April 2009
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Georgia: 2009 Article IV Consultation and Second Review Under the Stand-By Arrangement—Staff Report; Press Release and Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Georgia.

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2009 Article IV consultation with Georgia and second review under the stand-by arrangement, the following documents have been released and are included in this package:

- The staff report for the combined 2009 Article IV Consultation and Second Review Under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on February 11, 2009, 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 March 10, 2009. 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 and a Public Information Notice (PIN), summarizing the views of the Executive Board as expressed during its March 23, 2009, discussion of the staff report on issues related to the IMF arrangement and the Article IV consultation, respectively.

- A statement by the Executive Director for Georgia.

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

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

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

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INTERNATIONAL MONETARY FUND

GEORGIA

Staff Report for the 2009 Article IV Consultation and Second Review Under the Stand-By Arrangement

Prepared by the Middle East and Central Asia Department
(In consultation with other Departments)

Approved by David Owen (MCD) and Dominique Desruelle (SPR)

March 10, 2009

- **Relations with the Fund:** The 2008 Article IV consultation was postponed due to political developments and regional tensions (the last consultation was concluded in March 2006). An 18-month Stand-By Arrangement (SBA) for SDR 477.1 million (317 percent of quota) was approved on September 15, 2008 in the wake of the August armed conflict with Russia. A first purchase of SDR 161.7 million ($250 million) was disbursed upon approval. The authorities chose not to make the available purchase after the first review.
- **Main Issues:** Exchange rate and monetary policies should be geared to supporting external stability and restoring confidence, which were undermined by the armed conflict and the impact of the global crisis on foreign inflows, trade, and remittances. The authorities' commitment to allow more exchange rate flexibility, which was delayed by concerns about market uneasiness, is a key piece in this strategy. A fiscal stimulus package largely financed by official inflows will limit the slowdown in economic activity. Increasing bank vulnerabilities should be closely monitored, and crisis preparedness strengthened.
- **Response to Fund Advice:** Past advice focused on safeguarding macroeconomic stability amid significant resource inflows and political tensions. The authorities' policies were broadly consistent with Fund advice and, importantly, reflected their determination to advance an ambitious reform agenda. Some medium-term challenges remain, including strengthening institutions, reducing the dependence on foreign inflows, promoting investment in tradable sectors, and combating poverty.
- **Team:** A. L. Coronel (Head), C. Dieterich, H. Floerkemeier (all MCD), E. Kazarian (MCM), A. Sadikov (SPR), and E. Gardner (incoming Senior Resident Representative).
- **Exchange Rate Regime:** The regime has been reclassified as "stabilized" from "floating," based on the exchange rate policy introduced since the conflict.
- **Statistics:** Economic data are broadly adequate for surveillance and program monitoring. Georgia participates in the GDDS.

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Attachments

EXECUTIVE SUMMARY

The Georgian economy—seriously affected by the August armed conflict with Russia—is now feeling the impact of the global downturn. GDP contracted in the second half of 2008, resulting in real growth of 2 percent for the year as a whole, down from 12½ percent in 2007. Inflation slowed considerably as global commodity prices receded and domestic demand contracted. External imbalances remained large, and official inflows—which partly replaced the declining private capital inflows—financed a large fiscal deficit. Mounting depreciation pressures led to a lari devaluation in November, but the NBG's efforts to stabilize the exchange rate at the new level have required continued interventions. Money and credit growth slowed sharply, the profitability and quality of bank loans deteriorated, and deposit and loan dollarization increased.

2009 will be another difficult year as the recession in economic partners unfolds. Reflecting limited funding sources and continued regional tensions, growth will remain subdued. The external imbalances should begin to correct and inflation will be manageable. Nonetheless, depreciation pressures and a halt in domestic credit amid limited foreign exchange inflows and a barely adequate level of international reserves will challenge macroeconomic management. The authorities are determined to support economic activity through a donor-financed fiscal stimulus, but they are faced with risks associated with the needed exchange rate adjustment, and current and potential financial sector vulnerabilities.

The recent introduction of foreign exchange auctions should facilitate the move to a more flexible exchange rate regime to preserve macroeconomic and external stability. The additional strains that flexibility may impose on the financial sector is preferable to the costs of a disorderly exit from the peg that could be triggered by a continuous loss of reserves. Over the medium term, exchange rate flexibility will help to correct the current overvaluation of the real exchange rate, strengthen competitiveness, and reduce vulnerabilities posed by the structurally high current account deficit.

Close coordination between fiscal and monetary policies is also needed to support macroeconomic management. The interest rate instrument and the pacing of fiscal spending should be used in a coordinated fashion to contain pressures in the foreign exchange market.

The tightening of credit conditions and the weakening of the real economy have exposed vulnerabilities in the banking sector. This highlights the need for close supervisory oversight, measures to bolster depositor confidence through increased transparency and adequate safety nets (e.g. a deposit insurance scheme), and development of a contingency plan to respond to financial sector stress.

Program risks have increased mostly on account of possible adverse macro-financial interactions. Rising political tensions and the challenging global outlook could further damage investor confidence, reduce private capital inflows, and negatively affect trade, investment, remittances, and donor support. Should these risks materialize, economic growth would falter and credit contract further, and the authorities' policy response would need to combine exchange rate flexibility with fiscal tightening.

I. Recent Developments and Outlook

A. Recent Political and Economic Developments

1. **During recent years, Georgia achieved high economic growth buoyed by large capital inflows.** Foreign direct investment (FDI) responded to an improved business environment and aggressive privatization, and portfolio investment was mobilized with a first Eurobond issue in 2008. Economic growth reached double digits, was broad based (albeit led by non-tradable sectors, in particular, financial services and construction), and supported by generally sound macroeconomic policies and structural reforms that resulted in a simplified tax system, a liberalized customs regime, and reduced corruption and red tape.

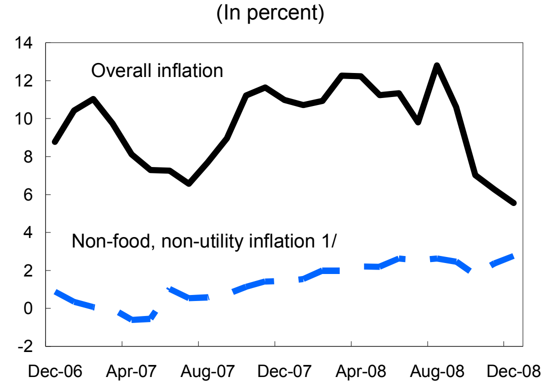
2. **Nevertheless, strong capital inflows along with deteriorating political conditions created a challenging economic environment.** Signs of overheating emerged as fiscal imbalances increased, domestic credit expanded rapidly, and the external current account deficit widened significantly. This resulted in real appreciation pressures and rising inflation. Mounting political tensions, mainly reflecting perceptions of an uneven distribution of the benefits of growth, fueled public discontent, culminating in civil unrest in late 2007. Political stability was restored and the government's power base consolidated through successive wins in the presidential and parliamentary elections in early 2008, but tensions with neighboring Russia increased and led to the early-August 2008 armed conflict.

3. **External and domestic political conditions have remained tense.** Russian troops have largely pulled out of undisputed Georgian territory but remain present in South Ossetia and Abkhazia. While international diplomatic efforts have helped calm the situation, significant uncertainty remains. The economic downturn adds to the dissatisfaction with the causes and consequences of the conflict. In response, the president has promised increased attention to social issues. The cabinet was reshuffled in December. The new prime minister resigned after only three months in office, and the minister of finance was appointed prime minister in early February. A new NBG president was appointed on February 26.

4. **Economic growth suffered a dramatic decline in the second half of 2008 and external imbalances remain large, but inflation pressures have receded (Table 1).**

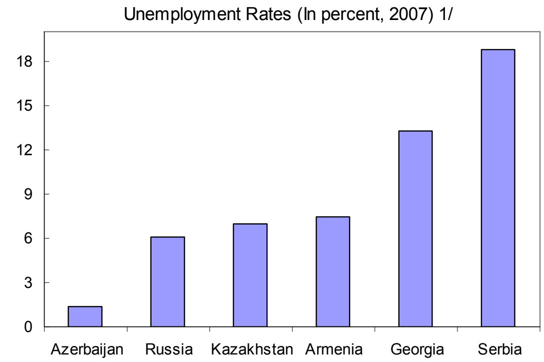
- **Annual real GDP growth** slowed to 8 percent in the first half of 2008, after having reached 12½ percent in 2007 and an average 9 percent in 2003–06. With the double impact of the armed conflict and the global crisis, GDP contracted by 4 percent in the third quarter and is estimated to have dropped further in the fourth quarter of the year, resulting in real growth of only 2 percent in 2008 (Figure 1).

Georgia: 12-Month CPI Inflation
(In percent)



Source: Department of Statistics of Georgia.
1/ Utility includes transportation, housing, and electricity.

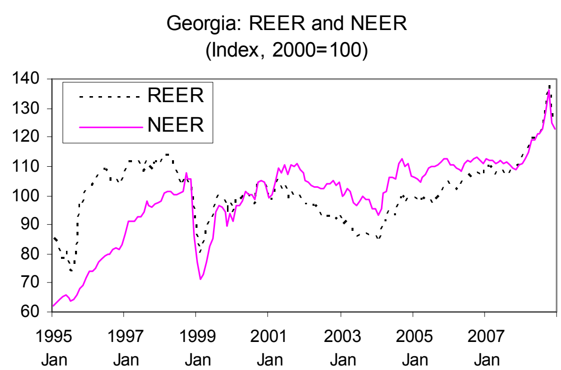
- **Inflation** peaked at 12¾ percent in August due to temporary transportation and supply disruptions associated with the conflict, but slowed to 5½ percent by December, as global food and energy prices (which account for more than half of the CPI basket) receded and demand weakened sharply. Inflation slowed further in January to 4½ percent.



- **Unemployment** has increased, with significant lay-offs reported in the construction, financial, and retail sectors, and poverty remains widespread at 21¼ percent.[1]

- The **external current account deficit** is estimated to have reached 22½ percent of GDP in 2008 (Figure 2), but narrowed substantially during the second half of the year (by some $500 million or 4 percent of GDP) led by large official inflows since September and lower earnings of nonresidents. The trade balance remained broadly unchanged relative to the first half of the year as a severe drop in metal exports (Figure 3) was broadly offset by lower FDI-related imports and petroleum prices. Private capital inflows, which had been financing the current account deficit, dropped from $1.7 billion during the first half of the year to an estimated $450 million during the second half.

- **Gross official reserves** fell immediately after the conflict but gradually recovered to $1.48 billion (3 months of next year's projected imports) at end-2008, despite significant central bank intervention in the market. The increase was aided by donor support, the SBA purchase, and transfers from the Sovereign Wealth Funds (SWFs)[2] to government accounts in the National Bank of Georgia (NBG).



Source: IMF Institute.

5. **The shock to confidence, fall in foreign inflows, and strengthening of the dollar (to which the local currency had been pegged) resulted in depreciation pressures on the lari** (Figure 4). After a 12 percent nominal appreciation vis-à-vis the dollar in the year through July 2008, a temporary peg was introduced during the August conflict in an effort to maintain public confidence and

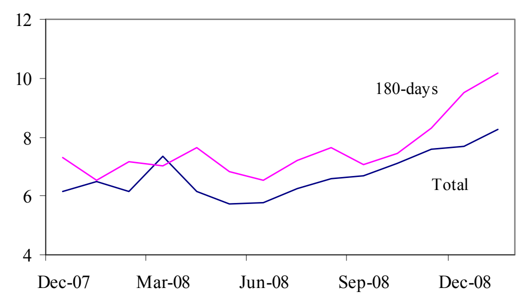
[1] While no official 2008 data are currently available, the authorities have reported an unemployment rate of 14 percent in early 2009. Unemployment figures may be underestimated, as employment statistics are weak and about two thirds of the working-age population is counted as 'self-employed'.

[2] Most proceeds from a $500 million Eurobond issue in April 2008 were deposited in SWFs.

macroeconomic stability. The authorities devalued the currency by about 17 percent in mid-November after substantial foreign reserve losses due to intervention in support of the peg. However, since then the NBG has allowed only minimal exchange rate flexibility, again at a significant cost in terms of intervention (about US$400 million between the November devaluation and end-February). Despite the devaluation, the REER appreciated in 2008 due to high domestic inflation, the nominal appreciation earlier in the year, and larger depreciations of main trading partners' currencies vis-à-vis the dollar.

6. **The fiscal deficit widened markedly in 2008, but the composition of spending improved in the second half of the year** (Figure 5). Tax revenue declined significantly in August but recovered moderately later, broadly in line with program projections. Spending shifted from high defense and election outlays in the first half of the year to conflict-related reconstruction, social spending (including emergency assistance for a large number of internally displaced people), and infrastructure investments.

Georgia: Deposit Interest Rate (In percent, Dec. 07-Jan. 09)



Source: National Bank of Georgia.

7. **Monetary conditions reflected the deteriorating economic situation** (Figure 6). Before the conflict, monetary policy focused on resisting inflationary pressures by allowing exchange rate appreciation and increasing interest rates. In the wake of the conflict, the declining demand for local currency and significant NBG intervention in the foreign exchange market led to a contraction of the monetary base. Banks stopped new lending despite the NBG's liquidity injections, reduced reserve requirements, and policy rate cuts by a cumulative 500 basis points between August and February. Deposit rates rose somewhat despite the sharp decline in the policy rate, and the deposit base suffered losses as confidence weakened and demand for cash increased.

8. **The tightening of credit conditions and weakening of the real economy have exposed vulnerabilities in the banking sector** (Figure 7). Liquidity and solvency ratios have deteriorated but remain satisfactory overall, partly due to liquidity support from the NBG. The level of nonperforming loans (NPL) has increased sharply and the need for greater loan-loss provisioning, together with higher funding costs and lost interest income, have severely impacted profitability. Additional vulnerabilities are the dependence on external financing and high banking sector concentration.

Georgia: Prudential Indicators of Commercial Banks, 2005–09

	2005	2006	2007	2008				2009
				Mar.	Jun.	Sep.	Dec.	Jan.
Capital adequacy ratio (in percent)	17.5	20.6	16.0	17.5	15.7	17.0	13.9	14.7
Nonperforming loans (in percent of total loans)	3.8	2.5	2.6	3.0	3.4	9.9	12.8	13.7
Loans in foreign exchange (in percent of total loans)	76.2	73.8	68.6	65.9	64.9	67.5	72.8	73.5
Net open foreign exchange position 1/	7.5	3.7	5.0	3.5	1.5	1.5	1.7	4.1
Liquidity ratio (in percent)	33.3	41.5	37.2	36,8	33.3	30.4	28.3	30.2
Return on equity	14.9	15.3	9.6	10.2	8.9	-2.9	-12.6	-5.2

Source: National Bank of Georgia.

1/ Percent of total regulatory capital.

9. **The government introduced several structural reforms during the first half of 2008.** Although tax rates are in line with other countries in the region, parliament amended the tax code to reduce income and dividend tax rates gradually. Parliament also approved a legal commitment to fiscal surpluses from 2009 (albeit counting privatization earnings as fiscal revenues), and subsequently an exception for 2009 in light of the new spending needs. The NBG is now legally committed to price stability as the main monetary policy objective, its accountability system has been strengthened, and a downsizing process was implemented. The Financial Supervisory Agency (FSA) became an independent legal entity, and a plan for establishing an independent statistics agency by end-2009 was developed.

B. Performance Under the Program

10. **All SBA performance criteria for end-December were observed.** The quantitative targets, the structural benchmark on budget submission to parliament, and the structural performance criterion on preparing a revised LOLR facility regulation—to ensure that loans are provided only to solvent institutions and that the FSA plays an active role in monitoring the use of resources—were met (Tables 1 and 2 of the Letter of Intent). The impact on the NIR target of greater-than-anticipated NBG intervention was offset by an accelerated repatriation of government savings (from the SWF) and higher donor support. The fiscal target was slightly adjusted upward to reflect the availability of additional financing.

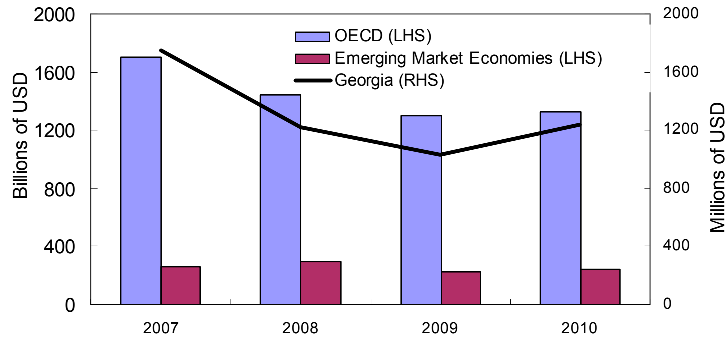
C. Macroeconomic Outlook

11. **2009 will be a difficult year for Georgia as the full impact of the global recession on domestic activity and financing conditions unfolds.** Reflecting limited funding sources and continued regional tensions, staff projects that real GDP will continue to contract in the first half of the year and recover somewhat in the second half, with growth averaging 1 percent for the year as a whole. Consumption is likely to fall due to higher unemployment and lower wages and remittances, and private investment will shrink—in particular in residential real estate, transport, and manufacturing. The fiscal impulse derived from the switch from defense to capital spending and income tax reductions will benefit growth. The projected increase in net exports will contribute to growth, but ultimately it is the mirror image of lower domestic consumption and investment.

12. **The authorities deemed staff's 2009 growth projection too pessimistic.** The authorities' projections assume a sharp recovery in the second half of the year (annual growth of 6 percent) and maintain the official forecast of 2–3 percent for the year as a whole. These projections are based on growth estimates by sectors and a December survey to enterprises on expected FDI and other capital inflows, rather than on demand-side calculations.[3] While uncertainty surrounding growth projections is high, staff preferred to build program projections on a more cautious approach—especially considering that the sharp deterioration of the global economic outlook may lead to further downward adjustments.

13. **External imbalances are set for a significant correction in 2009, with the current account deficit narrowing by 6 percentage points of GDP relative to 2008.** Demand for export commodities and consumer durables is projected to fall due to the recessions in the main trading partners (European Union, United States, Turkey, Ukraine), while import volumes are expected to decline even more sharply due to weaker domestic demand, and a drop in private capital inflows and defense-related imports. Capital inflow projections are estimated below the 2006 level and compare conservatively to the trend in capital outflow projections in the latest World Economic Outlook. Remittances, which fell by 13 percent year-on-year in January, are projected to decline by 10 to 15 percent, affected by the deterioration of economic conditions in the main remitter countries and the depreciation of the ruble.

Georgia: Outflows from OECD and Emerging Market Economies and FDI Inflows to Georgia
(In billions of U.S. dollars unless noted otherwise) 1/



Sources: Georgian authorities; and Fund staff estimates.
1/ Preliminary April 2009 WEO projections for OECD and emerging market economies; and staff projections for Georgia.

14. **Inflation is projected at 7 percent in 2009, reflecting the offsetting effects of the slowdown of economic activity and exchange rate movements.** While energy commodity prices are expected to remain subdued in the short term, early production forecasts suggest that world food prices—in particular cereal prices—could increase from their current lows.

15. **The macroeconomic outlook is anticipated to improve over the medium term.** The recovery of real GDP growth (4–5 percent during 2010–13) is predicated on the revival of private capital inflows and continued structural reform implementation, with moderate inflation (about 5 percent). Under the baseline assumptions, the current account deficit would decline to 12 percent of GDP by 2014. Narrowing the current account deficit to this level will require substantial gains in competitiveness through continued structural reforms, trade

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[3] The authorities plan to review projections only after first quarter data are available. Staff will also reassess its projections at that time.

facilitation through lower transportation costs, and the continuation of EU trade preferences.

II. Policy Discussions

16. **The radical reduction in the main source of financing of Georgia's fast growth is posing challenging policy dilemmas for the authorities.** Significant foreign inflows were not only the main engine of growth, but also created an environment of fast credit expansion, appreciation pressures, and overheating. Now the authorities have to deal with depreciation pressures and a halt in credit to the private sector in the face of limited foreign exchange inflows and a barely adequate level of international reserves. Handling these changed circumstances involves the difficult choice between allowing exchange rate adjustment to safeguard external stability and reducing domestic absorption. Furthermore, given the high degree of uncertainty, there is a need to develop contingency plans to deal with potential adverse events in the financial sector, and to maintain necessary cushions in the fiscal accounts and in international reserves.

17. **Discussions centered on how to gear policies to deal with these challenges.** Given that the authorities are determined to support economic activity through a fiscal stimulus, they are faced with the risks associated with the needed exchange rate adjustment. At the same time, they need to address current and potential financial sector vulnerabilities, and ensure that the fiscal stimulus does not threaten medium-term macroeconomic stability.

A. Using Exchange Rate and Monetary Policies to Support External Sustainability

Exchange rate policy

18. **Staff emphasized that the exchange rate regime since the conflict has not been consistent with external stability.** Concerns that abandoning the exchange rate anchor would undermine confidence and impair banks' balance sheets have led the authorities to postpone the needed move to exchange rate flexibility. However, in line with the FSA's assessment of financial sector stability and bank balance sheet resilience to exchange rate movements, staff concluded that further moderate depreciation is not likely to create undue systemic stress for the banking system. Against the backdrop of the recent foreign exchange market pressures and the dollar strength in world currency markets, staff argued that failure to limit interventions could lead to a much quicker depletion of reserves than the authorities anticipated. The authorities acknowledged that the risks associated with moving more rapidly toward flexibility are now outweighed by the potential costs of a forced exit from the peg. They now seem more committed to greater exchange rate flexibility, which would imply lower interventions going forward.

19. **To integrate market signals effectively into the pricing mechanism, the authorities have recently introduced an auction-based system for the foreign exchange market.** The intervention system in use for more than a decade proved too rigid to allow sufficient exchange rate flexibility in times of depreciation pressures. The new auction mechanism, introduced in early March, is intended to give market forces a greater role in setting the price, with a view to reaching faster and smoother convergence toward

equilibrium in the foreign exchange market and giving the market greater clarity about the authorities' policies.[4] The auctioned amounts should be aligned with the quarterly program NIR targets, which allow some room for intervention at the time the new system starts operating, but significantly less later on. As the market embraces the new mechanism, the NBG will abandon the existing system.

20. **Over the medium term, exchange rate flexibility will help to maintain competitiveness and reduce vulnerabilities posed by the structurally high current account deficit.** Staff's findings—subject to uncertainty related to data quality—point to an overvalued real effective exchange rate, but there is no evidence that the overvaluation causes external instability (Box 1). The overvaluation was exacerbated by the timing of the switch to the temporary peg, just as the dollar started to appreciate substantially against most trading partner currencies. The resulting effective appreciation was not fully corrected by the November devaluation. Going forward, the authorities' commitment to exchange rate flexibility and structural reforms to enhance competitiveness should help correct the overvaluation. Georgia's track record in structural reforms has been impressive, and past achievements should be complemented by improvements in the judicial system, property rights protection, infrastructure, agricultural productivity, and governance. These reforms—supported by large donor financing—are expected to foster private investment in the tradable sector.

