INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/188

GEORGIA

June 2022

REQUEST FOR A STAND-BY ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR GEORGIA

In the context of Request for a Stand-By 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 June 15, 2022, following discussions that ended on May 2, 2022, with the officials of Georgia on economic developments and policies. Based on information available at the time of these discussions, the staff report was competed on May 27, 2022
- A **Statement by the Executive Director** for Georgia.

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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International Monetary Fund
Washington, D.C.

IMF Executive Board Approves US$280 million Stand-By Arrangement for Georgia

FOR IMMEDIATE RELEASE

- The IMF approved today a three-year Stand-By Arrangement (SBA) for Georgia of US$280 million.
- The program focuses on rebuilding fiscal buffers, strengthening fiscal frameworks, reducing external vulnerabilities and inflation, maintaining financial sector resilience, and fostering stronger and more inclusive growth.
- The authorities intend to treat the arrangement as precautionary.

Washington, DC – **June 15, 2022:** The Executive Board of the International Monetary Fund (IMF) today approved a US$280 million (100 percent of quota and SDR 210.4 million) Stand-By Arrangement for Georgia which provides support for the authorities' economic policies over the next three years. The Board's decision makes about US$40 million (SDR 30 million or 14.3 percent of Georgia's quota) immediately available. The Georgian authorities intend to treat the new arrangement as precautionary.

The authorities' IMF-supported program seeks to further entrench macroeconomic stability, build resilience, and strengthen medium-term growth as the country emerges from the COVID-19 pandemic and contends with spillovers from the war in Ukraine.

Following the Executive Board's discussion on Georgia, Mr. Bo Li, Deputy Managing Director, made the following statement:

The Georgian economy has been resilient to the COVID-19 pandemic, reflecting the authorities' strong policy response, which helped to cushion the impact of the shock. The robust recovery from the pandemic is likely to slow, given Georgia's vulnerability to spillovers from the war in Ukraine, which are also expected to increase inflation and widen the current account deficit.

The Georgian authorities have adopted a program focused on addressing macroeconomic challenges, including reducing the fiscal deficit, inflation, and external vulnerabilities, and advancing the necessary structural reforms to strengthen growth. The program will be supported by a Stand-by Arrangement, which the authorities intend to treat as precautionary.

Rebuilding fiscal buffers, while reducing debt and protecting the vulnerable will be key. The authorities recognize the importance of adhering to the fiscal rule to anchor policy credibility, and are targeting full compliance with the fiscal rule's deficit ceiling by 2023. Important measures, such as saving revenue overperformance, strengthening tax administration, streamlining tax expenditures, and developing a medium-term revenue strategy would help facilitate priority spending while rebuilding fiscal buffers. Strengthening public financial management and reforming state-owned enterprises would help to mitigate fiscal risks.

The central bank's monetary policy stance remains appropriately focused on bringing down high inflation. The authorities are committed to maintaining exchange rate flexibility, strengthening reserves, and enhancing the central bank's communication strategy. They have managed the initial impact of sanctions, with the central bank requiring banks to adhere to international sanctions, which has limited risks.

The authorities have made commendable progress on enhancing financial sector regulation and supervision, aiding financial sector resilience to recent shocks. The next steps focus on enhancing financial safety nets, fostering capital market development, and strengthening the AML/CFT framework. A sound financial sector along with sustained strong macroeconomic policy implementation will help reduce dollarization and related vulnerabilities.

A reinvigorated structural reform agenda will help support stronger and more inclusive growth. Measures to strengthen the business environment and enhance governance would help to improve competitiveness. The authorities are focused on tackling entrenched high unemployment by advancing education reform and strengthening active labor market policies. Efforts to increase investment in information technology infrastructure and accelerate digitalization are welcome.

Georgia: Selected Economic and Financial Indicators, 2019–23

	2019	2020	2021	2022	2023
	Actual		Preliminary	Projections	
National accounts and prices	(annual percentage change; unless otherwise indicated)				
Real GDP	5.0	-6.8	10.4	3.2	5.8
Nominal GDP (in billion of laris)	49.3	49.3	60.2	69.0	77.0
Nominal GDP (in billion of U.S. dollars)	17.5	15.8	18.7	22.3	24.2
GDP per capita (in thousand of U.S. dollars)	4.7	4.3	5.0	6.0	6.5
GDP deflator, period average	4.9	7.3	10.6	11.3	5.3
CPI, Period average	4.9	5.2	9.6	10.9	5.1
CPI, End-of-period	7.0	2.4	13.9	8.1	3.4
Consolidated government operations	(in percent of GDP)				
Revenue and grants	27.1	25.2	25.4	25.2	25.3
o.w. Tax revenue	23.7	22.3	22.5	22.8	23.1
Expenditures	28.9	34.5	31.4	29.1	28.0
Expense	21.4	26.3	24.5	21.7	21.9
Net acquisition of non-financial assets	7.6	8.2	6.9	7.4	6.1
Capital spending	8.0	8.6	7.6	8.0	6.4
Privatization proceeds	-0.4	-0.4	-0.7	-0.7	-0.3
Net lending / borrowing after adjustment	-1.8	-9.3	-6.0	-3.9	-2.6
Net budget lending	0.2	0.1	0.1	0.1	0.2
Augmented Net lending / borrowing (program definition) 1/	-2.1	-9.4	-6.1	-4.0	-2.8
General government debt 2/	40.4	60.2	49.5	47.1	45.8
o.w. Foreign-currency denominated	32.0	47.6	39.8	37.5	35.5
Money and credit	(annual percentage change; unless otherwise indicated)				
Credit to the private sector	20.7	22.4	12.4	20.9	11.6
In constant exchange rate	16.1	9.0	18.2	21.2	9.9
Broad money	17.6	24.6	11.3	19.9	14.0
In constant exchange rate (estimate)	14.3	14.4	15.4	20.4	11.8
Broad money (excl. fx deposits)	18.8	18.8	17.8	16.8	14.6
External sector	(in percent of GDP; unless otherwise indicated)				
Current account balance	-5.5	-12.4	-9.8	-10.9	-7.5
Trade balance	-21.4	-20.0	-20.1	-20.3	-19.6
Terms of trade, goods (percent change)	-0.6	4.1	-14.0	-8.9	1.4
Gross international reserves (in billions of US$) 3/	3.5	3.9	4.3	3.3	3.3
In percent of IMF Composite measure (floating)	101.1	108.1	107.7	79.4	74.9
Gross external debt	87.7	109.6	98.2	85.8	80.6

Sources: Georgian authorities; and Fund staff estimates.
1/ Augmented Net lending / borrowing (program definition) = Net lending / borrowing - Budget lending.
2/ Excludes domestic legacy debt amounting to 1.2 percent of GDP.
3/ Using current exchange rates; includes SDR allocations (SDR 144 million before 2021 and SDR 346 million since 2021).

INTERNATIONAL MONETARY FUND

GEORGIA

REQUEST FOR A STAND-BY ARRANGEMENT

May 27, 2022

KEY ISSUES

Context. The authorities' policy response aided a robust recovery from the COVID-19 shock in 2021 with output growth above expectations reflecting pent-up demand and strong export performance. However, spillovers from the war in Ukraine are expected to dampen growth, raise inflation, and widen the current account deficit this year. The recovery in 2021 and scaling back of pandemic measures led to a decline in the fiscal deficit and government debt. Inflation is expected to remain higher for longer, reflecting elevated global food and commodity prices. The NBG has increased its policy rate by 3 percentage points since March 2021.

Program request and objectives. The authorities seek to build on the success of the previous EFF-supported program by continuing their reform agenda within the framework of a Stand-By Arrangement (SBA). Their policy program aims to further entrench macroeconomic stability, rebuild fiscal buffers, strengthen public financial management, reduce external vulnerabilities, achieve the inflation target, enhance financial sector resilience, and strengthen medium-term growth. While recognizing that there are significant risks of a deterioration in the external environment in the near term, the authorities intend to treat the program as precautionary to send a strong signal of their commitment to credible policies and macroeconomic stability.

- The program envisages medium-term fiscal adjustment anchored on compliance with the fiscal rule by 2023 and maintaining a buffer to respond to shocks. Strengthening tax administration and reviewing tax expenditures will help generate additional revenue to finance priorities such as capital spending and education.

- The program aims to strengthen public financial management and limit fiscal risks, including through reform of state-owned enterprises, a framework to guide energy investment, and an updated public investment management assessment.

- Following up on recent FSAP recommendations, the program will further bolster financial sector resilience through reforms to improve supervision, enhance the financial safety net, address large exposures, improve data collection, and strengthen AML/CFT regulations.

- Structural reforms include a focus on education and training to tackle high unemployment and address labor market mismatches.

Approved By
Subir Lall (MCD)
Natalia Tamirisa (SPR)

Discussions were held via videoconference between November 18, 2021 and May 2, 2022. The mission team comprised J. John (head), S. Saksonovs, S. Khan (MCD), A. Lagerborg (FAD), M. Leika (MCM), Y. Zhao (SPR), S. Cakir (Resident Representative) and N. Sharashidze (Local Economist). The mission was assisted by S. Zolotareva, N. Reyes (all MCD) and K. Danelia (IMF Tbilisi Office). Messrs. Rashkovan, and Tsur (OED) attended some meetings.

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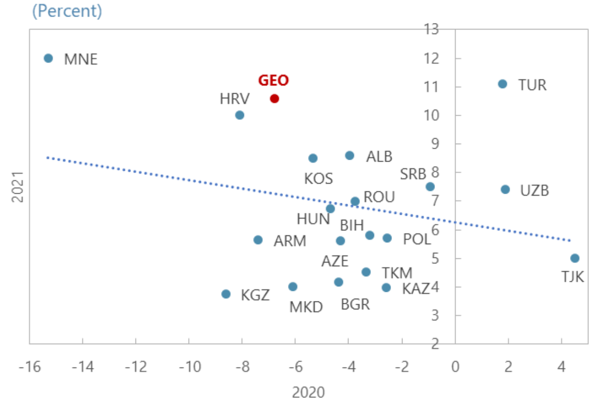
CONTEXT

1. The authorities' policy response aided a robust recovery from the COVID-19 shock in 2021. After a decline of 6.8 percent in 2020, real GDP grew by 10.4 percent in 2021 reflecting pent-up demand and strong export performance. Prudent fiscal policy before the crisis and significant donor and IFI support (including augmentation of the previous EFF arrangement) allowed the authorities to boost healthcare spending and provide targeted support to businesses and vulnerable households totaling 3.8 percent of GDP in 2020 and 3.3 percent of GDP in 2021. Exchange rate depreciation limited the deterioration in the balance of payments while contributing to higher-than-expected inflation. Strong financial supervision leading up to the crisis and the NBG's prompt supervisory actions ensured that banks were able to offer borrowers temporary payment holidays, while still providing credit to the economy.

Real GDP Growth
(Percent)



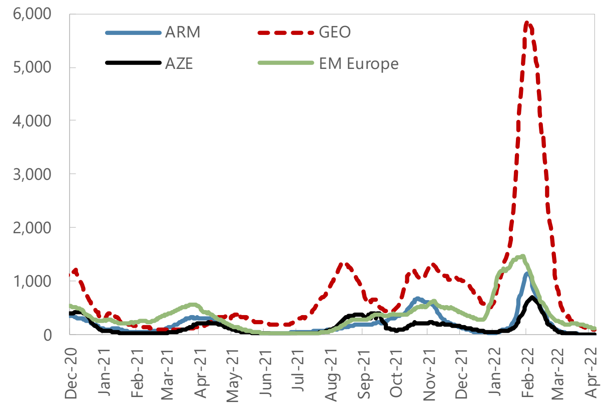
Source: IMF World Economic Outlook January 2022.

2. Spillovers from the war in Ukraine are expected to have a significant impact on Georgia's economy. Russia and Ukraine accounted for 22 percent of exports, 21 percent of remittances (mostly from Russia), and 25.4 percent of tourism inflows in 2021. Weaker export demand and lower remittances and tourism revenues will hurt growth and widen the current account deficit. Georgia also imports significant amounts of wheat from Russia and Ukraine, and the broader increase in commodity prices could keep inflation higher for longer. However, the fiscal impact is likely to be small, as the positive impact of higher inflation on revenues largely offsets the impact from lower growth and additional targeted support provided to vulnerable households.

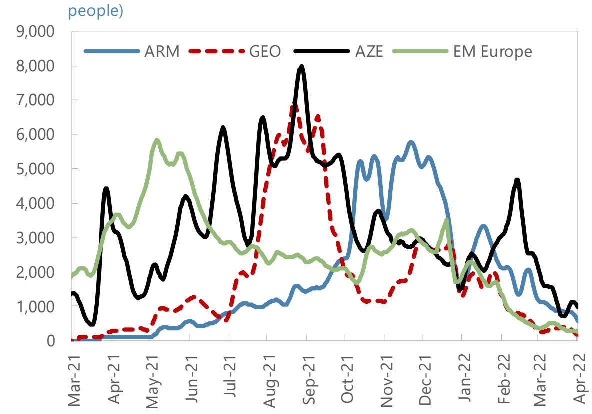
3. COVID-19 cases have declined after the Omicron wave. Georgia endured several waves of the pandemic and the seven-day moving average of infections remained higher than for peers as of April 2022. Although the authorities secured sufficient vaccine supplies, difficulties in reaching rural regions and vaccine hesitancy slowed vaccinations. After strict lockdowns earlier in the pandemic, the authorities have refrained from reimposing restrictions of the same magnitude and economic growth has been largely unaffected by successive spikes in cases.

4. Political polarization remains significant, but early elections are not expected. While deep divisions remain, strong performance by the ruling party in October 2021 local elections has made parliamentary elections before 2024 unlikely. Georgia applied for EU membership in March 2022.

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



New COVID-19 Vaccinations
(7-day moving average of new vaccination per one million people)



Source: Haver (Oxford University); Johns Hopkins University, Coronavirus Resource Center and IMF staff calculations.

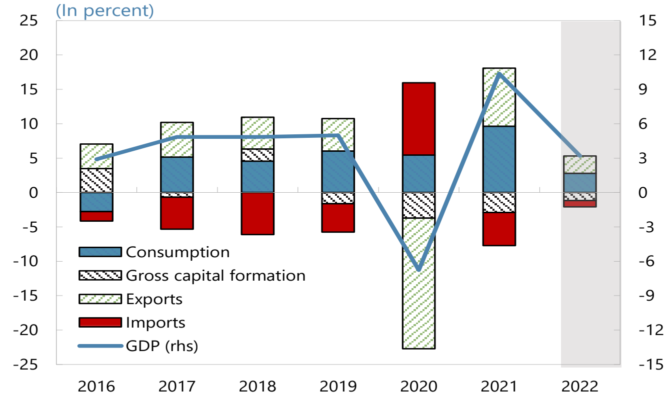
RECENT ECONOMIC DEVELOPMENTS

5. Growth maintained its momentum in the early months of 2022 (Table 1, Figure 1). Following four successive quarters of contraction, the economy began recovering in the second quarter of 2021, driven by private consumption and supported by exports and a resumption of tourism. Growth for 2021 as a whole stood at 10.4 percent and the momentum has continued into the first quarter of this year.

6. The recovery has put pressure on the trade deficit. The goods trade deficit widened in line with the recovery and rising oil prices but the strong growth in remittances and the recovery of tourism mitigated the adverse impact on the current account (Table 2, Figure 2).

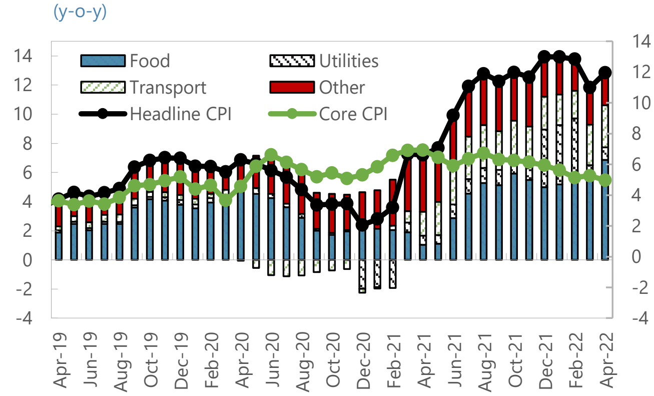
7. Headline inflation remains very high, while core inflation has eased somewhat. Headline inflation peaked in December 2021 at 13.9 percent (y/y) before declining about 1 percentage point by April 2022—well above the NBG's 3 percent target. Four-fifths of the elevated inflation is due to high food, transportation, and utility prices. Meanwhile,

Contributions to Growth
(In percent)



Source: Geostat and staff estimates.

Decomposition of Georgian Inflation
(y-o-y)

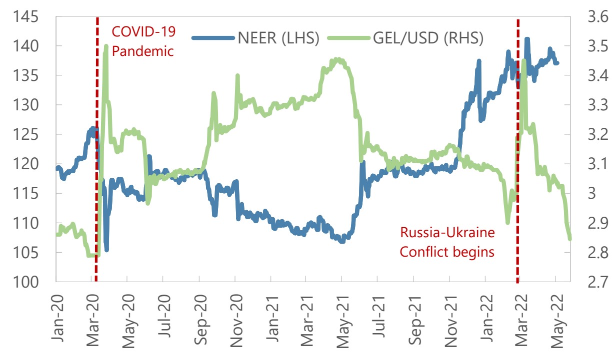


Source: Geostat, and IMF staff calculations.

core inflation has declined by almost 2 percentage points since its April 2021 peak of 6.9 percent (y/y). In response to emerging price pressures, the NBG has raised its policy rate by a cumulative 300 basis points (to 11 percent) since March 2021.

8. The outbreak of the war in Ukraine increased exchange rate volatility. The lari had been strengthening since April 2021 and prior to the war was stronger than its pre-pandemic levels in nominal and real effective terms (by 11.8 and 9.2 percent). After the outbreak of the war, the lari initially depreciated sharply against the dollar but has since recovered beyond its pre-war level and in May the NBG conducted its first auction to purchase foreign exchange (FX) since 2019. Gross international reserves, supported by donor and IFI disbursements, refinancing of the Eurobond, and the recent SDR allocation, reached US$ 4.3 billion at end-2021 or 108 percent of the ARA metric.

Lari Exchange Rates
(NEER, Dec 2005 = 100)



Source: Haver (National authorities).

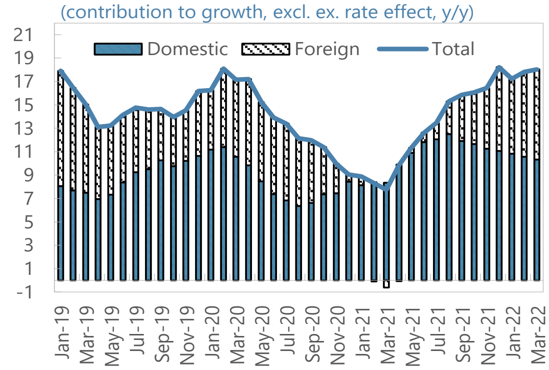
9. Better-than-expected fiscal outturns in 2021 have been followed by strong revenue performance in early 2022 (Table 3, Figure 3). The 2021 budget deficit was 6.1 percent of GDP, below the 6.8 percent deficit in the amended budget. Higher-than-anticipated revenues more than compensated the higher spending driven by pandemic-related health costs. Revenues grew at a brisk pace (31 percent y/y) led by VAT receipts reflecting private consumption growth.[1] The authorities also stepped up privatizations, with revenues more than doubling over the previous year. The deficit was financed largely by drawing on the large precautionary stock of government deposits as well as donor and IFI financing, while net domestic debt issuance was negative.

Text Table 1. Georgia: Budget Execution, Jan-Apr 2021/22

	Jan-Apr 2021		Jan-Apr 2022		Diff.
	GEL mls	% of GDP	GEL mls	% of GDP	% of GDP
Revenues and grants	4,240	7.0	5,565	8.1	1.1
Taxes	3,733	6.2	5,060	7.4	1.2
Other revenues	314	0.5	342	0.5	0.0
Grants	193	0.3	164	0.2	-0.1
Primary current spending	4,276	7.1	4,654	6.8	-0.3
Interest expense	294	0.5	250	0.4	-0.1
Net acquisition of non-financial assets	976	1.6	1,137	1.7	0.0
Capital spending	1,041	1.7	1,212	1.8	0.0
Privatization	-65	-0.1	-75	-0.1	0.0
Net lending / borrowing	-1,307	-2.2	-475	-0.7	1.5
Net budget lending	40	0.1	10	0.0	-0.1
Augmented balance	-1,346	-2.2	-485	-0.7	1.5
Nominal GDP	60,232		68,412		

Source: National authorities and IMF staff estimates.

[1] In early 2022, tax revenues have also been boosted by COVID-related personal income tax and property tax exemptions rolling-off.



Source: NBG

10. Credit growth has accelerated notwithstanding monetary policy tightening, prompting the NBG to adopt new macroprudential measures (Tables 4-5, Figure 4). Despite NBG policy rate increases, overall credit growth reached 18 percent (y/y) in March 2022. The most recent acceleration reflects a pickup in foreign currency lending especially to corporates, which are less constrained by the minimum size of FX loans.[2] To control risks stemming from rising credit growth, the NBG lowered the maximum maturity of mortgage loans (effectively tightening lending standards due to a payment-to-income (PTI) limit) and recalibrated the currency-induced credit risk (CICR) buffer to assign higher risk weights to more dollarized loan portfolios.[3] The NBG also increased the income threshold below which a stricter PTI ratio applies (effective April 1st) and introduced a 3-percentage point interest rate shock in calculating PTI on floating interest rate loans (effective May 1st).

11. Banks' liquidity ratios are above minimum requirements and asset quality has been improving with NPL and restructured loan ratios declining. As of April 2022, the banking sector liquidity coverage ratio was 118 percent, and all banks are above the 100 percent minimum requirement. Robust credit growth, stable real estate prices, and lari appreciation contributed to a decline in the NPL ratio from a peak of 8.3 percent in March 2021 to 5 percent in March 2022. The decline has been broad-based with retail and auto dealer loans contributing the most. Restructured loans have also declined since their peak in February 2021 (21.2 percent) to 15.3 percent in March 2022. On average, a fifth of loans to construction, real estate management companies, hotels, restaurants, and producers of consumer goods still exhibit signs of delinquency.

12. The authorities have managed the initial impact of sanctions. The authorities facilitated the unwinding of operations of VTB Georgia, which faced deposit pressures due to sanctions. Assets and liabilities were transferred to two other smaller banks and spillovers to the broader financial system were avoided. The NBG has required banks to adhere to sanctions, which has limited risks. While some smaller banks have lost correspondent relationships with Russian banks, the largest banks in Georgia retain western correspondent banking relationships and have provided services to customers of banks that no longer have such relationships. Trade, remittance, and other transactions generally continue, including with unsanctioned Russian banks. Some impact has been seen on businesses including a large mineral water company that suspended operations after bank accounts were frozen. The government is considering acquiring a small amount of shares to reduce the majority owner's stake to a minority one and facilitate resumed operations of the company.

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[2] Foreign currency lending is not allowed for amounts below GEL 200,000.

[3] This change was effective from January 1, 2022, and banks were given one year to comply with any additional capital requirements.

OUTLOOK AND RISKS

13. Spillovers from the war in Ukraine will weigh on growth in 2022, but medium-term prospects remain broadly unchanged. The strong V-shaped recovery in 2021 ensured that GDP surpassed its 2019 level. While domestic demand will continue to drive growth, the recovery is expected to moderate to around 3 percent due to dissipating pent-up demand and headwinds from higher uncertainty and lower remittances. Net export growth is expected to decline, reflecting lower tourism revenues and weaker growth in trading partners. Assuming dissipating impact from the war and no significant new economic impact from COVID-19, growth is expected to rebound in 2023 to 5.8 percent, as businesses find alternative suppliers and markets, before easing to its medium-term potential of around 5 percent by 2024. Medium-term growth should be supported by gross capital formation including public infrastructure projects, as well as by FDI, likely to be concentrated in the financial, energy, hotel and restaurant sectors based on recent trends.

14. High inflation is expected to persist in 2022 before gradually converging to the NBG's target by 2024. Continued supply constraints and rising commodity and food prices have led to persistent upward pressure on prices, without which inflation would have decelerated. With tight monetary policy, inflation in 2022 is expected to average around 11 percent before slowly converging to the NBG's inflation target of 3 percent in 2024 reflecting dissipating base effects and assuming no emergence of second-round wage effects.

15. Weaker external demand and higher commodity prices will lead to a temporary deterioration of the external position. After narrowing in 2021, the current account deficit is expected to widen to 10.9 percent in 2022, before gradually narrowing over the medium term to around 5½ percent of GDP in 2027. The larger current account deficit along with lower borrowing from development partners will contribute to a decline of gross international reserves to close to 80 percent of the ARA metric in 2022 before they gradually recover to 98 percent in 2027.

16. Risks to the outlook are broadly balanced. The key downside risk is that the spillovers from the war in Ukraine are deeper and more protracted than expected (Annex I). The possibility of new highly contagious COVID-19 variants is another risk. Significant external vulnerabilities remain. Further lari depreciation, including in the event of tighter global financial conditions, could increase inflation pressure and affect financial stability given high dollarization. Depreciation could also pose vulnerabilities for public debt, given the high foreign currency share (Annex II). Domestic political uncertainty could increase lari volatility, undermine investment and confidence, and hinder structural reform efforts. On the upside, the strong domestic demand seen through early 2022 could prove more durable than anticipated. Migration and capital flight to Georgia could help sustain demand and increase foreign exchange inflows, tourism flows could prove resilient, and trade could be diverted through Georgia. Businesses could also adjust faster to changes in logistics, supply chains, and payment systems.

17. The proposed program will enhance Georgia's resilience to the current shock and increase policy space if downside risks materialize. Annex III describes a scenario where the war in Ukraine escalates and the impact is prolonged. In this scenario, a slowdown in exports, remittances, and tourism further lowers growth and import demand in 2022 through 2024, while additional increases in commodity prices put pressure on inflation. Deteriorating global financial conditions result in capital outflows. Monetary policy would need to be tightened sooner and the authorities would need to augment spending plans to mitigate the impact. Reserves would be expected to decline to around 62 percent of the ARA metric by end-2024. Drawing on the program would boost reserves by about 6 percentage points of the ARA metric, bringing them to around 72 percent of the ARA metric by the end of the program (Text Table 2). Importantly, a program would signal a strong commitment to credible policies and could catalyze additional donor financing that would further boost reserves.

Text Table 2: Key Macroeconomic Indicators in Baseline and Downside Scenarios
(percent of GDP, unless otherwise noted)

	2021	2022		2023		2024		2025	
	Baseline	Baseline	Downside	Baseline	Downside	Baseline	Downside	Baseline	Downside
Real GDP growth (percent change)	10.4	3.2	2.7	5.8	3.8	5.2	4.4	5.2	5.2
GDP deflator (percent change)	10.6	11.3	11.5	5.3	6.7	3.0	3.6	3.0	3.0
Augmented net lending/borrowing	-6.1	-4.0	-4.3	-2.8	-3.3	-2.3	-2.5	-2.3	-2.3
Current account	-9.8	-10.9	-12.0	-7.5	-9.0	-6.3	-6.8	-5.8	-6.5
General government debt	49.5	47.1	49.7	45.8	47.2	44.3	45.8	42.9	44.4
External debt	98.2	85.8	88.3	80.6	83.6	74.6	77.9	68.9	71.9
GIR (in percent of ARA metric)	107.7	79.4	73.1	74.9	62.6	74.7	61.9	80.5	66.1
GIR after drawing (in percent of ARA metric)			75.1		66.4		67.4		72.1

Source: National authorities and IMF staff projections

PROGRAM OBJECTIVES AND POLICIES

Reflecting the authorities' desire for a framework to support strong policies, the proposed program focuses on: (i) the 2022 budget deficit and the medium-term fiscal path to comply with the fiscal rule and create policy space, improving public investment management, and strengthening revenue generation; (ii) reducing fiscal risks including by advancing state-owned enterprise (SOE) reform; (iii) maintaining a sufficiently tight monetary stance and further enhancing financial sector resilience; and (iv) undertaking medium-term structural measures to strengthen labor market participation. The overall policy package under the program would further entrench macroeconomic stability by supporting a gradual reduction of the large current account deficit and external vulnerabilities, achievement of the inflation target, and greater fiscal and financial sector resilience.

