INTERNATIONAL MONETARY FUND

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GEORGIA

2013 ARTICLE IV CONSULTATION

August 2013

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2013 Article IV consultation with Georgia, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 22, 2013, 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 June 24, 2013. 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.
- **Informational Annex** prepared by the IMF.
- **Press Release** summarizing the views of the Executive Board as expressed during its July 10, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Georgia.

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

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INTERNATIONAL MONETARY FUND

GEORGIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

June 24, 2013

KEY ISSUES

Context. After growing at a 7 percent average annual rate since 2010, the economy has slowed since the third quarter of 2012 due to political and policy uncertainty, government under-spending, and a weakening external environment. Over the last two years, inflation has fallen steadily, while the real and nominal effective exchange rate have both strengthened. Despite decreasing slightly, from more than 16 percent in 2010 to 15 percent in 2012, unemployment remains high. Last October's parliamentary elections saw the peaceful handover of power to a new government committed to sustaining growth and making it more inclusive. However, cohabitation of the new government with the President has proved challenging, and political tensions may have weakened business confidence.

Policy response to the recent slowdown. In the short term, the government needs to overcome recent budget under-spending and allow a higher budget deficit later this year, to the extent that revenues are lower due to the slowdown. Further monetary loosening, coupled with measures to strengthen the transmission mechanism, also appears warranted. Political stability together with greater clarity on government policies would also help reduce business uncertainty.

Medium-term outlook and challenges. Over the medium term, the main challenges are to: sustain strong economic growth and making it more equitable; reduce the current account deficit to secure external sustainability; improve further the NBG's inflation targeting regime and financial supervision; and improve social outcomes and reduce poverty and inequality.

Policies to address these challenges. The authorities' policy agenda includes structural reforms (agricultural reform, universal healthcare system, free trade agreements, revised labor code, investment funds, hydropower projects) aimed at boosting growth and sharing its benefits. Fiscal consolidation will continue but with some redirection from capital to social spending. The authorities agreed on the need for competitiveness improvements but questioned the case for exchange rate adjustment, emphasizing structural reforms instead.

Approved By
Juha Kähkönen and Vivek Arora

A staff team comprising Mark Griffiths (head), Mariana Colacelli, Edouard Martin (all MCD), Ruo Chen (SPR) and Christina Kolerus (FAD) visited Tbilisi May 8-22, 2013. The mission was assisted by Azim Sadikov (resident representative) and Nia Sharashidze (resident representative office). The mission met with Deputy Prime Minister and Minister of Energy Kaladze, Minister of Finance Khaduri, National Bank Governor Kadagidze, and other senior officials, as well as representatives of the private sector, labor unions, NGOs, and the donor community.

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ECONOMIC DEVELOPMENTS

A. Context

1. Last October's elections saw the first peaceful and democratic transfer of power in Georgia's recent history.[1] The new government is committed to sustaining Georgia's rapid growth and to strengthening the rule of law, transparency and social inclusion. However, substantial differences between incoming Prime Minister Ivanishvili and President Saakashvili (who will leave office in October) have increased political tensions, with some members of the former government charged with offences. Despite this political uncertainty, the new government has a substantial majority, and its ability to implement social and economic reforms has not been impeded.

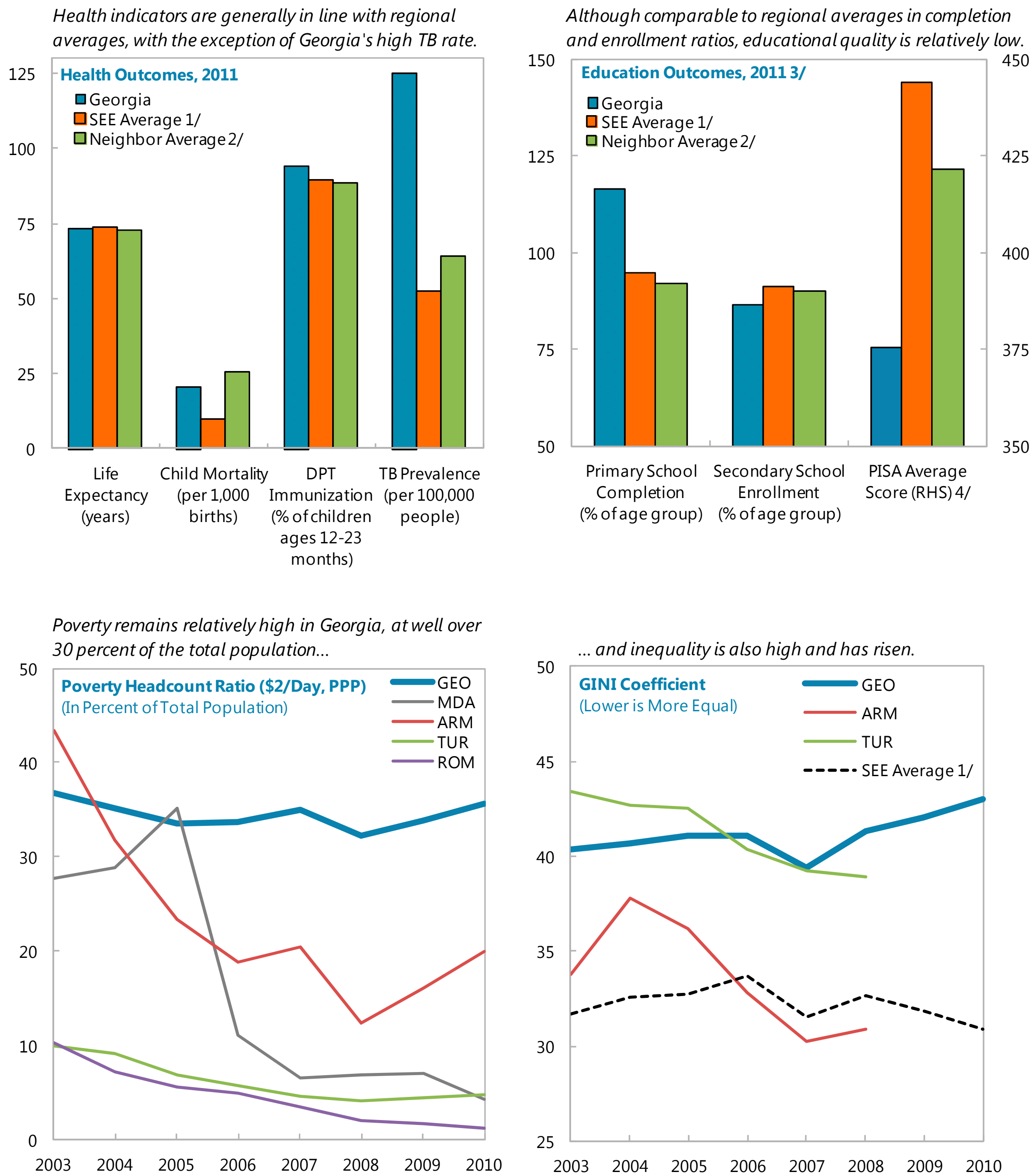
2. Over the last ten years, Georgia's economy has grown rapidly (Table 1). Economic growth averaged 6 percent from 2005-12 despite the global financial crisis and the 2008 conflict with Russia. Growth was driven by private investment and domestic consumption and, on the supply side, was supported by strong physical capital accumulation and total factor productivity (TFP) gains. Growth was broad based, and particularly strong in manufacturing, construction, transport, and financial services. However, agricultural output has continued to decline, reflecting lack of investment and the impact of the 2006 Russian trade embargo.

3. However, in sustaining this rapid growth, the previous government became increasingly interventionist. On first taking office in 2004, the previous government embraced a libertarian/free market approach, focused on improving the business environment and reducing corruption. Some of its reforms, such as the fight against low-level corruption, police reform, restoration of energy supply, and the overhaul of the tax system were fundamental to Georgia's emergence as a functioning state. Others, such as the very liberal labor code and the limited safety net, were less balanced and left much of the population economically vulnerable. While the strategy at first succeeded, private investment collapsed following the financial crisis and the 2008 conflict with Russia and failed to fully recover afterwards. The government responded by increasing public infrastructure investment, and then in 2011 by creating a Partnership Fund to catalyze private investment through minority public co-financing.

4. The benefits of Georgia's rapid growth have not been widely shared (Figure 1). From 2003 to 2012, employment fell by 5 percent, and unemployment remains high at 15 percent. Half the labor force is in small-scale agriculture, mostly underemployed. The previous government did create a rudimentary social safety net with: (i) public health insurance for means-tested eligible households, old-age pensioners, and infants; (ii) flat public pensions for all retirees; and (iii) targeted social assistance (TSA), which supports low-income households via direct transfers. However, pensions remain below subsistence, half the population lacks health insurance, and there are no

[1] The change in government and the time necessary to form a new economic team explain the slight delay in the Article IV consultation.

Figure 1. Georgia: Health and Education Outcomes, Poverty, and Inequality



Sources: National Authorities; World Bank, World Development Indicators; Eurostat, Statistics on Income and Living Conditions; OECD, Programme for International Student Assessment 2009.

1/ SEE includes: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Kosovo, Lithuania, Macedonia, Romania, Moldova, Serbia, and Ukraine.
2/ Includes Armenia, Azerbaijan, and Turkey, except for the PISA aggregate score, where data for Armenia are not available.
3/ Or latest available. PISA data from 2009.
4/ Calculated as the simple average between overall PISA reading, math literacy, and scientific literacy indicators. The scale for scores is 1-699, the higher the better.

unemployment benefits. Poverty is high, with more than 30 percent of the population living below the US$2 poverty line in 2011, and has increased slightly in recent years. Inequality is among the largest in the region, with a Gini coefficient above 0.4 (2010). Health and education outcomes are mixed, with educational quality lower than comparator countries.

5. **Georgia's rapid growth resulted in high current account deficits and significant external indebtedness (Table 2 and Figures 2 and 3)**. Despite tourism receipts increasing to 9 percent of GDP and remittances to 4½ percent of GDP, the current account deficit has persisted at around 11.5 percent of GDP from 2010 to 2012, one of the highest in the region. Georgia's trade deficit rose above 25 percent of GDP. With relatively low national savings, the investment needed to support high growth was also financed by capital inflows. While initially mainly FDI, in the last couple of years their composition shifted towards less stable sources of financing, including Eurobond issuance and increases in nonresident deposits (now 15 percent of total deposits). Net external liabilities have risen to close to 100 percent of GDP.

6. **Most of the 2011 Article IV consultation recommendations have been implemented.** Fiscal consolidation continued as envisaged, with streamlining of public investment creating fiscal space for increased social expenditures. The 2011 Economic Liberty Act diluted the constitutional referendum requirement for new taxes, preserving the government's flexibility to address unexpected developments. The NBG has made further progress improving its inflation forecasting and modeling capacity. In view of their further increase, the NBG also adopted measures to contain nonresident deposits. While the 2011 Article IV recommended more exchange rate flexibility, though the nominal effective exchange rate has been volatile, the lari-dollar exchange rate has become increasingly stable. The NBG has responded to higher-than-expected capital inflows by purchasing foreign currency.

B. Recent Developments

7. **Since mid-2012 the economy has slowed (Figure 4).** After growing at around 7 percent from 2010 to the first half of 2012, the economy started to level off in the third quarter of 2012, ahead of the October general elections. Growth fell to 2.7 percent y/y (-2 percent q/q seas. adj.) in the fourth quarter of 2012 and then to 2.4 percent y/y (+0.2 percent q/q seas. adj.) in the first quarter of 2013. On the demand side, causes seem to be weaker private investment (likely reflecting increased business uncertainty) and lower government spending.

8. **Inflation has fallen over time and the recent deflation is partly explained by the economic slowdown (Figure 5)**. Headline inflation has fallen well below the NBG's 6 percent medium-term inflation target and inflation volatility remains high. After rising to almost 15 percent in May 2011 due to higher food prices, inflation has fallen steadily (to minus 1.7 percent in April 2013). While the nominal effective exchange rate appreciated by 10 percent from end-2010 to end-2012, the lari-dollar rate has been increasingly stable since March 2011, remaining within a ±1 percent band between July 2012 and mid-May 2013 (Figure 5). The sharp decrease in inflation since May 2011 reflects lower food prices, lagged effects of exchange rate appreciation, cuts in administered energy prices and, most recently, subdued domestic demand.

9. The NBG has loosened monetary policy in response, but with little effect on credit growth (Tables 4 and 5, and Figures 5 and 6). The NBG cut its policy rate from 8 percent in mid 2011 to 4.25 percent in May 2013. Commercial bank lari deposit rates have fallen more or less in line, except during a short period at end-2012 when some small banks increased rates to attract funds. Despite the cuts in the policy rate, lending rates have barely dropped and private credit growth has declined from around 20 percent to 12–15 percent since October 2012. In addition to weak monetary policy transmission, this seems to reflect lower credit demand and banks' cautious approach to lending in response to the slowdown. The NBG has increased its foreign currency purchases, already buying US$335 million so far this year, which has helped resist appreciation pressures and lowered the risk of further deflation.