Monetary policy

21. **The post-conflict injection of liquidity was aimed at helping banks deal with substantial deposit withdrawals.** A part of the liquidity injections, in turn, fueled the demand for foreign exchange, while another part was used by banks to build up precautionary balances at the central bank. The authorities felt that there was no scope for raising interest rates to resist the flight from local currency in the uncertain climate that prevailed. They also felt that such an increase was not justified as an anti-inflationary policy in the current environment, and would generate additional problems for private borrowers, although most lending is in dollars.

22. **Staff suggested that, in the current less volatile environment, the interest rate instrument could be used to contain pressures in the foreign exchange market.** The authorities argued that the demand for lari had become inelastic to moderate interest rate changes, given expectations of further lari depreciation, and doubted that higher domestic rates would contain the demand for dollars. They also acknowledged, however, that the provision of additional liquidity to banks could fuel pressures in the foreign exchange market, and that a more cautious approach to liquidity management was warranted in the future, including by raising interest rates on central bank certificates of deposit, or rolling back recent reductions in the reserve requirement, if needed.

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[4] By means of the auctions, the NBG announces the amounts it is willing to sell. These amounts are derived from the NBG's foreign exchange liquidity forecasts, which take into account weekly government and financial sector requirements for external payments, as well as the shift from private sector inflows to donor funds channeled through the NBG.

23. **Over the medium term, the NBG needs to strengthen the interest rate channel and deepen financial markets.** This would facilitate the planned move to formal inflation targeting—a challenging task given current high dollarization. To this end, the NBG is working on a comprehensive liquidity framework (structural benchmark for end-March 2009) to enhance liquidity forecasting and ensure a consistent use of policy rates to improve market signaling. Financial sector development could be fostered by increased issuance of debt instruments—including government treasury bills—with benchmark maturities across the yield curve, and by preparing the regulatory and institutional framework for secondary market development. The authorities agreed in principle, but noted the need to delay this measure to avoid crowding out the already limited supply of bank credit to the private sector.

B. Addressing Financial Sector Vulnerabilities

24. **The main vulnerabilities of the financial system stem from the asset side, while rollover risks from external obligations appear to be largely contained.** The rapid credit growth in recent years, the impact of the conflict and the global economic slowdown on the economy, and the November 2008 devaluation, have affected the quality of bank assets (Box 2). Vulnerabilities on the liability side include weakened depositor confidence and increasing deposit dollarization, and lack of access to new private external financing.

25. **Additional exchange rate depreciation and the ongoing decline in asset prices will likely further weaken bank balance sheets.** While the banking system's foreign exchange position is roughly balanced, banks have extensive exchange rate exposure from their dollar lending to unhedged borrowers. In addition, anecdotal evidence indicates that real estate prices might have declined by about 15 to 20 percent. This would put additional pressures on nonperforming loans, which have risen sharply, and thus on provisioning and capital. The FSA is conducting bank stress testing and has requested Fund technical assistance for this purpose.

26. **Commercial banks still have to fully adapt to limited international market access and the impact of lower depositor confidence.** As deposit growth lagged credit growth, banks relied on substantial foreign borrowing in recent years. Although most of the debt incurred by banks is long-term, short-term borrowing has increased rapidly in the past year, leading to large external obligations maturing in 2009. While questions remain about the capacity to refinance all debt maturing in 2009—estimated above $700 million—banks should be able to roll over a significant part of these obligations through lending and equity injections by the EBRD and IFC, and possibly through credit lines and guarantees from official creditors. Mobilizing deposits will be crucial to ensure adequate bank funding in the future and to pave the way for an eventual recovery of private sector credit growth. For the moment, however, the increased risk aversion of banks is likely to act as a bigger constraint on lending than bank liquidity.

27. **The deteriorating quality of bank loan portfolios and the recent experience of deposit withdrawals highlight the need for strengthened vigilance over the banking system.** The FSA has required additional provisioning based on bank-by-bank assessments, while stressing to staff that individual banks' capital bases (including recent and planned capital injections) would be sufficiently strong to buffer the expected rising provisioning

need for NPL. Staff warned that the deteriorating economic environment will pose additional stress on bank capital and urged closer oversight, especially of systemically important banks. Staff also recommended seeking additional capital assurances from foreign parent banks.

28. **Staff suggested considering measures to bolster depositor confidence.** These measures could include the establishment of adequate safety nets (e.g. a limited deposit insurance scheme) and more timely public availability of banks' financial information. The authorities argued against deposit insurance at this juncture, as the level of insurance the financial system could presently afford would not be helpful should a confidence crisis occur. They also considered that deposit insurance could lower information incentives for depositors. At the same time, they felt that confidentiality considerations precluded the release of additional bank-specific data. Staff pointed out the benefits of complete and timely information as a signaling device for depositors.

29. **To strengthen the response framework to potential solvency issues, staff restated the importance of developing a contingency plan.** The authorities have created a Joint Financial Sector Committee, consisting of NBG and FSA staff, as the primary financial crisis management group, and have decided to develop such a plan in cooperation with the Ministry of Finance (structural performance criterion for end-June 2009). The plan will establish the institutional framework for managing potential financial sector stress and identify the most urgent policy and budgetary decisions for the containment of crisis situations, including the decision on whether, when, and how to use public funds to recapitalize ailing systemic banks, and the identification of the conditions under which the use of early intervention tools would be indicated. The authorities intend to treat the plan as an internal document not for publication.

C. Embedding the Fiscal Stimulus in the Medium-Term Framework

30. **Implementation of the fiscal stimulus should be flexible in order to allow a quick reaction to potential balance of payments pressures.** The 2009 fiscal stimulus, to compensate for the decline in private demand, is projected at about 3 percent of GDP.[5] Most of the stimulus is generated by a substantial expenditure switch from import-intensive defense spending to domestic social and infrastructure spending and a cut in income tax rates. Nevertheless, the fiscal deficit-to-GDP ratio is expected to decline somewhat in 2009 relative to 2008, reflecting lower than originally anticipated donor support. Spending is front-loaded and financed by a draw-down of government deposits at the NBG during the first half of 2009. Staff supported the authorities' swift fiscal policy response to the economic slowdown, but cautioned that the timing of spending would need to be carefully attuned to external stability needs. The authorities reassured staff that their close monitoring of developments and smooth policy coordination will facilitate a quick reaction to any deepening of external pressures.

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[5] The fiscal stimulus is calculated as the increase in non-defense, non-interest spending (close to 2 percent of GDP) plus the drop in income tax revenue (about 1 percent of GDP).

31. **The authorities are preparing an ambitious fiscal reform framework for 2009 and beyond to strengthen budget planning, execution, and audit.** The reforms include a strengthened medium-term budget process, better integration of annual budgets into the government's medium-term objectives, and the establishment of uniform internal audit standards in government agencies. As part of this exercise, the authorities will undertake a comprehensive revision of budget legislation with the aim to submit a new budget code to parliament (structural benchmark for end-July).[6] While staff considers this a valid initiative to improve spending efficiency, it cautioned against including rules and details into the code. The legal framework should contain only budgetary principles to avoid undue rigidity in managing budgetary issues.

32. **The commitment to reduce the fiscal deficit in the medium term remains in place, but a clearer strategy has yet to be developed.** Another exception to the existing budget systems law, according to which the government is obliged to run fiscal surpluses, is expected for 2010 when the implementation of major donor-financed infrastructure projects will prevent a decline in the deficit. While supporting the existence of a fiscal rule, staff argued that recent developments and future social and infrastructure needs are showing that the current rule may be too rigid. Staff suggested a revision to take into account debt sustainability considerations and cyclical fluctuations, complemented by a narrowly defined escape clause, to provide a clearer medium-term perspective to fiscal policy. While the authorities acknowledged the restrictiveness of the current rule, they stressed the benefits of a clearly understood (if simplistic) rule to guide future policy making and to ensure fiscal discipline.

33. **Georgia's debt is expected to remain sustainable over the medium term.**[7] Despite the substantial external financing in 2008–10 and the likely exchange rate depreciation, the low initial indebtedness and the concessionality of official inflows limit the risk that debt levels will become unsustainable. Roughly 40 percent of official financing is expected in grants, and some loans are on concessional terms. As a result, public external debt is projected to peak at around 30 percent of GDP in 2011 with its NPV amounting to 78 percent of exports. Although nominal private sector external debt is set to remain broadly constant in 2009, debt ratios will rise on account of the economic contraction and exchange rate depreciation. Assuming an improvement of global credit conditions in 2010, the private sector should regain capital market access, resulting in a gradual build-up of private debt. In terms of debt management, 2013 appears to be the most challenging year, as the $500 million Eurobond matures and repurchases under SBA obligations peak.

[6] This overhaul of all budget-related legislation replaces conditionality in the original program that required the upgrading of the budget systems law to an organic law. The authorities were legally advised not to proceed with the upgrade to an organic law.

[7] A Fund stand-alone DSA was prepared in September 2008 at the time of the SBA request. The planned joint LIC DSA was postponed at the request of the World Bank and will be conducted later in 2009.

III. Risks to the Economic Outlook

34. **Staff short-term projections are subject to significant downside risks.** The challenging global outlook, including the current recessions in key trading partners, constitutes a major risk to trade and investment. A deeper than projected recession in Russia or further depreciation of the ruble would hurt remittances, affecting particularly the poor. There could also be a shortfall in disbursements of pledged donor support given donor governments' challenges at home and competing demand for IFI resources. Finally, rising political tensions—either domestic or external—could further damage investor confidence, reducing private capital inflows and postponing their recovery. Domestic tensions could also weaken the authorities' ability to move forward with stabilization measures and structural reforms.

35. **Should some of these risks materialize, economic growth could falter, unemployment rise, and credit contract further,** while banking sector vulnerabilities could turn into a full-blown crisis. An external financing gap would reemerge, necessitating stronger policy adjustments and possibly additional external financing.

36. **The authorities' policy response to these scenarios would need to combine exchange rate flexibility with fiscal tightening.** A reduction of the fiscal deficit, while contractionary, would free resources to deal with potential problems in the banking sector and reduce the need for foreign exchange interventions to limit lari depreciation by alleviating balance of payments pressures. Spending cuts could focus on domestically financed current and non-essential infrastructure spending, as cuts in donor-financed projects would cause a loss in external financing, which in turn would aggravate the balance of payments gap. To complement the adjustment, the authorities will have to seek further financing sources.

37. **Medium-term risks revolve around the uncertainty regarding the timing and strength of the recovery in capital inflows.** The economy could suffer from a protracted and deep decline in foreign investment if global confidence remains weak and investors demonstrate increased risk aversion to Georgia. Under these circumstances, Georgia would face a difficult external account adjustment, which would weaken the economic recovery. If, on the other hand, Georgia manages to position itself as an attractive investment destination among newly emerging markets and regional tensions abate, capital inflows could recover to pre-conflict levels. Staff medium-term projections point to a cautiously optimistic resurgence in capital inflows by 2011–12, albeit below the levels observed in 2007 and early 2008.

IV. Other Issues

38. **Current AML legislation in Georgia ensures transparency and governance in the financial sector** through strengthened monitoring of financial data and AML/CFT preventive measures, including in relation to domestic bank deposits owned by Georgians but held in the names of offshore entities.

39. **The authorities have implemented the recommendations of the 2008 update safeguards assessment report within the agreed deadlines.** In particular, the NBG's Audit

Committee was reconstituted with only non-executive members, and the internal audit department is now required to audit the monetary data reported to the Fund at each test date and at the end of the financial year.

V. Program Issues

40. **The quantitative targets for 2009 were adjusted to reflect the updated projections of donor support.** While the end-March NIR target provides some cushion to help stabilize the market following the introduction of the auctions, the end-June target—which will be revised only under exceptional circumstances—contains very limited intervention space and will thus test the authorities' commitment to exchange rate flexibility. The ceiling on contracting or guaranteeing new nonconcessional loans was revised upward ($850 million for 2009) to accommodate borrowing from official creditors (WB, EBRD, EIB, and other multilateral and bilateral creditors) for projects pledged during the donor conference in Brussels in accordance with the Joint Needs Assessment report.[8] To better capture the impact of unexpected shortfalls or surpluses in external financing, the revised TMU introduces adjustors to the quantitative program targets.

41. **Use of Fund resources.** The authorities and staff agreed that the balance of payments projections should assume that the NBG would draw the amounts available at the completion of the review (SDR 126.2 million). The authorities' final decision will be made at a later stage and will depend on developments in the foreign exchange market.

VI. Staff Appraisal

42. **Economic and financial conditions have become more challenging since the last program review as Georgia has begun to be impacted by the global crisis.** The slowdown of world trade, weak commodity prices, as well as recessions and currency depreciations in major trading partners will likely prolong and deepen the contraction of external demand. Prospects for a recovery of private capital inflows, mainly FDI, have similarly weakened. On the upside, Georgia expects to receive a large package of donor financing, although uncertainties remain on the timing of disbursements, and there are risks that pledges will be scaled back as donors reassess spending priorities.

43. **Despite the worsening of the external environment, the authorities' strategy designed in the summer of 2008 remains appropriate.** Fiscal policy is assigned to support demand within the constraints of available external financing, while exchange rate flexibility is the primary instrument to ensure that external stability is maintained. However, projected official financing now appears insufficient to cover what has turned into a deeper and longer lasting external shock than was expected. This could require a larger adjustment—through the exchange rate—than initially planned.

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[8] While these loans are not expected to meet the program's criteria for concessional debt, they will be contracted at more favorable terms than currently available for Georgia in private markets.

44. **Program risks have increased, mostly on account of possible adverse macro-financial interactions.** The banking sector as a whole is generally well capitalized and external refinancing needs for 2009 have been largely addressed. However, profitability and the quality of the loan portfolio have deteriorated and strains will continue through 2009. Extensive loan dollarization creates additional vulnerabilities, and banks are tightening credit despite liquidity injections from the central bank. This has led the authorities to delay the move to exchange rate flexibility despite the obvious need to expedite external adjustment.

45. **The recent adoption of foreign exchange auctions is an important step toward protecting international reserves and external stability.** Central bank intervention through the auctions, aligned with the program's NIR targets, should result in an early move to greater exchange rate flexibility by mid-2009. As the authorities noted, this approach carries some risks due to its potential impact on the financial sector. However, these risks appear manageable compared with the financial and economic costs of a forced and disorderly exit from the peg that could be triggered by a continuous loss of reserves. Should pressures on the exchange rate turn out to be too strong for the banking sector to absorb in the short run, the current strategy may have to be rebalanced in favor of more fiscal adjustment. This scenario highlights the need to identify non-critical spending that could be postponed.

46. **Aligning public spending with available official external financing remains the other pillar of the authorities' macroeconomic program.** Although the surge in official lending will raise public debt, it does not compromise medium-term debt sustainability. For 2009, the authorities have appropriately reduced the fiscal deficit target to reflect a downward revision in expected official financing. The overall deficit-to-GDP ratio is now projected to be somewhat lower than in 2008, but expenditure switching toward infrastructure investment and better targeted social spending should nevertheless result in a positive fiscal stimulus. At the same time, planned public expenditure management reforms should increase the effectiveness of fiscal policy.

47. **Until now, the authorities have not considered monetary tightening necessary to contain pressures on international reserves, but interest rate policy might have to be used more actively going forward.** Liquidity concerns kept the monetary authorities from raising interest rates at the outset of the crisis. Also, in a very uncertain environment dominated by exchange rate expectations, the view was that interest rate increases would not be effective in curbing foreign exchange demand. Should balance of payments pressures increase again, however, it would be important to deploy all available policy instruments (including central bank refinancing, CD rates, and reserve requirements) in support of the adjustment strategy. The planned improvement of the central bank liquidity framework is very timely in this regard and should help enhance the effectiveness of interest rate policy.

48. **Strong supervisory vigilance over the banking system is crucial at this time of stress and heightened uncertainty.** The FSA has already taken appropriate actions by requiring additional provisioning based on bank-by-bank assessments. It will also receive

Fund technical assistance to strengthen its stress-testing capability. Enhanced supervision needs to be complemented by a quick reaction to adverse developments and effective planning for possible systemic risks. The authorities' commitment to developing such a plan is crucial to the coherence of the overall strategy. The plan should consider the risks of contingent fiscal liabilities arising from potential difficulties in the financial sector.

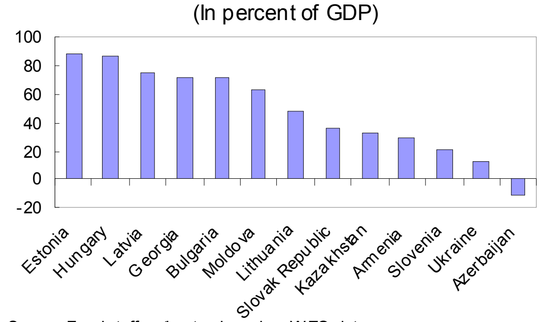
49. **While the severity of the challenges has focused attention on immediate actions, policies also have to be consistent with, and supportive of, a sustained economic recovery over the medium term.** In this regard, the authorities' commitment to macroeconomic stability is backed by a strong track record as well as clear fiscal and monetary medium-term mandates (i.e. a rule-based fiscal policy and an inflation objective). Sustained economic growth will also require a significant improvement in competitiveness. Georgia's large current account deficits have been the counterpart of high investment rates financed mostly by FDI. However, investments appear to have been mostly directed to the non-tradable sector, where an upgrade of the domestic infrastructure was undoubtedly needed, with little impact so far on export potential. Going forward, it will be important that structural and macroeconomic policies enhance the environment for private investment in the tradable sector so as to reduce the current account imbalance to more manageable levels.

50. **On the basis of Georgia's performance under the SBA arrangement, staff supports the authorities' request for completing the second review.** Staff also recommends approval of the modification of program conditionality, as specified in the Letter of Intent (¶13, ¶22, and Tables 1 and 2).

51. It is proposed that the next Article IV consultation be held on the standard 24-month cycle.

Box 1. Georgia: External Stability Assessment

Net International Liabilities 1/, 2007
(In percent of GDP)



Source: Fund staff estimates based on WEO data.
1/ Computed by using the Lane Milesi-Feretti (2006) data set, and updating to present by adding subsequent current account deficits (WEO).

External Stability and Competitiveness

The rapid increase in the current account deficit since 2005 has contributed to the build-up of external vulnerabilities. The resulting erosion in Georgia's net international investment position (with net liabilities of 70 percent of GDP by end-2007) puts Georgia in a similar position as other Eastern European countries with prolonged high current account deficits.

The composition of external financing and the temporary nature of large current account items mitigate concerns about external stability. Until the August conflict, the current account deficit was primarily financed by FDI with high import content. The recent surge in defense-related imports—expected to be temporary—also contributed to the high import bill. Staff estimates that FDI and defense-related imports amounted to around 10 and 8½ percent of GDP in 2007, respectively. Going forward, as these temporary factors unwind, the current account balance would be expected to converge to its underlying level, estimated at about 13 percent of GDP.[1]

Exchange Rate Assessment

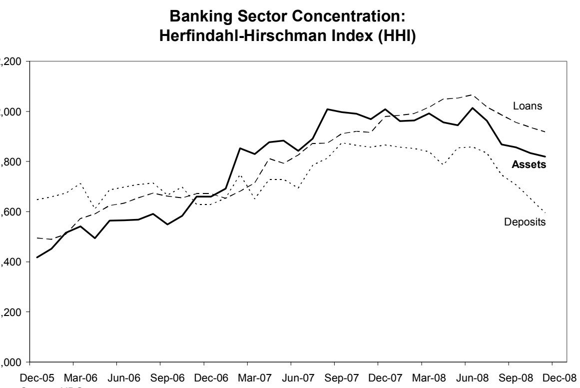
Staff does not find evidence of a significantly overvalued real exchange rate that could result in external instability. Based on various approaches, overvaluation of the lari is estimated in the 14 to 18 percent range.[2]

- The **macro balance approach** suggests a current account deficit norm of around 7 percent of GDP.[3] The difference between the norm and the underlying current account deficit indicates a REER overvaluation of 14 percent.[4]
- The **external sustainability approach** points to a sustainable external deficit norm of about 6 percent of GDP, assuming Georgia's negative net international investment position (IIP) will remain unchanged at some 70 percent of GDP, consistent with a 18 percent overvaluation.[5]
- The **equilibrium real exchange rate** approach suggests overvaluation of around 17 percent.[6]

[1] Staff assumes that FDI (as a percent of GDP) will moderate in the medium term as investment opportunities decrease. The FDI import component will likely decline as onshore sourcing of inputs increases. Military spending as a share of GDP is expected to fall to the average observed in comparable countries, and commodity import prices (oil and gas) will revert to their projected medium-term levels.
[2] As a general caveat, it is difficult to pinpoint the equilibrium exchange rate or the equilibrium current account for a transition economy. Georgia has undergone significant structural changes since 2003 with rapid growth and realignment of trade and investment links.
[3]The macro balance approach is applied using CGER's fixed-effects coefficients on fundamental variables and an estimate of the country-specific constant for Georgia.
[4] Staff use -0.36 for the Georgia-specific current account elasticity with respect to the real exchange rate. It is obtained by using a Georgia-specific export elasticity of -1.25 based on a vector error correction model of Georgia's exports and the CGER-based import elasticity of 0.92 (a vector error correction model of Georgia's imports did not yield stable and statistically significant estimates).
[5] The external sustainability approach stabilizes 2007 NFA, as proxied by Georgia's international investment position in 2007. The same current account elasticity is used.
[6] Due to data limitations, the CGER equilibrium real exchange rate approach is adapted to use Georgia specific time-series in AlShehabi and Ding (2008).

Box 2. Georgia: Financial Sector Developments and Vulnerabilities

The financial system is dominated by banks, although the non-bank financial sector has been growing rapidly. There are currently 20 banks (17 of which are foreign-controlled), 18 credit unions, 27 microfinance organizations, 13 insurance companies, and 6 pension funds operating in Georgia. The major insurance companies are associated with banks. Banking is highly concentrated, with two dominating banks and about six medium-sized banks, which together account for more than 90 percent of total banking system assets.



Source: NBG.

Banks have aggressively expanded credit in recent years, particularly in construction, real estate, and consumer and mortgage lending. Credit growth has outpaced deposit growth by a wide margin. As a result, banks have increasingly relied on external financing, consisting to a large extent of foreign bank loans and capital market financing.

