August 2007
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# Georgia: Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Georgia

In the context of the Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria, the following documents have been released and are included in this package:

- The staff report for the Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on June 1, 2007, with the officials of Georgia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 1, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Press Release summarizing the views of the Executive Board as expressed during its August 20, 2007 discussion of the staff report that completed the review.

- A statement by the Executive Director for Georgia.

The document listed below has been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Georgia*

*Also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

**To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.**

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INTERNATIONAL MONETARY FUND

GEORGIA

# Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion

Prepared by Middle East and Central Asia Department

Approved by David Owen and Adnan Mazarei

August 1, 2007

## EXECUTIVE SUMMARY


Economic performance in recent years has been impressive, with the establishment of macroeconomic stability, a dramatic fiscal turnaround, and remarkable improvements in governance and the business environment. The original targets under the PRGF arrangement have been reached or exceeded.

Recent economic performance has been strong, despite trade and transit barriers imposed by Russia. Real GDP growth was 9.4 percent in 2006, accelerating to 11.4 percent in the first quarter of 2007. Inflation fell from 8.8 percent in 2006 to 7.3 percent in June, due to a tight fiscal stance and a recovery in agriculture. Private capital inflows were roughly 18 percent of GDP in 2006, more than financing the 14 percent of GDP current account deficit.

While all quantitative performance criteria for the final review were met, the structural performance criterion to pass fit and proper legislation was missed; the authorities assure staff it will be passed soon. Three of four structural benchmarks were met or met with delays.

Discussions focused on designing macroeconomic policies to manage the large inflows, while maintaining macroeconomic stability and preserving international competitiveness. To prevent overheating of the economy, the authorities plan to pursue a tighter fiscal stance than envisaged in the budget. The keys to maintaining competitiveness in the medium term are continued structural reforms and fiscal surpluses as long as the inflows continue.

The authorities have completed debt renegotiations with all bilateral creditors except Kazakhstan, where productive discussions are underway.

Given the authorities' strong performance, staff supports the completion of the sixth review and the request for a waiver. Going forward, the authorities have indicated their desire for continued close cooperation with staff, but they have not decided whether to request a successor arrangement.

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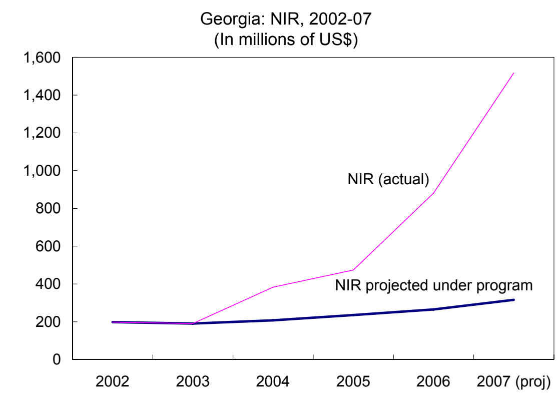
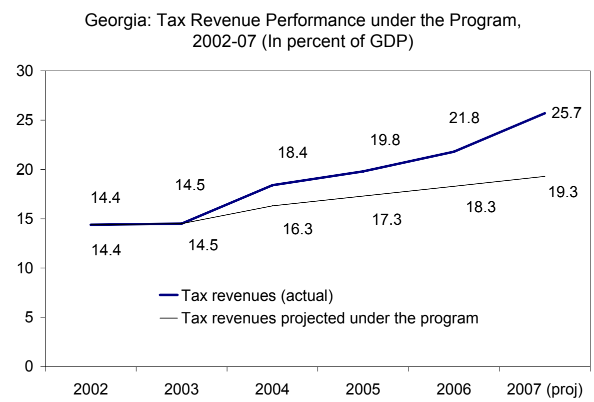
## I. Economic Performance in Recent Years

1. **Following the Rose Revolution in 2003, President Saakashvili's administration was determined to reduce graft, eliminate arrears, improve governance including through rapid privatization, and create a business-friendly environment.** To support the authorities' efforts to boost growth while generating macroeconomic stability, the Fund approved a PRGF arrangement shortly after the new government took office.

2. **Since then, Georgia's performance has been impressive.** Annual growth was over 8 percent on average in 2004–06 (Table 1), while inflation ranged from 6 to 9 percent. Growing confidence in the lari led to steady increases in the broad money/GDP ratio, while net international reserves grew much more than expected.

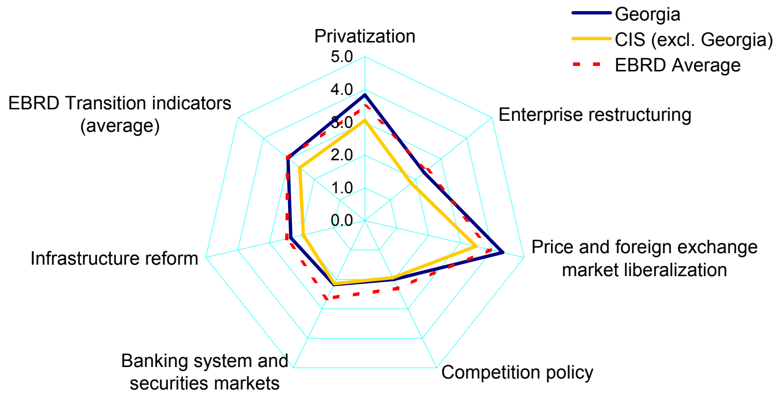



3. **Fiscal performance saw a spectacular improvement,** with tax revenues increasing from 14.5 percent of GDP in 2003 to almost 22 percent in 2006, despite a reduction in rates and the elimination of a number of taxes. Combined with privatization proceeds (which averaged 4.2 percent of GDP in 2005–06), this allowed the authorities to clear arrears, increase pensions, and upgrade defense capacity and economic infrastructure, while reducing public debt from close to 50 percent of GDP in 2003 to 22 percent in 2006.




4. **Improvements in the business environment have been equally impressive; the World Bank's Doing Business survey named Georgia the leading reformer in the world in 2006.** The EBRD 2006 transition indicators show Georgia now roughly in line with the EBRD average. This improvement in the business environment contributed to a dramatic increase in private capital inflows. Despite this strong economic performance, poverty remains roughly unchanged, at around 30 percent of the population according to World Bank estimates, apparently due to lagged development in rural areas.

Georgia: EBRD Transition Indicators, 2006 1/



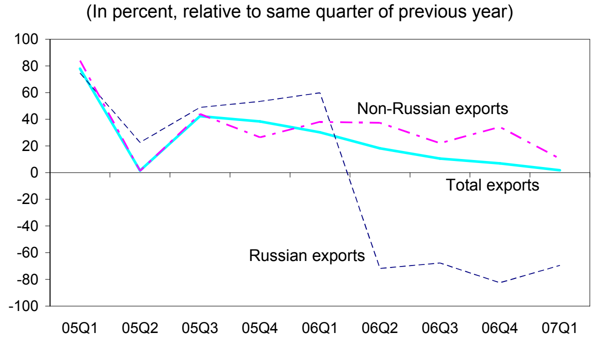

1/ The measurement scale for the indicators ranges from 1 to 4+, where 1 represents a rigid centrally-planned economy and 4+ represents the standards of an industrialized market economy.

5. **The capital inflows have become sufficiently large that managing them is the major economic challenge facing Georgia today.** The inflows have contributed to growing domestic demand, which is reflected in a large and rising current account deficit, and pressures for inflation and real exchange rate appreciation. Uncertainty over the potential inflows this year highlights the need for a flexible policy response to stem overheating pressures as they develop.

## II. Recent Economic Developments and Performance under the Program

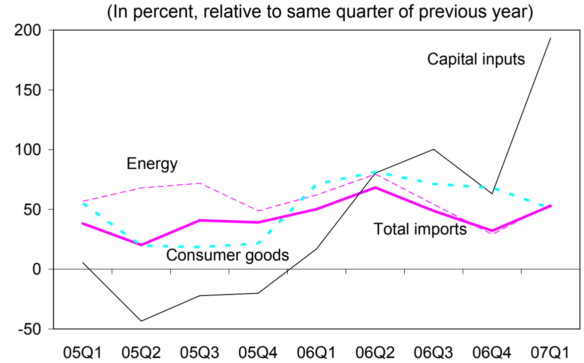
6. **Economic performance continues to be strong.** Real GDP growth was 9.4 percent in 2006, increasing to 11.4 percent in the first quarter of 2007, despite sanctions imposed by Russia, Georgia's former main trade partner (Box 1). Twelve-month inflation dropped from 8.8 percent at end-2006 to 7.3 percent at end-June 2007, due to a tight fiscal stance and a reported recovery in agricultural production.

Georgia: Goods Export Growth 1/, 2005-07
(In percent, relative to same quarter of previous year)




Source: Department of Statistics.
1/ Registered exports only.

Georgia: Import Growth by Commodity Type, 2005-07
(In percent, relative to same quarter of previous year)




Source: Department of Statistics.

7. **The current account deficit has deteriorated,** increasing to 13.8 percent of GDP in 2006 from 9.8 percent in 2005 (Table 2).[1] This development reflects declining export growth (due in part to the loss of Russian markets), and rapid import growth (due to growing domestic demand, FDI-related imports, and rising energy prices). The widened current account has been more than financed by private capital inflows, in particular, by FDI which reached 15 ½ percent of GDP in 2006.

## Box 1. Impact of the Russian Embargo

During the course of 2006, Russia—up to that point, Georgia's main trading partner—imposed a series of trade and transit barriers on Georgia. While this contributed to a sharp slowdown in export growth, other factors—including the significant private capital inflows—cushioned the impact of this slowdown, allowing the Georgian economy to continue to grow.

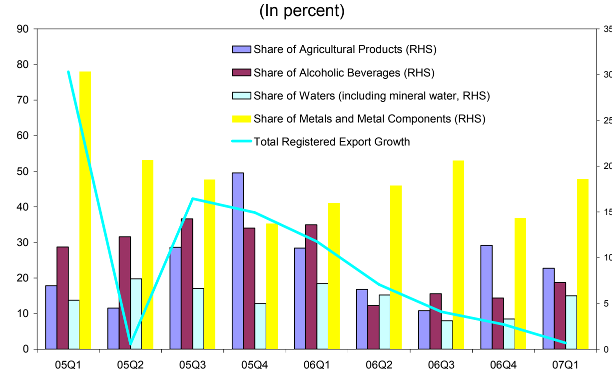
**Exports have been sluggish**

Notwithstanding the loss of Russian export markets in 2006, exports grew by 13 percent in 2006. However, after having grown at about 30 percent in the fourth quarter of 2005 and the first quarter of 2006, growth slowed throughout the year, with export growth in the first quarter of 2007 declining to 4 percent. Exports of alcoholic beverages, traditionally destined for Russia, declined sharply in this period. In contrast, exports of metals and metal components rose nearly 18 percent.

**Services**

The notable trend in services exports has been the surge in pipeline services. Pipeline transport service exports have grown over 100 percent over the last several quarters, rising nearly 140 percent in the first quarter of 2007, compared to the same quarter the previous year, with the BTC pipeline running near full capacity. Pipeline services accounted for about 20 percent of total services exports in Q1 2007.

Georgia: Goods Export Growth and Composition of Exports, 2005-07
(In percent)




Source: Department of Statistics.

**Remittances**

Despite concerns that remittances would fall because of the tensions with Russia, remittances have in fact continued to increase, more than doubling in the first five months of 2007, compared to the same period in the previous year.

8. **Private capital inflows have risen sharply.** Preliminary data show foreign direct investment (FDI) was US$285 million in the first quarter of 2007, more than double the level a year earlier. While pipeline-related FDI has stabilized, private inflows are now reaching a wide range of sectors (Box 2).

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[1] Export data going back to 2002 have been revised downward by 4–4½ percent of GDP, due to a previous mistake in classification of transiting Azeri oil as Georgian exports.

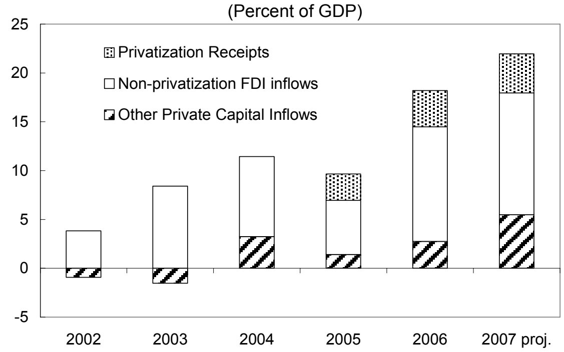
## Box 2. FDI Inflows

FDI inflows increased sharply in recent years. Having averaged around 9 percent of GDP over 2002–06, they are projected to be 17 percent of GDP in 2007. Per capita cumulative FDI in Georgia in the period 1989–2006 was more than twice the average of CIS countries.

In 2002–05, FDI inflows were driven by pipeline construction. In 2006, while pipeline construction remained significant, more than half of FDI was in the banking, manufacturing, and tourism sectors.

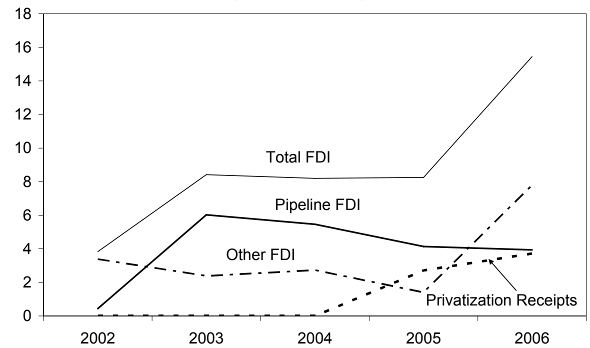
The largest source of FDI inflows in 2002–06 was the UK, followed by the U.S., Turkey, Azerbaijan, Russia, and Kazakhstan.

Georgia: Net Private Capital Inflows to Georgia, 2002-07
(Percent of GDP)



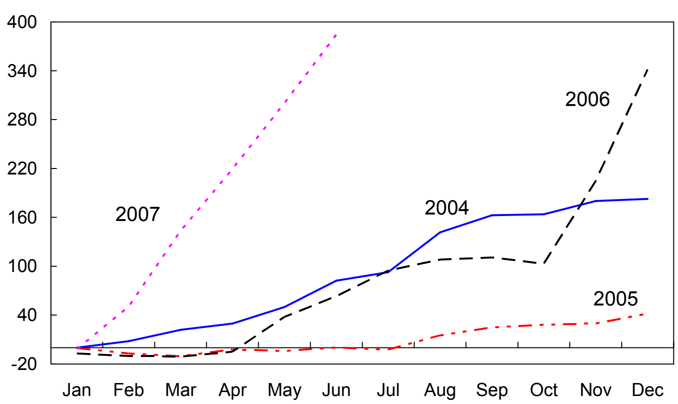

Sources: NBG and Ministry of Economic Development; and Fund staff estimates.

Georgia: Composition of FDI Inflows, 2002-06
(Percent of GDP)




9. **Monetary aggregates at end-March were in line with the program with broad money growth slightly higher than the programmed growth, despite much larger than programmed foreign exchange purchases by the NBG (Tables 3 and 4).** Reserve money was below the end-March performance criterion due to a strong revenue performance, which resulted in a significant accumulation of government deposits.

