi-fiscal activities (**end-December 2020 structural benchmark**). The 2020 FRS furthermore includes a section on SOE governance reform plans and sub-section on the impact of COVID-19 which will be extended in the 2021 FRS. We will continue to enhance the annual Fiscal Risk Statement by updating the estimates of potential fiscal costs arising from our Public-Private Partnerships (PPPs) including PPAs and those associated with SOEs. We are still working on increasing coverage of other areas of fiscal risks. We will incorporate individual assessment of risks stemming from the largest five PPA contracts, that will indicate annual fiscal costs of each project during PPA contract period.

16. **We are formulating a reform strategy for SOEs that would bring SOE governance consistent with best international practices.** Locking in benefits from fiscal transparency in SOEs requires moving from risk disclosure to risk management and mitigation. Hence, we are committed to developing a new governance framework that defines: (i) the commercial objectives of public corporations (ii) corporate governance of public corporations to be implemented based on the Organization for Economic Cooperation and Development (OECD) recommendations. (iii) rationale and policy guiding the ownership of public corporations, (iv) the performance management framework for public corporations, based on medium-term objectives defined by financial and non-financial key performance indicators (KPIs), (v) principles for competitive neutrality. We have agreed on a comprehensive SOE reform strategy, in consultation with IMF TA, and will explore the options for its implementation. We will refrain from taking over any SOE debt or providing equity injections to SOEs without a comprehensive strategy that, among other things, fully supports commercial viability and improves corporate governance.

17. **Our plans to develop the domestic capital market have been delayed because of the pandemic.** We will refinance the Eurobond maturing in April 2021 to preserve comfortable buffers for downside risks, and instead delay our plans to expand domestic issuance. In the future, we plan to gradually increase the size of domestic benchmark bonds, to encourage foreign investor participation. Such an approach would help our efforts to reduce FX risks over the medium term.

B. Structural Fiscal Policies

18. We are strengthening our revenue administration to improve taxpayer services and strengthen compliance. Following the 2016 Tax Administration Diagnostic Assessment and IMF TA, we have largely completed a reform program supported by the Revenue Mobilization Trust Fund.[3]

19. We have successfully reduced our stock of unrefunded VAT credits and will continue refunds to help provide liquidity to the private sector. We have reduced the outstanding stock of those VAT credits that are within the limitation period for audit from GEL1.4 billion at end-2017 to GEL 1,184 million at mid-December 2020, compared to the indicative target of GEL 1,470 million and down from GEL 1,303 million in mid-June. By July 2021, we aim to reduce the outstanding stock of VAT claims to GEL 1.0 billion. For the stock of existing credits, we remain committed to audit or risk-assess all declarations within the statute of limitations.

20. We have begun automatic refunding of new VAT credits. We have implemented the automatic refund system of VAT credits starting in November 2020, which accelerated the pace of new VAT refunds. Moreover, more than 90 percent of VAT credit claims (measured as the number of declarations) are automatically approved and the value of automated processed tax declarations[4] will be more than 85 percent by July 2021.

21. We have made a number of other improvements to tax administration.

- We plan to use risk-based audits to identify non-compliant cases that are likely to produce higher yields. We have been training staff to use the new audit case management system since February 8th of 2021. As of March 26th, 162 auditors had been trained. By May 2021, the audit case management system should be fully operational, which will enhance audit timeliness and productivity.

- The GRS will create a register of employees for tax administration purposes by end–2021.

- We have expanded the system of information sharing with government agencies and the Financial Monitoring Service (FMS) for monitoring suspicious transactions. Automatic reporting from financial institutions will be considered in the context of the international reporting requirements under the automatic exchange of financial information for tax purposes, which Georgia has committed to implementing by September 2023.

22. We believe that accurate and transparent budgeting and accounting is a cornerstone of fiscal stability. Accordingly, we commit to:

- Make the coverage of General Government consistent with the classification of SOEs into General Government units and Public Corporations. In general, treatment for GG SOEs should be the same as

[3] See previous MEFP for details.