The August 2008 armed conflict triggered a sizeable short-term deposit outflow (14 percent of total deposits). The deposit base has stabilized since September, and the FSA attributes recent deposit withdrawals mainly to the need to finance day-to-day expenditures. However, deposit dollarization has increased significantly owing to the November 2008 devaluation of the lari (both through a shift of depositors from lari into dollar and due to the valuation effect).

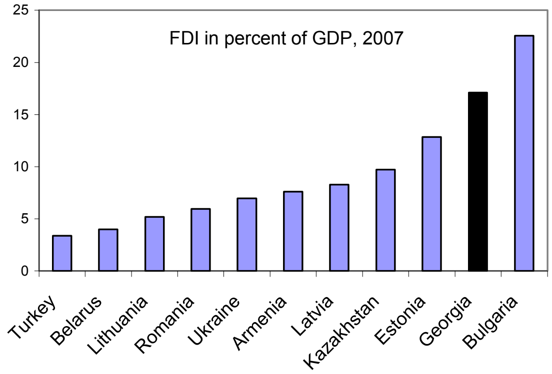
Financial soundness indicators have shown significant worsening since late 2007. The capital adequacy ratio decreased by 3 percentage points, nonperforming loans increased sharply, and the liquidity ratio declined by 7 percentage points. This has affected bank profitability significantly, resulting in a negative return on equity and on assets. The worsening of banking sector conditions is attributed to the rapid credit growth in recent years, the conflict with Russia, the impact of the global economic slowdown, and the November devaluation.

The banking sector is vulnerable to liquidity, refinancing, exchange rate, and credit risk:

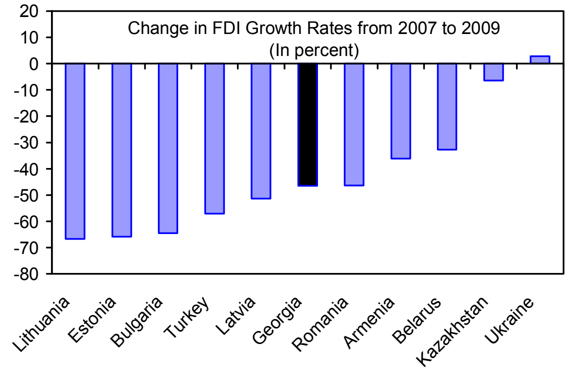
- Private external financing sources (with the exception of some capital injections from parent banks) have largely dried up in the wake of the recent crisis, but the major banks have been able to secure financing from international financial institutions and received significant liquidity support from the NGB.
- Deposit and credit dollarization is high (around 75 percent). Since the currency denomination of assets largely matches that of liabilities, the direct exposure to exchange rate risk is limited. Indirect exposure through the balance sheets of borrowers, however, is substantial.
- In addition, available data suggest considerable credit risk stemming from credit concentration in large borrowers, in particular with respect to foreign currency loans.
- More than 40 percent of total loans are collateralized by real estate, the prices of which are declining.

Figure 1. Georgia: Real Sector Developments and Outlook

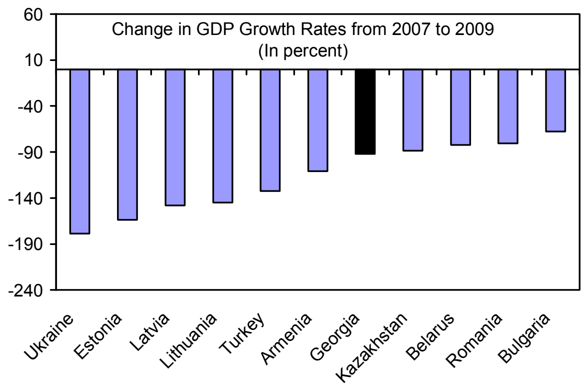
Georgia's growth performance has been particularly dependent on FDI...



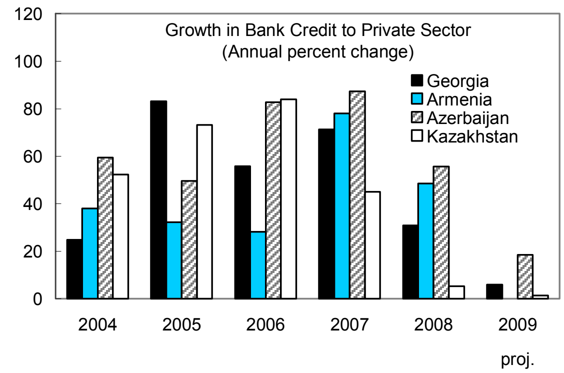
...whose slowdown is projected to be in the middle range of other transition economies...



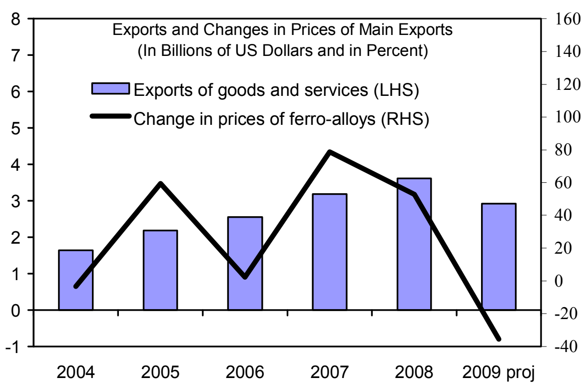
which is consistent with the projected decline in GDP growth rates.



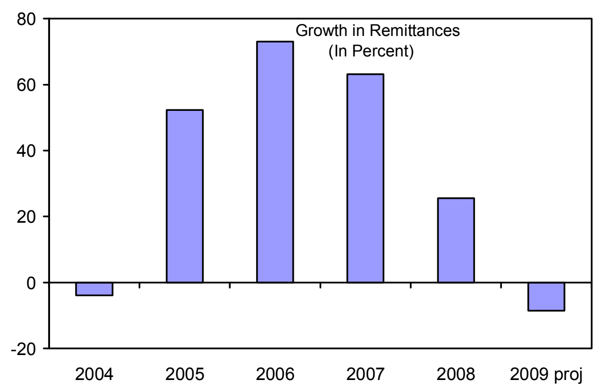
GDP growth in Georgia was particularly hard hit by the sharp decline in credit growth, ...



... by lower exports, partly due to the drop in its main export good, ferro-alloys,....



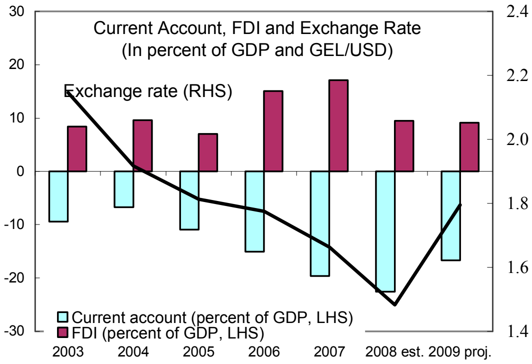
...and a decline in remittances which are particularly dependent on Russia.



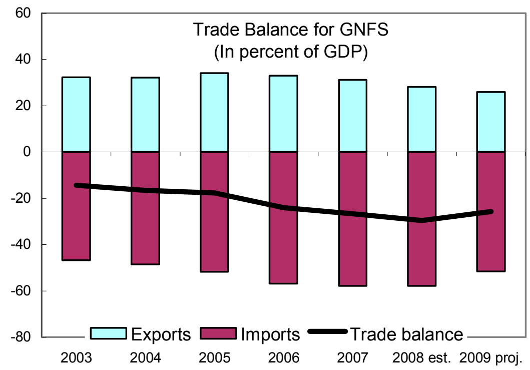
Sources: Department of Statistics of Georgia, IFC, Georgian authorities, and Fund staff estimates.

Figure 2. Georgia: External Sector Developments

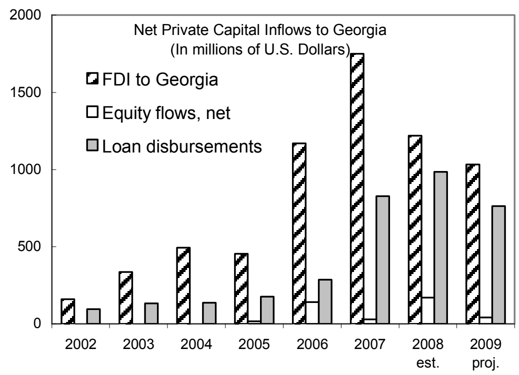
Rising government spending and higher FDI have contributed to a deterioration in the current account deficit...



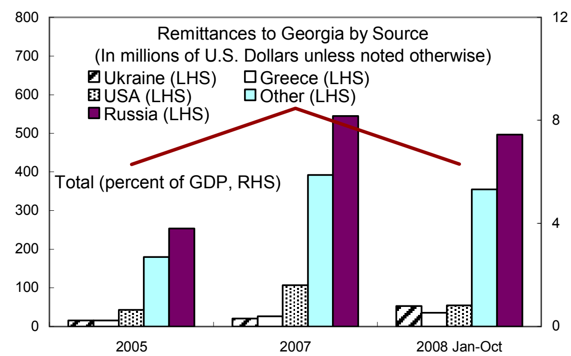
as imports increased sharply while exports remained stable relative to GDP.



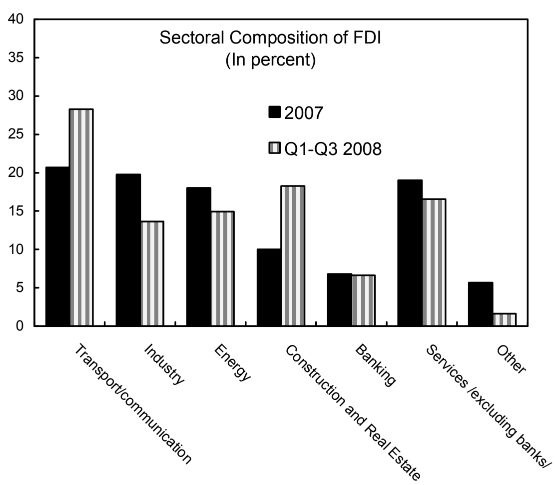
The large trade deficit has been financed by higher private capital inflows and...



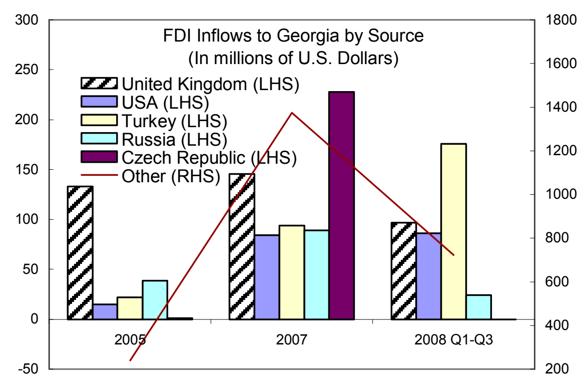
rising remittances, especially from Russia.



Although it has not spurred exports yet, large FDI into nontradable sectors is expected to enhance Georgia's competitiveness over the medium term.



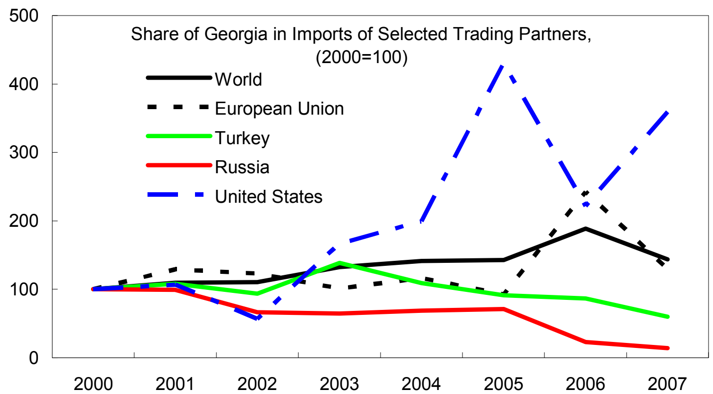
The source of FDI has been broad-based, reducing Georgia's exposure to a particular region.



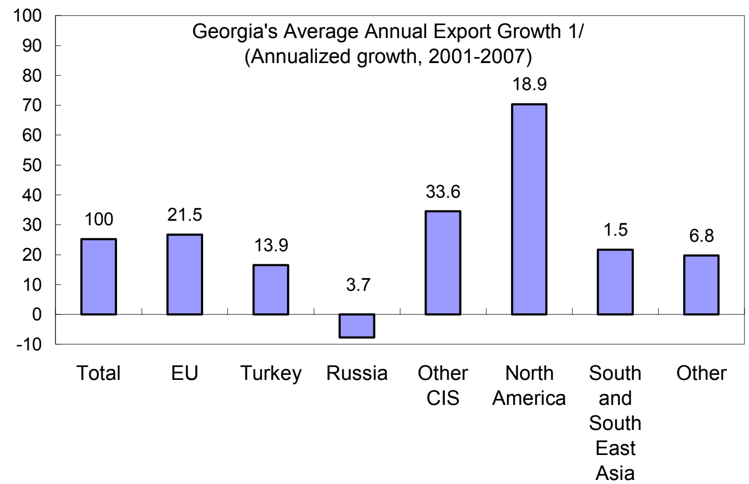
Source: National Bank of Georgia.

Figure 3. Georgia: Export Sector Indicators

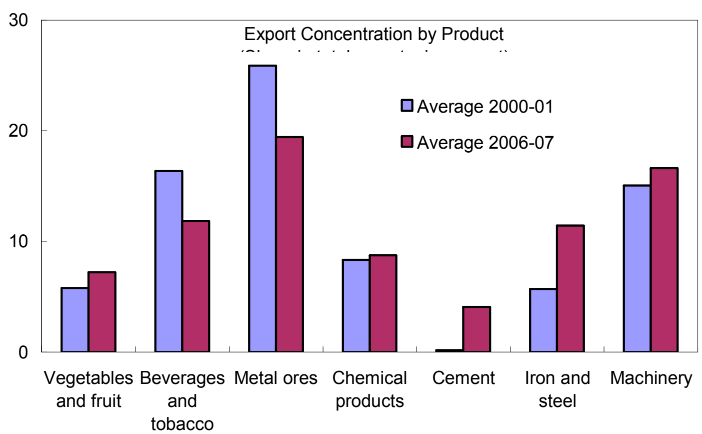
Georgia has gained market shares in world trade, but lost some ground in Russia and Turkey.



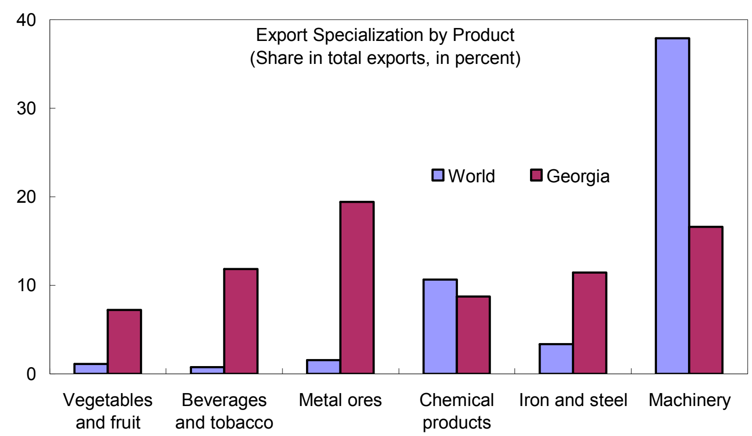
While the CIS countries and EU remain the main destinations for Georgian products, exports growth has been broad-based.



Despite large FDI, the export base has not changed dramatically.



Reflecting this, Georgia remains specialized in resource-based slow-growing sectors, such as metallurgy and food industry.

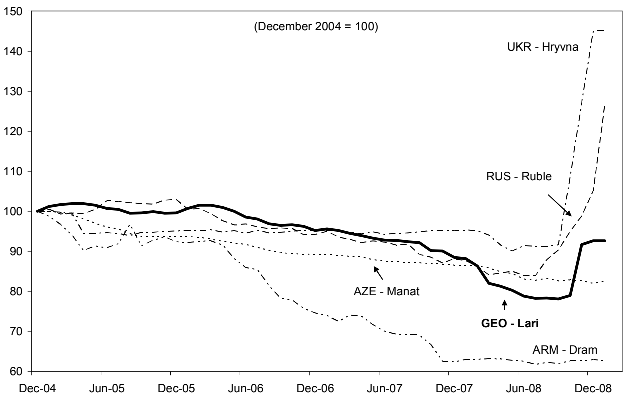


Source: National Bank of Georgia.

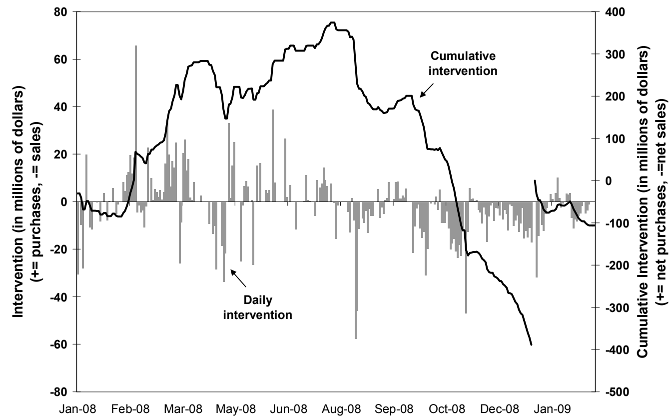
1/ The numbers on the top of each column reflect shares in Georgia's exports.

Figure 4: Georgia: Exchange Rate Developments

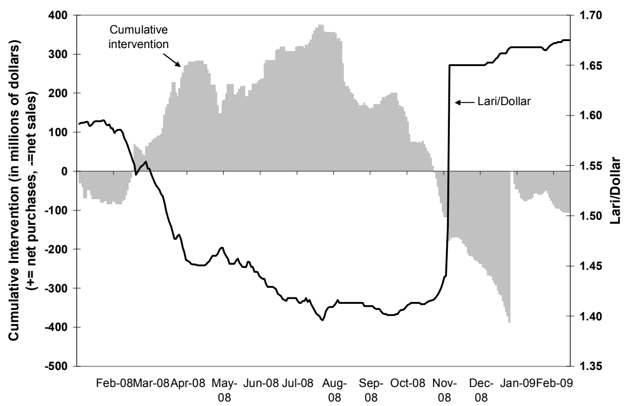
Several regional currencies have devalued in recent months:



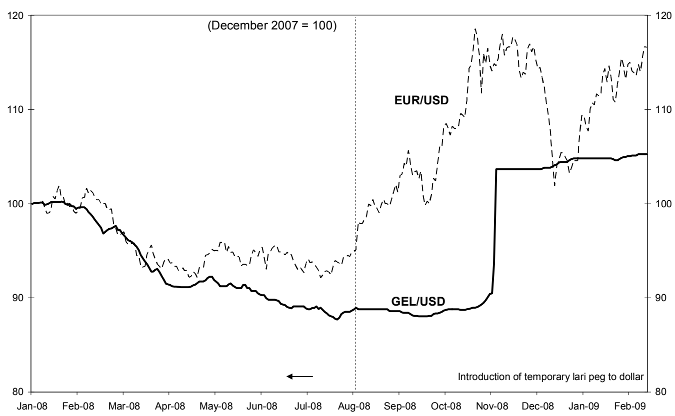
Exchange rate pressures built up in the wake of the conflict...



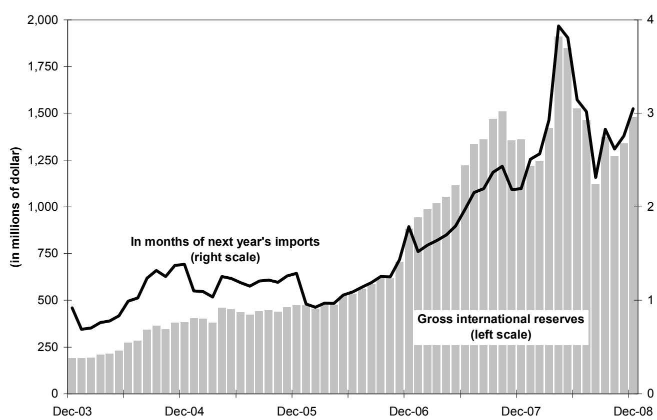
...and the authorities pegged the lari to the dollar...



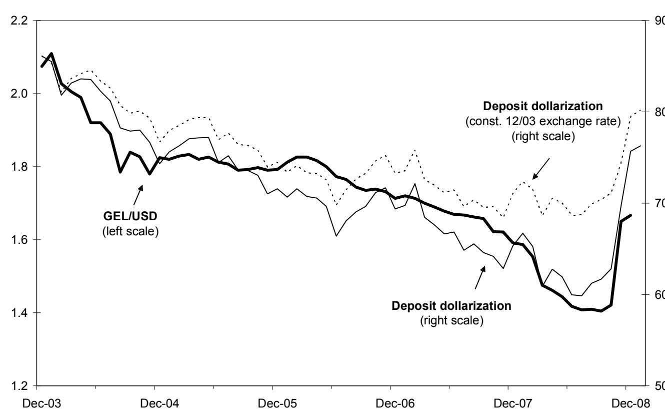
...just when the dollar strengthened against other currencies,



…which resulted in substantial international reserves losses...



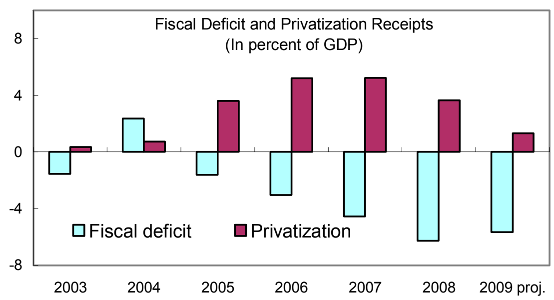
…and redollarization of bank deposits.



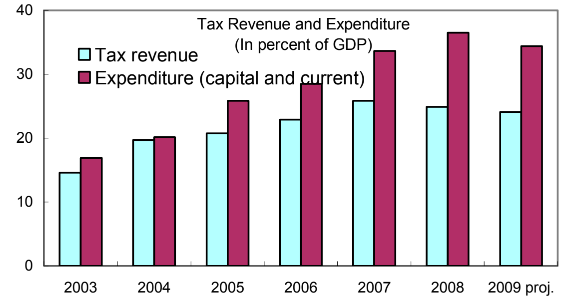
Source: National Bank of Georgia.