Georgia: NBG Interventions, Cumulative for the Year
(In million US$, Jan. 2004–Jun. 2007)

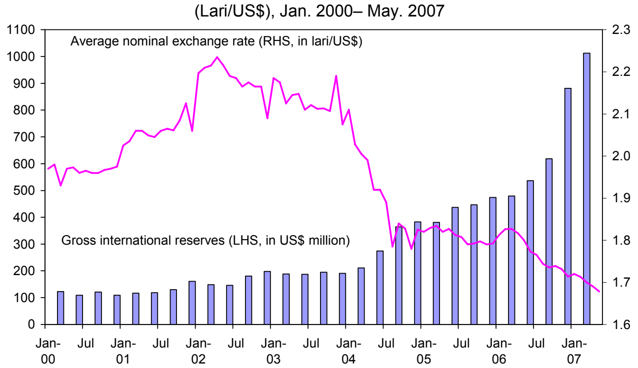


- In the first quarter of 2007, NBG net foreign exchange purchases amounted to US$144 million, with NIR increasing by US$110 million compared to the programmed US$44 million. Government deposits grew by GEL 278 million, more than triple the programmed growth.

- As of end-June, 12-month reserve money growth was 25 percent, slightly higher than programmed. NIR increased by almost US$200 million in the second quarter. Government deposits increased modestly in the same period.

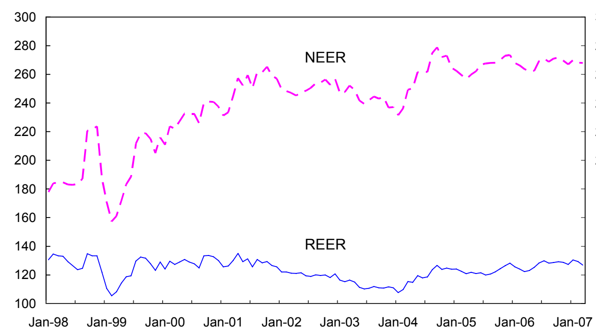
- With large inflows and despite substantial intervention, the lari has continued to appreciate against the weakening dollar. The REER, however, has remained relatively steady. The slowing export growth and rising current account deficit indicate that the real exchange rate may be overvalued.

Georgia: International Reserves and Average Nominal Exchange Rates (Lari/US$), Jan. 2000– May. 2007




Sources: Georgian authorities; and Fund staff estimates.

Gerogia: REER and NEER 1/, Jan. 1998-Mar. 2007, (1995=100)




Sources: Georgian authorities; and Fund staff estimates.
1/ Based on INS exchange rates and CPI. An increase indicates an appreciation.

10. **To keep reserve money growth in line with their inflation target, the NBG has been auctioning certificates of deposits (CDs) since September 2006.** At end-December 2006, the stock of CDs amounted to GEL 275 million (23 percent of reserve money), with the ratio of CDs to reserve money having increased to 29 percent at end-June 2007.

11. **Banking sector indicators look stable (Table 5),** with the share of nonperforming loans falling slightly in recent months. However, the quality of banking supervision has deteriorated, in part due to the loss of experienced staff in the NBG Banking Supervision Department.

12. **The first quarter of 2007 saw tremendous overperformance of tax revenues—almost 38 percent higher than programmed and 60 percent higher than the same quarter of the previous year (Table 6).** The main factors underlying this performance were higher than anticipated economic activity, continued administrative improvements, and lower VAT turnover thresholds. Expenditures were 15 percent higher than programmed, mainly

due to higher defense spending; nonetheless, there was a fiscal surplus of GEL 141 million (4 percent of quarterly GDP) on a cash basis, compared to a programmed deficit of GEL 60 million. Total revenues in the second quarter were well above programmed levels, but in line with revised projections.

13. **The authorities passed a supplementary budget in June, incorporating higher revenues and increasing expenditures by even more, despite a commitment at the time of the fifth review to save most above-budget revenues.** Thus, the budgeted deficit for the year increased to 3 percent of GDP. Expenditures are budgeted to increase by 23 percent from 2006 levels—about 3.5 percent of GDP higher than programmed—mainly on defense, local government, and capital expenditures.

14. **Legislation was recently passed to introduce free economic zones (FEZ)**. While staff urged that tax exemptions in the FEZs be limited to indirect taxes, some companies working in these zones will be exempt from profit taxes, and the import of goods from the FEZ to other parts of Georgia will be exempt from custom taxes.

15. **All quantitative performance criteria for end-March 2007 were met (Tables 7 and 8), but one structural performance criterion was missed.** The end-December 2006 structural performance criterion on the passage of fit and proper legislation was missed; parliamentary hearings are underway, and passage is reportedly imminent. **Overall, four of six structural measures were met or met with delay.** Little progress has been made on enhancing the operations and autonomy of the statistics agency. A tax modernization strategy and the NBG regulation requiring external auditors to include issues of relevance in their reports—both end-March benchmarks—were implemented with delays.

## III. Discussions on Revising the Macroeconomic Framework for 2007

16. **Discussions focused on designing macroeconomic policies to manage the large foreign inflows.**[2] While foreign inflows reduce financing constraints for investment and enhance medium-term growth prospects, the authorities recognize that overheating is likely, unless domestic policies adjust appropriately. In addition, these inflows will put upward pressure on the real exchange rate, at a time when declining export growth underlines the urgency of strengthening Georgia's external competitiveness.

17. **With capital inflows estimated to exceed $2 billion in 2007—the authorities believe they could reach US$2.5 billion, which would be roughly double their level in 2006—projected real GDP growth for 2007 has been revised upward to 10 percent.**

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[2] The staff team comprised Mr. Wakeman-Linn (head), Mr. Owen, Ms. George, and Ms. Koeda (all MCD), Mr. Zeuner and Ms. Lipscomb (PDR). Mr Norregaard (FAD) joined the mission to participate in tax policy discussions.

While the authorities are determined to keep inflation in single digits, they have increased their 2007 inflation target to 9 percent. They will also continue their attempts to limit appreciation. Given the magnitude of expected inflows, they agreed with staff that a tighter-than-budgeted fiscal stance would be needed to achieve these twin objectives. This was a significant change from the authorities' previous position, which was that fiscal policy would be determined by the country's development needs, and that the monetary authorities would be responsible for inflation and exchange rate developments.

## A. Monetary Policy

18. **The authorities believe a managed floating exchange rate regime remains appropriate for Georgia, with the NBG acting to limit nominal appreciation.** Given the large inflows, gross reserves are expected to be around 3.2 months of imports at end-2007, compared to only 2.4 months of imports in the most recent program projections. However, the authorities recognize this will increase the difficulty of keeping inflation in single digits.

19. **The higher inflation target and real GDP growth allow for a slight loosening of monetary policy,** with reserve money growth for 2007 now targeted at 20 percent, up from the originally programmed 15 percent. To offset part of the liquidity impact of their foreign exchange purchases, the NBG will continue selling CDs. However, they believe it will not be possible to withdraw more than 10 percent of the planned increase in NIR via CDs. Therefore, the authorities recognize that a tight fiscal policy which allows for a rapid accumulation of government deposits, will be necessary to keep reserve money in line with their inflation target and ease real appreciation and current account pressures.

20. **The authorities agreed that banking supervision needs to be strengthened, to monitor closely the rapidly growing private sector credit.** The NBG is preparing a strategy to improve supervision (LOI, paragraph 4). The authorities acknowledged that passage of fit and proper legislation would give the NBG greater authority to improve management in the banking sector.

## B. Fiscal Policy

21. **The authorities recognized that the supplementary budget was not in line with commitments made at the time of the fifth review.**[3] They cited security and defense needs that required additional spending, as well as difficulty resisting pressures for important local government and capital expenditures when revenue performance was strong.

[3] Their commitment was to save a large share of above-budget revenues (Country Report No. 07/107, MEFP, Para. 24).

22. **They also acknowledged that the 3 percent of GDP deficit in the supplement is inconsistent with their inflation and exchange rate objectives.** They noted that the revenue projection in the supplementary budget remains conservative, and agreed with staff that actual revenues are likely to exceed this level. Combined with anticipated under spending of the budget, the authorities believe the supplement would produce a deficit of less than half the budgeted level.

23. **Staff concurred with this analysis, but noted that this may not be sufficient to keep inflation in single digits.** Indeed, staff estimates that a modest surplus is likely to be necessary to contain the risks of potential domestic overheating. The authorities recognized this possibility, and indicated that they are prepared to adjust fiscal policy, as necessary, to keep inflation under control.

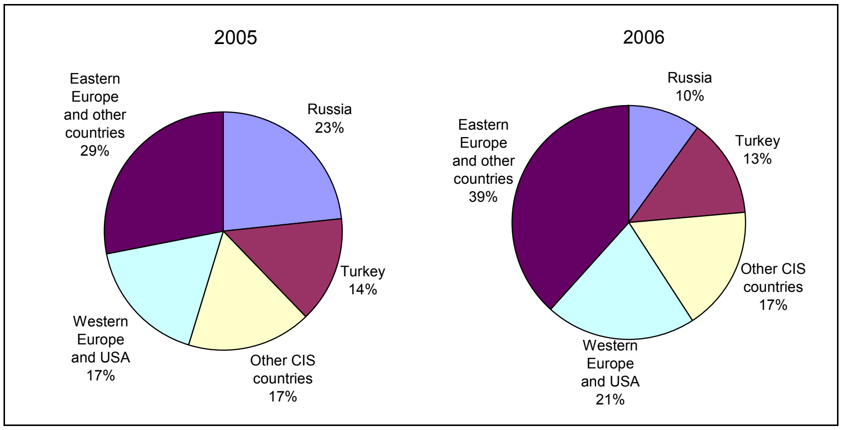
## C. External Sector

24. **The current account deficit is projected by staff to deteriorate in 2007 to 16 percent of GDP, reflecting continued strong import growth and relatively modest export growth.** Recent trends show both slowing export growth and a reorientation away from Russia. The current account deficit will continue to be financed by private capital inflows. The authorities believe staff's export forecast to be pessimistic, as they expect 25 percent export growth in 2007.

25. **Having successfully completed debt renegotiations with all Paris Club and non-Paris Club creditors (except Kazakhstan, where the authorities are making a good faith effort to reach a collaborative agreement and productive discussions are underway),** the authorities are in the process of negotiating loans for up to US$700 million from the Kuwait Fund and Japanese investors for a five-year hydropower project.[4] A roughly US$200 million concessional loan, to finance a railroad project, has been signed between a Georgian state-owned enterprise and Azerbaijan.

[4] Financing for this project is yet to be determined, pending completion of a nine-month feasibility study started in June 2007.

Georgia: Export Shares by Country Groups, 2005-06




## IV. The Medium-Term Outlook

26. **Georgia's medium-term economic prospects look strong, with continued rapid growth driven by private sector activities (Table 9–11).** The most important medium-term challenge facing policy-makers will be to strengthen Georgia's international competitiveness, thus contributing to an improvement in the current account balance**.** Given the large private inflows, the key to maintaining competitiveness—in addition to continued efforts to improve infrastructure and the business environment—will be generating fiscal surpluses. The authorities recognize this, and are focusing on the political challenge of achieving fiscal surpluses.

27. **The authorities are considering options for their engagement with the Fund after the completion of the program.** They plan to decide within a few months if they will request another arrangement which, if they do, would most likely be precautionary. Regardless, the authorities stressed the value of frequent missions and the role of the resident representative in maintaining a close policy dialogue. As outstanding use of Fund resources is currently greater than 100 percent of Georgia's quota, the country will temporarily be subject to post-program monitoring.

## V. Staff Appraisal

28. **Georgia's economic performance in recent years has been impressive, with rapid growth and generally modest inflation.** The fiscal turnaround has been remarkable, as has the improvement in governance and the business environment. Particularly noteworthy has been the economy's resilience to the trade and transport restrictions imposed by Russia, previously Georgia's largest trading partner.

29. **Similarly, performance under the PRGF arrangement has been strong, with virtually all program targets met or exceeded, in some cases by substantial margins.**

One area of disappointment has been in reducing poverty, with poverty rates virtually unchanged during the program period. Staff urges the authorities to strengthen their efforts to understand why growth has not led to poverty reduction.

30. **Going forward, the main challenge facing Georgia's economy is to strengthen competitiveness and increase exports, while avoiding overheating of the economy.** This will require fiscal policy that is both flexible and tight, with fiscal surpluses, the size of which will be determined in part by the magnitudes of external inflows. While this is a medium-term policy challenge, fiscal tightening should not be delayed, given inflation risks and the widening current account deficit. In this context, staff strongly urges the authorities to ensure their 2007 fiscal stance is consistent with single-digit inflation, and—notwithstanding upcoming elections—to budget for a surplus in 2008. Staff commends the authorities' track record in responding appropriately when inflation has picked up.

31. Amidst the positive fiscal reforms, staff notes that FEZ legislation is a step backward in the authorities' efforts to broaden the tax base, and urges the reversal of profit tax exemptions and exemptions from import duties on goods sold to the rest of Georgia.

32. **The role of monetary policy in managing inflows over the medium term should focus on ensuring inflation remains at modest levels.** The NBG's sterilization has limited short-term money creation and helped keep inflation down. However, sterilized intervention is a short-term strategy, and over time the liquidity effects of the NBG interventions will have to be offset by fiscal surpluses.

33. **Staff agrees that the NBG's effort to limit nominal exchange rate appreciation—if combined with supportive fiscal policy—is an appropriate response to the existing external challenges.** This change in the staff's position—in recent reviews staff has called for greater exchange rate flexibility to meet inflation targets—reflects the authorities' new commitment to use fiscal policy to ensure that the twin objectives of a stable exchange rate and single-digit inflation are compatible, in the current environment of massive inflows. Combined, these policies should limit the real appreciation of the lari, an important objective in light of the large and growing current account deficit. To ensure external competitiveness, the authorities will also need to continue their efforts to improve the business environment and economic infrastructure.

34. **The rapid growth in private sector credit is encouraging, but increases the importance of ensuring effective banking supervision.** Staff urges the NBG to take all necessary steps to improve banking supervision and assure its independence. In addition, staff remains concerned about the government's commitment to enacting fit and proper legislation consistent with international best practices, and urges its prompt passage. Particularly in light of the inflow of new domestic and foreign investors into the banking industry, staff believes such legislation is vital to ensuring the long-term health of the sector.