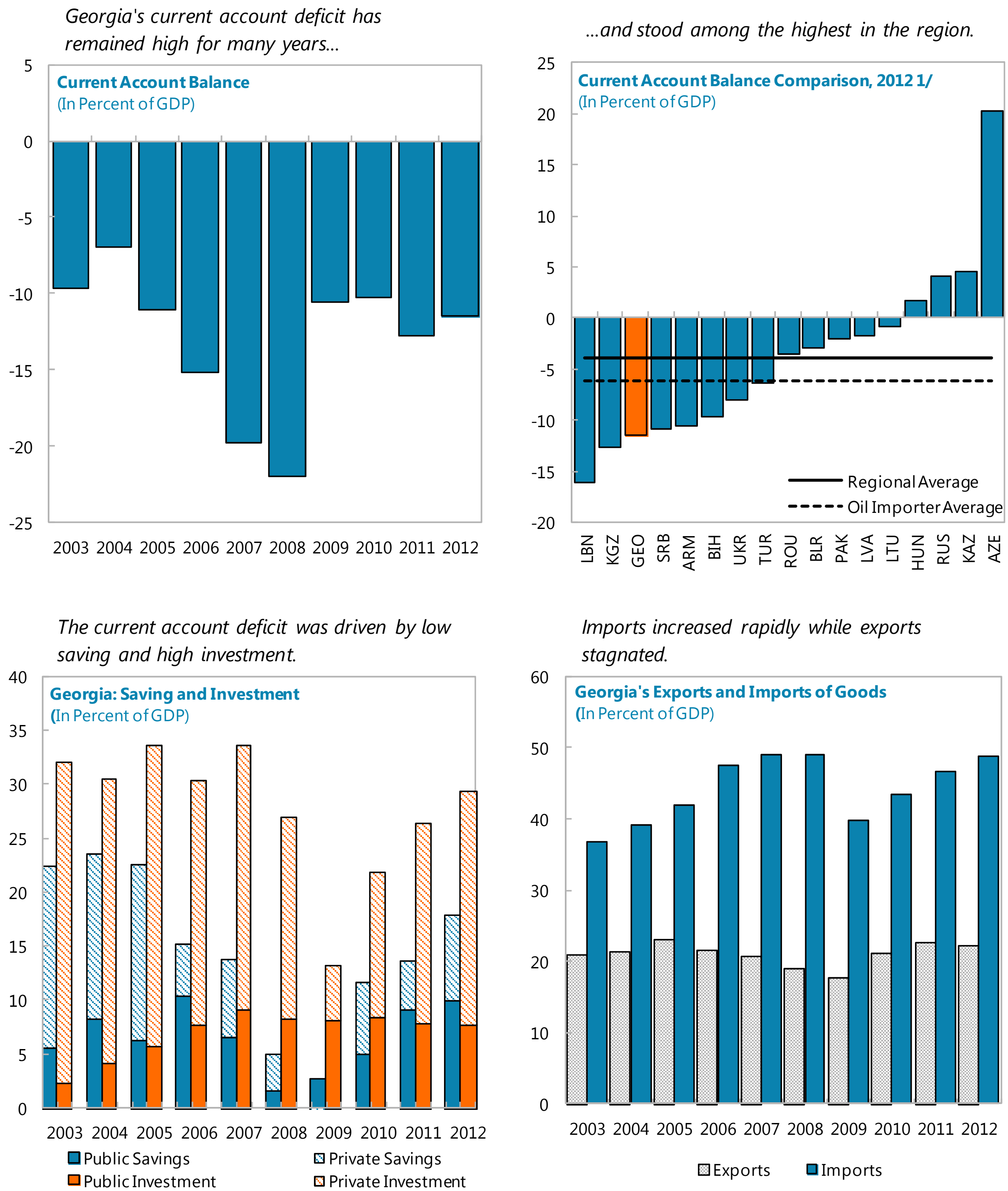
10. Unexpected fiscal tightening has added to the slowdown. Although revenues were lower than projected in the first quarter (by about GEL 100 million, 0.4 percent of GDP), the government ran a GEL 200 million surplus. The authorities emphasized this apparent tightening was unintentional and reflected procedural delays due to stricter procurement procedures, financial difficulties in some construction businesses, and savings from centralized purchases.

C. Policy Agenda

11. The new government aims to share the benefits of economic growth more widely, focusing on social protection, job creation, and agriculture. Labor Code revisions passed by Parliament in June are expected to enhance workers' rights, including job security, where previously workers could be fired at will. To support agriculture, the government has increased allocations in the 2013 budget and established an Agriculture Fund (privately funded, but from a foundation owned by the Prime Minister). The government plans to reorganize the Partnership Fund and also a private-equity Fund will be created to stimulate private investment.

12. The new government is redirecting government spending away from capital spending and towards social expenditures (Table 3). Public investment (averaging 8 percent of GDP over the past 5 years) is one of the highest in the region while total social expenditure (pensions, health, and education) has been among the lowest (11 percent of GDP). The government is spending an additional GEL 800 million (3 percent of GDP) on an annualized basis to address high private health care costs, low educational quality, and high rates of poverty and inequality. Reform plans include introducing universal healthcare system, raising pensions, doubling TSA allowances and expanding school vouchers (Box 1). Despite this increase in social expenditures, the authorities remain committed to fiscal consolidation and to meeting the 30 percent limit on spending introduced by the Economic Liberty Act from 2014 onward. While capital spending was reduced to meet these objectives, it would remain above 6 percent of GDP, broadly in line with comparator countries.

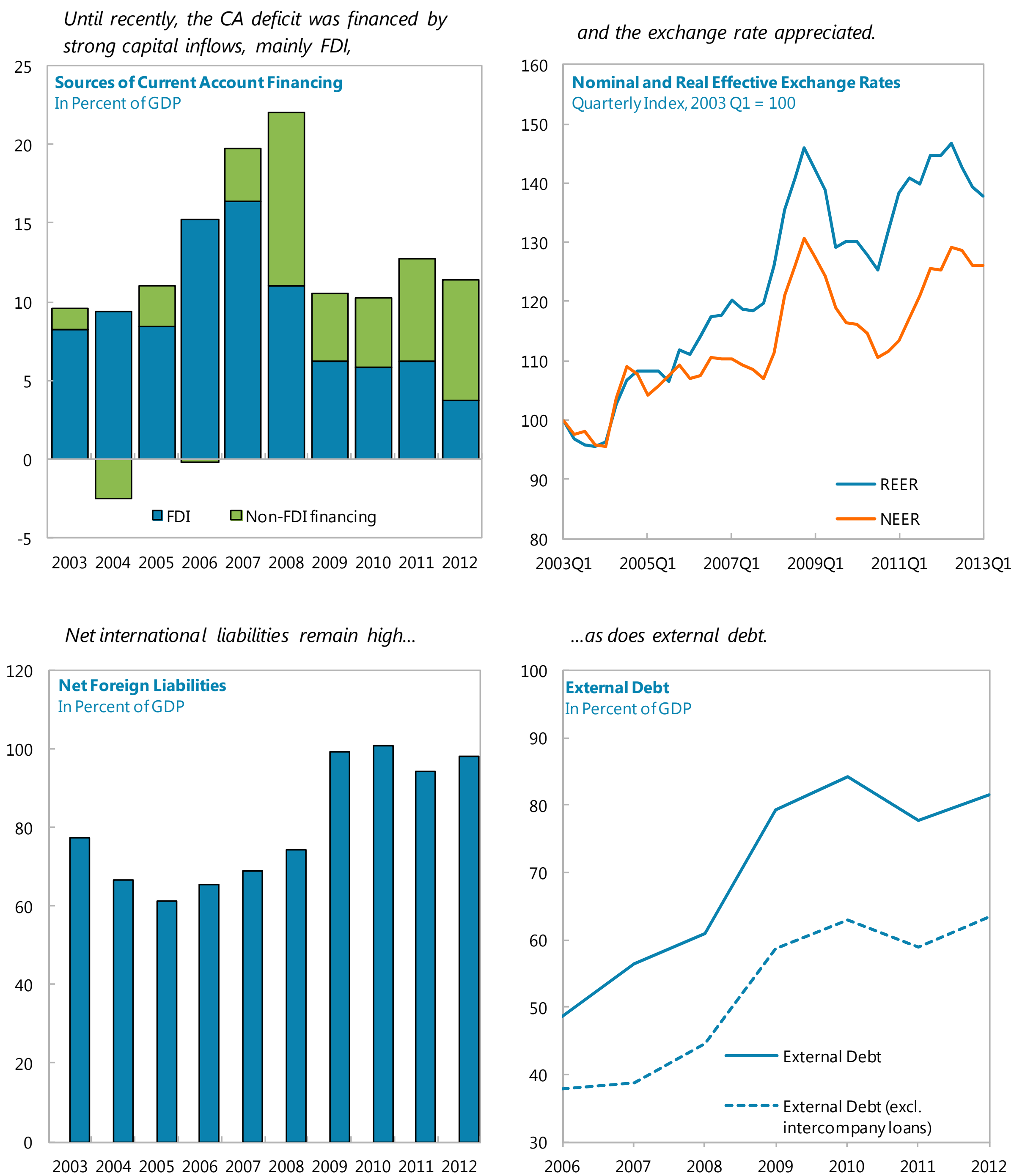
Figure 2. Georgia: Current Account Balance, 2003–12



Sources: National Authorities; IMF World Economic Outlook; and IMF staff estimates.

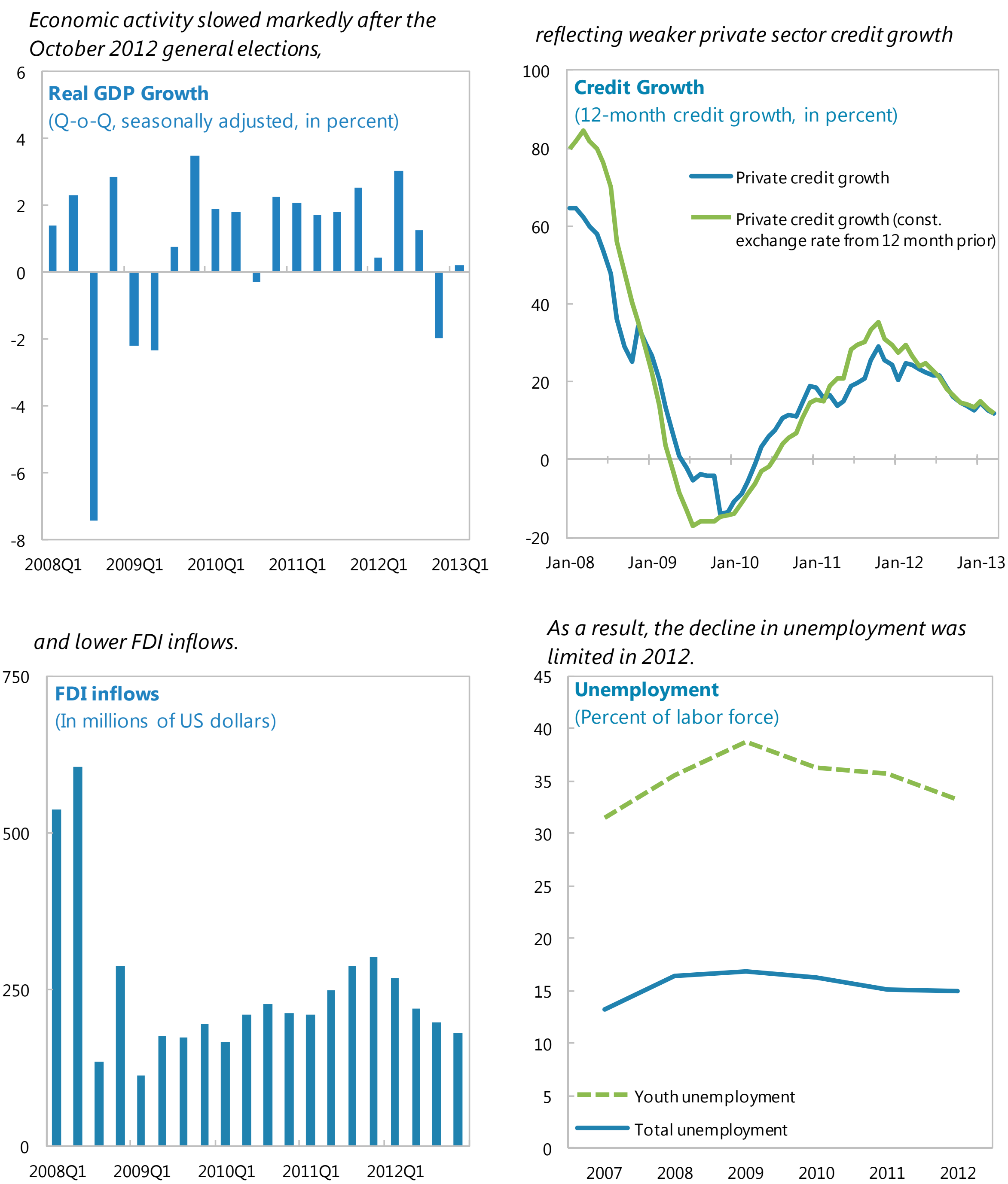
1/ Region includes: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Hungary, Kazakhstan, Kosovo, Kyrgyz Republic, Latvia, Lithuania, Macedonia, Poland, Romania, Serbia, Tajikistan, Turkey, Turkmenistan, Ukraine, and Uzbekistan.