[4] The value uses the definition of the TADAT methodology - POA 8. Percentage of Value is calculated by comparing refunded and rejected VAT claims' amount within 30 days to total values of VAT claims.

any general government unit. We will incorporate data from SOEs classified as general government in our fiscal reports, also, we will create mechanisms to have timely access to information. Initially we will compile SOE data for the reporting year 2019 and estimates of 2020 according to GFSM 2014. Any newly identified SOEs will be considered to be general government entities until there is sufficient evidence to classify them to the public corporation sector.

- Improve the quality of fiscal reports and complying with international accounting standards. In our efforts to improve fiscal transparency, starting in 2021, we will produce an annual consolidated central government sector financial report based on International Public-Sector Accounting Standards (IPSAS) basis.

23. We will further improve fiscal transparency by disclosing tax expenditures. The 2021 Budget documentation includes a statement on selected Value Added Tax (VAT) expenditures, and we aim to undertake a comprehensive tax expenditure review by end-2021, with IMF and USAID support.

C. Monetary Policy

24. We are committed to our inflation targeting (IT) framework to maintain price stability. Inflation in December 2020 fell within the inner band of the Inflation Consultation Clause (Table 1). Our monetary policy decisions will continue to depend on the inflation outlook. We closely monitor inflation expectations and developments as we would have to balance the need to control inflation expectations, which remain elevated, with the need to support demand in the aftermath of the COVID-19 pandemic. Continued adverse external developments may require further increases in the policy rate to preserve price stability.

25. We will maintain a flexible exchange rate regime to protect the economy against external shocks, while preventing excessive lari volatility. The floating exchange rate regime continues to work well as a shock absorber, but excessive lari volatility could become disruptive to financial stability as Georgia remains a dollarized economy. Our commitment to exchange rate flexibility has been evident in that we have consistently exceeded our targets on net international reserves (NIR), and we will continue to use reserves only to avoid disorderly market conditions. In the aftermath of the COVID-19 shock, we suspended the accumulation of reserves and focused on providing foreign exchange (FX) liquidity. Our FX sales remain mostly driven by ad-hoc interventions to support the supply of FX. This has been complemented by smaller sized and rule-based FX sales triggered by the volatility of the exchange rate and the need for FX market liquidity.

26. Despite challenging market conditions, we did not draw on our reserves as much as originally expected. The end-December NIR reached $1,335 million, significantly above the adjusted target (adjusted downwards to $899 million due to lower external disbursements). However, the situation remains volatile, and we are committed to intervene if needed to avoid disorderly market conditions.

27. Over the medium term, we remain committed to maintaining adequate reserves, design a clear FX intervention strategy, and strengthen NBG's communication. As the economy recovers from the shock and market conditions allow, we will start rebuilding external buffers. Our intervention strategy will remain guided by reserve adequacy and price stability goals; with reserve accumulation objectives suspended at times when markets become disorderly. To improve transparency of our FX interventions, we will finalize our intervention strategy by May 2021.

D. Financial Sector Policy

28. We continue to carefully monitor the increase in non-performing loans and encourage banks to promptly recognize losses related to the impact of the pandemic. Banks have been asked to evaluate the quality of their loan portfolios; on-site inspections have been suspended; encouraged the use of moratoria on loan repayments; and a moratorium on fines was introduced where a breach emerged due to the crisis. We provided banks with standardized scenarios and methodology to assess credit loss expected from the delayed COVID-19 recovery. These guidelines also aim at avoiding delays in recognizing potential losses due to the loan moratoria as well as the ongoing loan restructuring. Provisioning for business loans is based on forecasted 2022 debt-service-coverage and debt-to-ebitda ratios, which incorporate standardized sectoral forecasts. Provisioning for retail loans is assessed based on overdue days, restructuring status, previous use of moratorium, and payment-to-income ratios. Banks have conducted a granular assessment of COVID-19 impact on banks' loan portfolios to determine adequate general and specific provisions. These measures will support that inevitable losses are promptly recognized, but viable enterprises are not denied financing due to temporary liquidity difficulties.