35. **Given the strong performance under the program, and the authorities' assurance that appropriate fit and proper legislation will be adopted in 2007, so that the deviation from program commitments will be temporary, staff supports the request for a waiver for the nonobservance of a structural performance criterion and the completion of the sixth and final review.**

Table 1. Georgia: Selected Macroeconomic Indicators, 2004–07

| | 2004 | 2005 | 2006 | 2007 | |
|---|---|---|---|---|---|
| | | | Prel. | Prog. | Proj. |
| (Annual percentage change, unless otherwise indicated) | | | | | |
| National accounts | | | | | |
| Nominal GDP (million lari) | 9,825 | 11,621 | 13,784 | 16,099 | 16,527 |
| Real GDP | 5.9 | 9.6 | 9.4 | 7.5 | 10.0 |
| Population (million) 1/ | 4.3 | 4.3 | 4.4 | 4.3 | 4.4 |
| Consumer price index, period average | 5.7 | 8.3 | 9.2 | 6.3 | 8.5 |
| Consumer price index, end-of-period | 7.5 | 6.2 | 8.8 | 6.0 | 8.9 |
| GDP per capita (US$) | 1,188 | 1,486 | 1,799 | 2,156 | 2,214 |
| Poverty rate (in percent) 2/ | 27.2 | 32.9 | 31.0 | ... | ... |
| Unemployment rate (percent) | 12.6 | 13.8 | 13.9 | ... | ... |
| (In percent of GDP, unless otherwise indicated) | | | | | |
| Investment and saving | | | | | |
| Investment | 27.5 | 26.3 | 25.6 | 31.7 | 27.0 |
| Public | 2.4 | 4.2 | 5.5 | 5.5 | 5.9 |
| Private | 25.1 | 22.1 | 20.1 | 26.1 | 21.0 |
| Gross national saving | 15.2 | 16.5 | 11.8 | 16.4 | 11.0 |
| Public | 4.7 | 2.7 | 2.5 | 3.1 | 4.7 |
| Private | 10.6 | 13.8 | 9.3 | 13.3 | 6.3 |
| Saving-Investment balance | -12.2 | -9.8 | -13.8 | -15.3 | -16.0 |
| Budgetary operations | | | | | |
| Total revenue and grants | 22.0 | 23.4 | 26.3 | 24.4 | 28.3 |
| *Of which:* Tax revenue | 18.4 | 19.8 | 21.8 | 20.9 | 25.7 |
| Total expenditure and net lending | 18.9 | 24.9 | 29.2 | 26.8 | 29.6 |
| *Of which:* Current expenditure | 16.5 | 20.7 | 23.7 | 21.2 | 23.6 |
| Fiscal balance, commitment basis | 3.2 | -1.5 | -3.0 | -2.4 | -1.3 |
| Net change in expenditure arrears | -2.6 | -0.9 | -0.3 | -0.1 | -0.1 |
| Statistical discrepancy | -0.8 | 0.0 | 0.5 | 0.0 | 0.0 |
| Fiscal balance, cash basis | -0.2 | -2.4 | -2.8 | -2.5 | -1.3 |
| Financing | 0.2 | 2.4 | 2.8 | 2.5 | -0.3 |
| Privatization | 0.9 | 3.6 | 4.8 | 2.9 | 3.6 |
| External | 0.2 | -0.3 | -0.4 | 0.1 | 0.1 |
| Domestic | -0.9 | -0.9 | -1.6 | -0.5 | -4.0 |
| Required adjustment | 0.0 | 0.0 | 0.0 | 0.0 | 1.6 |
| (Annual percentage change, unless otherwise indicated) | | | | | |
| Monetary sector | | | | | |
| Reserve money | 44.3 | 19.7 | 19.2 | 15.0 | 20.0 |
| Broad money (including foreign exch. deposits) | 42.6 | 26.4 | 39.3 | 27.0 | 31.8 |
| Velocity of broad money, level (M3) | 7.6 | 6.8 | 6.0 | 5.3 | 5.4 |
| (In millions of U.S. dollars, unless otherwise indicated) | | | | | |
| External Sector | | | | | |
| Exports of goods and services (percent of GDP) | 50.0 | 39.0 | 40.0 | 39.1 | 37.1 |
| Annual percentage change | 33.8 | 40.2 | 24.2 | 8.8 | 14.1 |
| Imports of goods and services (percent of GDP) | 52.4 | 56.0 | 61.8 | 60.6 | 60.5 |
| Annual percentage change | 40.7 | 33.7 | 33.6 | 19.7 | 20.4 |
| Net imports of oil | 264 | 376 | 475 | 502 | 499 |
| Current account balance | -626 | -628 | -1069 | -1420 | -1526 |
| In percent of GDP | -12.2 | -9.8 | -13.8 | -15.3 | -16.0 |
| Gross international reserves | 383 | 474 | 881 | 1,109 | 1,517 |
| In months of imports of goods and services (excl. pipeline imports) | 2.0 | 1.7 | 2.3 | 2.4 | 3.2 |
| Foreign direct investment | 420 | 529 | 1,199 | 1,149 | 1,574 |

Sources: Georgian authorities; and Fund staff estimates.

1/ Excludes Abkhazia residents.

2/ Agreed with the World Bank, there were methodological changes in the calculation of poverty starting in 2004.

Table 2. Georgia: Summary Medium-Term Balance of Payments, 2005–10
(In million of U.S. dollars)

| | 2005 | 2006 | | 2007 | | | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|
| | | Prog. | Prel. | Q1 Prel. | Prog. | Proj. | Proj. | Proj. | Proj. |
| Current account balance | -628 | -742 | -1,069 | -254 | -1,420 | -1,526 | -1,674 | -1693 | -1621 |
| Trade balance | -1,214 | -1,671 | -2,019 | -598 | -2,273 | -2,710 | -3,110 | -3,442 | -3,716 |
| Exports | 1,472 | 1,909 | 1,667 | 391 | 2,082 | 1,788 | 1,947 | 2,141 | 2,357 |
| Imports | -2,686 | -3,580 | -3,686 | -989 | -4,356 | -4,498 | -5,056 | -5,582 | -6,073 |
| Services and income (net) | 76 | 269 | 297 | 150 | 213 | 449 | 591 | 866 | 1,171 |
| *Of which* : Interest (gross) | -39 | -38 | -38 | -9 | -59 | -59 | -40 | -38 | -36 |
| Transfers (net) | 510 | 660 | 653 | 193 | 640 | 736 | 844 | 883 | 924 |
| Official transfers | 147 | 190 | 190 | 42 | 170 | 169 | 187 | 175 | 182 |
| *Of which* : General government | 26 | 65 | 65 | 7 | 24 | 23 | 37 | 26 | 22 |
| Other transfers | 363 | 470 | 464 | 151 | 470 | 566 | 657 | 708 | 743 |
| *Of which* : Remittances | 337 | 410 | 403 | 146 | 410 | 507 | 594 | 642 | 673 |
| Capital and financial account balance | 570 | 1,130 | 1,372 | 324 | 1,625 | 2,138 | 1,913 | 1,954 | 1,875 |
| Public sector | -49 | -41 | -41 | 18 | 108 | 53 | 147 | 162 | 151 |
| Disbursements | 62 | 76 | 76 | 17 | 76 | 82 | 92 | 96 | 88 |
| *Of which* : World Bank | 41 | 56 | 56 | 11 | 55 | 60 | 45 | 45 | 45 |
| Amortization | -142 | -170 | -170 | -11 | -88 | -90 | -55 | -50 | -52 |
| Capital grants, incl. from MCC (beginning in 2006) | 32 | 53 | 53 | 12 | 120 | 60 | 110 | 117 | 115 |
| Private sector | 619 | 1,171 | 1,413 | 306 | 1,517 | 2,086 | 1,766 | 1,793 | 1,724 |
| Foreign direct investment, including privatization receipts | 529 | 861 | 1,199 | 286 | 1,149 | 1,574 | 1,165 | 810 | 565 |
| Other private capital, net | 90 | 309 | 213 | 20 | 368 | 512 | 601 | 983 | 1159 |
| Errors and Omissions | 91 | -43 | 42 | 52 | 0 | 0 | 0 | 0 | 0 |
| Overall Balance | 33 | 344 | 345 | 122 | 205 | 612 | 239 | 262 | 254 |
| Financing | -33 | -345 | -345 | -122 | -205 | -612 | -239 | -261 | -254 |
| Use of Fund resources, net | -13 | -8 | -8 | 9 | 3 | 3 | -33 | -27 | -21 |
| Purchases/disbursements | 41 | 41 | 41 | 21 | 42 | 42 | 0 | 0 | 0 |
| Repurchases/repayments | -54 | -49 | -49 | -12 | -39 | -39 | -33 | -27 | -21 |
| Program loans | 13 | 20 | 20 | 0 | 20 | 20 | 10 | 5 | 5 |
| Increase in reserves (-) | -91 | -407 | -407 | -131 | -228 | -636 | -215 | -239 | -238 |
| Change in arrears (+, increase) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Debt relief 1/ | 58 | 50 | 50 | 0 | 0 | 0 | 0 | 0 | 0 |
| Paris Club rescheduling | 58 | 50 | 50 | 0 | 0 | 0 | 0 | 0 | 0 |
| Rescheduling of arrears | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Financing gap | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Memorandum items** | | | | | | | | | |
| Nominal GDP | 6,411 | 7,807 | 7,764 | 1,971 | 9,306 | 9,553 | 10,989 | 12,522 | 14,136 |
| Current account deficit (percent of GDP) | 9.8 | 9.5 | 13.8 | 12.9 | 15.3 | 16.0 | 15.2 | 13.5 | 11.5 |
| Trade deficit (percent of GDP) | 18.9 | 21.4 | 26.0 | 30.3 | 24.4 | 28.4 | 28.3 | 27.5 | 26.3 |
| Merchandise export growth (percent) | 34.8 | 20.2 | 13.2 | 4.0 | 9.1 | 7.3 | 8.9 | 10.0 | 10.1 |
| Merchandise export volume growth (percent) | 33.3 | 20.3 | 13.0 | 3.5 | 8.6 | 6.9 | 8.1 | 9.1 | 9.3 |
| Merchandise import growth (percent) | 33.8 | 42.0 | 37.2 | 36.3 | 21.7 | 22.0 | 12.4 | 10.4 | 8.8 |
| Merchandise import volume growth (percent) | 23.6 | 31.2 | 27.5 | 26.9 | 15.6 | 15.8 | 18.7 | 17.3 | 14.7 |
| Gross international reserves 2/ | 474 | 881 | 881 | 1,013 | 1,109 | 1,517 | 1,732 | 1,971 | 2,209 |
| (In months of imports of goods and services) | 1.6 | 2.2 | 2.2 | 3.3 | 2.4 | 3.2 | 3.2 | 3.3 | 3.4 |
| Public and publicly guaranteed external debt (nominal) | 1,735 | 1,701 | 1,697 | … | 1,673 | 1,675 | 1,669 | 1,703 | 1,750 |
| (In percent of GDP) | 27.1 | 21.8 | 21.9 | … | 18.0 | 17.5 | 15.2 | 13.6 | 12.4 |
| Debt service from the budget (cash) | 111 | 145 | 145 | 17 | 133 | 136 | 71 | 74 | 73 |
| (In percent of exports of goods and services) | 4.4 | 4.3 | 4.7 | 2.2 | 3.7 | 3.8 | 1.8 | 1.6 | 1.4 |
| Total external debt service (cash) | 193 | 223 | 223 | 36 | 199 | 201 | 131 | 129 | 123 |
| (In percent of exports of goods and services) | 7.7 | 6.7 | 7.2 | 4.6 | 5.5 | 5.7 | 3.3 | 2.8 | 2.4 |

Sources: Georgian authorities; and Fund staff estimates.

1/ Includes the July 2004 Paris Club agreement on terms somewhat more generous than Houston terms.
2/ Projections at program exchange rates.

Table 3. Georgia: Accounts of the National Bank of Georgia, 2004–07

| | 2004 | 2005 | 2006 | | | | 2007 | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Dec. | Dec. | Mar. | Jun. | Sep. | Dec. | Mar. Prog. | Mar. Act. | Jun Prog. | Jun Proj. | Jun. Prel. | Sep. Proj. | Dec. Prog. | Dec. Proj. |
| | (Percent contribution compared to reserve money at the end of year) | | | | | | | | | | | | | |
| Net foreign assets 1/ | 77.1 | 27.2 | 3.0 | 11.3 | 28.1 | 73.5 | 7.1 | 16.9 | 14.4 | 51.1 | 45.9 | 72.5 | 35.1 | 96.6 |
| Net domestic assets | -32.8 | -7.5 | -5.3 | -7.0 | -18.6 | -54.4 | -8.0 | -20.3 | -11.0 | -45.2 | -36.4 | -59.1 | -20.1 | -76.6 |
| Net claims on general government | -10.5 | -9.1 | -9.1 | -6.1 | -18.3 | -22.1 | -7.5 | -24.8 | -9.3 | -43.4 | -27.6 | -51.1 | -11.1 | -61.2 |
| Claims on rest of economy | -3.5 | 0.0 | 0.0 | 0.1 | 0.1 | 0.2 | -0.1 | 0.0 | -0.1 | 0.0 | 0.0 | 0.0 | -0.1 | 0.0 |
| Claims on banks | -8.2 | 4.9 | 0.5 | -2.6 | 0.6 | -25.4 | -2.8 | 1.5 | -2.5 | -0.2 | -8.3 | -3.6 | -7.6 | -8.0 |
| Other items, net | -10.6 | -3.2 | 3.3 | 1.6 | -1.0 | -6.8 | 2.2 | 2.9 | 0.6 | -1.7 | -0.6 | -4.7 | -1.5 | -7.6 |
| | (Percentage change, relative to end of previous year) | | | | | | | | | | | | | |
| Reserve money | 44.3 | 19.7 | -2.3 | 4.3 | 9.5 | 19.2 | -0.9 | -3.4 | 3.3 | 5.9 | 9.6 | 13.4 | 15.0 | 20.0 |
| Currency in circulation | 42.9 | 20.0 | -4.4 | -1.0 | 5.2 | 14.6 | -0.5 | -7.7 | 5.3 | 2.2 | 4.1 | 8.1 | 14.8 | 9.6 |
| Required reserves | 13.4 | 40.6 | 7.3 | 22.2 | 55.8 | 73.0 | -13.2 | 2.9 | -2.5 | 5.6 | -37.7 | 35.5 | 18.8 | 41.7 |
| Balances on banks' correspondent accounts 3/ | 169.3 | -11.5 | 6.5 | 37.4 | -31.9 | -35.0 | 55.9 | 62.4 | -13.1 | 94.1 | 411.7 | 11.6 | -1.4 | 143.0 |
| | (In millions of lari) | | | | | | | | | | | | | |
| Net foreign assets 1/ | 118 | 345 | 375 | 458 | 627 | 1,081 | 1,166 | 1,283 | 1,253 | 1,691 | 1,629 | 1,946 | 1,501 | 2,234 |
| Net domestic assets | 719 | 656 | 604 | 586 | 470 | 112 | 16 | -131 | -20 | -427 | -322 | -594 | -128 | -803 |
| Net claims on general government | 722 | 646 | 554 | 585 | 463 | 425 | 335 | 128 | 314 | -94 | 95 | -185 | 292 | -306 |
| Claims on general government (incl. t-bills) | 841 | 833 | 833 | 833 | 833 | 785 | 785 | 785 | 737 | 737 | 775 | 737 | 737 | 737 |
| Nontradable govt. debt | … | … | … | 785 | 785 | 785 | 785 | 737 | 689 | 737 | 737 | 737 | 689 | 737 |
| Securitized debt (marketable) | … | … | … | 48 | 48 | 0 | 0 | 48 | 48 | 0 | 38 | 0 | 0 | 0 |
| Deposits | -120 | -187 | -279 | -248 | -370 | -360 | -449 | -656 | -423 | -830 | -680 | -922 | -445 | -1,043 |
| Claims on rest of economy | 97 | 97 | 98 | 98 | 98 | 99 | 97 | 98 | 97 | 98 | 98 | 99 | 97 | 99 |
| Claims on banks | -41 | 0 | 5 | -26 | 6 | -255 | -288 | -237 | -284 | -257 | -353 | -297 | -345 | -350 |
| Other items, net | -59 | -87 | -54 | -71 | -96 | -155 | -129 | -121 | -148 | -175 | -162 | -211 | -173 | -246 |
| Reserve money | 837 | 1,001 | 979 | 1,045 | 1,097 | 1,193 | 1,182 | 1,153 | 1,233 | 1,263 | 1,308 | 1,353 | 1,373 | 1,432 |
| Currency in circulation | 676 | 811 | 775 | 803 | 854 | 930 | 925 | 858 | 979 | 950 | 967 | 1,005 | 1,067 | 1,019 |
| Required reserves | 92 | 130 | 139 | 159 | 202 | 225 | 195 | 231 | 219 | 237 | 140 | 304 | 267 | 318 |
| Balances on banks' correspondent accounts 2/ | 68 | 60 | 64 | 83 | 41 | 39 | 61 | 64 | 34 | 76 | 200 | 44 | 39 | 95 |
| Memorandum items: | | | | | | | | | | | | | | |
| Growth of reserve money | 44.3 | 19.7 | 21.0 | 18.8 | 17.5 | 19.2 | 20.7 | 17.8 | 18.0 | 20.9 | 25.2 | 23.3 | 15.0 | 20.0 |

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

1/ Net foreign assets are valued at the program rate of 1.85 lari/US$, US$/SDR of 1.46 and US$/Euro of 1.21.