Figure 3. Georgia: Financing of the Current Account, 2003–12



Sources: National Authorities; IMF World Economic Outlook; and IMF staff estimates.

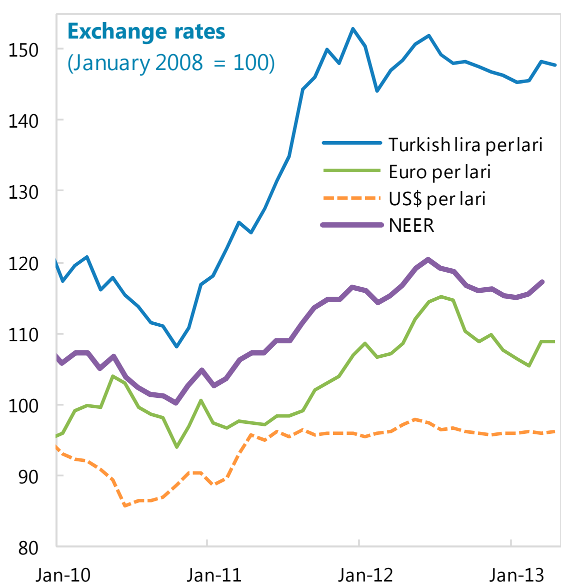
Figure 4. Georgia: Real Sector Developments, 2008–13



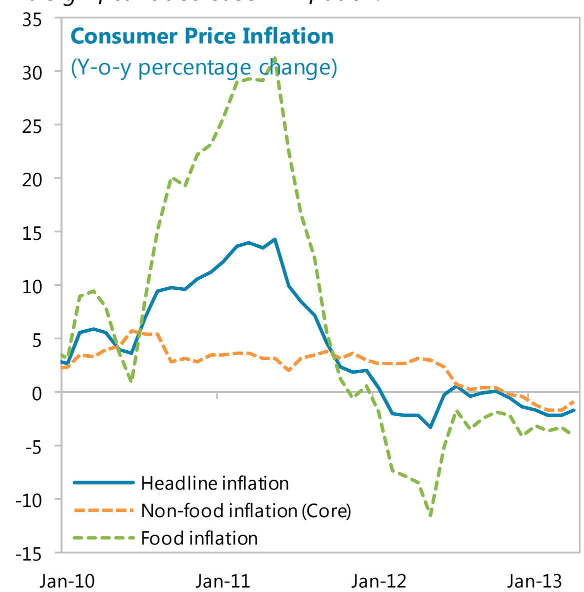
Sources: National Bank of Georgia; GeoStat; and IMF staff estimates.

Figure 5. Georgia: Money and Inflation, 2010–13

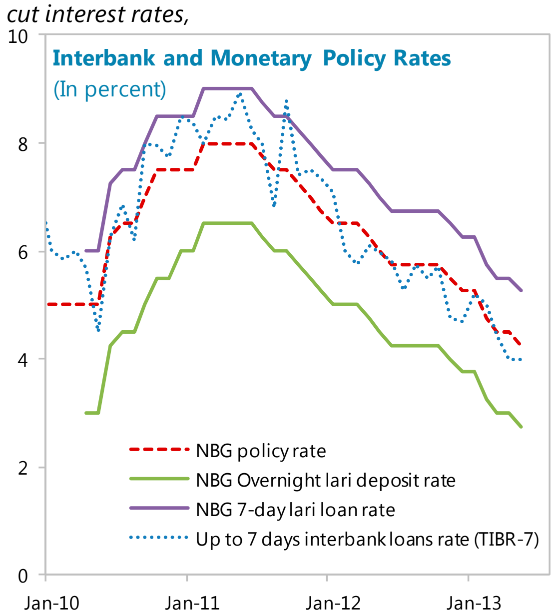
While stable against the dollar, the lari's appreciation against trade partner currencies,



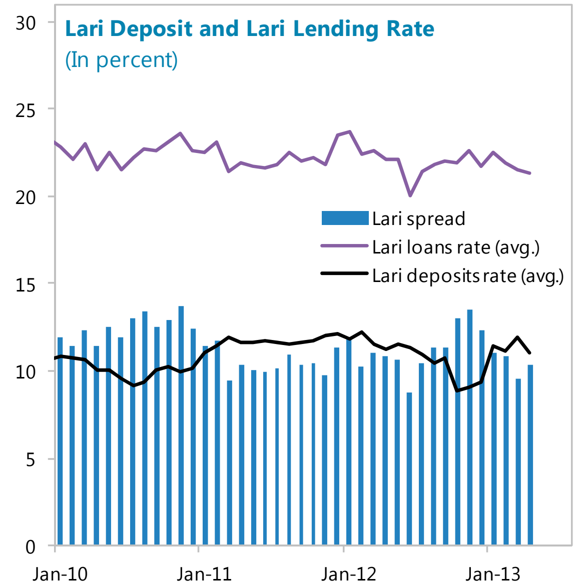
combined with lower food prices, has contributed to a significant decrease in inflation.



Reacting to the decrease in inflation, the NBG has cut interest rates,



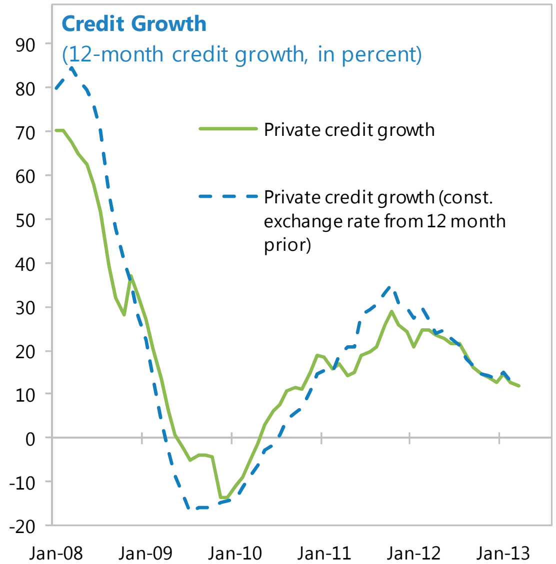
but the transmission to commercial bank lari rates has been weak.



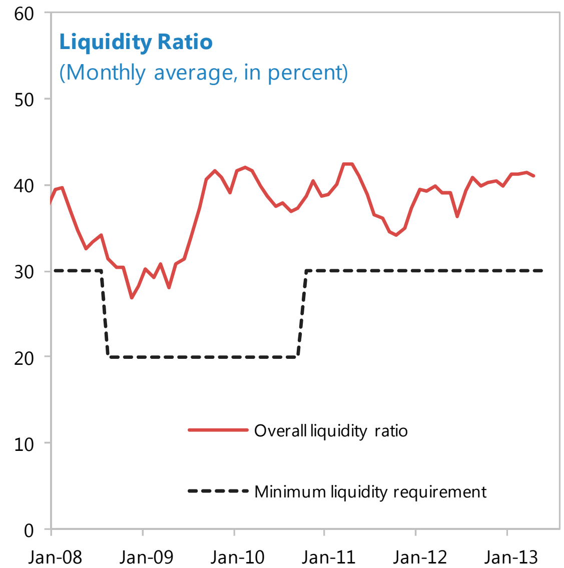
Sources: National Bank of Georgia; GeoStat; and IMF staff estimates.

Figure 6. Georgia: Monetary and Banking Sector, 2008–13

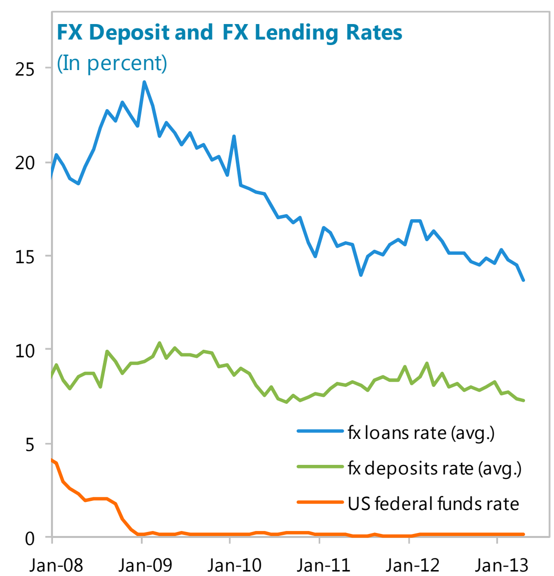
Private credit has slowed in recent months, likely caused by some tightening in lending standards



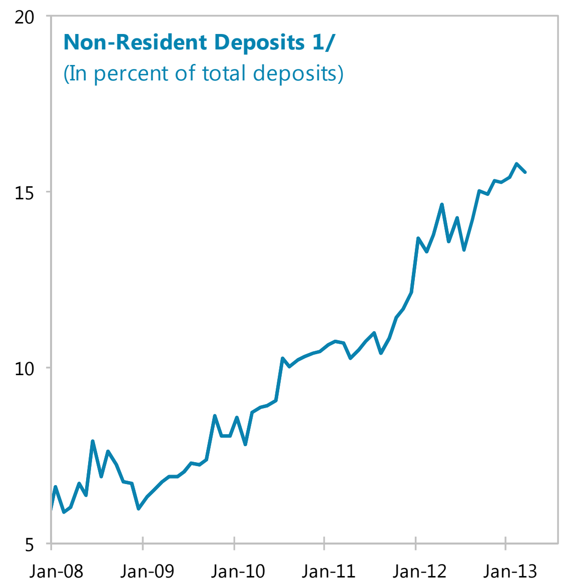
and weaker credit demand since banks' excess liquidity has increased.



Relatively high rates on dollar deposits...



...continue to attract non-resident deposits.

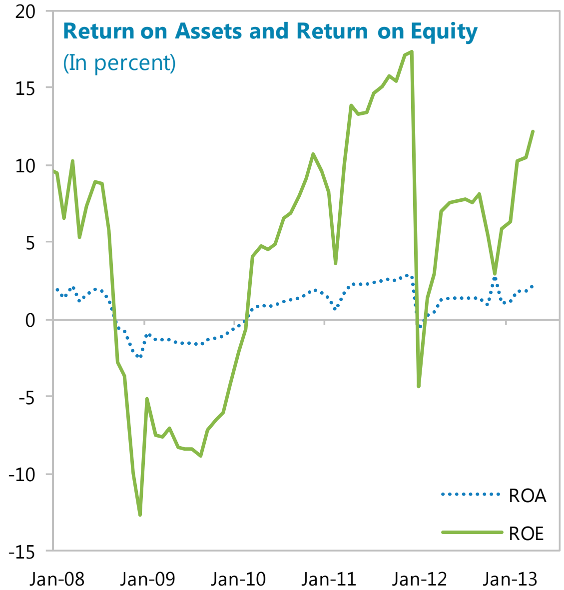


1/ Excluding deposits of non-resident banks in Georgian banks.

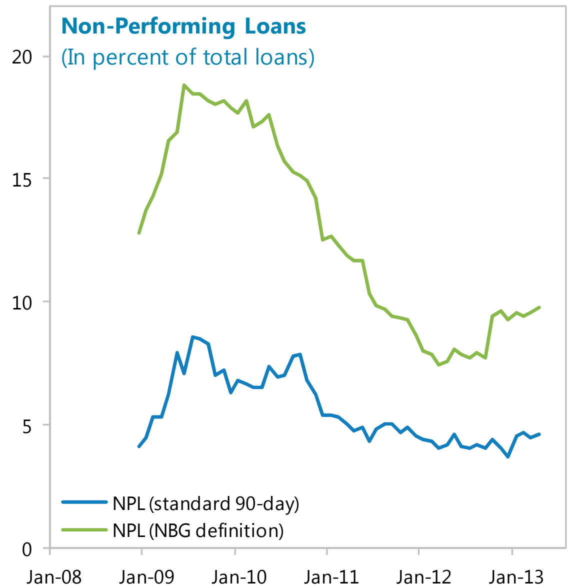
Sources: National Bank of Georgia; Board of Governors of the US Federal Reserve System; and IMF staff estimates.