29. We have postponed implementing large exposure limits until June 2022. In line with Basel III principles, we have tightened the large exposure limit to 25 percent of Tier–1 capital for both related and non-related parties (interconnected borrowers). Because of the lari depreciation, and additional expected credit losses in a challenging economic environment when borrowers have limited ability to reduce their exposures, we have granted banks until June 2022 to comply with the new requirement. From January 2022, banks should refrain from creating any new exposures that breach this limit. We regularly collect additional information from banks about the financial situation of large borrowers and monitor portfolio concentration risk.

30. Our pandemic support measures to support lending remain in effect. We released capital requirements in March 2020 by more than 3 percentage points for CET–1. We plan to give banks a two-year period to re-build capital buffers, subject to the path of economic recovery. The timing to rebuild capital buffers will depend on factors such as the banks' capital position and prospects for profitability. Distributions to shareholders will be restricted for banks until capital buffers are fully re-built.

31. We continue to strengthen the financial stability policy framework, regulation and supervision.

- We have initiated the transition to supervisory reporting from local accounting practices to international financial reporting standards (IFRS). Starting from 2021, banks can move voluntarily to new IFRS based reporting; however, they must meet the regulations under local accounting standards. Banks will be required to fully transfer their financial and regulatory reporting to IFRS framework by January 2022 while keeping local accounting standards in parallel to IFRS. Starting from 2023, the parallel reporting will be abolished and only IFRS reporting will be in place. We intend the transition to have no material impact on the prudential requirements, and therefore have developed IFRS-based supervisory reporting standards and forms, including new principles on asset provisioning and guidelines on models used for provisioning, which we are now refining and discussing with the industry. Once fully transitioned, we will request capital adequacy information both on stand-alone and consolidated basis under the IFRS accounting framework using relevant prudential filters.

- We will develop regulation on the fit-and-proper requirements for shareholders and beneficial owners of holding companies in line with EU legislation and Basel standards by June 2021.

- We are close to finalizing secondary legislation on notifying and approving concentration in the banking sector (e.g. mergers, acquisition of controlling holding), and procedures to investigate complaints on cases that may violate competition in the banking sector.

32. We have completed the rollout of implementing regulations of the new banking resolution framework. We have issued secondary legislation on: (i) resolution plans; (ii) temporary administrator and special manager; (iii) recapitalization tools; including the bail-in; (iv) temporary public support and ex-post resolution fund; and (v) ELA against government guarantees (**end-December 2020 structural benchmark**).

33. We continue to develop domestic capital market to support larization and reduce external vulnerabilities. The legislation for securities holding (creating the basis for dematerialized securities holding) and covered bonds (to improve access to long-term lari funding for commercial banks and help develop the fixed-income market) is expected to be approved in the third quarter of 2021 and by the end of 2021 respectively. The new framework for securities holding should strengthen investors' protection and incorporate an indirect holding regime, where only banks and brokers would be authorized to hold securities on behalf of their clients. The legislation on covered bonds should improve the availability of funding for banks. Our primary dealer (PD) system is operating in pilot mode since October 2020. The system includes a single issuance of a five-year bond that will be reopened periodically and six participating commercial banks.

34. We have developed a new Rule on Consumer Protection for Financial Organizations which better reflects requirements of relevant EU directives and responds to current local market developments. The rule will be enacted on April 1st, 2021. Changes include but are not limited to: (i) requiring financial institutions to provide the consumer with a choice of credit related insurance products[5]; (ii) an obligation of informing the consumer of the right to independently purchase

[5] This requirement applies in case financial institution requires insurance for disbursing a loan or insures credit itself. On the other hand, credit related insurance is not mandatory.

insurance at minimum terms to be acceptable for the financial institution; (iii) notification periods and requirements for unilateral change of the terms of a credit or deposit contract, including disbursements of new loans under previous agreements.

E. Structural Reforms

35. **We are committed to persevere with implementation of our comprehensive structural reform agenda to support the recovery and limit economic scarring from the pandemic.** Our reforms aim at strengthening Georgia's connectivity through infrastructure spending and trade initiatives, improving education and vocational training, mobilizing savings, the business environment, and land and energy reforms. These steps should boost productivity and raise long-term potential growth while limiting economic scarring. At the same time, targeted social assistance and healthcare will continue to protect the most vulnerable.