Figure 5. Georgia: Fiscal Sector Developments of the General Government

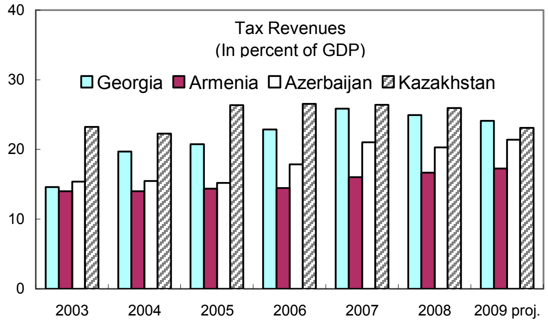
The fiscal deficit has been rising since 2004, partly financed by privatization proceeds,....



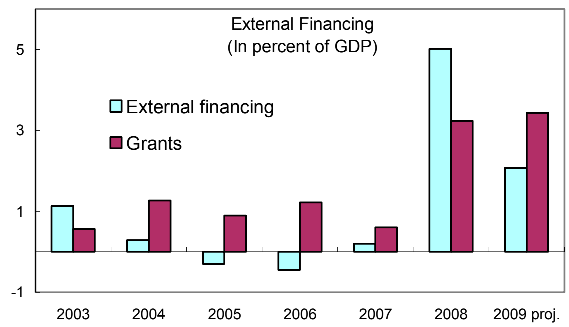
as expenditure growth exceeded revenue growth....



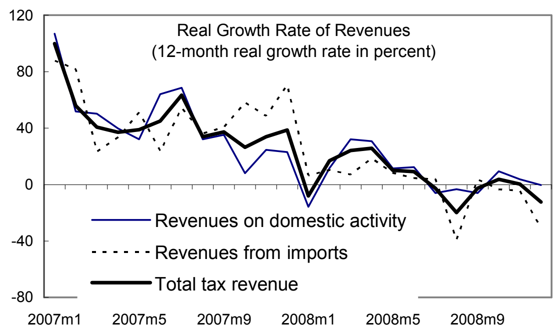
which nevertheless was impressive compared to other countries in the region.



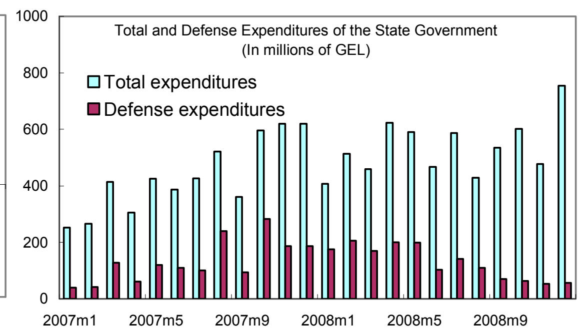
For 2008, donor inflows will provide the necessary financing, partly in form of grants.



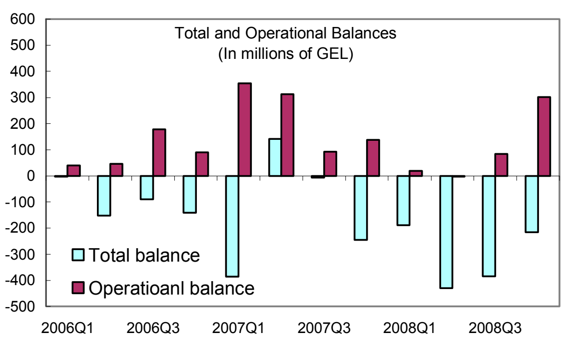
Looking at the recent past, revenue growth slowed down, but recovered from the sharp, conflict related decline in August.



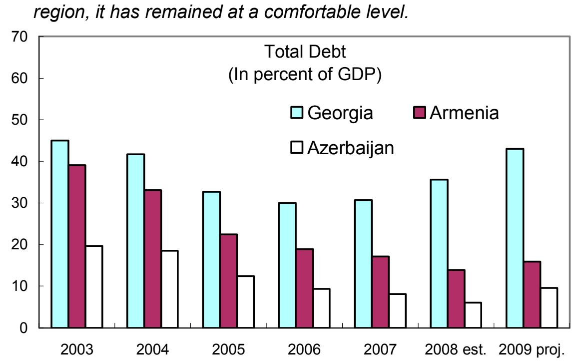
While defense expenditures declined since mid-2008, total expenditures remained high,...



which leads to a large fiscal deficit even though the operational balance has turned moderately positive again.



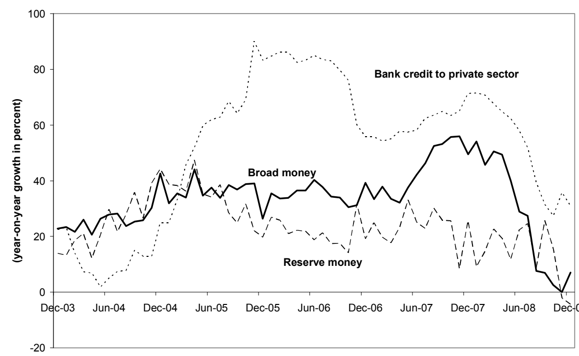
While Georgia's debt to GDP ratio is above other countries in the region, it has remained at a comfortable level.



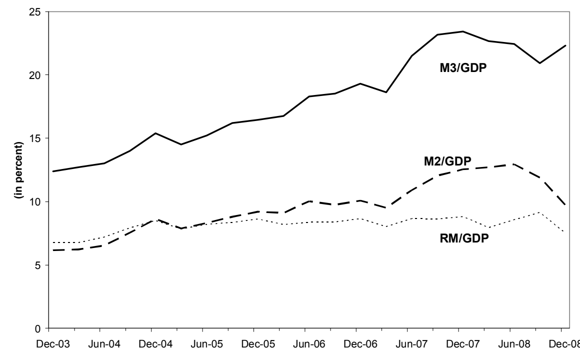
Sources: Georgian authorities; and Fund staff estimates.

Figure 6. Georgia: Monetary Developments

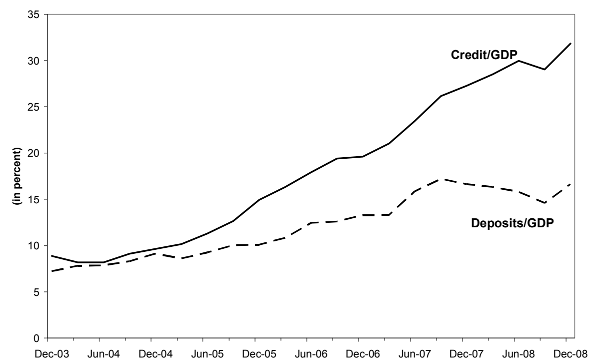
Money and credit growth have slowed significantly after a three-year boom...



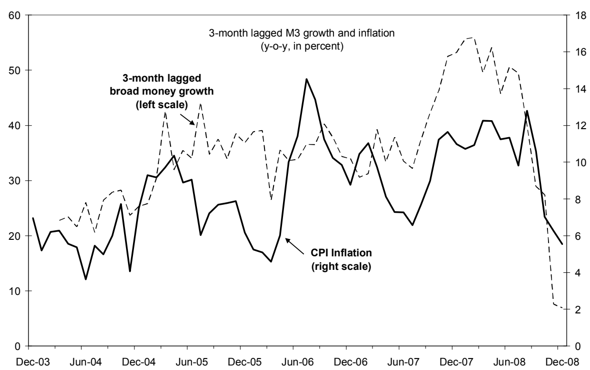
...which has resulted in significant monetary...



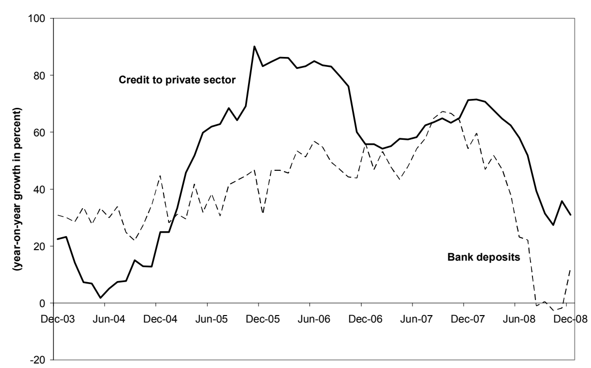
...and financial deepening...



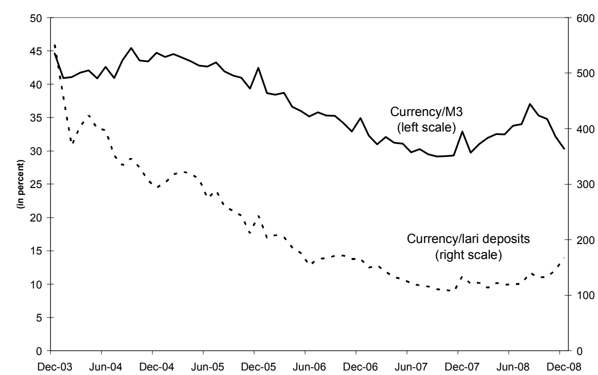
...but also contributed to inflation.



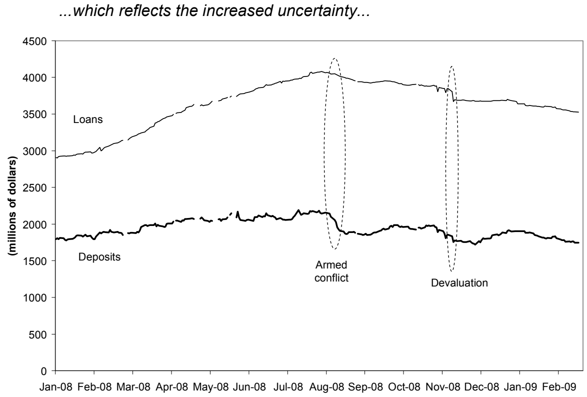
The recent slowdown in financial intermediation...



... is reflected in an increased liquidity preference,



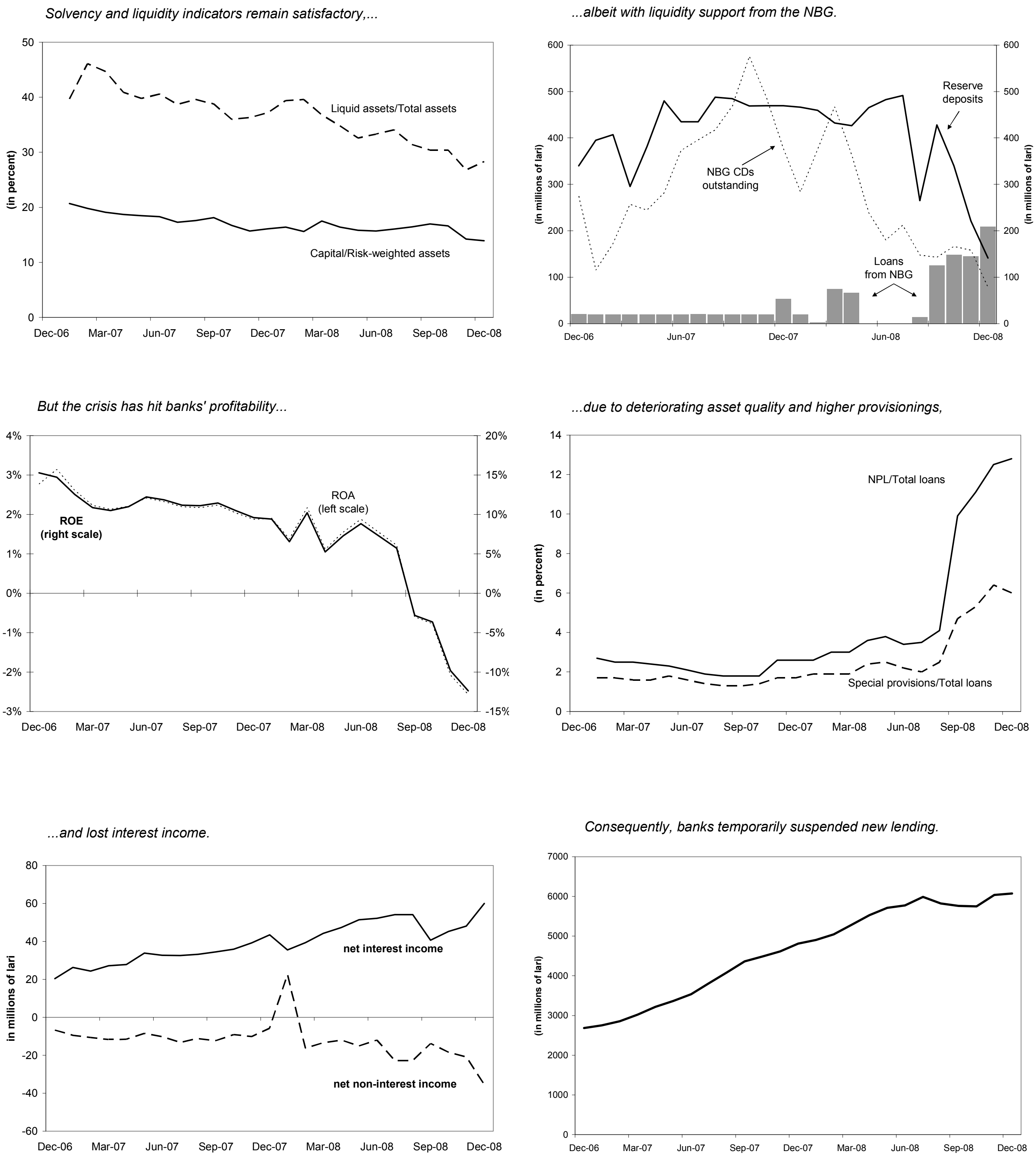
...which reflects the increased uncertainty...



...resulting from the armed conflict and global financial crisis.

Source: National Bank of Georgia

Figure 7. Georgia: Recent Banking Sector Developments



Source: National Bank of Georgia

Table 1. Georgia: Selected Macroeconomic Indicators, 2007–13

	2007 Prel.	2008 Est.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.
	(Annual percentage change, unless otherwise indicated)						
National accounts							
Real GDP growth	12.4	2.0	1.0	3.0	5.0	5.0	5.0
Population (million) 1/	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Consumer price index, period average	9.2	10.0	5.0	6.5	8.3	8.3	8.3
Consumer price index, end-of-period	11.0	5.5	7.0	6.0	6.0	6.0	6.0
GDP per capita (US$)	2,324	2,925	2,562	2,700	2,925	3,145	3,364
Poverty rate (in percent)	21.3	...	...	...	...	...	...
Unemployment rate (in percent)	11.5	...	...	...	...	...	...
	(In percent of GDP)						
Investment and saving							
Investment	28.1	23.7	22.0	22.8	23.2	23.5	23.5
Public	3.4	8.4	7.9	6.9	5.4	4.4	2.8
Private	24.7	15.3	14.1	15.9	17.8	19.1	20.7
Gross national saving	8.1	1.1	5.3	5.2	7.7	9.3	10.4
Public	4.2	2.1	3.0	1.9	2.1	2.5	2.3
Private	3.8	-1.0	2.3	3.2	5.6	6.9	8.1
Saving-investment balance	-20.0	-22.6	-16.7	-17.6	-15.5	-14.2	-13.1
Consolidated government operations	(In percent of GDP)						
Revenue	29.3	30.7	29.5	27.0	26.0	25.5	25.3
Expenses	25.0	28.6	26.5	25.1	23.9	23.0	23.0
Operational balance	4.2	2.1	3.0	1.9	2.1	2.5	2.3
Capital spending and net lending	9.0	8.5	8.7	7.1	5.5	4.5	4.1
Total balance	-4.7	-6.4	-5.6	-5.1	-3.4	-2.0	-1.9
Statistical discrepancy	0.2	0.1	0.0	0.0	0.0	0.0	0.0
Total financing	4.6	6.3	5.6	5.1	3.4	2.0	1.9
Domestic	-0.9	-2.4	2.2	-0.3	0.1	0.3	1.0
External	0.2	5.0	2.1	4.3	2.9	1.7	0.9
Privatization receipts	5.2	3.7	1.3	1.1	0.4	0.0	0.0
	(Annual percentage change, unless otherwise indicated)						
Monetary sector							
Reserve money	25.6	-4.5	8.0	…	…	…	…
Broad money (including foreign exch. deposits)	49.6	7.0	9.0	…	…	…	…
Bank credit to private sector	71.3	31.0	6.0	…	…	…	…
External sector							
Exports of goods and services (percent of GDP)	31.1	28.1	25.9	30.6	32.2	33.1	33.5
Annual percentage change	24.7	13.7	-19.3	24.7	14.6	12.3	10.3
Imports of goods and services (percent of GDP)	57.9	57.9	51.7	55.6	54.4	53.5	52.6
Annual percentage change	34.1	25.9	-21.8	13.4	6.8	7.3	7.0
Current account balance (in millions of US$)	-2,006	-2,911	-1,879	-2,096	-2,012	-2,005	-2,021
In percent of GDP	-19.6	-22.6	-16.7	-17.6	-15.5	-14.2	-13.1
Gross international reserves (in millions of US$)	1,361	1,480	1,470	1,545	1,666	1,803	1,946
In months of next year's imports of goods and services (excl. pipeline imports)	2.2	3.0	2.7	2.6	2.6	2.7	2.7
Foreign direct investment (percent of GDP)	17.1	9.5	9.2	10.4	11.2	12.1	11.7

Sources: Georgian authorities; and Fund staff estimates.

1/ Excludes Abkhazia residents.

Table 2: Georgia: Annual Consolidated Government Operations, 2007-13 1/

	2007	2008		2009		2010	2011	2012	2013	2007	2008		2009		2010	2011	2012	2013
		1st Rev.	Act.	1st Rev.	Proj.		Proj.				1st Rev.	Act.	1st Rev.	Proj.		Proj.		
	(In millions of lari)									(In percent of GDP)								
Revenues	4,972	5,790	5,854	6,287	5,961	5,939	6,331	6,867	7,518	29.3	29.9	30.7	29.8	29.5	27.0	26.0	25.5	25.3
Taxes	4,390	4,803	4,753	5,002	4,867	5,150	5,590	6,206	6,842	25.8	24.8	24.9	23.7	24.1	23.4	23.0	23.0	23.0
Other revenues	480	461	484	341	399	434	480	486	535	2.8	2.4	2.5	1.6	2.0	2.0	2.0	1.8	1.8
Grants	102	526	617	944	695	355	261	176	141	0.6	2.7	3.2	4.5	3.4	1.6	1.1	0.7	0.5
Current expenditure	4,254	5,245	5,452	5,010	5,351	5,513	5,813	6,206	6,842	25.0	27.1	28.6	23.7	26.5	25.1	23.9	23.0	23.0
Compensation for employees	676	1,023	1,007	1,119	1,159	1,247	1,281			4.0	5.3	5.3	5.3	5.7	5.7	5.3		
Use of goods and services	1,580	1,766	1,840	1,070	1,094	1,090	1,127			9.3	9.1	9.6	5.1	5.4	5.0	4.6		
Subsidies	399	421	394	416	470	510	515			2.3	2.2	2.1	2.0	2.3	2.3	2.1		
Grants	14	12	12	10	14	15	16			0.1	0.1	0.1	0.0	0.1	0.1	0.1		
Social expenses	851	1,264	1,287	1,525	1,376	1,495	1,632			5.0	6.5	6.7	7.2	6.8	6.8	6.7		
Other expenses 2/	636	631	788	657	1,027	909	957			3.7	3.3	4.1	3.1	5.1	4.1	3.9		
Interest	98	128	123	213	213	247	283			0.6	0.7	0.6	1.0	1.1	1.1	1.2		
To nonresidents	39	69	64	155	155	184	213			0.2	0.4	0.3	0.7	0.8	0.8	0.9		
To residents	59	59	59	58	58	63	70			0.3	0.3	0.3	0.3	0.3	0.3	0.3		
Operational balance	718	545	402	1,277	610	426	519	661	676	4.2	2.8	2.1	6.0	3.0	1.9	2.1	2.5	2.3
Capital spending and net lending	1,524	1,703	1,623	2,747	1,751	1,554	1,339	1,205	1,231	9.0	8.8	8.5	13.0	8.7	7.1	5.5	4.5	4.1
Capital	1,465	1,612	1,508	2,630	1,600	1,521	1,319	1,196	1,223	8.6	8.3	7.9	12.4	7.9	6.9	5.4	4.4	4.1
Net lending	59	91	114	117	151	33	20	9	8	0.3	0.5	0.6	0.6	0.7	0.2	0.1	0.0	0.0
Total balance	-806	-1,158	-1,220	-1,470	-1,141	-1,128	-820	-544	-555	-4.7	-6.0	-6.4	-7.0	-5.6	-5.1	-3.4	-2.0	-1.9
Statistical discrepancy	33	0	24	0	0	0	0	0	0	0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Total financing	774	1,158	1,196	1,470	1,141	1,128	820	544	555	4.6	6.0	6.3	7.0	5.6	5.1	3.4	2.0	1.9
Domestic	-149	-454	-460	464	454	-67	13	73	283	-0.9	-2.3	-2.4	2.2	2.2	-0.3	0.1	0.3	1.0
Amortization	-30	-63	-61	-77	-68	-67	13	73	283	-0.2	-0.3	-0.3	-0.4	-0.3	-0.3	0.1	0.3	1.0
Use of deposits at the NBG and banks	-119	-391	-399	541	522	0	0	0	0	-0.7	-2.0	-2.1	2.6	2.6	0.0	0.0	0.0	0.0
External	34	982	957	810	419	943	708	472	274	0.2	5.1	5.0	3.8	2.1	4.3	2.9	1.7	0.9
Borrowing	166	1,072	1,073	931	583	1,046	823	624	1,511	1.0	5.5	5.6	4.4	2.9	4.8	3.4	2.3	5.1
Repayment	-132	-53	-59	-157	-204	-103	-116	-152	-1,237	-0.8	-0.3	-0.3	-0.7	-1.0	-0.5	-0.5	-0.6	-4.2
Use of Sovereign Wealth Fund resources	0	-37	-58	37	40	0	0	0	0	0.0	-0.2	-0.3	0.2	0.2	0.0	0.0	0.0	0.0
Privatization receipts	889	630	697	196	269	252	100	0	0	5.2	3.3	3.7	0.9	1.3	1.1	0.4	0.0	0.0
Memorandum items:																		
Nominal GDP	16,999	19,353	19,080	21,126	20,231	21,987	24,356	26,981	29,746									
Fiscal deficit excluding grants	876	1,684	1,813	2,414	1,836	1,483	1,081	719	696	5.2	8.7	9.5	11.4	9.1	6.7	4.4	2.7	2.3

Source: Ministry of Finance; and Fund staff estimates.

1/ Consolidated government includes central and local governments and the Sovereign Wealth Funds.
2/ Other expenses include spending of Legal Entities of Public Law, for example, schools, universities, and hospitals.

