August 2009
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Georgia: Third Review Under the Stand-By Arrangement and Requests for Augmentation, Extension of the Arrangement, Rephasing of Purchases, and Modification of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Georgia

In the context of the third review under the Stand-By Arrangement for Georgia and its requests for augmentation, extension of the arrangement, rephasing of purchases, and modification of performance criteria, the following documents have been released and are included in this package:

- The staff report for the Third Review Under the Stand-By Arrangement and Requests for Augmentation, Extension of the Arrangement, Rephasing of Purchases, and Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on July 22, 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 July 30, 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 summarizing the views of the Executive Board as expressed during its August 6, 2009 discussion of the staff report that completed the review.

- 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

Third Review Under the Stand-By Arrangement and Requests for Augmentation, Extension of the Arrangement, Rephasing of Purchases, and Modification of Performance Criteria

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

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

July 30, 2009

- **Background**. An 18-month Stand-By Arrangement (SBA) in the amount of SDR 477.1 million ($744 million or 317 percent of quota) was approved by the Executive Board (Country Report No. 08/328) on September 15, 2008. A tranche in the amount of SDR 94.6 million will become available upon the completion of this review.
- **Revised Program Strategy.** In view of the weaker economic and external financing prospects, the proposed augmentation (by SDR 270 million or 180 percent of quota) and extension of the SBA (to June 14, 2011) aims at facilitating an orderly exit from high public and external deficits, and the associated dependence on official financial support.
- **Team:** E. Gardner (head and Senior Resident Representative), L. Bonato, A. Luca (all MCD), A. Sadikov (SPR), and L. Eyraud (FAD).
- **Exchange Rate Regime:** The regime has been reclassified as “other managed” from “stabilized,” based on the authorities’ policy to allow greater exchange rate flexibility since March 2009. The government uses the official exchange rate for budget and tax accounting purposes as well as for all payments between the government and enterprises and other legal entities. The official rate may differ by more than 2 percent from freely determined market rates, which gives rise to a multiple currency practice.
- **Safeguards Assessment:** The augmentation will require an update of the safeguards assessment that was completed in December 2008. Given the short passage of time since the previous assessment, staff expects that the update could be substantially, if not fully, completed by the time of the fourth review under the arrangement. The assessment will also look at the particular circumstances for channeling IMF resources to the budget through the NBG, including the framework between the central bank and the government for the management of disbursements and servicing of IMF lending, and the operational controls for the government's banking operations conducted through the central bank.
- **Statistics:** Economic data are broadly adequate for surveillance and program monitoring. Georgia participates in the GDDS.

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Attachments

Executive Summary

The economic downturn has turned out to be deeper than expected. The fall in FDI, remittances, and exports has continued through the first half of 2009, leading to a significant reduction of employment and incomes. Real GDP growth projections for the year as a whole have been revised down to -4 percent. Reflecting the slowdown, inflation has fallen and the external current account deficit narrowed. Foreign exchange pressures have eased due to a decline in imports, limiting the need for central bank intervention in the market. The political situation remains uncertain, but internal tensions have abated.

With monetary policy impaired by high dollarization, the authorities' response to the downturn relies mostly on fiscal stimulus. The reduction of policy interest rates and ample liquidity injections have not led to a resumption of bank lending, owing to balance sheet weaknesses and higher credit risk. The authorities have thus decided to accommodate tax revenue losses in a higher deficit in 2009. Significant fiscal adjustment will begin in 2010 to help preserve investor confidence and restore access to international capital markets ahead of the large repayment obligations coming due in 2013.

The authorities have requested an augmentation of access and an extension of the arrangement through mid-2011. Reflecting lower inflows and the fiscal policy response to the downturn, financing needs have increased. The augmentation of access would fill this gap as well as contribute to a somewhat faster international reserve accumulation. It would help preserve the program's objectives while avoiding the need for a disruptive adjustment in the external and fiscal accounts.

The financial sector has been resilient so far, but remains vulnerable to a deterioration in asset quality and continued uncertainty about the deposit base. The authorities are strengthening supervision and developing a contingency plan for managing potential financial sector stress.

I. BACKGROUND

1. **The Third Review under the SBA was postponed to allow further discussions on the implications of a deeper-than-expected economic contraction and a revision of government spending plans for 2009.** Following the postponement of the review, the authorities indicated that they also wished to discuss augmentation of access and an extension of the arrangement to cover additional financing needs through mid-2011. In order to align program discussions with the 2010 budget now under preparation, the authorities asked that the review and request for augmentation be considered in early August, prior to finalization of budgetary plans for 2010.

2. **The political situation remains uncertain, but internal tensions have abated.** Attempts to unseat the president through continuous street demonstrations have failed. However, negotiations between the government and the opposition have not yielded a political settlement. Regional political tensions remain elevated.

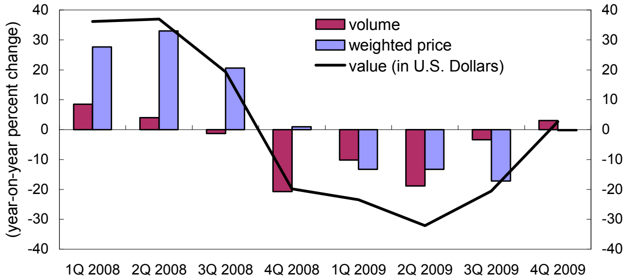
II. RECENT ECONOMIC DEVELOPMENTS

3. **Available data point to a deeper contraction than previously expected, and real GDP growth for 2009 has been revised down to -4 percent.** The revision follows the release of first quarter real GDP data (-5.9 percent year-on-year) and continued weakness of economic indicators in the second quarter. The contraction of output was led by falling exports and remittances and a contraction in bank lending of 10 percent since the end of 2008 (Figure 1). The stabilization of deposits, remittances, and trade indicators in May-June suggests that the economy may have bottomed out, and the staff projection incorporates a recovery beginning in the second half of 2009, led in part by back-loaded public spending in 2009. CPI inflation has stabilized in the low single digits (2.3 percent in June), reflecting weakened economic activity and a fall in world commodity prices. Based on production price developments, the increase in the GDP deflator in 2009 has been revised down from 5 to 0 percent. Significant lay-offs have been reported in the construction, financial, and retail sectors, and the unemployment rate reached 16.5 percent in late 2008.[1] Poverty remains widespread (23.7 percent in 2007)[2] and is likely to have increased due to the conflict and economic downturn.

[1] Unemployment figures may be underestimated. About two-thirds of the working age population is counted as self-employed.

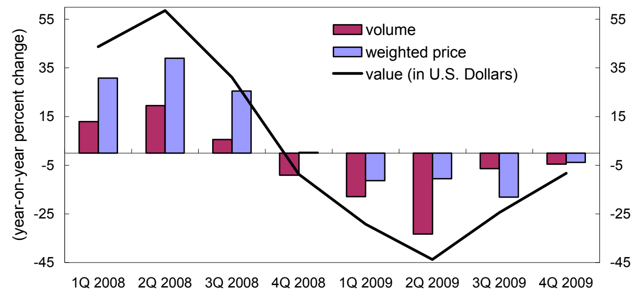
[2] World Bank estimate.

Georgia: Exports of Goods and Nonfactor Services



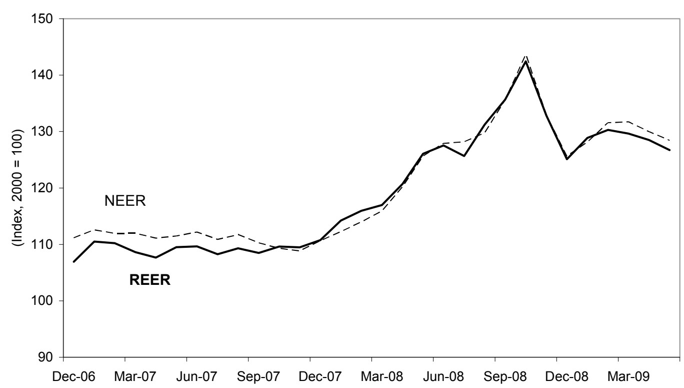
Sources: National Bank of Georgia; and Fund staff estimates.

Georgia: Imports of Goods and Nonfactor Services



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

Georgia: REER and NEER



Source: IMF Institute.

4. **The foreign exchange market has stabilized since mid-February, reflecting an easing of balance of payment pressures.** The external current account deficit has narrowed faster than expected, led by declining imports; but capital inflows have also fallen short of earlier projections. FDI—the main driver of economic activity in previous years—fell by about 70 percent in the first half of the year relative to the same period of 2008, while there was a net outflow in non-FDI private capital despite large injections from IFIs to commercial banks. The stabilization of the foreign exchange market, which coincided with the replacing of the daily fixing session with auctions, allowed the National Bank of Georgia (NBG) to acquire foreign exchange from the market in March and April and to limit its foreign exchange sales in May-June to $34 million compared with $130 million in January-February (Figure 2). Sales of foreign exchange in May-June were motivated in part by the desire to establish the credibility of the auctions with the market, even in the face of limited demand for foreign exchange. Since then, the amounts sold at auction have fallen to very low levels. Replenished by the $190 million SBA purchase of late March, gross official reserves stood at $1.5 billion (about 3 months of next year's projected imports) as of mid-July. The competitiveness gain achieved by the lari devaluation of November 2008 has been partly eroded by devaluations in partner countries.

5. **Despite strict public expenditure control, spending reductions in the first half of 2009 were outpaced by the decline in tax revenues by a wide margin.** Adjusted for one-off effects, expenditure in the first two quarters was 11 percent lower (in nominal terms) than over the same period of 2008 owing to cuts in defense spending. However, tax revenues

(adjusted for one-off effects) declined by 17 percent, due in part to a reduction of personal income tax rates from 25 to 20 percent, and reductions of taxes on interest and dividend income paid to nonresidents (Figure 3).

6. **Notwithstanding policy loosening, monetary conditions remain very tight, with monetary and credit aggregates contracting through the first half of the year and real deposit interest rates rising to 8½ percent**. Deposit rates have increased since the outset of the crisis as banks compete for a shrinking deposit base. Unlike in the immediate aftermath of the conflict, the contraction of monetary aggregates appears to reflect mostly a drawdown of financial savings by households and enterprises, rather than a loss of confidence. Despite stabilization in deposits and deposit dollarization since mid-May, banks have continued to curtail credit to preserve adequate liquidity buffers in the face of ongoing uncertainty and heightened credit risk. With increased credit risk, intermediation margins widened steadily through February 2009, but have since come down. The central bank's refinancing rate has been lowered repeatedly, but with limited eligible collateral available for accessing this window, this has only led to a widening disconnect between market rates and the policy rate (Figure 4).[3]

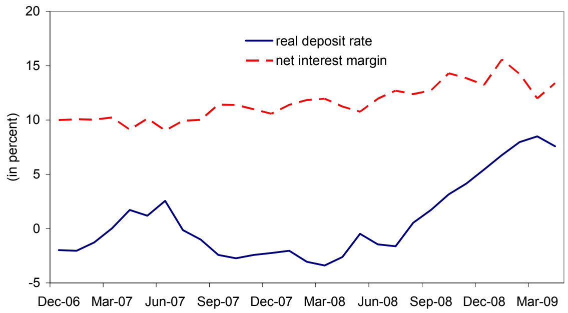
Georgia: Monetary Indicators, 2008-09

	2008				2009	
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
	(12-month growth, in percent)					
Broad money (M3)	50.6	28.9	6.9	7.0	-8.7	-14.2
Domestic currency money (M2)	65.4	46.8	17.1	-13.0	-27.7	-29.3
Reserve money	22.6	22.4	25.7	-4.5	-10.4	-4.5
Credit to private sector	62.4	53.9	28.3	28.2	13.6	-2.4
	(In percent)					
Loan-to-deposit ratio	174.6	189.6	198.9	191.3	212.1	212.2
Credit-to-GDP ratio	28.5	30.0	29.1	31.9	30.7	30.0
Deposit dollarization	60.9	60.0	61.7	75.7	75.2	73.2

Source: National Bank of Georgia.

[3] Eligible collateral includes central bank CDs, foreign exchange and T-bills.

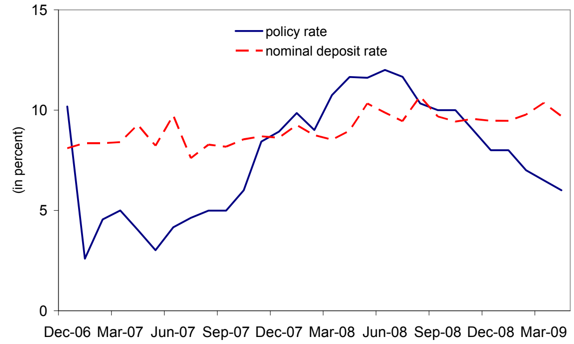
Georgia: Interest Rates, 2006-09 1/



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

1/ Net interest margin is defined as the average lending rate minus the average deposit rate.

Georgia: Interest Rates, 2006-09



Source: National Bank of Georgia.

7. **With the help of external financial support, the financial sector has been able to weather pressures, but remains vulnerable to a deterioration in asset quality and continued uncertainty about the deposit base.** Capital and liquidity injections into the two largest banks allowed them to meet external payment obligations and improved solvency and liquidity indicators, but the share of nonperforming loans in total loans has risen by 15 percentage points since June 2008. So far, domestic currency loans have been disproportionately affected, but stress testing points to the vulnerability of the loan portfolio to further exchange rate depreciation. Faced with deposit outflows and little prospect for additional recapitalization in the short term, banks have continued to build up precautionary balances. Banks' cautious attitude to lending has prudential benefits given very high loan-to-deposit ratios, but is placing additional strains on the economy.

Georgia: Selected Financial Soundness Indicators, 2008-09

	2008				2009	
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
Capital adequacy ratio (in percent)	17.5	15.7	17.0	13.9	15.2	17.6
Liquidity ratio (in percent)	36.8	33.3	30.4	28.3	30.8	31.4
Nonperforming loans (in percent of total loans) 1/	3.0	3.4	9.9	12.8	15.2	18.8
Loans collateralized by real estate (in percent of total loans)	43.6	40.5	41.6	43.6	46.4	48.0
Loans in foreign exchange (in percent of total loans)	65.9	64.9	67.5	72.8	75.3	77.3
Specific provisions (in percent of total loans)	1.9	2.2	4.7	6.0	7.5	9.4
Net foreign assets (in percent of total assets)	-17.2	-20.2	-21.6	-19.6	-22.5	-24.4
Net open foreign exchange position	3.5	1.5	1.5	1.7	9.1	8.8
Return on equity	10.2	8.9	-2.9	-12.6	-7.6	-8.4

Source: Georgian Financial Supervisory Agency.

1/ National definition.

8. **The authorities' policies have been in line with program expectations.** All quantitative and structural performance criteria have been met, and all but one of the structural benchmarks through end-July have been observed:

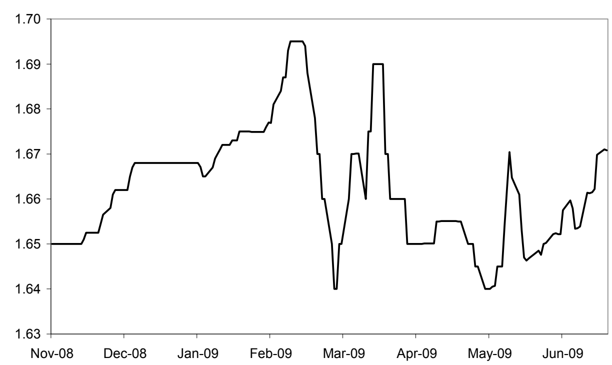
a) **The end-March and end-June fiscal deficit targets were met** because of expenditure underexecution during the first quarter (¶5). In the second quarter, the deterioration of the economic environment induced a tax revenue shortfall equivalent to 0.7 percent of annual GDP, and the deficit was consequently higher than anticipated but, on a cumulative basis, the end-June PC was still met comfortably.

b) **The end-March and end-June monetary targets were met** by a large margin. The NIR target was observed following lower-than-projected foreign exchange market intervention since mid-February due to lower speculative and import-related foreign exchange demand (¶4). NDA remained well below the program ceiling, owing to lower net credit to the government and lower claims on banks as liquidity conditions improved (¶6).

c) **The end-March structural benchmark on the development and publication of a liquidity management framework was implemented with delay** in April. The framework describes the monetary policy instruments available to the central bank and links them to monetary policy objectives.

d) Greater flexibility was allowed in the lari-dollar exchange rate. This followed the introduction in March of foreign exchange auctions, which initially replaced the daily fixing on alternate days, until the fixing session was eliminated altogether on May 22.

Georgia: Recent Lari/US Dollar Exchange Rate Developments



Source: National Bank of Georgia.

e) The assessment of bank vulnerabilities has been strengthened. An MCM mission in April 2009 found that the Financial Supervisory Agency (FSA) stress testing techniques were already well advanced. The FSA has continued to build on the stress test models developed with Fund technical assistance. **The end-June structural benchmark on the appointment of the remaining members of the FSA board was not observed** owing to the decision of the authorities to merge the FSA and the NBG.

f) **The end-June performance criterion on preparation of a contingency plan for the financial system was met.** The plan defines the roles and responsibilities of the different players—the NBG, the FSA and the government—in response to potential situations of stress, establishes a consultation mechanism, identifies modalities for possible state intervention in the event of systemic crises, and outlines next steps in the formulation of bank-by-bank contingency plans.

g) Efforts have increased to secure additional fiscal financing. To compensate for lower tax collections, the government is negotiating advanced budget support from the Asian

Development Bank and the World Bank, and has identified additional assets for privatization.

h) **The end-July structural benchmark on the submission of a new budget code to cabinet was observed.** The new budget code expands the coverage of the budget to public agencies and thereby enhances budget monitoring.

III. Augmentation of Access and Extension of the SBA-Supported Program

9. **In view of the weaker economic and external financing prospects, the proposed augmentation and extension of the SBA aims at facilitating an orderly exit from high public and external deficits, and the associated dependence on official financial support.** The original strategy was to cover through official financing (including the IMF) the gap created by the sudden drop of private capital inflows, thereby preventing a collapse in demand and a potential very disruptive external adjustment. The strategy was predicated on the expectation that the balance of payments and fiscal shock created by the conflict in 2008 would reverse itself starting in 2009-10. A reassessment of the impact of the international economic and financial crisis points to a downturn that will be more severe and prolonged than initially envisaged.

10. **While some aspects of the strategy supported by the IMF program remain valid, others have been adapted to the new circumstances**:

- The ***fiscal strategy*** will be rebalanced from an emphasis on supporting demand to a program of rapid fiscal adjustment starting in 2010, aimed at returning to viable fiscal and external positions by 2012.

- ***Exchange rate flexibility***—enhanced by recent institutional reforms—remains an essential instrument of external adjustment, in the event fiscal retrenchment proves insufficient in containing exchange rate pressures.

- ***Monetary policy*** should regain some traction as monetary conditions normalize, and the monetary stance will be geared at consolidating the disinflation gains.

- ***Financial sector supervision and regulation*** will continue to be strengthened through capacity building actions and by following up on the preparedness action plan outlined in the financial stability plan.

11. **External and fiscal adjustment is not expected to be constrained by structural impediments**. The return to viable fiscal and external positions over the medium term is driven by the expected gradual recovery of economic growth and private capital inflows, backed by fiscal adjustment measures. Georgia's strong record of structural reforms should enable the economy to respond flexibly and favorably to renewed opportunities for growth.

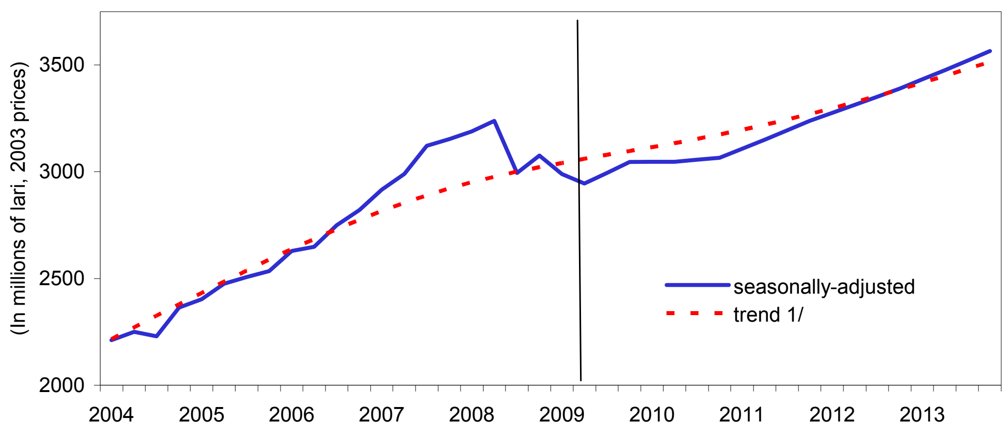
Accordingly, structural conditionality in the program is limited to fiscal and financial measures.

A. Macroeconomic Outlook and Risks

The return to sustained growth is now expected to take longer; the level of potential growth over the medium term remains uncertain.

12. **Based on a moderate recovery of activity, real GDP growth is projected at 2 percent in 2010.** After a sizable expansion of government spending in the second half of 2009, the withdrawal of fiscal stimulus in 2010 is expected to dampen the impact of the gradual pickup of FDI and of resumed bank lending. Inflation is projected to edge up as growth resumes.

Georgia: Real GDP



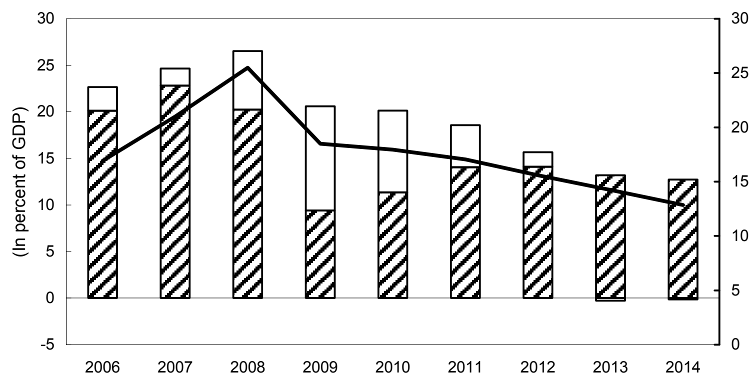
Source: Department of Statistics of Georgia; and Fund staff estimates.

1/ Trend is calculated using Hodrick-Prescott filter applied to 2004-2013 data.

13. **The authorities expect real GDP growth to rise gradually over the medium term to 6-7 percent, but the staff's medium-term scenario takes a more conservative view with growth trending at 5 percent over the medium term.** The Georgian economy should be able to capitalize on a recovery of world growth, given its geographic location as a natural transit point of world trade in goods and energy, a very favorable business environment, flexible economic institutions, and a demonstrated capacity for timely policy action. The difference in growth rate assumptions between the authorities and staff reflects simply different appreciations of this potential and the strength of the external environment. The staff's scenario assumes some pickup of inflation, which at 5 percent would remain well below pre-crisis levels.