36. **Enhancing regional connectivity remains a key priority for Georgia's development.** Despite the constraints imposed by the pandemic, we are continuing to advance investment in core infrastructure, which will transform Georgia into a transport and logistics hub connecting Europe with Asia and support regional development. To this end, two out of four subsections of the East-West Highway (F2 and F3) are well underway and construction on the remaining subsections (F1 and F4) is at an early stage.

37. **We will revisit our comprehensive education reform to improve job creation, productivity and wages in the aftermath of the pandemic.** As one of the first steps, we have updated a decree on teacher career advancement to establish a non-discretionary approach based on: (i) abolishing credit-point (incl. partial) accumulation system; (ii) introducing special exams for teacher 's promotion at each level of teacher status.

38. **We will continue to improve the business environment.** To improve corporate governance, corporations will gradually be required to publish audited financial statements based on IFRS standards. In September 2020, the Parliament approved the new insolvency law providing adequate protection of creditor rights, timely and efficient insolvency processes, and effective rehabilitation framework in line with best international standards. This law will promote more efficient insolvency procedures, which would be critical if corporate insolvencies increase in the aftermath of the COVID-19 shock. We have issued the ministerial decree establishing requirements for insolvency practitioners, but the actual licensing will begin after April 1st (**end-March 2021 structural benchmark**).

39. **Deepening trade relations would support economic diversification.** We have signed a free trade agreement (FTA) with the U.K. to continue our trade relations after its departure from the EU. We continue to negotiate with Turkey an expansion of the current FTA. In February 2021, we have initiated a feasibility study on a Free Trade Agreement with the Republic of Korea and are committed to pursuing other FTAs with priority countries, including the United States, Israel, and the GCC countries.

F. Program Monitoring and Safeguards

40. The program has been monitored through quantitative performance criteria, indicative targets, an inflation consultation clause, and structural benchmarks. Quantitative performance criteria and indicative targets for end-December 2020 are listed in Table 2, and a list of structural benchmarks under the program is 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.

41. The NBG continues to maintain a strong safeguard framework and internal control environment. As required by the safeguard policy, we 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 2020

	2020			
	End June	Outturn	End Dec.	Outturn
Inflation Consultation Bands for CPI (in percent)				
Central point	6.0	6.4	3.5	2.4
Inner band, upper limit/lower limit	8.0 / 4.0		5.5 / 1.5	
Outer band, upper limit/lower limit	9.0 / 3.0		6.5 / 0.5	

Source: Geostat, IMF staff estimates

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets for end-June through end-December 2020

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

	2020			2020			
	End-June			End-December			
	Adjusted Target	Outturn	Status	Target	Adjusted Target	Outturn	Status
Performance Criteria							
Ceiling on augmented general government deficit (program definition)	2,507	1,492	Met	4,300	4,998	4,617	Met
Ceiling on general government net budget lending	51.5	20.1	Met	150	104	57	Met
Floor on NIR of NBG[1] (end-period stock, million of U.S. dollars)	966	1,335	Met	1,100	899	1,335	Met
Ceiling on the accumulation of external debt arrears of the Public Sector (continuous criterion) (million of U.S. dollars)	0	0	Met	0	0	0	Met
Ceiling on new public guarantees (continuous criterion)	0	0	Met	0	0	0	Met
Ceiling on the cash deficit of the Partnership Fund (million of U.S. dollars)	0	-4	Met	0	0	0	Met
Ceiling on new investments by the Partnership Fund (continuous criterion)	0	0	Met	0	0	0	Met
Ceiling on the new net borrowing of the Partnership Fund (million of U.S. dollars, cumulative from the beginning of the EFF program)	0	0	Met	0	0	0	Met
Indicative Targets							
Ceiling on the accumulation of net domestic expenditure arrears of the general government	0	0	Met	0	0	0	Met
Ceiling on Primary Current Expenditures of the General Government (in mn lari)	6,000	5,482	Met	12,450	12,517	12,190	Met
Stock of VAT credits[2]	1,470	1,303	Met	1,470	1,470	1,184	Met

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

[2] The stock of VAT credits is evaluated in mid-June/mid-December respectively.