A. Rebuilding Fiscal Buffers and Controlling Risks

18. The 2022 budget would make substantial progress toward compliance by 2023 with the fiscal rule—a key anchor and source of policy credibility.[4] The 2022 budget implies a deficit

[4] Following a triggering of the escape clause during the pandemic, Georgia's Economic Liberty Act requires that by 2023 the fiscal deficit not exceed 3 percent of GDP and government debt not exceed 60 percent of GDP.

of 4.0 percent of GDP under the program (MEFP ¶7), reflecting a 1.8 percentage point of GDP increase in the cyclically adjusted primary balance vis-à-vis 2021. This fiscal stance strikes a balance between making credible progress towards compliance with the fiscal rule while accommodating remaining pandemic risks and strategic investment priorities (see ¶19). The authorities intend to amend the budget to increase targeted support to vulnerable households and subsistence farmers by around 0.2 percent of GDP to mitigate the impact of the recent energy and food price shocks resulting from the war in Ukraine (MEFP ¶7). The increase will be financed by higher expected revenues and spending reprioritization, and will not affect the deficit. The authorities intend to use any further revenue overperformance to reduce the deficit, and to meet any additional spending needs including those arising from the spillovers from the war and sanctions by spending reprioritization.[5]

19. The 2022 budget relies on expiration of COVID-19 measures and reducing goods and services expenditure while maintaining strong capital spending. Primary current spending is expected to decline by 2.6 percent of GDP, mostly due to unwinding temporary COVID-19 support (2.5 percent of GDP) and expenditure on goods and services. Social benefits decline overall reflecting the unwinding of COVID-19 support, but remain above pre-pandemic levels reflecting increased pension spending under the Pillar I indexation rule, the introduction of Pillar II,[6] and increased social assistance to vulnerable families with children, which was made permanent in 2021 and is being increased in the context of spillovers from the war in Ukraine as noted above. The budget also envisages a 10 percent increase in the basic public sector salary, which is in line with 2021 inflation, although the wage bill remains low relative to historic levels and other emerging markets. Capital spending is expected to reach 8 percent of GDP to finance ongoing infrastructure projects of strategic national importance including key highways.[7] In the context of high inflation, compressed spending on goods and services as well as wage restraint relative to historical standards risks creating spending pressures and may impede public sector delivery. It is therefore important to balance current and capital spending in future budgets. On the revenue side, tax revenues are expected to be boosted by COVID-related personal income tax and property tax exemptions rolling-off (estimated at 0.4 percent of GDP) and strong corporate income tax performance.[8] To increase fiscal transparency, the authorities will publish the 2022 consolidated financial statements for the central government based on international public sector accounting standards *(end-June 2023 SB)*.

[5] An exception to this is if additional COVID-19 related healthcare spending is needed beyond the roughly 0.8 percent of GDP budgeted in 2022 and 0.3 percent of GDP budgeted in 2023-25 (see TMU ¶14). In comparison, COVID-related healthcare spending totaled 2.1 percent of GDP in 2021.

[6] The pension system in Georgia currently rests on two pillars: Pillar I – a universal pension that everybody receives and Pillar II – a more recent defined contributions scheme to which the government pays 2 percent of the salary (along with the employer and the employee).

[7] Georgia's public capital stock is lower than Caucasus and Central Asia and emerging market averages.

[8] High CIT revenues are expected on the basis of strong corporate performance, especially in the financial sector, in 2021 (CIT in Georgia is paid based on previous year's income/profits). Over January-April 2022, CIT revenues grew over 60 percent y/y.

20. The authorities' medium-term fiscal adjustment path complies with the fiscal rule and would build space to respond to shocks (MEFP ¶6, ¶8). The authorities plan to reduce the deficit (including non-market SOEs[9]) to 2.8 percent of GDP in 2023 and 2.3 percent in 2024, which will create space to respond to downside shocks.[10] The authorities intend to reduce government debt to pre-pandemic levels over the medium term while also increasing the share of domestic debt to close to 30 percent, which would reduce FX vulnerabilities and support capital market development.

21. The authorities are seeking to raise revenues over the medium term to help finance priority spending (MEFP ¶9). Financing new priority spending (e.g., education reform, capital spending projects) while complying with the fiscal rule will likely require additional revenue, which the authorities plan to mobilize by:

- *Strengthening tax administration*. The authorities intend to build on tax administration improvements under the recent four-year program supported by IMF TA[11] by strengthening compliance risk management by finalizing the new audit case management system, applying key performance indicators for large taxpayers, creating a register of employees for tax administration, and increasing automatic access to third party information (MEFP ¶12).

- *Reviewing tax expenditures*. The authorities will submit amendments to the budget code to make annual tax expenditure reporting legally binding, establish a schedule for annual tax expenditure reporting (*end-September 2022 SB*), and publish a first tax expenditure report including the nature of existing tax expenditures and their costs (*end-December 2022 SB*). While a full cost-benefit analysis is not essential for tax expenditure reforms (costing can be sufficient), preparing a cost-benefit analysis for key tax expenditures (*end-June 2023 SB*) can help identify those that might be reduced or eliminated.

- *Developing a Medium-Term Revenue Strategy (MTRS)*. The authorities plan to develop an MTRS with IMF TA to help identify options for revenue mobilization while promoting tax efficiency and progressivity (*end-September 2023 SB*).

22. The authorities reaffirmed their commitment to timely refunds of VAT credits, providing an important source of liquidity to the private sector. The recently introduced automatic system for VAT refunds is generally working well. The authorities have now committed to automatically process at least 90 percent of new VAT credit claims measured as both the number and value of declarations within 30 calendar days (*end-July 2022* and *end-January 2023 SB*s). They will also reduce the stock of audited VAT declarations cleared for payment to no more than GEL 50 million (*end-December 2022 SB*).

[9] Estimates based on IMF TA suggest that incorporating non-market SOEs would have increased state debt by 1.1 percent of GDP and the fiscal deficit by 0.6 percent of GDP in 2019. Since most non-market SOEs do not have financing sources other than the budget, the deficit impact is expected to be mostly captured already.

[10] This would imply a 1.1 percent of GDP increase in the cyclically-adjusted primary balance in 2023 and around 0.7 percent in 2024.

[11] See the 2021 Tax Administration Diagnostic Assessment completed with IMF TA.

23. Continued progress on SOE reform is key to limit significant fiscal risks while enhancing performance, transparency, and accountability (MEFP ¶10). Following the comprehensive sectorization of SOEs carried out in 2020, the authorities have committed to incorporate non-market SOEs into the general government and reform those classified as public corporations to strengthen corporate governance and transparency and ensure operation based on commercial principles. A draft comprehensive reform strategy has been prepared and published by the Ministry of Finance (MoF), supported by IMF TA. More time, however, is needed for a final strategy to be adopted by the government (*end-July 2022 SB*)[12] and to issue a timebound plan for its implementation, including to pilot the strategy in three major SOEs (*end-August 2022 SB*). Staff stressed the importance of sustaining reform momentum[13] and submitting to Parliament the draft framework law for public corporations in line with the government strategy (*end-December 2022 SB*). Recognizing the importance of oversight by the MoF, the authorities will issue a decree requiring MoF approval for key financial governance decisions and statements of corporate intent for major public corporations (*prior action*) and will ensure that the MoF has such authority in the final SOE strategy.

24. The authorities' efforts to further mitigate fiscal risks include (MEFP ¶10):

- *Ensuring that expansion of power generation capacity is fiscally sustainable.* The authorities are keen to expand Georgia's renewable power generation capacity and reduce reliance on imported power especially in light of recent geopolitical developments. In consultation with the IMF staff, they intend to develop a complementary support scheme[14] for renewable power generation (*end-July 2022 SB*). To limit fiscal risks, the complementary scheme will operate until the liberalized wholesale electricity market is sufficiently developed, will support a limited annual and cumulative volume of new projects, and will seek to award projects based on competitive bidding and reduce potential fiscal risks from unsolicited proposals. Until the new framework is in place, the authorities have committed not to initiate new PPAs and other forms of government support for renewable power projects.

- *Strengthening public investment management (PIM)* is particularly important in light of the authorities' ambitious capital spending plans. To ensure careful review of proposed projects, the 2023 budget decree strengthens the application of the PIM framework, and requires that all investment projects above GEL 20 million in the 2023 budget be selected according to PIM guidelines (*end-December 2022 SB*). To ensure consistent application in the future, the authorities will submit an amendment to the budget code to make all investments above a threshold (to be identified with TA) subject to the PIM framework (*end-September 2022 SB*). The authorities will also update the Public Investment Management Assessment with TA to identify

[12] Items under further discussion include e.g., which state entity would exercise ownership functions.

[13] For example, by determining the ultimate entity exercising ownership functions for Georgian State Electrosystem, a systemic SOE managing energy transmission networks which is the first pilot SOE to undertake governance reforms consistent with the draft strategy (*end-July 2022 SB*).

[14] The new scheme would complement the existing feed-in premium scheme.

scope for additional improvements (*end-March 2023 SB*) including a climate-related assessment.

- *Curtailing the operations of the Partnership Fund*, in line with commitments under the previous EFF (*continuous quantitative performance criteria (QPCs)*). The authorities acknowledged the importance of avoiding fiscal risks and costs related to the Partnership Fund, but are not yet prepared to dismantle the fund.

- *Enhancing the Fiscal Risks Statement (FRS)*. The 2021 FRS published the SOE reform strategy and strengthened disclosure of fiscal risks from power purchase agreements. The authorities are further expanding the FRS to address medium-to-long term risks from climate change, health and aging-related spending, and legal disputes (*end-December 2022 SB*).

B. Achieving the Inflation Target and Rebuilding Reserves

25. A moderately tight monetary policy stance is appropriate and further tightening may be needed (MEFP ¶14). Prior to the Russian invasion of Ukraine, the record high interest rate differential between local and foreign currency deposits and some lari appreciation suggested that interest rate increases, which brought nominal interest rates to their highest level since 2008, would have the desired effect. However, inflation has remained high reflecting global developments, and the spillovers from the sanctions on Russia are likely to put additional pressure on inflation. The NBG recognizes the risk that transient inflation developments including due to the most recent shock can become entrenched in inflation expectations and stands ready to tighten interest rates further if needed. Should higher lari rates make borrowing or refinancing in foreign currency more attractive, the NBG's macroprudential tools will help limit financial sector risks.

26. Achieving the inflation target will require continued readiness to tighten monetary policy. In the short-term, rising global commodity prices, base effects, and potential renewed depreciation pressures, on top of previous inflationary shocks suggest that above-target inflation is inevitable. In this context, preserving NBG credibility is of paramount importance. The NBG should be prepared to tighten rates further if inflation expectations or core inflation begin to accelerate or if there are signs of rising wage pressures—all of which could be more likely if commodity prices continue to rise. Higher rates would signal the NBG's strong commitment to its inflation target, increase incentives to save in domestic currency, and have a positive effect on capital flows, helping mitigate external vulnerabilities. Clear communication of monetary policy objectives and actions is also important and the NBG is committed to update its communication strategy including through regular impact assessments (*end-December 2022 SB*).

27. The NBG remains committed to exchange rate flexibility and strengthening foreign exchange reserve coverage over the medium term. Georgia's external position in 2021 is estimated to be in line with the level implied by fundamentals and desirable policies (Annex IV). The NBG remains committed to its floating exchange rate regime—an important shock absorber—as evidenced by the lari's recent movements. The NBG purchased a small amount of reserves in early 2022, but in view of the latest shock and expected widening of the current account deficit, tighter global financial conditions, and high uncertainty, the proposed net international reserves (NIR) targets for 2022 are consistent with a significant decrease of gross international reserves to close to 80 percent of the ARA metric. A gradual increase in nominal reserves would keep coverage at 75 percent of the ARA metric by the end of the program before rising in subsequent years as the impact of the shock dissipates (MEFP ¶18). The initial weakening of reserve coverage in terms of the ARA metric also reflects lower official external loans following a sharp increase during the pandemic as the authorities rely more on domestic financing (decreasing external vulnerabilities) as well as rapid growth of the ARA metric denominator. If the current shocks are less severe than expected, the authorities would seek to make faster progress in strengthening reserves.

C. Keeping the Financial Sector Resilient

28. Georgia's financial system displays a number of strengths but faces a still-challenging environment. The financial sector has shown considerable ability to weather shocks, reflecting a robust supervisory and regulatory framework including the implementation in recent years of Basel III recommendations, introduction and recalibration of macroprudential measures, and rapid action in response to shocks. Emerging from the pandemic, the banking system is profitable, capital and liquidity levels are healthy, and asset quality is improving, but there are risks. The high pace of credit growth coupled with increasing debt burdens for households and corporates could create challenges in an environment of increasing policy rates, risk, and term premiums. Spillovers from the war in Ukraine or renewed COVID-19 challenges could weaken the recovery in tourism, restaurants, and real estate, and geopolitical risks could lead to higher bank funding costs in foreign markets. Larger than expected increases in interest rates in advanced economies might affect FX flows and bank funding.

29. The authorities have outlined and are implementing comprehensive plans to further enhance financial sector resilience, drawing on the FSAP recommendations. In addition to their commitment to maintain adequate capital and liquidity at banks, the authorities will focus financial sector reforms on improving governance of supervisory decision-making, enhancing the financial safety net, improving data collection, fostering capital market development, and strengthening AML/CFT regulations (MEFP ¶21-23, 26, 31). A robust financial sector approach along with sustained sound macroeconomic policies should also help reduce still-high dollarization and related vulnerabilities over time. Specific actions include:

- The authorities will closely monitor NPLs and restructured loans to ensure prompt provisioning and write-downs. Staff noted the importance of adequate loan loss reserves, and the benefits of retaining earnings by minimizing payments to shareholders and staff bonuses.

- To address concerns about the financial stability impact of an acceleration in demand for FX loans and credit growth more generally, the NBG recalibrated its macroprudential tools (see ¶10), in line with the FSAP recommendation to adjust tools based on developments.

- The authorities' plan to fully implement large exposure limits by June 2022.

- The FSAP recommended to formalize and improve the governance of key internal processes for supervisory operations and decisions. The NBG intends to codify its General Risk Assessment Program and update the guidelines for such assessments (*end-June 2022 SB*).

- To further enhance financial safety nets, the authorities will implement a prompt corrective action framework for banks by developing relevant policy guidance (*end-December 2022 SB*), drafting a playbook to make the bridge bank tool operational (*end-March 2023 SB*), and preparing crisis contingency plans for banks.

- The NBG intends to continue enhancing its data collection by signing memorandums of understanding with the Georgia Revenue Service and the Public Registry. It will also develop additional data fields for assessment of new types of risks such as climate, and will publish an assessment of climate-related financial sector risks (*end-December 2022 SB*).

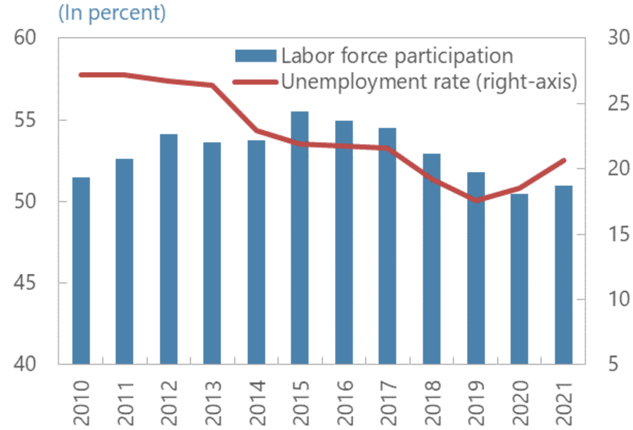
- Further efforts to encourage capital market development include draft legislation on dematerialized securities holdings and covered bonds.

- In terms of AML/CFT priorities, the NBG is working to implement FATF recommendations and recommended actions underlined in the MONEYVAL fifth round mutual evaluation report focusing on regulation and supervision for the gaming sector, virtual asset service providers, and real estate agents.

D. More Sustainable and Inclusive Growth

30. Labor market and education sector reforms are key to promoting stronger and more inclusive growth and reducing skills mismatches (MEFP ¶33–34). Georgia has had a persistently high unemployment rate when compared to its peer countries. While the unemployment rate had been declining prior to the onset of the pandemic, this was also matched by a drop in the labor force participation rate. Moreover, there has been a mismatch between the sources of growth and the sectors driving employment. The rebound from the pandemic has led to signs of improvement in the labor market, with the labor force participation rate increasing slightly although unemployment also rose. To reduce the skills mismatch and support sustained strong and inclusive growth, the authorities will undertake a comprehensive survey of labor demand and skills needs (*end-June 2023 SB*) to inform labor market policies. Raising the quality of education and active labor market policies—particularly vocational education and training—can help build human capital and promote job creation in high-productivity sectors of the economy. Accordingly, the authorities plan to improve qualification standards for teachers and develop professional orientation and

Labor Force Indicators
(In percent)



Source: Geostat

transition programs. The Ministry of Education and Science is also working with the private sector to design vocational education and training programs tailored to business hiring needs.

31. Strengthening the business environment and enhancing governance would improve competitiveness and help attract foreign investment. The authorities are committed to improving the information technology (IT) infrastructure and developing the human capital that is needed to catalyze the digitalization of the private and public sectors. Additionally, to improve corporate governance, corporations will gradually be required to publish audited financial statements based on IFRS standards. Staff welcomed the operationalization of the insolvency law, which significantly modernizes and strengthens the insolvency framework.

32. The authorities are committed to enhancing Georgia's connectivity with regional economies and deepening its trade ties. Significant progress is being made towards expanding road networks in Georgia, including the East-West Highway and North-South Corridor, which will help integrate remote regions facilitate efforts to establish Georgia as a transportation and logistics hub connecting Europe and Asia. The authorities noted progress towards free trade agreements with multiple countries (for example, India, Israel, Republic of Korea, the UAE and other GCC countries).

PROGRAM MODALITIES

33. Program length and access. The proposed three-year SBA would provide access of 100 percent of quota (SDR 210.4 million) phased equally over the duration of the program (Table 6). This reflects still sizeable external sector risks and Georgia's vulnerability to shocks. Under a plausible adverse scenario, which causes a further deterioration in the external position, drawing on the program would allow the authorities additional policy space and maintain reserves at around 70 percent of the ARA metric (Annex III). While recognizing that there are significant risks of a downturn in the external environment in the near term, the authorities have indicated their intention to treat the program as precautionary to send a strong signal of commitment to credible policies and macroeconomic stability. The program would be monitored via semi-annual reviews.

34. Financing and capacity to repay. Adequate financing is in place for the next 12 months and good prospects for financing for the full period of the arrangement are also in place (Table 2). Debt service is manageable, even under downside scenarios. If all drawings under the arrangement are made and assuming an adverse scenario materializes (Annex III), obligations from lending programs would reach 0.7 percent of GDP in 2027 (1.4 percent of exports and 5.2 percent of gross international reserves) (Table 7). Although Georgia's share of foreign currency debt is high, these risks are mitigated by long maturities and the large share owed to official creditors (Annex II). The authorities' capacity to repay is adequate.

35. Program monitoring. The program would be monitored through an inflation consultation clause (ICC), quantitative performance criteria and indicative targets, and structural benchmarks (Appendix I, Tables 1, 2, and 3):

- Monetary conditionality is embedded in the inflation consultation clause, which is set symmetrically around the projected 12-month percentage change in the headline inflation, consistent with staff's latest projections.

- Quantitative PCs include a ceiling on the augmented cash deficit of the general government as well as a ceiling on net budget lending; a floor on net international reserves; ceilings on the cash deficit, new borrowing and new investment by the Partnership Fund; as well as continuous PCs on the accumulation of external debt arrears of the general government and on new public guarantees. Considering spending pressures, the proposed program also includes an indicative ceiling on current primary spending. Since the fiscal target is defined on a cash basis, an indicative target is included on the accumulation of general government domestic expenditure arrears.

- Structural benchmarks are largely focused on controlling fiscal risks especially by implementing SOE reforms and enhancing public financial management. A number of benchmarks would follow up on 2021 FSAP recommendations.

36. Risks to the program are manageable and mitigated by the authorities' strong track record of policy implementation. The challenging external and domestic political environment and the ongoing pandemic contribute to risks of further shocks and of policy slippages and reform fatigue. This is balanced by the authorities' track record in delivering reforms under the previous EFF program and their keen appreciation of the value of the program as an anchor for policies in a difficult external environment and a strong signal to international investors and donors. An updated safeguards assessment of the NBG will be completed by the time of the first review of the program.

STAFF APPRAISAL

37. The Georgian economy has been resilient to the COVID-19 shock but now faces new challenges. COVID-19 hit the economy hard in 2020, but the government was able to provide substantial fiscal support to cushion the impact and prudent supervision by the NBG ensured that the financial sector was able to offer temporary payment holidays and provide credit for the recovery. Donor support and a commitment to exchange rate flexibility ensured that Georgia entered 2022 with historically high foreign exchange reserves. The recovery from the pandemic has exceeded expectations but is likely to be slowed by spillovers from the war in Ukraine, which is also expected to raise inflation and widen the current account deficit.

38. The proposed SBA will provide a framework for the authorities to address macroeconomic challenges and advance their reform agenda. Their policy program covers key near- and medium-term priorities: further entrenching macroeconomic stability, rebuilding fiscal buffers, strengthening public financial management, reducing external vulnerabilities, achieving the inflation target, enhancing financial sector resilience, and strengthening medium-term growth. The authorities have demonstrated their commitment to disciplined macroeconomic and financial policies through their 2022 budget, monetary policy tightening in response to inflation developments, and adjustment of macroprudential tools to limit financial stability risks from high credit growth. The authorities have made good use of Fund capacity development so far and will continue to utilize it to support program implementation.

39. Implementation of the 2022 budget will help make important progress toward compliance with the fiscal rule. The fiscal rule is an essential anchor for credibility and the 2022 budget as well as the authorities' intent to save revenue overperformance help put in reach compliance with the deficit ceiling by 2023, as required. The emphasis in the budget on investment is in line with the objective of the previous EFF program to rebalance toward capital spending, although restraining current spending may be reaching its limits. Targeted support to vulnerable families with children is a welcome step to help protect the incomes of the vulnerable in the context of high overall and food inflation.

40. Early action to increase fiscal space will help fund priority spending. Fiscal adjustment to comply with the fiscal rule and build buffers will become harder as the tailwind of unwinding COVID-19 support measures fades. At the same time, the authorities are seeking to sustain an ambitious capital spending agenda, along with potential new initiatives such as energy sector investment, and education reform. Strengthening tax administration, reviewing and streamlining tax expenditures, and developing a comprehensive medium-term revenue strategy will help reconcile these objectives. The program's emphasis on public investment management seeks to ensure high-quality capital outlays.

41. SOE reform is a critical step to mitigate fiscal risks. Georgia's Fiscal Risks Statements have identified key vulnerabilities and the priority now is to address them. Finalizing and adopting a strategy that is consistent with best international practices and strengthens the financial oversight functions, decision-making role, and effective enforcement mechanisms of the Ministry of Finance will help ensure that SOEs operate on commercial principles and limit a major source of fiscal risk. Once the strategy is adopted, it should be followed by a timebound plan for its implementation including piloting it in three major SOEs and anchoring the new governance model in law.

42. The NBG should persevere in its efforts to bring inflation back to target while and maintaining the flexible exchange rate regime. The current monetary policy stance is appropriate and the existing inflation targeting framework coupled with the floating exchange rate regime has served Georgia well. External developments imply above-target inflation for some time, as in many other countries. The NBG should be prepared to increase rates further to avoid the risk of transient developments becoming entrenched in higher inflation expectations.

43. The authorities' financial reform agenda will further strengthen the sector's resilience. Much progress has been achieved on enhancing the regulatory and supervisory framework in recent years as documented in the 2021 FSAP. The next steps should fill a few remaining gaps, notably enhancing financial safety nets, including by establishing bridge bank arrangements, and improving the governance of the supervisory decision-making framework. The NBG should continue utilizing its comprehensive macroprudential policy toolkit to address financial stability risks, including those stemming from foreign currency lending, and calibrate those tools as needed as done recently.

Ensuring a sound financial sector along with sustained strong macroeconomic policy implementation will help reduce dollarization and related vulnerabilities over time.

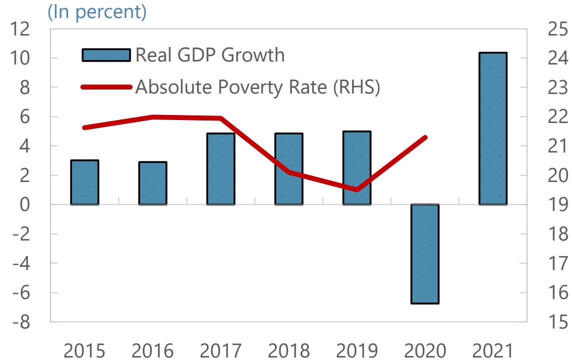
44. A reinvigorated structural reform agenda will help support stronger and more inclusive growth. Much of the "low hanging fruit" on structural reforms has been picked, for example to make it easy to open a business. Under the program the authorities will seek to tackle entrenched high unemployment by advancing education reform and strengthening active labor market policies. Both the recent COVID-19 shock and the spillovers from the war in Ukraine illustrate the importance of finding new sources of growth, which will require investments in physical and information technology infrastructure and accelerating digitalization.

45. Staff supports the authorities' request for approval of the three-year Stand-By Arrangement. The program provides a strong anchor for disciplined macroeconomic policies, a signal of policy credibility to donors and foreign investors, and a valuable source of financing in case downside risks materialize.

Figure 1. Georgia: Real Sector Developments

The COVID-19 crisis and large economic contraction increased absolute poverty...

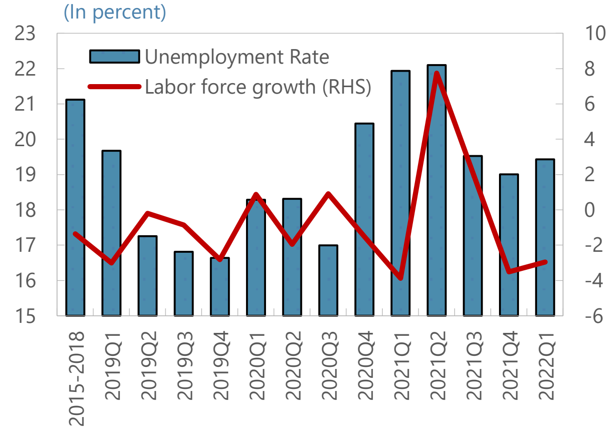
Real GDP Growth and Absolute Poverty Rate
(In percent)



Note: absolute poverty data up to 2020.

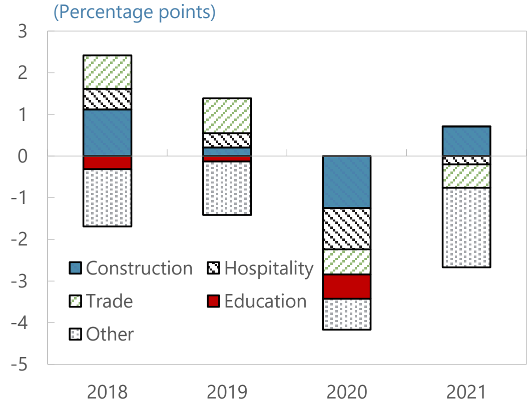
... and raised already high unemployment while depressing labor force growth.

Unemployment Rate and Labor Force Growth
(In percent)



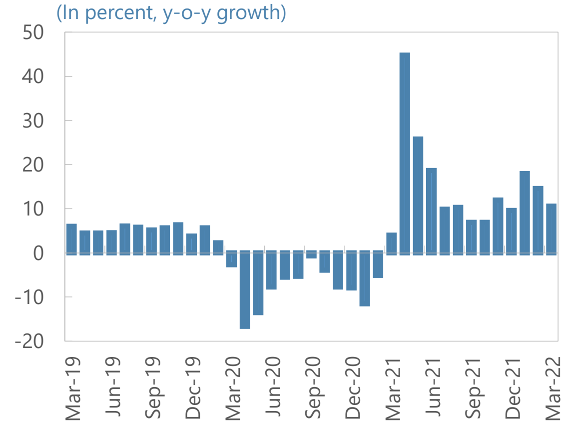
The loss in employment was driven by construction, hospitality and trade industries hurt by COVID-19.

Employment Growth by Economic Activity
(Percentage points)



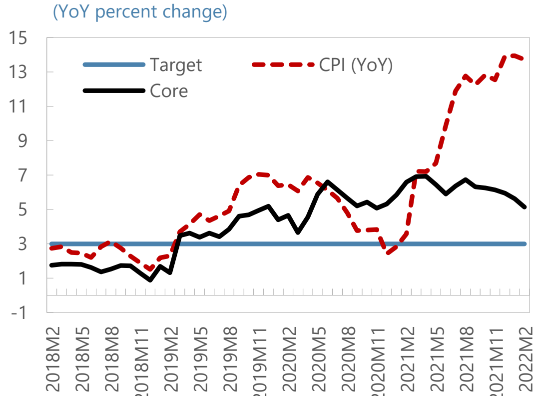
However, flash estimates now suggest a dramatic rebound in GDP growth.

Rapid Estimates of Real GDP Growth
(In percent, y-o-y growth)



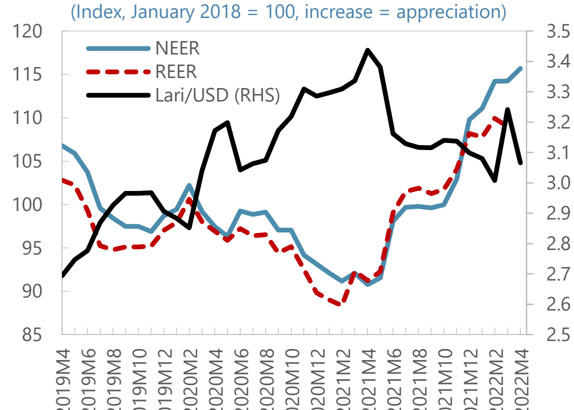
Sharply higher inflation reflects the removal of utility subsidies, and rising food and commodity prices.