14. **The deterioration in the external outlook and the need to maintain a larger reserve buffer give rise to an external financing gap in 2010-11.** Much of the gap is closed by policy adjustment, notably a reduction of the fiscal deficit (excluding grants) of 2½ percentage points of GDP in 2010. The remaining gap (about $300 million in 2010, and $100 million in 2011) would be financed by the proposed augmentation of access under the SBA. As shown in the table and figures below, the financing gap stems from the downward revision of private and official capital inflows, and the need for a faster increase of gross international reserves. A higher reserve buffer is called for in the face of highly uncertain private financial flows and unclear prospects about regaining market access in the near future. These factors outweigh the impact of a downward revision in the current account deficit projections for 2010 and 2011.

Georgia: Current Account Balance and Its Financing



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

Georgia: Balance of Payments Summary, 2008-11
(In millions of U.S. dollars)

	2008	2009		2010		2011
		March Country Rep. No. 09/127	Proj.	March Country Rep. No. 09/127	Proj.	Proj.
Current account balance	-2,915	-1,879	-1,768	-2,096	-1,782	-1,813
Capital and Financial Account	2,911	1,704	1,597	2,192	1,662	1,937
Of which: FDI (net)	1,523	1,032	907	1,240	1,046	1,222
Of which: other private inflows (net) 1/	562	304	118	294	167	359
Of which: General government (mostly loans)	652	235	376	511	309	263
Financing	51	175	151	-97	120	-124
Gross International Reserves (-increase)	-131	10	-230	-75	-234	-173
Use of Fund Resources	222	164	381	-22	354	48
Of which: proposed augmentation	...	...	...	...	303	106
Memorandum items:						
Gross international reserves (end of period)	1,480	1,470	1,708	1,545	1,942	2,115
(in months of next year GNFS imports)	3.2	2.7	3.5	2.6	3.7	3.8

Sources: Georgian authorities; and Fund staff estimates.

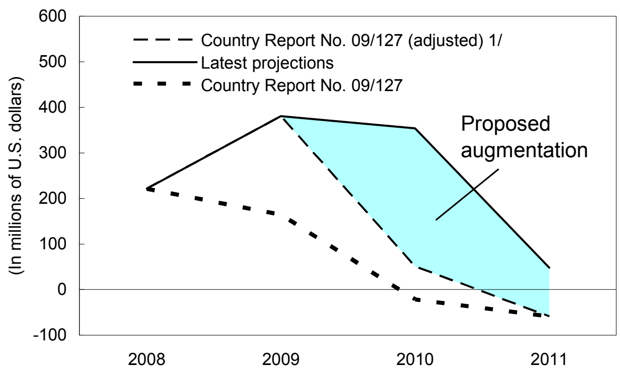
1/ Including errors and omissions.

Georgia: Reserve Accumulation in 2010

Reserve accumulation (+ increase)	234
due to:	
Reserve accumulation programmed in Country Report No. 09/127	75
Use of Fund resources treated as precautionary in Country Report No. 09/127	72
Augmentation of access to Fund resources in 2010	87

Source: Fund Staff calculations.

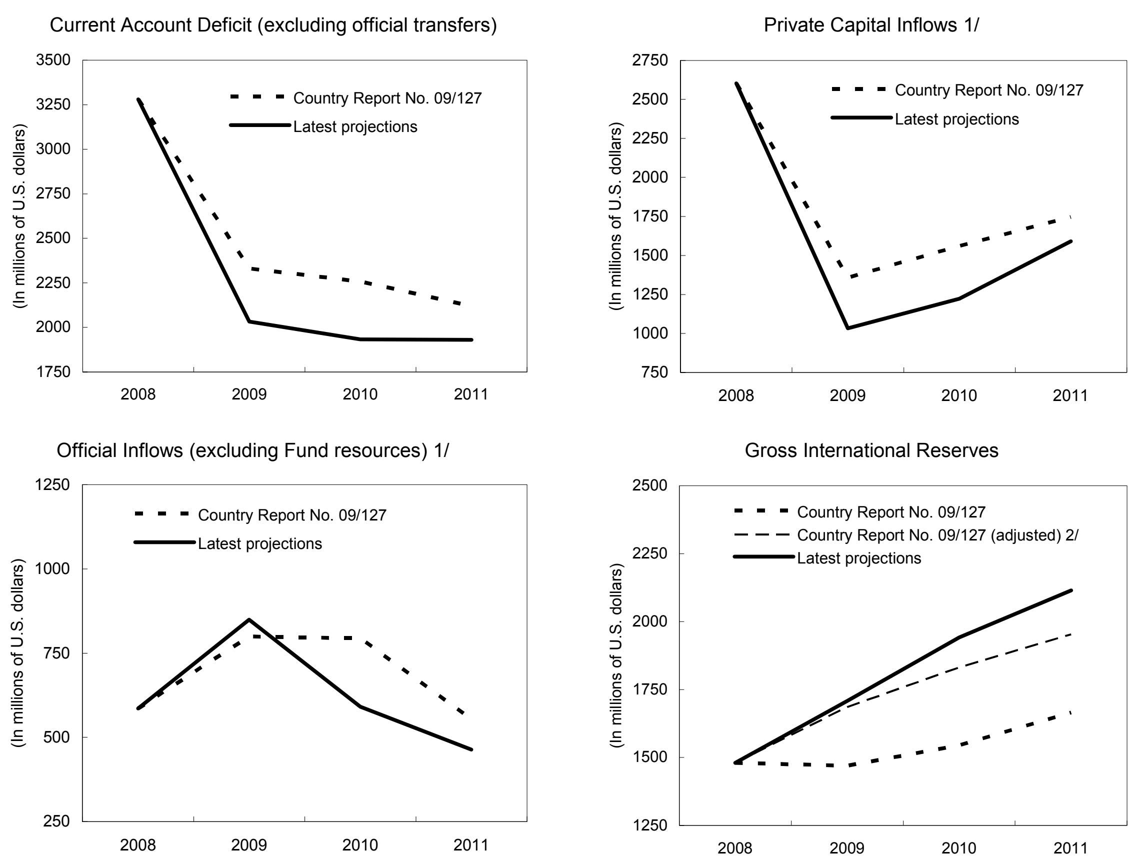
Georgia: Projected Use of Fund Resources



Sources: Country Report No. 09/127; and Fund staff projections.

1/ Assumes use of Fund resources treated as precautionary in Country Report No. 09/127.

Georgia: Balance of Payments Summary, 2008-11



Sources: Country Report No. 09/127; and Fund staff projections.

1/ For 2008, Eurobond-2013 is included under private capital inflows.
2/ Assumes use of Fund resources treated as precautionary in Country Report No. 09/127.

15. **The balance of risks remains on the downside, particularly as regards the size of the GDP contraction in 2009, the timing and pace of the economic recovery, and the resumption of private capital inflows.** Further declines in private capital inflows, exports, and remittances, as well as delays or shortfalls in official assistance, or prolonged domestic and regional political tensions could result in a deeper contraction than currently forecast. While foreign exchange pressures have eased recently, they could reemerge in the event of financing shortfalls, and the combined effect of output contraction and lari depreciation would have repercussions on the banking sector, which is exposed to highly-dollarized balance sheets of unhedged borrowers. Deteriorating bank asset quality could, in turn, damage depositor confidence, putting downward pressure on international reserves, and leading to more serious balance of payments and financial sector difficulties.

B. Fiscal Policy

Tax revenue losses associated with the sharper economic contraction have created new pressures for public finances. To reconcile the need to support demand in the short run with that of restoring debt sustainability, the strategy is to maintain expenditure in 2009 unchanged relative to the agreed program level, and to move to a strong fiscal adjustment beginning in 2010 as the economy starts to recover.

16. **The fiscal deficit is projected to increase from 5.6 percent of GDP (Second Review) to 9.4 percent, owing mainly to the downward revision in GDP growth.**[4] Spending is expected to remain unchanged compared with the second review projections despite the adoption in July of a supplementary budget, which increases spending authorization by 1½ percent of GDP (mostly in the areas of capital and social expenditures). This is explained by anticipated underexecution of spending relative to the revised budget appropriations, and by the fact that spending was projected to be higher than that of the budget at the time of the second review.[5] The authorities plan to contain overall spending by reallocating resources to social and capital spending from other less urgent needs. Thus, defense spending is expected to decline by 3½ percentage points of GDP relative to 2008, while social spending is projected to increase by 1 percentage point.[6] Revenue targets would come under stress in the event of a larger GDP contraction this year, but the authorities could exercise even stronger expenditure restraint to meet the deficit target.

[4] The increase in the deficit to GDP ratio by 3.8 percentage points comes from the decline in tax revenues (3/4 of the total effect) and a lower denominator effect (1/4).

[5] At the time of the second review, expenditure projections outstripped initial budget appropriations by 1/2 a percentage point of GDP on account of higher external financing assumptions.

[6] In 2009, the authorities plan to increase the minimum pension and extend the coverage of the assistance and health insurance schemes for the most vulnerable people.

Georgia: Social Expenditures (General Government), 2008-10

	2008	2009	2010
	(In percent of GDP)		
Health programs	1.2	1.6	1.4
Pensions	4.0	4.7	4.7
Social assistance 1/	0.9	1.0	1.2
IDP 2/	0.3	0.4	0.3
Other	0.9	0.6	0.7
Total	7.2	8.2	8.3

Sources: Ministry of Finance; and Fund staff estimates.

1/ Include assistance to IDPs (internally displaced persons) of 2008 war.
2/ Only covers assistance to 1990s IDPs.

17. **The authorities' medium-term fiscal adjustment strategy is heavily front loaded, and the 2010 budget now under preparation envisages sizeable expenditure cuts** (see table below)**.** With grants expected to fall by half, revenues are projected to decline by 2.8 percentage points of GDP in 2010.[7] The fiscal deficit will however improve by 2 percentage points of GDP. As illustrated in the table below, non-interest expenditures (adjusted for one-off effects) are projected to decline by nearly 10 percent in real terms (and 4.3 percent in terms of GDP). Policy options include substantial real reductions in administrative costs across the board, with the exception of the ministries of health education and agriculture, cuts in subsidies to semi-public institutions, capping the wage bill in real terms, reduction in cofinancing of investment projects, and cuts to the investment budget connected to the winding down of large infrastructure projects now under way (mainly roads and public buildings).

18. **Fiscal deficits in the second semester of 2009 and in 2010 will be financed by a mix of T-bill issuance, privatization receipts, and external budget support.** Part of the balance of payments support provided by the IMF in 2009 ($100 million) will be channeled to the budget, including the 2009 financing that was treated as precautionary in the second review. In 2010, all of the IMF financing is provisionally channeled to the budget pending confirmation of the amount of budget support that is in the pipeline from other IFIs (LOI ¶23).

Georgia: External Financing of the Public Sector, 2008-10
(Gross inflows in millions of U.S. dollars)

	2008	2009	2010
Total	1368	1208	916
IMF 1/	257	408	375
WB	126	245	169
Other Multilateral Institutions	135	280	152
Bilateral partners	350	275	219
Eurobond-2013	500	...	...
Memorandum items:			
Grants	388	334	157
Loans 2/ 3/	723	466	384
Budget support financing 3/	426	320	86
Project financing	185	480	455

Source: Georgian authorities; and Fund staff estimates.

1/ Includes the proposed augmentation of access in 2010-11.
2/ Includes Eurobond in 2008.
3/ Excludes SBA purchases.

[7] In addition, the transfer of the NBG profits to the budget will be suspended starting in 2010 to allow the NBG to build up reserves.

Georgia: Fiscal Adjustment, 2009-13

Measures	Change 2009-10	Change 2010-13	Comments
	(In percent of GDP)		
(1) Policy adjustment and automatic stabilizers	3.9	5.8	
Increase in revenues	-0.4	-0.3	
Tax revenues 1/	0.1	-0.4	Improvement in revenue administration (2010), tax cuts (2012), broadening of tax base (2011-13)
Other revenues	-0.5	0.1	NBG profit transfer to the budget discontinued after 2009
Decrease in expenditures	4.3	6.1	
Current spending 2/	1.9	4.6	
Compensation for employees	0.4	0.6	Reduction in defense personnel costs (2010), constant real wage bill (2011-13)
Use of goods and services	0.6	0.7	Administrative expenditure cuts of 4 percent in real terms in 2010 and 18% cumulatively in 2011-2013 (except in ministries of education, health and agriculture)
Subsidies	0.1	0.8	Decline of subsidies to public entities (LEPLs) by 4 percent in real terms in 2010 and 25 percent cumulatively in 2011-2013
Grants	0.0	0.0	
Social expenses	-0.1	1.0	Increase in pensions and social assistance (2010), health reform (2010-13), decrease in number of beneficiaries of subsistence minimum (2011-13)
Other expenses	0.6	1.4	Decrease in reserve funds and co-financing of investment projects (2010-13), no additional construction of houses for internally displaced persons (from 2011 on)
Capital spending	1.9	1.6	Phase-out of road rehabilitation, and reconstruction/renovation of public buildings (2010-13)
Net lending	0.5	-0.1	Termination of subsidized lending program (2010)
(2) Exogeneous factors	-1.8	-1.4	
Increase in revenues	-2.4	-0.9	
Arrears clearance	-0.8	0.0	Belated VAT payment received from a line ministry (2009)
External grants	-1.6	-0.9	Reduction in donor support (2010-13)
Decrease in expenditures	0.6	-0.5	
Arrears clearance	0.8	0.0	Belated VAT payment made by a line ministry (2009)
Interest payments	-0.2	-0.5	Public debt increase (2010-13)
(1)+(2) = Total reduction in fiscal balance	2.1	4.4	

Sources: Ministry of Finance; and Fund staff estimates.

1/ Excluding tax arrears cleareance.
2/ Excluding interest payments and arrears clearance.

Additional lending by the World Bank and the ADB is fully expected for 2010 based on staff discussions with these agencies, but the 2010 budget cannot legally reflect these loans until they are finalized. When these loans are approved, Fund support will be appropriately scaled back. Part of the fiscal gap in 2009 will be filled by domestic borrowing. The 2010 budget will seek authorization for additional T-bill issuance, which for now is slated for the replenishment of the government account. The re-launching of T-bills, which were discontinued in 2005, is welcome for financial sector development, and will increase the effectiveness of monetary policy instruments. Given the potential cost of this source of financing, the amounts will be limited (0.9 percent of GDP in 2009 and 0.6 percent in 2010 on a net basis), focusing on 6 month maturities.

19. **Beyond 2010, the adjustment strategy will continue to rely on expenditure containment.** If needed, the authorities would be ready to contemplate revenue measures to reach their medium-term deficit targets, but their priority remains on broadening the tax base while further reducing income tax rates once conditions permit. Under the authorities' scenario, current expenditures would decline by 3 percent in real terms from 2010 to 2013, and capital spending by 12 percent, reflecting the winding down of externally financed large scale projects initiated in the wake of the 2008 conflict, the impact of the economic recovery on the cost of social assistance, and potential cuts in military, administrative, and non-essential capital outlays. The fiscal deficit would decline steadily to 4 percent of GDP in 2012 and just under 3 percent in 2013. As a way of signaling their commitment, the authorities will include these medium-term fiscal targets in the 2010 budget document (October 1, 2009, structural benchmark). The strategy will be described in greater detail in the medium-term expenditure framework document, which the authorities plan to finalize by mid-2010.

20. **The increase in public debt associated with the fiscal response to the 2008 armed conflict and subsequent economic crisis is sizable, but the authorities' adjustment strategy helps allay debt sustainability concerns (Box 1).** While economic recovery and an ambitious fiscal consolidation are expected to moderate solvency ratios in the medium-term, debt service obligations are very high in 2013-14. These reflect a $500 million Eurobond maturing in 2013 and repurchase obligations to the Fund, which peak in 2013. Debt sustainability issues would become more pressing in the event of a deeper and more prolonged economic downturn, if government support of the financial sector became necessary, or if normal access to international capital markets could not be restored by 2012.

Box 1. Georgia: Debt Sustainability Analysis 1/ 2/

While the economic crisis and the government's fiscal response is leading to a sharp deterioration in public sector's indebtedness, solvency ratios do not raise immediate concerns. However, large risks stem from the bunching of external repayments in 2013-14, with public external debt service amounting to 25½ percent of exports in 2013. Staff assesses the risk of debt distress as moderate.

From 2004 through mid-2008, Georgia's private external debt increased rapidly, while public debt fell to low levels. This reflected a sharp increase in capital inflows, including loans and deposits from abroad, and a shift away from official to private forms of external financing. By mid-2008, private and public external debt both amounted to 20 percent of GDP.

The August conflict and the global financial crisis changed radically the debt dynamics. Private inflows dried up as banks lost access to capital markets, but large fiscal and balance of payments needs, including banks' repayment obligations, were addressed by loans and grants from donors, who committed $4.5 billion of external assistance over 2008–10 at the October 2008 Brussels conference. At end-June 2009, the stock of public external debt was slightly less than $3 billion, more than $500 million above the end-June 2008 level. Going forward, the fiscal impact of the crisis and the related policy response imply a further increase in public debt in the next two years.

To allay debt sustainability concerns, the authorities intend to undertake strong fiscal adjustment during the program and in the medium term. The authorities' medium-term framework envisages a reduction in fiscal deficit from 9.4 percent of GDP in 2009 to under 3 percent in 2013. As a result, after peaking at 47 percent of GDP in 2011, the public debt-to-GDP ratio is expected to decline gradually to 41 percent by the end of the projections.

Key risks to the debt outlook arise from the bunching of debt service obligations in 2013–14. Repurchases to the Fund are at their maximum in 2013, when the outstanding $500 Eurobond also matures. As a result, the external public debt service-to-exports ratio in 2013 is projected to exceed 25 percent, while external debt service obligations would amount to 46½ percent of exports, or about 100 percent of the projected end-2012 gross international reserves.

Alternative scenarios and stress tests show that Georgia's debt is sensitive to adverse developments. Public external debt indicators deteriorate most under the alternative scenarios that assume i) new loans at less favorable terms, ii) one-time nominal depreciation, iii) nondebt creating flows at lower levels than in the baseline. Nonetheless, none of the public external debt ratios breach relevant thresholds prescribed by the LIC DSA framework, except in 2013. Sensitivity analysis shows the unsustainability of the current primary balance, and underscores the importance of setting policies on a path of rapid deficit reduction.

1/ Fund staff update. Last DSA was presented in Country Report No. 08/328.
2/ See Figures 5a-5b, and Tables 13a, 13b, 14a, and 14b.

21. **The ministry of finance is making progress in designing fiscal reforms to improve budget preparation, execution, and audit.** In addition to the new budget code submitted to cabinet (¶8h), the reform agenda includes (i) strengthening the medium-term budget process; (ii) submitting to parliament the Law on Internal Audit (end-September 2009 structural benchmark), which will expand the ministry of finance's audit capacity and responsibilities; (iii) adopting the International Public Sector Accounting Standards (IPSAS) to increase transparency and accountability; (iv) creating an integrated information system for budget preparation and execution; (v) improving the risk-based audit functions in the revenue service; and (vi) implementing the electronic declaration and payment of all taxes.

C. Monetary policy

With limited scope for reviving credit growth through interest rate cuts and liquidity injections, the short-term monetary strategy is to ease credit conditions through selective instruments such as foreign exchange swaps. Meanwhile, liquidity injections from external budgetary support will be allowed to increase reserve money sufficiently to meet banks' demand for higher precautionary balances.

22. **Heightened credit risk and institutional constraints are hindering the ability of the monetary authorities to ease credit conditions.** The NBG has signaled monetary easing against the backdrop of declining inflation through repeated cuts in its refinancing (policy) rate. Also, banks' balances at the central bank have increased markedly as a share of their liabilities. Notwithstanding the range of tools at the disposal of the central bank (as described in the liquidity management framework, ¶8c), monetary transmission remains ineffective because of market segmentation, banks' risk aversion and preference for higher precautionary liquid holdings. While the increase in real interest rates may have dampened demand for credit, the main constraint on a resumption of credit lies with banks' reluctance to take on new credit risk and their need to reduce loan-to-deposit ratios to more prudent levels.[8]

23. **In an effort to encourage domestic currency lending, the NBG has introduced foreign exchange swaps.** Commercial banks rely heavily on foreign currency funding. Swaps with the NBG are intended to allow banks that have access to foreign exchange liquidity to finance lari loans to borrowers whose unhedged position makes them unsuitable for dollar borrowing. The central bank has so far issued only a limited amount of swaps and intends to cap the total amount outstanding at GEL 60 million (roughly 3.5 percent of reserve money) to limit NBG's contingent dollar liabilities and the risk that foreign exchange swaps will invite abuse and speculation.

[8] The two largest banks have covenants with the IFIs that provided capital injections, that require them to lower loan-to-deposit ratios over the medium term.

24. **The NBG has published its liquidity management framework (structural benchmark), which clarifies the policy objectives of the central bank and the modalities of operation.** In the current environment in which credit is constrained by deposit growth and banks are holding large reserve buffers, the traditional monetary instruments have proven to have very limited traction. In view of the ample liquidity in the system, the central bank intends to close the uncollateralized special lending facility which was introduce in the wake of the 2008 conflict, when the remaining GEL 68 million become due in September. In response to the planned T-bill issuance, NBG also intends to reduce the stock of certificates of deposit, to allow banks to channel their excess liquidity into T-bills and avoid further contraction in private credit. Once monetary and credit conditions normalize, the authorities also intend to restore reserve requirements to a level that would be more binding, thus increasing the role of the NBG's refinancing window, whose relevance will also be enhanced by the availability of T-bills as collateral.

D. Exchange Rate Policy

A flexible exchange rate remains a key component of the external adjustment strategy, although planned fiscal retrenchment should ease exchange rate pressures going forward.

25. **Improvements in exchange rate management have given the market a greater role in the determination of the exchange rate.** The introduction of auctions has increased day-to-day exchange rate volatility. Building on this successful reform, the authorities intend to reduce the frequency of auctions to once a week as soon as possible, and to widen the bidding spread from 1 to 2 percent.[9] Staff suggested that the NBG provide information to the market about its auction intentions over a longer horizon than one week, as a way of stabilizing expectations. However, the authorities indicated that, given the size of the market, greater disclosure could be counterproductive and that they needed flexibility to better handle speculative pressures.

26. **Foreign exchange auctions have so far operated in an environment of diminished exchange rate pressures, but the authorities consider that the institutional change guarantees that the exchange rate will be allowed to respond more flexibly in the event of more sustained pressures.** For now, however, the authorities expect the foreign exchange market to remain relatively stable through the rest of the year. They also consider that the auction system will allow for a smoother exchange rate adjustment than the step devaluation of November 2008.