2/ Including overnight deposits from banks.

## Table 4. Georgia: Monetary Survey, 2004–07

| | 2004 | 2005 | 2006 | | | | 2007 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Dec. | Dec. | Mar. | Jun. | Sep. | Dec. | Mar. Prog. | Mar. Act. | Jun. Prel. | Sep. Proj. | Dec. Prog. | Dec. Proj. |
| | (Percent contribution compared to broad money at the end of year) | | | | | | | | | | | |
| Net foreign assets 1/ | 43.2 | -4.4 | -0.2 | 1.6 | 4.5 | 29.3 | -4.3 | -2.4 | 5.3 | 6.7 | -11.7 | 7.7 |
| Net domestic assets | -0.6 | 30.8 | 5.0 | 18.0 | 22.2 | 10.0 | 2.0 | 2.9 | 16.8 | 19.4 | 38.7 | 24.1 |
| Domestic credit | 11.7 | 47.2 | 4.0 | 23.1 | 35.3 | 45.4 | 3.5 | 1.9 | 22.9 | 28.9 | 50.3 | 37.4 |
| Net claims on general government | -2.5 | -7.0 | -5.9 | -4.6 | -10.9 | -11.5 | -2.7 | -11.5 | -13.0 | -20.8 | -2.5 | -24.0 |
| Credit to the rest of the economy | 14.2 | 54.2 | 9.8 | 27.7 | 46.2 | 56.9 | 6.2 | 13.4 | 35.9 | 49.7 | 52.8 | 61.4 |
| Other items, net | -12.3 | -16.4 | 1.0 | -5.1 | -13.0 | -35.4 | -1.5 | 1.1 | -6.2 | -9.6 | -11.7 | -13.3 |
| | (Percentage change, relative to end of previous year) | | | | | | | | | | | |
| Broad money (M3) | 42.6 | 26.4 | 4.8 | 19.5 | 26.7 | 39.3 | -2.3 | 0.5 | 22.0 | 26.0 | 27.0 | 31.8 |
| Broad money, excl. forex deposits (M2) | 60.4 | 26.5 | 1.6 | 17.0 | 19.0 | 29.8 | -0.7 | -1.7 | 18.5 | 21.6 | 25.1 | 29.1 |
| Currency held by the public | 39.5 | 19.5 | -3.7 | -1.0 | 5.0 | 12.4 | 0.4 | -7.9 | 2.9 | 5.1 | 16.7 | 9.9 |
| Total deposit liabilities | 44.8 | 31.1 | 10.1 | 32.4 | 40.2 | 56.1 | -3.6 | 4.3 | 30.7 | 35.5 | 31.6 | 41.7 |
| | (In millions of lari) | | | | | | | | | | | |
| Net foreign assets 1/ | 173 | 106 | 102 | 136 | 191 | 666 | 550 | 601 | 806 | 843 | 355 | 871 |
| NBG | 118 | 345 | 375 | 458 | 627 | 1,081 | 1,166 | 1,283 | 1,629 | 1,946 | 1,501 | 2,234 |
| Commercial banks | 55 | -239 | -273 | -322 | -435 | -416 | -616 | -683 | -823 | -1,103 | -1,146 | -1,363 |
| Net domestic assets | 1,339 | 1,805 | 1,901 | 2,148 | 2,230 | 1,996 | 2,050 | 2,074 | 2,442 | 2,512 | 3,025 | 2,637 |
| Domestic credit | 1,796 | 2,510 | 2,586 | 2,951 | 3,184 | 3,377 | 3,471 | 3,426 | 3,987 | 4,147 | 4,716 | 4,372 |
| Net claims on general government | 739 | 633 | 521 | 545 | 424 | 413 | 342 | 107 | 66 | -141 | 346 | -227 |
| Credit to the rest of the economy | 1,057 | 1,877 | 2,065 | 2,406 | 2,759 | 2,964 | 3,129 | 3,320 | 3,921 | 4,288 | 4,370 | 4,599 |
| Other items, net | -457 | -705 | -685 | -803 | -954 | -1,381 | -1,421 | -1,353 | -1,545 | -1,635 | -1,691 | -1,735 |
| Broad money (M3) | 1,512 | 1,911 | 2,003 | 2,284 | 2,421 | 2,662 | 2,600 | 2,674 | 3,248 | 3,355 | 3,380 | 3,508 |
| Broad money, excl. forex deposits (M2) | 846 | 1,070 | 1,088 | 1,252 | 1,273 | 1,389 | 1,380 | 1,365 | 1,646 | 1,690 | 1,738 | 1,793 |
| Currency held by the public | 616 | 736 | 709 | 729 | 773 | 827 | 831 | 762 | 851 | 870 | 966 | 909 |
| Total deposit liabilities | 896 | 1,175 | 1,294 | 1,555 | 1,648 | 1,834 | 1,769 | 1,912 | 2,397 | 2,485 | 2,414 | 2,598 |
| Memorandum items: | | | | | | | | | | | | |
| Growth of M3 | 42.6 | 26.4 | 33.8 | 40.3 | 33.9 | 39.3 | 29.8 | 33.5 | 42.2 | 38.6 | 27.0 | 31.8 |
| Growth of M2 | 60.4 | 26.5 | 33.9 | 40.7 | 29.6 | 29.8 | 26.9 | 25.6 | 31.5 | 32.7 | 25.1 | 29.1 |
| Growth of credit to the rest of the economy (in percent, relative to end of previous year) | 16.6 | 77.6 | 10.0 | 28.2 | 47.0 | 57.9 | 5.6 | 12.0 | 32.3 | 44.7 | 47.4 | 55.2 |
| Growth of credit to the rest of the economy (in percent, relative to same period of previous year) | 16.6 | 77.6 | 79.3 | 81.4 | 78.6 | 57.9 | 51.6 | 60.8 | 62.9 | 55.4 | 47.4 | 55.2 |
| M2 multiplier 2/ | 1.01 | 1.07 | 1.11 | 1.20 | 1.16 | 1.16 | 1.17 | 1.18 | 1.26 | 1.25 | 1.27 | 1.25 |
| M3 multiplier 3/ | 1.81 | 1.91 | 2.05 | 2.19 | 2.21 | 2.23 | 2.20 | 2.32 | 2.48 | 2.48 | 2.46 | 2.45 |
| M3 velocity | 7.64 | 6.77 | 6.83 | 6.38 | 6.18 | 6.03 | 6.12 | 6.19 | 5.59 | 5.49 | 5.33 | 5.36 |
| Foreign exchange deposits in percent of total deposits | 74.3 | 71.6 | 70.8 | 66.4 | 69.6 | 69.4 | 69.0 | 68.4 | 66.8 | 67.0 | 68.0 | 66.0 |

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

1/ Net foreign assets are valued at the program rate of 1.85 lari/US$, US$/SDR of 1.46 and US$/Euro of 1.21.
2/ M2 divided by reserve money.
3/ M3 divided by reserve money.

Table 5. Georgia: Prudential Indicators of Commercial Banks, 2003–07

| | 2003 | 2004 | 2005 | 2006 | 2007 | |
|---|---|---|---|---|---|---|
| | | | | | Mar. | May |
| Capital adequacy ratio (in percent) | 20.3 | 18.8 | 17.5 | 20.6 | 19.1 | 18.5 |
| Leverage ratio1/ | 33.5 | 27.9 | 25.9 | 30.7 | 29.2 | 27.1 |
| Nonperforming loans (in percent of total loans) | 7.5 | 6.2 | 3.8 | 2.5 | 2.5 | 2.3 |
| Specific provisions (in percent of total loans) | 4.5 | 4.3 | 2.4 | 1.7 | 1.6 | 1.8 |
| Loans collateralized by real estate (in percent of total loans) | 31.9 | 33.5 | 30.8 | 31.1 | 34.1 | 39.0 |
| Loans in foreign exchange (in percent of total loans) | 87.7 | 86.7 | 76.2 | 73.8 | 74.6 | 75.0 |
| Net foreign assets (in millions of lari) | 42.5 | 54.6 | -231.5 | -385.1 | -627.3 | -786.8 |
| Net foreign assets (in percent of total assets) | 3.2 | 3.2 | -9.1 | -9.1 | -13.4 | -14.7 |
| Net open foreign exchange position 2/ | 8.5 | 7.4 | 7.5 | 3.7 | 2.2 | 5.8 |
| Liquidity ratio (in percent) | 43.3 | 45.0 | 33.3 | 41.5 | 44.7 | 39.8 |

Source: National Bank of Georgia.

1/ Defined as the ratio of total capital to total liabilities; an increase in the ratio indicates an improvement.
2/ Percent of Total Regulatory Capital.

Table 6. Georgia: Operations of the General Government, 2005–07

| | 2006 | 2007 | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Act. | Q1 | Q1 | Q2 | Q3 | Q4 | Annual | | |
| | Prel. | Prog. | Prel. | Rev. prog. | Proj. | | Prog. | Rev. proj. | First suppl. |
| | (In millions of lari) | | | | | | | | |
| Total revenue and grants | 3,620 | 793 | 1,027 | 1,074 | 1,210 | 1,363 | 3,909 | 4,677 | 4,472 |
| Total revenue | 3,418 | 751 | 1,006 | 1,065 | 1,179 | 1,284 | 3,660 | 4,533 | 4,328 |
| Tax revenue | 3,007 | 663 | 912 | 1,014 | 1,118 | 1,203 | 3,362 | 4,247 | 4,042 |
| Nontax revenue 1/ | 411 | 88 | 94 | 50 | 60 | 81 | 298 | 286 | 285 |
| Grants | 202 | 42 | 21 | 10 | 32 | 80 | 249 | 144 | 144 |
| Total expenditure and net lending | 4,027 | 851 | 978 | 1,100 | 1,350 | 1,457 | 4,310 | 4,887 | 4,957 |
| Current expenditure | 3,272 | 574 | 762 | 905 | 1,080 | 1,155 | 3,418 | 3,903 | 3,949 |
| Wages and salaries | 583 | 138 | 126 | 138 | 140 | 177 | 562 | 582 | 584 |
| Goods and services | 712 | 162 | 271 | 300 | 390 | 395 | 992 | 1,356 | 1,379 |
| Transfers and subsidies | 1,287 | 140 | 262 | 250 | 300 | 305 | 1,126 | 1,117 | 1,137 |
| *Of which:* Local budget transfers | 61 | ... | ... | ... | ... | ... | ... | 128 | 128 |
| *Of which:* Energy subsidies | 135 | ... | 6 | ... | ... | ... | ... | 197 | 197 |
| *Of which:* Poverty benefit | 9 | ... | ... | ... | ... | ... | ... | 93 | 93 |
| Interest payments | 100 | 37 | 24 | 47 | 35 | 34 | 140 | 141 | 141 |
| Domestic | 64 | 15 | 15 | 15 | 15 | 14 | 58 | 59 | 59 |
| External (cash) | 36 | 22 | 9 | 32 | 20 | 20 | 82 | 82 | 82 |
| Nonwage local government expenditures | 590 | 97 | 79 | 170 | 215 | 245 | 597 | 708 | 708 |
| Capital expenditure (central government) | 742 | 145 | 150 | 205 | 300 | 314 | 890 | 969 | 994 |
| *Of which:* Foreign financed | 228 | 69 | 51 | 44 | 72 | 81 | 340 | 248 | 205 |
| Net lending | 13 | 132 | 66 | -10 | -30 | -13 | 3 | 14 | 14 |
| Overall balance (commitments) | -407 | -57 | 49 | -26 | -139 | -94 | -401 | -210 | -485 |
| Adjustment to cash basis | 21 | -3 | 92 | -15 | -15 | -72 | -10 | -10 | -10 |
| Net change in expenditure arrears (-, reduction) 3/ | -46 | -3 | -8 | 0 | 0 | -2 | -10 | -10 | -10 |
| Statistical discrepancy | 68 | 0 | 100 | -15 | -15 | -70 | 0 | 0 | 0 |
| Overall balance (cash) | -386 | -60 | 141 | -41 | -154 | -166 | -411 | -220 | -495 |
| Total financing | 386 | 60 | -141 | 35 | -141 | 196 | 411 | -51 | 496 |
| Privatization | 656 | 156 | 154 | 60 | 162 | 224 | 483 | 599 | 325 |
| Domestic | -220 | -89 | -306 | -23 | -268 | -66 | -84 | -664 | 179 |
| External | -50 | -7 | 11 | -1 | -35 | 37 | 12 | 13 | -8.6 |
| Disbursements | 170 | 27 | 30 | 35 | 40 | 74 | 166 | 179 | 175 |
| Amortization (cash) | -219 | -34 | -19 | -35 | -75 | -37 | -154 | -166 | -184 |
| Required adjustment | ... | ... | 0 | 5 | 295 | -30 | ... | 271 | ... |
| Balance after adjustment | ... | ... | 141 | -35 | 141 | -196 | ... | 51 | ... |
| | (In percent of GDP) | | | | | | | | |
| Total revenue | 24.8 | 22.5 | 28.6 | 26.2 | 27.3 | 27.7 | 22.8 | 27.4 | 26.2 |
| *Of which:* Tax revenue | 21.8 | 19.8 | 25.9 | 25.0 | 25.9 | 26.0 | 20.9 | 25.7 | 24.5 |
| Grants | 1.5 | 1.3 | 0.6 | 0.2 | 0.7 | 1.7 | 1.5 | 0.9 | 0.9 |
| Total expenditure and net lending | 29.2 | 25.4 | 27.8 | 27.1 | 31.3 | 31.5 | 26.8 | 29.6 | 30.0 |
| Current expenditure | 23.7 | 17.2 | 21.7 | 22.3 | 25.0 | 24.9 | 21.2 | 23.6 | 23.9 |
| Capital expenditure and net lending | 5.5 | 8.3 | 6.1 | 4.8 | 6.3 | 6.5 | 5.5 | 5.9 | 6.1 |
| Overall balance | | | | | | | | | |
| Commitments | -3.0 | -1.7 | 1.4 | -0.6 | -3.2 | -2.0 | -2.5 | -1.3 | -2.9 |
| Cash | -2.8 | -1.8 | 4.0 | -1.0 | -3.6 | -3.6 | -2.6 | -1.3 | -3.0 |
| Total financing | 2.8 | 1.8 | -4.0 | 0.9 | -3.3 | 4.2 | 2.6 | -0.3 | 3.0 |
| Privatization | 4.8 | 4.7 | 4.4 | 1.5 | 3.7 | 4.8 | 2.9 | 3.6 | 2.0 |
| Domestic | -1.6 | -2.7 | -8.7 | -0.6 | -6.2 | -1.4 | -0.5 | -4.0 | 1.1 |
| External | -0.4 | -0.2 | 0.3 | 0.0 | -0.8 | 0.8 | 0.1 | 0.1 | -0.1 |
| Required adjustment | ... | ... | ... | 0.1 | 6.8 | -0.6 | ... | 1.6 | ... |
| Balance after adjustment | ... | ... | ... | -0.9 | 3.3 | -4.2 | ... | 0.3 | ... |
| | (In units indicated) | | | | | | | | |
| Memorandum items: | | | | | | | | | |
| Nominal GDP (millions of lari) | 13,784 | 3,344 | 3,520 | 4,058 | 4,318 | 4,632 | 16,099 | 16,527 | 16,527 |

Sources: Georgian authorities; and Fund staff estimates.