Inflation: Headline and Core Inflation
(YoY percent change)



The lari has strengthened considerably against the dollar and in effective terms relative to pandemic lows.

Nominal and Real Effective Exchange Rates
(Index, January 2018 = 100, increase = appreciation)

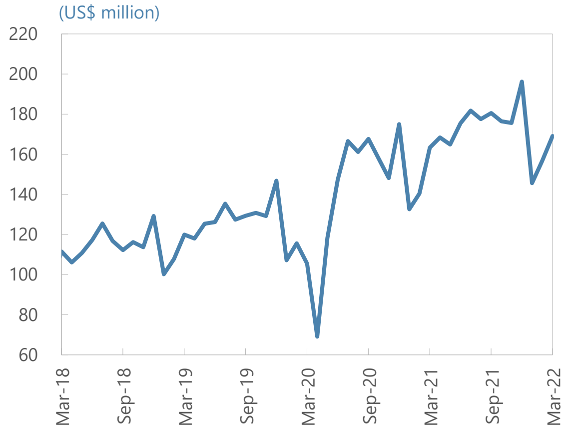


Source: National authorities, Haver, Geostat, and IMF staff calculations.

Figure 2. Georgia: External Sector Developments

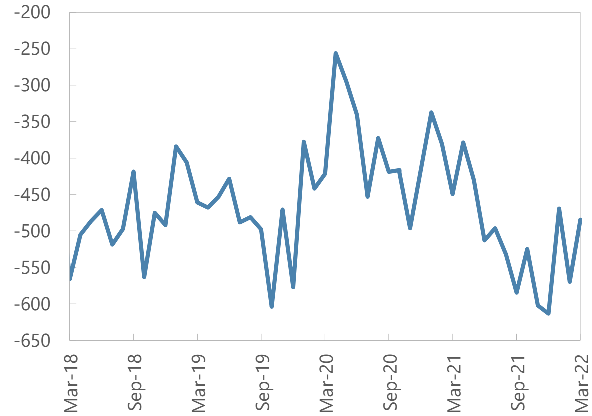
The increase in net money transfers has been sustained…

Net Money Transfers
(US$ million)



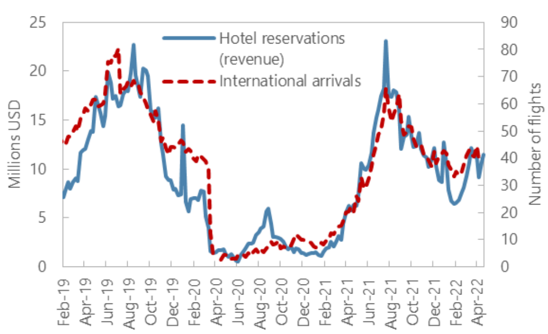
…but the goods trade balance has started to deteriorate.

Goods Trade Balance
(US$ million)



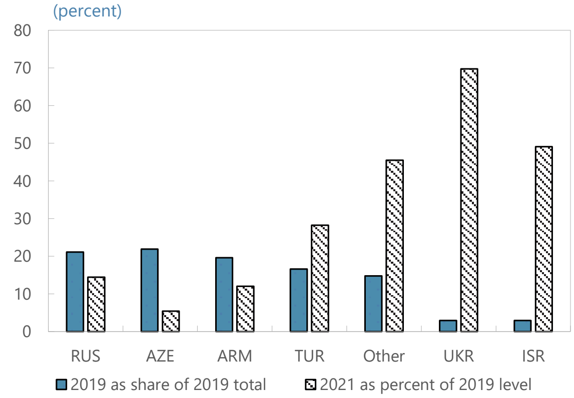
Hotel reservations and the number of flights rebounded before moderating recently…

Hotel Reservations and International Arrivals
(Revenue in millions USD and number of flights)



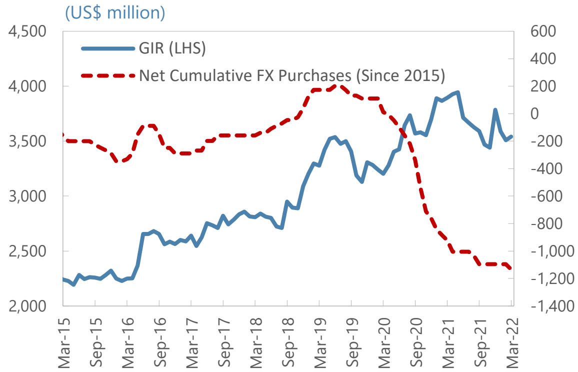
…and the major sources of tourism remain well below pre-COVID-19 levels.

Major Sources of Tourism
(percent)



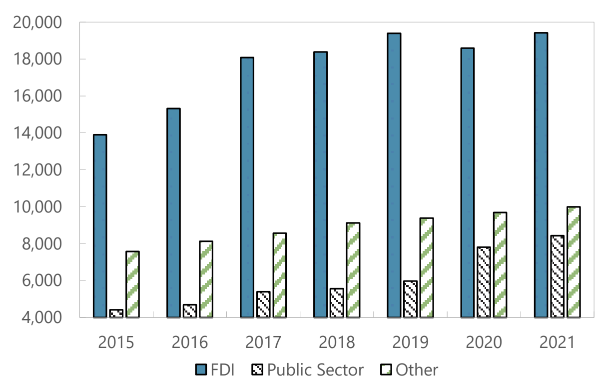
Gross international reserves reached a record high, even as the NBG sold FX in 2020-2021…

Gross International Reserves and Net FX Purchases
(US$ million)



… supported by external borrowing (including IMF and donor financing).

External Liabilities
(US$ million)

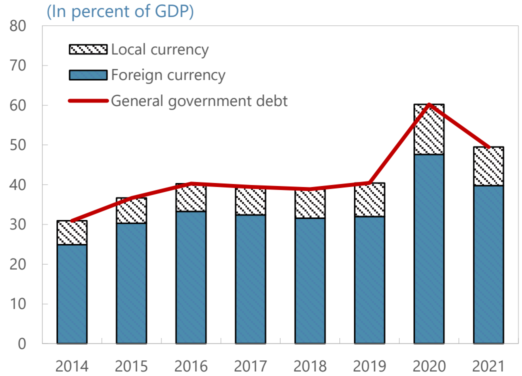


Source: National authorities, Haver, Geostat, and IMF staff calculations.

Figure 3. Georgia: Fiscal Sector Developments

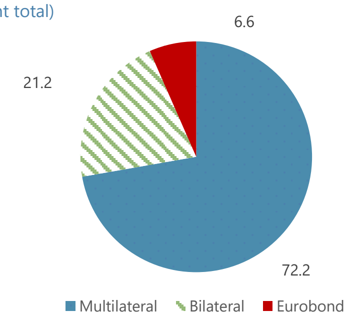
The COVID-19 crisis increased general government debt, which remains primarily FX denominated.

Government Debt
(In percent of GDP)



Most of the external debt is to bilateral and multilateral official creditors.

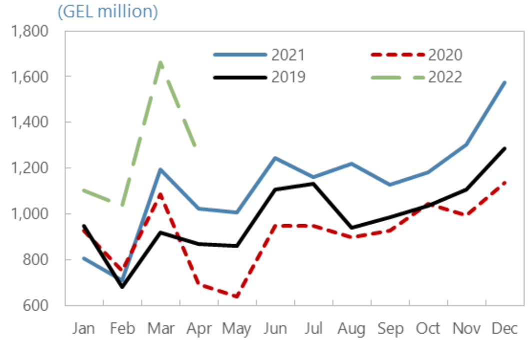
Composition of External Debt
(Percent total)



Note: data up to March 2022.

Revenue performance in 2022 has been strong so far…

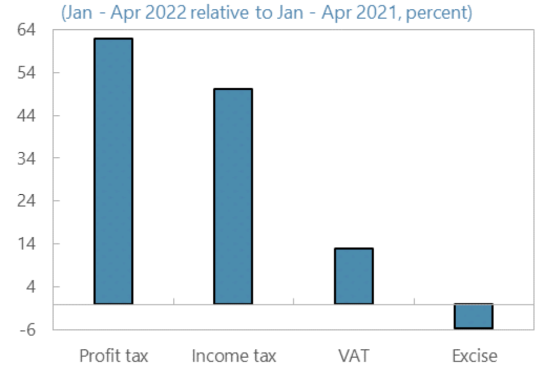
Monthly Tax Revenue
(GEL million)



Note: Includes tax outflows due to tax credit refunds.

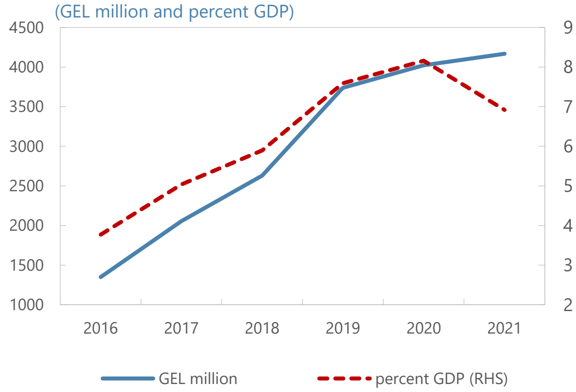
…driven by profit tax, income tax, and VAT.

Growth Rates of Key Tax Revenues
(Jan - Apr 2022 relative to Jan - Apr 2021, percent)



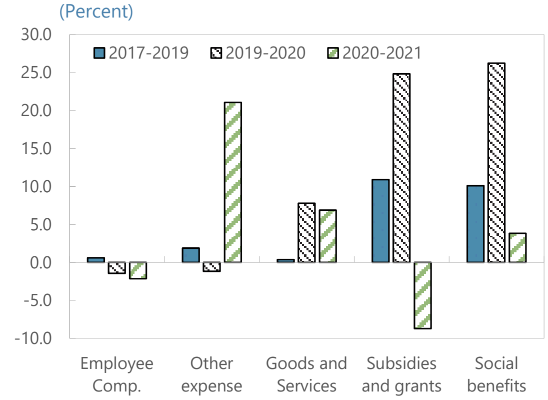
Capital spending reached a record high in 2020 both in GEL and as a share of GDP in spite of COVID-19.

Capital Spending
(GEL million and percent GDP)



For current spending, the COVID-19 crisis increased real spending on subsidies and social benefits.

Expenditure Growth in Real Terms
(Percent)

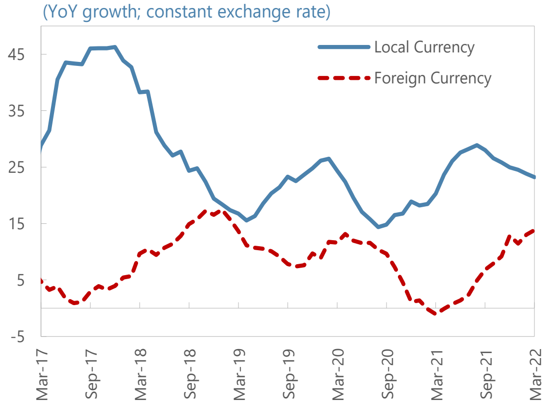


Source: National authorities, and IMF staff estimates.

Figure 4. Georgia: Financial Sector Developments

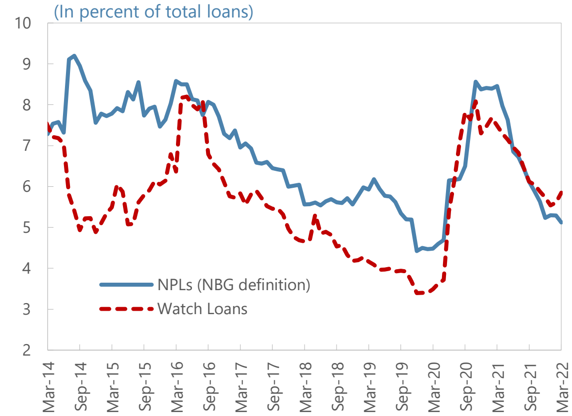
Private sector credit growth remained robust on account of local currency credit.

Private Sector Credit
(YoY growth; constant exchange rate)



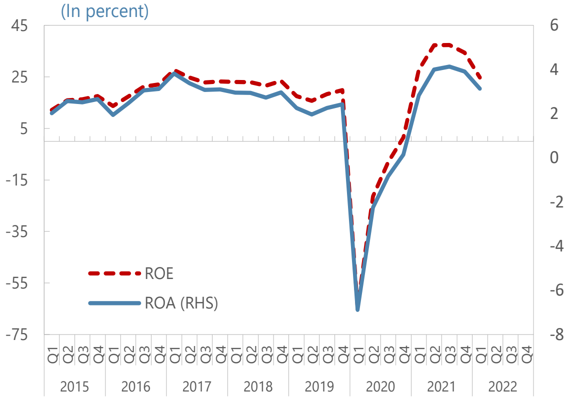
NPLs and watch loans have declined to levels close to those observed early in the pandemic.

Non-Performing and Watch Loans
(In percent of total loans)



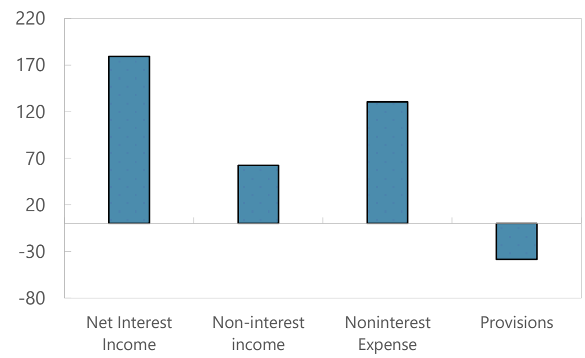
Bank profitability has recovered to pre-crisis levels….

Return on Assets and Equity Ratios
(In percent)



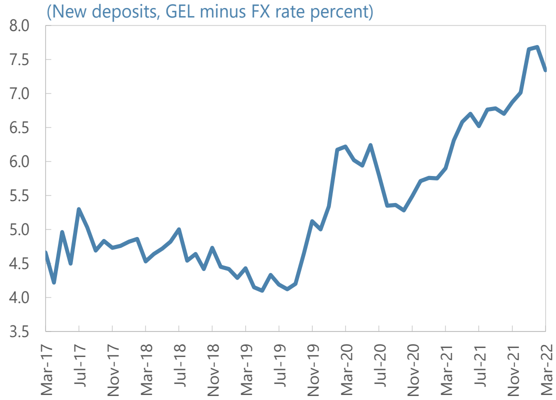
…owing to higher net interest income and lower provisions.

Key Drivers of Bank Profitability
(GEL million, 2022Q1 minus 2019Q4)



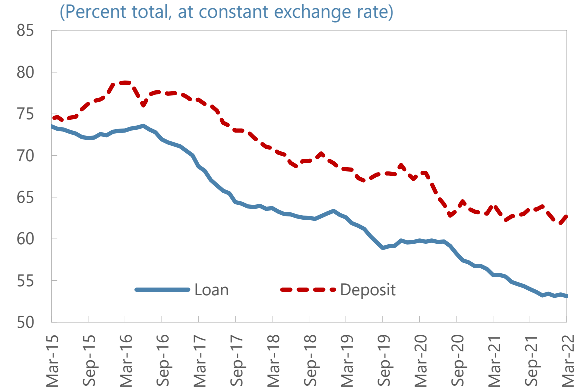
The interest rate differential between lari and FX deposits is near its highest level.

Interest Rates Differential
(New deposits, GEL minus FX rate percent)



Loan dollarization resumed its decline in the aftermath of COVID-19 shock, while deposit dollarization has been more persistent.

Loan and Deposit Dollarization
(Percent total, at constant exchange rate)



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

Table 1. Georgia: Selected Economic and Financial Indicators, 2019–27

	2019	2020	2021	2021	2022	2023	2024	2025	2026	2027
	Actual	Actual	Article IV	Prel.			Projections			
National accounts and prices			(annual percentage change; unless otherwise indicated)							
Real GDP	5.0	-6.8	7.7	10.4	3.2	5.8	5.2	5.2	5.2	5.2
Output Gap	-0.6	-5.2	-1.0	-0.4	-0.2	0.3	0.0	0.0	0.0	0.0
Nominal GDP (in billion of laris)	49.3	49.3	57.5	60.2	69.0	77.0	83.3	90.3	97.8	106.0
Nominal GDP (in billion of U.S. dollars)	17.5	15.8	17.8	18.7	22.3	24.2	26.6	29.2	31.9	35.0
GDP per capita (in thousand of U.S. dollars)	4.7	4.3	4.8	5.0	6.0	6.5	7.2	7.9	8.7	9.6
GDP deflator, period average	4.9	7.3	8.3	10.6	11.3	5.3	3.0	3.0	3.0	3.0
CPI, Period average	4.9	5.2	9.3	9.6	10.9	5.1	3.0	3.0	3.0	3.0
CPI, End-of-period	7.0	2.4	13.1	13.9	8.1	3.4	3.0	3.0	3.0	3.0
Core CPI, End-of-period	5.2	5.3	…	5.9	…	…	…	…	…	…
Investment and saving				(in percent of GDP)						
Gross national saving	19.8	11.5	15.6	12.1	9.6	11.8	13.7	14.0	13.9	13.6
Investment	25.3	23.9	25.6	21.9	20.6	19.3	20.0	19.8	19.6	19.2
Public	8.0	8.6	8.0	7.6	8.0	6.4	6.3	6.3	6.1	5.9
Private	17.3	15.3	17.5	14.3	12.5	12.9	13.7	13.6	13.5	13.4
Consolidated government operations				(in percent of GDP)						
Revenue and grants	27.1	25.2	25.7	25.4	25.2	25.3	25.4	25.4	25.3	25.2
o.w. Tax revenue	23.7	22.3	22.9	22.5	22.8	23.1	23.3	23.4	23.4	23.4
Expenditures	28.9	34.5	32.2	31.4	29.1	28.0	28.0	27.9	27.7	27.5
Expense	21.4	26.3	25.0	24.5	21.7	21.9	22.0	22.0	21.9	21.9
Net acquisition of non-financial assets	7.6	8.2	7.2	6.9	7.4	6.1	6.0	6.0	5.8	5.6
Capital spending	8.0	8.6	8.0	7.6	8.0	6.4	6.3	6.3	6.1	5.9
Privatization proceeds	-0.4	-0.4	-0.8	-0.7	-0.7	-0.3	-0.3	-0.3	-0.3	-0.3
Unidentified measures	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.4	0.4	0.3
Net lending / borrowing after adjustment	-1.8	-9.3	-6.5	-6.0	-3.9	-2.6	-2.2	-2.2	-2.1	-2.0
Net budget lending	0.2	0.1	0.2	0.1	0.1	0.2	0.1	0.1	0.1	0.1
Augmented Net lending / borrowing (program definition) 1/	-2.1	-9.4	-6.6	-6.1	-4.0	-2.8	-2.3	-2.3	-2.2	-2.1
General government debt 2/	40.4	60.2	54.2	49.5	47.1	45.8	44.3	42.9	41.6	40.5
o.w. Foreign-currency denominated	32.0	47.6	43.9	39.8	37.5	35.5	33.1	30.7	27.8	26.2
Money and credit			(annual percentage change; unless otherwise indicated)							
Credit to the private sector	20.7	22.4	10.5	12.4	20.9	11.6	8.1	8.5	8.3	8.4
In constant exchange rate	16.1	9.0	14.0	18.2	21.2	9.9	8.7	8.9	8.7	8.8
Broad money	17.6	24.6	14.1	11.3	19.9	14.0	10.9	11.1	12.0	12.1
In constant exchange rate (estimate)	14.3	14.4	18.7	15.4	20.4	11.8	11.6	11.7	12.5	12.6
Broad money (excl. fx deposits)	18.8	18.8	16.8	17.8	16.8	14.6	12.1	12.3	13.2	13.2
Deposit dollarization (percent of total) 3/	64.0	61.4	66.7	59.9	60.0	59.4	58.9	58.3	57.8	57.2
Credit dollarization (percent of total)	55.4	55.7	55.0	50.9	50.9	50.9	49.9	48.9	47.9	46.9
Credit to the private sector (percent of GDP)	62.8	76.8	72.6	70.6	74.6	74.6	74.6	74.6	74.6	74.6
External sector				(in percent of GDP; unless otherwise indicated)						
Current account balance (in billions of US$)	-1.0	-2.0	-1.8	-1.8	-2.4	-1.8	-1.7	-1.7	-1.8	-2.0
Current account balance	-5.5	-12.4	-10.0	-9.8	-10.9	-7.5	-6.3	-5.8	-5.7	-5.6
Trade balance	-21.4	-20.0	-19.1	-20.1	-20.3	-19.6	-17.6	-16.9	-16.6	-16.1
Terms of trade, goods (percent change)	-0.6	4.1	-2.1	-14.0	-8.9	1.4	1.8	0.9	-0.2	-0.3
Gross international reserves (in billions of US$) 4/	3.5	3.9	3.8	4.3	3.3	3.3	3.5	3.9	4.4	5.3
In percent of ARA metric	101.1	108.1	98.5	107.7	79.4	74.9	74.7	80.5	85.4	98.0
Gross external debt	87.7	109.6	95.9	98.2	85.8	80.6	74.6	68.9	63.9	59.5
Laris per U.S. dollar (period average)	2.82	3.11	…	3.22	…	…	…	…	…	…
Laris per euro (period average)	3.15	3.55	…	3.82	…	…	…	…	…	…
REER (period average; CPI based, Jan 2010=100)	100.5	97.5	…	99.2	…	…	…	…	…	…

Sources: Georgian authorities; and Fund staff estimates.

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

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

3/ Includes nonresident deposits.

4/ Using current exchange rates; includes SDR allocations (SDR 144 million before 2021 and SDR 346 million since 2021).

Table 2. Georgia: Balance of Payments, 2019–27

	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Actual	Actual	Prel.			Projections 1/			
				(in millions of U.S. dollars)					
Current account balance	-960	-1,966	-1,834	-2,435	-1,813	-1,684	-1,694	-1,811	-1,968
Trade balance (goods)	-3,736	-3,165	-3,758	-4,509	-4,746	-4,694	-4,921	-5,304	-5,637
Exports	4,944	4,347	5,539	5,567	6,336	7,626	8,590	9,563	10,718
Imports	8,681	7,512	9,297	10,076	11,083	12,320	13,511	14,867	16,355
Services	2,176	124	724	1,084	1,537	1,736	2,041	2,332	2,550
Services: credit	4,600	1,580	2,547	3,365	4,711	5,297	5,989	6,644	7,416
Of which : tourism/travel revenue	3,269	542	1,245	2,016	3,301	3,743	4,130	4,498	4,901
Services: debit	2,425	1,456	1,823	2,281	3,175	3,561	3,947	4,312	4,866
Primary income	-774	-734	-1,103	-1,011	-1,079	-1,209	-1,293	-1,391	-1,442
Secondary income	1,375	1,810	2,302	2,001	2,477	2,483	2,480	2,552	2,561
Of which : remittances	916	1,168	1,609	1,401	1,761	1,778	1,787	1,832	1,833
Capital account	47	41	38	40	40	40	40	40	40
Financial account (- is inflow)	-1,077	-1,995	-2,118	-1,459	-1,799	-1,865	-2,212	-2,315	-2,981
Direct investment (net)	-1,054	-549	-831	-916	-1,054	-1,402	-1,679	-1,737	-2,050
Net acquisition of financial assets	312	-15	347	23	312	415	552	557	676
Net incurrence of liabilities	1,366	534	1,178	939	1,366	1,817	2,231	2,294	2,726
Portfolio investment (net)	-698	-75	387	59	-140	-140	-139	72	-240
Net acquisition of financial assets	29	47	37	258	122	106	119	138	132
Net incurrence of liabilities	726	122	-350	199	262	246	259	66	372
Financial derivatives (net)	-4	-27	-1	-6	-8	-10	-9	-7	-8
Other investment (net)	678	-1,344	-1,673	-595	-597	-313	-385	-644	-683
Net acquisition of financial assets	471	-95	-62	155	-76	111	2	-155	-138
Of which : currency and deposits (+ is outflow) 2/	393	-44	-151	108	-120	76	-35	-211	-182
Net incurrence of liabilities 3/	-207	1,249	1,611	750	521	424	388	488	544
Of which : general government loans 4/	262	1,128	940	566	272	196	182	217	335
SDR (allocations)	0	0	286	0	0	0	0	0	0
Errors and omissions	-45	-80	-68	0	0	0	0	0	0
Overall balance (+ is surplus)	120	-10	254	-936	27	221	559	544	1,052
Financing	-120	10	-254	936	-27	-221	-559	-544	-1,052
Change in gross international reserves (- is increase)	-202	-305	-361	954	5	-162	-455	-432	-943
Use of Fund Resources (- is net repayment)	83	315	108	-18	-31	-59	-104	-113	-109
Disbursement	83	315	111	0	0	0	0	0	0
Repayment (Principal)	0	0	3	18	31	59	104	113	109
Memorandum items:				(in percent of GDP)					
Current account balance	-5.5	-12.4	-9.8	-10.9	-7.5	-6.3	-5.8	-5.7	-5.6
Trade balance (goods)	-21.4	-20.0	-20.1	-20.3	-19.6	-17.6	-16.9	-16.6	-16.1
Financial account (- is inflow)	-6.2	-12.6	-11.3	-6.6	-7.4	-7.0	-7.6	-7.2	-8.5
Foreign direct investment (net)	-6.0	-3.5	-4.4	-4.1	-4.3	-5.3	-5.8	-5.4	-5.9
Gross international reserves (in million of USD) 5/	3,506	3,911	4,272	3,318	3,314	3,476	3,931	4,362	5,305
in percent of ARA metric	101.1	108.1	107.7	79.4	74.9	74.7	80.5	85.4	98.0
in months of next year GNFS imports	3.8	5.2	4.6	3.2	2.8	2.6	2.7	2.7	3.0

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

1/ Balance of payments numbers are now presented according the BPM6 manual, so comparisons with Article IV, which used BPM5, are not presented.

2/ By deposit-taking corporations (except central bank) and other private sectors. This indicator partially reflects capital outflow.

3/ Excluding IMF loan disbursements (to both Ministry of Finance and NBG) and principal repayments.

4/ Excluding IMF loan disbursements to Ministry of Finance and the principal repayments.

5/ Using current exchange rates; includes SDR allocations (SDR 144 million before 2021 and SDR 346 million since 2021).