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[9] The central auction rate is set at the previous day's market rate, and banks are currently allowed to bid within a corridor of ± 0.5 percent around the auction rate. This corridor would be widened to ± 1.0 percent.

E. Safeguarding the Financial Sector

Banks have adequate liquidity and capital buffers, but the rise in systemic risks requires continued vigilance of banking supervision backed by strengthened contingency planning.

27. **Stress testing capacity is being strengthened.** After capital and liquidity injections from IFIs and bilateral partners, liquidity and solvency indicators have improved, particularly in largest banks. Nonetheless, bank asset quality has continued to worsen and NPLs are likely to increase further in the short run, even as the economy begins to recover. The banking system remains vulnerable to potential exchange rate shocks, declining real estate prices, and the possibility of a longer and deeper recession. Preliminary stress test results conducted with input from MCM technical assistance show that the banking system is relatively resilient to moderate exchange rate shocks, although the impact of currency-induced credit risk on bank capitalization would be disproportionately greater for large depreciation shocks. A large depreciation, combined with a significant interest rate shock and a deterioration in loan quality, would cause the system's capital adequacy ratio to drop well below the prudential requirement. The authorities are in the process of refining bank-by-bank stress testing.

28. **Financial system vulnerabilities are being addressed by strengthening supervision.** The authorities are acting on different fronts to improve supervision. The FSA and the NBG will be merged, creating a single supervisor for the whole financial system. The draft merger law now in parliament consolidates all financial sector supervision under the NBG, and also fills legal gaps in the authorities' arsenal of measures to deal with a potential crisis. With technical assistance financed by the ADB, the authorities are preparing the ground for risk-based and consolidated supervision, and convergence to International Financial Reporting Standards with well-defined supervisory filters. Moreover, with the assistance of MCM, they are building further on their stress-testing framework.

29. **The authorities are making good progress in the preparation of a contingency plan to safeguard the financial sector.** With the financial stability plan completed in June (¶8f), the authorities have established the institutional framework for managing potential financial sector stress. As a next step, the FSA will elaborate on bank-by-bank contingency measures based on stress test results and assurances of support received from foreign shareholders. A status report is expected by end-September (structural benchmark). To clarify the role of foreign parent banks in the event of a crisis, the authorities have signed memorandums of understanding with home country supervisors, and agreed on further collaboration. They remain, however, unconvinced of the merits of a deposit insurance scheme as a way of strengthening confidence, noting its doubtful benefits to large depositors and its moral hazard shortcomings.

IV. Capacity to Repay

30. **The augmentation would increase further the already large repurchase obligations of Georgia to the Fund.** With the requested augmentation of 180 percent of quota, at its peak, Georgia's outstanding credit to the Fund would amount to 33 percent of exports or 58 percent of gross reserves. The risks are high in 2013, when both the peak repurchases to the Fund of about $425 million (9½ percent of exports) and the $500 million Eurobond-2013 (equivalent to 11 percent of exports) would come due. In that year, total external debt service and public external debt service are expected to exceed 45 percent and 25 percent of exports, respectively. To rollover the Eurobond, the government will need to regain the access to capital markets, which will rest critically on achieving a sustainable fiscal position by 2012.

Georgia: Access and Phasing of Purchases Under the SBA

Approved access and schedule				Proposed access and schedule			
Schedule of reviews	Date of availability	Millions of SDRs	Percent of quota	Schedule of reviews	Date of availability	Millions of SDRs	Percent of quota
Completed				**Completed**			
Board approval of SBA	15-Sep-08	161.7	107.6	Board approval of SBA	15-Sep-08	161.7	107.6
First Review	15-Dec-08	63.1	42.0	First Review	15-Dec-08	63.1	42.0
Second Review	23-Mar-09	63.1	42.0	Second Review	23-Mar-09	63.1	42.0
Prospective				**Prospective**			
Third Review	15-Jun-09	47.3	31.5	Third Review 1/	6-Aug-09	94.6	62.9
Fourth Review	15-Sep-09	47.3	31.5	Fourth Review	15-Nov-09	47.3	31.5
Fifth Review	15-Dec-09	47.3	31.5	Fifth Review	15-Feb-10	97.3	64.7
Sixth Review	28-Feb-10	47.3	31.5	Sixth Review	15-May-10	50.0	33.3
				Seventh Review	15-Aug-10	50.0	33.3
				Eighth Review	15-Nov-10	50.0	33.3
				Ninth Review	15-Feb-11	35.0	23.3
				Tenth Review	15-May-11	35.0	23.3
	Prospective:	189.2	125.9		Prospective:	459.2	305.5
	Total:	477.1	317.4		Total:	747.1	497.1

Source: Fund staff estimates.

1/ It is proposed that the access amounts allocated to the third and fourth reviews under the approved schedule be made available upon the completion of the third review.

Box 2. Georgia: Rationale for the Structural Conditionality Under the Stand-By Arrangement

Financial Sector

FSA and NBG to sign and implement a memorandum of understanding to strengthen cooperation (October 2008).	To strengthen financial supervision and improve coordination to prepare adequately for potential problems in the banking sector.
Appointment of the remaining members to the FSA board (June 2009).	
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 (June 2009).	To 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.
Status report on the implementation of the action plan described in the Financial Stability Plan, including bank-by-bank contingency measures based on stress test results and assurances of support received from foreign shareholders (August 2009).	

Monetary and Exchange Rate Policies

NBG to introduce revised LOLR facility (December 2008).	To improve NBG's lender of last resort facility by (i) ensuring that loans are provided only to solvent institutions; and (ii) clarifying the role of the FSA in monitoring their use.
NBG to develop and publish a liquidity management framework, including the introduction of a refinancing mechanism as the main instrument to provide liquidity (March 2009).	To enhance liquidity forecasting and strengthen the monetary transmission mechanism as parts of the planned move to formal inflation targeting.

Fiscal Policy

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) (December 2008).	To ensure fiscal discipline and boost investor confidence in the wake of the conflict.
Submission to parliament of a state budget for 2010 that: (i) is consistent with the program targets and assumptions, and an overall deficit of no more than 7.3 percent of GDP (program definition); (ii) contains a medium-term fiscal framework consistent with the program's medium-term deficit reduction targets; and (iii) describes the medium-term policies underlying the fiscal deficit objectives through 2013 (October 2009).	
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 (July 2009).	To enhance the fiscal policy monitoring, planning, execution and auditing functions, so as to reinforce its efficiency through the consolidation process.
Submission to parliament of the Law on Internal Audit (September 2009).	

V. Staff Appraisal

31. **Since the last review, the balance of macroeconomic challenges has shifted from foreign exchange market pressures to the worsening state of the economy and of the external accounts.** The deterioration of the economic environment mirrors that of trading partners, but domestic political uncertainties have also dampened confidence, while the deteriorating quality of banks' loan portfolios has set in motion adverse financial-macroeconomic interactions. There are signs that the output contraction could be bottoming out, but the recovery in 2010 is expected to be slow. With imports contracting, pressures in the foreign exchange market have subsided, but could reemerge depending on the interplay of current account trends, private capital inflows, donor financing, and confidence in the currency.

32. **Policy performance has been good.** The government has contained the fiscal deficit well within the program ceiling despite significant tax revenue shortfalls, the monetary targets were met with ample margins, and the successful introduction of foreign exchange auctions has set the stage for the transition to a market-driven exchange rate system. The new exchange rate framework should enable faster convergence of the exchange rate to its equilibrium level, and promote the development of the interbank foreign exchange market, which in time will have beneficial stabilizing effects.

33. **The authorities' revised strategy for 2009–11 should ensure an orderly transition from an expansionary fiscal stance in 2009 to a path of steady adjustment consistent with medium-term fiscal and external sustainability.** The decision to allow revenue losses in 2009 to be accommodated in a higher deficit, while targeting a very substantial expenditure contraction in 2010, strikes the right balance between the needs to prevent a deeper economic downturn and to restore budget discipline over the medium term. While the withdrawal of fiscal stimulus in 2010 may dampen demand, it is also key to preserving investor confidence and to restoring access to international capital markets ahead of the large repayment obligations coming due in 2013 and 2014.

34. **The front loading of the proposed fiscal adjustment and the underlying improvement in the efficiency of spending provide added assurances of the authorities' commitment and of the effectiveness of the strategy.** Well over one third of the targeted adjustment through 2013 is planned to take place in 2010. The planned readjustment of spending priorities to meet essential needs provides added comfort about the social sustainability of the strategy. The projected decline in capital spending over the medium term is consistent with the winding down of donor financed projects, and should not compromise growth prospects. The authorities' decision to engage the Fund early in the budgetary process so as to better align the Fund program to the 2010 budget is particularly welcome. The authorities' desire to further reduce the tax burden over the medium term is noted, but flexibility in regard to revenue measures should be preserved given the uncertainties.

35. **Given the stability in the market, the authorities' commitment to exchange rate flexibility has not been fully tested since the foreign exchange auctions were introduced.** However, this institutional reform provides a strong presumption that market forces will be given a bigger say in exchange rate determination. The rapid acceptance of this change by banks attests to the effectiveness of the reform. In line with the authorities' stated intention, the amount of fx swaps should be capped at a low level to contain potential risks to the central bank's balance sheet.

36. **The FSA has strengthened its analytical capacity, and the financial stability plan prepared in June is a welcome step in the identification of financial sector contingency measures.** Backed by IMF technical assistance, the FSA has made important strides in developing in-house stress testing tools, which are now a functional instrument of financial supervision. Based on stress testing results and communications with foreign parents and shareholders of major banks, there is scope to further advance bank-by-bank action plans, and quantify the possible costs of contingency measures. The proposed merger of the NBG and the FSA could facilitate coordination between monetary and prudential policies.

37. **The augmentation of access would preserve the program's objectives while avoiding the need for a disruptive adjustment in the external and fiscal accounts.** A large part of the financing gap that has opened in 2010-11 will be closed by the authorities' planned fiscal adjustment. Timely disbursements of donor support pledged at the donor conference of October 2008 and access to Fund resources in 2010–11 would help cover the residual gap. Such assistance would help avoid the adverse social, economic and financial consequences of having to take adjustment measures during an economic downturn, including its adverse impact on banks. The faster build up of international reserves would strengthen confidence and the authorities' ability to face a more uncertain environment.

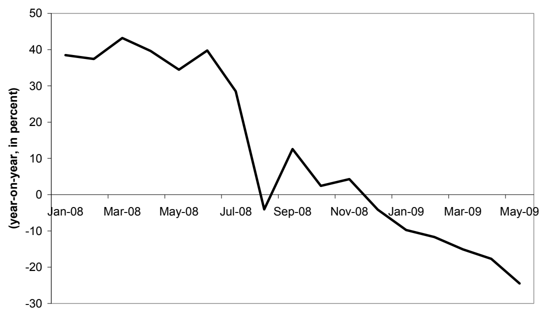
38. **Risks to the program relate to the economic and financial environment, and policy implementation.** Ability to sustain fiscal adjustment through 2012 may be tested by electoral cycles and adverse political, security, and economic developments. Difficulties in restoring market access would complicate a challenging debt service profile due to fact that the peak of repurchases to the Fund coincide with a $500 million Eurobond maturing in 2013.

39. **In all, the authorities have demonstrated considerable skills in adjusting and strengthening the policy framework to handle new and potential fiscal and financial pressures, but risks remain elevated.** The adaptability of policies and the improved planning capacity demonstrated over the course of the program give assurances that the authorities will be able to maintain economic stability. However, a further deterioration of the economic outlook cannot be ruled out. In these circumstances, exchange rate flexibility should be maintained and the pace of fiscal spending will need to be calibrated carefully to balance countercyclical considerations against the need to maintain a sufficient fiscal buffer to meet unexpected obligations and preserve medium-term debt sustainability.

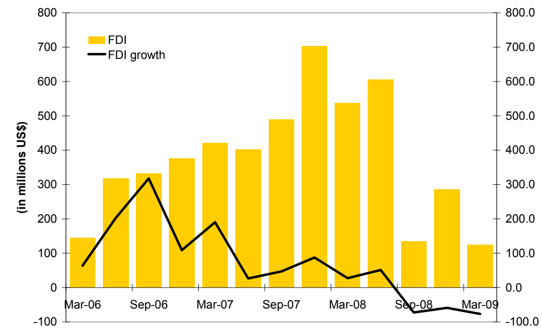
40. **Staff supports the authorities' request for completing the third review** on the basis of Georgia's performance under the SBA, and modification of program conditionality, as specified in the Letter of Intent (¶19, and Tables 1 and 2). Based on the policy adjustments described in the earlier sections, **staff also recommends approval of the authorities' request for an augmentation of access under the SBA** by SDR 270 million (around 180 percent of quota), of which SDR 200 million would be available in 2010, and **extension of the arrangement to June 14, 2011**. The augmentation would result in total access of 497 percent of quota.

Figure 1. Georgia: Real Sector Developments

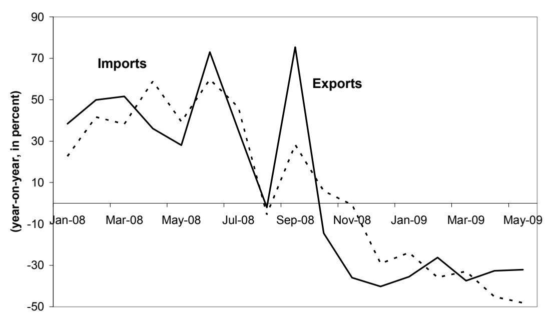
Continued decline in VAT turnover…



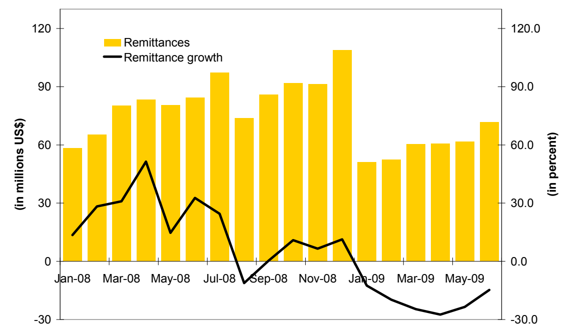
…and FDI inflows points to an unrelenting deterioration.



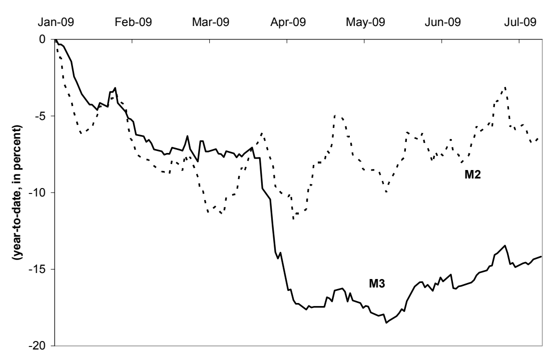
However, the rate of decline has stabilized for exports,…



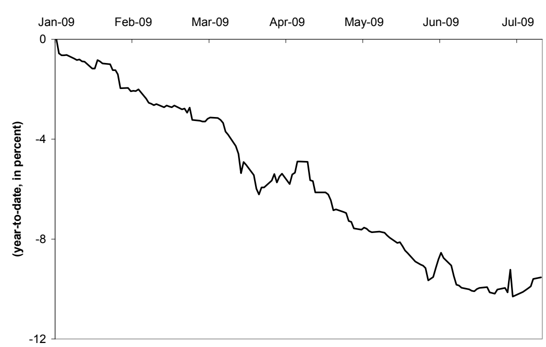
… remittances,…



…lari-denominated broad money M2 and total broad money M3,…



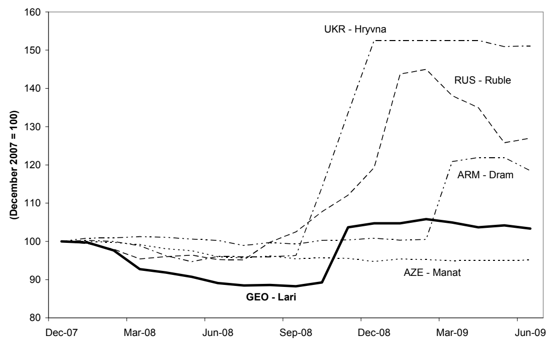
…and, possibly, credit to the private sector.



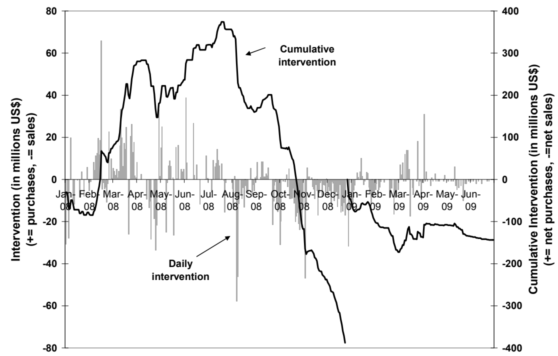
Sources: Department of Statistics of Georgia, Georgian authorities; and Fund staff estimates.

Figure 2. Georgia: Exchange Rate Developments

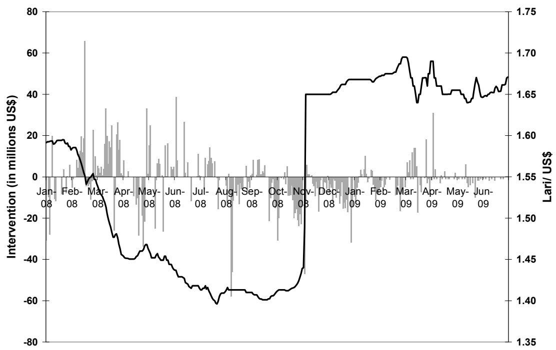
Regional foreign exchange markets have stabilized after several large devaluations in previous months.



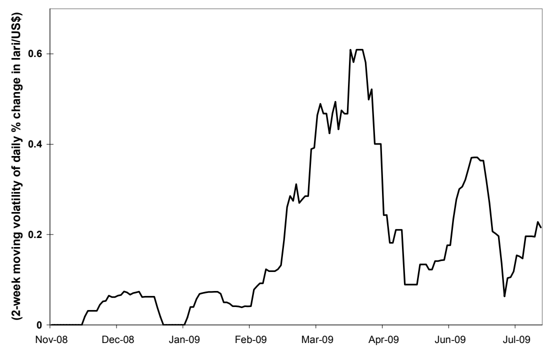
Since mid-March, NBG has switched to lower foreign exchange purchases...



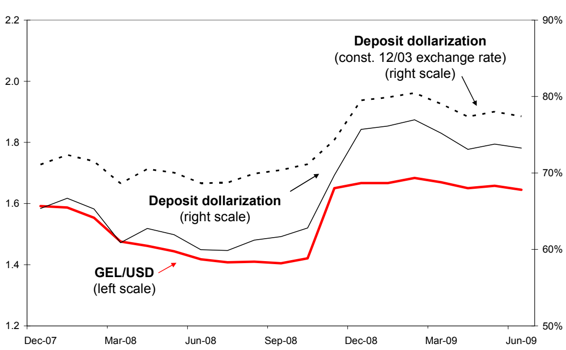
…amid lower exchange rate pressures...



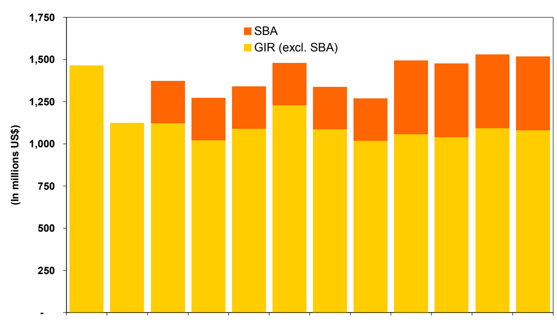
…and increased exchange rate volatility.



Lower devaluation pressures have led to the stabilization of bank deposit dollarization…



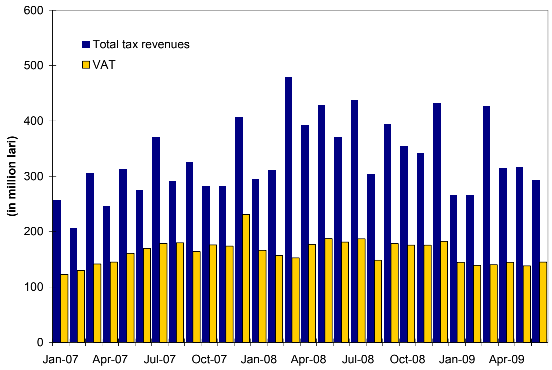
…and of the international reserves, with IMF support.



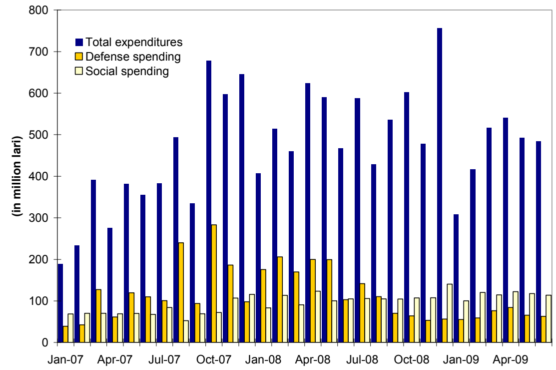
Source: National Bank of Georgia.

Figure 3. Georgia: Fiscal Sector Developments and Outlook

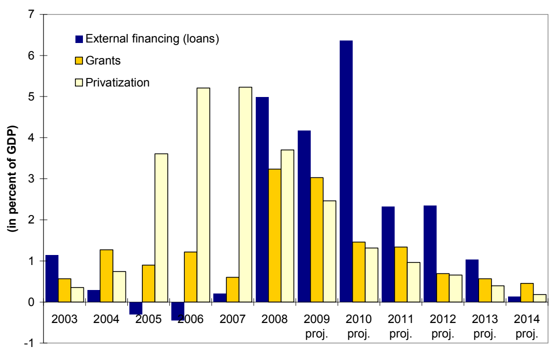
Since the 2008 conflict, tax revenues have trended down...



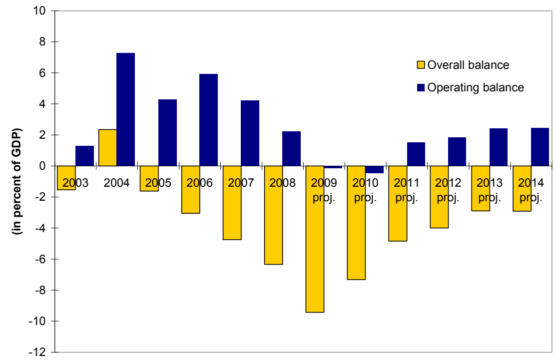
…but the decrease in expenditures has been less pronounced.