Table 3: Georgia: Quarterly Consolidated Government Operations, 2008-09 1/

	2008					2009				
	Q1 Actual	Q2 Actual	Q3 Act.	Q4 Act.	Annual Actual	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Annual Proj.
	(In millions of lari)									
Revenues	1,309	1,402	1,319	1,824	5,854	1,068	1,295	1,677	1,921	5,961
Taxes	1,123	1,265	1,183	1,182	4,753	947	1,116	1,183	1,621	4,867
Direct	520	565	517	511	2,113	400	473	493	527	1,893
Indirect	603	700	666	670	2,639	547	643	690	1,094	2,974
Other revenues	157	119	91	117	484	57	80	114	149	399
Grants	29	18	45	526	617	65	100	380	151	695
Current expenditure	1,290	1,404	1,235	1,522	5,452	1,178	1,250	1,258	1,666	5,351
Compensation for employees	235	257	250	266	1,007	266	282	299	313	1,159
Use of goods and services	525	578	390	347	1,840	260	296	269	269	1,094
Subsidies	97	70	77	150	394	102	125	132	111	470
Grants	6	3	2	2	12	8	4	1	1	14
Social expenses	287	329	316	355	1,287	336	338	341	360	1,376
Other expenses	116	146	175	351	788	153	153	162	559	1,027
Interest	25	22	24	52	123	53	52	54	54	213
To nonresidents	10	8	10	37	64	19	61	22	53	155
To residents	15	14	15	15	59	15	14	15	14	58
Operational balance	19	-2	84	302	402	-110	45	419	255	610
Capital spending and net lending	208	428	468	519	1,623	370	490	468	423	1,751
Capital	190	403	417	498	1,508	337	443	427	393	1,600
Net lending	18	25	51	21	114	33	47	41	30	151
Total balance	-189	-431	-384	-216	-1,220	-480	-444	-49	-168	-1,141
Statistical discrepancy	30	23	-60	30	24	0	0	0	0	0
Total financing	159	407	444	186	1,196	480	444	49	168	1,141
Domestic	-25	-190	273	-516	-460	303	302	21	-171	454
Amortization	-15	-19	-4	-23	-61	-19	-17	-19	-13	-68
Use of deposits at the NBG and banks	-10	-171	277	-494	-399	322	319	40	-158	522
External	16	218	110	613	957	121	109	-9	199	419
Borrowing	27	772	59	216	1,073	95	135	124	228	583
Amortization	-10	-13	-19	-17	-59	-14	-27	-134	-29	-204
Use of Sovereign Wealth Fund resources	0	-541	70	414	-58	40	0	0	0	40
Privatization receipts	168	379	61	90	697	56	34	38	141	269
Memorandum items:										
Nominal GDP	4182.5	4995.2	4826	5076	19,080	4,302	5,133	5,266	5,530	20,231

Sources: Ministry of Finance; and Fund staff estimates.

1/ Consolidated government includes central and local governments and the Sovereign Wealth Funds.

Table 4. Georgia: Summary Balance of Payments, 2007–13

(In millions of U.S. dollars)

	2007	2008 Est.	2009 1st rev.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.
Current account balance	-2,006	-2,911	-2,429	-1,879	-2,096	-2,012	-2,005	-2,021
Trade balance	-2,896	-3,840	-3,391	-3,115	-3,332	-3,397	-3,547	-3,744
Exports	2,088	2,428	2,420	1,748	2,190	2,490	2,768	3,014
Imports	-4,984	-6,268	-5,812	-4,863	-5,521	-5,887	-6,315	-6,757
Services	161	14	98	209	363	509	653	801
Income (net)	39	-172	-135	-82	-32	-35	-18	-40
Of which : interest payments	-118	-228	-275	-287	-293	-332	-355	-411
Transfers (net)	689	1,088	999	1,110	904	911	907	961
Of which : public sector	139	426	179	452	162	108	54	52
Capital account	128	100	495	133	148	97	93	75
Financial account	2,307	2,738	2057	1,571	2,044	2,095	2,278	2,312
Direct investment (net)	1,676	1,177	1,134	1,032	1,240	1,451	1,716	1,809
Monetary authorities, net	-101	-14	0	0	0	0	0	0
General government	116	589	543	235	511	376	269	179
Portfolio investment (net)	0	500	52	0	0	0	0	500
Long-term loans received	111	190	466	211	511	376	269	-321
Drawing	156	227	561	323	565	435	345	277
Repayment	-45	-37	-95	-112	-54	-59	-76	-598
Other, net	5	-102	25	24	0	0	0	0
Private Sector, excl. FDI	616	985	380	304	294	268	293	324
Banks	569	752	315	52	229	240	302	272
Portfolio investment, net	21	109	188	9	84	61	112	86
Of which : equity liabilities	34	101	116	9	14	16	32	36
Loans received (net)	653	807	-214	-168	59	89	59	86
Other, net (currency and deposits, loans extended)	-105	-164	341	211	85	90	130	100
Other sectors	47	233	65	252	65	28	-8	52
Portfolio investment, net	0	69	70	32	34	37	51	56
Long-term loans received (net)	78	133	66	287	5	-13	-76	-26
Other, net	-31	32	-71	-67	26	4	17	21
Errors and omissions	-21	18	0	0	0	0	0	0
Overall balance	408	-55	123	-175	97	180	366	366
Financing	-408	55	-123	175	-97	-180	-366	-366
Gross International Reserves (-increase)	-377	-132	-95	10	-75	-121	-137	-143
Use of Fund Resources	3	222	-27	164	-22	-59	-229	-223
Exceptional financing	-34	-35	0	0	0	0	0	0
Required financing (+ overfinancing)	0	0	0	0	0	0	0	0
Memorandum items:								
Nominal GDP	10,227	12,870	13,163	11,269	11,881	12,972	14,164	15,428
Current account balance (percent of GDP)	-19.6	-22.6	-18.5	-16.7	-17.6	-15.5	-14.2	-13.1
excluding official transfers (percent of GDP)	-21.0	-25.9	-19.8	-20.7	-19.0	-16.3	-14.5	-13.4
GNFS exports growth (percent)	24.7	13.7	-6.1	-19.3	24.7	14.6	12.3	10.3
GNFS exports volume growth (percent)	4.7	-3.8	11.4	-4.9	14.9	9.2	8.5	8.0
GNFS imports growth (percent)	34.1	25.9	-8.1	-21.8	13.4	6.8	7.3	7.0
GNFS imports volume growth (percent)	11.9	4.8	5.4	-7.9	6.5	3.9	5.7	5.6
Net capital inflows to private sector	2,292	2,163	1,514	1,336	1,534	1,719	2,009	2,133
(in percent of GDP)	22.4	16.8	11.5	11.9	12.9	13.3	14.2	13.8
Gross international reserves (end of period)	1,361	1,480	1,473	1,470	1,545	1,666	1,803	1,946
(in months of next year GNFS imports)	2.2	3.0	2.2	2.7	2.6	2.6	2.7	2.7
External debt (nominal) /1	3,136	4,581	4,617	4,851	5,599	6,053	6,191	6,434
(in percent of GDP)	30.7	35.6	35.1	43.0	47.1	46.7	43.7	41.7
External debt service /1	265	763	993	1,140	875	1,109	1,552	2,142
(in percent of exports)	8.20	21.1	26.6	39.0	24.0	26.6	33.1	41.4
External public sector debt (nominal)	1,790	2,668	3,057	2,935	3,556	3,894	4,033	4,115
(in percent of GDP)	17.5	20.7	23.2	26.0	29.9	30.0	28.5	26.7
External public debt service	143	161	169	227	189	247	464	1,027
(in percent of exports)	4.4	4.5	4.5	7.8	5.2	5.9	9.9	19.9

1/ For private debt starting 2008, estimates are based on the survey conducted by the National Bank of Georgia and Fund staff assumptions.

Table 5. Georgia: Accounts of the National Bank of Georgia, 2007–09

	2007				2008					2009			
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep. Act.	Dec. 1st Rev.	Dec. Act..	Mar. Proj.	Jun. Proj.	Sep. Proj.	Dec. Proj.
	(In millions of lari)												
Net foreign assets 1/	1,211	1,515	1,811	1,460	1,500	1,594	1,266	1,475	1,528	1,152	1,115	1,453	1,378
Net domestic assets	-58	-208	-431	38	-87	6	468	-7	-96	242	332	96	174
Net claims on general government	128	96	10	329	315	149	400	-62	-103	219	538	578	420
Claims on general government (incl. t-bills)	785	775	775	776	776	776	778	778	777	777	777	777	777
Nontradable govt. debt	737	737	737	737	689	689	689	689	689	641	641	641	641
Securitized debt (marketable)	48	38	38	39	87	87	89	89	88	136	136	136	136
Deposits	-656	-680	-766	-447	-461	-627	-377	-839	-880	-558	-239	-199	-357
Claims on rest of economy	99	99	104	103	3	3	3	3	4	4	4	4	4
Claims on banks	-237	-353	-448	-304	-392	-180	-18	-28	132	208	32	-262	-42
Certificates of deposits and bonds	-257	-373	-468	-377	-467	-180	-143		-77	-75	-100	-280	-100
Other items, net	-49	-49	-96	-90	-13	34	82	80	-129	-189	-242	-225	-208
Reserve money	1,153	1,308	1,380	1,499	1,414	1,600	1,734	1,469	1,432	1,394	1,447	1,549	1,552
Currency in circulation	858	967	1,081	1,310	1,287	1,413	1,399	1,366	1,291	1,252	1,295	1,348	1,350
Required reserves 2/	231	140	66	1	0	0	0	0	0	0	0	0	0
Balances on banks' correspondent accounts 3/	64	200	233	187	126	187	335	103	141	142	152	201	202
	(Percent contribution, compared to reserve money at the end of previous year)												
Net foreign assets	17.2	42.6	67.5	38.0	2.7	8.9	-13.0	1.0	4.5	-26.3	-28.8	-5.2	-10.5
Net domestic assets	-20.6	-33.1	-51.8	-12.5	-8.3	-2.2	28.7	-3.0	-8.9	23.6	29.9	13.4	18.9
Net claims on general government	-23.3	-26.1	-33.3	-6.5	-0.9	-12.0	4.8	-26.1	-28.8	22.5	44.8	47.6	36.5
Claims on rest of economy	0.0	-0.1	0.3	0.3	-6.6	-6.6	-6.6	-6.6	-6.6	0.0	0.0	0.0	0.0
Claims on banks	1.5	-8.3	-16.2	-4.1	-5.9	8.2	19.1	18.4	29.1	5.3	-7.0	-27.5	-12.2
Other items, net	1.3	1.3	-2.7	-2.1	5.1	8.2	11.5	11.3	-2.6	-4.2	-7.9	-6.7	-5.5
	(Percentage change, relative to end of previous year)												
Reserve money	-3.4	9.6	15.6	25.6	-5.7	6.8	15.7	-2.0	-4.5	-2.7	1.1	8.2	8.4
Currency in circulation	-7.7	4.1	16.3	41.0	-1.8	7.8	6.8	4.2	-1.5	-3.0	0.4	4.4	4.6
Required reserves 2/	2.9	-37.7	-70.7	-99.5	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Balances on banks' correspondent accounts 3/	62.4	411.7	495.3	377.7	-32.4	0.0	79.3	-45.0	-24.5	0.7	7.6	42.6	42.9
Memorandum items:													
Net international reserves													
(in millions of USD, at prog. exchange rates) 4/	460	658	807	…	…	1,055	848	851	909	633	585	769	728
Net domestic assets (in millions of lari, at prog. exchange rate)	163	156	162	…	…	42	452	214	116	310	446	240	311
Reserve money (in percent, 12-month growth)	17.8	25.2	25.8	25.6	22.6	22.4	25.7	-2.0	-4.5	-1.4	-9.6	-10.7	8.4

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

1/ New classification of gross international reserves reported since the beginning of 2007.

2/ The required reserve regime was modified in May 2007. Under the new regime, the lari reserves are deposited at banks' corresponding accounts; the foreign-currency reserves have been gradually converted into the required currency (USD) and included in the NFA as both asset and liability.

3/ Including the lari required reserves and overnight deposits from banks.

4/ Projections are based on projected exchange rates.

Table 6. Georgia: Monetary Survey, 2007–09

	2007				2008					2009			
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep. Act.	Dec. 1st Rev.	Dec. Est.	Mar. Proj.	Jun. Proj.	Sep. Proj.	Dec. Proj.
							(In millions of lari)						
Net foreign assets 1/	584	772	799	274	199	-40	-394	-185	-42	-453	-526	-225	-337
NBG	1,211	1,515	1,811	1,460	1,500	1,594	1,266	1,475	1,528	1,152	1,115	1,453	1,378
Commercial banks	-627	-743	-1,012	-1,186	-1,301	-1,634	-1,660	-1,660	-1,570	-1,605	-1,642	-1,678	-1,715
Net domestic assets	2,091	2,476	2,910	3,706	3,828	4,228	4,360	4,195	4,300	4,695	4,873	4,707	4,979
Domestic credit	3,228	3,705	4,251	5,032	5,336	5,682	5,846	5,495	5,921	6,201	6,532	6,694	6,808
Net claims on general government	107	67	-40	293	265	85	339	-99	-155	167	486	526	368
Credit to the rest of the economy	3,122	3,638	4,291	4,739	5,071	5,598	5,507	5,594	6,076	6,034	6,046	6,168	6,441
Other items, net	-1,138	-1,229	-1,341	-1,326	-1,508	-1,454	-1,486	-1,300	-1,621	-1,506	-1,658	-1,987	-1,830
Broad money (M3)	2,674	3,248	3,709	3,981	4,027	4,188	3,966	4,009	4,258	4,242	4,347	4,481	4,642
Broad money, excl. forex deposits (M2)	1,365	1,646	1,928	2,132	2,259	2,417	2,257	2,165	1,854	1,794	1,828	1,873	1,922
Currency held by the public	762	851	952	1,152	1,123	1,235	1,196	1,116	1,083	1,063	1,117	1,179	1,177
Total deposit liabilities	1,912	2,397	2,756	2,829	2,904	2,952	2,769	2,894	3,176	3,178	3,230	3,302	3,464
							(Percent contribution, compared to broad money at the end of previous year)						
Net foreign assets	-1.4	5.7	6.7	-13.0	-1.9	-7.9	-16.8	-11.5	-7.9	-9.7	-11.4	-4.3	-6.9
Net domestic assets	1.9	16.4	32.7	62.6	3.1	13.1	16.4	12.3	14.9	9.3	13.5	9.5	15.9
Domestic credit	0.4	18.3	38.8	68.1	7.6	16.3	20.4	11.6	22.3	6.6	14.3	18.1	20.8
Net claims on general government	-11.5	-13.0	-17.0	-4.5	-0.7	-5.2	1.1	-9.9	-11.3	7.6	15.1	16.0	12.3
Credit to the rest of the economy	11.9	31.3	55.8	72.6	8.3	21.6	19.3	21.5	33.6	-1.0	-0.7	2.2	8.6
Other items, net	1.5	-1.9	-6.1	-5.5	-4.6	-3.2	-4.0	0.6	-7.4	2.7	-0.9	-8.6	-4.9
							(Percentage change, relative to end of previous year)						
Broad money (M3)	0.5	22.0	39.3	49.6	1.2	5.2	-0.4	0.7	7.0	-0.4	2.1	5.2	9.0
Broad money, excl. forex deposits (M2)	-1.7	18.5	38.8	53.5	6.0	13.4	5.9	1.5	-13.0	-3.2	-1.4	1.0	3.7
Currency held by the public	-7.9	2.9	15.1	39.2	-2.5	7.2	3.9	-3.1	-6.0	-1.8	3.2	8.9	8.7
Total deposit liabilities	4.3	30.7	50.3	54.2	2.7	4.4	-2.1	2.3	12.3	0.1	1.7	4.0	9.1
Credit to the rest of the economy	11.3	29.7	52.9	68.9	7.0	18.1	16.2	18.0	28.2	-0.7	-0.5	1.5	6.0
Memorandum items:													
M3 (in percent, 12-month growth)	33.5	42.2	53.2	49.6	50.6	28.9	6.9	0.7	7.0	5.3	3.8	13.0	9.0
M2 (in percent, 12-month growth)	25.6	31.5	51.4	53.5	65.4	46.8	17.1	1.5	-13.0	-20.6	-24.4	-17.0	3.7
Credit to the economy (in percent, 12-month growth)	52.6	55.8	62.8	68.9	62.4	53.9	28.3	18.0	28.2	19.0	8.0	12.0	6.0
M2 multiplier 2/	1.18	1.26	1.40	1.42	1.60	1.51	1.30	1.47	1.29	1.29	1.26	1.21	1.24
M3 multiplier 3/	2.32	2.48	2.69	2.66	2.85	2.62	2.29	2.73	2.97	3.04	3.00	2.89	2.99
M3 velocity	5.37	4.65	4.32	4.27	4.41	4.46	4.78	…	4.48	4.53	4.45	4.41	4.36
Foreign exchange deposits in percent of total deposits	68.4	66.8	64.6	65.4	60.9	60.0	61.7	63.7	75.7	77.0	78.0	79.0	78.5

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

1/ New classification of gross international reserves reported since the beginning of 2007.
2/ M2 divided by reserve money.
3/ M3 divided by reserve money.

Table 7. Georgia: External Vulnerability Indicators, 2007-13

	2007 Act.	2008 Est.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.
Value of exports of goods and services, percent change	24.7	13.7	-19.3	24.7	14.6	12.3	10.3
Value of imports of goods and services, percent change	34.1	25.9	-21.8	13.4	6.8	7.3	7.0
Terms of trade (deterioration -)	-0.6	-1.5	-0.1	1.8	2.1	1.9	0.9
Current account balance (percent of GDP)	-19.6	-22.6	-16.7	-17.6	-15.5	-14.2	-13.1
Capital and financial account (percent of GDP)	23.8	22.0	15.1	18.5	16.9	16.7	15.5
External public debt (percent of GDP)	17.5	20.7	26.0	29.9	30.0	28.5	26.7
in percent of exports of goods and services	56.2	73.7	100.5	97.7	93.3	86.1	79.6
Debt service on external public debt							
(in percent of exports of goods and services)	4.4	4.5	7.8	5.2	5.9	9.9	19.9
External debt (percent of GDP)	30.7	35.6	43.0	47.1	46.7	43.7	41.7
in percent of exports of goods and services	98.5	126.6	166.1	153.8	145.1	132.2	124.5
Debt service on external debt							
(in percent of exports of goods and services)	8.2	21.1	39.0	24.0	26.6	33.1	41.4
Gross international reserves							
in millions of USD	1,361	1,480	1,470	1,545	1,666	1,803	1,946
in months of next year's imports of goods and servces	2.2	3.0	2.7	2.6	2.6	2.7	2.7
in percent of external debt	43.4	32.3	30.3	27.6	27.5	29.1	30.2
in percent of short-term external debt	283	...	...	...	...	...	...
in percent of short-term external debt 1/	549	646	...	...	...	...	...

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

1/ Excluding currency and deposit liabilities of banks.

Table 8. Georgia: Indicators of Fund Credit, 2007–17
(In millions of SDR)

	2006	2007	2008 Act.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.
Existing Fund credit												
Stock 1/	157.1	159.2	298.8	280.8	266.7	228.6	127.8	47.6	29.4	14.0	4.2	0.0
PRGF	157.1	159.2	137.1	119.1	105.0	87.1	67.2	47.6	29.4	14.0	4.2	0.0
SBA			161.7	161.7	161.7	141.5	60.6	0.0	0.0	0.0	0.0	0.0
Obligations	34.2	26.7	23.3	21.8	17.7	41.7	103.5	81.3	18.4	15.5	9.8	4.2
PRGF	34.2	26.7	22.8	18.6	14.7	18.4	20.3	19.9	18.4	15.5	9.8	4.2
SBA 2/			0.5	3.2	3.1	23.3	83.2	61.5	0.0	0.0	0.0	0.0
Prospective drawing under the SBA												
Disbursements	...	...	...	268.1	47.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	...	...	...	268.1	315.4	315.4	250.3	98.6	5.9	0.0	0.0	0.0
Obligations 2/	...	...	...	3.4	6.8	7.1	71.3	155.2	93.6	5.9	0.0	0.0
Principal (repurchases)	...	...	...	0.0	0.0	0.0	65.1	151.8	92.6	5.9	0.0	0.0
GRA charges (incl. level based and service surcharges)	...	...	...	3.4	6.8	7.1	6.3	3.4	1.0	0.0	0.0	0.0
Stock of existing and prospective Fund credit 1/	157.1	159.2	298.8	548.9	582.1	544.0	378.2	146.2	35.3	14.0	4.2	0.0
In percent of quota	104.5	105.9	198.8	365.2	387.3	361.9	251.6	97.2	23.5	9.3	2.8	0.0
In percent of GDP	3.0	2.4	3.7	7.5	7.5	6.5	4.1	1.5	0.3	0.1	0.0	0.0
In percent of exports of goods and nonfactor services	9.1	7.7	13.1	28.8	24.6	20.1	12.5	4.4	1.0	0.4	0.1	0.0
In percent of gross reserves	26.2	17.9	31.9	57.3	58.0	50.4	32.5	11.7	2.5	0.9	0.2	0.0
Obligations to the Fund from existing and prospective Fund credit 2/	34.2	26.7	23.3	25.1	24.6	48.7	174.8	236.5	112.0	21.4	9.8	4.2
In percent of quota	22.8	17.8	15.5	16.7	16.3	32.4	116.3	157.4	74.5	14.3	6.5	2.8
In percent of GDP	0.6	0.4	0.3	0.3	0.3	0.6	1.9	2.4	1.0	0.2	0.1	0.0
In percent of exports of goods and nonfactor services	2.0	1.3	1.0	1.3	1.0	1.8	5.8	7.1	3.1	0.5	0.2	0.1
In percent of gross reserves	5.7	3.0	2.5	2.6	2.4	4.5	15.0	18.9	8.0	1.4	0.6	0.2

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

1/ End of period.
2/ Repayment schedule based on repurchase obligations and GRA charges.