Figure 6. Georgia: Monetary and Banking Sector, 2008–13 (concluded)

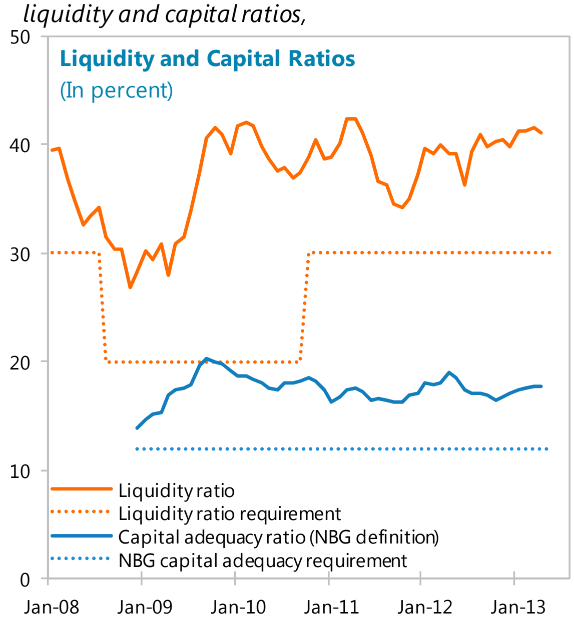
Banking sector profitability seems to have stabilized in 2013,



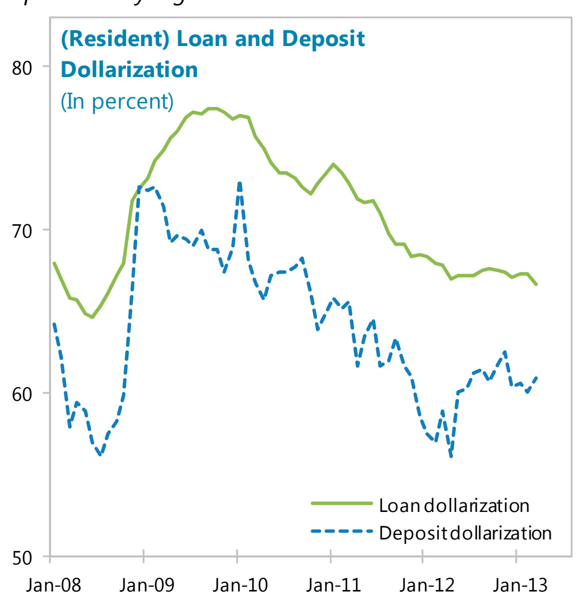
despite the increase in nonperforming loans since end-2012.



The banking sector maintains comfortable liquidity and capital ratios,



which balances the risks derived from persistently high dollarization.



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

Box 1. Georgia: Scaling Up Social Expenditures

The newly established universal healthcare system will cover around 2.5 million previously uninsured individuals and costs about 1 percent of GDP. Since March 2013, emergency health care has been made free of charge for in-patient and out-patient services. From July onwards, individuals previously not covered by state insurance programs (about half Georgia's population, including children above the age of 6 and adults) will benefit from non-emergency services without having to contribute to the scheme. A newly created Social Service Agency will negotiate rates and procedures and reimburse medical providers, which patients can choose freely. Most medical services will have a substantial co-pay (still to be decided), which could leave a market for existing private insurance companies. Under the basic scheme, most drugs will not be covered, but could be added in the future, together with additional medical procedures. From May 2014 onwards, the Social Service Agency will cover individuals previously covered by state programs (socially vulnerable, pensioners, children below 6) whose insurance was operated by private companies. While substantial savings are expected from centralized purchases and negotiations, the reform plans are estimated to add 1 percent of GDP per year to existing health costs, making health the largest reform area.

Pension increases will narrow the gap with the subsistence minimum. Old-age pensions, a flat basic allowance that includes a GEL 15 health insurance premium, are being increased in two stages: to GEL 125 in April and then to GEL 150 from September. The cost is around 0.8 percent of GDP. Disability pensions rise to GEL 150 and GEL 100 depending on the severity of the disability, and pensions for victims of political repression rise to GEL 100. Disability pensions and pensions for work related injuries are introduced (0.2 percent of GDP). The authorities are working on a mandatory second pillar contribution scheme.

Targeted social assistance (TSA) allowances are being doubled. Georgia's TSA currently covers around 10 percent of the population, identified by proxy means-testing. Monthly allowances will double: starting in July, the first household member will receive GEL 60 (US$37) and GEL 48 (US$29) for each additional household. This will cost 0.5 percent of annual GDP.

Education spending is being increased slightly (0.2 percent of GDP), mainly for vouchers used by public schools to finance their expenses, and for renovation of public school buildings scheduled for July/August. In addition, teacher salaries were increased in early 2013.

Social Expenditures, 2010–13

	2010	2011	2012	2013 proj.
	(In percent of GDP)			
Education	2.9	2.7	2.9	2.9
Health	2.2	1.6	1.6	2.7
Social Protection	6.9	6.4	6.6	7.2
Pension[1]	4.1	4.0	4.1	4.2
Social assistance[1]	1.2	0.9	1.0	1.8
Total	12.0	10.7	11.1	12.8

Sources: Ministry of Finance; and IMF staff estimates.

[1] Economic definition

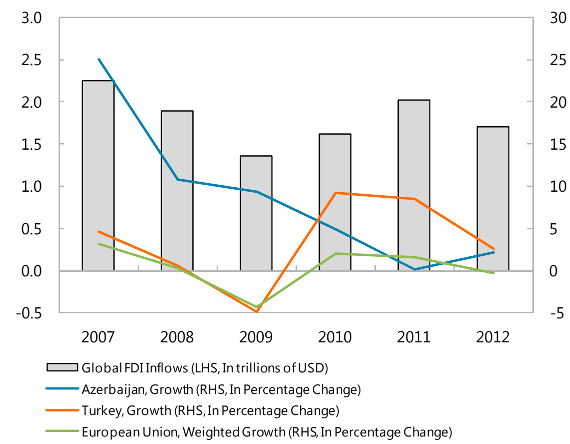
POLICY DISCUSSIONS

13. Against the background of the slowdown and the government's ambition for rapid and inclusive growth, discussions focused on: the size and causes of the current slowdown, and the appropriate policy response; the main economic risks, including reducing the current account deficit to ensure external sustainability; structural reforms for sustained medium-term growth; improvements to the NBG's inflation targeting regime and financial supervision; and the likely success of the government's reform initiatives in improving social outcomes.

A. Understanding and Ending the Slowdown

14. The recent slowdown has proved more protracted than originally hoped for. Both the authorities and staff accepted that some slowdown was likely, given investor uncertainty ahead of the elections. Global FDI and partner country growth had also weakened slightly. While lowering the policy rate during the election period would have been risky, the subsequent deflation meant that real interest rates (ex post) have been much higher than anticipated. Though clearer now, uncertainty over the new government's economic and political orientation probably also contributed. Conflict between President Saakashvili and Prime Minister Ivanishvili had discouraged foreign investors, while companies associated with the previous government have been reluctant to invest.

Global Foreign Direct Investment and Real Trade Partner Economic Growth



15. In light of the recent slowdown, staff projects that growth this year could fall to 4 percent, substantially below potential. The staff's projection assumes strong policy actions by the authorities (described below), that boost growth to an annualized rate of around 9 percent (seas. adj.) for the remainder of the year. In contrast, the Ministry of Finance expects a stronger acceleration, based on government spending recovering, higher investment once the private-equity funds are established, and opening of the Russian market. The Ministry was also concerned that prematurely releasing lower growth projections (which they argued were subject to considerable uncertainty) could weaken confidence.

16. To support recovery, staff urged the authorities to reverse the shortfalls in government spending and allow the automatic stabilizers to work. The authorities agreed and were confident of executing most budget spending, as several large infrastructure projects had already started in April. Due to the slowdown, revenues are expected to underperform this year by around 1 percent of GDP. With inflation subdued and the current account deficit falling, the mission argued for letting the automatic fiscal stabilizers operate. Lower revenues should only be partly offset by lower government spending, so that the deficit target might need to be increased from

2.8 to 3.3 percent of GDP. This would keep the structural deficit in line with First and Second Review projections. The same principles would apply to 2014, should the slowdown last longer than currently expected and carry over to next year. The authorities were confident that, even if revenue proved lower than budgeted, they would be able to meet the existing deficit target through spending cuts.

17. The mission encouraged the NBG to consider further policy rate cuts, given the slowdown and low inflation. While inflation is about 8 percentage points below the medium-term target, the NBG explained that half this difference reflects supply shocks to which monetary policy should not respond (Text Table 1). Staff noted that Taylor Rule calculations suggested further scope for rate cuts (in light of the output gap and low inflation). However, the NBG argued that its models predict inflation will soon pick up, which would call for future interest rate increases: cutting rates now could create unnecessary fluctuations in the policy rate. In contrast, staff was concerned that if recovery does not materialize, the present deflation and high real interest rates might be unnecessarily prolonged. Staff encouraged the government and the NBG to assess the severity of the slowdown, its likely permanence, and the government's intended policy response, so that the NBG could better judge whether more aggressive easing of monetary policy was warranted.[2]

Text Table 1: Inflation Determinants, March 2013.

Headline inflation	-2.1%
Difference from target	8.1%
Supply side factors	-4.4%
Base effect	-2.1%
Imported prices	-1.0%
Electricity	-0.3%
Utilities	-0.3%
Natural gas	-0.2%
Mark-up reduction effect	-0.4%
Other supply side factors	-0.1%
Demand side factors	-3.7%

Source: NBG calculations.

18. The mission welcomed the NBG's attempts to improve monetary transmission by steps to encourage long-term lari lending. In light of the steep yield curve, the NBG argued that increasing long-term lari liquidity and lowering long rates was needed. While the mission believed there was still a case for policy rate cuts, it agreed with the NBG's proposal for the government to issue treasury bills and deposit the proceeds long-term with commercial banks, to encourage long-term lari lending. The NBG's initiative to encourage flexible rate lari lending by banks, through

[2]Subsequent to the mission, on June 19 the NBG cut its policy rate a further 25 basis points, from 4.25 to 4 percent.

easing of NBG collateral standards (but in a way that protects the NBG from credit risk), should also help.

19. To reduce business uncertainty, the mission encouraged the government to strengthen communication of its policies and to announce them only once the main details have been agreed. Businesses expressed concern over the proposed Labor Code revisions, and the difficult and drawn-out consultation process, which weakened confidence. Details of the proposed US$3 billion private investment fund are also unclear. To reduce uncertainty, the mission urged the government to develop detailed information about the objectives, implementation, and timetable for new policy initiatives before public announcements. Resolving uncertainty faced by companies perceived as "close" to the previous government could also help.

B. Policies to Ensure External Sustainability and Reduce External Risks

20. Discussions on the medium-term outlook focused on how to lower the current account deficit and reduce external vulnerability without unduly sacrificing growth. Over the medium term, structural reforms are projected to sustain investment, factor productivity, and return growth to its potential of around 6 percent. Inflation would gradually realign with the NBG's medium-term target (5 percent for 2015), supported by continued improvements to the inflation targeting regime and central bank independence. To ensure external sustainability, the current account deficit needs to gradually decline to around 6 percent of GDP, which would lower the external debt ratio to around 70 percent of GDP by 2017. In addition to structural reforms to improve competitiveness, this will require continued fiscal consolidation. The authorities reiterated their commitment to gradually reduce the fiscal deficit to 1.5 percent of GDP by 2017, consistent with a modest reduction (¼-½ percent of GDP a year) of the primary structural balance from 2014–17.

21. The authorities agreed on the need to improve competitiveness but questioned the magnitude of the exchange rate overvaluation. Using the CGER methodology, with a 2012 current account deficit of almost 12 percent of GDP, staff estimates the exchange rate is approximately 15 percent overvalued, so exchange rate adjustment will likely be needed (Box 2). The NBG questioned the policy relevance of these estimates, given the substantial appreciation pressures currently faced, and noted the wide uncertainty bands attached to them. The authorities were reluctant to sacrifice Georgia's strong growth for the sake of current account deficit reduction.

22. The authorities argued that structural reforms would be more effective than real depreciation in reducing the trade deficit. While expanding Georgia's traditional exports (metals and minerals) seems challenging, structural reforms could boost exports in agriculture, hydropower, textile and other light processing sectors, and tourism. The authorities argued that agreement on the EU FTA and introduction of the private investment funds could encourage FDI and improve the financing of the current account. Staff agreed on the importance of these structural reforms, but argued that exchange rate adjustment would likely still be needed given that these reforms are difficult and take time to implement.

23. The authorities believed the main domestic risks were well contained. The government argued strongly that removal of the President's power to dismiss and install a new government had eliminated the main political risk. Notwithstanding October's Presidential elections, the government was confident the current political polarization would die down, which would encourage foreign investment. The Ministry of Finance argued that procurement delays had been largely overcome, so there was limited risk of a spending shortfall for the year.

24. The authorities broadly agreed with the mission's assessment of the main risks from external spillovers. They agreed that a decline in capital inflows, which could be triggered by higher interest rates in advanced economies or weaker growth in emerging markets, was the major downside risk. Conversely, the authorities noted that intensification of capital inflows (for example, if low world interest rates were to persist) was a significant medium-term risk, as it could delay the necessary external adjustment and lead to higher external liabilities. In view of Georgia's limited economic and financial linkages to the EU, the authorities were less worried by possible recession in Europe unless sufficiently deep to affect other countries in the region. They considered that a slowdown in neighboring Turkey (through the trade channel) or Russia (through the remittances channel) would have greater direct impacts. The authorities also viewed the opening of the Russian market to Georgian products as a two-sided risk, depending on whether this was delayed, or took place more quickly and for a broader range of goods than currently assumed. They agreed with the mission that, if these risks were to materialize, in most cases the policy response would involve exchange rate flexibility, acceleration of structural reforms, mobilization of financing from the IMF and other development partners, along with assessing the scope for a moderate counter-cyclical fiscal response.