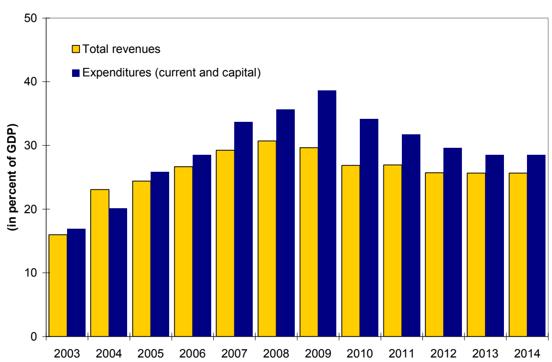
In 2008, external borrowing outstripped privatization proceeds as the main source of financing.



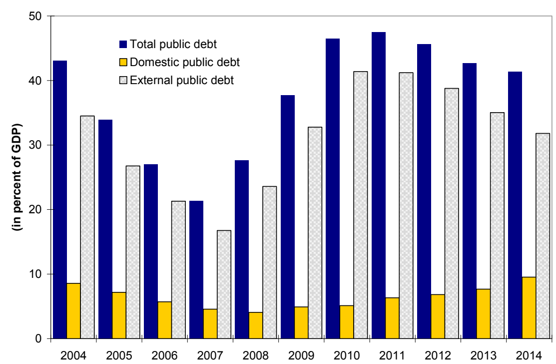
The fiscal deficit is expected to peak in 2009.



After 2009, public finances will be on a more sustainable path through expenditure reduction.



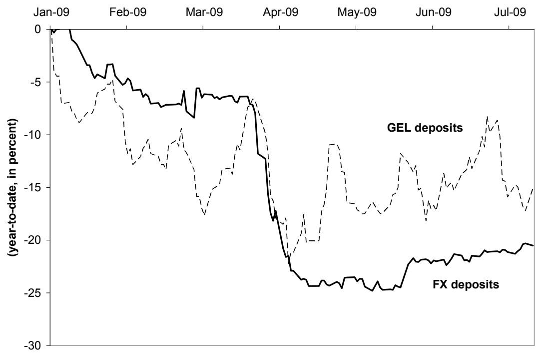
Owing to the accumulation of deficits, Georgia's public debt increases at a fast pace.



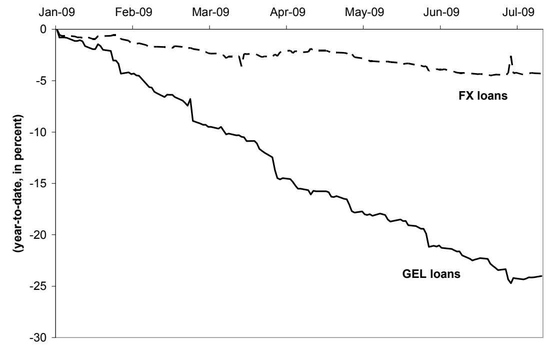
Sources: Georgian authorities; and Fund staff estimates.

Figure 4. Georgia: Monetary and Banking Sector Developments

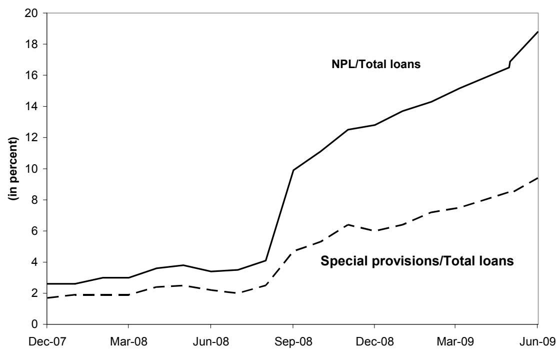
Deposits have stabilized since mid-May,



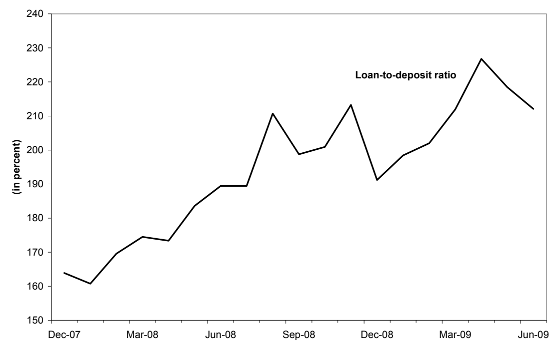
…while credit continues to be constrained…



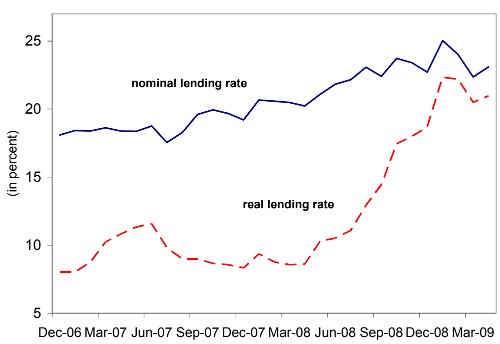
…by deteriorating non-performing loan ratios,



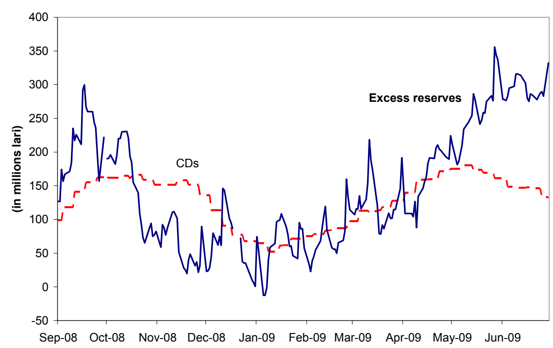
…large loan-to-deposit ratios,



…and hightened credit risk reflected in rising interest rates.

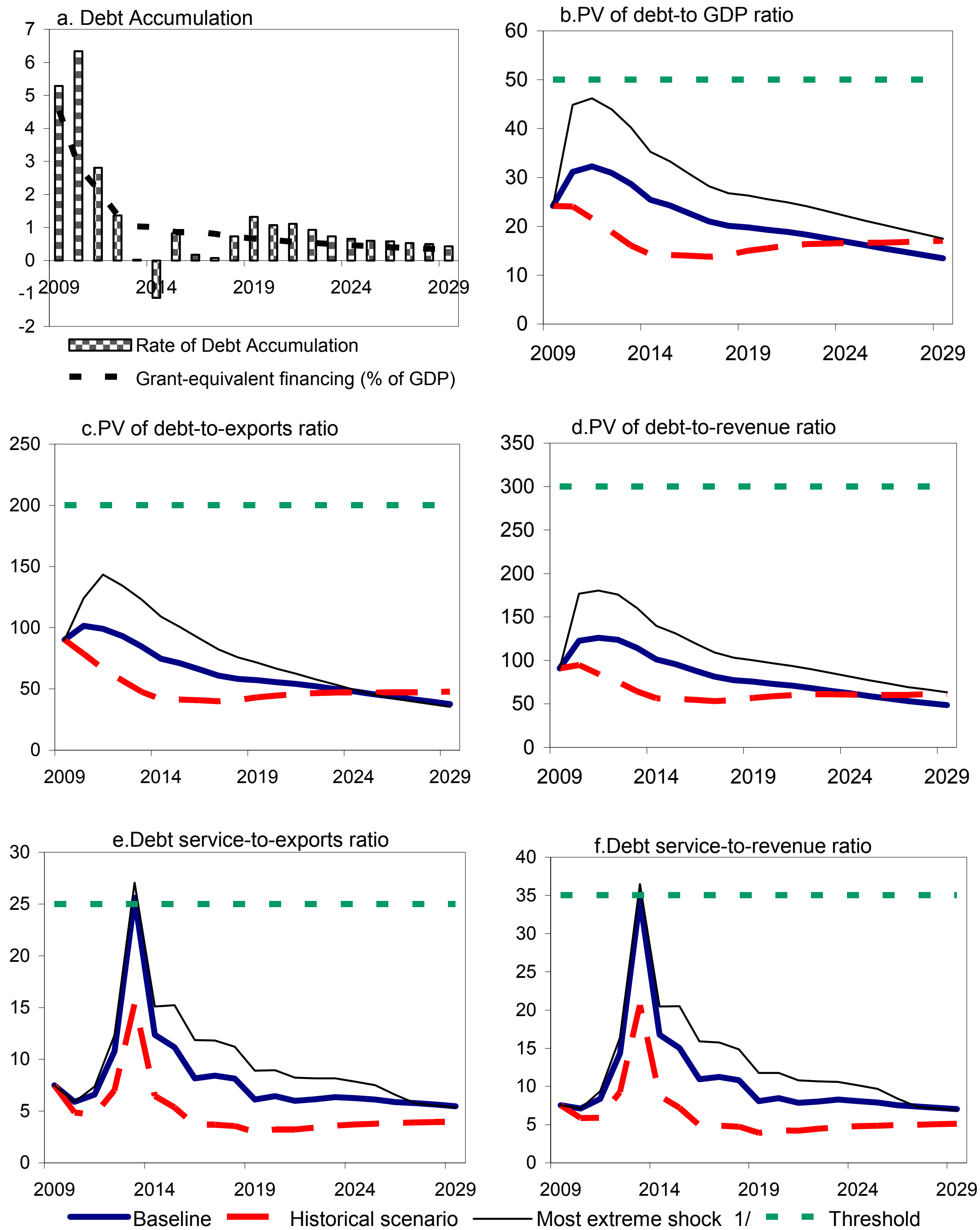


Banks hold excess liquidity in the form of unremunerated excess reserves and certificates of deposits with NBG.



Source: National Bank of Georgia.

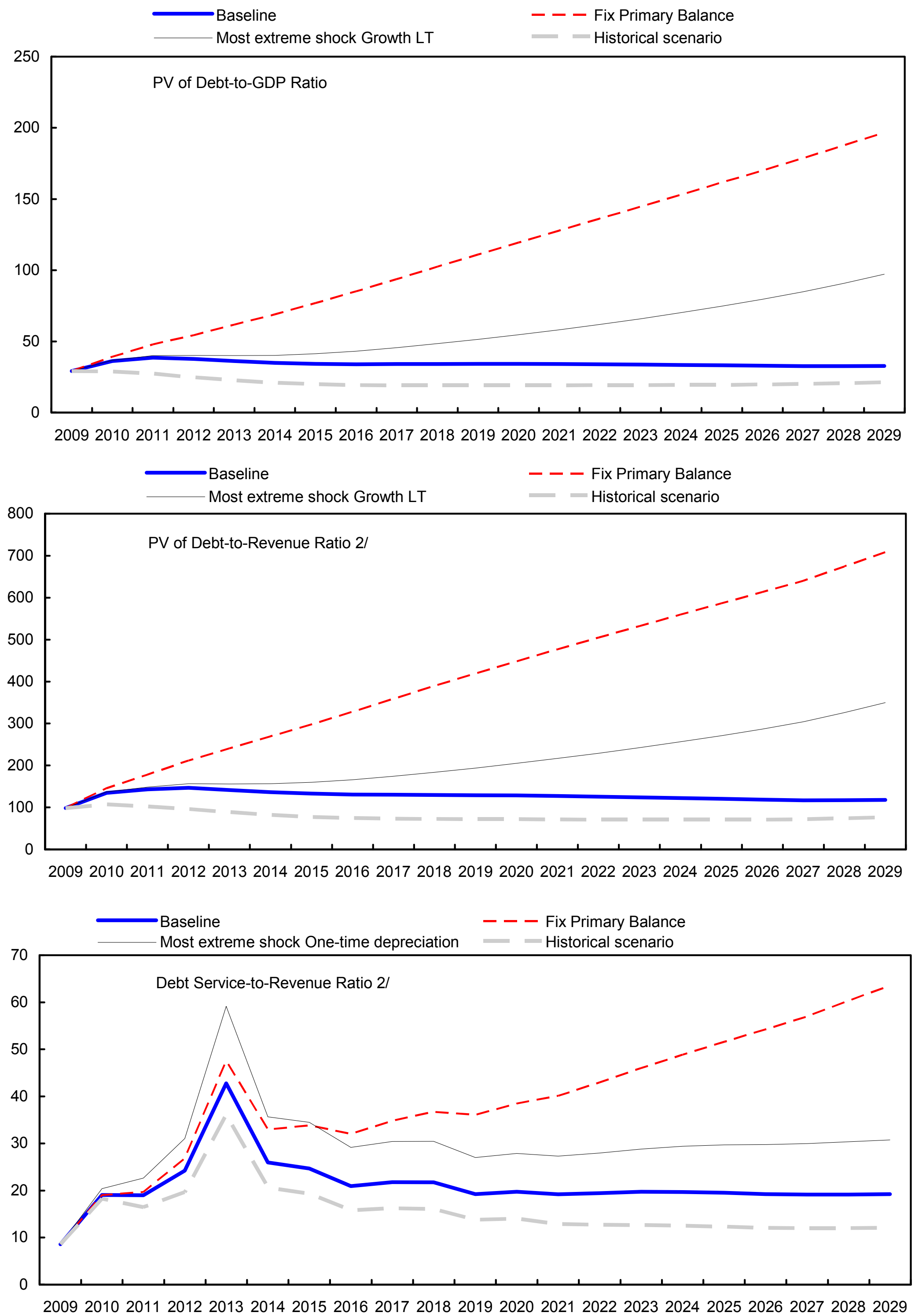
Figure 5a. Georgia: Indicators of Public and Publicly-Guaranteed External Debt under Alternatives Scenarios, 2009-2029 1/ 2/ 3/



Source: Staff projections and simulations.

1/ The most extreme stress test is the test that yields the highest ratio in 2019. In figure b. it corresponds to a One-time depreciation shock; in c. to a Non-debt flows shock; in d. to a One-time depreciation shock; in e. to a Non-debt flows shock and in picture f. to a Non-debt flows shock

Figure 5b. Georgia: Indicators of Public Debt Under Alternative Scenarios, 2009-2029 1/ 2/ 3/



Sources: Country authorities; and Fund staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2019.

2/ Fix Primary balance scenario corresponds to the scenario that maintains the primary balance unchanged at 2009 level

3/ Revenues are defined inclusive of grants.

Table 1. Georgia: Selected Macroeconomic Indicators, 2007–14

	2007	2008 Prel.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.
	(Annual percentage change, unless otherwise indicated)							
National accounts								
Real GDP growth	12.3	2.1	-4.0	2.0	4.0	5.0	5.0	5.0
Population (million) 1/	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Consumer price index, period average	9.2	10.0	1.8	3.2	4.0	5.0	5.0	5.0
Consumer price index, end-of-period	11.0	5.5	3.4	3.0	5.0	5.0	5.0	5.0
GDP per capita (US$)	2,324	2,924	2,497	2,457	2,570	2,780	3,007	3,236
Poverty rate (in percent)	23.7	…	…	…	…	…	…	…
Unemployment rate (in percent)	13.3	16.5	…	…	…	…	…	…
	(In percent of GDP)							
Investment and saving								
Investment	25.7	22.5	19.0	20.5	21.5	22.0	22.0	22.0
Public	3.4	4.3	7.1	5.9	5.4	5.1	4.9	5.1
Private	22.3	18.2	11.9	14.6	16.2	16.9	17.1	16.8
Gross national saving	8.1	-0.1	2.9	3.9	5.5	7.0	8.1	9.5
Public	4.2	2.2	-0.2	-0.5	1.5	1.8	2.4	2.5
Private	3.8	-2.4	3.1	4.4	4.0	5.2	5.7	7.0
Saving-investment balance	-19.6	-22.7	-16.1	-16.6	-16.0	-14.9	-13.8	-12.5
Consolidated government operations								
Revenue	29.3	30.7	29.6	26.9	26.9	25.7	25.7	25.7
Expenses	25.0	28.5	29.8	27.3	25.4	23.9	23.2	23.2
Operating balance	4.2	2.2	-0.2	-0.5	1.5	1.8	2.4	2.5
Capital spending and net lending	9.0	8.6	9.3	6.9	6.3	5.8	5.3	5.4
Overall balance	-4.7	-6.3	-9.4	-7.3	-4.8	-4.0	-2.9	-2.9
Statistical discrepancy	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Total financing	4.6	6.2	9.4	7.3	4.8	4.0	2.9	2.9
Domestic	-0.8	-2.5	2.8	0.0	1.6	1.0	1.5	2.6
External	0.2	5.0	4.2	6.4	2.3	2.3	1.0	0.1
Privatization receipts	5.2	3.7	2.5	1.0	0.9	0.7	0.4	0.2
	(Annual percentage change, unless otherwise indicated)							
Monetary sector								
Reserve money	25.6	-4.5	15.0	12.0	…	…	…	…
Broad money (including foreign exch. deposits)	49.6	7.0	-2.0	15.0	…	…	…	…
Commercial bank credit to the private sector	71.3	31.0	-5.8	5.9	…	…	…	…
External sector								
Exports of goods and services (percent of GDP)	31.1	28.7	26.8	30.7	32.6	33.2	33.8	34.1
Annual percentage change	24.7	15.9	-20.1	12.0	11.8	10.8	10.1	9.1
Imports of goods and services (percent of GDP)	57.9	58.3	49.8	54.6	55.5	54.3	53.2	52.0
Annual percentage change	34.1	26.7	-27.1	7.5	6.8	6.4	5.9	5.8
Net imports of oil (in US$)	556.3	762.5	503.4	564.0	614.1	658.2	701.9	741.2
Current account balance (in millions of US$)	-2,009	-2,915	-1,768	-1,782	-1,813	-1,837	-1,838	-1,795
In percent of GDP	-19.6	-22.7	-16.1	-16.6	-16.0	-14.9	-13.8	-12.5
Gross international reserves (in millions of US$)	1,361	1,480	1,708	1,942	2,115	2,124	1,950	1,913
In months of next year's imports of goods and services	2.2	3.2	3.5	3.7	3.8	3.6	3.1	2.9
Foreign direct investment (percent of GDP)	17.1	12.2	8.3	9.7	10.8	11.2	11.2	11.2
Average exchange rate (lari per dollar)	1.66	1.48	…	…	…	…	…	…

Sources: Georgian authorities; and Fund staff estimates.

1/ Excludes Abkhazia residents.

Table 2. Georgia: Annual General Government Operations, 2008-14 1/

	2008	2009 Country Rep. No. 09/127 2/	2009 Proj.	2010	2011	2012	2013	2014	2008	2009 Country Rep. No. 09/127 2/	2009 Proj.	2010	2011	2012	2013	2014
	(In millions of lari)								(In percent of GDP)							
Revenues	5,854	5,961	5,426	5,115	5,601	5,890	6,487	7,148	30.7	29.5	29.6	26.9	26.9	25.7	25.7	25.7
Taxes	4,753	4,867	4,457	4,507	4,949	5,319	5,889	6,521	24.9	24.1	24.4	23.7	23.8	23.2	23.3	23.4
Other revenues	484	399	414	331	374	413	455	502	2.5	2.0	2.3	1.7	1.8	1.8	1.8	1.8
Grants	617	695	554	277	278	159	143	126	3.2	3.4	3.0	1.5	1.3	0.7	0.6	0.5
Current expenditures	5,427	5,318	5,455	5,203	5,287	5,468	5,872	6,463	28.5	26.3	29.8	27.3	25.4	23.9	23.2	23.2
Compensation for employees	1,008	1,159	1,118	1,091	1,166	1,224	1,286	1,417	5.3	5.7	6.1	5.7	5.6	5.3	5.1	5.1
Use of goods and services	1,607	966	971	891	830	865	1,001	1,103	8.4	4.8	5.3	4.7	4.0	3.8	4.0	4.0
Subsidies	512	449	465	457	450	396	392	433	2.7	2.2	2.5	2.4	2.2	1.7	1.6	1.6
Grants	12	14	16	10	14	16	18	19	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social expenses	1,379	1,376	1,499	1,586	1,692	1,776	1,864	2,055	7.2	6.8	8.2	8.3	8.1	7.7	7.4	7.4
Other expenses	789	1,143	1,204	942	839	852	893	984	4.1	5.6	6.6	4.9	4.0	3.7	3.5	3.5
Of which : arrears clearance	22	190	220	25	0	0	0	0	0.1	0.9	1.2	0.1	0.0	0.0	0.0	0.0
Interest	121	213	183	226	296	339	418	450	0.6	1.1	1.0	1.2	1.4	1.5	1.7	1.6
To nonresidents	64	155	123	133	182	195	243	221	0.3	0.8	0.7	0.7	0.9	0.9	1.0	0.8
To residents	56	58	60	94	114	144	175	230	0.3	0.3	0.3	0.5	0.5	0.6	0.7	0.8
Operating balance	427	643	-29	-88	314	422	615	685	2.2	3.2	-0.2	-0.5	1.5	1.8	2.4	2.5
Capital spending and net lending	1,636	1,784	1,698	1,305	1,320	1,338	1,347	1,497	8.6	8.8	9.3	6.9	6.3	5.8	5.3	5.4
Capital	1,524	1,633	1,605	1,301	1,300	1,318	1,327	1,477	8.0	8.1	8.8	6.8	6.3	5.8	5.3	5.3
Net lending	111	151	92	4	20	20	20	20	0.6	0.7	0.5	0.0	0.1	0.1	0.1	0.1
Overall balance	-1,208	-1,141	-1,726	-1,393	-1,006	-917	-732	-812	-6.3	-5.6	-9.4	-7.3	-4.8	-4.0	-2.9	-2.9
Statistical discrepancy	36	0	0	0	0	0	0	0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total financing	1,173	1,141	1,726	1,393	1,006	917	732	812	6.2	5.6	9.4	7.3	4.8	4.0	2.9	2.9
Domestic	-483	454	511	0	342	229	373	725	-2.5	2.2	2.8	0.0	1.6	1.0	1.5	2.6
Borrowing	0	0	160	606	845	692	782	1,176	0.0	0.0	0.9	3.2	4.1	3.0	3.1	4.2
Amortization 3/	-33	-68	-37	-535	-503	-462	-409	-451	-0.2	-0.3	-0.2	-2.8	-2.4	-2.0	-1.6	-1.6
Use of deposits at the NBG and banks	-450	522	388	-71	0	0	0	0	-2.4	2.6	2.1	-0.4	0.0	0.0	0.0	0.0
External	950	419	765	1,211	484	538	259	36	5.0	2.1	4.2	6.4	2.3	2.3	1.0	0.1
Borrowing	1,073	583	909	1,343	601	643	1,603	652	5.6	2.9	5.0	7.1	2.9	2.8	6.3	2.3
Of which: IMF			166	664							0.9	3.5				
Amortization	-66	-204	-185	-132	-117	-106	-1,344	-616	-0.3	-1.0	-1.0	-0.7	-0.6	-0.5	-5.3	-2.2
Use of Sovereign Wealth Fund resources	-57	40	40	0	0	0	0	0	-0.3	0.2	0.2	0.0	0.0	0.0	0.0	0.0
Privatization receipts	706	269	451	182	180	150	100	50	3.7	1.3	2.5	1.0	0.9	0.7	0.4	0.2
Memorandum items:																
Nominal GDP	19,070	20,231	18,303	19,042	20,794	22,926	25,276	27,866								
Fiscal deficit excluding grants	1,790	1,836	2,281	1,670	1,283	1,075	875	938	9.4	9.1	12.5	8.8	6.2	4.7	3.5	3.4
Total expenditures (current prices)	6,951	6,951	7,060	6,504	6,587	6,787	7,199	7,940	36.5	34.4	38.6	34.2	31.7	29.6	28.5	28.5
Total expenditures (constant 2008 prices)	6,951		7,062	6,378	6,151	6,036	6,098	6,405								
Net T-bill issuance			160	106							0.9	0.6				

Sources: Ministry of Finance of Georgia; and Fund staff estimates.