Table 3. Georgia: Structural Benchmarks

Measure	Date	Status
Financial Sector		
Financial Stability		
Introduction of LCR for commercial banks, with preferential treatment of GEL-deposits	End-September 2017	Met
Adoption of regulation on capital add-ons in CAR for systemically important banks	End-December 2017	Met
Submit to Parliament legislation giving NBG oversight power over credit information bureaus	End-December 2017	Met
Increase in minimum regulatory capital for commercial banks to GEL50 million, phased in by 2019	End-June 2017	Met
Introduce regulation on bank's real estate appraisal in line with International Valuation Standards	End-June 2018	Met
Introduce regulation on leverage ratio based on Basel Principles and relevant EU regulation	End-September 2018	Met
Introduce regulation on banks corporate governance in line with Basel Principles	End-September 2018	Met
NBG to publish a renewed financial stability report	End-November 2019	Met
Capital Markets Development		
Publication of a multi-year calendar for government benchmark bonds	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	End-June 2017	Met
Deposit insurance		
Submission to Parliament legislation establishing deposit insurance as of January 1, 2018	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	End-September 2017	Met
Enact legislative changes to implement effective ELA and resolution framework in line with	End-December 2019	Met
Adopt the first phase of secondary legislation implementing bank resolution framework	End-June 2020	Met
Adopt the second phase of secondary legislation implementing bank resolution framework	End-December 2020	Met
Fiscal		
Submission to Parliament of a 2018 budget consistent with the fiscal deficit in the Fund-	End-December 2017	Met
Adopt a remuneration law for public civil service	End-December 2017	Met
Submit to Parliament a new fiscal rule framework consistent with IMF TA recommendations	End-December 2018	Met
Adopt a budget for 2020 with an augmented deficit of GEL1,320 million in line with policies	End-December 2019	Met
Adopting a 2021 budget consistent with the policies agreed at the Seventh Review	End-December 2020	Met
Tax Administration		
Action plan to address accumulated outstanding VAT refunds in an orderly manner over time	End-September 2017	Met
Restructure the GRS headquarters into a function-based organization	End-February 2018	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	End-March 2018	Not Met 1/
Create a new specialized VAT unit focusing on validating VAT claims	End-June 2018	Met
Submit to Parliament a revised penalty regime with gradual tax-geared penalties based on materiality and approve changes to the tax code granting the GRS powers to pay out refunds	End-December 2018	Met
90 percent of the VAT refund requests approved by the system will be automatically refunded, upon request, after offsetting against existing tax liabilities	End-June 2019	Met
Submit to Parliament changes in the legislation allowing the GRS access to the information received by the FMS from the monitoring entities on suspicious transactions, and put in place	End-December 2019	Met
Public-Private Partnership and Fiscal Risks		
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	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	End-December 2017	Met
The 2019 FRS will expand the analysis of fiscal risks stemming from PPPs and PPAs, and SOEs as	End-December 2018	Not Met 2/
Adopt the government decree implementing the PPP law as per the recommendations of the FAD	End-December 2018	Met
Publish a fiscal risk statement with a more comprehensive coverage of general government financial asset operations and provide information on the rates of return on general government	End-December 2019	Met
Issues guidelines establishing valuation methodology for PPPs	End-March 2020	Not Met 3/
Expand the 2020 Fiscal Risk Statement in line with recent FAD TA recommendations	End-December 2020	Met
Public Financial Management		
Issue guidelines for new budget lending operations requiring reasonable expectation of	End-December 2017	Met
Adopt a government decree clarifying the mandate of SOEs that are public interest entities, their governance and reporting requirements, in line with recent FAD recommendations	End-November 2019	Met
Strengthen the public investment management methodology that guides project appraisal, selection and management; and adopt a government decree implementing reporting and	End-December 2019	Met
Provide a complete list of the SOEs qualifying as public corporation and SOEs qualifying as general government under the GFSM2014, done in consultation with FAD's regional resident advisor	End-March 2020	Met
Pension Reform		
Submission of a pension law establishing a 2nd pillar pension system	End-December 2017	Met
Establishing an independent pension agency.	End-July 2018	Not Met 4/
Submit to Parliament legislation proposing a rule-based mechanism to index basic pensions	End-December 2019	Not Met 5/
Structural Reform		
Submit to parliament the new insolvency law ensuring adequate protection of creditors rights, timely insolvency processes and effective rehabilitation framework (in line with best international practice)	End-July 2019	Not Met 6/
Introduce the regulatory framework for insolvency professionals and begin licensing	End-March 2021	Not Met 7/