Box 2. Georgia: External Stability Assessment

Georgia's large current account deficit and external indebtedness remain sources of external vulnerability. Improving competitiveness and reducing financing vulnerabilities are critical to ensuring external stability over the medium term.

Despite recent depreciation, using CGER methodologies staff estimates real exchange rate overvaluation of around 15 percent:

- **The macro balance (MB) approach suggests a 15 percent real depreciation is needed to close the gap between the underlying current account deficit (10.3 percent of GDP) and its norm (6.8 percent of GDP).** A relatively "healthy" NFL position (60 percent of GDP) is used for the CA norm calculation.[1] The underlying current account is the medium-term current account deficit without policy actions or structural changes. The potential impact of structural reforms in reducing the underlying current account deficit is not included, given uncertainty over their magnitude.

- **The equilibrium real exchange rate (ERER) approach points to a smaller overvaluation, of only 5 percent.** Projected medium-term improvement in the terms of trade gradually reduces estimated ERER overvaluation from 12 percent in 2012 to 5 percent in the medium term.

Georgia: Exchange Rate Assessment

	MB	ERER	ES
Current Account Norm 1/	-6.8		-4.2
Underlying Current Account 2/	-10.3		-10.3
CA gap	3.5		6.1
Elasticity	0.2		0.2
Real Exchange Rate Gap 1/ 3/	15.3	5.1	27.1

1/ Current account norm and equilibrium real exchange rate are calculated using

2/ Underlying current account is based on actual current account balance in 2012

3/ Movement in real exchange rate needed to close the CA gap between norm and

- **The external sustainability (ES) approach suggests a substantially higher overvaluation, of about 27 percent.** This approach assumes that Georgia lowers its net foreign liabilities to a relatively "healthy" level (60 percent of GDP), which gives a much lower current account norm of 4.2 percent of GDP.

However, the results are subject to large uncertainties and are sensitive to assumptions. The estimated CA norm (in MB) and equilibrium REER (in ERER) are based on panel regressions, which may not fit for Georgia given transition-related structural breaks. Based on empirical studies, an NFL position at 60 percent of GDP is assumed sustainable: however, it is very hard to estimate a "sustainable" NFL position for Georgia.

Structural reforms that improve export competitiveness would reduce the need for exchange rate adjustment. Georgia's weak trade performance appears to reflect both price and quality competitiveness issues. Asymmetric bilateral trade development with the main trading partners (EU and Turkey) explains a

Box 2. Georgia: External Stability Assessment (continued)

large part of the trade deficit worsening. Bilateral regressions show that exports and imports are strongly linked to partner and domestic demand. In contrast, the real exchange rate seems to have a significant impact only for imports, pointing to diversification and quality issues.

Recent deterioration in the quality of external financing raises concerns about potential vulnerability. FDI used to be the main source of external financing, before 2012 accounting for more than 50 percent of foreign inflows. However, in 2012 only one-third of capital inflows were FDI, with SOE Eurobonds and increased nonresident deposits providing a large part of external financing. This decline reflects uncertainties from the election and the political transition, but also more fundamental trends. About 20 percent of the FDI during 2006–08 was privatization-related, which is unlikely to recur. In addition, returns to FDI don't seem very high: an annual rate of return of around 7 percent from 2007–12, compared to a 9 percent average dollar deposit rate. Restoring business confidence and further improving the business environment are critical for FDI recovery. The NBG decision to increase liquidity requirements for nonresident deposits, which will become effective later this year, should also help reduce financing vulnerability.

Net foreign liabilities remain high but have long maturity . Georgia's NFL position has been around 100 percent of GDP since 2009, but more than 85 percent of this is in the form of FDI and long-term concessional loans borrowed by the government. However, if financing quality keeps worsening and the current account deficit stays high, the large net external liabilities will be difficult to sustain.

Strengthening the international reserve position could provide better protection. At end-2012, official reserves were broadly adequate, equivalent to 102 percent of short-term debt at remaining maturity, 3.7 months of imports, or 144 percent using the IMF's composite metric. However, reserves are expected to decrease slightly in 2013–14 due to repayments to the Fund. More active reserve accumulation, as currently being implemented by NBG, is recommended to address these concerns and is also consistent with the finding of overvaluation.

Risk Assessment Matrix[1]

Nature/source of risk	Likelihood of realization in the next three years	Expected impact on the economy if risk is realized
Short-term: Financial stress in the Euro area re-emerges (triggered by stalled or incomplete delivery of national and Euro area policy commitments) **Medium-term: Protracted period of slower European growth** (larger than expected deleveraging or negative surprise on potential growth)	**Staff assessment: Medium (financial stress in Euro area) and High (slower European growth)** The resulting impact on Euro-area growth would likely spillover to Russia and the region.	**Staff assessment: Low to Medium** Georgia would likely be affected primarily through the trade and external roll-over channels and, to a lesser extent by the FDI and remittance channels. A protracted slowdown would reduce the gains expected from the opening of Russian markets to Georgian goods.
Global oil price shock triggered by geopolitical events (driving oil prices to $140 per barrel)	**Staff assessment: Low**	**Staff assessment: Medium** Reserves should be sufficient to address an immediate shock, but a prolonged shock would likely require adjustment. The trade impact of such a shock would be partly offset by the spillovers of the positive impact on the Russian economy.
Disorderly external adjustment in Georgia (the external current account deficit remains a source of vulnerability) **Emerging Markets capital flow reversal** (associated with a strong unwinding of asset price overvaluation in some countries)	**Staff assessment: Medium** A postponement of the external adjustment would result in a further increase of Georgia's already high foreign liabilities and could result in a sudden stop in capital inflows. Such a sudden stop could also be triggered by a reversal of capital flows to emerging markets.	**Staff assessment: Medium** Financing from international reserves and available under the SBA/SCF would need to be complemented by policy and exchange rate adjustment. NBG's stepped-up purchases on the FX market measures to contain non-resident inflows should mitigate these risks.
Political unrest ahead of the October elections (tension between the governmental majority and the opposition could flare up ahead of the elections)	**Staff assessment: Medium** Such tensions could prompt the government to increase spending ahead of the elections and to make populist electoral promises.	**Staff assessment: Low to Medium** The macroeconomic impact could be long-lasting if the government delivers on populist promises following the elections.
Political uncertainty as a result of the elections (the October presidential election could result in a new cohabitation)	**Staff assessment: Low to Medium** While the government seems to enjoy strong ratings, the 2012 general elections have shown the difficulty of predicting election results in Georgia.	**Staff assessment: Low to Medium** Prolonged uncertainty and a new cohabitation could dent further investor confidence.

[1] This matrix reflects staff views on the source of risks and overall level of concerns as of the time of discussions with the authorities.

C. Structural Reforms to Boost Growth and Competitiveness

25. The authorities agreed on the importance of structural reforms if Georgia is to sustain strong growth. Demographic trends point to a declining labor force, so economic growth will need to rely on capital accumulation but especially TFP gains (around 3–4 percent annually), which will hinge on the following structural reforms:

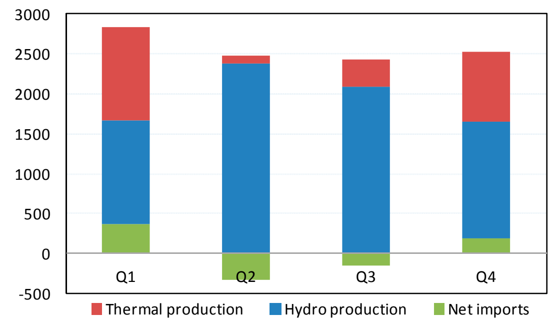
- Vocational training to reduce skill mismatches. Reallocation of workers away from subsistence agriculture to higher productivity sectors could generate large TFP increases, as could increase agricultural productivity.
- Enlarging market size by increasing the Georgian products' competitiveness and improving access to foreign markets, including through free trade agreements.
- Encouraging private savings by developing local capital markets, creating contributory pension systems and ensuring macro-economic stability.
- Strengthening property rights through an independent judiciary that fairly enforces the rule of law, and creation of a competition agency to combat domestic monopolies.

26. To realize Georgia's huge economic potential in energy, the mission (working with the World Bank) encouraged the government to focus on establishing transparent and fair "rules of the game" (Box 3). The mission questioned recent electricity tariff reductions (negotiated directly with distributors) as these would seem to lower distribution company profitability (unless there is some side-benefit) and could undermine future investment in the energy sector. The authorities emphasized that the distribution companies had agreed with the tariff cuts; investment in the sector would not be affected as there was no room for potential entrants in distribution. The authorities agreed that publishing the contracts would help assuage the mission's concerns but they would need the companies' consent to do so. With the World Bank, the mission encouraged the economics ministries to develop an energy policy strategy that would strengthen the regulatory framework, including how prices are set and rules for transmission line access. This would encourage new hydropower investment (three proposed large projects have an estimated cost of around 15 percent of GDP) and could lessen the need for issuing government guarantees. While willing to consider developing a strategy, the Ministry of Energy did not exclude the need to issue PPA guarantees for strategic projects (such as Nenskra, which they consider vital to Georgia's energy independence).

Box 3. Georgia: Electricity Sector

The hydropower sector is of significant macroeconomic importance in Georgia. Harnessing this domestic source of cheap energy will be critical for sustaining high growth, reducing external energy dependence, and improving the current account balance. This requires sector reforms and investment. If attracting private investment in large hydro projects requires government-backed power purchase agreements, they need to be structured properly to ensure sufficient risk transfer to the private sector and contain public sector risks.

Georgia: Electricity Balance, 2012, million KWh



Georgia has large hydropower resources. Water flow patterns make hydropower generation seasonal. Summer surpluses are exported to Russia or Turkey, while winter shortfalls are covered by electricity from gas-based thermal stations and imports. Hydro stations generate about 75 percent of annual output while summer exports offset winter imports.

Growing domestic consumption will lead to higher imports unless matched by increased hydropower capacity. Domestic consumption has outpaced production in recent years. Electricity imports have increased, with Georgia becoming a net electricity importer in 2012 for the first time in almost a decade. Moreover, while higher-cost gas-based generation increased, hydro generation fell. Reversing these trends, which have contributed to a worsening of Georgia's current account deficit, requires fuller utilization of its hydro potential.

Higher prices and large summer demand make Turkey an attractive export market. The Turkish market, where wholesale prices are more than 30 percent higher than in Georgia, is expected to grow rapidly, about 7 percent annually. The soon to be launched high-capacity power transmission line from Georgia to Turkey will link the countries' grids and could boost exports of Georgian electricity.

Hydropower generation costs are set to increase over time. The average generation cost in Georgia is currently low thanks to the fully amortized old hydropower stations. The largest, the half-century old state-owned Enguri plant, accounts for 32 percent of total generation with a very low price of less than 1 US$ cent per kWh. In comparison, electricity generated by new hydro stations would cost approximately 6 US$ cents per kWh. While still internationally competitive, the average generation cost is expected to increase as the share of electricity generated by the already amortized hydropower stations declines.

Recent tariff cuts may undermine investor interest in the sector. Tariffs were cut for low-end consumers in January and again in April, by about 25 percent. To help distribution companies offset the cost, they were allowed to purchase more of Enguri's cheap electricity. While agreed with distributors, the cut in tariffs went against the inevitable upward trend in the average generation cost. This could potentially undermine trust in the regulatory framework and discourage investment.

The sector needs investment and reforms to meet domestic demand and tap export markets. The electricity sector underwent serious reforms in the past decade. Its liberalization, especially unbundling and privatization of key assets, led to significant improvements in performance: losses were reduced, payment discipline strengthened, and the reliability of electricity supply improved. Further progress will depend on the success of reforms to strengthen the regulatory framework, make price-setting transparent and clear, improve access to the Turkish electricity market, and develop transparent rules for transmission line access.

27. The mission urged the government to clarify the objectives of the various investment funds it is establishing, and to align their governance with international best practice. The authorities have hired an independent adviser to improve governance of the Partnership Fund, which will retain its mandate of using minority financing to catalyze commercially viable projects. The mission urged the authorities to clarify the objectives, governance structure and size of the Agricultural Development Fund (which is expected to disburse around 0.8 percent of GDP in 2013), and the Private Equity Fund (planned size US$3 billion or 20 percent of GDP). It was still not clear what market imperfections the funds were addressing. The mission encouraged the authorities to carefully design the governance of these funds, to ensure that projects sponsored by these funds will not receive preferential treatment, and to avoid appearances of conflicts of interest. The authorities indicated they would provide more information on these funds soon, and ensure they follow best practice in terms of governance.