Table 9. Georgia: External Financing Requirements and Sources, 2007–13
(In millions of U.S. dollars)

	2007	2008	2009	2010	2011	2012	2013
Total requirements	-2,270	-3,253	-2,532	-2,667	-2,636	-2,868	-3,453
Current account deficit	-2,006	-2,911	-1,879	-2,096	-2,012	-2,005	-2,021
Capital outflows: Repayments of long-term loans	-264	-342	-653	-572	-624	-863	-1,432
Total sources	2,270	3,253	2,532	2,667	2,636	2,868	3,453
Capital flows	2,638	3,162	2,330	2,742	2,757	3,005	3,596
Public sector	128	695	460	686	505	410	822
Project grants	68	84	113	121	70	65	45
Long-term loan disbursements to public sector	156	227	323	565	435	345	277
Other 1/	-96	385	24	0	0	0	500
Private sector	2,510	2,467	1,871	2,056	2,252	2,595	2,774
Foreign direct investment in Georgia	1,750	1,218	1,032	1,240	1,451	1,716	1,809
Long-term loan disbursements to private sector	828	984	763	435	465	526	639
Other net inflows 2/	-68	264	75	381	336	353	326
Financing	9	222	192	0	0	0	0
IMF 3/	43	257	192	0	0	0	0
Change in arrears, net (- decrease)	-29	-8	0	0	0	0	0
Debt rescheduling, pre-payment (net) 4/	9	0	0	0	0	0	0
Advance Repayments	-14	-27	0	0	0	0	0
Change in reserves (- increase)	-377	-132	10	-75	-121	-137	-143
Financing gap	0	0	0	0	0	0	0
Memorandum items (in percent of GDP)							
Total financing requirements	-22.2	-25.3	-22.5	-22.5	-20.3	-20.2	-22.4
Total sources	22.2	25.3	22.5	22.5	20.3	20.2	22.4
Capital inflows	25.8	24.6	20.7	23.1	21.3	21.2	23.3
Exceptional financing	0.1	1.7	1.7	0.0	0.0	0.0	0.0
Change in reserves (- increase)	-3.7	-1.0	0.1	-0.6	-0.9	-1.0	-0.9

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

1/ Including the receipts from bond issuance.

2/ Including errors and omissions.

3/ PRGF disbursements in 2006 and 2007; SBA purchases from 2008 on.

4/ Assumes rescheduling of 2003 arrears in 2004 and of principal maturities falling due during 2004-06. Includes comparable treatment by non-Paris Club bilateral creditors.

Table 10. Georgia: Schedule of Reviews and Purchases

Availability Date	Condition	Available Purchases (in millions of SDR)
15-Sep-08	Approved the 18-month arrangement	161.7
15-Nov-08	Complete the first review based on end-September performance criteria and other relevant performance criteria	63.1
15-Feb-09	Complete the second review based on end-December performance criteria and other relevant performance criteria 1/	63.1
15-Jun-09	Complete the third review based on end-March performance criteria and other relevant performance criteria	47.3
15-Sep-09	Complete the fourth review based on end-June performance criteria and other relevant performance criteria	47.3
15-Dec-09	Complete the fifth review based on end-September performance criteria and other relevant performance criteria	47.3
28-Feb-10	Complete the sixth review based on end-December performance criteria and other relevant performance criteria	47.3
Total available		477.1

Source: Fund staff.

1/ As the authorities did not draw the purchase that became available at the time of the first review, at the second review SDR 126.2 million will become available.

ATTACHMENT I. GEORGIA: LETTER OF INTENT

March 10, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. Strauss-Kahn:

1. In September 2008, the International Monetary Fund (IMF) approved a Stand-By Arrangement for Georgia to assist with the recovery from the economic dislocation caused by the conflict between Georgia and Russia. This support proved invaluable in the months immediately following the conflict and we are grateful to the IMF for the support.

2. This letter of intent describes our economic strategy and the economic policies that we plan to implement during the rest of 2009. In the face of the worsening global economic and financial situation we are committed to implementing policies that will help protect the stability of the external and financial sectors while containing the slowdown in economic growth. We remain, of course, fully dedicated to carrying out the commitments made in the letters of intent dated September 9 and November 28, 2008.

Recent Economic Developments

3. Economic performance during the first half of 2008 was robust with an increase in real GDP of 8.7 percent year-on-year. As in past years, this strong performance was due mainly to large private capital inflows. In the first six months of 2008, private capital inflows totaled nearly USD 1.7 billion and for the year as a whole these inflows were in the range of USD 2-2.2 billion. Despite strong growth, disciplined monetary and fiscal policies kept inflation in single digits at 9.8 percent for the 12 months ending in July.

4. The military conflict with Russia in August 2008 caused serious economic, social and political damage. The immediate economic consequence was the disruption of our transport infrastructure, which severely hindered economic activity, and a slowdown in private foreign inflows. The conflict, along with the serious deterioration of the global environment, has badly affected almost all sectors of the economy. As a result, growth in the third quarter was negative 3.9 percent and is expected to have contracted by another 1.8 percent in the fourth quarter. For the year as a whole, we expect growth was around 2 percent.

5. Not surprisingly, inflation has moderated significantly in recent months. Since spiking to 12.8 percent in August last year, it has subsided to 4.4 percent for the 12 months ending January 2009. This reflects credible monetary policy, declining commodity prices and shrinking domestic demand.

6. In the midst and aftermath of the conflict with Russia, we defended the exchange rate for the lari. This was deemed necessary in order to maintain macroeconomic stability and

public confidence. In response to exchange rate pressures and reserve outflows in the context of the worsening global economy and a strengthening dollar, however, we devalued the lari by 16 percent in early November. While this measure eased pressure on the lari, it contributed to an immediate increase in the dollarization of bank deposits and an increase in the non-performing loans of banks.

7. Going forward, we are confident that Georgia's strong economic fundamentals, commitment to further economic reform, policy flexibility and strong support from the international donor community will allow us to overcome the current set of economic challenges. Nonetheless, we recognize there are substantial downside risks in the current environment and we are prepared to introduce the necessary policy changes should these risks materialize.

Macroeconomic Policies for 2009

8. Our major macroeconomic challenge continues to be the restoration of private capital inflows to support growth. The significant financial support made available to Georgia by the international community will be directed to capital expenditures necessitated by the conflict as well as spending to establish a foundation for sustained economic growth over the medium-term. These resources will help to support growth this year, but cannot be a full substitute for private sector investment. To enhance further our appeal to investors, we believe that maintaining macroeconomic stability and intensifying economic reforms must lie at the heart of our strategy moving forward.

9. Projecting economic growth in the present highly uncertain environment is difficult. The deleterious effects of the global economic crisis will likely result in economic growth this year that is less than originally projected. During the first half of 2009, the economy is anticipated to contract. For the year as a whole, however, we are cautiously optimistic that growth in 2009 will be positive, in the range of 2 to 3 percent, reflecting a modest recovery in the second half of the year. The recovery will be due to the lower base at end-2008, the fiscal impulse and a moderate level of private capital inflows. Whereas such inflows were slightly more than USD 2 billion in 2008, we project they will be in the range of USD 1.2 to 1.4 billion this year (excluding donor inflows), which should be sufficient to support projected growth.

10. Our growth projection is in contrast to the estimates of the recent IMF mission. While we value the opinion of the mission, we wish to observe that IMF growth projections have consistently underestimated actual performance in Georgia. We have a more optimistic growth projection than the IMF mission, but in the spirit of cooperation and recognizing the downside risks, we have agreed to base program targets on an annual growth rate of one percent.

11. Fiscal policies will support the economic recovery with a stimulus package that includes a moderate increase in total spending, a reduction in the rate of the profit tax, and a shift from import-intensive defense spending to labor-intensive construction projects. Particular emphasis will be given to capital projects, which improve our medium-term

competitiveness as the basis for future growth. These projects will be financed mainly from the pledges of the international community. The fiscal deficit for 2009 is projected to be less than 6 percent of GDP.

12. Our expenditures will also be oriented to protecting the most vulnerable groups in society. To this end, we increased the budget appropriations for social allowances. More importantly, we enhanced the targeting of social benefits, especially in the health and education sectors. All beneficiaries of social allowances are covered by a free health insurance scheme since January 2009.

13. Further, we are revising our fiscal legal framework in order to increase the efficiency in public finance management. For this purpose, we are developing a new budget code and will have a first draft ready and submitted to the cabinet in July of 2009 (structural benchmark for end-July). The goal of creation of a new budget code is to make a budget preparation process more inclusive, enhance the budget execution monitoring process and move to performance driven policy though improving strategic planning.

14. In 2008 we delayed law changes aiming mandatory surplus and expenditures capping due to the challenging environment. If global trend continues we will delay the policy enforcement in H2 of 2009 for 2011. However we are strongly committed to disciplined fiscal policy and a budgetary surplus together with limited public outlays remain our priority for longer term.

15. The combination of a tight monetary stance in the first half of 2008 and the current economic slowdown have significantly eased inflationary pressures. For 2009, we will continue to monitor monetary conditions closely and project growth in reserve money of 8 percent, while the growth rates of broader monetary aggregates are expected to be around 4 percent for M2 and 9 percent for M3. End-period inflation is projected to be in the range of 6–7 percent for 2009.

16. The National Bank of Georgia (NBG) will publish a liquidity framework (structural benchmark for end-March 2009) that will improve liquidity forecasting and strengthen the interest rate channel. The liquidity framework will elaborate on the link between the NBG's policy rate and the operational target. It will also include an assessment of how the Monetary Operational Framework is used to steer money market rates toward the operational target. The liquidity framework will also outline the set of monetary policy instruments and procedures that comprise the Monetary Operational Framework as well as guidelines for and objectives of short-term liquidity forecasting.

17. The NBG board approved the revisions to the regulation on the lender of last resort (LOLR) function at end-December 2008 (structural benchmark for end-December 2008). The main revisions included a change that permits LOLR access only to those institutions that are judged to be solvent but experiencing short-term liquidity problems, and refined the terms and procedures for issuing LOLR loans.

18. Exchange rate policy in recent months has posed difficulties, and our policy options have been constrained by nervousness in the market. We believe that a short period of exchange rate stability was essential for restoring confidence in the aftermath of the war and global financial turmoil. It also allowed time for assessing economic developments and prospects. We remain, however, fully committed to a flexible exchange rate policy. To this end, we have limited the NBG's interventions in the foreign exchange market and allowed greater exchange rate flexibility to protect international reserves. Moreover, should it be necessary to act decisively to withdraw liquidity, the NBG is prepared to raise interest rates on central bank securities to stem demand for foreign exchange.

19. As a device for making NBG interventions more market oriented, we introduced an auction-based mechanism for central bank sales of foreign exchange. This will help to reduce market interventions and will be conducive to achieving the programs objectives.

20. The financial sector has performed well despite numerous shocks. The quick and effective support from international financial institutions, has allowed the banking system to refinance its maturing foreign liabilities. The increase in non-performing loans—from 1.8 percent of the system assets in October 2007 to 12.8 percent at end 2008—reflects the deterioration in economic conditions. While it creates challenges, it does not pose a risk to the stability of the financial system. Average capital adequacy in banks remains satisfactory—about 14 percent—despite the recent need for additional provisioning. Taking into consideration our conservative capital requirements (including high risk weights on mortgages and foreign currency loans), and planned private sector injections of bank capital in the coming months, we remain confident that the banking system will continue to be sound and resilient.

21. In the current environment, it is essential for FSA to continue monitoring individual banks. To facilitate monitoring and analysis, the FSA is continuing to strengthen its institutional capacity. As part of this effort, the FSA has recently requested technical assistance from the IMF in area of stress testing. As part of this exercise and on an ongoing basis, the FSA will provide all necessary bank-by-bank data, including capital adequacy ratios, non-performing loans and current liquidity positions on a monthly basis, subject to the provisions of Georgian law. It should be stressed that these data are especially sensitive and must be subjected to the strictest confidentiality requirements by Fund staff.

22. While we are confident that our macroeconomic strategy going forward is the appropriate one, we see the potential downside risks. Consequently, we are in the process of developing a financial stability plan. The plan will contain policy actions to respond to potential situations of stress by defining the roles and responsibilities of the different players—the NBG, the FSA and the government—under each circumstance, and will be jointly prepared by the NBG, the FSA, and the Ministry of Finance. We will send this document to Fund staff, again on the condition of strict confidentiality (structural performance criterion for end-June 2009).

Program Monitoring

23. All performance criteria for the Second Review under the Stand-By Arrangement were met. We, therefore, request the completion of the second review. We will maintain the usual close policy dialogue with the Fund and stand ready to take additional measures as appropriate to ensure the achievement of the program objectives. In particular if the pressures on Georgia stemming from the global economic crisis were to be stronger than anticipated, the government would adjust its fiscal and exchange rate policy stance to maintain external stability.

24. The third and fourth reviews are expected to be completed by end-June 2009 and end-September 2009. We request the modification of the performance criteria for end-March and end-June, 2009 (attached Tables 1 and 2). We also request that the program's ceiling on contracting or guaranteeing new nonconcessional debt by the public sector accommodate borrowing from official creditors in view of the currently low interest rates, sustainable level of the public debt, and large conflict-related infrastructure needs that could not be met fully by concessional financing. This limit will be revised during subsequent reviews in case of further borrowing needs in line with the priorities outlined in the Joint Needs Assessment report. The next quarterly review will be based on end-March targets. To better capture the impact of unexpected shortfalls or surpluses in external financing, the revised Technical Memorandum of Understanding introduces adjustors to the program's quantitative targets.

25. We authorize the IMF to publish the Letter of Intent and its attachments as well as the accompanying staff report.

Sincerely yours,

/s/
Nika Gilauri
Prime Minister of Georgia

/s/
Kakha Baindurashvili
Minister of Finance

/s/
Giorgi Kadagidze
President of the NBG

Table 1. Georgia: Quantitative Performance Criteria, 2008–09

	Cumulative Change from End-June 2008					Cumulative Change from End-December 2008				
	Sep-08		Dec-08			Mar-09		Jun-09		Sep-09
	PC	Act.	PC	Adjusted PC	Act.	First review	PC 1/	First review	PC 1/	PC 1/
	(In millions of lari)									
Ceiling on cash deficit of the consolidated government	537	425	627	760	619	229	480	517	924	973
	(In millions of U.S. dollars)									
Ceiling on contracting or guaranteeing of new nonconcessional external debt by the public sector	0	0	250	...	...	250	850	250	850	850
	Stocks at the end of the period									
	(In millions of lari)									
Ceiling on net domestic assets (NDA) of the NBG 1/	765	452	214	...	116	295	310	329	446	240
	(In millions of U.S. dollars)									
Floor on net international reserves (NIR) of the NBG	602	848	851	...	909	836	633	861	585	769
Ceiling on accumulation of external arrears 2/	0	0	0	...	0	0	0	0	0	0

Sources: Georgian authorities; and Fund staff estimates.

1/ Actual figures and quantitative targets are based on program exchange rates.
2/ The continuous performance criterion for external arrears is defined in paragraph 15 of the TMU.

Table 2: Structural Benchmarks and Performance Criteria

Action	Proposed Time Frame (end of period)	Type of Conditionality	Status
FSA and NBG to sign and implement a memorandum of understanding to strengthen cooperation.	End-Oct-08	Structural Benchmark	Observed
NBG to introduce revised LOLR facility.	End-Dec-08	Structural Performance Criterion	Observed
Submission to parliament of a state budget for 2009 with an overall fiscal deficit of no more than 3¾ percent of projected GDP (subject to an adjustor of at most 3 percent of GDP as set out in the TMU).	End-Dec-08	Structural Benchmark	Observed
NBG to develop and publish a liquidity management framework, including the introduction of a refinancing mechanism as the main instrument to provide liquidity.	End-Mar-09	Structural Benchmark	
The NGB, the FSA, and the government to develop a financial stability plan that will contain policy actions to respond to potential situations of stress by defining the roles and responsibilities of the different players—the NBG, the FSA and the government—under each circumstance.	End-Jun-09	Structural Performance Criterion	
Appointment of the remaining members to the FSA board.	End-Jun-09	Structural Benchmark	
Submission of a new budget code to the cabinet to make the budget preparation process more inclusive, enhance the budget execution monitoring process, and move to performance driven policy by improving strategic planning.	End-Jul-09	Structural Benchmark	

ATTACHMENT II. GEORGIA: REVISED TECHNICAL MEMORANDUM OF UNDERSTANDING

March 10, 2009

1. This memorandum sets out the understandings between the Georgian authorities and the IMF staff regarding the definitions of quantitative and structural performance criteria and indicative targets, as well as respective reporting requirements for the Stand-By Arrangement (SBA). It replaces the technical memorandum of understanding dated November 28, 2008.

2. These performance criteria and indicative targets are reported in Tables 1 and 2 of the Memorandum of Economic and Financial Policies (MEFP), attached to the letter dated November 28, 2008 and Table 1 attached to the Letter of Intent dated March 10, 2009. The exchange rate for the purposes of the program of the Georgian lari to the U.S. dollar is set at GEL 1.67 = $1. The corresponding cross exchange rates are provided in Table 1.

Consolidated Government and the Public Sector

3. **Definition:** The consolidated government is defined as the central government, local governments, extrabudgetary funds, public services providing general government system LEPLs, and the Sovereign Wealth Funds (Future Generations and Stable Development Funds). In case the government establishes extrabudgetary funds, they will be consolidated within the consolidated government. The public sector consists of the consolidated government and the National Bank of Georgia (NBG).

4. **Supporting material:** The Treasury Department of the Ministry of Finance (MOF) will provide to the IMF detailed information on monthly revenues, expenditures, and arrears of the consolidated government. In addition, data will be provided on the cash balances in the accounts of the Ministry of Finance.

Quantitative Performance Criteria, Indicative Targets, and Continuous Performance Criteria: Definitions and Reporting Standards

I. Ceiling on the Cash Deficit of the Consolidated Government

5. **Definition:** The cash deficit of the consolidated government will be measured from the financing side at current exchange rates, and will be defined as equal to total financing. Total financing will be defined as the sum of (i) net domestic financing from banks and nonbanks, (ii) net external financing, and (iii) privatization receipts.

- Net domestic financing consists of bank and nonbank financing to the consolidated government which will be defined as follows:

  (i) Loans provided by commercial banks to the consolidated government minus accounts held by the consolidated government at commercial banks. These accounts and loans will be monitored based on the NBG's monetary survey. Any other securities issued by the consolidated government (for example, promissory notes) are also included in domestic financing.

  (ii) Loans provided by the NBG to the consolidated government minus accounts of the consolidated government held at the NBG in lari and foreign currency. Accounts that are outside of the MOF's control are excluded from domestic financing. These accounts include VAT refund account; earmarked grants account; account for state agencies deposits; account for local government revenues for the day to be transferred to their account; national disaster fund account; and investment grant and credit account. As of December 31, 2008, cash balances in these accounts were lari 768 million. These accounts will be monitored based on the changes in cash balances as recorded by the Treasury Department.

  (iii) Treasury bills that have been securitized and sold by the NBG, including the bills that have been purchased by nonbanks.

- Net external financing is defined as the total of loans disbursed to the consolidated government for balance-of-payments support and project financing (capital expenditure and net lending), net change in external arrears, change in the accounts of the consolidated government abroad, including the accounts of the Sovereign Wealth Fund, minus amortization. Amortization includes all external debt-related payments of principal by the consolidated government. Amortization to external creditors via third parties is accounted for at the time and in the amount of payment by the budget to the third party, rather than at the time of recognition of amortization by the external creditor.

- Privatization receipts consist of all transfers of monies received by the central and local governments in connection with the sale of central or local government assets, including privatization proceeds which were transferred to the Sovereign Wealth Funds. This includes receipts from the sales of shares, the sale of assets as well as leases and the sale of licenses with duration of 10 years and longer.

6. **Supporting material:**

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

- Data on external project financing as well as other external borrowing will be provided to the IMF monthly by the Debt Unit at the MOF (specifying projects by creditor) within two weeks of the end of each month.

- Data will be provided at the actual exchange rates.

- Data on the accounts of the Sovereign Wealth Funds will be provided by the NBG.

- Data on privatization receipts will be provided by the Treasury Department of the MOF to the IMF on a monthly basis within two weeks of the end of each month. The data will be consistent with the revenue account(s) in the NBG.

- Data on treasury bills that have been securitized and sold by the NBG, including the bills that have been purchased by nonbanks, will be reported by the NBG on a monthly basis within two weeks of the end of each month.

II. Floor on the Net International Reserves of the NBG

7. **Definition:** Net international reserves (NIR) of the NBG in U.S. dollars are defined as foreign assets minus foreign liabilities of the NBG. Foreign assets of the NBG include gold, gross foreign exchange reserves, SDR holdings, and the reserve position in the IMF. Gross foreign exchange reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents that are readily available. Pledged or otherwise encumbered assets, including (but not limited to) assets used as collateral (or guarantee for third party external liabilities) are excluded from foreign assets. Foreign liabilities shall be defined as outstanding liabilities to the IMF and any other liabilities of the NBG. This defined, the definition of NIR excludes foreign assets stemming from foreign currency deposits of financial institutions at the NBG. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the NBG shall be valued at program exchange rates as described on paragraph 2 above. The stock of NIR amounted to $891.9 million as of December 31, 2008 (at the program exchange rate).

8. **Adjustors:**

The floor on the NIR of the NBG will be adjusted:

- (a) upward/downward by 50 percent for any excess/shortfall in the balance-of-payments support loans and balance-of-payments support grants relative to the projected amounts presented in Table 2.
- (b) upward 100 percent for any shortfall in the amount of conversion for government imports relative to the projected amounts presented in Table 2.

9. **Supporting material:** Data on net international reserves (both at actual and program exchange rates); net foreign financing (balance of payments support loans, cash grants to the consolidated government, amortization (excluding repayments to the IMF), interest payments on external debt by the MOF and the NBG); conversions for government imports and transfers of receipts from the Sovereign Wealth Funds will be provided to the IMF in a table

on the NBG's foreign exchange flows (which include details of inflows, outflows, and net international reserves) on a weekly basis within three working days following the end of the week.

III. Ceiling on Net Domestic Assets of the NBG

10. **Definition:** Net domestic assets of the NBG are defined as the difference between its net foreign assets and reserve money. Thus defined, the net domestic assets are the sum of net claims on the government (the sum of loans and treasury bills purchased by the NBG, less deposits of the government with the NBG), claims on banks, claims on the rest of the economy, and other items net (comprising the NBG capital accounts, net unclassified assets, counterpart funds and exchange rate revaluation). Performance against the NDA target will be measured at program exchange rates.

11. **Supporting material**: The NBG will provide to the IMF its balance sheet, which includes data on its net domestic assets, on a monthly basis within two weeks of the end of each month. Data will be provided using both actual and program exchange rates.

12. **Adjustors:**

The ceiling on the NDA of the NBG will be adjusted:

- (a) downward/upward by 50 percent for any excess/shortfall in the balance-of-payments support loans and balance-of-payments support grants relative to the projected amounts presented in Table 2.
- (b) downward 100 percent for any shortfall in the amount of conversion for government imports relative to the projected amounts presented in Table 2.