1/ Excludes proceeds from leases of term 10 years and more, which have been reclassified as privatization revenue. Program nontax revenues in 2007 were corrected downwards by GEL 14.3 million and privatization upwards by the same amount.
2/ Based on Ministry of Defense budget; excludes defense spending from the President's Fund.
3/ The clearance of arrears in 2006 corrects a mistake in Country Report No. 07/107, which showed an increase of arrears by GEL 46 million.

Table 7. Georgia: Quantitative Performance Criteria and Indicative Targets, 2006–07 1/ 2/

| | Cumulative Change from End-December 2005 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Mar. 2006 | | Jun-06 | | Sep-06 | | Dec-06 | | Mar-07 | |
| | Performance criteria | | Indicative targets | | Performance criteria | | Indicative targets | | Performance crieteria | |
| | Prog. | Act. | Prog. | Act. | Prog. | Act. | Prog. | Prel. | Prog. | Prel. |
| | (In millions of lari) | | | | | | | | | |
| 1. Quantitative targets | | | | | | | | | | |
| Ceiling on cash deficit of the general government | 34.7 | 3.0 | 65.4 | 155.0 | 252.0 | 245.0 | 342.0 | 386.0 | 464.0 | 243.0 |
| Ceiling on net credit of the banking system to the general govt. (NCG) | 0.0 | -112.1 | -17.7 | -88.4 | -135.6 | -209.0 | -872.4 | -220.3 | -291.0 | -526.5 |
| Ceiling on reserve money | 42.9 | -22.5 | 70.8 | 43.2 | 118.3 | 96.0 | 150.4 | 191.8 | 181.0 | 151.2 |
| | (In millions of U.S. dollars) | | | | | | | | | |
| Floor on total net international reserves (NIR) of the NBG | 1.8 | 17.5 | 40.2 | 63.6 | 134.5 | 155.6 | 559.8 | 404.5 | 458.5 | 512.1 |
| Ceiling on contracting or guaranteeing of | | | | | | | | | | |
| A. Nonconcessional medium- and long-term external debt | 20.0 | 0.0 | 20.0 | 0.0 | 20.0 | 15.0 | 20.0 | 15.0 | 25.0 | 20.0 |
| B. Short-term external debt (less than one year) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Ceiling on accumulation of external arrears | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| | (In millions of lari) | | | | | | | | | |
| 2. Indicative target | | | | | | | | | | |
| Ceiling on net domestic assets (NDA) of the NBG | 39.5 | -55.0 | -3.5 | -74.4 | -130.6 | -192.3 | -885.3 | -546.7 | -640.0 | -791.3 |

Sources: Georgian authorities; and Fund staff estimates.

1/ Section 1 of this table shows quantitative targets for 2006; for stock variables, they are based on cumulative changes from end-December 2005 projections. The indicative target is shown in Section 2. The continuous performance criterion for external arrears is defined in paragraph 21 of the July 2005 TMU.

2/ Quantitative targets for 2006 are based on accounting exchange rates of GEL 1.85/US$, US$1.46/SDR, and US$1.21/EUR.

| Table 8. Georgia: Structural Performance Criteria (*) and Structural Benchmarks, 2006–07 | |
|---|---|
| Measure | Timing |
| Adopt financial reporting guidelines for all not-for-profit LEPLs.* | End-December 2006<br>Status: met |
| Enact legislation bringing Georgian Fit and Proper regulations in line with international best practices.* | End-December 2006<br>Status: not met |
| Introduce measures, through legislation or decrees, to enhance the operations and autonomy of the agency producing official statistics. | End-March 2007<br>Status: not met |
| Prepare a strategy for modernizing tax administration. | End-March 2007<br>Status: not observed |
| The NBG will issue a regulation requiring bank external auditors to include issues of relevance to the NBG in their audits and report to the NBG. | End-March 2007<br>Status: not observed |
| Have the BOP division at the NBG fully operational and publish $4^{th}$ quarter, 2006 BOP statistics. | End-March 2007<br>Status: met |

Table 9. Georgia: Macroeconomic Framework, 2005–10

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| | | Prel. | | Proj. | | |
| | | | (Percent change) | | | |
| Output, prices, money, and external trade | | | | | | |
| Real GDP | 9.6 | 9.4 | 10.0 | 7.5 | 7.0 | 6.5 |
| Consumer price index (average) | 8.3 | 9.2 | 8.5 | 6.9 | 5.0 | 5.0 |
| Broad money (M3, lari) | 26.4 | 39.3 | 31.8 | 26.5 | 24.0 | 22.0 |
| Exports (US$) | 34.8 | 13.2 | 7.3 | 8.9 | 10.0 | 10.1 |
| Imports (US$) 1/ | 33.8 | 37.2 | 22.0 | 12.4 | 10.4 | 8.8 |
| | | | (In percent of GDP) | | | |
| General government | | | | | | |
| Total revenues and grants | 23.4 | 26.3 | 28.3 | 28.5 | 28.9 | 29.4 |
| Tax revenues | 19.8 | 21.8 | 25.7 | 25.9 | 26.6 | 27.3 |
| Nontax revenues 2/ | 2.7 | 3.0 | 1.7 | 1.3 | 1.2 | 1.1 |
| Grants | 0.9 | 1.5 | 0.9 | 1.3 | 1.1 | 1.0 |
| Expenditures and net lending | 24.9 | 29.2 | 29.6 | 28.1 | 27.9 | 28.0 |
| Current expenditure | 20.7 | 23.7 | 23.6 | 22.9 | 23.2 | 23.5 |
| *Of which*: external interest | 0.3 | 0.3 | 0.5 | 0.3 | 0.2 | 0.2 |
| Capital expenditure and net lending | 4.2 | 5.5 | 5.9 | 5.2 | 4.7 | 4.5 |
| Overall balance (commitment basis) | -1.5 | -3.0 | -1.3 | 0.5 | 1.0 | 1.4 |
| Net change in expenditure arrears | -0.9 | -0.3 | -0.1 | 0.0 | 0.0 | 0.0 |
| Overall balance (cash basis) | -2.4 | -2.8 | -1.3 | 0.5 | 1.0 | 1.4 |
| Financing | 2.4 | 2.8 | -0.3 | -0.5 | -1.0 | -1.4 |
| Privatization | 3.6 | 4.8 | 3.6 | 0.5 | 0.3 | 0.2 |
| Domestic financing | -0.9 | -1.6 | -4.0 | -2.5 | -2.5 | -2.5 |
| External financing (net) | -0.3 | -0.4 | 0.1 | 1.5 | 1.1 | 1.0 |
| Required financing | 0.0 | 0.0 | 1.6 | 0.0 | 0.0 | 0.0 |
| Saving and investment | | | | | | |
| Investment | 26.3 | 25.6 | 27.0 | 26.8 | 27.1 | 27.5 |
| General government | 4.2 | 5.5 | 5.9 | 5.2 | 4.7 | 3.8 |
| Nongovernment sector 1/ | 22.1 | 20.1 | 21.0 | 21.6 | 22.4 | 23.7 |
| *Of which*: FDI | 8.3 | 15.4 | 16.5 | 10.6 | 6.5 | 4.0 |
| Gross domestic saving | 16.5 | 11.8 | 11.0 | 11.6 | 13.6 | 16.0 |
| General government | 2.7 | 2.5 | 4.7 | 5.7 | 5.7 | 5.2 |
| Nongovernment sector | 13.8 | 9.3 | 6.3 | 5.9 | 7.8 | 10.8 |
| Current account deficit 1/ | 9.8 | 13.8 | 16.0 | 15.2 | 13.5 | 11.5 |
| | | | (In millions of U.S. dollars; unless otherwise indicated) | | | |
| Gross official reserves of the NBG 3/ | 474 | 881 | 1517 | 1732 | 1971 | 2209 |
| (In months of imports of non-pipeline goods and services) | 1.7 | 2.3 | 3.2 | 3.3 | 3.4 | 3.5 |
| (In months of imports of goods and services) | 1.6 | 2.2 | 3.2 | 3.3 | 3.4 | 3.5 |
| External debt, public and guaranteed | | | | | | |
| External debt stock | 1,735 | 1,697 | 1,675 | 1,669 | 1,703 | 1,750 |
| External debt service, total | 193 | 223 | 201 | 141 | 129 | 123 |
| Memorandum items: | | | | | | |
| Nominal GDP (in millions of lari) | 11,621 | 13,784 | 16,527 | 19,010 | 21,663 | 24,456 |
| Nominal GDP (in millions of US$) | 6,411 | 7,764 | 9,553 | 10,989 | 12,522 | 14,136 |
| External debt stock (public and guaranteed; percent of GDP) | 27.1 | 21.9 | 17.5 | 15.2 | 13.6 | 12.4 |
| M3-velocity (M3) | 6.8 | 6.0 | 5.4 | 4.8 | 4.4 | 4.0 |

Sources: Georgian authorities; and Fund staff estimates.

1/ Large oil and gas pipeline projects are projected to increase imports, investment, and the current account deficit substantially in 2003–07.

2/ Sustained increase in nontax revenues from 2006 onward reflects transit fees from the BTC oil pipeline and the South Caucasus gas pipeline.

3/ International reserves are reported at current exchange rates and may differ from reserves at program rates as reported in the monetary accounts.

Table 10. Indicators of Financial Obligations to the Fund, 2004–10
(In millions of SDR)

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 Proj. | 2008 Proj. | 2009 Proj. | 2010 Proj. |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Fund credit outstanding | 228.6 | 228.0 | 194.3 | 171.3 | 162.1 | 157.1 | 159.2 | 137.1 | 119.1 | 105.0 |
| In percent of quota | 152.1 | 151.7 | 129.3 | 114.0 | 106.6 | 104.5 | 105.9 | 91.2 | 79.3 | 69.9 |
| In percent of GDP | 9.1 | 8.7 | 6.8 | 4.9 | 3.7 | 3.0 | 2.5 | 1.9 | 1.4 | 1.1 |
| In percent of exports of goods and non-factor services | 23.5 | 22.5 | 14.6 | 9.6 | 6.5 | 5.1 | 4.5 | 3.4 | 2.6 | 2.0 |
| Disbursements (PRGF) | 27.0 | 22.5 | 0.0 | 14.0 | 28.0 | 28.0 | 28.0 | 0.0 | 0.0 | 0.0 |
| Total obligations from existing and prospective drawings | 14.8 | 24.9 | 35.3 | 38.1 | 37.6 | 34.4 | 26.7 | 22.8 | 18.6 | 14.5 |
| Principal (repayments/repurchases) | 12.0 | 23.1 | 33.8 | 37.0 | 36.7 | 33.4 | 25.9 | 22.1 | 18.0 | 14.1 |
| Charges and interest | 2.8 | 1.8 | 1.6 | 1.1 | 0.9 | 1.0 | 0.8 | 0.7 | 0.6 | 0.4 |
| Total obligations to the Fund | | | | | | | | | | |
| In percent of quota | 9.8 | 16.6 | 23.5 | 25.4 | 25.0 | 22.9 | 17.8 | 15.1 | 12.3 | 9.7 |
| In percent of GDP | 0.5 | 0.7 | 0.9 | 0.7 | 0.6 | 0.4 | 0.3 | 0.2 | 0.1 | 0.1 |
| In percent of exports of goods and non-factor services | 1.9 | 3.2 | 3.7 | 3.2 | 2.2 | 1.6 | 1.1 | 0.9 | 0.6 | 0.4 |
| Net credit from the Fund | 15.0 | -0.6 | -33.8 | -23.0 | -8.7 | -5.4 | 2.1 | -22.1 | -18.0 | -14.1 |
| Net resources from the Fund | 12.2 | -2.4 | -35.3 | -24.1 | -9.6 | -6.4 | 1.3 | -22.8 | -18.6 | -14.5 |

Sources: IMF Finance Department; and Fund staff estimates and projections.

Table 11. Georgia: Schedule of Reviews and Disbursements
Under the PRGF Arrangement

| | Test Date | Board Date | Amount |
|---|---|---|---|
| Board Approval | | June 4, 2004 | SDR 14 million |
| First Review | June 30, 2004 | December 20, 2004 | SDR 14 million |
| Second Review | December 31, 2004 | July 20, 2005 | SDR 14 million |
| Third Review | September 30, 2005 | March 31, 2006 | SDR 14 million |
| Fourth Review | March 31, 2006 | September 29, 2006 | SDR 14 million |
| Fifth Review | September 30, 2006 | February 28, 2007 | SDR 14 million |
| Sixth Review | March 31, 2007 | August 20, 2007 | SDR 14 million |

**ATTACHMENT. GEORGIA: LETTER OF INTENT**

August 1, 2007
Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street N.W.
Washington, D.C. 20431

Dear Mr. de Rato:

In June 2004, shortly after the Rose Revolution, the International Monetary Fund approved a three-year Poverty Reduction and Growth Facility (PRGF) arrangement for Georgia. In the subsequent three years, we have accomplished much, including macroeconomic stability, strong economic growth, improved governance, and wide-ranging structural reforms. Such was our performance that the World Bank named Georgia the leading economic reformer for 2007. During this period, the support of the International Monetary Fund was of great importance and we wish to thank you for the Fund's efforts on our behalf.

Looking forward, we plan to continue implementing economic policies that will enhance macroeconomic stability and encourage growth led by the private sector. In the face of continuing strong economic performance—real GDP growth was close to 10 percent in 2006 and we expect even faster growth in 2007—the major economic challenge confronting us will be managing the large private inflows to Georgia, in a way that allows these inflows to contribute effectively to future growth, while keeping inflation under control and maintaining external competitiveness.

To accomplish this objective, the National Bank of Georgia (NBG) will have as its primary target keeping inflation below 10 percent in 2007. We recognize that, to achieve this in the face of the significant inflows and a need to increase the NBG's international reserves, fiscal policy will need to be supportive of this inflation target. Thus, while the recently adopted first supplement to our 2007 budget targets a fiscal deficit of three percent of GDP, we will act to ensure that the actual deficit is below this level. In addition, the Ministry of Finance will work closely with the NBG and will stand ready to tighten fiscal policy further to insure macroeconomic stability.