28. The mission welcomed the government's focus on agriculture but encouraged the authorities to complement greater financial support with sector reforms. The government is improving irrigation infrastructure and trying to complete the land registry. The Agriculture Fund has distributed vouchers to small farmers to finance seed and fertilizer purchases. Though some vouchers may have been misused and traded, and allegations of misspending by officials led to the Agriculture Minister's resignation, the result has been a doubling in the area of land under cultivation. In cooperation with commercial banks, the Fund has developed interest-subsidy lending schemes for farmers and for investment in agro-processing.

29. Recent revisions to the Labor Code could make growth more inclusive. An election commitment, the revised code requires employers to pay overtime, increases severance pay (to 1–2 month's salary), strengthens workers' rights to challenge employer's decisions in courts, prohibits firing without clear reasons for dismissal, and guarantees basic working conditions. These changes may increase employer costs (unless overtime pay is offset by a reduction in the basic hourly wage), but should help boost employee morale and productivity and bring labor regulations closer to commitments under the prospective Association and DCFT agreements with EU. While, on balance, welcoming the proposed Labor Code revisions, the mission noted that delays in drafting and the changing government position on the content had added to business uncertainty.

D. New Government's Social Policies

30. The new government has ambitious plans to match better economic performance with improved social outcomes. The mission discussed these plans with the authorities, given past problems achieving inclusive growth, and because spending on these reforms form a large part of the 2013 budget (an extra 3 percent of GDP)**.**

31. The mission welcomed the government's plans to introduce universal healthcare system (extra 1 percent of GDP cost in the 2013 budget) but cautioned on implementation risks. While government health spending as a share of GDP is low in Georgia, total health spending is quite high. The mission agreed the planned health care reform could help reduce Georgia's very high private health costs (and so reduce the risk of individual financial distress) and improve health outcomes. However, the proposed reforms would still leave sizeable co-payments for drugs and left the future role for private insurers unclear. The authorities acknowledged that the speed of reform could create implementation risks, in particular at the outset, and were cooperating closely with the World Bank and WHO to overcome these. The authorities expected the Social Service Agency would achieve major cost savings through centralized procedures and better control of medical services.

32. The mission welcomed the authorities' plans to improve educational quality and vocational training. The government plans major reforms to address skills mismatches (promoting tertiary education in mathematics and financing new science faculties) and lack of skills, for instance in agriculture. The government has recently made pre-school free, but low quality and bad infrastructure means enrollment has been poor. Teacher salaries have been increased by GEL 60–205 per month (depending on performance) to an average of GEL 413 (US$250) per month, according to the World Bank.

33. Because they are universal rather than targeted, proposed increases in social expenditures might be less effective in reducing inequality. Staff acknowledged the planned reforms and spending increases should improve health, education, and – to some extent – poverty outcomes. However, 80 percent of the new spending is on universal transfers and so may have limited effects on inequality. New health insurance should benefit the (lower) middle classes most, as socially vulnerable households are already covered. Pension increases are completely universal given the flat benefit and no contribution scheme. Instead of doubling the monthly TSA allowance, the mission and the World Bank would have recommended broadening coverage (30 percent of the population still lives below the US$2 poverty line). To lower inequality, the mission suggested complementing these measures with revenue reforms – for example, by making personal income tax more progressive.

E. Monetary and Financial Sector Reform

34. The NBG continues to improve monetary operations and Georgia's inflation targeting framework. Improvements in monetary operations have seen interbank, NBG CD, and Treasury rates more closely aligned with the policy rate over the last two years. The mission welcomed the NBG's efforts to improve its forecasting capabilities and to increase transparency by strengthening its communication strategy with an upgraded inflation report and press conferences that discuss economic forecasts and monetary policy performance. The mission recommended these events follow a pre-announced schedule, to improve transparency and accountability, and strongly stressed the importance of preserving the independence of the NBG.

35. Despite these improvements, the mission also discussed possible further refinements to the inflation targeting regime:

- The mission supported the NBG's initiatives to strengthen the monetary policy transmission mechanism and to encourage de-dollarization of the financial sector, including the recent

- introduction of floating-rate lari loans by banks, and the authorities' goal of developing the corporate bond market and the stock market.
- Despite price deflation, both sides agreed there was little benefit to lowering the inflation target. For the medium term, staff concurred with the authorities that a relatively high target for headline inflation might need to be retained given Balassa-Samuelson effects plus the difficulty of hitting any specific point target given Georgia's inflation volatility and weaknesses in the transmission mechanism.
- Despite recent stability against the dollar, the NBG reiterated its commitment to a floating exchange rate. The mission agreed that recent foreign exchange purchases help address the need to build reserves, resist overvaluation pressures, and avoid further deflation. The true test would come were the lari to face depreciating pressures.

36. The NBG reports that the financial system continues to retain comfortable levels of capital and liquidity (Table 6 and Figure 6). As of April, the system's capital adequacy ratio (NBG measure) was 18 percent and the liquidity ratio 41 percent, both comfortably above minimum requirements (of 12 and 30 percent). Even though NPLs increased at end-2012, banking sector profitability has been stable so far in 2013, which the NBG argued was due to banks provisioning for these ahead of time. Moreover, the NBG explained that the increase in NPLs reflected idiosyncratic events affecting corporate loans and do not pose financial stability risks given buffers and profits in the banking sector.

37. The mission stressed the risks arising from nonresident deposits, which have become a significant source of funding for banks. Dollarization, at around two-thirds of loans and deposits, continues to pose the main risk to the financial sector. The NBG noted that an increasing fraction of the nonresident deposits were only withdrawable at maturity. New supervisory measures (the end-June 2013 new liquidity requirement for nonresident deposits; liquidity coverage ratio adoption, with assumed higher outflow rates for FX deposits than without taking into account currency denomination by end-2013; and capital add-ons for FX lending risks in 2013 stress tests) should help discourage nonresident deposits and dollarization. Staff supported the NBG's vision to further deepen the financial sector by developing the local corporate bond and stock markets, for which pension reform would be helpful. These measures, together with maintaining financial sector stability, could also help encourage private savings.

38. The NBG has completed a self-assessment of its banking supervision framework and will share it with staff in the coming weeks. The mission discussed with the NBG and its ADB consultant its current transition to risk-based supervision. The NBG is currently fine tuning the process of submission and review of bank ICAAP forms to better monitor banks' risk analysis. The mission expressed concern over the removal of insurance supervision from the NBG, but also over delays in establishing a new insurance supervisory body. To maintain the quality of NBG supervision, staff stressed the importance of maintaining competitive salaries. Staff noted the authorities' request for an FSAP, and hoped that it could start in the coming year.

STAFF APPRAISAL

39. Georgia's economic performance has continued to be strong, despite a recent slowdown. Real GDP growth averaged 6½ percent in 2011–12, about 1½ percentage points more than projected at the 2011 Article IV consultation. Unemployment has fallen slightly, from more than 16 percent in 2010 to 15 percent in 2012, but remains high. Inflation has fallen steadily, reflecting lower food prices, lagged effects of the appreciation of the nominal effective exchange rate, and cuts in administered energy prices. The exchange rate has faced appreciation pressures but has been kept stable against the US dollar. However, political uncertainty in the run up to the October 2012 elections, policy uncertainty, government under-spending after the elections, and a lackluster global environment have contributed to a marked economic slowdown and the persistence of inflation well below its medium-term target.

40. Georgia needs to overcome a number of challenges to continue this strong performance. In addition to making sure the recent slowdown proves only a temporary pause, these include the need to sustain strong growth while making it more inclusive, reduce the current account deficit to levels consistent with external sustainability, and address structural weaknesses, including in terms of governance and rule of law.

41. Reluctance to recognize that growth in 2013 may be lower than expected has delayed consideration of the causes of the slowdown and the appropriate policy response. This delay could prove costly if the slowdown turns out to be more protracted than the authorities have expected. Earlier acknowledgement that growth may be lower, together with policy measures, would enhance the government's credibility, increase business confidence, and help support growth.

42. In the short term, more expansionary fiscal and monetary policies are needed to support recovery. The government needs to address the causes of recent budget under-spending, to make sure spending recovers later in the year. Given the fall in inflation and the current account deficit, there could be scope for allowing a higher budget deficit in the near term, to the extent that revenues are lower due to the slowdown. Further monetary loosening also appears warranted, accompanied by measures to strengthen the transmission mechanism, including issuing treasury bills and depositing the proceeds long-term with commercial banks, to encourage longer-term lari lending.

43. Greater clarity and improved communication of economic policies can reduce business uncertainty. While many of the goals of the new government's reforms are welcome, insufficient detail on major policy initiatives has increased uncertainty. Combined with political tensions, this has deterred private investment, adding to the economic slowdown. The adoption of the Labor Code revisions removes one of the key sources of investor uncertainty, while striking a better balance between the interests of employers and employees, to improve welfare and enhance productivity. The government should also clarify the role and improve the governance of the different investment funds it intends to establish, as well as the barriers to investment they are designed to overcome.

44. Greater cooperation between the government and the central bank is also essential for recovery. The NBG's moves towards greater transparency, by improving the inflation report and launching regular meetings to explain inflation developments and reasons behind interest rate decisions, are welcome. However, further cooperation between the NBG and the Ministry of Finance, in a way that preserves central bank independence, would make it easier to discuss the slowdown, and to devise a coordinated monetary and fiscal policy response for recovery.

45. Over the medium term, Georgia's main macroeconomic challenge remains to gradually reduce its current account deficit and foreign indebtedness. Though welcome, the recent decline in the current account appears largely cyclical. To ensure external sustainability, and to strengthen the economy's resilience to external shocks, the government should aim to gradually lower the current account deficit to around 6 percent of GDP in the medium term through continued fiscal consolidation, higher private saving (through pension reform and deepening of local financial markets), exchange rate adjustment, and structural reforms to improve competitiveness. Continuing reserve accumulation is recommended given the exchange rate overvaluation. The authorities also need to continue to take steps to reduce dollarization, both through regulatory measures and, more permanently, by improving Georgia's economic and political fundamentals.

46. The government's agenda of more inclusive growth is welcome, but increased social expenditures might have been better targeted. Substantial increases in social and agricultural spending should help address Georgia's problems of relatively high poverty, inequality, and unemployment. However, rapid introduction of universal healthcare system may run into implementation delays, and does not seem to address the problem of high drug costs, a main cause of risk and impoverishment. In line with World Bank recommendations, coverage of targeted social assistance might also have been broadened.

47. The authorities' commitment to tackle structural impediments to growth is welcome. Addressing skill mismatches, opening up foreign markets to Georgian products and improving their competitiveness, strengthening property rights and the rule of law, and promoting competition should build on the previous government's record in improving the business environment and fighting low level corruption. In the energy sector, the government should aim at establishing transparent and fair rules, monitored by an independent regulator. This would lessen the need to provide investors with guarantees.

48. The staff recommends that the next Article IV consultation be held in accordance with the September 28, 2010 Decision on Article IV Consultation Cycles, as amended.

Table 1. Georgia: Macroeconomic Framework, 2010–14

	2010	2011	2012	2013		2014
				1st/2nd		
	Act.	Act.	Est.	Rev.	Proj.	Proj.
National accounts	(annual percentage change; unless otherwise indicated)					
Real GDP	6.3	7.2	6.1	6.0	4.0	6.6
Nominal GDP (in billion of laris)	20.7	24.3	26.1	28.9	27.2	30.2
Nominal GDP (in billion of U.S. dollars)	11.6	14.4	15.8	17.0	16.3	17.3
GDP per capita (in thousand of U.S. dollars)	2.6	3.2	3.5	3.8	3.6	3.9
GDP deflator, period average	8.5	9.5	1.2	3.5	0.2	4.0
Population (in million) 1/	4.4	4.5	4.5	4.5	4.5	4.5
Unemployment rate (in percent)	16.3	15.1	15.0	...	...	...
Investment and saving	(in percent of GDP)					
Gross national saving	11.3	13.4	17.5	16.1	16.0	18.6
Investment	21.6	26.2	29.0	26.1	25.1	26.3
Private	13.4	18.5	21.4	20.3	18.7	20.1
Inflation	(in percent)					
Period average	7.1	8.5	-0.9	1.0	-0.8	4.5
End-of-period	11.2	2.0	-1.4	3.2	1.5	5.5
Consolidated government operations	(in percent of GDP)					
Revenue 2/	28.3	28.2	28.8	27.5	28.1	27.9
o.w. Tax revenue	23.5	25.2	25.4	25.3	25.7	25.5
Expenditures	34.9	31.8	31.8	30.4	31.5	30.3
Current expenditures	26.0	23.1	23.2	23.7	24.6	23.8
Capital spending and net lending	8.8	8.8	8.7	6.6	6.9	6.4
Overall balance	-6.6	-3.6	-3.0	-2.8	-3.3	-2.4
Public debt	39.2	33.8	32.3	31.2	31.8	31.8
Of which: foreign-currency denominated	33.6	28.8	27.6	26.6	26.8	26.3
Money and credit	(annual percentage change; unless otherwise indicated)					
Credit to the private sector	18.8	24.3	12.8	25.4	14.3	22.6
Credit to the private sector (constant exchange rate from 12 month prior)	14.5	29.5	13.4	21.7	13.1	17.3
Broad money (incl. fx deposits) 3/	23.9	20.3	11.4	20.5	15.5	18.5
Broad money (incl. fx deposits, constant exchange rate from 12 month prior) 3/	20.9	23.7	11.8	17.9	14.6	14.7
Deposit dollarization (in percent)	68.6	63.3	66.0	64.8	65.5	62.3
Policy rate (in percent, end-of-period)	7.5	6.8	5.3	...	...	...
Deposit interest rate (in percent, annual average)	7.9	9.4	8.6	...	...	...
Lending interest rate (in percent, annual average)	19.5	18.7	19.0	...	...	...
External sector	(in percent of GDP; unless otherwise indicated)					
Gross international reserves (in billions of US$)	2.3	2.8	2.9	2.6	2.8	2.7
In months of next year's imports of goods and services	3.4	3.7	3.7	3.2	3.4	3.2
In percent of broad money and non-resident deposits	62.0	59.3	51.9	41.6	44.4	40.3
Current account balance (in billions of US$)	-1.2	-1.8	-1.8	-1.7	-1.5	-1.3
In percent of GDP	-10.2	-12.7	-11.5	-10.0	-9.1	-7.7
Trade balance	-22.3	-24.2	-26.6	-24.7	-24.8	-23.7
Foreign direct investment (inflows)	7.0	7.3	5.5	5.7	5.8	6.0
Gross external debt	84.1	77.8	81.4	77.8	81.8	79.0
Gross external debt, excl. intercompany loans	62.9	58.9	63.4	59.0	63.5	60.9
Exchange rates						
Laris per U.S. dollar (period average)	1.78	1.69	1.65	...	...	...
Laris per euro (period average)	2.36	2.35	2.12	...	...	...
REER (period average; CPI based, 2005=100)	118.5	129.6	131.8	...	...	...