IV. Ceiling on Contracting or Guaranteeing of New Nonconcessional External Debt by the Public Sector

13. **Definition:** Nonconcessional external loans are defined as loans from lenders other than the IMF with a grant element of less than 35 percent of the value of the loan. The grant element is to be calculated by using currency-specific discount rates reported by the OECD

(CIRRs).[1] For maturities of less than 15 years, the grant element will be calculated based on six-month averages of commercial interest rates. For maturities longer than 15 years, the grant element will be calculated based on 10-year averages. This performance criterion applies not only to debt as defined in point No. 9 of the IMF's Guidelines on Performance Criteria with Respect to External Debt (Decision No. 12274-(00/85) August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received.[2] Previously contracted nonconcessional external debt that has been rescheduled will be excluded from the definition of "new debt" for the purposes of this performance criterion.

14. **Supporting material:** Details of all new commitments and government guarantees for external borrowing, with detailed explanations, will be provided by the MOF to the IMF on a monthly basis within two weeks of the end of each month. Data will be provided using actual exchange rates.

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[1] An electronic spreadsheet file that shows the relevant discount rates reported by the OECD (CIRRs) will be provided on a periodic basis by IMF staff. A web-based grant element calculator is available at http://www.imf.org/concessionality.

[2] Point No. 9 of the IMF's guidelines reads as follows: "(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the leaser retains the title to the property. For the purpose of the Guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt."

V. Continuous Performance Criteria on Nonaccumulation of External Arrears

15. **Definition:** During the period of the arrangement, the consolidated government and the NBG will not accumulate any new external payment arrears on debt service obligations to official creditors. Official external payment arrears are defined as unpaid debt service by the consolidated government and the NBG beyond 30 days after the due date. The performance criterion on nonaccumulation of external debt is continuous.

16. **Supporting material:** Details of official arrears accumulated on interest and principal payments to creditors will be reported to the IMF within one week from the date of the missed payment. Data will be provided using actual exchange rates.

Table 1. Program Exchange Rates

	Currency Name	Currency/US$
SDR	Special Drawing Rights	0.65
GEL	Georgian lari	1.67
EUR	Euro	0.72

Table 2. Projected Balance-of-Payments Support Financing 1/
(in million U.S. Dollars)

	Balance-of-payments support grants	Balance-of-payments support loans	Conversion for government imports
March 31,2009	6.5	0	105.2
June 30, 2009	32.5	0	196.2
September 30, 2009	207.8	0	255.6
December 31, 2009	269.6	80.0	395.8

1/ Cumulative from the beginning of the calendar year.

INTERNATIONAL MONETARY FUND

GEORGIA

2009 Article IV Consultation and Second Review
Under the Stand-By Arrangement

Informational Annex

Prepared by the Middle East and Central Asia Department

March 10, 2009

Contents Page

ANNEX I. GEORGIA: RELATIONS WITH THE FUND

(As of January 31, 2008)

I. **Membership Status:** Georgia joined the Fund on May 5, 1992.

II. **General Resources Account:**	**SDR Million**	**Percent of Quota**
Quota	150.30	100.00
Fund holdings of currency	312.00	207.58
Reserve position in Fund	0.01	0.01

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Holdings	4.84	N/A

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
Stand-by Arrangements	161.70	107.58
PRGF Arrangements	133.91	89.10

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn SDR Million)
Stand-By	9/15/08	3/14/10	477.10	161.70
PRGF	6/4/04	9/30/07	98.00	98.00
PRGF	1/12/01	1/11/04	108.00	49.50

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

	Forthcoming				
	2009	**2010**	**2011**	**2012**	**2013**
Principal	14.81	34.31	98.75	80.54	19.60
Charges/interest	3.39	3.15	2.46	1.07	0.28
Total	18.20	37.46	101.21	81.61	19.88

VII. **Safeguard Assessments:**

An update safeguards assessment of the National Bank of Georgia (NBG) required in conjunction with the Stand-By Arrangement approved on September 15, 2008 was completed on December 10, 2008. This assessment found that the NBG has developed its safeguards in many respects, namely: (i) its financial statements comply with International Financial Reporting Standards; (ii) the financial statements are audited by international firms in compliance with International Standards on Auditing, and receive a "clean" opinion (latest opinion is for the year ended December 31, 2007); and (iii) the audited financial statements are published in the NBG's Annual Report and on its website. However, the NBG faces emerging risks as it modernizes its reserve management practices and accounting systems, and responds to the impact of the August conflict and the global financial crisis. To address such risks, the NBG needs to modernize its audit oversight functions by reconstituting its audit committee with only non-executive members, commission a quality assurance review of its internal audit function, move to longer-term appointments of its external auditor to improve audit efficiency and effectiveness, and require its internal audit department to audit the monetary data reported to the Fund at each test date and at the financial year-end.

VIII. **Implementation of Multilateral Debt Relief Initiative (MDRI):**

Not Applicable.

IX. **Implementation of HIPC Initiative:**

Not Applicable.

X. **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. A temporary de facto exchange rate peg to the U.S. dollar was introduced in the wake of the early August armed conflict. During the second week of November, the authorities allowed a 16 percent depreciation of the lari. In March 2009, the authorities introduced an auction-based system for the foreign exchange market.The new mechanism is intended to give market forces a greater role in setting the price, with a view to reaching faster and smoother convergence toward equilibrium in the foreign exchange market and giving the market greater clarity about the authorities' policies.

(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).

XI. **Article IV Consultation:**

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

XII. **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.

XIII. **Technical Assistance:**

See Table 1 of this Annex.

XIV. **Resident Representative:**

The sixth resident representative, Mr. Edward Gardner, is scheduled to take up his post on March 15, 2009.

XV. **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 served from September 2004 to October 2007 as a resident advisor on banking supervision issues.

XVI. **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, 2004–08

Subject	Type of Mission	Timing	Counterpart
	Fiscal Affairs Department (FAD)		
Tax Policy	Review of tax policy	Jun. 8–21, 2004	Ministry of Finance
Public Expenditure Management	Assessment of Treasury system.	Nov. 8–23, 2004	Ministry of Finance
Public Financial Management	Expert assistance (Zohrab)	Mar. 2005–Nov. 2006	Ministry of Finance
Tax Administration	Mission—review of modernization program	Nov. 8-21, 2005	Ministry of Finance
Tax Administration	Expert assistance	Jul. 9–14, 2006	Ministry of Finance
Tax Administration	Expert assistance (Bosch)	Oct. 9–25, 2006	Ministry of Finance
Tax Administration	Follow-up mission	Jan. 17–30, 2007	Ministry of Finance
Tax Administration	Expert assistance (Woodley)	Jan/Feb and Apr/May 2008	Ministry of Finance
Budget Classification and Accounting Reforms	Expert assistance (Swarap)	Jun. 11-22, 2007	Ministry of Finance
Budget Classification and Accounting Reforms	Expert assistance (Swarap)	Oct. 8-19, 2007	Ministry of Finance
	Monetary and Capital Markets Department (MCM)		
Government Securities Market, Deposit Insurance, Anti-Money Laundering	Advisory	Apr. 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	Apr. 18–29, 2005	National Bank of Georgia
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

Table 1. Georgia: Fund Technical Assistance Missions, 2004–08

Subject	Type of Mission	Timing	Counterpart
Consolidated Supervision	Advisory	Dec. 4–14, 2007	National Bank of Georgia
Lender of Last Resort Framework	Advisory	Dec. 11-17, 2008	National Bank of Georgia
National Accounts	Follow-up assistance	Apr. 26–May 7, 2004	State Department of Statistics
National Accounts	Follow-up assistance	Apr. 18–29, 2005	State Department of Statistics
Price Statistics	Follow-up assistance	May 23–Jun. 3, 2005	State Department of Statistics
Balance of Payments Statistics/International Investment Position	Follow-up assistance	Jun. 15–28, 2005	State Department of Statistics and National Bank of Georgia
Price Statistics	Follow-up assistance	Jun. 20–Jul. 13, 2006	State Department of Statistics
Balance of Payments	Follow-up assistance	Sep. 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	Jul. 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. Georgia had a strong economic performance until August of 2008 when the conflict with Russia broke out resulting in severe shocks to macroeconomic stability and a sharp deterioration in investor and consumer confidence. GDP growth, which had averaged above 12 percent in 2007 and 8.6 percent in the first half of 2008, is projected to decline sharply in the second half of 2008 and remain below 4 percent through 2009. Growth is largely affected by the sharp decline in private capital inflows, which have been the main driver in the last few years.

2. The international community through an October 2008 Donors' Conference led by the World Bank and the European Commission responded positively by providing pledges of financial support totaling $4.5 billion over the period of 2008–2010 to provide financial assistance in light of the sudden decline in capital inflows; to help Georgia with its external financing needs to maintain its macro stability; to assist with rebuilding of its damaged infrastructure; and to help Georgia cope with the downturn of the economy and the substantial social needs of its new and past displaced population.

3. Georgia has been a member of the World Bank since 1992 and the International Development Association (IDA) since 1993. With borrowings of $1062.5 million for 48 operations, Georgia is one of the largest IDA borrowers in the CIS. There are currently sixteen IDA operations under implementation. The last 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 CPS, built on the Economic Development and Poverty Reduction Program (EDPRP) of the Government (its PRSP), was designed to assist Georgia in implementation of its reform program. A CPS Progress Report to assess the mid-term progress in the implementation of the CPS was presented to the Board in June 2008.

4. Regarding the Poverty Reduction Support Operation series, four annual operations during the last four years have been the cornerstone of the Georgia CPS Strategy. They have supported further elaboration and implementation of the key elements of the Government's poverty reduction strategy as described in the PRSP (EDPRP) Progress Report. The Fourth PRSO, the last in the series, was approved on May 27, 2008.

5. In response to the August conflict and to help Georgia sustain its overall reform program in the face of unanticipated strains to the 2008 budget, a Supplemental Financing to Georgia's PRSO IV in the amount of $40 million was processed on an expedited basis and presented and approved by the IDA Board on October 2, 2008, along with a Municipal Infrastructure Development Project in the amount of $40 million, which included an

additional component to provide funding for the housing needs of the newly displaced population. In parallel, IDA responded to a request from the Government for the extension of the East-West Highway to improve transport access in light of the infrastructure damage caused by the conflict, by providing $20 million additional funding to the existing Second East-West Highway which was approved by the Board on October 30, 2008.

6. A Joint Staff Advisory Note was prepared, and together with the second PRSP Progress Report were presented to the Boards of IDA and IMF in September 2006. The IMF presented the Staff Report of the Sixth and final Review under the PRGF arrangement to the IMF Board in August 2007. In the wake of the August events, an 18-month Stand-By Arrangement (SBA) in the amount of $750 million was approved by the IMF Board on September 15, 2008 to restore investor confidence, with its first purchase of $250 million disbursed upon approval. The IMF conducted a first review mission of the SBA in early November.

7. 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.

8. The PRSO program and Supplemental Financing to PRSOIV have focused 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.

9. 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 2008. A Programmatic Public Finance Policy Review (PPFPR) and a Country Economic Memorandum (CEM) are planned for FY09.

10. Georgia became a shareholder and a member of IFC in 1995, and IFC has financed projects in the financial, infrastructure, oil and gas, and manufacturing sectors. IFC's

portfolio in Georgia as of January 2008 stands at about $93 million with seven clients. In the financial sector, IFC has focused on supporting the development of the housing finance market, providing investment and technical assistance to three leading banks—TBC Bank, the Bank of Georgia, and Bank Republic. 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. In FY08, IFC also supported GRDC in their financing of the development of office and retail space.

11. IFC has also mobilized its investment assistance to provide stability to the Georgian banking system, which is facing significant challenges following the August conflict as well as funding constraints exacerbated by the current situation in international financial markets. In partnership with EBRD and OPIC, a new investment project will provide Bank of Georgia, the largest bank in Georgia, with the required capital to continue lending to Georgian individuals and SMEs, which is critical for the further development of the Georgian economy. Support to the banking sector would remain IFC's first priority in the World Bank Group's post-conflict strategy in Georgia. IFC would continue to look for opportunities to provide systemically important banks with a mix of equity, subordinated loans, trade lines and senior debt funding. In addition, IFC would continue to support SME and microfinance borrowers through the banks, as well as other emerging financial market leaders to deepen the financial sector and increase the range of financial products available.

12. In the real sector, IFC's most recent transaction is a loan to TAV to support the 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 agrobusiness, infrastructure, manufacturing, and the development of natural resources.

13. 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 a top reformer in its Doing Business 2008 report, and the government is actively engaged with IFC to make further progress on reforms to improve the business environment.

14. The division of responsibilities between the World Bank and the IMF 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 could serve as an input 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

15. 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.

16. In **education,** the Adaptable Program Credit of Education System Realignment & Strengthening Program (APL #1 and APL #2) 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. The second phase of the program provides continued assistance to the implementation of the institutional and policy framework adopted under phase one of the program and includes support to schools in emergency conditions. The PRSO program is supporting the government's efforts in institutionalizing systemic changes initiated with its education reform strategy.

17. In **health**, IDA credits support the government in improving provision of primary health care services by providing training, equipment and supporting the health information system as well as capacity building in management. IDA is supporting the provision of health insurance coverage for the poor and has conducted the initial impact evaluation of this program. IDA is engaged in policy dialogue with the government on health sector reform

through the PROS program, as well as health technical assistance by providing policy advice on regulatory frameworks for health insurance market, provider payment issues and benefit package.

18. In **infrastructure,** support is being provided through the Secondary and Local Roads Project, the First East-West Highway Improvement Project, and the Second East-West Highway Improvement Project and its additional funding to finance improvement of country's main, secondary and local road infrastructure, as well as through the Municipal Development and Decentralization Project II and the Social Investment Fund Project to finance critical infrastructure needs at the municipal and community level. Under the latter primarily school and health facility heating and repair, small hydropower schemes rehabilitation, drinking water and sanitation rehabilitation, street lightning improvements, as well as local transportation infrastructure rehabilitation has been targeted. The ongoing 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. Specifically, it targets preparation of First and Second East-West Highway Improvement projects, preparation of Khudoni Hydro Power Plant project (if feasible).

19. 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 set 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.

20. 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 could serve as input into the IMF program

21. 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 and IFC's advisory work focus on improving the 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 worked with the authorities to conduct 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 worked 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. At the beginning of the PRGF program, the Fund focused on reducing quasi-fiscal losses in the sector. The World Bank through the PRSO program focused on improved bill collections, the handling of sector legacy debt, some sector restructuring, and 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 have prepared and implemented Energy Sector Strategic Action Plans and updates thereof under the PRSO program since 2005. In an ongoing operation, the World Bank finances 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 provided 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.

e) **Health Sector.** The Structural Reform Support Project supported the GoG in improving secondary health care services by reducing the surplus of hospitals and personnel, providing the various types of the technical assistance in health care financing, HR development, service provision, and quality of services. A number of medical facilities has been renovated and equipped, and staff has been trained, to offer a decent quality of services to the population of Georgia.

Areas of shared responsibility

22. The World Bank and the Fund have worked jointly in the following main areas:

a) **Poverty Reduction Strategy.** Both institutions have worked 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 investments to support budget planning and management processes within the MoF and line ministries. The Fund has focused on treasury reform within the Ministry of Finance.

c) **Financial Sector Reforms.** The joint Financial Sector Assessment Program has supported: (i) strengthening banking and non-banking supervision; (ii) introducing international accounting standards; (iii) consolidating 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 focused on banking supervision, anti-money laundering legislation, and improvements in monetary control instruments with extensive technical assistance from its Monetary and Capital Markets 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, prices, 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.

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.

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. A CPS Progress Report assessing mid-term progress in the implementation of the CPS was presented to the Board in June 2008. In general, the first two and a half years of the CPS period have been characterized by rapid reform with most of the CPS goals achieved on schedule or earlier than anticipated. The First PRSO, of a series of single tranche annual Poverty Reduction Support Operations was approved in September 2005 ($13.5 million is a regular IDA credit and $6.5 million is an IDA grant). The Second PRSO for $ 20 million of IDA credit was approved by the World Bank's Board in October 2006. The Third PRSO for $20 million of IDA was approved by the World Bank's Board in June 2007, and the Fourth PRSO, the last in the series of PRSO was approved in May 2008.

A Supplemental Financing to Georgia's PRSO IV in the amount of $40 million was processed on an expedited basis and presented and approved by the IDA Board on October 2, 2008. Other recent operations include a $40 million Municipal Infrastructure Development Project, which was approved on October 2, 2008, and a$20 million additional financing for the Second East-West Highway Project approved on October 30, 2008.

The $19 million First East-West Highway Improvement Project and a $35 million Second East-West Highway Improvement Project were approved in November 2006 and November 2007 respectively. A $15 million Education System Realignment & Strengthening Program supported by the Japanese government co-financing grant in the amount of $4.9 million,, a $5 million Infrastructure Pre-Investment Facility, a $3 million grant Public Sector Financial Management Reform Support Project, a $24 million Reform Support Credit, a $20 million Secondary and Local Roads Project, a $3.6 million Electricity Market Support Project, a $10 million Rural Development Project, $20 million PHC Development Project, $10 million Avian Influenza Control and Human Pandemic Preparedness and Response Project and a $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 possible future programmatic Development Policy Credit series and technical assistance operations.

ANNEX III. GEORGIA: RELATIONS WITH THE EBRD

(As of January 31, 2009)

1. As of January 31, 2009 the European Bank for Reconstruction and Development (EBRD) had signed 114 investments in Georgia with cumulative commitments totaling $921.0 million.[1] Current Portfolio Stock equals to $653.2 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 2007 the Bank had signed 23 transactions in Georgia totaling $162.00 million. The Bank provided a syndicated loan to ProCreditBank Georgia ($8 million); increased its equity participation in Republic Bank, introduced a medium size co-financing facility (MCFF) in Republic Bank and signed three sub operations under the facility in agriculture and health sectors (total $9.35 million). MCFF has been successfully working for several years in one of the country's largest Bank TBC, with which the Bank signed six additional projects under the MCFF in agriculture ($26 million), general industry ($1 million) and natural resources ($3 million) sectors. The Bank financed mortgage lines to TBC Bank ($12 million) and Republic Bank ($ 4m) and provided loans to the Republic Bank ($ 10 million), Cartu Bank ($7 million) and Basis Bank ($6 million) for on-lending purposes to medium, small and micro enterprises. The Bank introduced Energy Efficiency facility in two Georgian Banks: TBC Bank ($10 million) and Cartu Bank ($5 million).

3. As at 31 December 2008 the Bank's annual business volume reached $276.2 million through its 28 transactions. The project examples include: $7.5 million loan to TBC Bank for development of SMEs, additional mortgage loan ($20 million) to Republic Bank, the equity investment in Basis Bank, equity increase and subordinated debt ($5 million) to Republic Bank. In 2008 the Bank signed three operations in municipal and environmental infrastructure development sector, namely: Batumi Public transport ($3.2 million), Kobuleti ($1.9 million) and Borjomi ($1.9 million) water supply improvement projects. In October 2008 the Bank provided $14 million loan to the company Geo Steel to finance construction and operation of 175 k ton capacity steel mini-mill. In December 2008 the EBRD, along with the IFC provided Bank of Georgia, the largest bank in the country, with $200 million loan facilities comprising of convertible subordinated, non-convertible subordinated and senior loans intended to support Bank of Georgia during a post-war period.

4. The ratio of private sector projects in the portfolio now stands at 93 percent. The Bank plans to focus primarily on private sector financing, but may also consider selected public sector

[1]Evaluated at an exchange rate of $1.2827 per euro.

projects. The Bank will give preference to non-sovereign operations although, where sovereign guarantees are required, donor co-funding on a grant basis will be sought.

5. 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.