1/ Implemented with two months delay
2/ Implemented with one month delay
3/ Implemented with four month delay
4/ Implemented with a two week delay
5/ Implemented with seven months delay
6/ Implemented with seven months delay
7/ Expected to be implemented in April 2021

Attachment II. Technical Memorandum of Understanding

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 denominated assets will be valued in lari at program exchange rates as specified below. Amounts denominated in currencies other than the U.S. dollar 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 and the Partnership Fund.

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, daily, 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 indicative targets. Performance criteria are set with respect to:

- a performance criterion (ceiling) on the augmented cash deficit of the general government;
- a performance criterion (ceiling) on net budget lending operations;
- 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;
- 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.
- an indicative target (ceiling) on the primary current spending of the general government;
- an indicative target (ceiling) on outstanding VAT credits;
- an indicative target (ceiling) on new domestic expenditure arrears by the general government.

In addition, the program will include a consultation clause on the 12-month rate of inflation (Tables 1, 2 attached to the Letter of Intent).

6. In addition to the performance criteria listed above and in Table 2 of Attachment I, the arrangement includes the performance criteria standard to all Fund arrangements, namely: (i) no imposition or intensification of restrictions on the making of payments and transfers for current international transactions; (ii) no introduction or modification of multiple currency practices; (iii) no conclusion of bilateral payments agreements that are inconsistent with Article VIII of the IMF Articles of Agreement; and (iv) no imposition or intensification of import restrictions for balance of payments reasons. These four performance criteria will be monitored continuously.

7. Performance criteria and indicative targets have been set for end-June 2020 and end-December 2020 (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 terms 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

8. Inflation consultation bands around the projected path for inflation are set for each test date under the program. Test date inflation is defined as the year-on-year percentage change of the monthly consumer price index (CPI) in the month of the test date as measured and published by the National Statistics Office of Georgia (GEOSTAT).

9. If test date inflation 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 test date 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

Ceilings on (i) the augmented cash deficit of the general government and (ii) net budget lending

10. 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.

11. 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.

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).

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 cumulative amount of VAT credits refunded in cash above/below the program amounts (Table 2).

15. Adjustor: The ceiling on net budget lending will be adjusted upward (higher deficit)/downward (lower deficit) by the cumulative total amount of on-lent amounts from foreign-financed project loan disbursements above/below the program amounts (Table 2).

16. Adjustor: The ceilings on the augmented cash deficit and the primary current spending (indicative target) will be adjusted upward (higher deficit and higher primary current spending) for healthcare costs related to prevent the COVID-19 spread and treating COVID-19 cases in excess of the originally planned amount of GEL351 million (Table 2). Activities included for the adjustor are the ones defined by:

- Government Decree #164 28.01.2020 "On approval of preventive measures against spread of Novel Coronavirus and operational plan on treating diseases caused by the Novel Coronavirus":
  - Article 4.1 – Activities under the competencies of NCDC and Center for coordinating Emergency situation;
  - Article 4.8[2] – Tourism Agency providing quarantine services, including renting hotels and providing catering for the people in quarantine
  - Annex #20 "Managing Novel COVID-19" of the Government Decree #674 31.12.2019 "On Approving 2020 Healthcare Programs", added to the decree by the Government decree #176 17.03.2020;
- Government Decree #653 25.12.2019 "On approving 2020 State Program of Rehabilitating and equipping Medical Facilities".

Table 2. Georgia: Projected Financing for Cash Deficit of the General Government (in millions of GEL, cumulative from the beginning of the calendar year)	
	December 31, 2020
Healthcare costs related to prevent the COVID-19 spread and treating COVID-19 cases	351
Disbursements of foreign-financed project loans[1]	1,170
Receipts from sale of non-financial assets	150
VAT refunds	600
On-lent amounts from project loan disbursements	250

[1]This value excludes project loans that are used to support the budget and/or the healthcare sector, namely, the World Bank's Fast Track COVID-19 Facility and EIB's healthcare project. Adjustments will not be made on these loans.