1/ General government includes central and local governments and the Sovereign Wealth Funds.
2/ Adjusted to take into account the reclassification of expenditures applied by the authorities (GFS 2001).
3/ Excluding arrears clearance.

Table 3. Georgia: Quarterly General Government Operations, 2009 1/

	2009				
	Q1 Act.	Q2 Act.	Q3 Proj.	Q4 Proj.	Annual Proj.
	(In millions of lari)				
Revenues	1,267	1,118	1,294	1,747	5,426
Taxes	1,139	996	1,091	1,231	4,457
Direct	458	452	438	440	1,787
Indirect	681	544	653	792	2,670
Other revenues	79	84	80	171	414
Grants	48	38	123	345	554
Current expenditures	1,296	1,300	1,358	1,501	5,455
Compensation for employees	248	260	280	329	1,118
Use of goods and services	207	273	230	261	971
Subsidies	87	105	157	117	465
Grants	7	3	2	4	16
Social expenses	352	377	375	396	1,499
Other expenses	370	226	280	328	1,204
Of which : arrears clearance	171	5	15	29	220
Interest	26	56	34	66	183
To nonresidents	13	40	20	50	123
To residents	13	16	14	16	60
Operating balance	-30	-182	-64	247	-29
Capital spending and net lending	199	338	531	630	1,698
Capital	169	333	487	617	1605
Net lending	30	5	44	13	92
Overall balance	-228	-520	-595	-383	-1,726
Statistical discrepancy	0	0	0	0	0
Total financing	228	520	595	383	1,726
Domestic	63	375	32	41	511
Borrowing	0	0	60	100	160
Amortization 2/	-9	-11	-12	-5	-37
Use of deposits at the NBG and banks	72	386	-16	-54	388
External	64	40	508	153	765
Borrowing	37	60	574	239	909
Of which : IMF	0	0	82	84	166
Amortization	-13	-20	-66	-86	-185
Use of Sovereign Wealth Fund resources	40	0	0	0	40
Privatization receipts	101	106	55	189	451
Memorandum items:					
Nominal GDP	3,848	4,484	4,825	5,147	18,303
Net T-bill issuance	0	0	60	100	160

Sources: Ministry of Finance of Georgia; and Fund staff estimates.

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

2/ Excluding arrears clearance.

Table 4. Georgia: Summary Balance of Payments, 2007-14
(In millions of U.S. dollars)

	2007	2008	2009		2010		2011	2012	2013	2014
			Country Rep. No. 09/127	Proj.	Country Rep. No. 09/127	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-2,009	-2,915	-1,879	-1,768	-2,096	-1,782	-1,813	-1,837	-1,838	-1,795
Trade balance	-2,896	-3,833	-3,115	-2,733	-3,332	-2,888	-2,961	-3,027	-3,081	-3,150
Exports	2,088	2,428	1,748	1,717	2,190	1,915	2,152	2,399	2,656	2,911
Imports	-4,984	-6,261	-4,863	-4,450	-5,521	-4,804	-5,113	-5,426	-5,736	-6,062
Services	161	23	209	211	363	307	370	434	506	576
Income (net)	37	-166	-82	-99	-32	-52	-81	-92	-118	-108
Of which : interest payments	-121	-249	-287	-271	-293	-295	-331	-348	-375	-362
Transfers (net)	688	1,061	1,110	853	904	851	860	849	855	887
Of which : public sector	138	365	452	265	162	151	118	79	53	52
Capital account	128	105	133	211	148	140	92	80	71	62
Financial account	2,323	2,806	1571	1,386	2,044	1,522	1,844	2,009	2,003	2,060
Direct investment (net)	1,675	1,523	1,032	907	1,240	1,046	1,222	1,378	1,490	1,587
Monetary authorities, net	-101	21	0	5	0	0	0	0	0	0
General government	116	652	235	376	511	309	263	294	269	250
Private Sector, excl. FDI	633	610	304	98	294	167	359	337	243	223
Banks	569	402	52	31	229	69	269	320	204	207
Portfolio investment, net	21	109	9	-2	84	58	95	100	105	55
Of which : equity liabilities	34	101	9	-2	14	8	30	30	30	30
Loans received (net)	653	595	-168	-312	59	-53	64	110	-1	72
Other, net (currency and deposits)	-105	-302	211	345	85	65	110	110	100	80
Other sectors	64	207	252	67	65	98	90	16	39	16
Portfolio investment, net	0	14	32	17	34	38	20	32	35	48
Long-term loans received (net)	95	58	287	122	5	31	27	-19	-19	-50
Other, net	-31	136	-67	-72	26	28	43	4	24	18
Errors and omissions	-34	-48	0	20	0	0	0	0	0	0
Overall balance	408	-51	-175	-151	97	-120	124	252	236	326
Financing	-408	51	175	151	-97	120	-124	-252	-236	-326
Gross International Reserves (-increase)	-377	-131	10	-230	-75	-234	-173	-9	174	37
Use of Fund Resources	3	222	164	381	-22	354	48	-243	-410	-363
Purchases (SBA)	43	257	192	408	0	375	106	0	0	0
Of which: proposed augmentation	...	...	...	...	...	303	106	...	...	...
Repayments (SBA and PRGF)	-39	-35	-27	-27	-22	-21	-58	-243	-410	-363
Exceptional financing	-34	-39	0	1	0	0	0	0	0	0
Memorandum items:										
Nominal GDP	10,227	12,864	11,269	10,981	11,881	10,761	11,311	12,291	13,293	14,377
Current account balance (percent of GDP)	-19.6	-22.7	-16.7	-16.1	-17.6	-16.6	-16.0	-14.9	-13.8	-12.5
excluding official transfers (percent of GDP)	-21.0	-25.5	-20.7	-18.5	-19.0	-18.0	-17.1	-15.6	-14.2	-12.9
Trade balance (in percent of GDP)	-28.3	-29.8	-27.6	-24.9	-28.0	-26.8	-26.2	-24.6	-23.2	-21.9
GNFS exports growth (percent)	24.7	15.9	-19.3	-20.1	24.7	12.0	11.8	10.8	10.1	9.1
GNFS exports volume growth (percent)	4.7	-2.0	-4.9	-8.2	14.9	9.1	8.5	7.9	7.6	7.2
GNFS imports growth (percent)	34.1	26.7	-21.8	-27.1	13.4	7.5	6.8	6.4	5.9	5.8
GNFS imports volume growth (percent)	11.9	6.7	-7.9	-14.6	6.5	2.1	3.6	4.5	4.3	4.3
Net capital inflows to private sector	2,308	2,133	1,336	1,005	1,534	1,213	1,581	1,714	1,733	1,810
(in percent of GDP)	22.6	16.6	11.9	9.1	12.9	11.3	14.0	13.9	13.0	12.6
Gross international reserves (end of period)	1,361	1,480	1,470	1,708	1,545	1,942	2,115	2,124	1,950	1,913
(in months of next year GNFS imports)	2.2	3.2	2.7	3.5	2.6	3.7	3.8	3.6	3.1	2.9
External debt (nominal) 1/	3,613	5,345	4,851	6,016	5,599.0	6,868	7,359	7,518	7,496	7,541
(in percent of GDP)	35.3	41.5	43.0	54.8	47.1	63.8	65.1	61.2	56.4	52.5
MLT External debt service 1/ 2/	389	612	...	970	875	796	953	1,191	2,095	1,447
(in percent of exports)	12.2	16.6	...	32.9	24.0	24.1	25.8	29.1	46.6	29.5
External public sector debt (nominal)	1,790	2,691	2,935	3,509	3,556	4,306	4,638	4,722	4,613	4,527
(in percent of GDP)	17.5	20.9	26.0	32.0	29.9	40.0	41.0	38.4	34.7	31.5
External public debt service	111	125	227	221	189	181	243	440	1,152	607
(in percent of exports)	3.5	3.4	7.8	7.5	5.2	5.5	6.6	10.8	25.6	12.4

Sources: Georgian authorities; and Fund staff estimates.

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

2/ Includes interest on short-term debt.

Table 5. Georgia: Accounts of the National Bank of Georgia, 2008–10

	2008				2009				2010
	Mar.	Jun.	Sep.	Dec.	Mar. Act.	Jun. Act.	Sep. Proj.	Dec. Proj.	Dec. Proj.
					(In millions of lari)				
Net foreign assets	1,500	1,594	1,266	1,528	1,313	1,303	1,461	1,470	2,030
Gross International Reserves	2,099	2,164	1,930	2,467	2,493	2,517	2,835	2,920	3,553
Other foreign assets	76	70	87	41	35	14	14	14	14
Foreign liabilities	-675	-640	-750	-981	-1,215	-1,228	-1,389	-1,465	-1,537
Of which : use of Fund resources	-361	-342	-655	-769	-1,040	-1,068	-1,198	-1,261	-1,304
Of which : compulsory reserves in USD	-282	-296	-88	-121	-125	-109	-109	-121	-148
Of which : swap liabilities	0	0	0	0	0	-30	-60	-62	-64
Net domestic assets	-87	6	468	-96	-47	226	239	177	-186
Net claims on general government	315	149	400	-103	-34	398	382	328	257
Claims on general government (incl. T-bills)	776	776	778	777	777	778	778	778	778
Nontradable govt. debt	689	689	689	689	641	641	641	641	641
Securitized debt (marketable)	87	87	89	88	136	137	137	137	137
Deposits	-461	-627	-377	-880	-812	-380	-396	-450	-521
Claims on rest of economy	3	3	3	4	4	4	4	4	4
Claims on banks	-392	-180	-18	132	90	-17	-55	-15	-195
Certificates of deposits and bonds	-467	-180	-143	-77	-114	-148	-135	-115	-255
Other items, net	-13	34	82	-129	-106	-160	-92	-141	-252
Reserve money	1,414	1,600	1,734	1,432	1,267	1,529	1,700	1,647	1,844
Currency in circulation	1,287	1,413	1,399	1,291	1,141	1,201	1,300	1,300	1,500
Bank lari reserves 1/	126	187	335	141	126	328	400	347	344
					(Percent contribution, compared to reserve money at the end of previous year)				
Net foreign assets	2.7	8.9	-13.0	4.5	-15.0	-15.7	-4.7	-4.1	34.0
Net domestic assets	-8.3	-2.2	28.7	-8.9	3.4	22.5	23.4	19.1	-22.0
Net claims on general government	-0.9	-12.0	4.8	-28.8	4.8	35.0	33.9	30.1	-4.3
Claims on rest of economy	-6.6	-6.6	-6.6	-6.6	0.0	0.0	0.0	0.0	0.0
Claims on banks	-5.9	8.2	19.1	29.1	-2.9	-10.4	-13.0	-10.2	-10.9
Other items, net	5.1	8.2	11.5	-2.6	1.6	-2.2	2.6	-0.8	-6.8
					(Percentage change, relative to end of previous year)				
Reserve money	-5.7	6.8	15.7	-4.5	-11.5	6.8	18.7	15.0	12.0
Currency in circulation	-1.8	7.8	6.8	-1.5	-11.6	-6.9	0.7	0.7	15.4
Bank lari reserves 1/	-32.4	0.0	79.3	-24.5	-11.0	132.0	183.1	145.5	-0.7
Memorandum items:									
Net international reserves									
(in millions of USD, at prog. exchange rates)	…	1,055	848	909	777	775	813	740	609
Net domestic assets (in millions of lari, at prog. exchange rate)	…	42	452	116	-66	189	344	413	829
Reserve money (in percent, 12-month growth)	22.6	22.4	25.7	-4.5	-10.4	-4.5	-2.0	15.0	12.0

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

1/ Comprises of required and excess reserves on lari-denominated deposits.

Table 6. Georgia: Monetary Survey, 2008–10

	2008				2009				2010
	Mar.	Jun.	Sep.	Dec.	Mar. Act.	Jun. Act.	Sep. Proj.	Dec. Proj.	Dec. Proj.
	(In millions of lari)								
Net foreign assets	481	256	-306	79	-356	-357	-229	-150	213
NBG	1,783	1,890	1,355	1,649	1,438	1,442	1,630	1,653	2,242
Commercial banks	-1,301	-1,634	-1,660	-1,570	-1,794	-1,800	-1,859	-1,803	-2,029
Net domestic assets	3,545	3,932	4,272	4,179	4,031	3,952	3,996	4,324	4,586
Domestic credit	5,336	5,682	5,846	5,921	5,644	5,733	5,710	6,085	6,459
Net claims on general government	265	85	339	-155	-114	270	314	360	395
Of which : government deposits at NBG	-461	-627	-377	-880	-812	-380	-396	-450	-521
Of which : T-bills at commercial banks							60	160	266
Credit to the rest of the economy	5,071	5,598	5,507	6,076	5,758	5,462	5,395	5,725	6,064
Other items, net	-1,791	-1,750	-1,574	-1,742	-1,613	-1,781	-1,713	-1,762	-1,873
Broad money (M3)	4,027	4,188	3,966	4,258	3,675	3,594	3,767	4,173	4,799
Broad money, excl. forex deposits (M2)	2,259	2,417	2,257	1,854	1,634	1,709	1,880	2,082	2,245
Currency held by the public	1,123	1,235	1,196	1,083	960	1,020	1,216	1,384	1,450
Total deposit liabilities	2,904	2,952	2,769	3,176	2,715	2,574	2,551	2,789	3,349
	(Percent contribution, compared to broad money at the end of previous year)								
Net foreign assets	5.2	-0.5	-14.6	-4.9	-10.2	-10.3	-7.2	-5.4	8.7
Net domestic assets	-4.0	5.7	14.2	11.9	-3.5	-5.3	-4.3	3.4	6.3
Domestic credit	7.6	16.3	20.4	22.3	-6.5	-4.4	-5.0	3.9	9.0
Net claims on general government	-0.7	-5.2	1.1	-11.3	1.0	10.0	11.0	12.1	0.8
Credit to the rest of the economy	8.3	21.6	19.3	33.6	-7.5	-14.4	-16.0	-8.3	8.1
Other items, net	-11.7	-10.7	-6.2	-10.5	3.0	-0.9	0.7	-0.5	-2.7
	(Percentage change, relative to end of previous year)								
Broad money (M3)	1.2	5.2	-0.4	7.0	-13.7	-15.6	-11.5	-2.0	15.0
Broad money, excl. forex deposits (M2)	6.0	13.4	5.9	-13.0	-11.9	-7.8	1.4	12.3	7.8
Currency held by the public	-2.5	7.2	3.9	-6.0	-11.3	-5.7	12.4	27.9	4.7
Total deposit liabilities	2.7	4.4	-2.1	12.3	-14.5	-19.0	-19.7	-12.2	20.1
Credit to the rest of the economy	7.0	18.1	16.2	28.2	-5.2	-10.1	-11.2	-5.8	5.9
Memorandum items:									
M3 (in percent, 12-month growth)	50.6	28.9	6.9	7.0	-8.7	-14.2	-5.0	-2.0	15.0
M2 (in percent, 12-month growth)	65.4	46.8	17.1	-13.0	-27.7	-29.3	-16.7	12.3	7.8
Credit to the economy (in percent, 12-month growth)	62.4	53.9	28.3	28.2	13.6	-2.4	-2.0	-5.8	5.9
Ratio of bank lari reserves to M2	5.59	7.74	14.85	7.61	7.69	19.17	21.27	16.65	15.34
M3 multiplier	2.20	2.07	2.13	2.61	2.49	2.10	2.00	2.25	2.27
M3 velocity	4.41	4.46	4.78	4.48	5.10	5.07	4.85	4.39	3.97
Foreign exchange deposits in percent of total deposits	60.9	60.0	61.7	75.7	75.2	73.2	74.0	75.0	76.3

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

Table 7. Georgia: External Vulnerability Indicators, 2007-14

	2007 Act.	2008 Act.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.
Value of exports of goods and services, percent change	24.7	15.9	-20.1	12.0	11.8	10.8	10.1	9.1
Value of imports of goods and services, percent change	34.1	26.7	-27.1	7.5	6.8	6.4	5.9	5.8
Terms of trade (deterioration -)	-0.5	-0.5	1.9	-2.6	-0.1	0.9	0.7	0.3
Current account balance (percent of GDP)	-19.6	-22.7	-16.1	-16.6	-16.0	-14.9	-13.8	-12.5
Capital and financial account (percent of GDP)	24.0	22.6	14.5	15.4	17.1	17.0	15.6	14.8
External public debt (percent of GDP)	17.5	20.9	32.0	40.0	41.0	38.4	34.7	31.5
(in percent of exports of goods and services)	56.2	73.0	119.1	130.5	125.7	115.6	102.6	92.3
Debt service on external public debt								
(in percent of exports of goods and services)	3.5	3.4	7.5	5.5	6.6	10.8	25.6	12.4
External debt (percent of GDP)	35.3	41.5	54.8	63.8	65.1	61.2	56.4	52.5
(in percent of exports of goods and services)	113.5	144.9	204.2	208.2	199.5	184.0	166.7	153.7
Debt service on MLT external debt								
(in percent of exports of goods and services)	12.2	16.6	32.9	24.1	25.8	29.1	46.6	29.5
Gross international reserves								
in millions of USD	1,361	1,480	1,708	1,942	2,115	2,124	1,950	1,913
in months of next year's imports of goods and servces	2.2	3.2	3.5	3.7	3.8	3.6	3.1	2.9
in percent of external debt	37.7	27.7	28.4	28.3	28.7	28.2	26.0	25.4
in percent of short-term external debt	232	165	...	...	...	...	...	...
in percent of short-term external debt 1/	752	392	...	...	...	...	...	...

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, 2007-2017
(In millions of SDR)

	2007	2008	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.
Existing Fund credit											
Stock 1/	159.2	298.8	407.0	392.9	354.8	206.7	63.4	29.4	14.0	4.2	0.0
PRGF	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	287.9	287.9	267.7	139.5	15.8	0.0	0.0	0.0	0.0
Obligations	26.7	23.3	22.2	18.6	42.6	151.8	145.1	34.3	15.5	9.8	4.2
PRGF	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	3.6	3.8	24.0	131.4	125.2	15.9	0.0	0.0	0.0
Prospective purchases under the SBA											
Disbursements	...	...	141.9	247.3	70.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	...	...	141.9	389.2	459.2	447.4	321.2	116.5	13.1	0.0	0.0
Obligations 2/	...	...	0.3	3.2	5.6	17.8	131.6	208.0	104.4	13.2	0.0
Principal (repurchases)	...	...	0.0	0.0	0.0	11.8	126.2	204.7	103.4	13.1	0.0
GRA charges	...	...	0.3	3.2	5.6	6.0	5.4	3.3	1.0	0.1	0.0
Surcharges	...	...	0.0	1.8	5.3	5.0	1.9	0.0	0.0	0.0	0.0
Stock of existing and prospective Fund credit 1/	159.2	298.8	548.9	782.1	814.0	654.1	384.6	145.9	27.1	4.2	0.0
In percent of quota	105.9	198.8	365.2	520.4	541.6	435.2	255.9	97.1	18.0	2.8	0.0
In percent of GDP	2.4	3.7	7.6	11.0	10.9	8.1	4.4	1.5	0.3	0.0	0.0
In percent of exports of goods and nonfactor services	7.7	12.8	28.3	36.0	33.4	24.3	13.0	4.5	0.8	0.1	0.0
In percent of gross reserves	17.9	31.9	48.8	61.1	58.3	46.7	30.0	11.6	2.0	0.3	0.0
In percent of public external debt	13.6	17.5	23.7	27.6	26.6	21.0	12.7	4.9	0.9	0.1	0.0
Obligations to the Fund from existing and prospective Fund credit 2/	26.7	23.3	22.5	23.6	53.5	174.7	278.6	242.2	119.9	23.1	4.2
In percent of quota	17.8	15.5	15.0	15.7	35.6	116.2	185.3	161.2	79.8	15.3	2.8
In percent of GDP	0.4	0.3	0.3	0.3	0.7	2.2	3.2	2.6	1.2	0.2	0.0
In percent of exports of goods and nonfactor services	1.3	1.0	1.2	1.1	2.2	6.5	9.4	7.5	3.4	0.6	0.1
In percent of gross reserves	3.0	2.5	2.0	1.8	3.8	12.5	21.7	19.3	8.8	1.5	0.3
In percent of public external debt service	36.9	29.4	15.5	19.8	33.3	60.2	36.8	60.8	30.8	7.5	1.2

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

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

Table 9. Georgia: Schedule of Prospective Reviews and Purchases 1/

Availability Date	Condition	Available Purchases (In millions of SDR)	Available Purchases (In percent of quota)
15-Sep-08	Approve the 18-month arrangement	161.7	107.6
15-Dec-08	Complete the first review based on end-September 2008 performance criteria and other relevant performance criteria 2/	63.1	42.0
23-Mar-09	Complete the second review based on end-December 2008 performance criteria and other relevant performance criteria 2/	63.1	42.0
6-Aug-09	Complete the third review based on end-June 2009 performance criteria and other relevant performance criteria	94.6	62.9
15-Nov-09	Complete the fourth review based on end-September 2009 performance criteria and other relevant performance criteria	47.3	31.5
15-Feb-10	Complete the fifth review based on end-December 2009 performance criteria and other relevant performance criteria	97.3	64.7
15-May-10	Complete the sixth review based on end-March 2010 performance criteria and other relevant performance criteria	50.0	33.3
15-Aug-10	Complete the seventh review based on end-June 2010 performance criteria and other relevant performance criteria	50.0	33.3
15-Nov-10	Complete the eighth review based on end-September 2010 performance criteria and other relevant performance criteria	50.0	33.3
15-Feb-11	Complete the ninth review based on end-December 2010 performance criteria and other relevant performance criteria	35.0	23.3
15-May-11	Complete the tenth review based on end-March 2011 performance criteria and other relevant performance criteria	35.0	23.3
Total available		747.1	497.1

1/ Reflects the authorities' request to augment the access by SDR270 million and extend the arrangement through June 2011.

2/ As the authorities did not draw the purchase that became available at the time of the first review, SDR 126.2 million were available and purchased at the second review.