Table 3a. Georgia: General Government Operations, GFSM2001 2019–27
(In millions of GEL)

	2019	2020	2021	2021	2022	2023	2024	2025	2026	2027
	Actual	Actual	Article IV	Actual			Projections			
Revenue	13,350	12,422	14,810	15,313	17,354	19,493	21,161	22,927	24,721	26,721
Taxes	11,860	10,979	13,161	13,550	15,707	17,769	19,400	21,125	22,877	24,789
Taxes on Income, profits and capital gains	4,349	4,246	4,861	4,791	6,042	6,785	7,452	8,083	8,754	9,481
Payable by individuals	3,483	3,327	3,928	3,776	4,676	5,335	5,885	6,383	6,912	7,492
Payable by corporations	866	919	933	1,015	1,367	1,450	1,567	1,700	1,841	1,988
Taxes on property	474	434	466	511	556	588	612	638	691	749
Taxes on goods and services	6,746	6,457	7,680	7,898	8,833	10,075	10,980	11,910	12,897	13,979
General taxes on goods and services (VAT)	5,239	4,837	5,840	6,030	6,904	7,862	8,587	9,314	10,087	10,933
Excises	1,507	1,619	1,840	1,869	1,929	2,213	2,393	2,595	2,810	3,046
Taxes on international trade	79	74	84	86	90	101	110	119	129	139
Other taxes 1/	212	-232	70	263	186	220	246	375	406	440
of which VAT Refunds	-615	-1,040	-1,800	-1,930	-2,100	-2,333	-2,515	-2,619	-2,837	-3,075
Grants	422	405	304	344	288	295	290	287	284	281
Other revenue	1,067	1,038	1,345	1,419	1,359	1,429	1,471	1,515	1,560	1,652
Total Expenditure	14,257	16,981	18,546	18,939	20,066	21,529	23,289	25,222	27,104	29,167
Expense	10,518	12,960	14,406	14,770	14,967	16,831	18,308	19,833	21,438	23,258
Compensation of employees	1,785	1,851	1,977	1,984	2,284	2,550	2,809	3,046	3,299	3,576
Use of goods and services	1,659	1,881	2,240	2,203	2,207	2,458	2,654	2,903	3,144	3,407
Interest	611	769	870	800	761	862	993	1,201	1,240	1,345
External	324	337	330	284	219	239	241	243	239	236
Domestic	287	433	539	516	542	623	752	959	1,002	1,109
Subsidies	990	1,452	1,595	1,660	1,582	1,766	1,910	2,072	2,244	2,432
Grants	126	237	214	196	267	298	290	283	307	332
Social benefits	4,198	5,575	5,915	6,342	6,251	7,082	7,702	8,276	8,992	9,766
Other expense 2/	1,150	1,196	1,595	1,586	1,615	1,814	1,949	2,051	2,213	2,399
Net acquisition of nonfinancial assets	3,739	4,022	4,140	4,169	5,099	4,698	4,982	5,389	5,666	5,909
Increase (capital spending)	3,945	4,229	4,620	4,591	5,549	4,948	5,232	5,660	5,960	6,227
Decrease (privatization proceeds)	-206	-208	-480	-422	-450	-250	-250	-271	-293	-318
Net lending / borrowing before adjustment	-907	-4,559	-3,735	-3,627	-2,711	-2,036	-2,128	-2,295	-2,383	-2,446
Unidentified measures	0	0	0	0	0	0	332	338	352	348
Net lending / borrowing	-908	-4,559	-3,735	-3,627	-2,711	-2,036	-1,795	-1,957	-2,032	-2,098
Change in net financial worth, transactions	-908	-4,559	-3,735	-3,626	-2,711	-2,036	-1,795	-1,957	-2,032	-2,098
Net acquisition of financial assets ("+": increase in assets)	456	1,773	-1,030	-1,103	-28	87	232	220	205	380
Domestic	456	1,773	-1,030	-1,103	-28	87	232	220	205	380
Budget lending (net)	111	57	91	41	75	120	120	120	120	120
Deposits (NBG and commercial banks)	346	1,736	-1,121	-1,141	-103	-33	112	100	85	260
Financial privatization	0	-21	0	-3	0	0	0	0	0	0
Net incurrence of liabilities ("+": increase in liabilities)	1,364	6,332	2,705	2,524	2,683	2,123	2,027	2,178	2,237	2,478
Domestic	898	1,970	-244	-377	801	1,260	1,460	1,660	2,460	1,610
Securities other than shares	898	1,970	-244	-377	801	1,260	1,460	1,660	2,460	1,610
Loans	0	0	0	0	0	0	0	0	0	0
Foreign	467	4,362	2,949	2,901	1,882	863	567	518	-223	868
Loans	467	4,362	2,949	2,901	1,882	863	567	518	-223	868
Memorandum items:										
Nominal GDP	49,253	49,267	57,549	60,232	68,971	77,006	83,273	90,323	97,813	106,020
Government debt 3/	19,915	29,654	31,218	29,812	32,511	35,267	36,889	38,755	40,706	42,912
End-year government deposits	1,454	3,190	2,069	2,049	1,946	1,913	2,024	2,125	2,210	2,469
Operating balance	2,831	-538	405	543	2,388	2,662	2,854	3,094	3,283	3,463
Net lending / borrowing (excluding privatization)	-1,114	-4,767	-4,215	-4,048	-3,161	-2,286	-2,378	-2,566	-2,677	-2,764
Augmented Net lending / borrowing (program definition) 4/	-1,019	-4,617	-3,826	-3,667	-2,786	-2,156	-1,915	-2,077	-2,152	-2,218
Cyclically-adjusted primary balance (program definition)	-329	-3,192	-2,807	-2,806	-1,990	-1,354	-922	-876	-911	-873

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

4/ Augmented Net lending / borrowing (program definition) = Net lending / borrowing - Budget lending (net).

Table 3b. Georgia: General Government Operations, GFSM2001 2019–27
(In percent GDP)

	2019	2020	2021	2021	2022	2023	2024	2025	2026	2027
	Actual	Actual	Article IV	Actual			Projections			
Revenue	27.1	25.2	25.7	25.4	25.2	25.3	25.4	25.4	25.3	25.2
Taxes	24.1	22.3	22.9	22.5	22.8	23.1	23.3	23.4	23.4	23.4
Taxes on Income, profits and capital gains	8.8	8.6	8.4	8.0	8.8	8.8	8.9	8.9	8.9	8.9
Payable by individuals	7.1	6.8	6.8	6.3	6.8	6.9	7.1	7.1	7.1	7.1
Payable by corporations	1.8	1.9	1.6	1.7	2.0	1.9	1.9	1.9	1.9	1.9
Taxes on property	1.0	0.9	0.8	0.8	0.8	0.8	0.7	0.7	0.7	0.7
Taxes on goods and services	13.7	13.1	13.3	13.1	12.8	13.1	13.2	13.2	13.2	13.2
General taxes on goods and services (VAT)	10.6	9.8	10.1	10.0	10.0	10.2	10.3	10.3	10.3	10.3
Excises	3.1	3.3	3.2	3.1	2.8	2.9	2.9	2.9	2.9	2.9
Taxes on international trade	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other taxes 1/	0.4	-0.5	0.1	0.4	0.3	0.3	0.3	0.4	0.4	0.4
of which VAT Refunds	-1.2	-2.1	-3.1	-3.2	-3.0	-3.0	-3.0	-2.9	-2.9	-2.9
Grants	0.9	0.8	0.5	0.6	0.4	0.4	0.3	0.3	0.3	0.3
Other revenue	2.2	2.1	2.3	2.4	2.0	1.9	1.8	1.7	1.6	1.6
Total Expenditure	28.9	34.5	32.2	31.4	29.1	28.0	28.0	27.9	27.7	27.5
Expense	21.4	26.3	25.0	24.5	21.7	21.9	22.0	22.0	21.9	21.9
Compensation of employees	3.6	3.8	3.4	3.3	3.3	3.3	3.4	3.4	3.4	3.4
Use of goods and services	3.4	3.8	3.9	3.7	3.2	3.2	3.2	3.2	3.2	3.2
Interest	1.2	1.6	1.5	1.3	1.1	1.1	1.2	1.3	1.3	1.3
External	0.7	0.7	0.6	0.5	0.3	0.3	0.3	0.3	0.2	0.2
Domestic	0.6	0.9	0.9	0.9	0.8	0.8	0.9	1.1	1.0	1.0
Subsidies	2.0	2.9	2.8	2.8	2.3	2.3	2.3	2.3	2.3	2.3
Grants	0.3	0.5	0.4	0.3	0.4	0.4	0.3	0.3	0.3	0.3
Social benefits	8.5	11.3	10.3	10.5	9.1	9.2	9.2	9.2	9.2	9.2
Other expense 2/	2.3	2.4	2.8	2.6	2.3	2.4	2.3	2.3	2.3	2.3
Net acquisition of nonfinancial assets	7.6	8.2	7.2	6.9	7.4	6.1	6.0	6.0	5.8	5.6
Increase (capital spending)	8.0	8.6	8.0	7.6	8.0	6.4	6.3	6.3	6.1	5.9
Decrease (privatization proceeds)	-0.4	-0.4	-0.8	-0.7	-0.7	-0.3	-0.3	-0.3	-0.3	-0.3
Net lending / borrowing before adjustment	-1.8	-9.3	-6.5	-6.0	-3.9	-2.6	-2.6	-2.5	-2.4	-2.3
Unidentified measures	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.4	0.4	0.3
Net lending / borrowing	-1.8	-9.3	-6.5	-6.0	-3.9	-2.6	-2.2	-2.2	-2.1	-2.0
Change in net financial worth, transactions	-1.8	-9.3	-6.5	-6.0	-3.9	-2.6	-2.2	-2.2	-2.1	-2.0
Net acquisition of financial assets ("+": increase in assets)	0.9	3.6	-1.8	-1.8	0.0	0.1	0.3	0.2	0.2	0.4
Domestic	0.9	3.6	-1.8	-1.8	0.0	0.1	0.3	0.2	0.2	0.4
Budget lending (net)	0.2	0.1	0.2	0.1	0.1	0.2	0.1	0.1	0.1	0.1
Deposits (NBG and commercial banks)	0.7	3.5	-1.9	-1.9	-0.1	0.0	0.1	0.1	0.1	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	12.9	4.7	4.2	3.9	2.8	2.4	2.4	2.3	2.3
Domestic	1.8	4.0	-0.4	-0.6	1.2	1.6	1.8	1.8	2.5	1.5
Securities other than shares	1.8	4.0	-0.4	-0.6	1.2	1.6	1.8	1.8	2.5	1.5
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.9	8.9	5.1	4.8	2.7	1.1	0.7	0.6	-0.2	0.8
Loans	0.9	8.9	5.1	4.8	2.7	1.1	0.7	0.6	-0.2	0.8
Memorandum items:										
Nominal GDP (in millions of GEL)	49,253	49,267	57,549	60,232	68,971	77,006	83,273	90,323	97,813	106,020
General government debt 3/	40.4	60.2	54.2	49.5	47.1	45.8	44.3	42.9	41.6	40.5
End-year government deposits	3.0	6.5	3.6	3.4	2.8	2.5	2.4	2.4	2.3	2.3
Operating balance (before adjustment)	5.7	-1.1	0.7	0.9	3.5	3.5	3.4	3.4	3.4	3.3
Net lending / borrowing (excluding privatization)	-2.3	-9.7	-7.3	-6.7	-4.6	-3.0	-2.9	-2.8	-2.7	-2.6
Augmented Net lending / borrowing (program definition) 4/	-2.1	-9.4	-6.6	-6.1	-4.0	-2.8	-2.3	-2.3	-2.2	-2.1
Cyclically-adjusted primary balance (program definition)	-0.7	-6.5	-4.9	-4.7	-2.9	-1.8	-1.1	-1.0	-0.9	-0.8

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

4/ Augmented Net lending / borrowing (program definition) = Net lending / borrowing - Budget lending (net).

Table 4. Georgia: Monetary Survey, 2019–22

	2019	2020	2021		2022	
	Actual				Projections	
			June	Dec	June	Dec
Central Bank			(in billions of lari)			
Net foreign assets	8.8	10.9	10.2	10.3	8.9	7.5
Gross international reserves	10.1	12.8	12.4	13.2	11.8	10.3
Foreign liabilities	1.3	1.9	2.2	2.9	2.9	2.8
Of which : use of Fund resources	0.7	1.2	1.5	1.4	1.4	1.4
Net domestic assets	0.2	-0.1	0.3	0.1	2.1	4.2
Net claims on central government	-0.4	-0.1	0.7	0.1	0.5	0.9
Claims on general government (incl. T-bills)	1.0	1.4	1.7	1.8	1.9	2.0
Nontradable govt. debt	0.2	0.2	0.2	0.2	0.1	0.1
Debt securities (tradable)	0.8	1.2	1.5	1.6	1.7	1.8
Deposits	1.5	1.5	1.0	1.7	1.4	1.0
Net claims on banks (excl. reserves)	3.1	3.2	2.5	3.1	4.7	6.4
Bank refinancing (incl. swap lines)	3.1	3.2	2.6	3.1	4.8	6.4
Certificates of deposits and bonds	0.1	0.1	0.1	0.1	0.1	0.1
Other items, net	-2.5	-3.2	-3.0	-3.1	-3.1	-3.1
Reserve Money	8.9	10.8	10.5	10.4	11.0	11.7
Banking System			(in billions of lari)			
Net foreign assets	-0.4	0.9	0.1	0.0	-1.6	-3.3
NBG	8.8	10.9	10.2	10.3	8.9	7.5
Commercial banks	-9.1	-10.0	-10.1	-10.3	-10.5	-10.8
Net domestic assets	24.7	29.4	30.3	33.9	38.9	44.0
Domestic credit	33.3	40.2	41.4	45.4	50.4	55.4
Net claims on central government	1.6	1.5	1.6	1.9	2.4	2.8
Of which : government deposits at NBG	1.5	1.5	1.0	1.7	1.4	1.0
Of which : T-bills at commercial banks	0.8	2.8	2.5	1.6	1.9	2.1
Claims on Other Sectors	31.7	38.7	39.7	43.4	48.0	52.5
Other items, net	-8.6	-10.7	-11.1	-11.5	-11.4	-11.4
Broad money (M3)	24.4	30.4	30.4	33.8	37.2	40.5
Lari Broad money (M2)	11.5	13.7	14.1	16.1	17.7	18.8
Currency held by the public	3.2	3.7	3.7	3.5	3.9	4.2
Lari resident deposits	8.3	9.9	10.4	12.6	13.8	14.6
Resident foreign exchange deposits	12.9	16.7	16.3	17.7	19.5	21.9
Sources of funds of commercial banks	39.8	49.7	48.1	51.8	57.1	62.4
Resident deposits	22.0	29.7	29.7	32.3	35.7	39.1
Non-resident deposits	5.0	5.6	5.6	5.9	6.0	6.1
Other resident liabilities	3.7	3.9	3.3	3.7	5.3	7.0
Other foreign liabilities	9.1	10.4	9.6	9.9	10.1	10.3
Uses of funds of commercial banks	39.8	49.7	48.1	51.8	57.1	62.4
Claims on Central Bank	5.7	7.1	6.9	7.0	7.3	7.5
Credit to the Private Sector	31.7	38.7	39.7	43.4	48.0	52.5
National currency	14.1	17.1	18.8	21.3	23.6	25.8
Foreign currency	17.6	21.5	21.0	22.1	24.4	26.7
Other foreign assets	5.0	6.1	5.0	5.5	5.6	5.6
Other items, net	-2.6	-2.2	-3.6	-4.2	-3.7	-3.3
			(in percent of GDP)			
Broad money (M3)	49.5	61.7	50.4	56.1	53.9	58.7
Lari Broad money (M2)	23.3	27.7	23.4	26.7	25.7	27.3
Currency held by the public	6.6	7.6	6.1	5.9	5.6	6.1
Non-resident deposits (percent of total deposits)	18.5	16.0	15.8	15.5	14.5	13.6
Credit to the Economy	64.4	78.5	66.0	72.1	69.6	76.2
Nominal GDP (billions of lari)	49.3	49.3		60.2		69.0
			(year-on-year growth)			
Reserve Money	30.6	20.8	10.4	-3.6	5.1	12.5
Broad money (M3)	24.6	24.6	18.8	11.3	22.3	19.9
NBG Claims on Banks	315.3	2.3	-7.4	-2.1	83.3	103.8
Credit to the Economy (percent change, year on year)	30.5	22.0	16.3	12.3	20.7	20.9

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

Table 5. Georgia: Financial Soundness Indicators, 2019–22Q1
(In percent, unless otherwise indicated)

	2019	2020	2021				2022
	Dec	Dec	Mar	Jun	Sep	Dec	Mar
Capital Adequacy							
Capital to risk-weighted assets 1/	19.5	17.6	18.2	19.2	19.1	19.6	20.1
Nonperforming loans net of provisions to capital	5.2	7.3	7.3	6.5	6.3	5.1	4.8
Leverage ratio 2/	19.0	16.3	17.1	18.6	18.5	19.2	19.6
Asset Quality							
Nonperforming to total gross loans (IMF) 3/	1.9	2.3	2.4	2.2	2.2	1.9	1.8
Nonperforming to total gross loans (NBG) 4/	4.4	8.2	8.3	6.7	6.0	5.2	5.0
Substandard and restructured loans to total gross loans 5/	12.9	34.5	36.0	32.8	31.4	29.2	26.3
Specific provisions to total loans	1.9	3.2	3.2	2.7	2.5	2.2	2.1
Sectoral distribution of loans to total loans							
Residents	97.4	96.4	96.5	96.3	96.3	96.4	96.6
Deposit-takers	0.1	0.2	0.2	0.0	0.0	0.0	0.0
Other financial corporations	0.0	0.0	0.8	0.8	0.8	0.0	0.0
Nonfinancial corporations	49.8	47.1	46.2	45.6	45.7	46.5	45.5
Other domestic sectors 6/	47.5	49.1	49.3	49.9	49.8	49.9	51.2
Non-residents	2.6	3.6	3.5	3.7	3.7	3.6	3.4
Earnings and Profitability							
Return on assets (ROA)	2.4	0.1	2.8	4.0	4.1	3.9	3.1
Return on equity (ROE)	20.3	1.4	29.4	37.3	37.3	34.4	24.8
Interest margin to gross income	58.1	58.4	59.9	57.1	57.0	57.9	60.4
Non-interest expenses to gross income	52.9	54.3	49.1	46.8	46.5	48.1	53.8
Liquidity							
Liquid assets to total assets ratio	19.6	21.1	22.5	20.9	19.4	20.2	20.7
Liquid assets to total short-term liabilities 7/	24.2	25.2	27.3	26.8	25.2	26.3	26.9
Loan-to-deposit ratio (in percent) 8/	121.7	110.6	108.0	113.6	114.4	115.9	116.9
Liquidity coverage ratio (GEL, percent)	100.8	120.3	117.8	108.9	103.1	115.1	104.8
Liquidity coverage ratio (FX, percent)	154.0	154.6	161.0	146.2	136.5	132.9	129.3
Foreign Currency Position and Dollarization							
Deposit dollarization (total non-bank deposits)	64.0	61.4	63.5	60.0	60.7	59.9	59.4
Loans in foreign exchange to total loans	55.2	55.7	55.6	52.8	51.7	50.9	50.6
Net foreign assets to total assets	-18.9	-17.6	-16.7	-18.0	-16.1	-17.0	-15.9
Net open foreign exchange position to regulatory capital	0.2	0.2	-0.9	2.0	1.4	2.6	3.1
Borrowed funds from abroad-to-GDP ratio 9/	19.1	18.0	18.5	16.5	15.9	17.0	14.3
Other							
Loans collateralized by real estate to total loans	64.9	53.5	64.8	65.4	64.1	64.0	61.0
Memorandum items							
Georgia EMBIG Sovereign Spread	157	407	232	181	210	206	294
Georgia EMBIG Sovereign Yield	3.2	4.2	2.4	2.3	3.0	3.3	4.8

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. Proposed Schedule of Reviews and Available Purchases

Availability Date	Condition	Amount of Purchase (SDR millions)	Amount of Purchase (Percent of quota)
15-Jun-22	Approve the 36-month SBA	30.0	14.3
3-Oct-22	Complete the first review based on end-June 2022 performance criteria and other relevant performance criteria	30.0	14.3
3-Apr-23	Complete the second review based on end-December 2022 performance criteria and other relevant performance criteria	30.0	14.3
2-Oct-23	Complete the third review based on end-June 2023 performance criteria and other relevant performance criteria	30.0	14.3
1-Apr-24	Complete the fourth review based on end-December 2023 performance criteria and other relevant performance criteria	30.0	14.3
7-Oct-24	Complete the fifth review based on end-June 2024 performance criteria and other relevant performance criteria	30.0	14.3
7-Apr-25	Complete the sixth review based on end-December 2024 performance criteria and other relevant performance criteria	30.4	14.4
Total available		210.4	100.0

Source: Fund staff estimates and projections.

Table 7. Indicators of Fund Credit, 2019–27
(In millions of SDR)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Actual	Actual	Actual			Projections			
Existing Fund credit									
Purchases (EFF)	60.0	226.0	78.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	180.0	406.0	481.5	469.0	446.5	404.3	330.1	249.4	171.2
SBA and EFF	180.0	406.0	481.5	469.0	446.5	404.3	330.1	249.4	171.2
Obligations	38.1	4.2	4.2	16.9	30.9	49.8	80.2	85.4	81.7
SBA and EFF	38.1	4.2	4.2	16.9	30.9	49.8	80.2	85.4	81.7
Principal (repurchases)	35.0	0.0	2.5	12.5	22.5	42.3	74.2	80.7	78.2
Interest charges	3.1	4.2	1.7	4.4	8.4	7.6	6.0	4.7	3.5
Prospective purchases 1/									
Purchases	0.0	0.0	0.0	60.1	60.1	60.1	30.1	0.0	0.0
Stock 2/	0.0	0.0	0.0	60.1	120.2	180.3	202.9	165.4	97.9
Obligations 3/	0.0	0.0	0.0	0.8	3.1	5.6	15.8	43.7	69.9
Principal (repurchases)	0.0	0.0	0.0	0.0	0.0	0.0	7.5	37.5	67.5
Interest charges	0.0	0.0	0.0	0.8	3.1	5.6	8.3	6.2	2.4
Stock of existing and prospective Fund credit 2/	180.0	406.0	481.5	529.1	566.7	584.6	533.0	414.8	269.1
In percent of quota 4/	85.6	193.0	228.8	251.5	269.4	277.8	253.3	197.2	127.9
In percent of GDP	1.4	3.6	3.7	3.5	3.5	3.4	2.8	2.0	1.2
In percent of exports of goods and nonfactor services	2.6	9.5	8.5	8.9	8.1	7.2	5.9	4.2	2.4
In percent of gross reserves	7.1	14.5	16.1	25.3	30.3	30.4	24.9	17.7	9.2
In percent of public external debt	4.1	7.2	9.0	9.8	10.3	10.6	9.6	7.7	5.1
in percent of total government revenues and grants	5.9	16.2	17.2	15.1	15.9	15.3	13.0	9.3	5.6
Obligations to the Fund from existing and prospective Fund credit	38.1	4.2	4.2	17.7	34.0	55.4	96.0	129.1	151.6
In percent of quota	18.1	2.0	2.0	8.4	16.2	26.3	45.6	61.3	72.0
In percent of GDP	0.3	0.0	0.0	0.1	0.2	0.3	0.5	0.6	0.7
In percent of exports of goods and nonfactor services	0.6	0.1	0.1	0.3	0.5	0.7	1.1	1.3	1.4
In percent of gross reserves	1.5	0.2	0.1	0.8	1.8	2.9	4.5	5.5	5.2
In percent of public external debt service	11.5	1.4	1.4	5.5	10.1	15.5	27.0	37.9	53.9
in percent of total government revenues and grants	1.2	0.2	0.2	0.5	1.0	1.5	2.3	2.9	3.1

Source: Fund staff estimates and projections.

1/Although the authorities intend to treat the arrangement as precautionary, indicators are computed assuming the adverse scenario outlined in Annex III and purchases phased equally over the duration of the program (except in 2022 where a purchase of SDR 60.1 million is assumed in October 2022).

2/ End of period.

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

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

Annex I. Risk Assessment Matrix[1]

Risk Assessment Matrix			
Source of Risks	**Likelihood**	**Expected Impact on the Economy if Risks Materialize**	**Policy Response**
Conjunctural Risks			
Russia's invasion of Ukraine leads to escalation of sanctions and other disruptions. Sanctions on Russia are broadened to include oil, gas, and food sectors. Russia is disconnected almost completely from the global financial system and large parts of the trading system. This, combined with Russian countersanctions and secondary sanctions on countries and companies that continue business with Russia, leads to even higher commodity prices, refugee migration, tighter financial conditions, and other adverse spillovers, which particularly affect LICs and commodity-importing EMs.	**High**	**High** The war in Ukraine and sanctions on Russia could lower exports, remittances, and investment, and increase inflation and depreciation pressure on the lari. Risks of domestic food insecurity could be elevated due to supply disruptions and bans on food exports by Russia. Migration of refugees could increase social tensions and involve fiscal costs. Sanctions may lead to AML/CFT compliance risks for financial institutions.	Allow flexible exchange rate to act as a shock absorber. Utilize foreign exchange reserves to prevent disorderly market conditions that could jeopardize financial stability. Maintain tight monetary policy to keep inflation expectations anchored and avoid capital outflows. Reprioritize spending to provide targeted fiscal support to the most vulnerable segments of the population and affected industries. Seek external official support should a larger fiscal response be necessary and to bolster foreign exchange reserves. Seek new markets to diversify exports.

[1] Prepared by Sergejs Saksonovs, Shujaat Khan, and Masud Al-Taj. 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.

Risk Assessment Matrix			
Source of Risks	**Likelihood**	**Expected Impact on the Economy if Risks Materialize**	**Policy Response**
			Strengthen AML/CFT compliance monitoring.
Rising and volatile food and energy prices. Commodity prices are volatile and trend up amid supply constraints, war in Ukraine, export restrictions and currency depreciations. This leads to short-run disruptions in the green transition, bouts of price and real sector volatility, food insecurity, social unrest, and acute food and energy crises (especially in EMDEs with lack of fiscal space).	**High**	**High** Rising global commodity prices would further increase inflationary pressures and diminish households' purchasing power.	Maintain tight monetary policy to keep inflation expectations anchored. Reprioritize spending to provide targeted fiscal support to the most vulnerable. Seek external official support should a larger fiscal response be necessary and to bolster foreign exchange reserves.
Outbreaks of lethal and highly contagious Covid-19 variants. Rapidly increasing hospitalizations and deaths due to low vaccine protection or vaccine-resistant variants force more social distancing and/or new lockdowns. This results in extended supply chain disruptions and a reassessment of growth prospects, triggering capital outflows, financial tightening, currency depreciations, and debt distress in some EMDEs.	**Medium**	**High** Further lockdowns would negatively affect growth, including through lower tourism and investment. Capital outflows in the context of a high current account deficit and external financing requirements would lead to lari depreciation and accelerating inflation. Poverty among the vulnerable would rise.	Allow the exchange rate to adjust to new fundamentals. Utilize foreign exchange reserves to prevent a disorderly depreciation that would jeopardize financial stability. Further tighten monetary policy to keep inflation expectations anchored. Reprioritize spending to meet health needs and provide targeted support to affected populations and businesses.
Structural Risks			
Geopolitical tensions and deglobalization. Intensified geopolitical tensions, security risks,	**High**	**High**	Allow the exchange rate to adjust to

Risk Assessment Matrix			
Source of Risks	**Likelihood**	**Expected Impact on the Economy if Risks Materialize**	**Policy Response**
conflicts, and wars cause economic and political disruptions, fragmentation of the international monetary system, production reshoring, a decline in global trade, and lower investor confidence.		Conflicts, geopolitical tensions, and deglobalization would lower exports, remittances, and investment, and keep price pressures elevated. These factors could increase depreciation pressure on the lari and further increase inflation despite weaker growth. Accelerating de-globalization would weaken the potential for Georgia to serve as a logistics hub.	reflect the new fundamentals. Utilize foreign exchange reserves to prevent a disorderly depreciation that would jeopardize financial stability. Reprioritize spending to provide targeted fiscal support to individuals and businesses. Undertake structural reforms to promote new sources of growth less reliant on the external environment, and seek to diversify export destinations.
Georgia-Specific Structural Risks			
Financial risks. As a result of one of the global shocks above, the exchange rate could depreciate rapidly, undermining confidence in the currency and increasing inflation expectations.	Medium	Medium 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. Allow the exchange rate to adjust to new fundamentals. Utilize foreign exchange reserves to prevent a disorderly depreciation that would jeopardize financial stability. Strengthen the resolution framework to ensure that financial stability

Risk Assessment Matrix			
Source of Risks	**Likelihood**	**Expected Impact on the Economy if Risks Materialize**	**Policy Response**
			challenges can be addressed. Allow use of capital and liquidity buffers to cope with shocks Adjust macroprudential measures to avoid an undue tightening of financial conditions. Enforce provisioning rules in line with international best practices.
Fiscal risks. Materialization of contingent liabilities/fiscal risks could put pressure on the deficit.	**Medium**	**High** The need to cover contingent liabilities could complicate efforts to comply with the fiscal rule or result in lower capital or current spending, the latter of which has already been significantly compressed.	Continue improving SOE governance and fiscal risk management practices. Strengthen revenue raising capacity. Strengthen reform agenda and seek IFI support.
Political risks. Political instability and/or reform fatigue could undermine efforts to undertake structural reforms.	**Medium**	**Medium** Policy uncertainty could undermine confidence and hurt growth.	Maintain macroeconomic policy discipline. Strengthen social safety nets to protect the most vulnerable segments of the population and ensure that growth is sufficiently inclusive.

Annex II. 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 due to the COVID-19 pandemic. After peaking at the fiscal rule limit of 60 percent of GDP in 2020, public debt dropped by 10 percentage points in 2021 and is expected to decline further to close to 40 percent of GDP by 2027. Although the authorities' plan to expand coverage of fiscal reporting to include non-market SOEs in the general government will add to the projected stock of debt starting in 2022, adequate buffers safeguard compliance with the fiscal rule debt ceiling. External debt would decline steadily from about 98 percent of GDP in 2021 under the baseline and would be near or below this level under all standard shock scenarios through the projection horizon. The main risks to both public and external debt 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 remained stable at around 40 percent of GDP during 2016-19 reflecting fiscal discipline and a build-up of government deposits. However, faced with the COVID-19 pandemic in 2020, debt abruptly increased by 20 percentage points of GDP, reaching the upper limit of the fiscal rule. This sharp increase reflected: (i) a widening of the fiscal deficit triggered by lower revenues coupled with a rise in spending, including to finance the government's fiscal response package (3.8 percent of GDP in 2020); (ii) economic contraction; (iii) an accumulation of government deposits (which increased by 3.6 percent of GDP) to guard against downside risks; (iv) exchange rate depreciation; and (v) other residual debt-increasing factors.[2]

2. **After a sharp fall in 2021, public debt as a share of GDP is expected to continue to decline over the medium term and remains sustainable.** The public debt-to-GDP ratio declined by 10 percentage points in 2021, on the back of higher growth, exchange rate appreciation, and lower real interest rate effects (Figure 2). The debt level is expected to continue declining in the medium run, as one-off spending measures wane and growth resumes under a realistic baseline medium-term fiscal path.[3] In 2027, public debt is projected to return to its pre-pandemic level of close to 40 percent of GDP in gross terms (38 percent of GDP measured net of government deposits), in line with previous program commitments.[4] Gross financing needs are expected to average 6 percent of GDP over 2022-27.