Sources: Georgian authorities; and IMF staff estimates.

1/ Excludes Abkhazia residents.

2/ Includes grants.

3/ Not including the proceeds of the Georgian Railway eurobond issuance of July 2010, deposited in Georgian commercial banks which placed the corresponding funds abroad.

Table 2. Georgia: Summary Balance of Payments, 2011–18
(In millions of U.S. dollars)

	2011	2012	2013		2014	2015	2016	2017	2018
			1st/2nd						
	Act.	Est.	Rev.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-1,840	-1,814	-1,694	-1,489	-1,335	-1,314	-1,300	-1,389	-1,460
Trade balance	-3,494	-4,214	-4,193	-4,038	-4,105	-4,252	-4,402	-4,689	-4,940
Exports	3,254	3,501	3,790	3,879	4,082	4,409	4,764	5,164	5,634
Imports	-6,748	-7,715	-7,983	-7,917	-8,187	-8,661	-9,167	-9,853	-10,574
Services	748	1,101	1,266	1,257	1,459	1,573	1,741	1,938	2,094
Services: credit	2,008	2,541	2,738	2,710	2,940	3,120	3,356	3,623	3,889
Services: debit	-1,261	-1,440	-1,472	-1,453	-1,480	-1,547	-1,615	-1,685	-1,794
Income (net)	-422	-103	-173	-119	-130	-144	-221	-298	-356
Of which: interest payments	-310	-399	-391	-413	-452	-434	-469	-482	-452
Transfers (net)	1,329	1,402	1,407	1,410	1,441	1,509	1,582	1,660	1,742
Of which: remittances	617	710	746	749	787	828	869	912	958
Capital account	153	134	85	87	72	73	73	73	73
General government	136	124	77	77	62	62	62	62	62
Financial account	2,225	1,916	1,757	1,652	1,431	1,665	1,692	1,295	1,902
Direct investment (net)	902	603	794	679	770	930	1,036	1,156	1,288
Monetary authorities, net 1/	2	1	0	0	0	0	0	0	0
General government	319	503	355	354	330	279	174	116	73
Portfolio investment (net)	44	106	-15	-15	10	10	10	10	10
Long-term loans received	274	396	369	369	320	268	164	106	63
Other, net	1	0	1	0	0	0	0	0	0
Private Sector, excl. FDI	1,002	810	609	619	330	456	481	23	541
Banks	834	192	448	376	89	226	240	-342	217
Portfolio investment, net	89	223	5	5	20	25	30	-115	112
Of which: equity liabilities	-7	73	15	15	20	25	30	35	37
Loans received (net)	212	-87	207	151	148	166	188	-240	62
Long-term loans	-1	4	200	153	151	168	190	-237	65
Short-term loans	213	-91	7	-2	-2	-2	-3	-3	-3
Other, net (currency and deposits)	533	56	236	220	-79	35	22	13	43
Assets	339	-194	170	170	88	-13	-15	-16	-18
Liabilities (including NRDs)	194	250	66	50	-167	49	36	29	60
of which: NRDs	179	264	66	50	-167	49	36	29	74
Other sectors	169	617	161	243	242	230	241	365	323
Portfolio investment, net	1	510	0	0	0	-11	0	0	0
Long-term loans received (net)	335	155	197	279	262	251	246	367	326
Other, net	-167	-47	-37	-36	-20	-10	-5	-3	-2
Errors and omissions	13	-24	0	0	0	0	0	0	0
Overall balance	551	212	148	250	169	423	465	-22	515
Financing	-551	-212	-148	-250	-169	-423	-465	22	-515
Gross International Reserves (-increase)	-572	-38	238	104	84	-345	-450	28	-515
Use of Fund Resources	-59	-245	-385	-380	-252	-79	-15	-6	0
Purchases (SBA/SCF)	0	0	0	0	0	0	0	0	0
Repayments (SBA/SCF)	-59	-245	-385	-380	-252	-79	-15	-6	0
Exceptional financing	80	72	0	26	0	0	0	0	0

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

1/ SDR allocation included under monetary authorities' long-term liabilities.

Table 2. Georgia: Summary Balance of Payments, 2011–18 (concluded)
(In millions of U.S. dollars)

	2011	2012	2013		2014	2015	2016	2017	2018
			1st/2nd						
	Act.	Est.	Rev.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
			(in percent of GDP)						
Current account balance	-12.7	-11.5	-10.0	-9.1	-7.7	-7.1	-6.4	-6.3	-6.1
excluding official transfers	-13.7	-12.2	-10.3	-9.5	-7.8	-7.1	-6.5	-6.3	-6.1
Trade balance	-24.2	-26.6	-24.7	-24.8	-23.7	-23.0	-21.8	-21.3	-20.5
Net capital inflows to private sector	13.2	8.9	8.2	8.0	6.4	7.5	7.5	5.3	7.6
			(growth rates, in percent)						
Exports of GNFS									
value growth	29.6	14.8	7.6	9.0	6.6	7.2	7.8	8.2	8.4
volume growth	12.0	15.0	8.8	8.8	9.7	7.6	6.9	6.7	7.0
price change	15.7	-0.2	-1.1	0.2	-2.8	-0.4	0.9	1.4	1.3
Imports of GNFS									
value growth	30.5	14.3	2.8	2.3	3.2	5.6	5.6	7.0	7.2
volume growth	9.5	18.3	4.3	3.1	5.0	6.4	6.4	6.6	6.6
price change	19.2	-3.3	-1.4	-0.7	-1.8	-0.7	-0.7	0.4	0.6
			(in billions of U.S. dollars, unless otherwise indicated)						
Gross international reserves (end of period)	2.8	2.9	2.6	2.8	2.7	3.0	3.5	3.5	3.3
in months of next year GNFS imports	3.7	3.7	3.2	3.4	3.2	3.4	3.6	3.3	3.3
in percent of short-term debt at remaining maturity	118	102	103	100	105	115	112	116	101
in percent of broad money and non-resident deposit	59	52	42	44	40	39	40	34	29
Reserve cover 1/	64	55	48	52	52	59	65	61	56
External debt	11.2	12.9	13.2	13.3	13.7	14.6	15.5	15.5	16.3
External debt, excluding intercompany loans	8.5	10.0	10.0	10.3	10.5	11.3	12.0	11.9	12.3
Public	4.2	4.4	4.4	4.3	4.4	4.6	4.8	4.9	4.9
Private	4.3	5.7	5.6	6.0	6.1	6.7	7.3	7.0	7.4
Long-term	2.8	3.8	3.7	4.1	4.3	4.7	5.2	4.8	5.2
Short-term	1.6	1.9	1.9	2.0	1.9	2.0	2.1	2.2	2.2
Intercompany loans	2.7	2.8	3.2	3.0	3.1	3.3	3.5	3.7	4.0
			(in percent of GDP)						
External debt	77.8	81.4	77.8	81.8	79.0	78.8	76.9	70.4	67.8
External debt, excluding intercompany loans	58.9	63.4	59.0	63.5	60.9	60.9	59.6	53.8	51.2
Public	29.1	27.5	26.0	26.5	25.4	24.9	23.6	22.1	20.5
Private	29.8	35.9	33.0	36.9	35.5	36.0	36.0	31.7	30.7
Long-term	19.1	24.0	21.8	24.9	24.7	25.3	25.6	21.7	21.4
Short-term	10.8	11.9	11.1	12.0	10.7	10.7	10.4	10.0	9.3
Intercompany loans	18.9	17.9	18.8	18.3	18.1	17.9	17.3	16.6	16.6
Memorandum items:									
Nominal GDP (billions of U.S. dollars)	14.4	15.8	17.0	16.3	17.3	18.5	20.2	22.0	24.1

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

1/ Gross international reserve in percent of total short-term liabilities plus the current account deficit.

Table 3. Georgia: General Government Operations, 2012–18 1/

	2012	2013		2014	2015	2016	2017	2018
		1st/2nd						
	Act.	Rev.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In millions of lari)							
Revenues	7,539	7,942	7,654	8,408	9,417	10,563	11,853	13,241
Taxes	6,644	7,289	7,000	7,687	8,624	9,695	10,901	12,196
Direct taxes	2,880	3,160	3,047	3,243	3,663	4,137	4,673	5,241
Taxes on income	1,765	1,955	1,856	1,888	2,133	2,409	2,721	3,058
Taxes on profits	851	923	918	1,018	1,149	1,298	1,466	1,640
Other Taxes (incl. property)	264	281	273	337	381	430	486	544
Indirect taxes	3,764	4,129	3,954	4,444	4,961	5,557	6,228	6,955
VAT	3,015	3,349	3,179	3,603	4,065	4,586	5,174	5,808
Excises	660	686	679	744	796	865	942	1,027
Custom duties	90	95	95	97	100	106	112	120
Other revenues	618	450	450	534	597	668	747	835
Grants	277	203	203	187	196	201	205	210
Budget	106	75	75	79	83	85	87	89
Project	170	127	128	108	113	116	118	121
Expenditures	8,318	8,760	8,563	9,132	10,092	11,205	12,486	13,948
Current expenditures	6,054	6,847	6,698	7,187	7,976	8,860	9,870	11,031
Compensation of employees	1,203	1,296	1,296	1,335	1,459	1,594	1,749	1,955
Use of goods and services	1,298	1,225	1,126	1,195	1,303	1,434	1,604	1,793
Subsidies and grants	526	468	468	479	536	599	670	749
Social expenses	1,858	2,500	2,500	2,863	3,201	3,580	4,004	4,477
Other expenses	917	1,045	995	1,003	1,122	1,255	1,403	1,569
Interest	254	314	314	312	356	399	442	487
Capital spending and net lending	2,265	1,913	1,865	1,946	2,115	2,345	2,616	2,917
Capital	1,971	1,810	1,762	1,866	2,060	2,295	2,566	2,867
Net lending	293	103	103	80	55	50	50	50
Overall balance	-779	-819	-909	-724	-675	-642	-633	-708
Statistical discrepancy	0	0	0	0	0	0	0	0
Identified financing	779	819	909	724	675	642	633	708
Domestic	-95	422	506	421	219	285	401	575
Net T-bill issuance	58	150	200	350	380	400	430	460
Amortization 2/	-44	-50	-50	-52	-54	-56	-59	-62
Use of deposits at the NBG and banks	-109	323	357	123	-107	-59	30	177
External	595	247	253	234	386	307	202	123
Borrowing	690	718	717	702	690	541	495	482
Budget	99	68	67	136	139	120	157	156
Of which: IMF	0	0	0	0	0	0	0	0
Project	591	650	650	566	551	420	338	326
Amortization	-95	-471	-464	-468	-304	-233	-293	-359
Of which: IMF	-20	-250	-246	-324	-103	0	0	0
Use of Sovereign Wealth Fund resources	0	0	0	0	0	0	0	0
Privatization receipts	280	150	150	70	70	50	30	10
Unidentified financing	0	0	0	0	0	0	0	0
Memorandum items:								
Public debt	8,442	8,995	8,657	9,603	10,512	11,358	12,140	12,891
Of which: foreign-currency denominated	7,218	7,672	7,284	7,932	8,515	9,017	9,428	9,780
End-year government deposits 3/	830	547	474	351	458	517	488	311
Primary balance	-526	-505	-596	-413	-319	-243	-192	-221
Operating/Current balance	1,485	1,094	956	1,221	1,441	1,703	1,982	2,209
Structural primary balance	-815	-618	-628	-513	-433	-360	-306	-331
Fiscal deficit excluding grants	1,056	1,021	1,112	911	871	842	838	918

Sources: Ministry of Finance; and IMF staff estimates.