Table 10. Georgia: External Financing Requirements and Sources, 2007–14

(In millions of U.S. dollars)

	2007	2008	2009	2010	2011	2012	2013	2014
Total requirements	-2,277	-3,278	-2,466	-2,283	-2,434	-2,680	-3,557	-2,880
Current account deficit	-2,009	-2,915	-1,768	-1,782	-1,813	-1,837	-1,838	-1,795
Capital outflows: Repayments of MLT loans	-268	-363	-699	-501	-622	-843	-1,720	-1,085
Total sources	2,277	3,278	2,466	2,283	2,434	2,680	3,557	2,880
Capital flows	2,645	3,191	2,288	2,142	2,501	2,689	3,383	2,843
Public sector	128	796	691	515	410	405	893	376
Project grants	68	87	202	131	83	60	50	40
Long-term loan disbursements to public sector	156	227	466	384	327	345	343	336
Other 1/	-96	482	23	0	0	0	500	0
Private sector	2,518	2,395	1,597	1,627	2,091	2,284	2,490	2,467
Foreign direct investment in Georgia	1,750	1,564	907	1,046	1,222	1,378	1,490	1,612
Long-term loan disbursements to private sector	849	756	577	425	500	576	672	672
Other net inflows 2/	-81	75	113	156	369	330	328	183
Financing	9	218	409	375	106	0	0	0
IMF 3/	43	257	408	375	106	0	0	0
Change in arrears, net (- decrease)	-29	-10	-1	0	0	0	0	0
Advance Repayments	-14	-29	-1	0	0	0	0	0
Change in reserves (- increase)	-377	-131	-230	-234	-173	-9	174	37
Memorandum items:				(In percent of GDP)				
Total financing requirements	-22.3	-25.5	-22.5	-21.2	-21.5	-21.8	-26.8	-20.0
Total sources	22.3	25.5	22.5	21.2	21.5	21.8	26.8	20.0
Capital inflows	25.9	24.8	20.8	19.9	22.1	21.9	25.5	19.8
Exceptional financing	0.1	1.7	3.7	3.5	0.9	0.0	0.0	0.0
Change in reserves (- increase)	-3.7	-1.0	-2.1	-2.2	-1.5	-0.1	1.3	0.3

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

1/ Including the receipts and the repayment of the Eurobond-2013.

2/ Including errors and omissions.

3/ PRGF disbursements in 2006 and 2007, SBA purchases from 2008 on, including requested augmentation in 2010-11.

Table 11. Georgia: Public External Debt, 2007-09

	Dec-07	Dec-08	Jun-09	Dec-07	Dec-08	Jun-09
	(In millions of U.S. dollars)			(In percent of GDP)		
Total	1,790	2,691	2,925	17.5	20.9	26.6
Multilateral	1,253	1,650	1,879	12.3	12.8	17.1
WB - IDA	883	988	1,016	8.6	7.7	9.3
IMF	249	465	647	2.4	3.6	5.9
Other	120	197	216	1.2	1.5	2.0
Bilateral	523	531	538	5.1	4.1	4.9
Paris Club	385	400	412	3.8	3.1	3.7
Non Paris Club	138	131	127	1.4	1.0	1.2
Other	14	510	508	0.1	4.0	4.6
Eurobond	-	500	500	-	3.9	4.6
Guaranteed	14	10	8	0.1	0.1	0.1

Source: Ministry of Finance of Georgia.

Table 12. Georgia: Private External Debt, 2006-09

	Dec-06	Dec-07	Dec-08	Mar-09	Dec-06	Dec-07	Dec-08	Mar-09
	(In millions of U.S. dollars)				(In percent of GDP)			
Total Private debt 1/	992	1,823	2,653	2,816	12.8	17.8	20.6	21.9
Banks	549	1,295	1,874	1,737	7.1	12.7	14.6	13.5
Short-term	221	400	566	404	2.9	3.9	4.4	3.1
Of which : Loans	83	164	355	214	1.1	1.6	2.8	1.7
Of which : Currency and deposits 2/	139	233	209	187	1.8	2.3	1.6	1.5
Long-term	327	895	1,308	1,333	4.2	8.8	10.2	10.4
Of which : Loans	327	895	1,308	1,333	4.2	8.8	10.2	10.4
Other Sectors	443	528	779	1,079	5.7	5.2	6.1	8.4
Short-term	204	185	332	359	2.6	1.8	2.6	2.8
Of which : Trade credits	165	146	293	292	2.1	1.4	2.3	2.3
Long-term	239	342	446	720	3.1	3.3	3.5	5.6
Of which : Loans	239	342	446	720	3.1	3.3	3.5	5.6
Direct Investment: Intercompany Lending	827	1,686	1,928	2,019	10.6	16.5	15.0	15.7

Source: National Bank of Georgia.

1/ Excluding intercompany debt from foreign direct investors.

2/ In line with the recommendations of the Debt Statistics Manual that all currency and deposits be included in the short-term category unless detailed information is available to make short-term/long-term attribution.

Table 13a. Georgia: External Debt Sustainability Framework, Baseline Scenario, 2006-2029 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009-2014 Average	2019	2029	2015-2029 Average
External debt (nominal) 1/	**34.6**	**35.3**	**41.5**			**54.8**	**63.8**	**65.1**	**61.2**	**56.4**	**52.5**		**41.9**	**28.9**	
o/w public and publicly guaranteed (PPG)	21.9	17.5	20.9			32.0	40.0	41.0	38.4	34.7	31.5		24.6	15.8	
Change in external debt	2.0	0.7	6.2			13.2	9.0	1.2	-3.9	-4.8	-3.9		-1.2	-1.2	
Identified net debt-creating flows	-5.8	-4.9	4.0			10.3	6.0	3.1	1.0	0.1	-0.9		-1.1	-1.9	
Non-interest current account deficit	**14.3**	**18.5**	**20.7**	**10.7**	**5.8**	**13.6**	**13.7**	**13.1**	**12.1**	**11.0**	**10.0**		**8.6**	**5.8**	7.7
Deficit in balance of goods and services	24.0	26.7	29.6			23.0	24.0	22.9	21.1	19.4	17.9		15.1	10.3	
Exports	32.9	31.1	28.7			26.8	30.7	32.6	33.2	33.8	34.1		34.7	35.7	
Imports	56.8	57.9	58.3			49.8	54.6	55.5	54.3	53.2	52.0		49.8	46.0	
Net current transfers (negative = inflow)	-6.7	-6.7	-8.2	-6.5	1.3	-7.8	-7.9	-7.6	-6.9	-6.4	-6.2		-5.2	-3.7	-4.7
o/w official	-1.8	-1.4	-2.8			-2.4	-1.4	-1.0	-0.6	-0.4	-0.4		-0.2	-0.1	
Other current account flows (negative = net inflow)	-2.9	-1.5	-0.6			-1.6	-2.4	-2.2	-2.1	-1.9	-1.8		-1.3	-0.8	
Net FDI (negative = inflow)	**-15.3**	**-16.4**	**-11.8**	**-9.1**	**4.7**	**-8.3**	**-9.7**	**-10.8**	**-11.2**	**-11.2**	**-11.0**		**-10.0**	**-8.1**	-9.4
Endogenous debt dynamics 2/	**-4.8**	**-6.9**	**-4.9**			**4.9**	**2.1**	**0.8**	**0.1**	**0.3**	**0.2**		**0.3**	**0.4**	
Contribution from nominal interest rate	0.9	1.4	2.3			3.0	3.2	3.2	3.1	3.1	2.8		2.3	1.8	
Contribution from real GDP growth	-2.5	-3.3	-0.6			1.9	-1.1	-2.4	-3.0	-2.8	-2.6		-2.0	-1.4	
Contribution from price and exchange rate changes	-3.2	-5.1	-6.7			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**7.7**	**5.5**	**2.3**			**3.0**	**3.0**	**-1.8**	**-4.9**	**-4.9**	**-3.1**		**0.0**	**0.7**	
o/w exceptional financing	1.0	0.3	0.3			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	36.0			47.0	54.9	56.3	53.7	50.3	46.4		37.0	26.6	
In percent of exports	...	...	125.4			175.2	179.2	172.7	161.6	148.8	136.0		106.9	74.5	
PV of PPG external debt	**...**	**...**	**15.3**			**24.2**	**31.1**	**32.3**	**31.0**	**28.7**	**25.4**		**19.8**	**13.5**	
In percent of exports	**...**	**...**	**53.5**			**90.1**	**101.5**	**99.0**	**93.1**	**84.7**	**74.6**		**57.1**	**37.7**	
In percent of government revenues	**...**	**...**	**55.9**			**90.8**	**122.5**	**126.1**	**123.9**	**114.1**	**101.0**		**75.5**	**48.7**	
Debt service-to-exports ratio (in percent)	**11.8**	**12.2**	**16.6**			**32.9**	**24.5**	**25.8**	**29.1**	**46.6**	**29.5**		**21.1**	**17.0**	
PPG debt service-to-exports ratio (in percent)	**8.0**	**3.5**	**3.4**			**7.5**	**5.9**	**6.6**	**10.8**	**25.6**	**12.4**		**6.1**	**5.5**	
PPG debt service-to-revenue ratio (in percent)	**10.3**	**3.8**	**3.6**			**7.5**	**7.1**	**8.4**	**14.3**	**34.5**	**16.7**		**8.1**	**7.0**	
Total gross financing need (Billions of U.S. dollars)	0.4	1.0	2.3			2.5	1.8	1.8	2.0	2.8	2.1		2.0	2.9	
Non-interest current account deficit that stabilizes debt ratio	12.3	17.8	14.5			0.4	4.7	11.9	16.0	15.8	13.9		9.8	7.0	
Key macroeconomic assumptions															
Real GDP growth (in percent)	9.4	12.4	2.1	6.5	3.8	-4.0	2.0	4.0	5.0	5.0	5.0	2.8	5.0	5.0	5.0
GDP deflator in US dollar terms (change in percent)	10.7	17.1	23.2	11.7	8.8	-11.1	-3.9	1.1	3.5	3.0	3.0	-0.7	3.0	3.0	3.0
Effective interest rate (percent) 5/	3.2	5.3	8.2	3.0	2.6	6.1	5.7	5.3	5.2	5.5	5.4	5.5	5.7	6.5	6.0
Growth of exports of G&S (US dollar terms, in percent)	16.6	24.7	15.9	18.6	14.8	-20.1	12.0	11.8	10.8	10.1	9.1	5.6	8.5	8.5	8.5
Growth of imports of G&S (US dollar terms, in percent)	33.0	34.1	26.7	19.1	17.0	-27.1	7.5	6.8	6.4	5.9	5.8	0.9	7.2	7.3	7.3
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	18.1	16.6	19.8	21.3	6.9	20.3	17.2	14.1	11.3	13.6
Government revenues (excluding grants, in percent of GDP)	25.5	28.6	27.5			26.6	25.4	25.6	25.0	25.1	25.2		26.2	27.7	26.7
Aid flows (in Billions of US dollars) 7/	0.2	0.2	0.6			0.8	0.5	0.5	0.4	0.4	0.4		0.4	0.4	
o/w Grants	0.1	0.1	0.4			0.3	0.2	0.2	0.1	0.1	0.1		0.1	0.1	
o/w Concessional loans	0.1	0.2	0.2			0.5	0.4	0.3	0.3	0.3	0.3		0.3	0.4	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			4.5	2.8	2.1	1.4	1.0	1.0		0.7	0.3	0.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			40.0	29.1	39.7	35.2	14.1	31.5		22.1	16.0	20.7
Memorandum items:															
Nominal GDP (Billions of US dollars)	7.8	10.2	12.9			11.0	10.8	11.3	12.3	13.3	14.4		21.3	46.6	
Nominal dollar GDP growth	21.1	31.7	25.8			-14.6	-2.0	5.1	8.7	8.2	8.1	2.2	8.2	8.2	8.2
PV of PPG external debt (in Billions of US dollars)			2.0			2.7	3.3	3.7	3.8	3.8	3.7		4.2	6.3	
(PVt-PVt-1)/GDPt-1 (in percent)						**5.3**	**6.3**	2.8	1.4	0.0	-1.1	2.4	1.3	0.4	0.7

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that PV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table13b. Georgia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009-2029

(In percent)

	Projections							
	2009	2010	2011	2012	2013	2014	**2019**	2029
PV of debt-to GDP ratio								
Baseline	24	31	32	31	29	25	**20**	13
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	24	24	22	19	16	14	**15**	17
A2. New public sector loans on less favorable terms in 2009-2029 2/	24	32	34	32	29	27	**24**	20
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	24	31	32	30	28	24	**18**	12
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	24	33	38	36	33	30	**21**	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	24	29	29	28	25	22	**17**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	24	38	47	45	42	37	**25**	13
B5. Combination of B1-B4 using one-half standard deviation shocks	24	30	31	30	27	24	**17**	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	24	45	46	44	40	35	**26**	18
PV of debt-to-exports ratio								
Baseline	90	102	99	93	85	75	**57**	38
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	90	78	66	57	48	42	**43**	48
A2. New public sector loans on less favorable terms in 2009-2029 2/	90	105	104	97	86	79	**68**	55
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	90	101	97	91	82	71	**52**	34
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	90	116	135	126	114	101	**70**	40
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	90	101	97	91	82	71	**52**	34
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	90	124	143	134	123	109	**71**	35
B5. Combination of B1-B4 using one-half standard deviation shocks	90	111	118	110	100	88	**61**	35
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	90	101	97	91	82	71	**52**	34
PV of debt-to-revenue ratio								
Baseline	91	123	126	124	114	101	**76**	49
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	91	95	84	75	64	56	**57**	62
A2. New public sector loans on less favorable terms in 2009-2029 2/	91	126	132	129	116	107	**90**	71
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	91	121	125	121	111	97	**69**	44
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	91	129	148	144	133	117	**79**	44
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	91	113	114	111	101	88	**63**	40
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	91	150	183	179	166	148	**94**	46
B5. Combination of B1-B4 using one-half standard deviation shocks	91	117	121	118	109	96	**65**	36
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	91	177	180	176	160	140	**100**	63

Table 13b. Georgia:Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009-2029 (continued)

(In percent)

	Projections							
	2009	2010	2011	2012	2013	2014	2019	2029
Debt service-to-exports ratio								
Baseline	7	6	7	11	26	12	**6**	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	7	5	5	7	15	6	**3**	4
A2. New public sector loans on less favorable terms in 2009-2029 2/	7	6	6	8	17	7	**6**	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	7	6	7	11	26	12	**6**	5
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	7	6	8	13	30	15	**8**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	7	6	7	11	26	12	**6**	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	7	6	7	12	27	15	**9**	5
B5. Combination of B1-B4 using one-half standard deviation shocks	7	6	7	12	27	14	**7**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	7	6	7	11	26	12	**6**	5
Debt service-to-revenue ratio								
Baseline	8	7	8	14	35	17	**8**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	8	6	6	9	21	9	**4**	5
A2. New public sector loans on less favorable terms in 2009-2029 2/	8	7	8	10	23	9	**8**	8
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	8	7	8	14	35	17	**8**	6
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	8	7	9	15	35	18	**9**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	8	7	8	13	32	15	**7**	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	8	7	9	16	36	20	**12**	7
B5. Combination of B1-B4 using one-half standard deviation shocks	8	6	7	12	29	15	**8**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	8	10	12	21	50	24	**11**	9
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	11	11	11	11	11	11	**11**	11

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 14a. Georgia:Public Sector Debt Sustainability Framework, Baseline Scenario, 2006-2029

(In percent of GDP, unless otherwise indicated)

	Actual						Projections									
	2005	2006	2007	2008	Average 5/	Standard Deviation 5/	2009	2010	2011	2012	2013	2014	2009-14 Average	2019	2029	2015-29 Average
Public sector debt 1/	34.2	27.6	22.1	25.0			36.9	45.1	47.3	45.2	42.4	41.0		39.1	35.1	
o/w foreign-currency denominated	27.1	21.9	17.5	20.9			32.0	40.0	41.0	38.4	34.7	31.5		24.6	15.8	
Change in public sector debt	-10.6	-6.7	-5.5	2.9			11.9	8.2	2.2	-2.1	-2.9	-1.4		-0.3	0.0	
Identified debt-creating flows	-10.6	-8.0	-6.8	-1.4			10.7	6.8	1.6	-0.5	-1.0	-0.6		-0.3	-0.4	
Primary deficit	0.4	2.2	4.1	5.6	0.8	2.8	8.3	5.9	3.3	2.4	1.1	1.2	3.7	0.9	0.2	0.7
Revenue and grants	24.4	26.7	29.3	30.7			29.6	26.9	26.9	25.7	25.7	25.7		26.5	27.8	
of which: grants	0.9	1.2	0.6	3.2			3.0	1.5	1.3	0.7	0.6	0.5		0.3	0.1	
Primary (noninterest) expenditure	24.8	28.8	33.4	36.3			38.0	32.7	30.2	28.1	26.8	26.9		27.4	28.0	
Automatic debt dynamics	-7.3	-5.0	-5.7	-3.4			4.8	1.9	-0.8	-2.2	-1.8	-1.7		-1.2	-0.6	
Contribution from interest rate/growth differential	-4.3	-3.3	-3.4	-0.7			2.2	0.2	-1.0	-1.7	-1.5	-1.4		-0.8	-0.4	
of which: contribution from average real interest rate	-0.4	-0.4	-0.3	-0.2			1.1	0.9	0.8	0.6	0.7	0.6		1.1	1.3	
of which: contribution from real GDP growth	-3.9	-2.9	-3.0	-0.4			1.0	-0.7	-1.7	-2.3	-2.2	-2.0		-1.9	-1.7	
Contribution from real exchange rate depreciation	-3.1	-1.7	-2.3	-2.7			2.7	1.7	0.2	-0.6	-0.3	-0.2		...	...	
Other identified debt-creating flows	-3.6	-5.2	-5.2	-3.7			-2.5	-1.0	-0.9	-0.7	-0.4	-0.2		0.0	0.0	
Privatization receipts (negative)	-3.6	-5.2	-5.2	-3.7			-2.5	-1.0	-0.9	-0.7	-0.4	-0.2		0.0	0.0	
Residual, including asset changes	0.0	1.3	1.3	4.4			1.1	1.4	0.6	-1.6	-1.8	-0.8		0.0	0.4	
Other Sustainability Indicators																
PV of public sector debt	7.2	5.7	4.6	19.4			29.1	36.2	38.6	37.8	36.3	35.0		34.2	32.8	
o/w foreign-currency denominated	0.0	0.0	0.0	15.3			24.2	31.1	32.3	31.0	28.7	25.4		19.8	13.5	
o/w external	...	...	...	15.3			24.2	31.1	32.3	31.0	28.7	25.4		19.8	13.5	
PV of contingent liabilities (not included in public sector debt)	...	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	5.0	5.7	5.7	7.1			10.9	11.0	8.4	8.6	12.1	7.9		6.0	5.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	29.3	21.3	15.6	63.2			98.1	134.9	143.3	147.1	141.5	136.3		129.2	118.2	
PV of public sector debt-to-revenue ratio (in percent)	30.5	22.4	15.9	70.7			109.3	142.6	150.8	151.2	144.7	138.8		130.6	118.6	
o/w external 3/	…	…	…	55.9			90.8	122.5	126.1	123.9	114.1	101.0		75.5	48.7	
Debt service-to-revenue and grants ratio (in percent) 4/	19.1	13.4	5.5	4.7			8.6	19.0	19.0	24.2	42.8	26.0		19.3	19.2	
Debt service-to-revenue ratio (in percent) 4/	19.8	14.0	5.6	5.3			9.5	20.1	20.0	24.9	43.7	26.4		19.5	19.3	
Primary deficit that stabilizes the debt-to-GDP ratio		8.8	9.6	2.7			-3.5	-2.4	1.1	4.5	4.0	2.6		1.2	0.2	
Key macroeconomic and fiscal assumptions																
Real GDP growth (in percent)	9.6	9.4	12.4	2.1	6.5	3.8	-4.0	2.0	4.0	5.0	5.0	5.0	2.8	5.0	5.0	5.0
Average nominal interest rate on forex debt (in percent)	1.9	1.8	1.6	3.0	1.6	1.2	3.1	2.9	2.7	2.6	3.0	2.6	2.8	2.8	3.4	3.1
Average real interest rate on domestic debt (in percent)	1.6	-0.3	-2.0	-2.4	-0.1	2.2	7.7	8.2	6.4	5.7	5.9	6.5	6.7	5.4	5.5	5.5
Real exchange rate depreciation (in percent, + indicates depreciation)	-9.4	-6.8	-12.2	-15.8	-7.4	7.0	11.8	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	7.9	8.5	9.7	9.9	7.5	2.2	0.0	2.0	5.0	5.0	5.0	5.0	3.7	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.4	0.3	0.3	0.1	0.3	0.1	0.0	-0.1	0.0	0.0	0.0	0.1	0.0	0.1	0.0	0.1
Grant element of new external borrowing (in percent)	...	...	...	...	…	…	18.1	16.6	19.8	21.3	6.9	20.3	17.2	14.1	11.3	...

Sources: Country authorities; and Fund staff estimates and projections.

1/ General government or government guaranteed public debt. In gross terms.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 14b. Georgia:Sensitivity Analysis for Key Indicators of Public Debt 2009-2029

	Projections							
	2009	2010	2011	2012	2013	2014	2019	2029
PV of Debt-to-GDP Ratio								
Baseline	29	36	39	38	36	35	34	33
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	29	29	27	25	23	21	19	21
A2. Primary balance is unchanged from 2009	29	39	48	54	62	69	111	197
A3. Permanently lower GDP growth 1/	29	37	40	40	40	40	51	97
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	29	36	39	38	37	36	36	36
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	29	34	36	36	34	33	32	31
B3. Combination of B1-B2 using one half standard deviation shocks	29	31	32	30	28	26	20	10
B4. One-time 30 percent real depreciation in 2010	29	48	51	50	50	49	51	57
B5. 10 percent of GDP increase in other debt-creating flows in 2010	29	49	51	50	49	47	46	44
PV of Debt-to-Revenue Ratio 2/								
Baseline	98	135	143	147	142	136	129	118
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	98	107	102	96	89	82	72	77
A2. Primary balance is unchanged from 2009	98	146	178	212	241	269	419	708
A3. Permanently lower GDP growth 1/	98	137	148	157	156	157	194	350
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	98	133	144	148	143	139	135	129
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	98	125	135	138	133	128	121	111
B3. Combination of B1-B2 using one half standard deviation shocks	98	116	119	118	109	100	77	36
B4. One-time 30 percent real depreciation in 2010	98	179	188	195	194	191	192	204
B5. 10 percent of GDP increase in other debt-creating flows in 2010	98	181	190	196	190	184	173	159
Debt Service-to-Revenue Ratio 2/								
Baseline	9	19	19	24	43	26	19	19
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	9	18	16	20	36	21	14	12
A2. Primary balance is unchanged from 2009	9	19	20	27	47	33	36	64
A3. Permanently lower GDP growth 1/	9	19	19	25	45	28	24	37
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	9	19	19	24	43	26	20	20
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	9	19	18	23	42	25	19	18
B3. Combination of B1-B2 using one half standard deviation shocks	9	19	17	22	40	23	16	12
B4. One-time 30 percent real depreciation in 2010	9	20	23	31	59	36	27	31
B5. 10 percent of GDP increase in other debt-creating flows in 2010	9	19	22	29	46	29	22	23

Sources: Country authorities; and Fund staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

ATTACHMENT I. GEORGIA: LETTER OF INTENT

July 30, 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 (SBA) for Georgia. This support has been valuable in dealing with the many economic challenges facing Georgia and we are grateful for IMF support.