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

[1] Prepared by Andresa Lagerborg (FAD) and Yunhui Zhao (SPR). The public sector throughout this analysis is defined as the general government (i.e., it excludes NBG debt to the IMF). The analysis excludes non-market SOEs, which are expected to enter general government fiscal reporting in 2022.

[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 provide a buffer against downside risks.

[3] Gross debt is projected to rise slightly in 2022, driven by residual debt-creating flows (see Figure 2).

[4] The EFF program target for public debt net of deposits was 45 percent of GDP but included NBG debt.

years of the escape clause being triggered due to the pandemic). Georgia's 2023 public debt is currently projected at 46 percent of GDP under the baseline. After including non-market SOEs and PPP liabilities, debt is estimated to reach 48 percent of GDP in 2023, still complying with the fiscal rule limit. [5] Government deposits, projected at 2.5 percent of GDP, provide some additional cushion for adherence to the rule. However, fiscal risks arising from an uncertain impact of incorporating non-market SOEs into general government reporting (starting in 2022), PPP liabilities, and contingent liabilities in the form of PPAs and SOEs, could further add to projected debt and reduce 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 (at 2021 levels), this scenario is not realistic, considering the fiscal policy support measures in response to the unprecedented external shock related to the Covid-19 pandemic and the authorities' good past record of fiscal discipline. Under the combined macro-fiscal shock of low growth, inflation, a deteriorated primary balance, and high interest rates, debt stabilizes at a level that breaches the benchmark threshold; such a scenario seems unlikely to unfold without a policy response as it would also breach Georgia's fiscal rule.

5. **After a successful Eurobond rollover in April 2021, risks associated with high gross financing needs remain low, while vulnerabilities stem mostly from a high share of FX-denominated debt.** Currently, 80 percent of public debt is FX-denominated, causing debt dynamics to be vulnerable to exchange rate depreciation. A $500 million sovereign Eurobond maturing on April 12, 2021 was refinanced at a historically low interest rate (2.75 percent coupon rate for 5-year maturity). The MOF's public debt management strategy published in December 2021 outlines plans to deepen the local capital market and reduce FX-denominated debt over the medium term. The government has been successful in securing debt of long maturity (representing over 97 percent of outstanding debt), government deposits are adequate, the public debt service profile is relatively smooth (averaging 5 percent of GDP over 2022-27), and much of the external debt service is owed to international financial institutions at concessional terms, mitigating risks to debt sustainability.

6. **The public debt projections do not incorporate contingent liabilities to the general government.** Key fiscal risks stem from power purchasing agreements and SOEs. Under the EFF arrangement, the authorities took 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

[5] Georgia's fiscal rule applies to the general government including non-market SOEs (as classified under the 2020 sectorization exercise) as well as outstanding PPP commitments. The 2021 Fiscal Risk Statement estimates that: (i) PPP liabilities totaled GEL 395 million (0.8 percent of GDP) in 2020 and (ii) incorporating non-market SOEs would increase state debt by 1.1 percent of GDP and the fiscal deficit by 0.6 percent of GDP in 2019 based on IMF TA pilot balance sheet compilations (covering 84 percent of non-market SOEs in terms of annual turnover). The impact of incorporating non-market SOEs into public finance statistics is yet to be estimated for 2021-26.

government sector starting in 2021. The authorities are also committed to a comprehensive governance reform of SOEs classified as public corporations, which will help reduce fiscal risks.

7. Under the baseline, external debt is expected to decline steadily from about 98 percent of GDP in 2021 through the projection horizon. External debt remained stable at around 85 percent of GDP during 2016-19, reflecting fiscal discipline. However, mainly driven by the government's large borrowings from IFIs to combat the COVID-19 pandemic, external debt abruptly increased by 22 percentage points of GDP in 2020, reaching about 110 percent of GDP. The external debt-to-GDP ratio sharply declined in 2021, driven by the much lower need for external borrowing and by the sharp USD-denominated GDP rebound. Under the baseline, external debt is expected to continue to steadily decline through the projection horizon to just below 60 percent of GDP in 2027, reflecting the low external financing needs (Table 5) and the government's efforts to reduce dependence on external borrowing and develop domestic capital markets.

8. Stress tests suggest that the external debt-to-GDP ratio would be near or below its 2021 level in the medium term under standard shock scenarios. The external debt-to-GDP ratio remains near or below its level in 2021 in all standardized stress tests (Figure 6), considering individual shocks to the real interest rate, real GDP growth, and non-interest current account balance (all with permanent 1/2 standard deviation shocks), as well as a combined shock (with permanent 1/4 standard deviation shocks to these three variables). The external debt-to-GDP ratio would rise sharply following a one-time real depreciation of 30 percent in 2023, confirming the aforementioned vulnerabilities stemming from a high share of FX-denominated debt. However, this ratio would decline steadily to 90 percent in 2027, below the 2021 level (98 percent). While external debt would not fall under the historical scenario (with historical averages calculated over the ten-year period), this scenario is deemed less relevant.[6]

[6] For example, the 10-year average inflation is negative, which is distorted by an outlier in 2015 (Table 5).

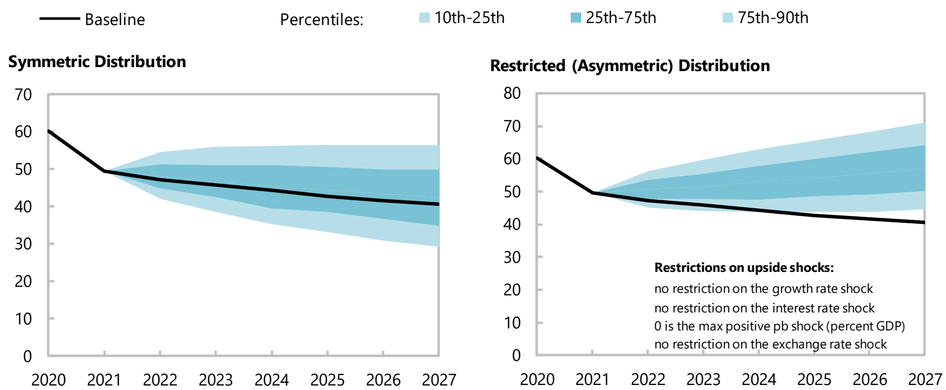
Figure AII. 1. Georgia: Public DSA Risk Assessment

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

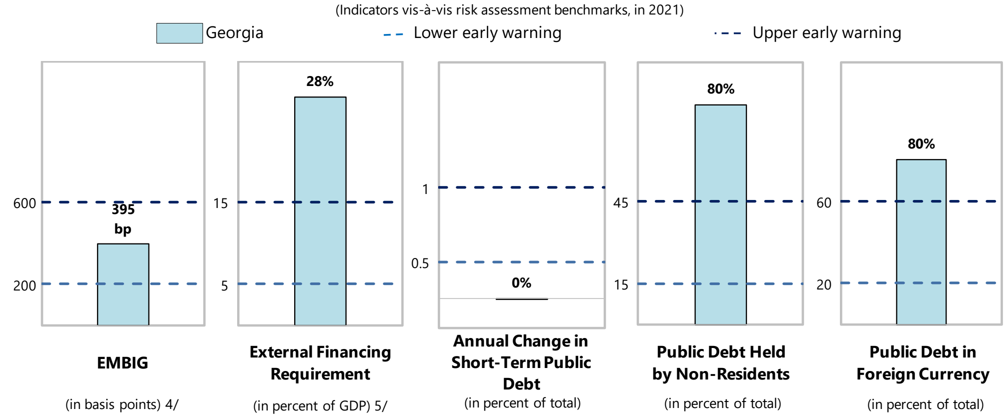
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2021)



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, 17-Feb-22 through 18-May-22.

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 AII. 2. Georgia: Public DSA – Baseline Scenario

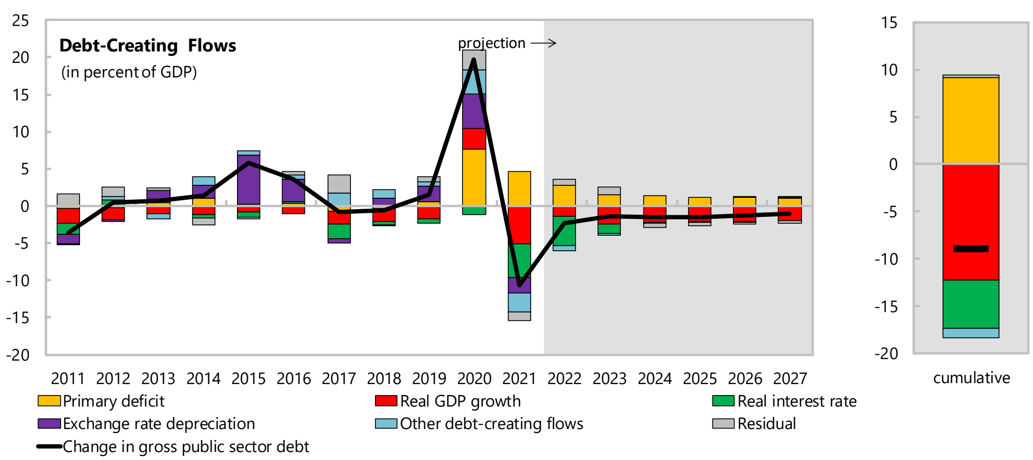
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of May 18, 2022		
	2011-2019 [2/]	2020	2021	2022	2023	2024	2025	2026	2027	Sovereign Spreads		
Nominal gross public debt	34.8	60.2	49.5	47.1	45.8	44.3	42.8	41.6	40.6	EMBIG (bp) 3/		377
Public gross financing needs	4.5	14.3	13.3	7.4	5.7	5.1	5.5	6.4	5.9	5Y CDS (bp)		n.a.
Real GDP growth (in percent)	4.7	-6.8	10.4	3.2	5.8	5.2	5.2	5.2	5.2	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	4.5	7.3	10.6	11.3	5.3	3.0	3.0	3.0	3.0	Moody's	Ba2	Ba2
Nominal GDP growth (in percent)	9.5	0.0	22.3	14.5	11.6	8.1	8.5	8.3	8.4	S&Ps	BB	BB
Effective interest rate (in percent) [4/]	3.4	3.9	2.7	2.5	2.7	2.8	3.0	3.3	3.6	Fitch	BB	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2011-2019	2020	2021	2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.9	19.8	-10.7	-2.37	-1.3	-1.5	-1.5	-1.2	-1.0	-8.9	
Identified debt-creating flows	0.3	17.1	-9.6	-3.17	-2.4	-1.0	-1.0	-0.9	-0.7	-9.2	
Primary deficit	0.1	7.7	4.7	2.83	1.5	1.4	1.2	1.2	1.0	9.1	-1.8
Primary (noninterest) revenue and gr	26.7	25.2	25.4	25.16	25.3	25.4	25.4	25.3	25.2	151.7	
Primary (noninterest) expenditure	26.8	32.9	30.1	27.99	26.8	26.8	26.6	26.4	26.2	160.9	
Automatic debt dynamics [5/]	-0.4	6.2	-11.7	-5.31	-3.7	-2.3	-2.2	-2.0	-1.8	-17.3	
Interest rate/growth differential [6/]	-1.9	1.5	-9.6	-5.31	-3.7	-2.3	-2.2	-2.0	-1.8	-17.3	
Of which: real interest rate	-0.5	-1.2	-4.5	-3.93	-1.3	-0.1	-0.1	0.1	0.2	-5.1	
Of which: real GDP growth	-1.4	2.7	-5.1	-1.38	-2.5	-2.2	-2.1	-2.1	-2.0	-12.2	
Exchange rate depreciation [7/]	1.5	4.7	-2.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.6	3.2	-2.5	-0.69	-0.2	0.0	-0.1	-0.1	0.1	-1.0	
GG: Privatization and Drawdown of	-0.5	3.1	-2.6	-0.80	-0.4	-0.2	-0.2	-0.2	-0.1	-1.8	
Contingent liabilities	0.0	0.0	0.0	0.00	0.0	0.0	0.0	0.0	0.0	0.0	
GG: Net acquisition of financial asse	1.1	0.1	0.1	0.11	0.2	0.1	0.1	0.1	0.1	0.8	
Residual, including asset changes [8/]	0.6	2.7	-1.1	0.81	1.1	-0.5	-0.5	-0.3	-0.3	0.3	



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).

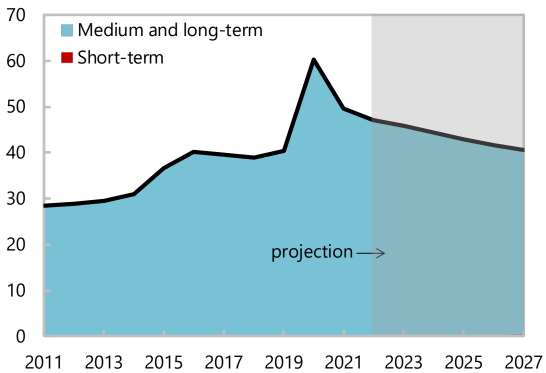
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

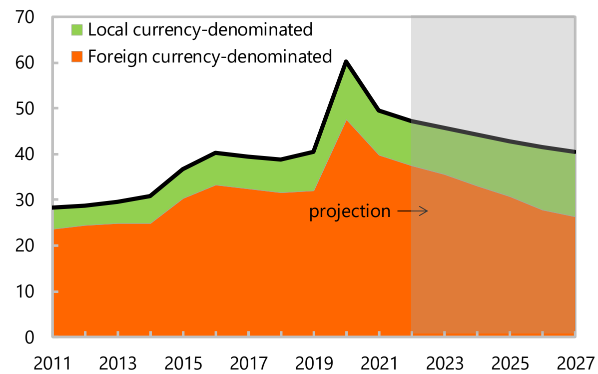
Figure AII. 3. Georgia: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



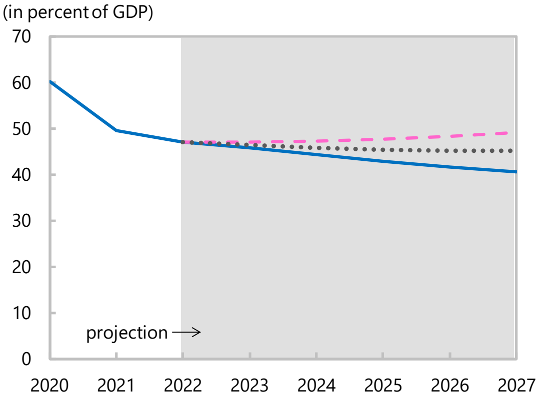
By Currency
(in percent of GDP)



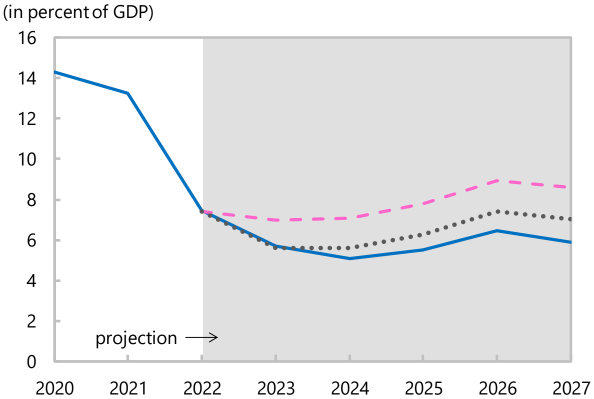
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



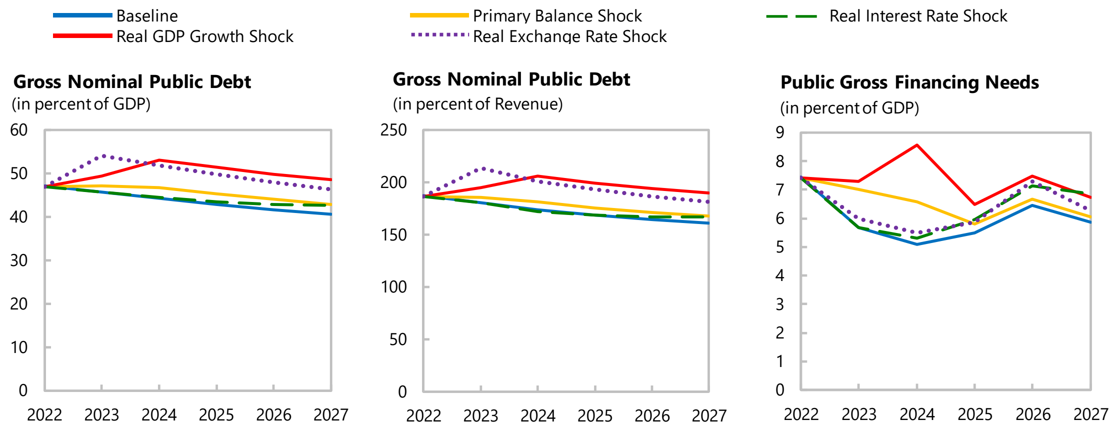
Underlying Assumptions
(in percent)

Baseline Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	3.2	5.8	5.2	5.2	5.2	5.2
Inflation	11.3	5.3	3.0	3.0	3.0	3.0
Primary Balance	-2.8	-1.5	-1.4	-1.2	-1.2	-1.0
Effective interest rate	2.5	2.7	2.8	3.0	3.3	3.6
Constant Primary Balance Scenario						
Real GDP growth	3.2	5.8	5.2	5.2	5.2	5.2
Inflation	11.3	5.3	3.0	3.0	3.0	3.0
Primary Balance	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8
Effective interest rate	2.5	2.7	2.9	3.2	3.5	3.8

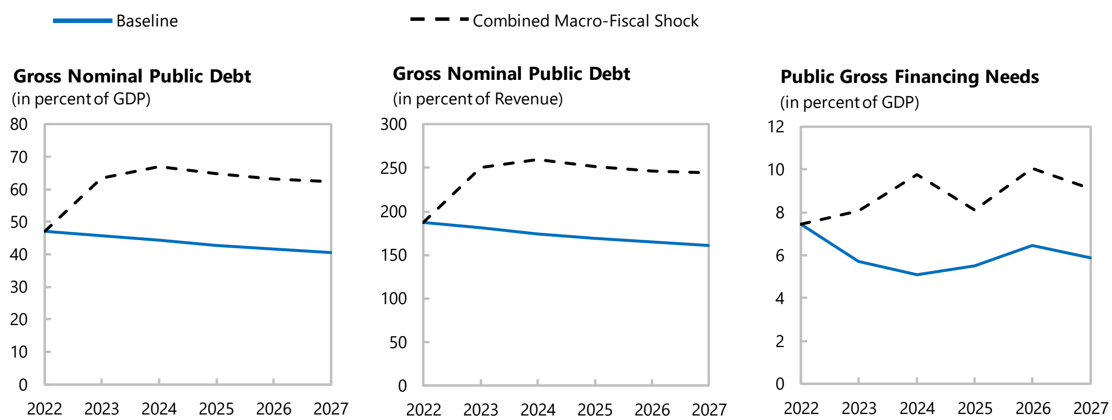
Historical Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	3.2	3.9	3.9	3.9	3.9	3.9
Inflation	11.3	5.3	3.0	3.0	3.0	3.0
Primary Balance	-2.8	-1.4	-1.4	-1.4	-1.4	-1.4
Effective interest rate	2.5	2.7	2.8	3.1	3.4	3.7

Figure AII. 4. Georgia: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests

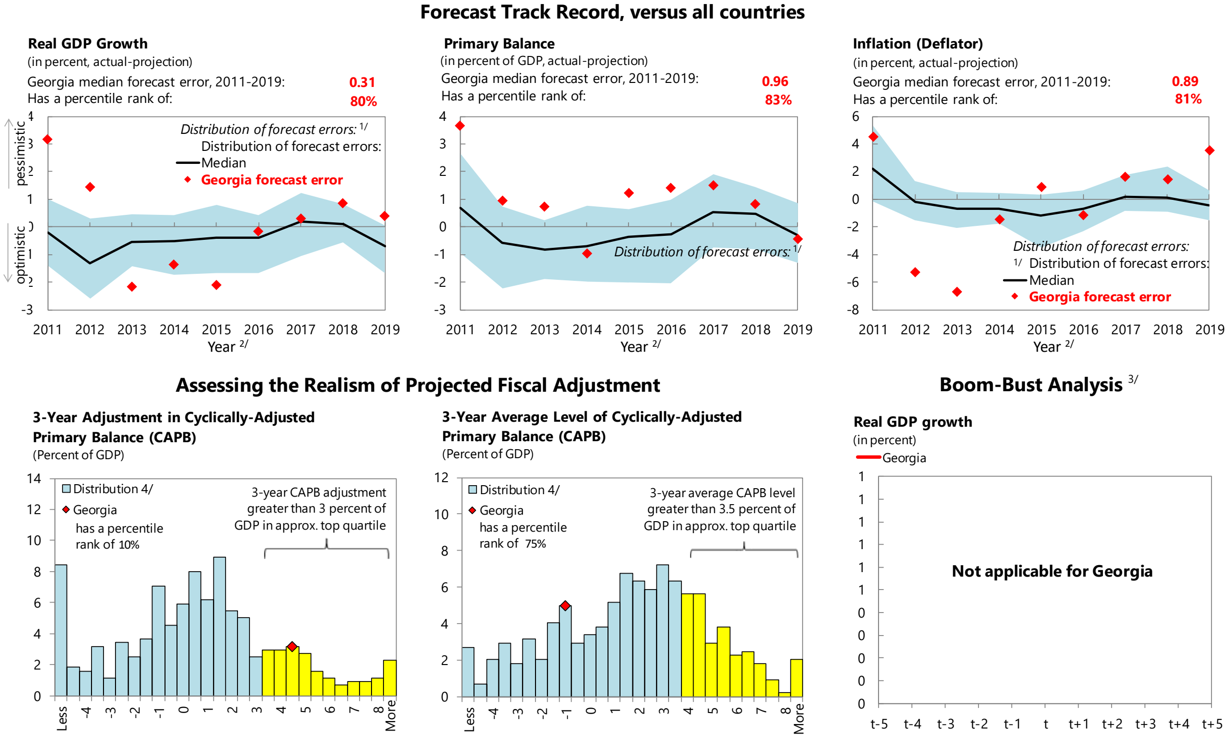


Underlying Assumptions
(in percent)

Primary Balance Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	3.2	5.8	5.2	5.2	5.2	5.2
Inflation	11.3	5.3	3.0	3.0	3.0	3.0
Primary balance	-2.8	-2.9	-2.3	-0.8	-0.8	-0.7
Effective interest rate	2.5	2.7	2.9	3.2	3.5	3.7
Real Interest Rate Shock						
Real GDP growth	3.2	5.8	5.2	5.2	5.2	5.2
Inflation	11.3	5.3	3.0	3.0	3.0	3.0
Primary balance	-2.8	-1.5	-1.0	-0.8	-0.8	-0.7
Effective interest rate	2.5	2.7	3.4	4.1	5.0	5.8
Combined Shock						
Real GDP growth	3.2	1.5	0.9	5.2	5.2	5.2
Inflation	11.3	4.3	1.9	3.0	3.0	3.0
Primary balance	-2.8	-2.9	-3.8	-0.8	-0.8	-0.7
Effective interest rate	2.5	2.9	3.1	4.0	4.8	5.7

Real GDP Growth Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	3.2	1.5	0.9	5.2	5.2	5.2
Inflation	11.3	4.3	1.9	3.0	3.0	3.0
Primary balance	-2.8	-2.9	-3.8	-0.8	-0.8	-0.7
Effective interest rate	2.5	2.7	2.9	3.3	3.6	3.8
Real Exchange Rate Shock						
Real GDP growth	3.2	5.8	5.2	5.2	5.2	5.2
Inflation	11.3	14.8	3.0	3.0	3.0	3.0
Primary balance	-2.8	-1.5	-1.0	-0.8	-0.8	-0.7
Effective interest rate	2.5	2.9	2.4	2.7	3.0	3.3

Figure AII. 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.

Table AII. 5. Georgia: External Debt Sustainability Framework, 2017-2027
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2017	2018	2019	2020	2021			2022	2023	2024	2025	2026	2027	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	85.6	83.1	87.7	109.6	98.2			**85.8**	**80.6**	**74.6**	**68.9**	**63.9**	**59.5**	**-11.0**
2 Change in external debt	1.2	-2.5	4.6	22.0	-11.5			-12.4	-5.1	-6.0	-5.8	-5.0	-4.4	
3 Identified external debt-creating flows (4+8+9)	-8.1	-5.3	0.3	17.9	-11.2			4.2	-1.4	-2.8	-3.5	-3.0	-3.3	
4 Current account deficit, excluding interest payments	4.4	2.9	1.1	7.8	5.8			7.4	3.9	2.8	2.4	2.3	5.6	
5 Deficit in balance of goods and services	11.0	10.6	8.9	19.2	16.2			15.4	13.2	11.1	9.9	9.3	8.8	
6 Exports	46.5	50.6	54.6	37.4	43.3			40.1	45.6	48.6	49.9	50.7	51.8	
7 Imports	57.5	61.2	63.5	56.6	59.5			55.5	58.8	59.7	59.8	60.0	60.7	
8 Net non-debt creating capital inflows (negative)	-10.5	-5.5	-6.0	-3.5	-4.5			-4.1	-4.3	-5.3	-5.8	-5.4	-5.9	
9 Automatic debt dynamics 1/	-2.0	-2.7	5.2	13.5	-12.6			0.9	-1.0	-0.3	-0.1	0.1	-3.0	
10 Contribution from nominal interest rate	3.7	3.9	4.4	4.6	4.0			3.6	3.6	3.5	3.4	3.3	0.0	
11 Contribution from real GDP growth	-3.8	-3.8	-4.2	6.5	-9.6			-2.6	-4.6	-3.8	-3.5	-3.3	-3.0	
12 Contribution from price and exchange rate changes 2/	-1.9	-2.7	5.0	2.4	-7.0			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	9.4	2.8	4.3	4.1	-0.2			-16.6	-3.7	-3.2	-2.3	-1.9	-1.1	
External debt-to-exports ratio (in percent)	183.8	164.4	160.5	293.1	227.0			213.6	176.9	153.7	137.9	126.0	114.8	
Gross external financing need (in billions of US dollars) 4/	4.3	4.5	4.4	5.3	5.2			6.1	5.4	5.2	5.2	5.4	5.6	
in percent of GDP	26.4	25.6	25.4	33.2	28.0	10-Year	10-Year	27.2	22.1	19.4	17.6	16.8	16.1	
Scenario with key variables at their historical averages 5/								**85.8**	**85.4**	**86.8**	**88.8**	**91.0**	**94.1**	**-4.3**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	4.8	4.8	5.0	-6.8	10.4	3.9	4.3	3.2	5.8	5.2	5.2	5.2	5.2	
GDP deflator in US dollars (change in percent)	2.2	3.3	-5.6	-2.7	6.8	-1.4	6.7	15.7	2.8	4.5	4.2	4.1	4.0	
Nominal external interest rate (in percent)	4.7	4.9	5.2	4.7	4.3	5.0	0.5	4.4	4.5	4.7	5.0	5.3	0.0	
Growth of exports (US dollar terms, in percent)	22.4	17.7	7.3	-37.9	36.4	6.6	21.0	10.5	23.7	17.0	12.8	11.2	11.9	
Growth of imports (US dollar terms, in percent)	10.2	15.2	3.1	-19.3	24.0	4.2	13.3	11.1	15.4	11.4	9.9	9.9	10.6	
Current account balance, excluding interest payments	-4.4	-2.9	-1.1	-7.8	-5.8	-5.7	2.7	-7.4	-3.9	-2.8	-2.4	-2.3	-5.6	
Net non-debt creating capital inflows	10.5	5.5	6.0	3.5	4.5	6.7	2.4	4.1	4.3	5.3	5.8	5.4	5.9	

Source: IMF Staff.