Another action that will be necessary to ensure the effective utilization of these inflows will be to strengthen our financial sector. To accomplish this, we are determined to strengthen the independence and effectiveness of financial sector supervision. Specifically, we have signed several agreements with supervision authorities of different countries to expand the exchange of information on banks' activities. Recently approved legislation will strengthen supervision of insurance and securities firms and constitutes a step toward consolidated supervision. We have intensified work on systemic risks, conduct more frequent targeted inspections and are going to increase the number of supervision staff and their salaries. We believe that despite the rapid credit expansion of recent years, the Georgian banking system is healthy. At the same time we take into account need of gradual responses to some, but increasing risks.

We have complied with all but one of the performance criteria, indicative targets and benchmarks for end- December 2006 and end-March 2007, as detailed in our most recent Memorandum of Economic and Financial Policies. We hereby request a waiver of the performance criterion that called for the adoption, by end-December 2006 of Fit and Proper legislation consistent with international best practices. While we had submitted appropriate legislation to Parliament in 2006, action on this legislation was delayed because of a heavy work load. Parliament has now begun discussions of this draft legislation and we expect formal adoption later this year.

In light of our recent performance and given our commitment to macroeconomic stability, we request the completion of the sixth and final review under the PRGF arrangement.

Further, we grant our permission for the publication on the IMF's website of the staff report and this letter.

Sincerely yours,

/s/
Zurab Nogaideli
Prime Minister of Georgia

/s/
Aleksi Aleksishvili
Minister of Finance

/s/
Roman Gotsiridze
President of the National Bank

INTERNATIONAL MONETARY FUND

GEORGIA

# Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criterion

## Informational Annex

Prepared by Middle East and Central Asia Department

August 1, 2007

Contents                                                Page

## Annex I. Georgia: Fund Relations

(As of May 31, 2007)

I. **Membership Status:** Georgia joined the Fund on May 5, 1992 and has Article VIII Status.

| II. **General Resources Account:** | **SDR Million** | **Percent of Quota** |
|---|---|---|
| Quota | 150.30 | 100.00 |
| Fund holdings of currency | 150.30 | 100.00 |
| Reserve position in Fund | 0.01 | 0.01 |

| III. **SDR Department:** | **SDR Million** | **Percent of Allocation** |
|---|---|---|
| Holdings | 0.80 | N/A |

| IV. **Outstanding Purchases and Loans:** | **SDR Million** | **Percent of Quota** |
|---|---|---|
| PRGF Arrangements | 156.75 | 104.29 |

V. **Latest Financial Arrangements:**

| Type | Approval Date | Expiration Date | Amount Approved (SDR million) | Amount Drawn SDR Million) |
|---|---|---|---|---|
| PRGF | 6/4/04 | 9/30/07 | 98.00 | 84.00 |
| PRGF | 1/12/01 | 1/11/04 | 108.00 | 49.50 |
| PRGF | 2/28/96 | 8/13/99 | 172.05 | 172.05 |

VI. **Projected Payments to Fund:** (SDR million; based on existing use of resources and present holdings of SDRs):

| | Forthcoming | | | | |
|---|---|---|---|---|---|
| | **2007** | **2008** | **2009** | **2010** | **2011** |
| Principal | 11.58 | 22.11 | 17.96 | 14.10 | 17.90 |
| Charges/interest | 0.76 | 0.66 | 0.56 | 0.49 | 0.40 |
| Total | 12.34 | 22.77 | 18.52 | 14.59 | 18.30 |

VII. **Implementation of HIPC Initiative:**

Not applicable.

VIII. **Safeguards Assessments:**

Under the Fund's safeguards assessment policy, the National Bank of Georgia (NBG) is subject to an assessment with respect to the PRGF arrangement approved on June 4, 2004.

The assessment was completed on December 10, 2004 and concluded that safeguards in place at the NBG appear generally adequate. However, certain vulnerabilities were identified in the internal audit and internal controls areas, and the safeguards assessment recommended measures to address them.

IX. **Exchange Arrangements:**

(a) Since April 29, 1993, the Tbilisi Interbank Currency Exchange (TICEX), established by the NBG and a group of commercial banks, has conducted periodic auctions to determine the exchange rate of the domestic currency vis-à-vis the U.S. dollar. These auctions are conducted daily. Foreign exchange bureaus are allowed to buy and sell foreign currency bank notes. Georgia's exchange rate regime is classified as "managed floating."

(b) Georgia maintains no exchange restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons, and notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

X. **Article IV Consultation:**

The 2006 Article IV consultation was concluded on March 31, 2006.

XI. **FSAP Participation:**

Two FSAP missions visited Tbilisi during May 1–15, and July 24–August 7, 2001. An FSAP update mission visited Tbilisi during February 15–28, 2006.

XII. **Technical Assistance:**

See Table 1 of this Appendix.

XIII. **Resident Representative:**

The fifth resident representative, Mr. Christiansen, took up his post on August 1, 2004.

XIV. **National Bank of Georgia Resident Advisors:**

Ms. Vance, MAE peripatetic banking supervision advisor to the NBG, commenced a series of visits to Tbilisi in September 1997. Mr. Nielsen, an MAE advisor, provided technical assistance to the NBG in May 1998. Mr. Viksnins was an MAE peripatetic advisor to the NBG president starting in October 1999. Mr. Fish was resident advisor on banking supervision from August 10, 1999 to January 31, 2002. Mr. Bernard Thompson provided peripatetic technical assistance in accounting and internal audit in March and August 2000. Mr. Wellwood Mason provided technical assistance on payment system issues on a peripatetic basis in 2002 and 2003. Mr. Howard C. Edmonds serves since September 2004 as a resident advisor on banking supervision issues.

## XV. **Ministry of Finance Resident Advisors:**

Mr. Sharma was an FAD resident advisor and assisted the authorities in the development of a Treasury beginning in May 1997. Mr. Sainsbury, an FAD advisor, assisted the Ministry of Finance from June 1998 to November 1999. Mr. Chaturvedi was FAD resident advisor in 2001 and 2002 to assist the authorities in continuing the development of the Treasury and the Treasury Single Account, in revising the legislative framework, expenditure control systems, and budgeting issues. Between 2001 and 2003, Mr. Welling was an FAD peripatetic advisor to assist the State Customs Department in preparing and introducing measures for the custom reform and modernization program. In March 2005, Mr. Zohrab started advising the authorities on treasury-related reforms, and his term ended in November 2006.

Table 1. Georgia: Fund Technical Assistance Missions, 2004–07

| Subject | Type of Mission | Timing | Counterpart |
|---|---|---|---|
| | **Fiscal Affairs Department (FAD)** | | |
| Tax Policy | Review of Tax Policy | June 8–21, 2004 | Ministry of Finance |
| Public Expenditure Management | Assessment of Treasury system. | Nov. 8–23, 2004 | Ministry of Finance |
| Revenue Administration | Modernizing Tax Administration | November 2005 | Ministry of Finance |
| Tax Administration | Installation | July 9–14, 2006 | Ministry of Finance |
| Tax Administration | Follow-up assistance | Oct. 9–25, 2006 | Ministry of Finance |
| Tax Administration Reform | Provide strategic and technical advice on tax administration reform program | Jan. 17–30, 2007 | Ministry of Finance |
| | **Monetary and Capital Markets Department (MCM)** | | |
| Government Securities Market, Deposit Insurance, Anti-Money Laundering | Advisory | April 20–30, 2004 | National Bank of Georgia |
| Monetary Operations, Banking Sector Competition | Advisory | Oct. 24–Nov. 5, 2004 | National Bank of Georgia |
| Liquidity Management; Trends in Securities and Insurance Sectors | Advisory | April 18–29, 2005 | National Bank of Georgia |

Table 1. Georgia: Fund Technical Assistance Missions, 2004–07

| Subject | Type of Mission | Timing | Counterpart |
|---|---|---|---|
| FSAP Update | Assessment | Feb. 15–28, 2006 | National Bank of Georgia |
| Monetary Operations/Monetary Policy/Foreign Exchange | Advisory | Feb. 16–Mar. 2, 2007 | National Bank of Georgia |
| | **Statistics Department (STA)** | | |
| National Accounts | Follow-up assistance | April 26–May 7, 2004 | State Department of Statistics |
| National Accounts | Follow-up assistance | April 18–29, 2005 | State Department of Statistics |
| Price Statistics | Follow-up assistance | May 23–June 3, 2005 | State Department of Statistics |
| Balance of Payments Statistics/International Investment Position | Follow-up assistance | June 15–28, 2005 | State Department of Statistics and National Bank of Georgia |
| Price Statistics | Follow-up assistance | June 20–July 13, 2006 | State Department of Statistics |
| Balance of Payments | Follow-up assistance | Sept. 6–19, 2006 | National Bank of Georgia |
| GDDS/Government Finance Statistics | Follow-up assistance | Nov. 8–22, 2006 | State Department of Statistics, National Bank of Georgia, Ministry of Finance |
| Balance of Payments | Follow-up assistance | July 9-20, 2007 | National Bank of Georgia |
| | **Legal Department (LEG)** | | |
| Tax Code | Follow-up assistance | Jan. 28–Feb. 9, 2001 | Ministry of Finance, Tax Inspectorate of Georgia |
| Tax Code | Follow-up assistance | Jul. 13–24, 2001 | Ministry of Finance, Tax Inspectorate of Georgia |

## ANNEX II. GEORGIA: IMF-WORLD BANK RELATIONS

### Partnership in Georgia's Development Strategy

1. The Government has prepared a second PRSP Progress Report—or the Economic Development and Poverty Reduction Program (EDPRP) Progress Report as it is known in Georgia. A Joint Staff Advisory Note was prepared which together with the Progress Report on the EDPRP were presented to the Boards of IDA and IMF in September 2006. The IMF presented the Staff Report of the Fourth Review under the PRGF arrangement to the IMF Board in September 2006. The latest World Bank Country Partnership Strategy (CSP) of Georgia for FY06-09 was presented to the World Bank Board of Executive Directors in September 2005. The Third Poverty Reduction Support Operation (PRSO III), the third in a series of PRSOs was discussed and approved by the Board in June 2007, and a proposed Fourth PRSO is currently under preparation.

2. The Fund has taken the lead in assisting Georgia in improving macroeconomic stability and pursuing fiscal reforms. The World Bank has taken the lead in the policy dialogue on structural issues, focusing on: (i) strengthening public expenditure management; (ii) improving performance of the public sector; (iii) reducing corruption; (iv) deepening and diversifying sources of growth; (v) protecting the environment; and (vi) reducing poverty. Georgia is one of the largest IDA borrowers in the CIS, with borrowing of US$881.6 million for 38 operations. The PRSO program has supported further elaboration and implementation of the key elements of the Government's poverty reduction strategy as described in the PRSP Progress Report (or EDPRP Progress Report).

3. The PRSO program focuses on four central reform areas: (i) strengthening public sector accountability, efficiency, and transparency; (ii) improving electricity and gas sector services; (iii) improving the environment for private sector development; and (iv) improving social protection, education and health care services.

4. Other support has come in the form of project support and Analytic and Advisory Activities across a broad spectrum of areas including education, health care, social protection, energy, roads, water and sanitation, agriculture, agricultural research and extension, irrigation and drainage, forestry, environment, biodiversity, enterprise development, municipal development, judicial reform, and cultural heritage. A Public Expenditure Review (PER) was prepared in 2002, and a Trade Study in 2003. A Country Procurement Assessment Report (CPAR) was prepared in 2002 and a Country Financial Accountability Assessment (CFAA) in 2003. A Country Fiduciary Assessment (CFA) was prepared in 2007. A series of annual programmatic Poverty Assessments are being implemented with a report to be issued in 2007. A Programmatic Public Finance Policy Review (PPFPR) and a Country Economic Memorandum (CEM) are planned for FY08.

5. Georgia became a shareholder and a member of IFC in 1995. As of January 1, 2007, IFC has invested around $180 million to finance projects in the financial, infrastructure, oil and gas, and manufacturing sectors. In the financial sector, IFC has focused on supporting the development of the housing finance market, providing investment and technical assistance to two leading banks—the Bank of Georgia and TBC Bank. To reach small and medium enterprises, IFC helped to establish ProCredit Bank of Georgia, the country's first bank specializing in lending to micro and small enterprises. IFC has also provided a credit line to TBC Leasing to support the rapid growth of their portfolio of SME clients; this project grows out of two year's of technical assistance to the Government and private sector to support the growth of the leasing sector. IFC continues to look for opportunities to support these clients, as well as other emerging financial market leaders to deepen the financial sector and increase the range of financial products available.

6. In the real sector, IFC's most recent transaction is a loan to TAV to support their construction of new airport terminals in Tbilisi and Batumi. In oil transit, IFC has provided equity and credit to local and international companies, including investments by British Petroleum and other sponsors in the construction of the Baku- Supsa Early Oil Pipeline and the Baku-Tbilisi-Ceyhan Pipeline. Other investment projects have been in electricity distribution (AES-Telasi), mineral water (GGMW), and glass bottle production (Ksani Glass Factory). In the real sector, IFC continues to look for opportunities to support the growth of the private sector, particularly in export-oriented companies or those that support overall private sector development. Sectors of interest include agribusiness, infrastructure, manufacturing, and the development of natural resources.

7. IFC has also provided donor-supported technical assistance to strengthen its client banks and introduce new financial products (including leasing and housing finance). IFC is currently providing technical assistance in Georgia to improve the business climate and corporate governance practices. The World Bank-IFC Doing Business report has ranked Georgia as the top reformer in its Doing Business 2007 report, and the Government is actively engaged with IFC to make further progress on reforms for the business enabling environment.

8. The division of responsibilities between the two institutions is described in the next section. In a number of areas—for example, the social sectors, rural development, environment, and infrastructure—the World Bank takes the lead in the dialogue and there is no related conditionality in the IMF-supported program. The World Bank is also leading the dialogue on private sector development and energy, and the World Bank analysis serves as inputs into the Fund program. In other areas—the financial sector, public expenditure management, and civil service reform—both institutions are working together. Finally, in areas like monetary policy and domestic customs revenue, the IMF takes the lead.

## IMF-World Bank Collaboration in Specific Areas

### Areas in which the World Bank leads and there is no direct IMF involvement

9. In the **social sectors**, IDA updates Georgia's Poverty Assessment based on quarterly household survey data. IDA's focus has been to improve execution of budgetary expenditures for health, education and poverty benefits and to raise the efficiency in the use of scarce public resources. Through the Social Investment Fund credits, IDA is focusing in particular on areas with high poverty levels to provide basic infrastructure to the poorest communities. Through the PRSO program, IDA is strengthening the dialogue with the Government on social protection reform (safety nets, pensions, poverty benefits, labor market institutions and policies). Under the PRSO program, a poverty benefit targeted for the extreme poor is being implemented.

10. In **education,** the Adaptable Program Credit of Education System Realignment & Strengthening Program addresses a broad spectrum of educational reform issues, aimed at improving learning outcomes of primary and secondary students through curriculum reform, development of a national assessment and examination system, training of teachers, provision of learning materials, and development of capacity to make better use of physical, financial, and human resources. It also tackles key financing issues through the introduction of a per capita based formula for financing basic education. While the investment needs of school buildings are substantially higher than is currently affordable, the Social Investment Fund projects continue to assist in financing urgent repairs to school facilities in many communities. The PRSO program is supporting the Government's efforts in institutionalizing systemic changes initiated with its education reform strategy.