Table 1. Georgia: EBRD Portfolio for Georgia
As of January 31, 2009 (US$, million)

Project Name	Date of Agreement	Outstanding Amount
Bank Republic - MSE Loan	27-Apr 2006	2.1
Bank Republic - MSME	12-Dec 2008	10.0
Bank Republic Equity	15-Sep 2006	7.6
Bank Republic Equity (Capital Increase)	23-Apr 2008	1.3
Bank Republic Mortgage Loan	20-Dec 2006	7.8
Bank Republic Mortgage Loan II	22-Aug 2008	14.0
Bank Republic Subordinated Debt	07-Jul 2008	5.0
Bank of Georgia - convertible subordinated debt	30-Dec 2008	26.0
Bank of Georgia - subordinated debt	30-Dec 2008	24.0
Bank of Georgia Senior Loan	30-Dec 2008	50.0
Basis Bank Equity Investment - Georgian Financial Sector F/W	19-May 2008	3.8
Batumi Public Transport Project	02-Sep 2008	3.2
Borjomi Water Project	01-Dec 2008	1.9
CEEP - Bank Republic	19-Dec 2008	5.0
CEEP - Cartu Bank	20-Dec 2007	5.0
CEEP - TBC	30-Nov 2007	5.0
DIF - Alfapet	08-Dec 2007	0.1
DIF - Delidor	17-Jun 2005	1.4
DIF - Georgian Hazelnut Production Ltd.	26-Oct 2006	0.8
DIF - Iberia Refreshments	25-Sep 2003	3.1
DIF - Imedi L	30-Dec 2006	1.5
DLF - BTM TEKSTIL	21-Dec 2006	2.2
DLF - Georgian Hazelnut Production Ltd	26-Oct 2006	2.8
DLF- Populi	31-Dec 2008	13.1
ETC Non-Bank MFI Framework II - Constanta	28-Nov 2006	2.8
ETC Non-Bank MFI Framework II - WV Credo	07-Mar 2008	1.5
Enguri Hydro power Plant Rehabilitation project	22-Dec 1998	25.7
Geo Steel	20-Oct 2008	14.0
Georgia: Trans-Caucasian Rail Link Project	22-Dec 1998	4.4
Georgian Financial Sector F/W - Basis Bank (MSME Loan)	21-Sep 2007	6.0
Georgian Financial Sector F/W-Bank Republic MSE Loan	21-Dec 2007	12.0
Georgian Financial Sector F/W-Cartu Bank SME Loan	20-Dec 2007	7.0
Georgian Financial Sector FW-TBC Bank Mortgage Line II	21-Dec 2007	12.0
Georgian Property Debt FW - Tbilisi Central Train Station	28-Dec 2007	8.5
Georgian Property Debt Facility - Green Building	19-Mar 2007	2.8
Georgian Property Equity Investment	29-Aug 2007	13.9
Georgian Wines & Spirits Ltd.	10-Mar 2005	6.1
JSC Channel Energy Poti Port	19-Mar 2002	3.7
Kobuleti Water	27-Jun 2008	1.9
Kutaisi Water Project	15-Sep 2006	3.8
MCFF - Bank Republic - Begi Co. II	28-Dec 2007	5.6
MCFF - Bank Republic - Begi Company	28-Dec 2007	0.9
MCFF - Bank Republic - Full Recourse	05-Dec 2008	10.0
MCFF - Bank of Georgia Full Recourse Portion	14-Jun 2005	4.0
MCFF - BoG Iberia Refreshments Sub-Loan (NRP)	27-Sep 2006	2.7
MCFF - TBC - Tsiskvilkombinati II	21-Nov 2007	2.0

MCFF - TBC Bank - Jaokeni Company JSC	04-Aug 2008	3.0
MCFF - TBC Bank EMBAWOOD Sub Loan	13-Jun 2007	0.8
MCFF - TBC Bank JSC Full Recourse Portion	13-Jun 2005	2.1
MCFF - TBC Bank Lomisi Ltd Sub-Loan (NRP)	03-Aug 2005	1.2
MCFF - TBC Bank Tegeta Motors	01-Apr 2008	6.8
MCFF - TBC Bank Wissol Sub-Loan (NRP)	10-Oct 2007	5.6
MCFF - TBC Coca Cola Ltd. sub-loan	02-Feb 2007	5.1
MCFF - TBC Tsiskvilkombinati	21-Nov 2007	2.1
MCFF BOG - Renewable Energy Programme - Okami SHPP NRP	21-Dec 2006	0.1
MCFF BOG - Renewable Energy Programme Lopota SHPP NRP	21-Dec 2006	0.2
MCFF Bank Republic - Mediclub Georgia	30-Oct 2007	2.5
MCFF TBC Bank - Goodwill	31-Oct 2007	7.5
Poti Water Supply Project	15-Sep 2006	3.2
Power Rehabilitation Project	20-Dec 1994	1.6
ProCredit Georgia - Syndicated Loan	21-Jun 2007	8.0
Regional TFP Basisbank (Guarantee & Pre-export)	06-Nov 2007	0.3
Regional TFP: Bank Republic (Guarantee & Pre-export)	15-Feb 2006	0.0
Regional TFP: Bank of Georgia (Guarantee & Pre-export)	29-Jul 1999	20.1
Regional TFP: Cartu Bank	28-Apr 2006	3.6
Regional TFP: TBC Bank (guarantee & pre-export)	17-Aug 1999	43.9
Regional TFP: VTB Bank Georgia	24-Dec 2000	0.0
TBC Bank - SME Credit Line	19-Dec 2003	0.8
TBC Bank Mortgage Loan	29-Jun 2006	11.7
TBC Bank SME Credit Line III	26-Sep 2005	2.5
TBC Bank SME Line	29-Jul 2008	7.5
TBC Leasing - Equity Investment	01-Mar 2006	0.1
TBC Leasing, Senior Debt	21-Dec 2005	1.7
Tbilisi International Airport	17-May 2006	24.9
Tbilisi Public Transport Project	29-Jul 2005	1.7
VTB Bank Georgia	09-Oct 2006	8.9
VTB Bank Georgia (debt, equity)	20-Nov 1997	2.3
VTB Bank Georgia Capital Increase	09-Oct 2006	2.3
TOTAL		**530.1**
Aureos Central Asia Fund LLC	01-Dec 2008	0.8
BIH	18-Dec 2006	0.0
BSR Europe Co-Investment Facility	14-Aug 2006	9.0
Baku-Tbilisi-Ceyhan (BTC) Pipeline	03-Feb 2004	53.1
Baring Vostok Private Equity Fund	13-Dec 2000	0.1
Caucasus Online	22-Dec 2008	30.6
First NIS Regional Fund	21-Nov 1994	0.0
Lukoil Overseas : South Caucasus Gas Pipeline	28-Jul 2005	29.4
NIS Restructuring Facility	16-Mar 2000	0.0
TOTAL REGIONAL		**123.0**
GRAND TOTAL		**653.2**

ANNEX IV. GEORGIA: STATISTICAL ISSUES

1. Data provision has some shortcomings, but is broadly adequate for surveillance and program monitoring. The Fund has provided technical assistance (TA) in the compilation of macroeconomic statistics (Annex I, Table 1). Despite improvements in the areas of national accounts, price, monetary, and government finance statistics, the quality of macroeconomic statistics reflects insufficient resources and deficiencies in statistical methodologies and coverage. Problems are particularly acute in the compilation of national accounts, balance of payments, foreign trade, and fiscal statistics.

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. A General Data Dissemination System (GDDS) mission in November helped finalize metadata and on December 15, 2006 Georgia began participation in the GDDS. Since then the country is working to meet the requirements of the Special Data Dissemination Standards.

Real sector statistics

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. Preliminary national accounts estimates are available after 85 days, and final estimates after 13 months. The 2002 data ROSC mission found several weaknesses regarding data sources, including poor coverage of units in terms of value added for agriculture, retail trade, construction, catering, and services; limited administrative sources to estimate the nonobserved economy; and inadequate data for imports and exports of services (taken from the balance of payments). Follow-up missions in 2004 and 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 the development of the system of supply and use tables. On price statistics, both STA missions in May/June 2006 and August/September 2007 reported important progress regarding the development of agricultural price indices, although inadequate funding was causing delays in implementation. The authorities' plans for improvements include the compilation of supply and use tables in current and constant prices, as well as launching a PPI for agriculture.

Monetary and financial statistics

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 mission 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 nonbank 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 the *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.

6. A TA mission is scheduled for March 2009 to assist the NBG in developing a data reporting and compilation framework for other financial corporations.

Government finance statistics

7. Annual and monthly government finance statistics (GFS) compiled on a cash basis in accordance with the methodology of the *GFSM 2001* are reported to STA for publication in the *GFS Yearbook* and *International Financial Statistics*, respectively. The country is well advanced 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), including the 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 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).

External sector statistics

8. A September 2006 TA mission assisted the authorities to prepare an action plan for the transfer of responsibility for the compilation of balance of payments statistics from the DS 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. The mission also 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 January 2007, although DS will remain the main provider of data for exports of goods and services and direct investment. The transfer led to improvements in data quality.

9. The STA Resident Statistics Advisor (RSA) stationed in Baku undertook six peripatetic TA missions to Georgia during April 2007–October 2008. The work of the RSA was focused on further improving Georgia's data collection and compilation programs for external sector statistics. The major remaining weaknesses in external sector statistics are: (i) data sharing between the public institutions involved in producing external sector statistics is

not yet implemented, and (ii) the data collection system for private sector liabilities should be improved.

GEORGIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(AS OF MARCH 9, 2009)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo Items:	
						Data Quality—Methodological soundness[8]	Data Quality—Accuracy and reliability[9]
Exchange Rates	03/06/09	03/02/09	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	03/05/09	03/09/09	D	D	M		
Reserve/Base Money	03/05/09	03/09/09	D	D	M	O, LO, LO, O	O,O,O,O,LO
Broad Money	03/05/09	03/09/09	D	D	M		
Central Bank Balance Sheet	03/05/09	03/09/09	D	D	M		
Consolidated Balance Sheet of the Banking System	01/09	02/25/09	M	M	M		
Interest Rates[2]	03/09/09	03/09/09	D	D	D		
Consumer Price Index	02/09	03/06/09	M	M	M	O,LO,O,O	LO,LO,O,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	12/08	01/28/09	M	M	M	LNO,LO,LNO, O	LO,O,LO,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	02/09	03/02/09	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/08	02/27/09	Q	Q	Q		
External Current Account Balance	12/08	02/17/09	Q	Q	Q	O,LO,LO,LO	LNO, LNO, LNO ,LNO, LNO
Exports and Imports of Goods and Services	12/08	02/17/09	Q	Q	Q		
GDP/GNP	Q3/08	01/02/09	Q	Q	Q	O,LO,O,LO	LNO, LNO, LNO, LO, LO
Gross External Debt	12/08	02/27/09	Q	Q	Q		
International Investment Position[6]	Q4/07	10/21/08	A	A	A		

[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] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[8] 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).
[9] Same as footnote 8, 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.

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FOR IMMEDIATE RELEASE
March 24, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review under Stand-By Arrangement for Georgia and Approves US$186.6 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) on March 23 completed the second review of Georgia's performance under an 18-month Stand-By Arrangement totaling SDR 477.1 million (about US$705.3 million). The completion of the review allows for the immediate disbursement of an amount equivalent to SDR 126.2 million (about US$186.6 million).

The Arrangement was approved in September 2008 (see Press Release No. 08/208) to support the Georgian authorities' macroeconomic policies, rebuild gross international reserves, and bolster investor confidence.

The Executive Board also concluded the 2009 Article IV consultation with Georgia. Details of the findings will be published in a Public Information Notice in due course.

After the Executive Board's discussion on March 23, 2009, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

"Economic and financial conditions have become more challenging since the last program review, as Georgia feels the effects of the global crisis. Sharp declines in trade and workers' remittances, weak commodity prices, and recessions and currency depreciations in major trading partners are threatening domestic confidence and adversely affecting foreign direct investment inflows, and growth prospects. The authorities plan to mitigate the impact of the economic slowdown through a donor-financed fiscal stimulus and a reorientation of expenditures.

"With the aim of aligning public spending with available official external financing, the authorities have reduced the 2009 fiscal deficit target. To ensure that public spending has the maximum impact on the population at large and to alleviate pressures on the poorest, expenditures will be reoriented in favor of essential productivity-enhancing infrastructure investment and targeted social support measures. A reform of expenditure management is also being planned.

“The authorities are encouraged to use all the instruments of monetary policy, including the interest rate and reserve requirements, as part of their adjustment strategy. In this regard, the planned improvements in the central bank’s liquidity framework are timely, and should help enhance the effectiveness of interest rate policy.

“Foreign exchange auctions have been introduced, an important step toward exchange rate flexibility and the preservation of external stability. This will also help the authorities to protect, and ultimately to rebuild, international reserves.

“Against the background of a deterioration in banks’ loan portfolios and the impact of a sharp contraction in credit on bank profitability, strong supervisory vigilance over the banking system will be crucial. In that vein, the Financial Supervisory Agency is strengthening provisioning based on bank-by-bank assessments, and will stress-test banks with technical assistance from the Fund. The authorities are encouraged to consider measures to bolster depositor confidence and deal with possible systemic risks.

“Georgia’s economic policies are being crafted not only in response to the immediate crisis, but also with a view to supporting sustained economic growth over the medium term. The authorities are encouraged to build on their strong track record of reforms and their commitment to fiscal prudence and low inflation. Special focus should be placed on improving Georgia’s competitiveness, notably by enhancing the environment for private investment in the tradable sector, and thus helping to reduce the current account deficit and raise employment,” Mr. Kato said.

INTERNATIONAL MONETARY FUND
Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 09/37
FOR IMMEDIATE RELEASE
March 27, 2009

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

IMF Executive Board Concludes 2009 Article IV Consultation with Georgia

On March 23, 2009 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Georgia.[1]

Background

With the double impact of the August 2008 armed conflict and the global crisis, real economic growth suffered a dramatic decline from 12½ percent in 2007 to an estimated 2 percent in 2008, after a sharp contraction in the second half of the year. Inflation slowed to 5½ percent at end-2008 as global food and energy prices receded and demand weakened. The external current account deficit is estimated to have reached 22½ percent of GDP in 2008 but narrowed substantially in the second half of the year. Private capital inflows, which had been financing the current account deficit, dropped from $1.7 billion during the first half of the year to an estimated $450 million during the second half. Gross official reserves fell immediately after the conflict but recovered later, aided by donor support, borrowing from the Fund under the Stand-By Arrangement approved last September, and transfers from the sovereign wealth funds to government accounts in the central bank.

The fiscal deficit widened markedly in 2008 but the composition of spending improved from high defense and election outlays in the first half of the year to infrastructure and social spending in the second half. Monetary policy, which focused on resisting inflationary pressures until the

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

conflict, had to deal the impact of declining demand for local currency on bank liquidity. The central bank intervened heavily in the foreign exchange market to support the lari, and banks stopped new lending despite central bank liquidity injections, reduced reserve requirements and policy rate cuts.

The tightening of credit conditions and weakening of the economy exposed vulnerabilities in the banking sector. Liquidity and solvency ratios deteriorated. The level of nonperforming loans increased sharply and the need for loan-loss provisioning together with higher funding costs and lost interest income have affected profitability.

The government introduced important structural reforms in the first half of 2008 , including a gradual reduction of income and dividend taxes, and the introduction of rules to guide fiscal and monetary policies in the medium term while ensuring public sector discipline and price stability.

Executive Board Assessment

Executive Directors observed that, following a long period of strong performance owing to the implementation of sound economic policies and structural reforms, the Georgian economy has been seriously affected by the August 2008 armed conflict, and now by the global downturn. The combined shocks to the current and capital accounts are likely to be larger and more prolonged than originally expected, increasing the external adjustment challenge and diminishing near-term growth prospects. Directors endorsed the authorities' economic strategy, which assigns fiscal policy to support domestic demand and exchange rate flexibility to achieve external stability. Structural reforms aim to secure sustained economic growth over the medium term. Directors saw considerable downside risks to the economic outlook and recommended that the authorities should stand ready to adapt their economic policies as warranted.

Directors supported the authorities' plans to contain the economic slowdown through a donor-financed fiscal stimulus and a reorientation of expenditures. The authorities have reduced the targeted 2009 fiscal deficit in line with a downward revision in expected official external financing, and have switched expenditure from imported defense goods toward essential productivity-enhancing infrastructure investment and better targeted social spending. Directors welcomed the planned expenditure management reforms.

Directors welcomed the move to foreign exchange auctions as an important step to achieving greater exchange rate flexibility and protecting international reserves, which are relatively low. They agreed with the authorities that exchange rate flexibility needed to be managed so as to preserve confidence in the financial sector. Directors took note of the staff assessment that the real effective exchange rate is overvalued. Over the medium term, the authorities' commitment to exchange rate flexibility and structural reforms to enhance competitiveness should help correct the overvaluation, and reduce vulnerabilities posed by the large underlying current account deficit.

Directors recommended that all instruments of monetary policy, including the interest rate and reserve requirements, be employed in support of the authorities' more cautious liquidity management, which would ease pressures on the foreign exchange market. They welcomed the planned improvement of the central bank's liquidity framework, which should strengthen the effectiveness of interest rate policy. Directors stressed the importance of closely coordinating fiscal and monetary policies in order to contain pressures in the foreign exchange market.

Against the background of deterioration in banks' loan portfolios and profitability, Directors emphasized that close supervision will be crucial. They welcomed the Financial Supervisory Agency's actions to increase provisioning based on bank-by-bank assessments, and the upcoming technical assistance from the Fund to strengthen its stress-testing capability. Directors endorsed the authorities' measures to bolster depositor confidence through increased transparency and adequate safety nets. Directors welcomed the authorities' commitment to developing a financial stability plan to respond to potential situations of stress.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Georgia: Selected Economic Indicators, 2004–2008

	2004	2005	2006	2007	2008
Real Sector					
Real GDP growth (percentage change)	5.9	9.6	9.4	12.4	2.0
GDP (in millions of U.S. dollars)	5,126	6,411	7,768	10,227	12,870
GDP per capita (in U.S. dollars)	1,188	1,486	1,800	2,324	2,925
Inflation (in percent)					
Period average	5.7	8.3	9.2	9.2	10.0
End-of-period	7.5	6.2	8.8	11.0	5.5
Central government operations (in percent of GDP)					
Revenue and grants	23.1	24.4	26.7	29.3	30.7
Expenditure and net lending	20.7	26.0	29.7	34.0	37.1
Overall balance (cash basis)	2.4	-1.6	-3.0	-4.7	-6.4
Monetary indicators					
Reserve money (end-of-period growth rate, in percent)	44.3	19.7	19.2	25.6	-4.5
Broad money (end-of-period growth rate, in percent)	42.6	26.4	39.3	49.6	7.0
Broad money velocity	7.64	6.79	5.18	4.27	4.48
External Sector					
Current account balance (including transfers)					
In millions of U.S. dollars	-344	-701	-1,174	-2,006	-2,911
In percent of GDP	-6.7	-10.9	-15.1	-19.6	-22.6
External debt					
In millions of U.S. dollars	2,138	2,095	2,328	3,136	4,581
In percent of exports of goods and services	41.7	32.7	30.0	30.7	35.6
Gross official international reserves					
In millions of U.S. dollars	352	474	881	1,361	1,480
In months of imports of goods and services	1.3	1.3	1.8	2.2	3.0
Exchange rate, lari/dollar, period average	1.92	1.81	1.78	1.66	1.48

Sources: Georgian authorities; and IMF staff estimates.

Statement by Age Bakker, Executive Director for Georgia
March 23, 2009

Recent developments

Following 8 years of strong performance, in which the economy has grown 7 percent on average, GDP growth is estimated to have decelerated to around 2 percent last year. This figure disguises a sharp contraction in the second half of 2008 owing to the armed conflict and the unfolding global economic and financial crisis. Besides disrupting key sectors in the economy, the conflict triggered a fall in confidence, bank deposits and private capital flows. Until recently these inflows acted as the engine of growth and were attracted by Georgia's sound policies and appealing environment for doing business. In the aftermath of the conflict, the authorities managed to stabilize the macroeconomic situation. The rapid response by the IMF in September supported the authorities in their policies, and helped to catalyze other financial support. In October 2008, the donor community pledged USD 4.5 bln over the years 2008-2010. All pledges for 2008 were disbursed, which provided room for countercyclical macro policies. The authorities are grateful to the IMF for the support.

Notwithstanding efforts by the authorities and the international community, the global crisis increasingly affected the economy in the final quarter of 2008. In response to growing exchange pressures and reserve outflows, the authorities made a one-step devaluation of the currency by about 17 percent in mid-November. Despite this devaluation, inflation has subsided sharply, owing to slower economic activity as well as softer energy and food prices. By the end of January 2009, inflation reached 4.4 percent, down from the 12 percent peak in August 2008. As part of its planned transition to inflation targeting, the central bank has also gained the legal foundation last year to commit itself to price stability.

Over the last few months deposits have recovered somewhat, indicating that savers entrust their money to the banking sector. However, exchange rate uncertainties have contributed to further dollarization of deposits, reversing the downward trend of previous years. On account of the deteriorating real economy, declining real estate prices and the lari devaluation, non performing loans in the banking sector have climbed steeply. In the face of uncertain conditions, banks suspended new lending, despite the fact that the central bank significantly relaxed liquidity conditions. Higher provisioning, steeper funding costs and lower lending activity have negatively affected banks' profitability. Liquidity and solvency ratios have also come down, but they remain at comfortable levels.

Despite the difficult situation, the authorities have met all performance criteria for the 2nd review by the end of December 2008. Besides meeting all quantitative criteria, the 2009 budget was submitted to Parliament, and the Financial Stability Authority (FSA) and the central bank signed and implemented a Memorandum of Understanding to enhance their cooperation in the area of financial stability. Subject to a structural performance criterion, the central bank's lender of last resort facility was enhanced. These achievements reflect the authorities' commitment to achieve the program's objectives. The new Prime Minister, Minister of Finance and Central Bank President will continue that commitment.

The outlook

The authorities will face a challenging year. Restoring private capital inflows and domestic confidence remains a main priority. This task will not be easy in an environment of subdued activity and ongoing global financial deleveraging. Portfolio investment and private external borrowing are projected to fall steeply this year. Foreign direct investment is also expected to slow relative to last year. However, an important part of these flows is still expected to come due to the quasi-public dimension of these investments. With declining interest of private investors and the expected fall in remittances, donor support will be critical in restoring stability. Despite the more difficult external environment, major donors have for this year either disbursed or reaffirmed their commitment to disburse their pledges.

Enhanced and sufficiently front-loaded donor support is expected to partially substitute for private investment. Nevertheless, in view of the worsening external outlook and the credit freeze by banks, staff expects the economy to grow by 1 percent in 2009. Relative to the baseline of the 1st review, this implies a downward revision by 3 percentage points. The authorities anticipate a recovery in the second half of 2009, reflecting a fiscal impulse and a lower base in the second half of 2008. The significant cooling in consumer prices may also help to restore consumers' purchasing power.

Slower domestic demand growth and private capital inflows are expected to weaken import growth. Import reduction is likely to more than offset falling exports revenues resulting from a slump in commodity prices and a recession in Georgia's main trading partners. These developments are projected to narrow the current account deficit in 2009 by 6 percentage points. While a deficit of 16.7 percent of GDP is still large, it is expected to be covered by foreign direct investment, donor inflows, and the use of Fund resources.

The authorities' policies

To support economic activity, the authorities are implementing a fiscal stimulus, which entails a shift from import-intensive defense spending to social and capital spending. With this stimulus package, the authorities expect to provide a cyclical impulse to the economy and improve medium-term competitiveness. The 2009 budget deficit is projected to be close to 6 percent of GDP. In case donor money would fall short of expectations, which is considered unlikely, the authorities will revise the 2009 deficit target downward. Despite higher fiscal deficits since 2008, the rise in external public debt has been limited by favorable debt terms. Projected at circa 25 percent of GDP for 2009, the level of public external debt also remains manageable. In order to improve the process of budget planning, execution and auditing, the authorities will introduce a new budget code. It is the aim to submit this code to cabinet later this year.

Lower inflation has provided the room for considerable monetary easing. At the same time, the authorities recognize that providing ample liquidity to banks adds pressures in the foreign exchange market. In this context, they see merit in a more cautious liquidity provision. Anticipating a future move to inflation targeting, the authorities are working on improving the interest rate channel. By the end of March, the central bank is expected to introduce and publish a new liquidity framework (structural benchmark), which aims to strengthen the link between the policy rate and the operational target. Developing a liquid domestic securities market will also aid the smooth conduct of monetary policy, but this will take time, particularly in the current environment of diminished appetite for emerging market securities.

While recognizing the need to move to a more flexible exchange rate regime, the authorities have so far only showed some flexibility. Their preference for moving gradually to flexibility stems from the concern that a sudden abandoning of the exchange rate anchor would hurt depositor confidence and would expose banks to negative balance sheet effects. However, in the face of the worsening external environment and the current level of reserves, the authorities have stepped up preparations for a swifter move to a flexible regime. During March they have slowed the pace of interventions, and successfully introduced an auction-based mechanism for selling foreign exchange. These steps are reflected in the NIR targets, which over the course of this year leave significantly less scope for interventions.

The conflict and the global crisis have affected the banking sector. However, conservative prudential policies have anchored the stability of the banking sector. Swift support from international institutions, including EBRD and IFC, should also enable banks to cover their maturing external obligations for 2009. While the FSA is confident about the strength of the banking sector, it recognizes the need for monitoring the banking system very closely in a situation of worsening loan quality. Based on this assessment, it has required banks to step up loan-loss provisioning. In further enhancing the FSA's analytical toolkit, the Fund will provide technical assistance in stress testing banks' balance sheets. To better prepare for contingencies, the authorities are developing a financial stability plan for managing financial sector stress. They are committed to finalize this plan by end-June.

In light of the performance under the SBA so far and the commitment to further policy adjustments, the authorities request the completion of the 2nd review. They have indicated their intention to draw the amounts that will become available at the completion of this review.