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

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

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

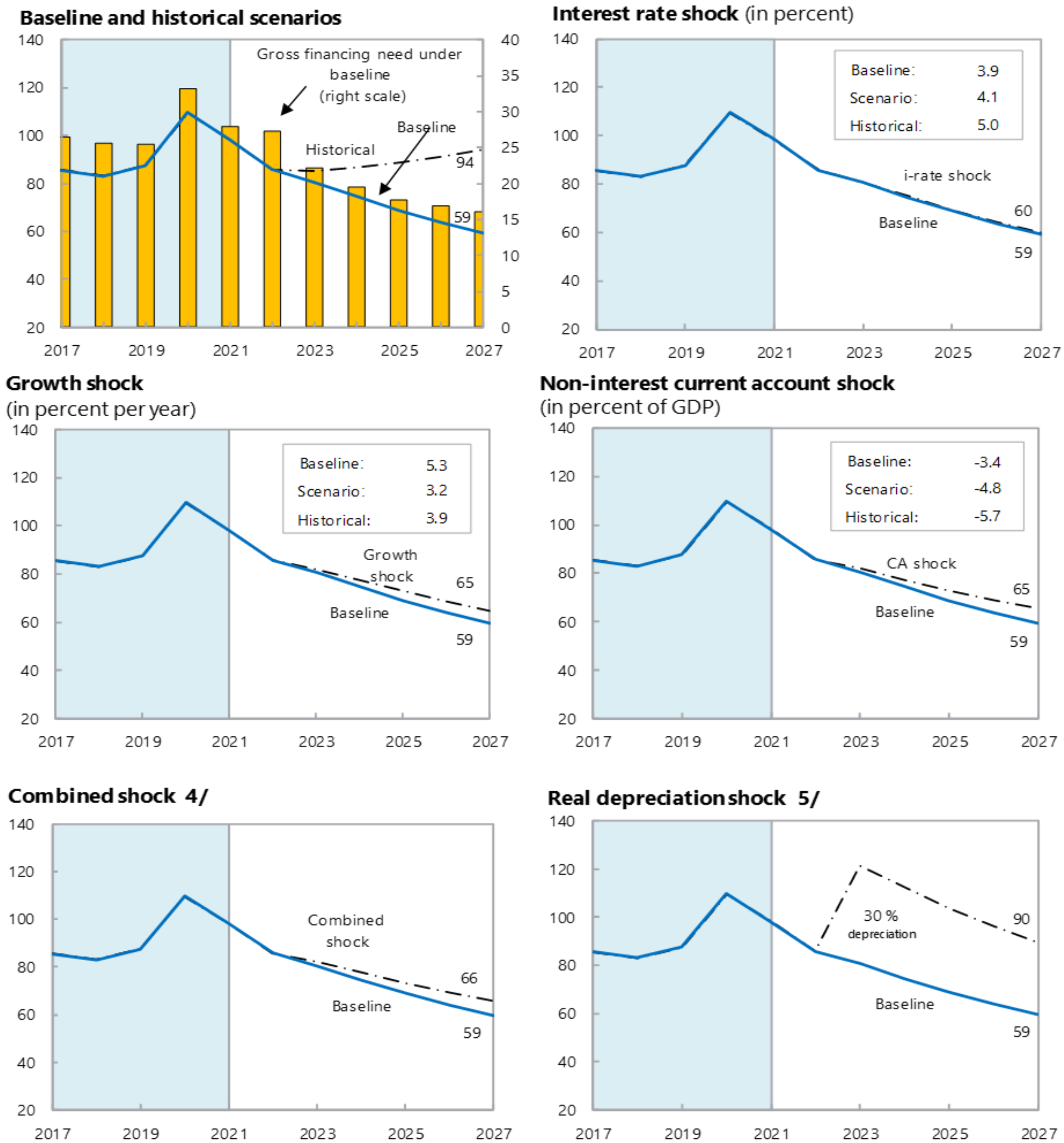
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Figure AII. 6. Georgia: External Debt Sustainability: Bound Tests 1/ 2/ 3/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/The analysis excludes inter-company loans, which are part of FDI.
2/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
3/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
4/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
5/ One-time real depreciation of 30 percent occurs in 2023, one year after the first projection year.

Annex III. Downside Scenario[1]

The adverse scenario considers the impact of a protracted downside shock such as due to an escalation and prolongation of the war in Ukraine. The impacts of such a shock would be felt via (i) elevated commodity prices for longer, (ii) lower exports, (iii) slower than expected recovery of tourism revenues and remittances, and (iv) capital outflows.

1. **The scenario assumes that a more protracted regional conflict would result in the following negative shocks:**

- **Commodity prices.** Due to global supply disruptions, oil and commodity prices are assumed to be 10 percent higher in 2023, compared to the baseline levels. Prices are assumed to decline gradually to baseline levels in 2025.
- **Remittances**. The growth of remittances, which has been strong in recent years, is assumed to be depressed in 2023, declining by 10 percent compared to the baseline.
- **Services exports/tourism.** The recovery in tourism is expected to be more protracted, reflecting high geopolitical tensions in the region. While in the baseline tourism revenue recovers to its 2019 level by 2023, in the downside scenario it happens in 2024, implying lower services exports receipts in 2022 and subsequent years.
- **Lower exports.** Lower economic growth in key trading partners results in lower goods exports by around 4 percent compared to the baseline in 2022.
- **Capital outflows.** It is assumed that nonresidents sell all their holdings of local government bonds (around US$130 million) in 2022.

2. **The downside shock would lower growth and increase inflation.** Lower tourism revenue, exports, and remittances would hurt growth in addition to an already conservative baseline scenario in 2022 and result in larger deteriorations in 2023 and 2024. The lari would be expected to depreciate to reflect weaker fundamentals, which would increase inflation in 2022 and beyond, somewhat mitigating the impact on nominal GDP. Lari depreciation and lower growth would worsen the outlook for external and public debt.

3. **The current account deficit would increase with reserves bearing the brunt of adjustment.** While lower external demand will dampen exports of goods and services including tourism, the impact on the balance of payments would be somewhat mitigated by lower imports due to depreciation and weaker domestic demand and tourism activity. Still the current account deficit is expected to deteriorate by about 1 percent of GDP in 2022 and 1.5 percent in 2023. Without additional financing, the deterioration would be financed by reserves which would fall to 62 percent of the ARA metric by 2024.

[1] Prepared by the Georgia team.

4. The authorities would be expected to respond to the shock by maintaining tight monetary policy to arrest inflation pressures while providing fiscal support. The NBG would focus on keeping interest rates high, while allowing the exchange rate to act as a shock absorber and utilizing reserves to prevent disorderly exchange rate adjustment (Annex II). The government would increase its targeted support to the vulnerable by 0.2 percent of GDP (doubling the measures already done). Furthermore, the scenario assumes that the downside shock to growth in 2023 is sufficiently large so as to trigger the escape clause from the fiscal rule[2], which would allow the authorities to provide additional targeted and temporary fiscal support. We assume 0.3 percent of GDP for vulnerable households and 0.2 percent of GDP for affected businesses (most likely in the tourism sector, though some manufacturing enterprises could also be affected due their economic ties to sanctioned individuals and associated payment restrictions). The scenario also assumes a small increase in current spending on goods and services to deal with spending pressures arising from current prices.

5. Although the exchange rate would be allowed to adjust, the authorities would likely have to utilize reserves to prevent the adjustment from turning disorderly. In the downside scenario, the reserve level of about 62 percent of the ARA metric in 2024 is 13 percentage points lower compared to the baseline. Reserve coverage remains weak through the medium-term, rising to only 66 percent of the ARA metric in 2025. Drawing on the SBA would allow the authorities to reach 72 percent of the ARA metric by the end of the program in 2025. However, these levels are still somewhat lower than reserve adequacy in the aftermath of the last regional shock in 2015–16 (86–89 percent of the ARA metric). To further boost reserves, the authorities could consider an augmentation and additional financing from other IFIs and development partners, as they did during the COVID-19 shock.

Table AIII.1. Key Macroeconomic Indicators in Baseline and Downside Scenarios
(percent of GDP, unless otherwise noted)

	2021	2022		2023		2024		2025	
	Baseline	Baseline	Downside	Baseline	Downside	Baseline	Downside	Baseline	Downside
Real GDP growth (percent change)	10.4	3.2	2.7	5.8	3.8	5.2	4.4	5.2	5.2
GDP deflator (percent change)	10.6	11.3	11.5	5.3	6.7	3.0	3.6	3.0	3.0
Augmented net lending/borrowing	-6.1	-4.0	-4.3	-2.8	-3.3	-2.3	-2.5	-2.3	-2.3
Current account	-9.8	-10.9	-12.0	-7.5	-9.0	-6.3	-6.8	-5.8	-6.5
General government debt	49.5	47.1	49.7	45.8	47.2	44.3	45.8	42.9	44.4
External debt	98.2	85.8	88.3	80.6	83.6	74.6	77.9	68.9	71.9
GIR (in percent of ARA metric)	107.7	79.4	73.1	74.9	62.6	74.7	61.9	80.5	66.1
GIR after drawing (in percent of ARA metric)			75.1		66.4		67.4		72.1

[2] The fiscal rule can be suspended if y/y growth for two consecutive quarters is at least 200 basis points lower than the 10-year average.

Annex IV. External Sector Assessment[1]

Georgia's external position in 2021 was broadly in line with the level implied by fundamentals and desirable policies. External vulnerabilities decreased relative to 2020, reflecting a robust recovery of exports and remittances and the slower build-up of external debt. The net international investment position narrowed in 2021 to -140.5 percent GDP and, although still higher than before pandemic, was deemed sustainable according to the external sustainability approach. End-2021 gross international reserves coverage was about 108 percent of the ARA metric. The war in Ukraine is expected to delay the economic recovery from the COVID-19 shock and cause the current account deficit to widen in 2022 before gradually narrowing to 5.6 percent of GDP by 2027. Prudent fiscal policy, exchange rate flexibility, and progress on structural reforms remain essential to safeguard external sustainability over the medium term.

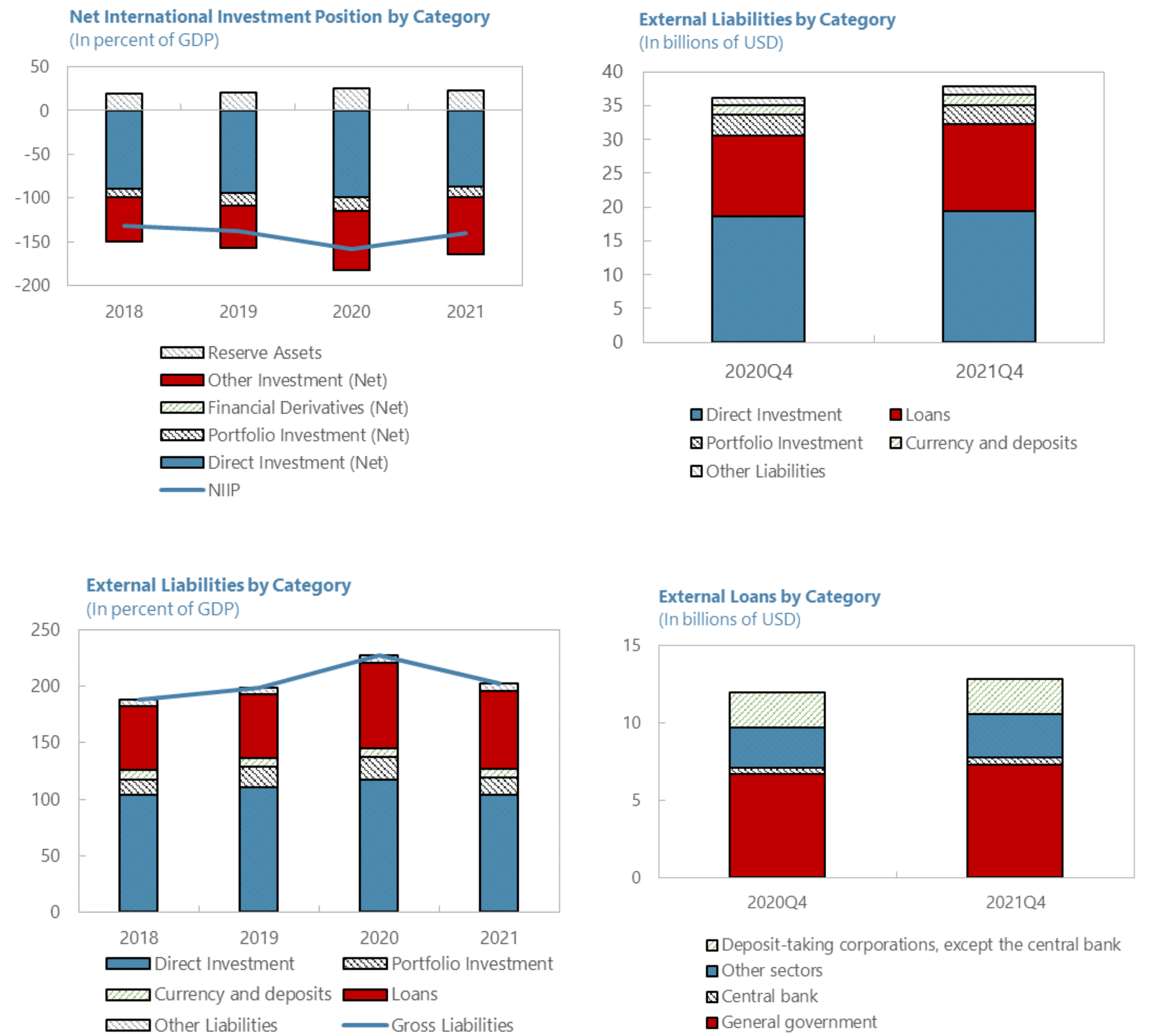
Foreign Assets and Liabilities: Position and Trajectory

1. Georgia's negative net international investment position (NIIP) narrowed in 2021, and the External Sustainability (ES) approach suggests that Georgia's NIIP in 2021 is sustainable. Georgia's NIIP (i.e., gross foreign assets minus gross foreign liabilities) at end-2021 stood at negative 140.5 percent of GDP. Despite being large, the (negative) NIIP narrowed by 17.0 percent of GDP relative to end-2020, mainly due to the much higher USD-denominated GDP, which more than offset a deterioration in the nominal NIIP including stronger gross FDI inflows. Moreover, under the current baseline scenario, the IMF's External Balance Assessment (EBA-lite) external sustainability approach suggests that the NIIP does not deteriorate in net present value terms, that is, the NIIP is sustainable based on this definition. Accordingly, no exchange rate adjustment is needed to maintain the same level of NIIP over the medium term. However, this assessment is relatively narrow, and potential vulnerabilities associated with the current level of the NIIP or its composition require further analysis. The bottom-line assessment of the country's overall external position also needs to take into consideration the CA and the REER Index approaches discussed below.

2. The composition of Georgia's NIIP limits its vulnerability to shocks. FDI and loans accounted for about 51.3 percent and 33.9 percent of gross liabilities at end-2021, respectively. Further mitigating Georgia's external sustainability risks is the large share of the government's loans in the external loan stock (about 56.8 percent as of 2021Q4), and much of the recent increase in external debt reflects concessional loans to the government from IFIs. In contrast, the private sector's external debt remained almost unchanged in nominal terms at end-2021 relative to end-2020, as shown in "other sectors" in the bottom right panel of the figure below).

[1] Prepared by Yunhui Zhao.

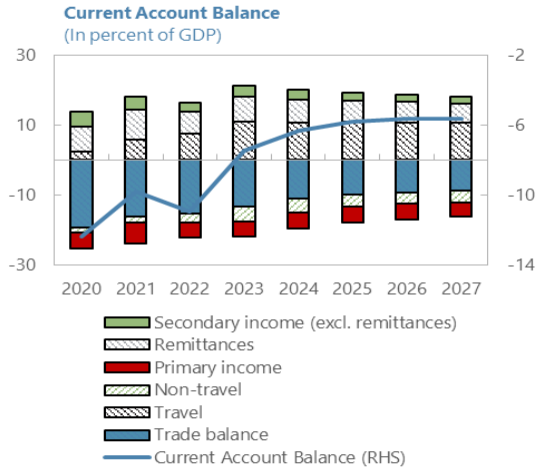
Figure AIV. 1. Georgia: External Sector Indicators



Sources: National Bank of Georgia and IMF staff calculations.

Current Account and Real Exchange Rate

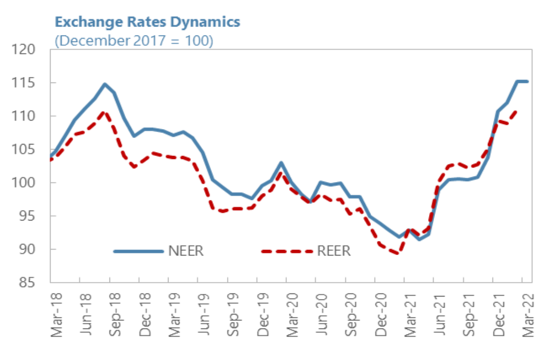
3. **The 2021 current account (CA) deficit narrowed moderately due to a partial recovery in tourism and strong remittances.** Preliminary data show that the 2021 CA deficit was 9.8 percent of GDP, 2.6 percentage points lower than in 2020. The smaller CA deficit reflects significant increases in remittances (38 percent y/y) and tourism revenues (130 percent y/y, although still at only 38 percent of the 2019 level).



Source: NBG, GeoStat and IMF staff calculations.

4. **The CA deficit is expected to widen in 2022 due to the war in Ukraine and then narrow gradually afterwards.** In 2022, the war is expected to significantly decrease net remittances (by 13 percent y/y) and somewhat lower the tourism revenue (from 66 percent of the 2019 level projected before the war to 62 percent). The impact on the balance of goods and services is limited as imports and the services debit are also expected to decrease. Overall, the CA deficit in 2022 is expected to widen to 10.9 percent of GDP. The impact of the war is expected to dissipate in 2023 and beyond, with net remittances in 2023 expected to exceed the 2021 level and tourism revenue fully recovering to the 2019 level by 2023. Accordingly, the CA deficit is expected to decline to 7.5 percent in 2023 and gradually to 5.6 percent of GDP in 2027 (close to the historically low level of 5.5 percent in 2019), assuming no significant deterioration of the COVID-19 pandemic, a gradual recovery in exports, and timely implementation of structural reforms to diversify the economy and increase competitiveness.[2]

5. **The lari rebounded moderately from the sharp depreciation induced by the COVID-19 shock and remained resilient against the shock of the war in Ukraine.** From February 2020 to April 2021, the lari depreciated by 11.2 percent and 9.4 percent in nominal and real effective terms, respectively, mainly attributable to the adverse effect of the COVID shock at the initial outbreak stage in March-May 2020 and the COVID case surge in November-December 2020. Since spring 2021 and before the war started, strong goods exports and tourism growth, global vaccination progress, and NBG policy interest rate increases were followed by appreciation of the lari: the NEER appreciated by 22.4 percent from April 2021 to January 2022, and the REER appreciated by 18.1 percent during the same period. The war in Ukraine which started in late February 2022 halted this appreciation trend and led to a sharp temporary



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

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

weakening against the USD. However, as of end-March 2022, the lari has nearly recovered to its pre-war level against the USD and it has remained broadly stable in nominal effective terms.

6. The CA and the REER Index approaches suggest a slightly positive CA gap in 2021. The CA approach of the IMF's EBA-lite methodology compares a cyclically adjusted value of the CA deficit in 2021 to a CA norm predicted by the regression model. The cyclical adjustment largely reflects the temporary impact of the pandemic on tourism (2.9 percent of GDP), in line with the updated EBA-lite template[3] as well as other cyclical considerations. The cyclically adjusted current account balance is 0.6 percent higher than the CA norm in 2021, compared with a negative gap of 1.0 percent of GDP in 2020. A positive CA gap of 0.6 percent of GDP corresponds to REER undervaluation of 1.5 percent. Economic fundamentals play a larger role in driving the CA gap compared to policy gaps (policy gaps account for 0.3 percent of GDP out of the total CA gap of 0.6 percent of GDP).[4] Furthermore, the REER Index approach suggests a similar positive CA gap of 1.2 percent of GDP and a corresponding REER undervaluation of 3.3 percent.[5] Therefore, given the small CA gaps, Georgia's external position in 2021 is assessed to be broadly in line with the level implied by fundamentals and desirable policies. However, given the caveats of both approaches and pandemic uncertainty, these results should be interpreted with greater caution than usual, and the authorities are still advised to sustain their reform agenda to enhance external competitiveness and raise net private savings.

Text Table AIV. 1. Georgia: EBA Model Estimates for 2021

(in Percent of GDP)

	CA model	REER model
CA-Actual	**-9.8**	
Cyclical contributions (from model) (-)	-1.2	
COVID-19 adjustor (+) 1/	2.9	
Natural disasters and conflicts (-)	-0.1	
Adjusted CA	**-5.6**	
CA Norm (from model) 2/	**-6.2**	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	**-6.2**	
CA Gap	**0.6**	**1.2**
o/w Relative policy gap	0.3	
Elasticity	-0.37	
REER Gap (in percent)	**-1.5**	**-3.3**

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism (2.9 percent of GDP).
2/ Cyclically adjusted, including multilateral consistency adjustments.

Source: IMF staff calculations.

Capital and Financial Flows

7. The financial account surplus in 2021 moderated as exceptional donor support waned. The financial account surplus was at 11.3 percent of GDP in 2021 (Table 2 in the staff report), about

[3] The tourism adjustor accounts for medium-term scarring and is based on the comparison between the tourism revenue estimates/projections in 2020-2026 for Georgia in the current vintage and those in the January 2020 WEO, just before the pandemic. The tourism adjustor obtained using this method was 2.9 percent of GDP.

[4] The "policy gap" is the difference between the actual and desirable policy levels. There are five policy variables in the CA and REER index models: cyclically-adjusted fiscal balance (fiscal policy), change in reserves (FX intervention), private credit (financial policy), short-term interest rate (monetary policy), and capital controls. (*Methodological Note On EBA-lite*, IMF, February 2016, Paragraphs 12 and 24)

[5] Although the REER approach is generally less accurate than the CA approach, it may have greater merits for a tourism-dependent economy such as Georgia (*Methodological Note On EBA-lite*, IMF, February 2016, Paragraph 28).

1.3 percentage points lower than that in 2020 but still much higher than that in 2019 (by 5.2 percentage points). Although net loan inflows and net portfolio inflows were lower in 2021 than 2020, these were mainly offset by the SDR allocation (1.5 percent of GDP).

8. **Financial flows are expected to stabilize over the medium term.** The financial account surplus is projected to be around 8 percent of GDP over the medium term. In the aftermath of the COVID-19 shock, portfolio inflows are expected to stabilize over the medium term. As the Georgian and global economies recover from the impacts of COVID-19 and the war in Ukraine, FDI flows (net) are projected to gradually increase and stabilize around 6 percent of GDP. Net external loan inflows (including public and private loans) are expected to gradually decrease from their peak in 2021, as COVID-related external borrowing falls. Over the medium term, the bulk of Georgian debt is expected to be to IFIs and mostly on concessional terms. In terms of maturity, the external debt is also expected to remain largely medium- and long-term.

Reserves

9. **Gross international reserves (GIR) reached 107.7 percent of the ARA metric at the end of 2021.** Despite moderately lower program and project loans and grants, net international reserves (NIR) stood at $1,725 million (at program exchange rates, including the SDR allocation) and GIR at $4,272 million (at market exchange rates) by end-2021.

10. **In 2022, GIR are expected to decrease significantly in terms of the ARA metric.** The sharp decrease in COVID-related donor financing (partially reflecting the government's strategic priority of developing local capital markets as opposed to relying on external financing), as well as lower remittances and a slower recovery in tourism in 2022 due to the war, would lead to a significant decrease in GIR relative to 2021. Staff project GIR coverage to be 79.4 percent of the ARA metric in the baseline scenario, 74.7 percent by end-2024, and to gradually increase to 98.0 percent by end-2027.

Overall Assessment

11. **In conclusion, Georgia's external position in 2021 is assessed to be broadly in line with fundamentals and desirable policies**. External vulnerabilities are assessed to decrease relative to 2020. However, external vulnerabilities remain relatively high with the large decline in remittances caused by the war, the protracted recovery in tourism, a gradually narrowing CA deficit, and a large negative NIIP. Hence, strong and prudent macroeconomic policies are needed to maintain and strengthen external sustainability over the medium term.

Appendix I. Letter of Intent

Tbilisi, May 27, 2022

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

Dear Ms. Georgieva:

1. **The ongoing war in Ukraine and related sanctions have added to the challenges facing the Georgian economy.** The duration and ultimate consequences of this crisis are highly uncertain, but it is expected to lead to lower growth, higher inflation, and a higher current account deficit than previously anticipated. At the same time, although the number of COVID-19 cases has declined dramatically as the Omicron wave has receded, we recognize that the ongoing pandemic may also threaten the recovery. We are ready to continue our investment in the public healthcare system and, if necessary, will implement additional measures to control the pandemic. These challenges require concerted efforts to maintain macroeconomic stability while strengthening growth, making it more inclusive, and diversifying its sources.

2. **The new geopolitical turmoil threatens the impressive recovery that began in 2021 and adds to unwelcome inflation pressures.** The Georgian economy grew 10.4 percent in 2021, much higher than the 3.5 percent we expected at the conclusion of the previous EFF arrangement. We expect that the crisis will reduce our growth in 2022 from close to the 6 percent we anticipated previously to 3.2 percent now. Inflation remains high, reaching an average of 9.6 percent in 2021 (y-o-y), much higher than our 3 percent target, and 12.8 percent (y-o-y) in April 2022. Much of this inflation reflects rising commodity prices and transportation costs that are increasing inflation everywhere in the world and are expected to continue to increase. We recognize, however, that such levels pose a risk to stable inflation expectations. A weaker external environment is expected to widen the current account deficit in 2022 to 10.9 percent of GDP, somewhat lower than the 2020 level but much higher than the historically low level of 5.5 percent of GDP achieved in 2019.

3. **We are focusing our economic policy agenda on maintaining macroeconomic stability and strengthening medium-term growth potential.** On the fiscal policy front, we have passed a budget for 2022 that is focused on making progress toward compliance with our fiscal rule and restoring fiscal buffers, and will work to strengthen public finance management, and mitigate fiscal risks, notably by enhancing the governance of state-owned enterprises. Monetary policy is focused on bringing inflation back to target and maintaining exchange rate flexibility. We have been working to implement the recommendations of the most recent Financial Sector Assessment Program to further strengthen the resilience of our financial system, which has remained robust to the COVID-19 shock and the spillovers from the war in Ukraine. By pursuing continued strong macroeconomic and financial sector policies, we will seek to achieve further progress on de-dollarization. Finally, we will

continue to pursue structural reforms, with an emphasis on liberalizing energy markets and increasing the quality of our education system.

4. To support our efforts, we are requesting a 36-month Stand-By arrangement (SBA) with a cumulative amount of SDR 210.4 million (100 percent of quota). We intend to treat the arrangement as precautionary and will only consider making purchases if our balance of payments deteriorates materially. The EFF arrangement that concluded in April 2021 helped safeguard macroeconomic stability and catalyzed significant donor assistance. We want to build on this success and use the SBA to send a strong signal of our commitment to macroeconomic policy discipline and structural reforms.

5. The attached Memorandum of Economic and Financial Policies (MEFP) provides comprehensive details of our reform agenda. Our program will be monitored through an inflation consultation clause (ICC), quantitative performance criteria (QPC) and indicative targets (IT) with end-June and end-December test dates. Consistent with our reform agenda, our program also envisages structural benchmarks (SBs). These are set out in Tables 1–3 of the MEFP (Attachment I) and defined in the attached Technical Memorandum of Understanding (TMU, Attachment II). The first review will be based on end-June 2022 performance criteria and would take place on or after October 3, 2022. We will monitor progress continuously, and stand ready to take further measures if needed to reach our objectives. We will continue to consult with the IMF staff on the adoption of measures, and in advance of any revisions to policies included in this letter of intent (LOI) in accordance with the IMF's policies on such consultations. We will also provide the IMF staff with the information for monitoring program implementation. We authorize the IMF to publish this LOI and its attachments, and the related staff report.

Very truly yours,

/s/

Koba Gvenetadze
Governor of the National Bank of Georgia

/s/
Levan Davitashvili
Vice Prime Minister, Minister of Economy and Sustainable Development

/s/
Lasha Khutsishvili
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 outlines 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 the war in Ukraine, and over the medium term.

Macroeconomic Framework

2. A strong economic recovery has been underway in Georgia. After contracting by 6.8 percent in 2020, the economy rebounded strongly starting in the second quarter of 2021. Real GDP growth in 2021 was 10.4 percent, 2.7 percentage points higher than expected at the time of the 2021 Article IV and much higher compared to the expectations at the time of the last review of the EFF program. Growth is expected to decline this year to around 3 percent, as the war in Ukraine and sanctions are projected to depress external transfers, net exports, and investment. Conditional on a de-escalation of the war, the Georgian economy is expected to rebound in 2023, before easing to its medium-term growth rate of around 5 percent by 2024, driven by public investment in infrastructure projects and FDI. Achieving this growth will require advancing structural reforms to increase productivity and strengthen the role of the private sector.