11. In **health**, IDA credits support the government in improving health care financing, exploring risk-pooling options, introducing a new system of primary health care, and improving the focus of publicly-funded services to the poor and on priority public health interventions. IDA is engaged in policy work in health sector reform in the context of the PRSO program through a health care reform sub-component as well as through the public expenditure policy reform sub-component.

12. In **infrastructure,** support is being provided through the Secondary and Local Roads Project, the Municipal Development and Decentralization Project II and the Social Investment Fund Project. These projects provide financing at the community level for critical infrastructure needs, primarily for school and health facility heating and repair, small hydropower schemes to provide electricity, drinking water and sanitation rehabilitation, as well as transportation infrastructure rehabilitation. IFC supported the privatization of Tbilisi electricity distribution through an investment in AES-Telasi, and IFC Advisory Services advised the Government on the management contract for UEDC. The recently approved Infrastructure Pre-Investment Facility project is to facilitate infrastructure investments of

strategic importance and/or special complexity by providing technical assistance to assess the feasibility and effectiveness of investments, focusing on energy and transport sectors.

13. In **rural development**, IDA credits have supported development of private sector farming and agro-processing improvements, agricultural credit, irrigation and drainage, and agricultural research. IDA credits have also been supporting creation of local institutions, such as rural credit unions and water users associations. A recently approved Rural Development Project is to develop the productivity and profitability of the private agriculture sector with the aim to increase incomes and employment and reduce poverty in rural areas.

14. A recently closed **Judicial Reform** Project provided funds for development of new court administration and case management procedures, rehabilitation and construction of courthouses, a computerized network system, assistance for judicial training, and an extensive public information and education outreach effort to inform citizens of their rights and communicate the Government's reform efforts.

**Areas in which the World Bank leads and its analysis serves as input into the IMF program**

15. The World Bank leads the dialogue on structural reforms through the PRSO program. Institution building and technical assistance have been supported through the Structural Reform Support Project. The World Bank also leads in the areas of:

a) **Private Sector Development.** The PRSO program focuses on improving investment climate and reducing constraints to private sector development in Georgia. IDA has also been supporting private sector participation in other areas, such as energy, urban services and agriculture. The IMF has worked with the authorities to initiate audits of the accounts of three major state-owned enterprises.

b) **Energy.** The energy system was in poor condition, with unreliable supply and unsustainable debts. However, under the PRSO program, the Georgian authorities have made progress and payment collections and service levels have improved substantially in the power sector. The Government of Georgia has been working with IDA and other donors, including the Fund, to implement a series of short-term action plans and longer term steps to improve the overall functioning of the sector. IDA has also provided additional funding to the power sector in 2004. At the beginning of the PRGF program, the Fund has been focusing on reducing quasi-fiscal losses in the sector. The World Bank through the PRSO program focused on improved bill collections, and supported the pursuit of tariff policies at cost-recovery levels was facilitated by a World Bank-assisted review of the tariff policy methodology. The Georgian authorities prepared the Energy Sector Strategic Action Plan for 2005–08 which is being implemented and updated periodically under the PRSO program. In a new operation, the World Bank will finance a feasibility study for a major, new hydropower plant that could add about 20 percent to the country's hydropower capacity.

c) **Public Sector Management.** The PRSO program supports through its first pillar, inter alia, improving public expenditure policies and management; implementing procurement reform; strengthening public financial management accountability; implementing intergovernmental fiscal reform; developing a strategy for administrative and civil service reform; and implementing the National Anti-corruption Strategy. The Public Sector Financial Management Reform Support Project (IDA grant pooled together with resources from other donors) is to provide technical assistance and capacity building in support of the first pillar of the PRSO program. The Fund is providing technical assistance in support of tax and customs administration reform.

d) **Municipal Finance:** The Municipal Development and Decentralization Project II has been assisting the Government to review the current intergovernmental fiscal relation, and to suggest an equalization transfer system to compensate for horizontal fiscal disparities across local governments.

**Areas of shared responsibility**

16. The World Bank and the Fund have been working jointly in the following main areas:

a) **Poverty Reduction Strategy.** Both institutions have been working closely with the Government to support the implementation of the PRSP (or EDPRP as it is known in Georgia), through seminars and workshops, direct staff input, and donor coordination. A JSAN on the progress with implementation of the Government's EDPRP was issued in September 2006.

b) **Budget Planning and Execution.** The PRSO program is supporting reforms to improve public expenditure policies and management including development of an MTEF, and strengthening public financial accountability. The Public Sector Financial Management Reform Support Project is financing technical assistance and necessary investment to support budget planning and management processes within the MoF and line ministries. The Fund is focusing on treasury reform within the Ministry of Finance.

c) **Financial Sector Reforms.** The joint Financial Sector Assessment Program has supported: (i) strengthened banking and non-banking supervision; (ii) introduction of international accounting standards; (iii) consolidation of banks through higher capital requirement ratios; (iv) anti money-laundering legislation; (v) strengthening the regulatory environment and removing impediments for development of viable non-bank financial institutions; and (vi) strengthening the payment system. IFC has worked to strengthen the banking sector through investment and technical assistance, and has supported the development of the financial leasing market through technical assistance. The Fund has focused on banking supervision, anti-money laundering legislation, and improvements in monetary control instruments with extensive technical assistance from its Monetary and Financial Systems Department.

**Areas in which the IMF leads and its analysis serves as input into the World Bank program**

a) **Fiscal Framework and reforms in tax policy and tax and customs administration**. The Fund's focus on prudent fiscal policy has served as an important framework for IDA's work on public expenditure management. The Fund's Fiscal Affairs Department has the lead in the areas of tax policy and tax and customs administration reform.

b) **Economic Statistics.** IMF technical assistance has been conducive to improvements in national accounts, price, monetary and government financial statistics. The World Bank's grant on Statistical Capacity Building will build on the recommendations of Fund TA to strengthen the quality of national accounts statistics.

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**Areas in which the IMF leads and there is no direct World Bank involvement**

a) **Monetary Framework**. The IMF collaborates closely with the NBG in the design and implementation of a monetary program that aims at rebuilding international reserves while keeping inflation low and monetizing the economy.

## World Bank Group Strategy

On September 15, 2005, the World Bank Executive Board endorsed the new Country Partnership Strategy (CPS) for FY06-09 designed to assist Georgia with deeper institutional reform as well as more fundamental infrastructure improvements. The First PRSO, of a series of single tranche annual Poverty Reduction Support Operations was approved in September 2005 (US$13.5 million is a regular IDA credit and US$6.5 million is an IDA grant). The Second PRSO for US$ 20 million of IDA credit was approved by the World Bank's Board in October 2006. The Third PRSO for US$20 million of IDA was approved by the World Bank's Board in June 2007. The Fourth PRSO is under preparation. Other recent operations include a US$19 million First East-West Highway Improvement, a US$15 million Education System Realignment & Strengthening Program, a US$5 million Infrastructure Pre-Investment Facility Project, a US$3 million grant Public Sector Financial Management Reform Support Project, a US$24 million Reform Support Credit, a US$20 million Secondary and Local Roads Project, a US$3.6 million Electricity Market Support Project, a US$10 million Rural Development Project, and a US$5 million Irrigation and Drainage Community Development Project Additional Funding for flood control. The World Bank continues its discussion with the Government on a more comprehensive medium-term reform strategy that would be supported by future Poverty Reduction Support Operations and technical assistance operations.

Questions may be referred to Ms. R. Quintanilla (202-473-7673), Ms. Afsaneh Sedghi (202-473-7518), or Mr. A. Cholst (202-458-0324).

## ANNEX III. GEORGIA: RELATIONS WITH THE EBRD

(As of April 30, 2007)

1. As of April 30, 2007, the European Bank for Reconstruction and Development (EBRD) had signed 75 investments in Georgia with cumulative commitments totaling US$535.6 million.[1] Current Portfolio Stock equals to US$349.0 million. The EBRD's first operation, a power rehabilitation project, was signed in December 1994. Since then, the pace and composition of portfolio growth has varied significantly from year to year.

2. During 2006, the Bank signed 26 transactions in Georgia for US$150.25 million. The project examples include: additional US$10 million loan to Georgia State Electro System for Enguri HPP Phase II rehabilitation program; US$ 21.2 million loan to TAV Georgia, the concession of the Tbilisi International Airport for construction of new passenger terminals in Tbilisi and Batumi; mortgage loan of US$8 million to Bank Republic and US$3 million credit line for on-lending purposes to SMEs; Loan to the cities of Kutaisi and Poti of €3 million and €2.5 million respectively to improve the water supply in the cities.

3. The ratio of private sector projects in the portfolio now stands at 83.6 percent. The Bank plans to focus primarily on private sector financing, but may also consider selected public sector projects. The Bank will give preference to non-sovereign operations although, where sovereign guarantees will be required, donor co-funding on a grant basis will be sought.

4. The EBRD is helping Georgia to benefit from its privileged location, transforming it into a regional transportation and natural resources hub. Georgia is part of the 'Early Transition Countries' (ETC) initiative. Launched in April 2004, the initiative aims to increase investments in the Bank's seven poorest countries. The initiative builds on international efforts to address poverty in these countries. Through this initiative, the EBRD focuses its efforts on private sector business development and selected public sector interventions. It aims to stimulate market activity by using a streamlined approach to financing, focusing on smaller projects, mobilizing more investment, and encouraging ongoing economic reform. The Bank will accept higher risk in the projects it finances in the ETCs, while still respecting the principles of sound banking. Since launch of the ETC initiative the Bank's annual business volume in Georgia has been increased five times.

[1]Evaluated at an exchange rate of US$1.3646 per euro.

**Table 1. Georgia: EBRD Portfolio for Georgia**
**As of April 30, 2007 (US$, million)**

| Project Name | Date of Agreement | Outstanding Amount |
|---|---|---|
| Bank Republic - MSE Loan | 27/04/06 | 3.0 |
| Bank Republic Equity | 15/09/06 | 8.4 |
| Bank Republic Mortgage Loan | 20/12/06 | 4.0 |
| DIF - Delidor | 17/06/05 | 1.6 |
| DIF - Georgian Hazelnut Production Ltd. | 26/10/06 | 0.8 |
| DIF - Iberia Refreshments | 25/09/03 | 2.8 |
| DIF - Imedi L | 30/12/06 | 1.6 |
| DIF - Lomisi | 20/12/05 | 3.4 |
| DIF - Mantashev Trade Rows JSC | 22/12/06 | 0.8 |
| DLF - BTM TEKSTIL | 21/12/06 | 2.4 |
| DLF - Georgian Hazelnut Production Ltd | 26/10/06 | 3.4 |
| DLF - Lomisi | 08/12/06 | 2.0 |
| ETC Non-Bank MFI Framework II - Constanta | 28/11/06 | 3.0 |
| Georgia: Trans-Caucasian Rail Link Project | 22/12/98 | 7.8 |
| Georgian Property Debt Facility | 19/03/07 | 3.3 |
| Georgian State Electrosystem | 22/12/98 | 33.6 |
| Georgian Wines & Spirits Ltd. | 10/03/05 | 7.1 |
| JSC Channel Energy Poti Port | 19/03/02 | 8.6 |
| Kutaisi Water Project | 15/09/06 | 4.1 |
| MCFF - Bank of Georgia Full Recourse Portion | 14/06/05 | 4.8 |
| MCFF - BoG Iberia Refreshments Sub-Loan (NRP) | 27/09/06 | 3.2 |
| MCFF - TBC Bank JSC Full Recourse Portion | 13/06/05 | 3.5 |
| MCFF - TBC Bank Lomisi Ltd Sub-Loan (NRP) | 03/08/05 | 2.7 |
| MCFF - TBC Coca Cola Ltd. sub-loan | 02/02/07 | 6.0 |
| MCFF BOG - Renewable Energy Programme - Okami SHPP NRP | 21/12/06 | 0.1 |
| MCFF BOG - Renewable Energy Programme Lopota SHPP NRP | 21/12/06 | 0.2 |
| MCFF BOG - Renewable Energy Programme Machakhela SHPP NRP | 29/12/06 | 0.1 |
| Poti Water Supply Project | 15/09/06 | 3.4 |
| Power Rehabilitation Project | 20/12/94 | 4.6 |
| ProCredit Bank Georgia | 11/10/01 | 1.5 |
| Regional TFP: Bank Republic (Guarantee & Pre-export) | 15/02/06 | 0.6 |
| Regional TFP: Bank of Georgia (Guarantee & Pre-export) | 29/07/99 | 13.0 |
| Regional TFP: Cartu Bank | 28/04/06 | 2.5 |
| Regional TFP: TBC Bank (guarantee & pre-export) | 17/08/99 | 9.0 |
| Regional TFP: United Georgian Bank (UGB) | 24/12/00 | 4.9 |
| TBC Bank - SME Credit Line | 19/12/03 | 3.8 |
| TBC Bank - Syndicated Loan | 20/12/05 | 7.0 |
| TBC Bank Mortgage Loan | 29/06/06 | 15.0 |

| | | |
|---|---|---|
| TBC Bank SME Credit Line III | 26/09/05 | 5.0 |
| TBC Leasing - Equity Investment | 01/03/06 | 0.1 |
| TBC Leasing, Senior Debt | 21/12/05 | 3.0 |
| TbilComBank (Sub Project of Georgia SME) | 12/12/96 | 0.2 |
| Tbilisi International Airport | 17/05/06 | 27.0 |
| Tbilisi Public Transport Project | 29/07/05 | 3.5 |
| United Georgian Bank (debt, equity) | 20/11/97 | 2.5 |
| United Georgian Bank Capital Increase | 09/10/06 | 2.4 |
| VTB Bank Georgia | 09/10/06 | 10.0 |
| **Direct Investments / Sub Total** | | **241.2** |
| **Regional Projects** | | |
| BIH | 18/12/06 | 6.4 |
| BSR Europe Co-Investment Facility | 14/08/06 | 9.6 |
| Baku-Tbilisi-Ceyhan (BTC) Pipeline | 03/02/04 | 62.2 |
| Baring Vostok Private Equity Fund | 13/12/00 | 0.2 |
| First NIS Regional Fund | 21/11/94 | 0.0 |
| Lukoil Overseas : South Caucasus Gas Pipeline | 28/07/05 | 29.4 |
| NIS Restructuring Facility | 16/03/00 | 0.0 |
| **Regional Projects / Sub Total** | | **107.8** |
| **TOTAL** | | **349.0** |

## ANNEX IV. GEORGIA: STATISTICAL ISSUES

1. The core statistical indicators compiled by the authorities are provided on a timely basis and are generally adequate for surveillance and program monitoring, however there is scope for improvement. The Fund has provided technical assistance in the compilation of macroeconomic statistics (Appendix I, Table 1). Despite improvements in the areas of national accounts, price, monetary, and government finance statistics, the quality of macroeconomic statistics remains poor, reflecting deficiencies in statistical methodologies, coverage, and insufficient resources. Problems are particularly acute in the compilation of national accounts, balance of payments, foreign trade, and fiscal statistics. The transfer of responsibility for the balance of payments from the State Department of Statistics (SDS) to the National Bank of Georgia (NBG) in January 2007 is expected to lead to improvements.

2. The data module of the Report on the Observance of Standards and Codes (ROSC), prepared in July 2002 was published on the Fund's external website on May 27, 2003. In August 2005, the authorities notified the Fund of their commitment to participate in the General Data Dissemination System (GDDS), and appointed a national GDDS coordinator. A GDDS mission visited Tbilisi during November 8–22, 2006 to finalize metadata and make recommendations about required steps for subscription to the Special Data Dissemination Standard (SDDS), which were included in the GDDS plans for improvement. On December 15, 2006 Georgia began participation in the GDDS.