2. This letter of intent describes the economic policies that we plan to implement during the rest of 2009 and in 2010. As always, we are committed to policies that will maintain macroeconomic stability, protect the economy from shocks associated with the global economic crisis and facilitate the process of macroeconomic adjustment. We, of course, remain committed to implementing the measures contained in previous letters of intent, i.e. those dated September 9, 2008, November 28, 2008 and March 10, 2009.

3. In view of the deterioration in the economic and financial outlook, we hereby request an augmentation of access under the current SBA by SDR 270 million and an extension of the arrangement to June 14, 2011.

Recent Economic Developments

4. Growth in 2008 was a modest 2.1 percent, which reflects the consequences of Russia's invasion of Georgia and the global economic crisis. In the first quarter of this year, the economy contracted by 5.9 percent. While the contraction affected most sectors of the economy, retail trade, manufacturing and construction contributed most to the decline. Lower commodity prices (especially for metals and fertilizers), a decline in the demand for the Georgian exports and a significant decline in private capital inflows were the main transmission channels through which the global crisis affected the Georgian economy.

5. Against the background of a broad decline in economic activity and falling global commodity prices, inflationary pressures have all but disappeared. End-period inflation was 5.5 percent for 2008 and twelve-month inflation was only 2.3 percent as of end-June 2009. Year-on-year growth of reserve money and broad money aggregates has been negative since November 2008.

6. Fiscal performance has been adversely affected by the ongoing economic decline. Tax collection in the first half of 2009 declined by 16.5 percent in nominal terms compared with the same period of last year (excluding one-off effects). Expenditure was contained at GEL 2,921million, or 11percent lower than the same period of last year

(excluding one-off effects). In all, the fiscal deficit reached 4.1 percent of projected annual GDP in the first half of the year, in line with program projections.

7. Consistent with our commitment to increase exchange rate flexibility, we introduced a foreign exchange auction mechanism for the central bank interventions starting from March 10, 2009. Furthermore, from May 25, 2009 the NBG stopped participating in the TICEX trading sessions and since then interventions are conducted only through the foreign exchange auctions. These changes in the operational framework of the foreign exchange market have allowed the NBG to minimize its role as a market maker and have resulted in greater exchange rate flexibility as well as greater reliance on market mechanisms. Interbank market activity has markedly increased and the NBG interventions dropped substantially. The fall in imports has reduced the demand for foreign exchange. In particular, while the NBG's net sales of foreign currency were USD142 million in the first quarter of this year, sales were only USD 0.4 million during the second quarter of 2009. Increased exchange rate flexibility also has curbed speculative pressures and contributed to a more balanced demand for foreign currency.

8. Balance of payments data for the first quarter of 2009 show that exports and imports of goods and services declined by 23 percent and 29 percent, respectively, which reflects both a drop in commodity prices and lower domestic demand. Worker remittances dropped by 26 percent with the majority of decline accounted for by those from Russia. While narrowing, the current account deficit remains high at 17.6 percent of GDP for the first quarter of 2009. FDI inflows, one of the main sources of financing for the current account deficit and a principal driver of economic growth, decline by more than 75 percent compared with the same period in 2008. Other capital inflows—mainly donor assistance--increased by 28 percent thereby partially offsetting the drop in private capital.

9. The financial sector continues to perform well despite a difficult environment. Thanks to the assistance of international financial institutions, commercial banks refinanced most of the foreign liabilities due to mature in the first half of this year thereby avoiding major contractions of their loan portfolios. While the level of non-performing loans has increased—from 3.5 percent of total loans in mid-2008 to 18.8 percent at end-June 2009—this is consistent with the projections of the Financial Supervisory Agency (FSA). This deterioration does not, however, pose a serious risk to the stability of the financial system. Average capital adequacy—at 17.6 percent—is at its highest level in 12 months despite the need for higher loan loss reserves. Consequently, we remain confident that the banking system will continue to be sound and resilient.

10. We developed and published the liquidity management framework (structural benchmark for end-March 2009). The liquidity management framework describes the main objectives of the National Bank of Georgia (NBG), the liquidity forecasting framework and instruments that are used under the existing liquidity management framework.

11. In order to supply additional lari liquidity to the banking sector, we introduced foreign exchange swaps on June 3, 2009. The introduction of the new instrument will help the country to attract additional foreign capital inflows, to allow banks to increase lending in domestic currency and thus mitigate foreign currency exposure risk of the borrowers and to

reduce dollarization of the domestic economy. At the same time, foreign exchange swaps have been kept at a relatively low level to gauge the reaction of commercial banks.

12. In July, the NBG signed an Investment Management Agreement with the World Bank as part of the Sovereign Investment Partnership Program. This program will significantly strengthen our operations with respect to reserves management. Specifically, the program will cover portfolio management, risk management, back-office, accounting, legal and IT areas to enhance asset management practices and infrastructure related to international reserves management functions at the central bank.

13. In order to enhance the safety and efficiency of all interbank payments and to boost financial sector stability, the NBG is working to modernize the Georgian payments system. We aim to conform to international principles and recommendations, including those provided by the Committee on Payment and Settlement Systems of the Central Banks of the Group of Ten Countries and those from the International Organization of Securities Commissions. In July, the NBG signed a contract with a supplier and launched the project. When completed, the project will provide a modern and efficient payments system.

14. We have recently prepared a financial stability plan that describes a set of actions that could be implemented in response to a capital shortage at a commercial bank (structural performance criterion for end-June 2009). Importantly, the plan outlines roles and responsibilities of the NBG, the FSA and the Government in such a situation and outlines possible instruments of public intervention.

15. We continue to strengthen our fiscal legal framework in order to increase the efficiency in public finance management. In this regard, we have submitted a new budget code to the cabinet (structural benchmark for end-July), which will enhance monitoring of budget execution and improve strategic planning.

Macroeconomic Policies for 2009 and 2010

16. Our major macroeconomic challenge continues to be the restoration of economic growth. This will, of course, require the resumption of private capital inflows and domestic lending in support of investment projects. At the same time, we recognize that many of the extraordinary actions undertaken in response to the economic crisis are not sustainable in the medium term. Hence, our efforts to enhance macroeconomic stability will concentrate on intensifying economic reforms, refining policy instruments and achieving a sustainable fiscal and external balance as quickly as possible.

17. The ongoing global economic crisis continues to cast a shadow over our growth prospects. This situation has been exacerbated by domestic political tensions with the result that there was likely a further contraction of economic activity in the second quarter of this year. We continue to expect a modest recovery in the second half of the year, but it is difficult to assess the magnitude of any such recovery. So, while we envision a scenario whereby the contraction for the year as a whole could be only 1.5 percent, we are prepared for a larger contraction. Our projections and planning—and hence program targets—assume a contraction in real GDP of 4 percent this year.

18. Beginning in 2010, we anticipate that economic recovery will strengthen and that our economy will again grow. An important source of this growth is expected to be a recovery in exports. Further, we anticipate a strong recovery in FDI beginning in 2010. As result, we project real GDP will increase by 2 percent next year, inflation is projected at around 3 percent and nominal GDP at GEL 19,042 million in 2010.

19. The current account deficit for this year is expected to moderate to around 16 percent of GDP from a record high level of nearly 23 percent in 2008. Exports and imports of goods and services are projected to decline by 20 percent and 27 percent, respectively. Worker remittances are expected to drop by around 18 percent for the year. We project FDI inflows in the amount of around US$ 900 million for 2009, which is 40 percent lower than in 2008 and deprives the economy of an important source of growth. Overall, we expect an accumulation of gross reserves in the amount of over US$230 million, assuming that all available purchases under the SBA are made.

20. Our fiscal stance for the remainder of 2009 will continue to sustain demand through donor financed spending. While overall spending will be roughly in line with previous plans, the shortfall in revenue linked to the deterioration in economic activity will widen the fiscal deficit to 9.4 percent of GDP for the year. The recent amendment to the 2009 budget law envisions additional expenditures of about GEL 300 million relative to the initial budget, in the areas of infrastructure investments (e.g., water and road projects), which are intended to enhance our competitiveness and deliver critical services to the population. These additional outlays will be offset in part through underexecution of other spending by about GEL130 million, which is broadly-based and about evenly divided between capital spending and current spending (notably subsidies and goods and services).

21. In 2010-11, we expect a recovery in private capital inflows to begin. Moreover, despite considerable fiscal adjustment, the current account deficit is expected to improve only marginally owing to adverse terms of trade developments. Also, in view of the continued high uncertainty in the external environment, there is a need to increase the reserve buffer to more comfortable levels. Accordingly, we anticipate a financing gap of around $400 million in 2010-11, for which we are asking for additional Fund support.

22. We realize that the fiscal stimulus measures currently deployed by the Government are essential for minimizing the impact of the global financial downturn on Georgia, we also believe that this stimulus must not jeopardize Georgia's longer-term fiscal sustainability. We consider that restoring a sound fiscal position is also critical in view of external debt repayment obligations falling due in 2012-14. Starting in 2010, we are therefore committed to an ambitious program of deficit reduction. Largely through expenditure reductions, we are targeting to reduce the deficit to 7.3 percent of GDP in 2010 (SBA definition). Expenditure reductions will focus on domestically financed capital spending, where government intervention is being replaced by donor-financed projects. These intentions will be fully reflected in the budget which is to be submitted to parliament by October 1. Social expenditures will not be affected by the proposed cuts. Based on further expenditure containment, as well as an expected recovery of tax revenues, we are committed to steady reductions in the deficit to 2-3 percent of GDP by 2013. These targets will be presented to parliament by October 1, as part of our 2010 budget submission. We propose to make this a

structural benchmark under the program and we will maintain close dialogue with the Fund in the context of elaboration of the next year's budget and of the medium-term expenditure framework.

23. While we plan to introduce domestic debt instruments (treasury bills) in the second half of this year, we are reluctant to meet all of the incremental financing needs via this mechanism. The market for treasury bills in Georgia is untested of late and a large issuance may not be well received by the market. Further, while we wish to develop the market for treasury bills—not least so as to provide the NBG with another monetary policy tool and allow the banks to diversify their portfolio to include an important class of risk-free assets—the cost of financing from this source is high. Consequently, we plan to limit issuance of T-bills in 2009 to around GEL 160 million, and we will need to rely on external balance of payments support to finance a portion of our budgetary needs. In the context of sustaining the agreed cap on fiscal deficit, we expect to be able to mobilize additional external budget support in 2010 and the Government use of IMF resources for deficit financing will be reduced as such commitments are finalized. We intend to continue issuance of T-bills for 2010 and the NBG will support development of secondary market for T-bills by introducing electronic trading platform shortly after the launch of primary auctions.

24. We continue to implement our public finance reform program, which we view as an important prerequisite to ensuring transparency, discipline, efficiency and accountability in the public finance area. Our public finance reform action plan for 2009 implies actions in a large number of areas, including developing liquidity management guidelines, preparing the functional and technical specification for the PFMS, developing new format of the medium-term framework (Basic Data and Directions) document, improving the format of local budgets, ensuring functionality of the risk assessment tax audit system, further streamlining tax and customs codes and developing necessary sub-legislation, establishing electronic information exchange system between banks and the Revenues Service, improving capital budget forms, establishing customs audit and progressing towards risk-based customs control, fostering full functionality of the electronic treasury system and inclusion of all taxes into the e-filing system. We believe that implementation of these reforms enhances efficiency and effectiveness in the use of public financial resources and contributes to the overall resilience of the economy both now, in the time of stress, and over the medium term.

25. We realize that further improvement of effectiveness and efficiency of public expenditure management and of proper monitoring thereof are positively correlated with the level of development of public internal financial audit both at institutional and systemic levels. The Government has thus approved an internal audit strategy and an internal audit harmonization unit has been established in the Ministry of Finance. The Law on internal audit will be submitted to the Parliament by end- September, 2009. We propose this to be a structural benchmark.

26. We envision that monetary policy will remain strongly expansionary in 2009 The early experience with foreign currency swaps suggests that they have eased credit conditions without adversely affecting the foreign exchange market, but we will limit the use of this instrument to limit liquidity injections. Most of the liquidity injections this year will come from external financing of the budget. Using a combination of swaps, sales of certificates of

deposit and treasury bills, we are confident that the NBG has the necessary tools to adjust monetary conditions without rekindling inflationary pressures. We continue to project end-period inflation to be 3.5 percent. These projections are, of course, sensitive to assumptions regarding the money multiplier and, in turn, commercial bank lending to the private sector. We are confident, however, that should price pressure begin to develop late this year or early next year, that the NBG has the necessary tools to respond appropriately.

27. We remain fully committed to a flexible exchange rate policy. We anticipate that recent structural changes—most notably the introduction of foreign exchange auctions—will greatly enhance the role of the interbank foreign exchange market thereby allowing the NBG to be less interventionist in the future. This should allow market forces the predominant role in the determination of the exchange rate. To that end, additional measures are planned, including a reduction in the number of regular weekly auctions from two to one. Additionally, we will increase the allowed range of bids at the auctions from 0.5 percent plus or minus the official exchange rate to one percent.

28. Enhancing the competitiveness of the Georgian economy is, of course, of primary importance to us and is key to reducing Georgia's external current account deficit to more sustainable levels over the medium term. Georgia's extremely favorable business environment and geographic advantages place it in a good position to benefit from a recovery of FDI flows to emerging markets. We expect that additional structural reforms will be at the root of future competitiveness gains. These include further privatization and reductions of the state's role in the economy.

29. Overall, our experience with the separation of the NBG and the FSA has been positive, especially as regards policy formulation and coordination. Nonetheless, we believe there is scope for efficiency gains by combining some of the administrative and technical functions of the two agencies and we have submitted to parliament a draft law for their merger.

30. As part of our effort to prepare for possible stresses in the financial sector, we continue to refine our financial stability plan. We will provide a status report on progress with respect to developing bank-by-bank measures based on stress test results and assurances of support received from foreign shareholders (structural benchmark end-September 2009).

31. While we are confident that the Georgian economy will continue to perform well in an adverse economic environment, we recognize that potential risks lurk. The economic team meets regularly to monitor developments and we take in our history of flexibility in response to changing circumstances. Against a background of strong macroeconomic management, we continue to be prepared to introduce appropriate corrective measures, including the necessary fiscal and monetary adjustments, should these risks materialize. In particular, we stand ready to consider a broader range of fiscal measures to ensure that our deficit reduction targets remain robust to lower GDP growth outcomes.

Program Monitoring

32. All end-March and end-June performance criteria under the Stand-By Arrangement were met. We, therefore, request the completion of the Third Review and a rephasing of purchases through the remainder of 2009, with amounts previously scheduled to be available following third and fourth reviews becoming available after the completion of this review in August. We intend to purchase the SDR94.6 million that will be available to us upon completion of third review. We will maintain the usual close policy dialogue with the Fund and are ready to take additional measures as appropriate to ensure that we meet program objectives. In particular, if the pressures on Georgia stemming from the global economic crisis are greater than anticipated, the government would adjust its fiscal and exchange rate policies to maintain external stability.

33. We request a modification of end-September PCs according to the attached Table 1, which also establishes end-December PCs and indicative targets for 2010. The fourth review will be based on end-September performance criteria and is scheduled for completion by end-December 2009, and the fifth review will be based on end-December performance criteria and is scheduled for completion by end-March 2010. The revised Technical Memorandum of Understanding clarifies the treatment of the purchases under the SBA that are directed for budget support and of SDR allocations in the calculations of net international reserves of the NBG as defined by the program. Structural benchmarks under the program are described in Table 2.

34. We welcome the Executive Board's decision to back the US$250 billion general SDR allocation. We intend to use our share of the allocation to bolster international reserves.

35. We authorize the IMF to publish this 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 National Bank of Georgia

Table 1. Georgia: Quantitative Performance Criteria and Indicative Targets, 2009-10

	Cumulative Change from End-December 2008									
	Mar-09			Jun-09			Sep-09		Dec-09	Dec-10
	Second review	Adjusted PC	Actual	Second review	Adjusted PC	Actual	Second review	Proposed PC	Proposed PC	Indicative targets
	(In millions of lari)									
Ceiling on cash deficit of the consolidated government	480		208	924		660	973	1,255	1,638	1,393
	(In millions of U.S. dollars)									
Ceiling on contracting or guaranteeing of new nonconcessional external debt by the public sector	850		0	850		0	850	850	850	600
	Stocks at the end of the period									
	(In millions of lari)									
Ceiling on net domestic assets (NDA) of the NBG 1/	310	237	-66	446	328	189	240	344	413	829
	(In millions of U.S. dollars)									
Floor on net international reserves (NIR) of the NBG 1/	633	677	777	585	656	775	769	813	740	609
Ceiling on accumulation of external arrears 2/	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. Georgia: Structural Benchmarks

Action	Proposed Time Frame	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	Not observed. Implemented with delay
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 Benchmark	Observed
Appointment of the remaining members to the FSA board.	End-Jun-09	Structural Benchmark	Not observed
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	
Status report on the implementation of the action plan described in the Financial Stability Plan, including bank-by-bank contingency measures based on stress test results and assurances of support from foreign shareholders.	End-Sep-09	Structural Benchmark	
Submission to parliament of the Law on Internal Audit.	End-Sep-09	Structural Benchmark	
Submission to parliament of a state budget for 2010 that: (i) is consistent with the program targets and assumptions, and an overall deficit of no more than 7.3 percent of GDP (program definition); (ii) contains a medium-term fiscal framework consistent with the program's medium-term deficit reduction targets; and (iii) describes the medium-term policies underlying the fiscal deficit objectives through 2013.	October 1, 2009	Structural Benchmark	

ATTACHMENT II. GEORGIA: REVISED TECHNICAL MEMORANDUM OF UNDERSTANDING

July 30, 2009

1. This memorandum sets out the understandings between the Georgian authorities and the IMF staff regarding the definitions of quantitative 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 March 10, 2009.

2. These performance criteria and indicative targets are reported in Tables 1 and 2 attached to the Letter of Intent dated March 10, 2009 and Tables 1 and 2 attached to the Letter of Intent dated July 30, 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:** For the program purposes, net international reserves (NIR) of the NBG in U.S. dollars are defined as foreign assets of the NBG minus the sum of foreign liabilities of the NBG. Foreign assets of the NBG include gold, gross foreign exchange reserves, Georgia's SDR holdings, and the reserve position in the IMF. Gross foreign exchange reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents, including cash holdings of foreign exchange, that are readily available. Pledged or otherwise encumbered assets, including (but not limited to) assets used as collateral (or guarantee for third party external liabilities) are excluded from foreign assets. Foreign liabilities of the NBG shall be defined as the sum of Georgia's outstanding liabilities to the IMF, Georgia's SDR allocation, and any other liabilities of the NBG, excluding the foreign exchange balances in the government's account with the NBG. Thus defined, the definition of NIR excludes foreign assets stemming from foreign currency deposits of financial institutions at the NBG and foreign assets arising from the currency swaps with financial institutions. 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 $879.8 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/downward by 50 percent for any excess/shortfall in the disbursements of the project loans and project grants to the Treasury Single account at the NBG relative to the projected amounts presented in Table 2.
- (c) 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 reserve money and NIR as defined above, and as adjusted according to paragraph 8.

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.

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

12. **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]

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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

(continued)

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.

13. **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.

V. Continuous Performance Criterion on Nonaccumulation of External Arrears

14. **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.

15. **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

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.”

Table 2. Projected Balance-of-Payments Support Financing 1/ (In millions U.S. dollars)			
	Balance-of-payments support loans and balance-of-payments support grants	Project loans and project grants	Conversion for government imports
September 30, 2009	188.6	127.2	230.5
December 31, 2009	318.1	184.1	353.2
1/ Cumulative from the beginning of the calendar year.			

INTERNATIONAL MONETARY FUND

GEORGIA

Third Review Under the Stand-By Arrangement and Requests for Augmentation, Extension of the Arrangement, Rephasing of Purchases, and Modification of Performance Criteria

Informational Annex

Prepared by the Middle East and Central Asia Department

July 30, 2009

Contents Page

ANNEX I. GEORGIA: RELATIONS WITH THE FUND

(As of June 30, 2009)

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	438.20	291.55
Reserve position in Fund	0.01	0.01

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Holdings	8.48	N/A

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
Stand-by Arrangements	287.90	191.55
PRGF Arrangements	128.78	85.68

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	287.90
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	9.68	14.10	38.11	148.08	143.34
Charges/interest	2.34	4.53	4.45	3.74	1.77
Total	12.02	18.63	42.56	151.81	145.11

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 17 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 allow more flexibility and 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. In end-May 2009, the authorities officially ended foreign exchange market interventions on TICEX.

(b) The government uses the official exchange rate for budget and tax accounting purposes as well as for all payments between the government and enterprises and other legal entities. The official rate may differ by more than two percent from freely determined market rates, which gives rise to a multiple currency practice.

XI. **Article IV Consultation:**

The 2009 Article IV consultation was concluded on March 23, 2009.

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, took 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
Stress Testing and Foreign Exchange Market	Advisory	Apr. 21-30, 2009	Financial Supervisory Agency; National Bank of Georgia
	Statistics Department (STA)		
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
Monetary and Financial Statistics	Advisory	Mar. 18-31, 2009	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

(As of July 20, 2009)

1. Georgia has been a member of the World Bank since 1992 and the International Development Association (IDA) since 1993. Georgia has borrowed $1,125 million for 52 operations to date. Up until FY09, all borrowings were IDA, but in FY09, Georgia became eligible for IBRD borrowings as well and is now a "blend" country. Georgia became a shareholder and member of the IFC in 1995.

2. The last World Bank Country Partnership Strategy (CPS) of Georgia for FY06-09, anchored on the Economic Development and Poverty Reduction Program (EDPRP) of the Government, was designed to assist Georgia with deeper institutional reform as well as more fundamental infrastructure improvements. Since then, the Government has moved forward in its strategy development through the program "United Georgia without Poverty" in early 2008, and its annual Basic Data and Trends (BDT) document.