3. Inflation accelerated significantly in 2021 and is expected to stay high this year. Inflation increased from 2.4 percent at end-2020 to 13.9 percent at end-2021, averaging 9.6 percent for the year. One-off factors are estimated to have contributed roughly 9 percentage points to headline inflation in December. These factors include the rise in global food prices, diversion of some domestically produced foods for exports, the impact of higher electricity costs for households, and the increase in international transportation costs. Due to further increases in global commodity and food prices related to the war in Ukraine, average inflation is expected to rise to 10.9 percent in 2022, in contrast to previous expectations of a significant decline. As global factors impacting inflation slowly dissipate, inflation is projected to begin converging toward its target around end-2023. While inflationary pressures have been high globally, the NBG is strongly committed to its inflation target. In order to keep inflation expectations firmly anchored, the NBG increased the policy rate by a cumulative 300 basis points since March 2021 and stands ready to increase the policy rate further if inflation expectations increase.

4. Macroeconomic policy discipline and prudent reserves' management should ensure adequate reserve coverage over the medium term. Despite the strong rebound in 2021, the current account deficit narrowed to 9.8 percent of GDP, reflecting the partial recovery in tourism revenues and strong growth in remittances. Financial inflows, however, declined, reflecting a lower need for donor disbursements than at the peak of the pandemic. Accordingly, gross international reserves (GIR) increased to 108 percent of the IMF's ARA metric at end-2021. Reflecting the still high current account deficit and lower donor support relative to the pandemic as well as the economic fallout of the war in Ukraine, reserves are projected to drop to close to 80 percent of the ARA metric by end-2022. Over the medium-term, however, we expect to accumulate reserves, supported by stronger FDI and a narrowing of the current account deficit, which is expected to fall below 6 percent of GDP by 2025.

5. Downside risks to the outlook stem in particular from a prolonged war in Ukraine and an intensification of sanctions on Russia. Since Russia is one of the major trading partners and sources of external inflows for Georgia, a prolonged war and further intensification of sanctions would worsen Georgia's external position, and the ensuing rise in import prices for food and energy would also add to already high inflationary pressures. Rising geopolitical tensions would not only dampen external demand—including tourism—it could also harm investment for longer. In addition, albeit subsiding, COVID-19 remains a risk and in the midst of a major regional conflict, a resurgence of COVID-19 cases could further strain the economy. Our first line of defense against these considerable risks is our continued commitment to exchange rate flexibility, sound macroeconomic and financial policies, and implementation of structural reforms.

Economic Policies

A. Fiscal Policy

6. We are committed to consolidating public finances in compliance with our fiscal rule and rebuilding fiscal buffers. As a result of the COVID-19 pandemic, the fiscal deficit widened to 9.4 percent of GDP in 2020. This reflected reduced revenues, record high VAT refunds which supported the private sector, high capital spending, and 3.8 percent of GDP in COVID-19 related healthcare costs as well as support to households and businesses. In 2021, a strong recovery helped narrow the deficit to 6.1 percent of GDP, with the budget still including 2.1 percent of GDP in healthcare costs and 1.3 percent of GDP in household and business support. Our fiscal rule requires us to bring the deficit below 3 percent of GDP by 2023. To leave room for countercyclical policies, we will gradually reduce the augmented general government deficit from 4.0 percent of GDP in 2022 to 2.8 percent of GDP in 2023 and 2.3 percent of GDP in 2024, while at the same time expanding the general government perimeter to include state-owned enterprises classified as general government units. Meeting these deficit targets in 2023-2024 will require additional measures (see ¶9), which we will adopt in consultation with IMF staff.

7. We have adopted a 2022 budget with a spending envelope consistent with the policies agreed for this program

- The adopted budget envisages total spending excluding interest payments of GEL 19,655 million. In the event of revenue overperformance relative to our adopted budget, we intend to save any windfalls to achieve additional deficit reduction, with the exception of small amounts to allow for targeted support for the vulnerable to cushion the impact of higher global prices (see below). Under higher expected nominal growth and revenues of around GEL 17.4 billion, this spending envelope is consistent with an augmented deficit of 4.0 percent of GDP, implying a contractionary stance in line with the economic recovery and high inflation. We stand ready to adopt additional measures, in consultation with IMF staff, including reductions in expenditures, if needed to meet an augmented deficit target of 4.0 percent of GDP.

- The budget phases out temporary fiscal support measures in response to COVID-19 while allowing for essential healthcare expenditure and elevated capital spending to finance ongoing investment projects of strategic national importance (e.g., major highway corridors). To narrow the growing gap with private sector salaries, we introduced a 10 percent increase in the basic public sector salary (from GEL 1,000 to 1,100) in January 2022, in line with the law for civil service servant remuneration adopted in 2017. We are working on developing an indexation rule for salary increases to avoid discretionary increases going forward.

- To shield vulnerable low-income consumers from the sharp rise in global commodity prices, we will amend the budget to increase ongoing targeted support to qualifying families with children and provide one-off fertilizer vouchers to qualifying subsistence farmers (both measures total about 0.2 percent of GDP in 2022). We are committed to the end-June 2022 augmented cash deficit of the general government of GEL 1,370 million (**performance criterion**) and we will strive to keep primary current spending below GEL 7,030 million (**indicative target**).

8. We are committed to reducing general government debt to 45 percent of GDP in the medium term and increasing the share of local currency-denominated debt. A sharp increase in general government debt in 2020 (reflecting the pandemic impacts, associated exchange rate depreciation, and an accumulation of government deposits to guard against downside risks) brought the debt-to-GDP ratio to the 60 percent ceiling specified in our fiscal rule. We have successfully reduced the debt-to-GDP ratio to 50 percent as of 2021 and are committed to keeping debt comfortably below the fiscal rule requirements. We project the debt-to-GDP ratio to decline sustainably below 50 percent of GDP in 2024, supported by fiscal adjustment and economic growth. Our public debt management draft strategy for 2022-25, published in November 2021, outlines measures to deepen the local capital market and increase the share of local currency debt from 20 percent in 2021 to 28 percent in 2025, thereby reducing debt vulnerabilities due to exchange rate risks. We published our 2022 domestic debt issuance calendar in December 2021, including a schedule for issuance of benchmark bonds.

9. We are committed to mobilizing additional revenues to support deficit reduction while making space for priority spending in the medium term. Our program objectives imply higher education, health, and infrastructure spending (including to enhance energy independence), which would require creating additional fiscal space within the current spending envelope and/or mobilizing revenues.

- **Expenditure-reducing measures:** Despite phasing out all temporary COVID-19 fiscal support to households and businesses, primary current spending in 2022 is expected to be 0.5 percent of GDP higher than in 2019, driven largely by an increased pension bill (0.6 percent of GDP, due to introduction of the pension indexation rule and Pillar II) and COVID-19 healthcare spending (0.7 percent of GDP). To create room for these current spending pressures, we have introduced cuts in goods and services and the wage bill relative to pre-pandemic levels (0.3 percent of GDP each). In the medium term, we believe further savings can be achieved by improving the efficiency of public healthcare provision, greater targeting of social programs in municipalities, and strengthening SOE performance through comprehensive SOE reform (MEFP ¶10). Infrastructure projects in the pipeline could also be delayed if needed to meet deficit targets.
- **Revenue-enhancing measures:** Tax revenues-to-GDP have fallen during the pandemic; we will implement measures to increase tax revenues-to-GDP to achieve our medium-term deficit targets, while making room for priority spending. Previous estimates suggest that efficiency improvements in tax administration (MEFP ¶12), streamlining tax expenditures (MEFP ¶13), and other measures (e.g., modernizing property taxes) could yield significant revenues by 2024. Expected yield estimates will be refined with IMF technical assistance (TA).

10. We remain committed to reducing fiscal risks. In particular:

- **We will limit risks from power purchase agreements (PPAs) and will expand Georgia's power generation capacity in a fiscally sustainable manner.** Reducing our reliance on electricity imports requires continued investment into new generation in an efficient way, and the importance of energy security and independence has increased in the wake of recent geopolitical tensions, but any public sector involvement must limit fiscal risks and safeguard medium-term debt sustainability. To ensure technology neutrality and limit fiscal risks, we have amended Government Decree 403 to specify that not only hydropower energy generation, but also other renewable projects are to be promoted through feed-in premiums. We also intend to develop a complementary support scheme for renewable power generation that limits fiscal risks and on which we will consult IMF staff (**end-July 2022 SB**). Until the new scheme is in place, we will refrain from initiating new PPAs and other forms of government support for renewable power projects. To reduce potential fiscal risks and promote efficiency, among other elements, the complementary scheme will operate until the liberalized wholesale electricity market can enable projects to be developed under the feed-in premium scheme, will support a limited annual and cumulative volume of new projects, and will seek to award projects based on competitive bidding and reduce potential fiscal risks from unsolicited proposals. Fiscal risks for projects supported by the new scheme will be assessed by the Ministry of Finance and these assessments will be shared with the IMF staff to analyze fiscal sustainability of energy investment. We will seek to terminate previously issued but non-operational PPAs that cannot be migrated to the new framework. We will consider the potential for other investments to further strengthen energy independence should fiscal space become available. Further, no energy generation investment projects will be initiated by the government without an independent technical evaluation that supports commercial viability.

- **We will strengthen public investment management (PIM) practices.** Given our ambitions to maintain elevated levels of infrastructure spending, ensuring high efficiency of public investment is especially important. To ensure selected projects are of high quality, we have included a mandate in the 2023 budget decree to subject all new public investment projects over GEL 5 million to the existing PIM framework and will not include any new investment projects over GEL 20 million in the 2023 state budget law, unless they are selected according to the PIM guidelines (**end-December 2022 SB**). To provide a durable legal foundation in this area, we will submit to Parliament an amendment to the budget code to make all investments above a threshold (to be identified with TA) subject to the PIM framework (**end-September 2022 SB**). To further strengthen the framework, we will develop a process for external independent review of large investments and undertake an updated Public Investment Management Assessment (PIMA) with the help of IMF TA (**end-March 2023 SB**).
- **We will avoid domestic/external debt payment arrears.** We will not (i) accumulate any general government 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.
- **We are committed to advancing SOE reform.** We have formulated and published a draft comprehensive reform strategy for SOEs that are defined as public corporations, supported by IMF TA that reflects best international practices.[1] Progress with corporatization will be key to increase profitability and the investment potential of SOEs in the medium term, thereby reducing on-lending and transfers from the budget. In line with this, on-lending to public corporations will take place only if the enterprise expresses its readiness to make reforms, and on-lending will stop for fully corporatized enterprises. Next steps in SOE reform will include:
    - We will finalize and adopt the public corporation reform strategy in agreement with the IMF staff and in line with OECD principles, including by ensuring clear separation between the state's shareholder and policymaking functions **(end-July 2022 SB)**. The strategy will reflect OECD principles and IMF TA recommendations to ensure that the governance of public corporations is transparent and accountable and complies with high-quality

[1] In its first stage of implementation, the strategy will be applied to the 24 public corporations that are public interest entities (PIEs) plus selected other SOEs that could realistically become public corporations in the near future. At a later stage, the strategy would be applied to the remaining 28 smaller public corporations.

corporate governance standards. The legal and regulatory framework for public corporations will provide a level playing field and fair competition in the marketplace.

- The reform strategy will strengthen the financial oversight functions, decision-making role, and effective enforcement mechanisms of the Ministry of Finance (MOF). Among other elements, we will ensure that the MOF will make the decisions on the financial governance of public corporations. MOF approval will be required for all key financial decisions (including financial plans, borrowing, setting of financial targets, and other aspects of financial governance, including financial accountability) as well as for public corporations' statements of corporate intent, which will define among other aspects, financial objectives (including key performance indicators, financial targets, and dividend policy), any transfers to or from the budget and quasi-fiscal activities, financial risk limits, and consequences if public corporations fail to achieve their objectives or comply with their risk limits or other obligations. We will also develop and implement additional enforcement mechanisms for the MOF's role.

- The ownership structure for public corporations in the final strategy adopted by the government will be defined in agreement with the IMF staff and will take into account the published draft strategy's call for ownership of public corporations to be centralized in the Ministry of Finance with a possible exception for either electricity generation or electricity transmission companies in order to comply with the EU directive on unbundling.[2] MOF ownership would help ensure that public corporations are profit-maximizing in-line with their commercial objectives and subject to effective financial oversight and control. To limit risks while the government strategy is being developed and until it is implemented, we will issue a government decree developed in consultation with IMF staff including TA experts to require MOF approval for key financial governance decisions (including large investments, borrowing, and dividend policy) and statements of corporate intent for major public corporations[3] **(prior action)**.

- We will issue a timebound plan to implement the SOE reform strategy, including to pilot it in three major SOEs[4] starting in 2022, to be selected in consultation with IMF staff (**end-August 2022 SB**).

- With the help of ADB TA, we have taken important steps to pilot the strategy in Georgian State Electrosystem (GSE), such as developing a corporate governance code and selecting an independent board, and will continue the reform momentum with further ADB TA. We

[2] If the MoESD remains the ownership entity for either electricity transmission or generation companies, additional measures will be taken to separate its ownership role from its policy/regulatory role in order to reduce the impact of the MoESD's potential conflict of interest.

[3] The major public corporations to be covered include GSE, Georgian Railway, Georgian Oil and Gas Corporation, Georgian Gas Transportation Company, United Airports of Georgia, and United Water Supply Company.

[4] The three pilot SOEs will be selected from among the following: Georgian Railway, Georgian Oil and Gas Corporation, Georgian Gas Transportation Company, United Airports of Georgia, or United Water Supply Company.

will determine the ultimate ownership of GSE by **end-July 2022 (SB)** (recognizing that the EU directive requires that GSE and power generation companies cannot have the same owner) and in any scenario will ensure the MoF's responsibility for financial governance in line with the prior action and strategy as discussed above.

- We will submit a draft framework law for public corporations to Parliament in accordance with the strategy approved by the Government of Georgia and in consultation with IMF staff (**end-December 2022 SB**).
- We will continue identification, analysis and disclosure of quasi-fiscal activities (QFAs). To help ensure competitive neutrality, we will elaborate mechanisms within the SOE legal framework to ensure that public corporations avoid engaging in implicit QFAs and that any QFAs are explicitly mandated by the government. On the other hand, the government will refrain from asking public corporations to engage in any new quasi-fiscal operations. We will introduce a transparent mechanism to identify and compensate public corporations for public service obligations (starting in reporting year 2023) in line with the SOE reform strategy.
- To foster competitive neutrality, we will ensure that SOEs do not enjoy competitive advantages with respect to private companies. They will face the same regulatory and other requirements as well as the same market conditions for debt and equity, and will not benefit from indirect financial support from the government.
- We also commit to enhancing corporate governance standards for SOEs classified as general government entities and will consider subjecting them to similar regulations as Legal Entities of Public Law (LEPLs). In 2022, we will implement efficiency-enhancing reforms formulated with the help of ADB TA in the SOE Georgian Amelioration, including approval and registration of a charter providing for establishment of an independent supervisory board and adopting basic principles of corporate governance as described in the corporate governance code of SOEs.

- **We will continue to enhance our monitoring of fiscal risks.** Our annual Fiscal Risk Statement (FRS) provides updated estimates of potential fiscal costs arising from our public-private partnerships (PPPs) including PPAs and those of SOEs, and will expand coverage over other areas of fiscal risks. Compared to previous years, the 2021 FRS included the finalized draft SOE reform strategy, a qualitative assessment of fiscal risks from climate change, and an expanded analysis of risks from PPAs that simulated the impact of another COVID-like shock in the future and individually disclosed risks stemming from the three largest PPA contracts. The 2022 FRS will include a quantitative assessment of fiscal risks from climate change and legal claims, and a long-term sustainability assessment for health and aging-related spending (**end-December 2022 SB**).
- **To help control fiscal risks, we will continue to curtail Partnership Fund operations.** As under the recent EFF, the Partnership Fund will not undertake any new investments or borrowing **(continuous performance criteria)**, and will not run a deficit **(performance**

criterion). The Partnership Fund will comply with future deadlines to submit its financial statements to the MOF, after sending its 2020 figures well past the 2021 deadline.

11. We are considering the scope for additional mechanisms to support SMEs while limiting governance risks. In consultation with IMF staff, we will explore whether there could be scope for minority government participation in private equity or venture capital investment funds focused on small and medium-sized enterprises, ideally alongside international financial institution co-investors. Any support for equity investment would be based on OECD corporate governance principles and, via legislative amendments, would ensure the government's minority shareholding function and passive participation (i.e., it would not be involved in selecting investment recipients). Conditions of government participation would also require an exit strategy and a specific time horizon for investment. Apart from possible minority participation in a private fund as described above,[5] the government will refrain from taking new equity stakes in private Georgian businesses or from establishing any institution that would seek to take such equity stakes. The Partnership Fund will not be involved in any way in government participation in private equity or venture capital investment funds.

B. Structural Fiscal Policies

12. We are strengthening our revenue administration to improve taxpayer services, establish better management and governance arrangements, and strengthen compliance. We completed a four-year tax administration reform program supported by the Revenue Mobilization Trust Fund in April 2021 and a Tax Administration Diagnostic Assessment led by the IMF in 2021 concluded that significant improvements in Georgia's revenue administration were made over 2016-2020. We are committed to further improvements to tax administration, including:

- **Compliance and audit yields.** We plan to enhance the use of risk-based audits to identify non-compliant cases that are likely to produce higher yields. We have been training staff in the Georgia Revenue Service (GRS) Audit Department to use the new audit case management system (CMS) since the system began to be piloted in February 2021. We are addressing technical issues, which have caused significant delays in making the audit case management system fully operational, and began to implement the CMS in January 2022. This will enhance compliance risk management, audit timeliness, and productivity.
- **Compliance improvement plan.** We will implement a compliance improvement plan (CIP) to address high-risk sectors from a holistic perspective. We have adopted a continuing process for annual tax compliance planning focusing on the largest compliance risks, based on IMF advice. We will enhance large taxpayer management, including through utilizing key performance indicators (KPIs).

[5] An additional potential exception relates to possible actions to preserve the viability of a company whose operations have been suspended due to international restrictions related to the Russia -Ukraine war on its majority owner (e.g., sale or transfer to the government of a small amount of shares sufficient to reduce the majority stake to a minority one and allow the company to resume operations).

- **Taxpayer register.** We are creating a register of employees for tax administration purposes. The new taxpayer register provides a strong basis for improving filing compliance and arrears management. We will take further steps to enforce compliance including auditing employer withholding taxes.
- **Automatic access to third-party information.** We have expanded the system of information-sharing with government agencies and the Financial Monitoring Service (FMS) for monitoring high-risk suspicious transactions and will expand the system further for monitoring all suspicious transactions, not only those considered to be high-risk. 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 December 2024, and we will explore scope for earlier action, recognizing that limiting the tax administration's access to data from financial institutions hinders the achievement of robust tax compliance risk management.
- **VAT refunds.** We will further step-up VAT refunds to help provide liquidity to the private sector and reduce our stock of unrefunded VAT credits. We reduced the outstanding stock of those VAT credits that are within the limitation period for audit from GEL1.4 billion at end-2017 to GEL1.0 billion at end-December 2021 and we commit to reducing the audited stock of VAT declarations cleared for payments (so-called "green credits") to no more than GEL 50 million (**end-December 2022 SB**). We also implemented an automatic refund system of VAT credits in November 2020, which accelerated the pace of new VAT refunds. Under this new system, we commit to automatically process (refund, offset, or permanently disallow) at least 90 percent of VAT credit claims (measured as both the number and value of declarations) within 30 calendar days and we will produce statistics on a monthly basis that monitor compliance with this measure (**end-July 2022** (for June 2022) **and end-January 2023 SBs** (for July-December 2022)).

13. We will begin work on mobilizing revenue within Georgia's existing tax framework.[6] There is significant potential to mobilize revenues by expanding the tax base:

- **Tax expenditures.** Although some tax expenditures are intended to boost investment and make growth more inclusive, they often turn out to be regressive and ineffective in stimulating growth. Moreover, their cost to the budget is often not known. As a first step to improving transparency and identifying the scope for streamlining tax expenditures, we have assessed VAT and income tax expenditures, with TA from the IMF and USAID respectively, which quantified the fiscal cost of tax expenditures at close to 6 percent of GDP, and disclosed selected VAT expenditures as part of the 2021 budget documentation. Since the government is a large consumer in sectors with tax expenditures, the net impact of streamlining tax expenditures (and substituting them with more targeted government

[6] Georgia's Economic Liberty Act (ELA), adopted in 2011, limits the ability of the government to increase taxes (a referendum is required for any introduction of new state taxes or increase in the top tax rate, except for excise taxes, for longer than three years).

programs), is expected to be significantly lower. We will submit to Parliament budget code amendments to authorize the requirement for tax expenditure reporting including the nature of tax expenditures and their costs, and establish a schedule for annual tax expenditure reporting (**end-September 2022 SB**), and publish a first tax expenditure report, including the nature of existing tax expenditures and their costs (**end-December 2022 SB**). We will draw on analysis from the report to achieve greater efficiency in tax expenditures in future budgets. We will complete a tax expenditure evaluation for VAT and income taxes including cost-benefit analysis for key tax expenditure items (**end-June 2023 SB**).

- **Property taxes.** We will modernize Georgia's property tax system by introducing a more centralized and comprehensive valuation process, for example based on satellite technology to make it simpler and fairer (declarations currently rely on self-assessment). We will consider changing the property tax so that only properties with a value above a certain threshold are taxed to protect the poor.[7]
- **Medium-term revenue strategy (MTRS).** We will also develop an MTRS with the help of IMF TA (**end-September 2023 SB**) to identify options for revenue mobilization, while promoting tax efficiency and progressivity.

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

- Making the coverage of general government (GG) consistent with the classification of SOEs into general government units (GG SOEs) and public corporations. In general, treatment for GG SOEs should be the same as any general government unit. In 2022, we will incorporate data from GG SOEs in our fiscal reports for 2021 actual data, and we will create automated mechanisms to have timely access to information in GFS reporting format starting in 2023, including by possibly transferring bank accounts of major SOEs to the Treasury account. We have compiled SOE data for the reporting year 2019 according to GFSM 2014. Any newly identified SOEs will be classified as general government entities until there is sufficient evidence to classify them as part of the public corporation sector.
- Improving the quality of fiscal reports and complying with international accounting standards. In our efforts to improve fiscal transparency, we consolidated the central government sector financial reporting based on International Public Sector Accounting Standards (IPSAS) for the first time in 2021. We will publish the 2022 consolidated financial statements for the central government based on IPSAS and consistent with FAD advice (**end-June 2023 SB**).

C. Monetary Policy

15. We are committed to our inflation targeting (IT) framework to maintain price stability. Our monetary policy decisions will continue to depend on the inflation outlook. We

[7] Currently households with income below GEL 40,000 are exempt, which protects foreigners who receive little income in Georgia.

recognize the risk that transient inflation developments become entrenched in inflation expectations or that another external shock such as the one Georgia is experiencing now could trigger another round of lari depreciation and inflationary pressure, and increase inflation expectations persistently. We stand ready to tighten rates further to avoid this risk.

16. We will maintain a flexible exchange rate regime to protect the economy against external shocks, while preventing disorderly market conditions. The floating exchange rate regime continues to work well as a shock absorber, but disorderly exchange rate adjustments could become disruptive to financial stability as Georgia remains a highly dollarized economy, even after progress in recent years. Our commitment to exchange rate flexibility has been evident in that we have consistently met our targets on net international reserves (NIR) under the previous EFF arrangement with comfortable margins, and we will continue to use reserves only to avoid disorderly market conditions. In the aftermath of the COVID-19 shock and in response to the new geopolitical crisis, we have largely 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, rule-based FX sales triggered by the volatility of the exchange rate and the need for FX market liquidity.

17. To avoid disorderly market conditions during the pandemic, we began selling foreign exchange to public corporation SOEs through the Treasury. Occasionally public corporations need to purchase large amounts of foreign currency in a short period of time. Their purchases far exceed daily transaction volumes on the FX market and may cause unwarranted exchange rate fluctuations due to limited liquidity. Given the uncertainty from the pandemic, we have sought to minimize these risks by selling FX to public corporation SOEs through the Treasury. However, we also recognize that this risk needs to be balanced against the need to deepen the foreign exchange market in Georgia. Accordingly, and assuming pandemic and geopolitical volatility recedes, the Treasury will phase out such sales in 2023.

18. Over the medium term, we remain committed to maintaining adequate reserves, and strengthening the NBG’s communications especially regarding foreign exchange reserve management. Our current balance of payments projections imply that the ratio of gross international reserves to the IMF reserve adequacy metric (ARA) is expected to decrease by about 5 percentage points between 2022 and 2024, reflecting the negative impact of the back-to-back shocks of the war in Ukraine and the pandemic including a difficult external environment, as well as reduced external borrowing by the government. Over the medium term, we expect our reserve coverage to improve gradually and reach about 98 percent of the ARA metric by 2027. We are committed to rebuilding our external buffers faster, consistent with exchange rate flexibility, and if market conditions allow. Our intervention strategy will remain guided by reserve adequacy and price stability goals, with reserve accumulation objectives suspended at times when markets become disorderly. We will update the NBG communication strategy including by specifying objectives for and introducing regular impact assessments of NBG communications **(end-December 2022 SB)**. We will strengthen communications about FX reserves management by announcing the goals and intermediate objectives of our FX intervention strategy.

D. Financial Sector Policy

19. Our prompt actions at the onset of the COVID-19 crisis successfully stabilized the financial system and we are committed to take all necessary steps to maintain adequate capital and liquidity buffers at banks. In response to the COVID-19 shock, in 2020 we completed a targeted loan quality assessment and stress tests, which resulted in additional *ex ante* general and specific provisions. We required banks to preserve capital to strengthen loss absorption capacity. We are committed to undertaking similar measures if warranted by conditions, including in light of rapid credit growth and the war in Ukraine. Furthermore, we continue to monitor developments in non-performing loans (NPLs) and restructured loans, and will ensure that banks promptly account for expected losses through provisioning and write-downs.

20. In light of sanctions against VTB and its subsidiaries, we took prompt actions to successfully restructure the operations of VTB Bank Georgia without impact on banking system stability. When VTB Bank Georgia experienced a significant withdrawal of customers deposits, the NBG facilitated several transactions to restructure VTB's balance sheet. Namely, Basis Bank purchased the retail loan and deposit portfolio, and Liberty Bank bought part of the loans and deposits of the corporate (SME) sector.

21. In line with FSAP advice, we have continued to calibrate our macroprudential toolkit to better deal with risks to financial stability from the high pace of credit growth and borrowers' unhedged FX exposures. We have reduced the maximum maturity of FX mortgages from 15 years to 10 years and recalibrated the currency-induced credit risk buffer (CICR) so that it varies between 40 and 100 percent based on a bank's loan portfolio dollarization. Banks will be given one year to adjust to the new CICR buffer. Consistent with the FSAP recommendations we have recalibrated some requirements of the Regulation on Responsible Lending. We have increased the income threshold below which borrowers are subject to a 25 percent payment-to-income ratio (from GEL 1,000 to GEL 1,500) and required banks to subject variable interest rate loans to an additional 3 percentage point interest rate shock in assessing the borrower's capacity to repay. These measures will dampen over-indebtedness risks for households over time by moderating retail credit growth to a more sustainable level and further incentivize de-dollarization.

22. We will formalize and enhance governance of key internal processes for supervisory operations and decisions. We plan to establish specific procedures across the entire supervisory cycle, from supervision planning to decision-making and communications with banks with respect to supervisory assessments, and to follow up on banks' actions to address issues raised. Following FSAP recommendations, we will **by end-June 2022 (SB)**: (i) develop an internal procedure for the General Risk Assessment Program (GRAPE) which will specify the entire assessment process in detail (including communication with banks' supervisory boards), the structural units involved, and terms and the decision-making processes; and (ii) update the GRAPE guidelines that will largely enhance the transparency and compliance of the assessment process with advanced international practices. We will also routinely contact external auditors to discuss findings and risk analysis.

23. We will continue to strengthen our bank recovery and resolution framework. Banks have submitted their first recovery plans and the NBG has prepared its first resolution plans. We intend to develop internal procedures, which will encourage competitive bidding for the sale of business resolution tool and will support execution of the bail-in tool. In line with the recommendations of IMF TA the MOF in cooperation with NBG will develop a playbook to make the bridge bank tool operational **(end-March 2023 SB)**. This playbook will address matters such as establishment, governance, capitalization and financing, operation and eventual sale of the bridge bank. We will also amend the Banking Law to update and simplify the creditor hierarchy by adopting a simplified tiered structure that is consistent with deposit insurance coverage.

24. We will further strengthen the prompt corrective action framework. To ensure timely recognition of risks, we will: (i) amend the Recovery Planning Rule to require that thresholds for triggering management escalation are set appropriately relative to minimum prudential regulatory requirements; (ii) develop policy guidance **(end-December 2022, SB)** to ensure that timely action, including the initiation of license revocation or alternative failure resolution action, is taken promptly in response to financial deterioration in any bank. Furthermore, we will continuously monitor and evaluate banks' recovery plans and compliance with indicators.

25. We will fully implement large exposure limits by 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). The definition of connected parties and the use of supervisory discretion will be in line with international standards. Temporary postponement of the implementation will expire by June 2022. From January 2022, banks should refrain from creating any new exposures that breach this limit. We will regularly collect additional information from banks about the financial situation of large borrowers and monitor portfolio concentration risk.