### Real sector

3. National accounts statistics follow the concepts and definitions of the *System of National Accounts 1993.* Annual and quarterly GDP estimates are compiled by both the production and expenditure approaches. Revisions of the national accounts follow an established schedule. Preliminary national accounts estimates are available after 85 days, and final estimates after 13 months. The 2002 data ROSC mission found several weakness regarding data sources, including: inadequate coverage of the business register; poor coverage of units in terms of value added for agriculture, retail trade, construction, catering, and services; limited administrative sources to estimate the non-observed economy; and inadequate data for imports and exports of services (taken from the balance of payments). Follow-up missions in early 2004 and April 2005 found that although the authorities have made good progress in addressing some of these issues, there was scope for improving the constant price estimates and advancing in the development of the system of supply and use tables. On price statistics, a May/June 2006 mission reported important progress regarding the development of agricultural price indices and plans to upgrade both CPI and PPI methodology, PPI specification, and dissemination practices.

### Money and banking

4. A March 2002 STA mission found that the authorities had implemented many of the recommendations of the December 2000 mission. The July 2002 data ROSC found that most elements in the data quality assessment framework for monetary statistics were fully or largely observed, and recommended improvements in the statistical coverage of non-bank

depository corporations and the provision of documentation on metadata. It also recommended increased transparency regarding access by governmental agencies to monetary statistics prior to their release to the public.

5. In accordance with *Monetary and Financial Statistics Manual*, the NBG has begun compiling monetary data using the framework of the STA's Standardized Report Forms (SRF) and has been providing data regularly. These data have been published in the *IFS Supplement* since September 2006. Beginning from December 2001, data published in *IFS* have been revised in accordance with the SRF.

**Government finance**

6. Government finance statistics (GFS) on a cash basis are reported to STA for publication in the *GFS Yearbook.* The GFS mission of November 2006 found that Georgia has embarked on a program of reform to their central and local government budget and accounting systems to fully adopt the *GFSM 2001* methodology and the International Public Sector Accounting Standards (IPSASs). The strategy will be implemented in stages. Initially the *GFSM 2001* functional and economic classifications are being applied to the current cash data. This will be followed by a staged introduction of accrual recording into transactions data, and an expansion in the range of items recorded in the balance sheet. These reforms are documented in the paper *Accounting Reform Strategy—2007–17.* The Georgian authorities' commitment to the accounting reform strategy is set out in Decree 101 issued by the Minister of Finance on February 10, 2006. This decree approves the general strategy, but implementation of some of the individual steps in the transition plan will require amendments to the Law of Georgia on the Budget System (Budget System Law).

**Balance of payments**

7. A technical assistance mission in September 2006 assisted the authorities to prepare an action plan for the transfer of responsibility for the compilation of the balance of payments from the SDS to NBG; advised on the structure of the NBG's new balance of payments division; and developed a framework for the collection of source data. Also, the mission helped to further develop the framework for compilation of an international investment position statement.

The balance of payments compilation function was transferred to NBG in mid-January 2007, although SDS will remain the main provider of data for exports of goods and services and direct investment.

8. The Statistics Advisor stationed in Baku undertook the first of a series of planned missions to Georgia during April 23–May 4, 2007. Major findings and recommendations of the mission were: (i) amendments are needed to the Law on Statistics or to the National Bank Law to assign responsibility and authority for collection, processing and dissemination of international investment position and external debt statistics; (ii) NBG should be represented

on the National Statistics Council; (iii) the government and NBG should agree to a data provision/data sharing scheme, such as that proposed by the mission; (iv) a Balance of Payments Expert Group should be established to identify problems in data collection, compilation, and dissemination, and also agree on the direction to take for future data improvement; and (v) the international transactions reporting system should be developed and the data collected should be used in the balance of payments compilation;

In addition, recommendations were made (i) for specific improvements to the data collection for private sector liabilities and transactions of the Georgian Pipeline company; and (ii) for further investigation of discrepancies between the national data on portfolio investment liabilities and the derived liability data from the Coordinated Portfolio Investment Survey.

## GEORGIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE (AS OF JULY 17, 2007)

| | Date of latest observation | Date received | Frequency of Data[6] | Frequency of Reporting[6] | Frequency of publication[6] | Memo Items: | |
|---|---|---|---|---|---|---|---|
| | | | | | | Data Quality—Methodological soundness[7] | Data Quality—Accuracy and reliability[8] |
| Exchange Rates | 06/07 | 7/9/07 | M | M | M | | |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1] | 05/07 | 06/07 | D | W | M | | |
| Reserve/Base Money | 06/07 | 7/15/07 | M | M | M | O, LO, LO, O | O,O,O,O,LO |
| Broad Money | 06/07 | 7/15/07 | M | M | M | | |
| Central Bank Balance Sheet | 06/07 | 7/15/07 | M | M | M | | |
| Consolidated Balance Sheet of the Banking System | 06/07 | 7/15/07 | M | M | M | | |
| Interest Rates[2] | 05/07 | 7/10/07 | W | W | M | | |
| Consumer Price Index | 06/07 | 07/07 | M | M | M | O,LO,O,O | LO,LO,O,O,O |
| Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4] | 07/06 | 8/23/06 | M | M | M | LNO,LO,LNO,O | LO,O,LO,O,O |
| Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government | 04/07 | 05/07 | M | M | M | | |
| Stocks of Central Government and Central Government-Guaranteed Debt[5] | 04/07 | 5/29/07 | M | M | M<br>Domestic not disseminate d | | |
| External Current Account Balance | Q4/06 | 4/9/07 | Q | Q | Q | O,LO,LO,LO | LNO, LNO, LNO ,LNO, LNO |
| Exports and Imports of Goods and Services | Q4/06 | 06/07 | Q | Q | M | | |

## GEORGIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE (CONTINUED)
## (AS OF JULY 17, 2007)

| | Date of latest observation | Date received | Frequency of Data[6] | Frequency of Reporting[6] | Frequency of publication[6] | Memo Items: | |
|---|---|---|---|---|---|---|---|
| | | | | | | Data Quality—Methodological soundness[7] | Data Quality—Accuracy and reliability[8] |
| GDP/GNP | Q4/06 | 6/11/07 | Q | Q | Q | O,LO,O,LO | LNO, LNO, LNO, LO, LO |
| Gross External Debt | 08/05 | 09/06/05 | M | M | M | | |

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC (published on May 27, 2003, and based on the findings of the mission that took place during July 15 – 31, 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] 8 Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 07/182
FOR IMMEDIATE RELEASE
August 20, 2007

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Executive Board Completes Sixth and Final Review of Georgia's PRGF Arrangement and Approves US$21.3 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) today completed the six and final review of Georgia's economic performance under the three-year program supported by the Poverty Reduction and Growth Facility (PRGF) arrangement. In completing the review, the Board approved the authorities' request for a waiver for the nonobservance of the end-December 2006 structural performance criterion on the enactment of legislation bringing Georgian fit and proper regulations in line with international best practice.

The Executive Board approved the PRGF arrangement on June 4, 2004 (see Press Release No. 04/107) for an amount equivalent to SDR 98 million (about US$149.4 million). Completion of this review will enable Georgia to make the final drawing for an amount equivalent to SDR 14 million (about US$21.3 million) under the arrangement.

Following the Executive Board discussion of Georgia's economic performance, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, made the following statement:

"Georgia's economic performance has been impressive in recent years, with rapid growth maintained over the last year despite the loss of major export markets. Such resilience reflects the authorities' pursuit of consistently strong policies, allowing them to achieve macroeconomic stability and remarkable improvements in fiscal performance and the business environment.

"This success has, however, brought challenges, in the form of large foreign inflows and a widening current account deficit. In response, the government plans to implement a tighter-than-budgeted fiscal stance this year to avoid overheating and limit pressures for lari appreciation, which could undermine international competitiveness. The National Bank of Georgia will maintain its focus on keeping inflation in single-digits. In the medium term, budget surpluses are likely to be needed as long as foreign inflows remain strong.

"The authorities intend to press ahead with an ambitious structural reform agenda which, supported by prudent fiscal policies, will be key to maintaining competitiveness in the medium term. In this regard, passage of fit and proper legislation will be important for the healthy development of the banking sector.

“The authorities intend to remain closely engaged with the Fund after the expiration of the PRGF arrangement," Mr. Kato said.

**Statement by Yuriy G. Yakusha, Alternate Executive for Georgia and Thomas Rookmaaker, Advisor to Executive Director August 20, 2007**

## Background

Georgia's three-year PRGF arrangement has been very successful. The macroeconomic performance has been strong in many respects and an ambitious reform agenda has been pursued. The dynamism in the country is illustrated by the unexpectedly high economic growth during the program period. At the time of the program approval in June 2004, the projected real GDP growth for 2004-2007 averaged 5.3 percent. This average is now expected to be 8.7 percent. Real GDP growth is projected at 10 percent for 2007. Furthermore, the economy proved resilient to external shocks. The authorities' commitment to macroeconomic stability was illustrated when they successfully dealt with an inflationary spike in the summer of 2006.

During the program period, the investment climate has sharply improved, not in the least by the authorities' strong anti-corruption drive. This is illustrated by significant changes in several independent institutes' indicators, most prominently the Doing Business indicator of the World Bank. Last year's Doing Business report proclaimed Georgia the number one reformer, while a year earlier Georgia was the number two. Fitch recently published its long-term foreign currency sovereign rating for Georgia. Its BB- rating is similar to the ratings for, e.g., Serbia and Ukraine. The PRGF arrangement clearly contributed to these successes, as it helped build domestic and international credibility, enhanced investor confidence and mobilized support for the authorities' ambitious reform agenda.

Over the program period, the authorities have built a very strong track record in tax collection. In 2003 tax revenues were equivalent to some 14.5 percent of GDP. At the start of the program, tax revenues were projected to reach 18.3 percent of GDP in 2006. While this would already have been quite an achievement, tax revenues amounted to 21.8 percent of GDP in 2006 and are expected to be even higher in 2007. This is mainly the result of tax reforms, creating a simple and clear tax system with relatively low rates. In addition, the recent merger of the agencies for tax collection and enforcement has been pursued to improve both efficiency and service to tax payers, while at the same time contributing to the fight against corruption and smuggling.

With regard to the sixth and final review of the PRGF arrangement, all quantitative performance criteria were met. The structural performance criterion related to passing the fit and proper legislation has not yet been met. Draft legislation has been submitted to Parliament in time, but discussions have been delayed as a result of Parliament's busy work schedule. Parliamentary discussions have now begun.

**Monetary policy and the exchange rate**

The strengthened investment climate has led to a sharp increase in foreign capital inflows. This particularly relates to FDI, the allocation of which among the different sectors has become more diverse. While these inflows contribute to growth and a build-up of foreign reserves to more comfortable levels, they emphasize the challenge to keep inflation within single digits and to maintain external competitiveness. The authorities recognize the challenge of managing these inflows and they are determined not to let Georgia become a victim of its own success.

Staff have now agreed with the authorities on the need to limit nominal exchange rate appreciation in the context of the challenges caused by the foreign capital inflows. We very much welcome staff's flexible approach that is now putting more emphasis on the fiscal policy. In the end it is policy consistency that is key.

We note that the staff report mentions that slowing export growth and a rising current account deficit indicate that the real exchange rate may be overvalued. Going forward, we ask staff to look into this matter more carefully in the context of the next Article IV Consultation. As determining the real effective exchange rate is not straightforward and subject to much uncertainty, we encourage staff to use several of the available methodologies. The preliminary conclusion is now primarily based on the current account, leaving the capital and financial account aside. While slowing export growth and a widening current account deficit would ceteris paribus lead to an adjustment through real exchange rate depreciation, the effect of accelerated capital inflows is likely to be dominating in Georgia. Export growth is slowing somewhat, but for 2007 private sector inflows are projected to increase by almost 50 percent to a level significantly higher than the projected current account deficit. The real exchange rate may just as well be in line with fundamentals.

The slowdown in export growth itself is the result of exogenous events rather than a loss in competitiveness. In addition to lower exports to Russia as a result of the trade restrictions, the export of aircraft to Turkmenistan, which was in fact an in-kind payment for its debt, decreased as a result of dropped debt levels last year. After excluding Russia and Turkmenistan, the export growth rates show an upward trend.

**Fiscal policy**

Since the scope for sterilization through, e.g., the sale of CDs is limited, the authorities believe that fiscal policy has become the main policy tool to avoid overheating as a result of the foreign capital inflows. Hence, the authorities are prepared to adjust fiscal policy if necessary to respond to inflationary pressures. They are committed to a responsive fiscal policy, pursued on a day-to-day basis. Flexibility is consistent with the uncertain nature of international capital movements. While realizing that expenditures have increased as a result of a recently approved budgetary supplement, tax revenues are expected to overperform again, allowing for the needed flexibility. In the past the authorities have often proved to be able to generate higher than expected tax revenues. Data for the first quarter of 2007 show a very strong overperformance of tax revenues.

**Financial sector**

The financial sector has grown rapidly and its health improved significantly in recent years. The share of non-performing loans came down, while capital adequacy remained high. On the banks' balance sheets the foreign currency-denominated loans are relatively high, but the extent of dollarization has declined substantially over the recent years, illustrating improved confidence in the banking system. Georgia is in the process of opening up the financial sector to the world, which resulted in the acquisition of several local banks by foreign investors, and in a major foreign bank recently receiving a banking license. The entry of foreign financial players contributes to the development of a sound, modern financial system, which is one of the priorities of the authorities.

Financial sector supervision has much improved in recent years, also in the context of NBG's efforts related to implementing its comprehensive three-year banking system development strategy. Nonetheless, the authorities believe supervision needs further strengthening, including through an increase in the number of supervision staff. They have stepped up their targeted inspections and improved the information-sharing arrangements with the authorities of other countries. Moreover, supervision of insurers and securities firms has been strengthened by recently adopted legislation to merge the National Commission on Securities and State Service for Insurance Supervision with the Financial Monitoring Service. Strengthened consolidated supervision is part of NBG's financial sector development strategy.

**Poverty reduction**

Poverty reduction remains a key priority, as it takes time for a dramatic change in poverty indicators to materialize. Central in the authorities' strategy to reduce poverty is sustainable economic growth. At the same time, they realize that sustainable growth alone is not enough. Hence, the social security system has been reformed, leading to monetization of assistance and better targeting of the poor. Furthermore, basic health insurance is now provided with free consultation and essential medical treatment. Other measures include free secondary education and discounts on transportation and utilities.

**Going forward**

The authorities' drive for reform is homegrown and goes well beyond the limits of the program conditionality. Perhaps at the risk of stating the obvious, the authorities have the intention to continue on the path of reform. For instance, while Georgia already has one of the most open trade regimes in the world, the authorities have the intention to liberalize it further. Moreover, the government is planning to start another round of privatizations, including of the railways and postal communications, as well as of the Tbilisi potable water company.

Finally, on behalf of the authorities, we would like to thank staff and management for their highly-valued policy advice and dedication during the program period. The authorities have the intention to decide this fall on whether they will request a new Fund arrangement or, instead, have a surveillance-only relationship with the Fund. Irrespective of what their choice will be, the authorities look forward to continue their very fruitful relations with the Fund.