3. A new CPS for Georgia for FY10-13 is under preparation against the backdrop of twin crises – the August conflict followed by the global economic downturn. As a result, the joint World Bank/IFC strategy will focus on key post-conflict and vulnerability issues in the near term, as well as strengthening the foundations for medium term competitiveness and growth. The CPS envisages Bank Group financing of about $740-900 million over the four year period underpinned by a strong program of knowledge services. The financing envelope includes full use of the remaining IDA-15 envelope (projected at about $130 million), indicative IBRD lending (of about $266 million), disbursements under ongoing IDA/IBRD projects (of about $135 million), and IFC investments and lending (of about $210-360 million).

4. In response to the August conflict—and at the request of the Government—the World Bank in collaboration with other development partners prepared a *Joint Needs Assessment* (JNA) which was presented at the October 2008 Donors' Conference. The international community responded positively by pledging financial support totaling $4.5 billion over the period of 2008–2010. This was meant to provide financial assistance to the country in the light of increased spending needs (on infrastructure, social sectors, banking, and general budgetary support), and a decline in capital inflows.

5. The World Bank and the IMF have a strong track record of coordinated assistance to Georgia. The IMF has taken a lead on issues of macroeconomic policy, and the Bank and the Fund work together on financial sector strengthening. The World Bank has led the policy dialogue on social and structural policy issues, focusing on strengthening public expenditure policies and management, improving performance in the social sectors; poverty targeting and

social assistance delivery, deepening and diversifying sources of growth; and rehabilitating infrastructure.

6. Development policy lending has been a core element of Bank strategy and will continue to be so in the new CPS. Following past successful reform track record under the Poverty Reduction Support Operations, a programmatic series of three Development Policy Operations (DPOs) is planned under the new CPS. The first DPO in amount of USD85 million was approved on July 2, 2009. The DPO program aims at (i) mitigating the economic downturn; and (ii) facilitating recovery and preparing Georgia for post-crisis growth. It promotes policy and institutional reforms in (i) public finances, including improving efficiency and effectiveness of public expenditures, and public investment strengthening; (ii) social protection strengthening, including targeting and scaling up of the safety net system, pensions, and improving health coverage for the poor, and (iii) on specific measures to further improve the investment climate, including actions to modernize tax and customs administration.

7. The Bank's program also includes strong support to strengthen connectivity, essential for Georgia's prospects as a transit corridor and spatially inclusive growth. This is primarily in the area of roads, through the Secondary and Local Roads Project and the East-West Highway Improvement Projects. In March 2009, the Bank extended its first IBRD loan to Georgia in the amount of $70 million for the Secondary and Local Roads Project and will soon be presenting for Board approval a follow up Project to support the East-West Highway program and as well as on regional roads. Donor coordination has been central to Bank strategy, especially in the context of the roads program where different donors are working together on a common platform of assistance.

8. Ongoing Bank-financed projects will continue to support progress in health, education, public sector, municipal development, and rural development. These include:

- In **education,** IDA credits are supporting education system realignment and strengthening which address a broad spectrum of educational reform issues, aimed at improving learning outcomes of primary and secondary students, and in rehabilitating schools.
- I**n health,** an IDA-financed project is supporting the government in improving provision of primary health care services through the new Medical Insurance Program (MIP), providing training and equipment, and supporting the health information system as well as management capacity building.
- 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.

- In **public financial management**, an IDA grant is pooled together with resources from other donors under the Public Sector Financial Management Reform Support Project to provide technical assistance and the necessary investments to support budget planning, execution, and overall management within the Ministry of Finance and line ministries. It also aims to strengthen public accountability and oversight of public financial management.
- In **municipal development,** IDA is supporting the government to rehabilitate priority municipal infrastructure, support IDP housing, and strengthen intergovernmental fiscal arrangements.

9. **Analytical and advisory activities** across a broad spectrum of areas have been a central part of the Bank strategy. Significant pieces include the recent Progress Report on the JNA, an upcoming Country Economic Memorandum focusing on the drivers of growth, a Poverty Assessment, an IFC Competitiveness study, a Country Procurement Assessment in 2007, and a joint WB-EU Public Expenditure and Financial Assessment in 2008. Planned new work includes analysis of expenditure policy choices, work on regional trade integration, financial sector monitoring and risk assessment, programmatic poverty monitoring and analysis, a social sector review, and energy sector work.

10. A key part of the Bank Group assistance has been to the private sector where IFC has financed projects in banking, infrastructure, oil and gas, and manufacturing sectors. IFC's committed portfolio in Georgia as of June 2009 stood at about $298 million, of which $240 million is disbursed. The portfolio includes 9 clients, primarily in the banking sector but also including several real sector clients. In the financial sector, IFC has focused on 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.

11. More recently, IFC has also mobilized its investment assistance to provide stability to the Georgian banking system in the wake of the global financial crisis. 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. IFC has also provided technical assistance to strengthen its client banks and introduce new financial products (including leasing and housing finance), and 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 report, and the government is actively engaged with IFC to make further progress on reforms to improve the business environment.

Questions may be referred to Mr. A. Cholst (202-458-0324).

ANNEX III. GEORGIA: RELATIONS WITH THE EBRD

(As of June 30, 2009)

1. As of June 30, 2009 the European Bank for Reconstruction and Development (EBRD) had signed 120 investments in Georgia with cumulative commitments totaling $975.4 million.[1] Current Portfolio Stock equals to $696.3 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. The Bank's annual business volume in 2008 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. As at 30 June 2009 the Bank has signed eight projects in private sector arriving at the business volume of USD 84.4 million. As a response to the global financial crisis, EBRD, IFC and FMO joined forces to provide TBC Bank, with a funding package of $161 million in

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[1]Evaluated at an exchange rate of $1.4025 per euro.

loans and equity investment. The EBRD contribution is worth up to $70 million and includes the acquisition of an equity stake for $36.8 million and the provision of an $18.5 million subordinated and a $14.7 million senor loans.

5. The ratio of private sector projects in the portfolio now stands at 94 percent. The Bank plans to focus primarily on private sector financing, but may also consider selected public sector projects. The Bank will give preference to non-sovereign operations although, where sovereign guarantees are required, donor co-funding on a grant basis will be sought.

6. 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 (In millions of US$)
(As of June 30, 2009)

Project Name	Date of Agreement	Outstanding Amount
Bank Republic - MSE Loan	27-Apr 2006	1.7
Bank Republic - MSME	12-Dec 2008	10.0
Bank Republic Equity	15-Sep 2006	8.3
Bank Republic Equity (Capital Increase)	23-Apr 2008	1.4
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	4.1
Batumi Public Transport Project	02-Sep 2008	3.5
Borjomi Water Project	01-Dec 2008	2.1
CEEP - Bank Republic	19-Dec 2008	5.0
CEEP - Cartu Bank	20-Dec 2007	5.0
CEEP - TBC	30-Nov 2007	5.0
Cartu Bank SME Loan II	30-Mar-09	5.0
DIF - Alfapet	08-Dec 2007	0.1
DIF - Delidor	17-Jun 2005	1.5
DIF - Georgian Hazelnut Production Ltd.	26-Oct 2006	0.8
DIF - Iberia Refreshments	25-Sep 2003	3.3
DIF - Imedi L	30-Dec 2006	1.6
DLF - BTM TEKSTIL	21-Dec 2006	2.0
DLF - Georgian Hazelnut Production Ltd	26-Oct 2006	3.1
DLF- Populi	31-Dec 2008	13.1
ETC Non-Bank MFI Framework II - Constanta	28-Nov 2006	2.3
ETC Non-Bank MFI Framework II - WV Credo	07-Mar 2008	1.5
Enguri Hydro power Plant Rehabilitation project	22-Dec 1998	23.2
Geo Steel	20-Oct 2008	14.0
Georgia: Trans-Caucasian Rail Link Project	22-Dec 1998	3.3
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	2.6
Georgian Property Equity Investment	29-Aug 2007	15.2
Georgian Wines & Spirits Ltd.	10-Mar 2005	4.8
JSC Channel Energy Poti Port	19-Mar 2002	3.0
Kobuleti Water	27-Jun 2008	2.1
Kutaisi Water Project	15-Sep 2006	4.2
MCFF - Bank Republic - Begi Co. II	28-Dec 2007	5.1
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	0.2
MCFF - TBC Bank - Jaokeni Company JSC	04-Aug 2008	2.8
MCFF - TBC Bank EMBAWOOD Sub Loan	13-Jun 2007	0.7
MCFF - TBC Bank JSC Full Recourse Portion	13-Jun 2005	2.1
MCFF - TBC Bank Lomisi Ltd Sub-Loan (NRP)	03-Aug 2005	1.0
MCFF - TBC Bank Tegeta Motors	01-Apr 2008	6.7
MCFF - TBC Bank Wissol Sub-Loan (NRP)	10-Oct 2007	4.9
MCFF - TBC Coca Cola Ltd. sub-loan	02-Feb 2007	4.5
MCFF - TBC Tsiskvilkombinati	21-Nov 2007	1.9
MCFF BOG - Renewable Energy Program - Okami SHPP NRP	21-Dec 2006	0.1
MCFF BOG - Renewable Energy Program 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	7.0
MCFF-Bank Republic - BCFS	18-May-09	1.5
Poti Water Supply Project	15-Sep 2006	3.5
Power Rehabilitation Project	20-Dec 1994	0.8
ProCredit Georgia - Syndicated Loan	21-Jun 2007	8.0
Regional TFP Basisbank (Guarantee & Pre-export)	06-Nov 2007	0.5
Regional TFP: Bank Republic (Guarantee & Pre-export)	15-Feb 2006	0.0
Regional TFP: Bank of Georgia (Guarantee & Pre-export)	29-Jul 1999	19.0
Regional TFP: Cartu Bank	28-Apr 2006	2.5
Regional TFP: TBC Bank (guarantee & pre-export)	17-Aug 1999	21.9
Regional TFP: VTB Bank Georgia	24-Dec 2000	0.0
Rustavi Solid Waste Management Project	02-Jun 2009	2.2
TBC Bank - SME Credit Line	19-Dec 2003	0.7
TBC Bank - Senior Loan	14-Apr 2009	14.7
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 Bank: Subordinated Loan	14-Apr 2009	18.5
TBC Bank: investment in ordinary shares	7-Apr 2009	38.7
TBC Leasing - Equity Investment	01-Mar 2006	0.1
TBC Leasing, Senior Debt	21-Dec 2005	1.7
Tbilisi International Airport	17-May 2006	23.6
Tbilisi Public Transport Project	29-Jul 2005	1.9
VTB Bank Georgia	09-Oct 2006	8.9
VTB Bank Georgia (debt, equity)	20-Nov 1997	2.5
VTB Bank Georgia Capital Increase	09-Oct 2006	2.5
	TOTAL	**578.1**
Aureos Central Asia Fund LLC	01-Dec 2008	0.8
BIH	18-Dec 2006	0.0
BSR Europe Co-Investment Facility	14-Aug 2006	9.8
Baku-Tbilisi-Ceyhan (BTC) Pipeline	03-Feb 2004	49.2
Baring Vostok Private Equity Fund	13-Dec 2000	0.0
Caucasus Online	22-Dec 2008	30.6
Lukoil Overseas : South Caucasus Gas Pipeline	28-Jul 2005	27.7
	TOTAL REGIONAL	**118.2**
	GRAND TOTAL	**696.3**

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 June 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	06/09/09	06/09/09	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	06/08/09	06/09/09	D	D	M		
Reserve/Base Money	06/09/09	06/09/09	D	D	M	O, LO, LO, O	O,O,O,O,LO
Broad Money	06/08/09	06/09/09	D	D	M		
Central Bank Balance Sheet	06/08/09	06/09/09	D	D	M		
Consolidated Balance Sheet of the Banking System	04/09	05/25/09	M	M	M		
Interest Rates[2]	06/09/09	06/09/09	D	D	D		
Consumer Price Index	05/09	06/08/09	M	M	M	O,LO,O,O	LO,LO,O,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	05/09	06/08/09	M	M	M	LNO,LO,LNO, O	LO,O,LO,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	05/09	06/08/09	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	Q4/08	03/26/09	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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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third Review Under the Stand-by Arrangement with Georgia

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Georgia's performance under an 18-month Stand-By Arrangement (SBA) totaling SDR 477.1 million (about US$748.3 million). The completion of the review allows for the immediate disbursement of an amount equivalent to SDR 94.6 million (about US$148.4 million).

The Board also approved an augmentation under the SBA in the amount of SDR 270 million (about US$423.5 million), equivalent to 180 percent of quota, and the SBA's extension to June 14, 2011. The SBA was approved on September 15, 2008 (see Press Release No. 08/208) to support the Georgian authorities' macroeconomic policies, rebuild gross international reserves, and bolster investor confidence. In view of the weaker economic and external financing prospects, the augmentation and extension of the SBA aims at facilitating an orderly exit from high public and external deficits, and the associated dependence on official financial support.

After the Executive Board's discussion, Mr. Murilo Portugal Deputy Managing Director and Acting Chair, said:

"The economic and financial impact of the crisis on Georgia will stretch into 2010, despite some signs that the economy may have reached its trough. Risks remain elevated due to uncertainties about the international economic environment and the strength of the recovery of private capital inflows and bank credit.

"Against this background, the authorities' economic strategy aims to support the incipient recovery by maintaining an expansionary fiscal stance in 2009, specifically by allowing revenue shortfalls to be fully accommodated in a widening of the fiscal deficit.

“Starting in 2010, the authorities intend to move to a path of strong fiscal adjustment. While the withdrawal of fiscal stimulus in 2010 may dampen demand, it is key to preserving investor confidence and to restoring access to international capital markets. The emphasis placed by the authorities on expenditure reduction as the primary instrument of adjustment—while safeguarding social spending—is appropriate, but revenue measures should not be excluded if necessary. Structural fiscal reforms aimed at enhancing monitoring, planning, execution, and auditing of public expenditure will strengthen the efficiency of fiscal policy.

“In the foreign exchange market, the authorities have made a successful transition from the daily fixing session to foreign exchange auctions, which should set the stage for more exchange rate flexibility in response to market conditions, thereby protecting international reserves.

“Monetary policy options are limited by high dollarization and constraints in banks’ balance sheets. As traditional monetary policy tools regain traction and the economy recovers, the authorities intend to adjust the monetary policy stance to preserve the gains made in terms of disinflation.

“The banking sector has weathered pressures so far, but the worsening quality of the loan portfolio and profitability warrant continued close monitoring and preparedness. The authorities have prepared a Financial Stability Plan, which outlines policy options for public intervention in the event of additional stress. With IMF technical assistance, they have also strengthened stress testing capacity. The supervisory authority, which is to be merged with the National Bank, is encouraged to develop more fully bank-by-bank risk assessments drawing from stress test results and discussions with foreign shareholders and parent companies of local banks. “

Statement by Age Bakker, Executive Director for Georgia
August 6, 2009

In spite of the very challenging situation, the authorities have met all performance criteria for the third review by a wide margin. Clear progress has also been made in the structural area. A new liquidity framework has been established and published, albeit with a small delay, and the authorities have developed a financial contingency plan, which outlines required actions among the relevant parties in case of financial stress. By end-July, they also submitted a new budget code to cabinet, which will enhance monitoring of the budget and improve planning. The only structural benchmark that was not met was on the appointment of the remaining members of the Financial Supervisory Agency (FSA). The reason for this is that the authorities are working on merging the central bank and the FSA to create one supervisor for the entire financial system. These achievements reflect the authorities' ongoing commitment to fulfill the program's objectives.

The past months

As a small and open economy, Georgia has been significantly affected by the global crisis. The impact has chiefly been felt through a decline in exports, remittances and foreign direct investment, which until recently acted as the country's engine of growth, and were attracted by the country's sound policies and attractive business environment. Although the external environment remains challenging, tensions in the foreign exchange rate market have abated since March. The introduction of an auction-based mechanism has helped to produce greater exchange rate flexibility, which has limited speculative pressures on the lari, lowered central bank interventions and protected international reserves.

Stabilization in the foreign exchange market also stemmed from falling imports as economic activity weakened substantially. After a decade of strong performance, GDP growth slowed to 2.1 percent in 2008. While positive for a year as a whole, the economy shrunk by 2.5 percent in the last quarter of 2008, and contracted by almost 6 percent in the first quarter of 2009. Besides through a deterioration of the external environment, GDP declined on the back of a domestic credit contraction. Following months of deposit outflows, banks have been cautious to provide credit to borrowers, reflecting their desire to raise liquidity buffers in an environment of worsening asset quality. At the same time, credit demand is hampered in the face of deteriorating economic conditions. Domestic political unrest has not been helpful in restoring confidence, which was already low as a result of the conflict and the economic situation. Over the last month, however, the political situation has stabilized, which has contributed to some improvement in market sentiment.

Against the backdrop of declining economic activity and falling commodity prices, inflation has slowed significantly. By the end-June, inflation reached 2.3 percent, slightly higher than in the months before, but significantly below levels of previous year. The fiscal deficit over the first 6 months of 2009 was also lower than program targets. Although tax revenues dropped by almost 17 percent as the economy contracted, expenditures were kept in check, reflecting both under execution and cuts in defense spending.

The outlook

Georgia's economic prospects are tough. Relative to the second review, export growth is expected to retrench somewhat further this year and import growth is likely to show a much steeper drop than earlier anticipated, mainly due to reduced domestic demand. As a result of these developments, the current account deficit is expected to decline this year by more than 6.5 percent. While narrowing distinctly, the current account deficit remains sizable at 16 percent of GDP. Private capital inflows, which were the main source of current account financing, are projected to slow further relative to earlier projections. Enhanced and frontloaded donor inflows will at least partially compensate for this decline in private investment. These inflows help to cover the 2009 current account deficit and cushion the contraction. Even so, an external financing gap is looming in 2010 and 2011 as a result of the worsening external outlook and the need for a faster reserve buildup. Higher reserves are warranted to strengthen confidence and to weather the uncertain financial market environment. Most of the projected financing gap will be closed by policy adjustment. The remainder is covered by the proposed augmentation of the SBA.

The ongoing global crisis, recent domestic political unrest, and the banks' credit freeze are weighing on economic activity. Real GDP growth projections for 2009 have been revised downward by the authorities to -4 percent. While acknowledging that uncertainties are particularly large in these times, the authorities expect that a modest recovery will begin in the second half of this year, but that growth, at 2 percent, will remain subdued in 2010. Apart from a low base in the second half of 2008, this expectation reflects a normalization in the political situation, and the impact of the authorities' countercyclical policies. Due to the wide output gap, CPI inflation is projected to remain low over the next year, in the range of 3-3.5 percent.

The policies

The authorities' main challenge remains the restoration of growth, while ensuring medium-term macroeconomic and external stability.

Monetary and exchange rate

Low inflation and inflation expectations have provided room to the central bank for considerable monetary relaxation. However, as in many other countries, the effectiveness of the interest rate channel has been hampered by banks' risk aversion and need to deleverage their balance sheets. To stimulate banks to lend in domestic currency, the authorities have recently introduced foreign currency swaps, which may entice banks that rely on foreign currency funding to provide loans to borrowers in domestic currency. While these swaps have contributed to some easing in credit conditions, the authorities decided in consultation with staff to limit their use in light of the risks of speculation. After the development and publication of the liquidity framework, the authorities consider that the monetary policy tools at their disposal are adequate. However, in due time, an increase in reserve requirements back to more normal levels may become desirable as a way of improving the effectiveness of the central bank refinancing facility.

The authorities also remain fully committed to a flexible exchange rate policy. Improvements in exchange rate management have allowed for a greater role of market forces in determining the exchange rate. In line with strengthening the external position, the authorities have also indicated to use the upcoming SDR allocation to increase international reserves.

Fiscal

With monetary transmission hampered, the authorities' response to containing the recession and protecting the society's vulnerable groups relies strongly on fiscal stimulus, with emphasis on frontloaded and targeted social and capital spending. Despite the adoption of the supplementary budget in July, the level of overall spending remains in line with earlier projections, as new infrastructure spending will be offset by under execution of other spending. Nevertheless, the 2009 fiscal deficit is expected to rise from 5.6 percent to 9.4 percent of GDP owing to a sharp decline in GDP and tax revenues.

The authorities fully realize that this fiscal response should be temporary and not undermine medium-term fiscal sustainability. In order to reverse the deterioration in public debt ratios, they are strongly committed to implement an ambitious and front-loaded fiscal adjustment strategy next year. Based on the 2010 budget, which is under preparation, next year's fiscal balance is expected to improve by 2 percentage points. With revenues projected to decline by 2.8 percentage points of GDP, this entails a 4.3 percentage point of GDP decline in non-interest rate expenditures, excluding one-off measures. Most spending cuts will be delivered by reducing domestically-financed capital projects, administrative costs, subsidies to semi-public institutions and capping public salaries.

The fiscal deficits over 2009 and 2010 will be financed through a combination of external budget support, privatization receipts and the issuance of treasury bills. For this year, the bulk of external support is coming from donors and IFIs on relatively favorable terms. The Fund is expected to cover about 9 percent of the financing in 2009. For next year, the Fund's share is projected to be higher. However, the authorities expect additional budget support from the World Bank and ADB will be forthcoming in 2010. They agreed that once this financing has been formally secured, Fund support to the budget can be reduced accordingly.

Driven by further expenditure constraint and a recovery of tax revenues, the authorities are committed to gradually reduce the deficit in the range of 2-3 percent of GDP by 2013. If these measures would not suffice to meet the deficit targets, the authorities will take additional steps. To underline their commitment to deficit reduction, the authorities propose to make the 2010 budget, which includes the multi-year targets and related adjustment policies, a structural benchmark under the program.

Financial sector

Conservative prudential and regulatory policies have proved to be of great value in maintaining stability in the banking sector in these difficult times. The banking sector remains resilient, despite that banks face shocks in both the liability and asset side of the balance sheet. Nonperforming loans are rising, but liquidity and capital buffers are strong. Both were boosted further thanks to injections from multilateral organizations into the country's largest banks. However, the authorities are fully cognizant of the risks that may materialize in case of a more protracted downturn together with strong downward exchange rate pressures. They therefore remain committed to closely monitor the banks, also by using their advanced stress-testing framework supported by Fund technical assistance. In the meantime, the ADB has been approached for technical assistance in the area of risk-based and consolidated supervision.

In their efforts to contain risks, the authorities have been seeking and receiving assurances from foreign parent banks that they will continue provide liquidity and capital support to their Georgian subsidiaries. As also recommended by staff, in some cases formal comfort letters have been obtained. The authorities are also making rapid progress in working out contingency plans. After establishing the financial stability plan, which clarifies and identifies the policy steps that will be taken in case of financial sector stress, the FSA is now refining this plan. Taking into account the stress tests results and the assurances from foreign shareholders, the authorities will submit a status report to staff by September on the required actions in case of problems at individual banks.

The request

In light of the good performance under the SBA, strong commitment to program conditionality and further policy adjustments, the authorities request the Board's approval of the completion of the third review, augmentation of the arrangement by SDR 270 million and extension of the arrangement to mid-2011. They have indicated their intention to draw the amount that becomes available at the completion of this review.