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. Healthcare spending specified under (i)the Government Decree #164 28.01.2020, "On approval of preventive measures against spread of Novel Coronavirus and operational plan on treating diseases caused by the Novel Coronavirus" under the categories of Articles 4 and 4.8[2], and Annex #20; and (ii) Government Decree #653 25.12.2019 "On approving 2020 State Program of Rehabilitating and equipping Medical Facilities".

d. Data will be provided at actual exchange rates.

e. 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.

f. 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.

g. Data for the previous month will be provided by the Georgia Revenue Service by the end of each month on:

- Number and GEL value of claims for cash refunds submitted by taxpayers, separately for VAT and other taxes,
- Number and GEL value of cash refunds paid, separately for VAT and other taxes,
- Number and GEL value of cash refunds paid automatically (i.e., without manual check or audit), separately for VAT and other taxes.

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

Ceiling on the Current Primary Expenditures of the General Government

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

19. **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.

Ceiling on the Outstanding stock of VAT credit refunds

20. **Supporting material:** Data for the period from the 16th day of the previous month to the 15th day of the current month will be provided by the Georgia Revenue Service by the end of each month on:

- Opening balance in taxpayer accounts (stock)
- New tax credits declared by taxpayers,
- Tax credit balance adjustments made by GRS after desk check / audit and by taxpayers,
- Tax payments to the budget
- Tax credits offset against tax liabilities,
- Tax credit refunds paid in cash,
- Other flows (residual),
- Closing balance in taxpayer accounts (stock),

- Closing balance amounts not eligible for a cash refund (stock).

Continuous Performance Criterion on Accumulation of General Government External Debt Arrears

21. 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.

22. 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]

23. 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

24. 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.

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

Continuous Ceiling on the New Guarantees Issued by the Public Sector

26. Definition: For the purposes of the program, a **guarantee** of a debt arises from any explicit legal obligation of the public sector to service such a debt in the event of nonpayment by the recipient (involving payments in cash or in kind).

[1] Arrears to Turkmenistan.

27. **Supporting Material:** The Ministry of Finance will provide to the IMF information on any new guarantees issued by the public sector within 4 weeks after the end of each quarter.

Partnership Fund

Ceiling on the Cash Deficit of the Partnership Fund

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

29. 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.

30. 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

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

32. **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.

Continuous Ceiling on New Investments by the Partnership Fund

33. **Definition:** New investments by the Partnership Fund are defined as gross acquisition of non-financial and financial assets, excluding (i) currency and deposits and (ii) other accounts receivables. Further excluded are transactions which are unambiguously required by contractual obligations established before November 1, 2019.

34. **Supporting Material:** The Ministry of Finance will provide to the IMF detailed information on the Partnership Fund's quarterly acquisition of financial and non-financial assets within four weeks of the end of each quarter. The Ministry of Finance will notify the IMF about transactions required by preexisting contractual obligations within 10 days of their occurrence and provide the necessary documentation establishing such obligation.

Net International Reserves

Floor on the Net International Reserves of the NBG

35. 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 $1,335 million as of December 31st, 2020 (at program exchange rates).

36. 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.

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

- Upward (downward) by 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 any excess (shortfall) of budget support grants compared to program amounts (Table 3).
- Downward by any shortfall of budget support loans compared to program amounts (Table 3).
- Upward by the sum of the total excess of budget support loans compared to program amounts (Table 3) and any negative net Eurobond issuance by the government, if this sum is positive.
- Upward by any positive net Eurobond issuance by the government.

- Upward/downward by 100 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[1]
(Million of U.S. dollars)

	December 31, 2020[2]
Projected privatization revenue	0.0
Budget support grants from external donors and not related to project financing	118.6
Budget support loans, including bilateral and multilateral donors for budget support	908.1
Disbursements of project loans and grants	335.1

[1] Flows are valued at program exchange rates for the June and December targets.
[2] Cumulative from January 2020 to end-December 2020.

38. 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.