26. We will continue to monitor shadow lending practices (sale and leaseback). We will continue to identify, monitor, and assess the impact of certain shadow lending practices on financial stability. We will initiate legislation as needed to close potential leakages from macroprudential tools to entities outside of the NBG's perimeter of regulatory coverage.

27. We will refine data collection to strengthen assessment of systemic risk, enhance calibration of macroprudential tools, and improve macroprudential decision making. Data collection will be strengthened by signing memorandums of understanding between the NBG, the Georgia Revenue Service, and the Public Registry to establish formal procedures for data exchanges. The data collection and subsequent publication will include inter alia granular real estate price and transactions data (e.g., by city/region, property types including commercial real estate coverage, number of transactions, rental rates, ownership of secondary homes, land prices, and building permits issued). The credit registry will be another source of data collection, including detailed data on loans, interest rates, and borrower information such as income. We will also develop additional data fields for assessment of new types of risks such as climate. We will publish an assessment of climate-related financial sector risks **(end-December 2022 SB)**.

28. We have almost completed the adoption of International Financial Reporting Standards (IFRS). Since 2021, commercial banks have been allowed to voluntarily start preparing their financial statements according to IFRS. We have specified the guidelines to standardize reporting for expected losses and calibrated capital requirements so that they remain unchanged as a result of the transition to IFRS. By 2022, banks will be required to submit their statements under both the current standards and IFRS. This will make banks' financial reports more comparable internationally and allow us to strengthen our supervisory capacity by updating provisioning standards and drawing on audited reports. Any reduction in provisioning due to the transition to IFRS9, which is less conservative than local provisioning standards, will be reflected in additional capital requirements, so that the IFRS transition has no net impact on the overall capital position of the banking system.

29. We will facilitate better functioning of payment systems and competition among payment services providers. Though the Law of Georgia on "Payment Systems and Payment Services" is substantially compliant with the revised Payment Services Directive (PSD2) of the EU, the NBG will propose further amendments to the law to increase the security of cashless payments, competition among providers, and consumer protection. To increase competition, the law will enable regulated third-party providers to acquire access to users' data at commercial banks subject to users' consent. This will enable innovations and more competition, including among licensed financial technology providers, to offer their services directly to clients. The NBG will also foster development of common industry-specific technical standards for open banking.

30. In order to increase financial inclusion, we have prepared legislation establishing a new class of regulated banks – "micro-banks". The micro-bank, which will fill the existing gap between commercial banks and microfinance organizations, will be a new financial institution with a medium-size, stable business model and high reputation in the financial sector. It will be focused on lending for entrepreneurial and agricultural activities. The NBG will define the business model and size of the micro-bank and will set a minimum amount of regulatory capital of 10 million GEL, a maximum loan limit of 1 million GEL, capital adequacy, credit and liquidity ratios, and other prudential limits and standards. A few microfinance organizations are expected to become micro-banks upon approval of legislation which will increase the competitiveness of lending for SMEs and improve financial inclusion for underserved clients, especially in the regions.

31. We will continue with our agenda for capital market development. After Parliament's adoption of legislation on investment funds and amendments to the securities' market law, the NBG has fully updated the capital market regulatory framework, notably concerning the Pension Agency. The draft law on dematerialized securities holdings has been submitted to the Parliament and is expected to be adopted by end-December 2022. This law will strengthen the foundation for the securities market, allow for centralized issuance of public securities with a central securities depository and improve investor protection. In 2021 NBG became a regular member and MoU signatory of the International Organization of Securities Commissions. Covered bond legislation has been submitted to Parliament for approval. In 2022, we plan to initiate securitization legislation. Both frameworks will provide liquidity management and improved long-term funding mechanisms for financial institutions, which will help further develop the fixed-income market. We have introduced a corporate governance code for listed entities.

32. We will continue to strengthen our AML/CFT framework. We are designing regulations on virtual asset providers in line with IMF TA recommendations. We will strengthen regulation and supervision for the gaming sector, virtual asset service providers, and real estate agents in line with FATF recommendations and according to recommended actions underlined in the MONEYVAL fifth round mutual evaluation report of Georgia. Furthermore, we will consider issuing guidelines to strengthen due diligence measures on cash transactions by financial institutions and/or setting maximum cash thresholds for certain transactions for: (i) the use of financial institutions by trading companies to purchase goods in foreign currency; and (ii) the use of cash in real estate transactions. We will also strengthen the analysis of suspicious transactions reported by banks by increasing supervisory attention and issuing additional guidelines. We have mandated and will monitor that the financial sector complies with international sanctions, including sanctions imposed as a result of the war in Ukraine.

33. We will review the framework for decision-making, oversight, transparency, internal controls, and accountability for key monetary and financial sector policies. This includes, inter alia, assessing the advantages of collegial versus presidential decision-making practices for monetary and financial sector policies against increased responsibilities of the NBG and the dynamic development of the financial system. We will ask for the Fund's TA in this area, benchmarked against international best practices, and will consult with Fund staff before suggesting possible changes to the Organic Law on the NBG, if need be. We will also clarify the roles and responsibilities of the NBG board regarding financial supervision activities, in line with FSAP recommendations.

34. We have approved a Code of Ethics for debt collection by financial institutions, based on best international practices. The enactment of the code will help strengthen the reputation of financial institutions as trusted partners in the eyes of consumers, and protect consumer rights and interests in the best way practicable, while ensuring that financial institutions conduct business relationships based on the principles of good faith, transparency and fairness. The Code introduces obligations of financial institutions vis-à-vis customers in the process of collecting debt. In addition, amendments to the Rule on Consumer Protection for Financial Organizations were introduced, which are based on the requirements of the European Directives and market challenges. The new requirements and changes are meant to achieve greater transparency in terms of financial products and improve the quality of consumer protection in the financial sector.

E. Structural Reforms

35. Decreasing the skills mismatch in the labor market will be key to reducing high unemployment in Georgia. While the unemployment rate declined between 2010 and 2019, it is still very high, and a significant share of the labor force is engaged in less productive sectors of the economy. To foster evidence-based labor market policies, we will conduct a labor market survey to monitor labor demand and skills needs (**end-June 2023 SB**). As the economy emerges from the fallout of the pandemic, such policies would play a key role in promoting a strong and inclusive recovery. To reduce skills mismatch in the labor market, vocational education and training (VET) programs are being strengthened, with the highest number of programs offered in the fields of engineering, manufacturing and construction, business administration and law, and information technology, communications and services. This is in line with the National Strategy 2019–2023 for Labor and Employment Policy of Georgia, which aims to increase human capital and promote job creation in high-productivity sectors of the economy.

36. We are committed to improving the quality of education and training, and the cost-effectiveness of education spending. Additional funding for the education sector over the medium term will be conditional on concrete steps to improve the quality of teachers and we will prioritize funding for the various education sub-systems (early and preschool education, general education, vocational education, and higher education) based on an assessment of marginal benefits at the different levels. At the general education level, we plan to develop a professional orientation system, improve the qualification of teachers, and develop a transition program from general education to the VET system, including for students with disabilities. We will also continue to work with businesses and development partners to strengthen VET. In June 2021, the Vocational Skills Agency was jointly established by the Ministry of Education and Science and the Georgian Chamber of Commerce and Industry. The agency will facilitate designing VET programs that reflect the needs of the labor market, while at the same time offering on-site training. To facilitate and encourage participation in VET programs, amongst other steps, the government amended the Law of Georgia on Military Obligation and Military Service (passed in September 2020 and effective in September 2021) to allow students engaged in vocational education to postpone their compulsory military service. We recognize that the number of students receiving vocational training has declined in recent years and concerted efforts will be needed to increase the enrollment of students, particularly those who are socially vulnerable, into VET programs.

37. Protecting the most vulnerable continues to be a key priority. We plan to conduct a comprehensive review of social protection measures and consider improvements, including policies to reduce the gender gap in the labor market. Following the goals set out in the National Strategy 2019–2023 for Labor and Employment Policy of Georgia, we have provided training to government staff to promote gender impact assessment in the policy-making process. Georgia is already a member of the Equal Pay International Coalition, which aims to achieve equal pay for women and men, and we have taken several steps (such as improved maternity benefits, daycare services) to reduce the gender gap. We have developed guidelines for labor inspectors to evaluate job-specific remuneration, and we intend to strengthen labor inspection services to monitor equal pay for women. In addition, we also plan to improve Targeted Social Assistance programs by digitalizing the service, which should reduce the time for initial disbursement from roughly 12 to 6 weeks.

38. We will continue to improve the business environment, including for foreign direct investment (FDI). We are making substantial advances on core infrastructure investments, including major highway corridors which will better integrate regions within the country, facilitate exports, and support the establishment of Georgia as a transport and logistics hub connecting Europe with Asia. We also strive to improve our connectivity with countries along the Black Sea. In this regard, we plan on conducting an updated feasibility study with possible support from the EU for the development of ferry and container services between the ports of Georgia, Bulgaria, Romania, and Ukraine. In addition, we are actively working to improve the information technology (IT) infrastructure and develop human capital in IT to meet the demand for digitalization from both the private and public sectors, with special priority for the digitalization of SMEs. To improve corporate governance, corporations will gradually be required to publish audited financial statements based on IFRS standards. The recently approved insolvency law is being operationalized to improve the efficiency of insolvency procedures, with the training and licensing of insolvency practitioners gaining pace.

39. We are committed to deepening trade relations, which would support economic diversification. We will continue to liberalize trade and have ongoing discussions with several countries (Republic of Korea, Israel, India, the UAE and other GCC countries) to launch negotiations on free trade agreements (FTAs). Discussions are ongoing with Turkey to expand the existing FTA that covers trade in goods to also include trade in services. We are committed to pursuing an FTA with the United States. Relatedly, we are also working towards improving labor migration management, strengthening legal labor immigration, and developing a bilateral contractual basis for emigration and temporary employment abroad (circular migration).

F. Program Monitoring and Safeguards

40. The program will be monitored through quantitative performance criteria, indicative targets, an inflation consultation clause, and structural benchmarks. The inflation consultation clause targets and bands are shown in Table 1, quantitative performance criteria and indicative targets for end-June and end-December 2022 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. We will complete an updated IMF Safeguards Assessment before the first review of the program. As required by the safeguard policy, we continue to engage independent external audit firms to conduct audits of the NBG in accordance with international standards.

Table 1. Inflation Consultation Targets and Bands for 2022

	End June	End Dec.
Inflation Consultation Bands for CPI (in percent)		
Central point	11.8	8.1
Inner band, upper limit/lower limit	13.8 / 9.8	10.1 / 6.1
Outer band, upper limit/lower limit	14.8 / 8.8	11.1 / 5.1

Source: IMF staff estimates

Table 2. Quantitative Performance Criteria and Indicative Targets for end-June and end-December 2022

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

	End-June	End-December
Performance Criteria		
Ceiling on the augmented cash deficit of the general government (program definition)	1,370	2,740
Ceiling on general government net budget lending	30	75
Floor on NIR of NBG 1/ (end-period stock, million of U.S. dollars)	1,204	840
Ceiling on the accumulation of external debt arrears of the general government (continuous criterion) (million of U.S. dollars)	0	0
Ceiling on new public guarantees (continuous criterion)	0	0
Ceiling on the cash deficit of the Partnership Fund (million of U.S. dollars)	0	0
Ceiling on new investments by the Partnership Fund (continuous criterion)	0	0
Ceiling on the new net borrowing of the Partnership Fund (million of U.S. dollars, cumulative from the beginning of the program, continuous criterion)	0	0
Indicative Targets		
Ceiling on the accumulation of net domestic expenditure arrears of the general government	0	0
Ceiling on primary current expenditures of the general government	7,030	14,210

/1 The NIR target is proposed using a constant USD/EUR exchange rate on March 15, 2022 (1.09875)

Table 3. Prior Action and Structural Benchmarks

Action /1	Proposed Date
Prior Action	
Fiscal	
Fiscal Risks	
Issue a government decree, in consultation with the IMF staff, to require Ministry of Finance approval for key financial governance decisions and statements of corporate intent for major public corporations	Prior Action
Structural Benchmarks	
Fiscal	
Fiscal and Tax Policy	
Submit budget code amendments to authorize the requirement for tax expenditure reporting including the nature of tax expenditures and their costs and establish a schedule for annual tax expenditure reporting	End-September 2022
Publish first tax expenditure report including the nature of existing tax expenditures and their costs	End-December 2022
Complete a tax expenditure evaluation for VAT and income taxes including cost-benefit analysis for key tax expenditure items	End-June 2023
Develop a medium-term revenue strategy supported by IMF TA	End-September 2023
Public Financial Management	
Develop a complementary support scheme for renewable power generation that limits fiscal risks in consultation with the IMF staff	End-July 2022
Submit to Parliament an amendment to the budget code to make all investments above a threshold (to be identified with IMF TA) subject to the PIM framework	End-September 2022
Require all investment project over GEL 20 million in the 2023 state budget law to be selected according to the PIM guidelines	End-December 2022
Undertake an updated Public Investment Management Assessment (supported by IMF TA)	End-March 2023
Fiscal Risks	
Finalize and adopt public corporation reform strategy in consultation with the IMF staff and in line with OECD principles, including by ensuring a clear separation between state shareholding and policymaking functions	End-July 2022
Determine the ultimate ownership of Georgian State Electrosystem	End-July 2022
Issue a timebound plan for the implementation of the SOE reform strategy, including to pilot it in three major SOEs starting in 2022, to be selected in consultation with the IMF staff	End-August 2022
Submit to Parliament a draft framework law for public corporations developed in consultation with IMF staff that is consistent with the strategy approved by the Government of Geogia	End-December 2022
Include in the 2022 Fiscal Risk Statement a quantification of fiscal risks from climate change and legal claims, and a long-term sustainability assessment for health and aging-related spending	End-December 2022
Publish the consolidated central government financial statements for 2022 based on IPSAS standard and consistent with IMF staff advice	End-June 2023
Tax Administration	
Automatically process (refund, offset, or permanently disallow) at least 90 percent of VAT credit claims (measured as both the number and value of declarations) within 30 calendar days and produce statistics on a monthly basis to monitor compliance	End-July 2022
Reduce the audited stock of VAT declarations cleared for payments to no more than GEL 50 million	End-December 2022
Automatically process (refund or offset) at least 90 percent of VAT credit claims (measured as both the number and value of declarations) within 30 calendar days and produce statistics on a monthly basis (for July through December 2022) to monitor compliance	End-January 2023
Monetary Policy and Financial Sector	
Communication	
Update NBG communication strategy including by specifying objectives and introducing regular impact assessments of NBG communications	End-December 2022
Financial Stability	
Develop policy guidance on corrective action framework for banks (see MEFP ¶24)	End-December 2022
Enhance governance of key internal processes for supervisory operations and decisions in line with FSAP recommendations (see MEFP ¶22)	End-June 2022
Develop a playbook to make the bridge bank tool operational.	End-March 2023
Publish an assessment of climate-related financial sector risks	End-December 2022
Structural Reform	
Conduct a labor market survey to monitor labor demand and skills needs	End-June 2023

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 Stand-By Arrangement (SBA) 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 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 March 15, 2022, published on the IMF web site https://www.imf.org/external/np/fin/data/rms_sdrv.aspx.

Table 1. Georgia: Program Exchange Rates

	Currency Name	US$ per Currency
SDR	Special Drawing Rights	1.37933
GEL	Georgian lari[1]	0.30939
EUR	Euro	1.09875
AUD	Australian dollar[2]	0.72440
CAD	Canadian dollar[2]	0.78371

1 Equivalently, 1 US$ = 3.23220 GEL.

2 Cross-calculations based on the NBG's daily official exchange rates are available at https://nbg.gov.ge/en/monetary-policy/currency.

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 continuous 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 continuous performance criterion (ceiling) on new investments by the Partnership Fund;
- a continuous performance criterion (ceiling) on new net borrowing by the Partnership Fund;
- an indicative target (ceiling) on new domestic expenditure arrears by the general government; and
- an indicative target (ceiling) on the primary current spending of the general government.

In addition, the program will include a consultation clause on the 12-month rate of inflation (Table 1, 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 2022 and end-December 2022 (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 expenses, 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, the 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 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).

13. 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).

14. 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 preventing the spread of COVID-19 and treating COVID-19 cases in excess of the originally planned amount (excluding vaccination costs) (Table 2) for up to GEL 200 million. The ceilings will be adjusted upward by 50 percent for any additional health spending above GEL 200 million (the remaining 50 percent should be met through cuts in other spending or increases in revenue). Activities included for the adjustor will exclude vaccination costs and are otherwise 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 #4 12.01.2022 "On Approving 2022 Healthcare Programs";
- Government Decree #47 01.02.2022 "On approving 2022 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)

	Jun. 30, 2022	**Dec. 31, 2022**
Healthcare costs related to prevent the COVID-19 spread and treating COVID-19 cases	350	500
Receipts from sale of non-financial assets	175	450
On-lent amounts from project loan disbursements	85	205

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 VAT credits submitted by taxpayers within 30 calendar days,
- Number and GEL value of VAT refunds paid under the Automatic VAT System (AVS) within 30 calendar days,
- Number and GEL value of VAT cash refunds paid automatically within 30 calendar days,
- Number and GEL value of VAT credits offset automatically within 30 calendar days,
- Number and GEL value of VAT credits permanently disallowed within 30 calendar days,
- Number and GEL value of VAT credits manually reviewed in less than 30 calendar days, and
- GEL value of the old stock of VAT credits.

15. **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

16. **Definition**: primary current expenditures are defined as expenses (as defined by GFSM 2001) on a cash basis, minus interest payments.

17. **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 expenses and net acquisition of non-financial assets of the general government should be reported to the IMF within four weeks after the end of the quarter.

Continuous Performance Criterion on Accumulation of General Government External Debt Arrears

18. **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.

19. **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]

20. **Supporting Material.** The accounting of non-reschedulable external arrears by creditor (if any), with detailed explanations, will be transmitted monthly, within two weeks of the end of each month.

Continuous Indicative Target on Accumulation of General Government Domestic Expenditure Arrears

21. **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

[1] Arrears to Turkmenistan.

become 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.

22. 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

23. 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).

24. 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

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

26. 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.

27. 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.

Continuous Ceiling on New Net Borrowing by the Partnership Fund

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

29. 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

30. 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.

31. 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

32. 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 (excluding the SDR allocations). **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) 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 and SDR allocations. 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 $1,725 million as of December 31, 2021 (at program exchange rates).

33. For program purposes, 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.

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

- Upward (downward) by any excess (shortfall) of privatization revenue in foreign exchange above (below) the programmed amounts (Table 3). 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]
(Millions of U.S. dollars)

	Jun. 30, 2022[2]	Dec. 31, 2022[2]
Projected privatization revenue	0.0	0.0
Budget support grants from external donors and not related to project financing	0.0	18.9
Budget support loans, including bilateral and multilateral donors for budget support	33.0	323.3
Project loans and grants	153.1	218.9

[1] Flows are valued at program exchange rates for all targets.
[2] Cumulative from January 1, 2022.

35. 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.

Statement by Mr. Rashkovan and Mr. Tsur on Georgia
June 15, 2022

The Georgian authorities thank staff for the dedicated and constructive engagement during the negotiation of the proposed program, and for a well-written report. The dialogue between staff and the authorities resulted in a clear diagnosis: with good institutions, credible fiscal and monetary policies, and proven commitment to reforms, Georgia has significant potential to maintain sustainable and inclusive growth. The Fund's precautionary SBA supports this development goal. At the same time, the recent shocks to the global economy, initially due to COVID-19, and followed by Russia's invasion of Ukraine, reiterate the importance of the authorities' formal commitment to sound macroeconomic policies to maintain fiscal, monetary, and financial stability, even at times of turbulent global conditions. ***The authorities see the suggested IMF program as a vehicle to continue and communicate their strong short- and long-term policies.***

<u>**The real macroeconomic outlook is positive despite slower growth and larger uncertainty**</u>

Growth at the start of 2022 is stronger than expected and reflected in the latest forecast, even with the gradually decreased monthly growth since February. The geopolitical turmoil threatens the impressive recovery and adds to unwelcome inflationary pressures. At the same time, average real GDP increased by 10.8 percent between January-April and grew in April by 2.6 percent YoY. Growth in this period continued in sectors that suffered most from the COVID-19 restrictions, such as the hospitality sector. The growing domestic demand led to favorable fiscal conditions. During January-April, Value Added Taxpayers' turnover increased significantly, with an 11.7 percent growth YoY.

Foreign demand recovered compared to the beginning of 2021, but external uncertainty is high. In January-April 2022, exports of goods increased by 33 percent YoY. Goods imports also increased against a background of activated domestic demand - by 34 percent YoY. In January-March, revenues from international travel increased approximately 7.4-fold YoY, though still subdued compared to the corresponding pre-pandemic period of 2019 (32 percent).

The positive developments at the beginning of the year are built on strong fundamentals owing to years of sound macroeconomic policies. The strong growth and the improved external sector position, especially in early 2022, illustrate that a broader and faster recovery of the economy during this year could be expected had the geopolitical shock not materialized. Given current events, forecast uncertainty is high and recent strong data on tourism and remittances are somewhat difficult to interpret.

The authorities are determined to use the forthcoming program to enhance the positive momentum even against the backdrop of uncertain and difficult global conditions.

<u>**The government is committed to fiscal stability, medium-term fiscal consolidation, and enhanced transparency.**</u>

The government is committed to rebuilding buffers to absorb possible shocks, especially at these uncertain times. Georgia's fiscal policy is consistent with the IMF's recent recommendation to the membership to limit fiscal support to start reducing debt as soon as possible. Therefore, government support to vulnerable households and subsistence farmers will be financed by windfall revenue and spending reprioritization. Despite the improved fiscal balance at the beginning of the year, the downward revision in the growth projections owing to Russia's invasion of Ukraine forced some adjustments in the government's fiscal plans to reduce the deficit from 6.1 in 2021 to 4 percent of GDP in 2022. All these actions reflect an appropriate contractionary fiscal stance when recovery and inflationary pressures continue.

Going forward, the authorities plan to reduce general government debt to 45 percent, approaching below 50 percent as early as 2024. They will gradually reduce the government deficit from 4.0 percent of GDP in 2022 to 2.8 and 2.3 percent of GDP in 2023 and 2024, respectively. This path is consistent with the government's intention to increase the room for larger capital spending to finance growth-enhancing capital spending and educational reforms. To support this, the government will deepen revenue mobilization by improving the tax administration and modernizing property tax, among others.

The government has taken various measures to safeguard fiscal stability in the medium- and long-term, in particular through reforming SOEs. The authorities are committed to ensuring clear separation between the state's shareholder and policymaking functions, with the Ministry of Finance approving all key financial decisions. The cabinet approved a decree formalizing this and therefore met the prior action. Previously, the government formulated and published a draft comprehensive reform strategy for SOEs, supported by IMF Technical Assistance (TA), and according to best international practices. On-lending to public corporations will take place only if the enterprise expresses its readiness to adopt this reform to increase profitability and the investment potential of SOEs. The Ministry of Finance will include SOEs classified as general government units in the general government perimeter to increase the transparency of budget management. The government will further reduce fiscal risks, taking several measures as detailed in the staff report.

The efforts of the Georgian authorities to increase fiscal transparency received recognition with the country being ranked first in the results of the Open Budget Survey released by the International Budget Partnership (IBP) for 2021. In recent years, various measures were implemented within the scope of a PFM reform, supported by IMF TA. These included improved midterm planning, the introduction of program budgeting, increased scope of accountability, the introduction of an electronic system of PFM, the publication of budget documentation, the development of citizen engagement guidelines, the design of a citizen participation mechanisms, and others.

<u>Monetary policy will keep a tightening stance until the risks of rising inflation expectations are sufficiently mitigated</u>

While inflationary processes were envisaged to stabilize in 2022, the Russian war against Ukraine created new pressures and risks. Elevated inflation and inflationary risks remain a recent global challenge. The invasion, the resultant sanctions, and supply-side disruptions have significantly increased prices on international markets. This global surge in prices transmitted to the Georgian market as well, and despite the moderation of price increases compared to the beginning of the year, inflation in Georgia remains high (13.3 percent in the last 12 months, including May).

The NBG forecasts that inflation will remain high in 2022 on average but will decline during the second half of 2022 and the first half of 2023 as one-off effects are phased-out and given that monetary policy remains tight. The NBG increased its policy rate by 3 percentage points in March 2021, and there are signs that this policy restrains inflationary pressures. The NBG assesses that there are no significant pressures on prices stemming from the labor market. While nominal wage growth recently accelerated, it is driven mostly by prominent productivity growth.

Developments in the external sector are central to monetary developments for a small, open, and still dollarized economy like Georgia. The recent appreciation of the lari supports a decrease in imported inflation, but the external sector outlook is still highly uncertain against the backdrop of Russia's actions and global monetary tightening. The floating exchange rate regime continues to work well as a shock absorber, but the NBG will prevent disorderly exchange rate movements that risk financial stability in a dollarized economy even after progress in recent years. As part of the commitment to increase reserves when conditions allow, the NBG purchased foreign exchange using an FX auction last month for the first time after more than two years. This purchase came after a volatile period due to the war in Ukraine that concluded with a stronger lari compared to the pre-war level

Despite monetary policy tightening, the growth in foreign currency loans is a challenge that the NBG faces given the still high dollarization in Georgia. Credit activity remains strong and the NBG has taken macroprudential measures to mitigate the financial risk steaming from dollar-denominated loans; these are becoming more attractive for borrowers as rounds of policy stance tightening made loans in the lari expensive. The NBG announced that it could introduce additional measures, including an increase in the upper bound of FX reserve requirements (currently at 25 percent) if reducing further growth in foreign currency (FX) loans is required.

<u>The authorities intend to further strengthen financial sector resilience through reforms along the lines of the 2021 FSAP recommendations</u>

The COVID-19 crisis, followed by the war in Ukraine, demonstrates the resilience of Georgia's economy against shocks. Despite the scale of these two crises, the NBG's monetary and macroprudential policy instruments served this resilience very well. The financial sector is sustainable, and the accumulated buffers helped the economy bolster these shocks, with fewer costs than in previous crises.

The Russian invasion of Ukraine and following sanctions led to specific financial difficulties that the Georgia authorities mitigated swiftly. Among others, the 4th largest bank in Georgia – the Georgian branch of VTB – experienced deposit withdrawals, and it became clear that action needed to be taken. The NBG communicated that the banking sector is strong and stable and that public deposits are secured. These prompt actions by the NBG proved that this is indeed the case, with VTBs assets and liabilities being transferred to other banks within days. Thanks to these actions the contagion risks have abated and the system functions properly.

The NBG mandated banks and all supervised entities to comply with the sanctions of the US, EU, and the UK from day one. They enhanced sanctions monitoring, including during their on-site inspections, and are currently increasing the capacity and resources of supervisory staff to monitor, assess and mitigate risks in this regard to ensure that the Georgian financial sector is not used for avoidance of financial sanctions against the Russian Federation.

The authorities continued calibrating their macroprudential toolkit to avoid risks to financial stability, in line with FSAP advice. The measures that the NBG has taken, such as reducing the maximum maturity of FX mortgages from 15 years to 10 years and strengthening some of the payment-to-income requirements, are meant to moderate retail credit growth to a more sustainable level and further incentivize de-dollarization. The NBG also started implementing the FSAP recommendations to formalize and improve the governance of key internal processes for supervisory operations and decisions. The NBG will codify its General Risk Assessment Program and update the guidelines for these assessments. They will further enhance financial safety nets, among others by enhancing crisis contingency plans for banks.

<u>Georgia's macro-structural reforms aim at achieving green, digital, and inclusive recovery</u>

The reform agenda is rich with measures to facilitate sustainable growth in the long run. The authorities plan to expand Georgia's renewable power generation capacity and reduce reliance on imported power, especially against the backdrop of recent geopolitical developments. The authorities are improving the information technology (IT) infrastructure to facilitate digitalization both in the private and public sectors. Additionally, substantial advances are made on core infrastructure investments, including major highway corridors to better integrate regions within the country, facilitate economic activity, and better welfare for rural areas. These efforts will also support establishing Georgia as a transport and logistics hub connecting Europe with Asia. Furthermore, the authorities plan to review social protection measures, including policies to reduce the gender gap in the labor market.

The government highly prioritizes educational reforms with a special focus on early and pre-school education. Recognizing that the quality of teachers is the most important factor to improve educational outcomes, additional funding for the education system are concrete steps to improve the quality of teachers. This process is led by a committee of educational experts with the involvement of teachers. Additional reforms in vocational education, including adopting European standards to the certificating framework, will increase both the quantity and quality of this system.

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Georgia's strong track record and continued close cooperation with international partners, including the IMF, the World Bank, the US, and the European Union, will conceivably catalyze resources to help finance some of the reforms and infrastructure projects needed for Georgia's green, digital, and inclusive development. The authorities look forward to continuing the close engagement and cooperation with the Fund. The new SBA is a top priority for the authorities, to maintain the reform momentum and the confidence of the markets in Georgia's economy.