1/ General government includes central and local governments.
2/ Excluding arrears clearance, provisions and T-bill repayment.
3/ Include Treasury single account, Revenue reserve account, and local government deposits.

Table 3. Georgia: General Government Operations, 2012–18 (concluded) 1/

	2012	2013		2014	2015	2016	2017	2018
		1st/2nd						
	Act.	Rev.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In percent of GDP)							
Revenues	28.8	27.5	28.1	27.9	27.9	28.0	28.1	28.0
Taxes	25.4	25.3	25.7	25.5	25.6	25.7	25.8	25.8
Direct taxes	11.0	10.9	11.2	10.7	10.9	11.0	11.1	11.1
Taxes on income	6.8	6.8	6.8	6.3	6.3	6.4	6.4	6.5
Taxes on profits	3.3	3.2	3.4	3.4	3.4	3.4	3.5	3.5
Other Taxes (incl. property)	1.0	1.0	1.0	1.1	1.1	1.1	1.2	1.2
Indirect taxes	14.4	14.3	14.5	14.7	14.7	14.7	14.8	14.7
VAT	11.5	11.6	11.7	11.9	12.0	12.1	12.3	12.3
Excises	2.5	2.4	2.5	2.5	2.4	2.3	2.2	2.2
Custom duties	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other revenues	2.4	1.6	1.7	1.8	1.8	1.8	1.8	1.8
Grants	1.1	0.7	0.7	0.6	0.6	0.5	0.5	0.4
Expenditures	31.8	30.4	31.5	30.3	29.9	29.7	29.6	29.5
Current expenditures	23.2	23.7	24.6	23.8	23.6	23.5	23.4	23.4
Compensation of employees	4.6	4.5	4.8	4.4	4.3	4.2	4.1	4.1
Use of goods and services	5.0	4.2	4.1	4.0	3.9	3.8	3.8	3.8
Subsidies and grants	2.0	1.6	1.7	1.6	1.6	1.6	1.6	1.6
Social expenses	7.1	8.7	9.2	9.5	9.5	9.5	9.5	9.5
Other expenses	3.5	3.6	3.7	3.3	3.3	3.3	3.3	3.3
Interest	1.0	1.1	1.2	1.0	1.1	1.1	1.0	1.0
Capital spending and net lending	8.7	6.6	6.9	6.4	6.3	6.2	6.2	6.2
Capital	7.5	6.3	6.5	6.2	6.1	6.1	6.1	6.1
Net lending	1.1	0.4	0.4	0.3	0.2	0.1	0.1	0.1
Overall balance	-3.0	-2.8	-3.3	-2.4	-2.0	-1.7	-1.5	-1.5
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Identified financing	3.0	2.8	3.3	2.4	2.0	1.7	1.5	1.5
Domestic	-0.4	1.5	1.9	1.4	0.6	0.8	0.9	1.2
Net T-bill issuance	0.2	0.5	0.7	1.2	1.1	1.1	1.0	1.0
Amortization 2/	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1
Use of deposits at the NBG and banks	-0.4	1.1	1.3	0.4	-0.3	-0.2	0.1	0.4
External	2.3	0.9	0.9	0.8	1.1	0.8	0.5	0.3
Borrowing	2.6	2.5	2.6	2.3	2.0	1.4	1.2	1.0
Of which : IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.4	-1.6	-1.7	-1.6	-0.9	-0.6	-0.7	-0.8
Of which : IMF	-0.1	-0.9	-0.9	-1.1	-0.3	0.0	0.0	0.0
Privatization receipts	1.1	0.5	0.6	0.2	0.2	0.1	0.1	0.0
Memorandum items:								
Public debt	32.3	31.2	31.8	31.8	31.1	30.1	28.8	27.3
Of which: foreign-currency denominated	27.6	26.6	26.8	26.3	25.2	23.9	22.3	20.7
End-year government deposits 3/	3.2	1.9	1.7	1.2	1.4	1.4	1.2	0.7
Primary balance	-2.0	-1.7	-2.2	-1.4	-0.9	-0.6	-0.5	-0.5
Operating/Current balance	5.7	3.8	3.5	4.0	4.3	4.5	4.7	4.7
Structural primary balance 4/	-3.1	-2.2	-2.3	-1.7	-1.3	-1.0	-0.7	-0.7
Fiscal deficit excluding grants	4.0	3.5	4.1	3.0	2.6	2.2	2.0	1.9

Sources: Ministry of Finance; and IMF staff estimates.

1/ General government includes central and local governments.
2/ Excluding arrears clearance, provisions and T-bill repayment.
3/ Includes Treasury single account, revenue reserve account, and local government deposits.
4/ In percent of potential GDP.

Table 4. Georgia: Monetary Survey, 2010–14

	2010	2011	2012	2013		2014
				Mar.	Dec.	
	Act.	Act.	Act.	Act.	Proj.	Proj.
	(In billions of lari)					
Broad money (M3)	5.9	7.1	7.9	8.0	9.1	10.8
Lari Broad money (M2)	3.0	3.8	4.1	4.0	4.6	5.6
Currency held by the public	1.4	1.4	1.6	1.4	1.7	1.8
Lari resident deposits	1.6	2.3	2.5	2.6	3.0	3.8
Resident foreign exchange deposits	2.9	3.3	3.8	4.0	4.5	5.3
Net foreign assets	0.9	0.7	0.8	1.2	0.5	-0.2
NBG	2.5	3.3	3.7	4.0	4.0	4.2
Commercial banks	-1.6	-2.6	-2.9	-2.8	-3.5	-4.4
Of which : liabilities	-2.8	-3.5	-4.2	-4.0	-4.7	-5.7
Net domestic assets	5.0	6.4	7.1	6.8	8.7	11.0
Domestic credit	6.4	7.8	8.6	8.4	10.4	13.0
Net claims on general government	0.2	0.1	-0.1	-0.4	0.4	0.8
Of which : government deposits at NBG	-0.8	-0.8	-1.0	-1.2	-0.6	-0.5
Of which : T-bills at commercial banks	0.4	0.5	0.6	0.7	0.8	1.2
Private credit	6.2	7.7	8.7	8.8	9.9	12.2
Other items, net	-1.3	-1.4	-1.5	-1.6	-1.7	-2.0
Sources of funds of commercial banks	7.4	9.2	10.5	10.5	12.2	14.8
Resident deposits	4.5	5.7	6.4	6.5	7.5	9.0
Non-resident deposits	0.6	0.8	1.3	1.4	1.4	1.2
Other foreign liabilities	2.2	2.7	2.9	2.6	3.4	4.5
Uses of funds of commercial banks	7.4	9.2	10.5	10.2	12.2	14.8
Reserves	2.1	2.3	2.8	2.6	3.2	3.3
Lari domestic credit	1.9	2.6	3.2	3.2	3.8	4.9
Fx domestic credit	4.6	5.3	5.8	5.8	6.6	8.1
Other foreign assets	0.1	0.1	0.1	0.1	0.1	0.1
Other items, net	-1.3	-1.0	-1.4	-1.5	-1.6	-1.7
	(Percentage change, year on year)					
Broad money (M3)	23.9	20.3	11.4	16.4	15.5	18.5
Broad money (M3, constant exchange rate from 12 month prior)	20.9	23.7	11.8	16.5	14.6	14.7
Private credit	18.8	24.3	12.8	11.7	14.3	22.5
Private credit (constant exchange rate from 12 month prior)	14.5	29.5	13.4	11.8	13.1	17.3
	(Percent of GDP, unless otherwise indicated)					
Memorandum items:						
Broad money (M3)	28.5	29.2	30.2	30.3	33.5	35.8
Non-resident deposits (percent of total deposits)	10.5	12.1	15.3	17.1	14.2	10.4
Private credit	29.9	31.7	33.3	33.3	36.5	40.4
Nominal GDP (billions of lari)	20.7	24.3	26.1	26.3	27.2	30.2

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

Table 5. Georgia: Accounts of the National Bank of Georgia, 2010–14

	2010	2011	2012	2013		2014
				Mar.	Dec.	
	Act.	Act.	Act.	Act.	Proj.	Proj.
	(In millions of lari)					
Net foreign exchange position	2,218	2,596	2,858	3,093	3,011	3,089
Gross International Reserves	4,013	4,707	4,760	4,875	4,662	4,838
Other foreign assets	8	1	1	4	4	5
Foreign currency liabilities	1,803	2,113	1,902	1,786	1,656	1,754
Of which : use of Fund resources	1,150	981	590	462	200	94
Of which : compulsory reserves in USD	245	752	874	865	984	1,156
Net domestic assets	-396	-457	-548	-1,088	-562	-469
Net claims on general government	-95	-74	-425	-636	-67	55
Claims on general government (incl. T-bills)	714	685	529	522	521	521
Nontradable govt. debt	601	561	521	482	481	441
Securitized debt (marketable)	113	124	8	40	40	80
Deposits	809	759	954	1,159	588	466
Claims on rest of economy	2	2	1	1	1	1
Claims on banks	-165	-429	-172	-507	-508	-330
Bank refinancing	190	14	391	115	100	300
Certificates of deposits and bonds	355	442	563	623	608	630
Other items, net	-138	43	48	55	12	-195
Reserve money	1,822	2,139	2,310	2,006	2,449	2,620
Currency in circulation	1,618	1,754	1,918	1,746	2,010	2,110
Bank lari reserves	144	155	200	253	297	378
Banks overnight deposits	60	230	192	6	142	132
	(Percentage change, year on year)					
Reserve money	4.5	17.4	8.0	7.1	6.0	7.0
Currency in circulation	11.0	8.4	9.4	13.2	4.8	5.0
Bank lari reserves	-49.7	7.8	28.9	19.2	48.5	27.4
Memorandum items:						
Net international reserves						
(in millions of USD, at prog. exchange rates) 1/	882	1,152	1,326	1,482	1,549	1,664
Net domestic assets (in millions of lari) 1/	349	216	95	-470	-138	-159

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

1/ Based on 2012 program definition as defined in the TMU attached to EBS/12/46.

Table 6. Georgia: Selected Monetary and Financial Soundness Indicators, 2007–13

	2007 Dec.	2008 Dec.	2009 Dec.	2010 Dec.	2011 Dec.	2012 Dec.	2013 Mar.
Deposit dollarization (residents and non-residents, in percent)	66.1	74.8	71.8	68.6	63.3	66.0	66.7
Deposit dollarization (residents, in percent)	62.3	72.6	68.8	65.0	58.6	60.4	60.9
Loan-to-deposit ratio (in percent)	130.7	155.9	124.2	107.6	105.3	106.7	104.2
Credit-to-GDP ratio (in percent)	27.4	31.7	29.0	29.9	31.7	33.3	33.3
Capital adequacy ratio (in percent) 1/	16.0	13.9	19.1	17.4	17.1	17.0	17.7
Capital adequacy ratio (in percent) 2/	30.0	24.0	25.6	23.6	25.6	25.3	26.5
Liquidity ratio (in percent) 3/	37.2	28.3	39.1	38.7	37.3	39.8	41.5
Nonperforming loans (in percent of total loans) 4/	2.6	12.8	17.9	12.5	8.6	9.3	9.5
Nonperforming loans (in percent of total loans) 5/	0.8	4.1	6.3	5.4	4.6	3.7	4.5
Loans collateralized by real estate (in percent of total loans)	43.8	43.6	55.5	47.5	53.4	50.6	50.8
Loans in foreign exchange (in percent of total loans)	68.6	72.8	76.9	74.0	68.8	67.5	66.9
Specific provisions (in percent of total loans)	1.7	6.0	9.7	6.5	4.6	4.6	4.8
Net foreign assets (in percent of total assets)	-17.7	-19.6	-14.9	-8.2	-13.7	-19.7	-19.5
Net open foreign exchange position (in percent of regulatory capital)	5.0	1.7	1.8	8.1	5.9	3.3	3.3
Return on equity (cumulative through the year, annualized) 6/	9.6	-12.4	-4.3	9.6	17.3	5.8	10.5
Borrowed funds from abroad-to-GDP ratio 7/	9.5	12.7	11.6	12.2	9.4	11.4	9.5

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

1/ National definition. Risk weight to forex loans was reduced from 200 to 175 percent in September 2008, and to 150 percent in August 2009, and raised to 175 percent in January 2011.

2/ Basel I definition.

3/ Ratio of liquid assets to all deposits plus other liabilities with 6-month and shorter maturity.

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

5/ Standard 90-day overdue definition.

6/ Pre-tax.

7/ Borrowed funds include subordinated debt.

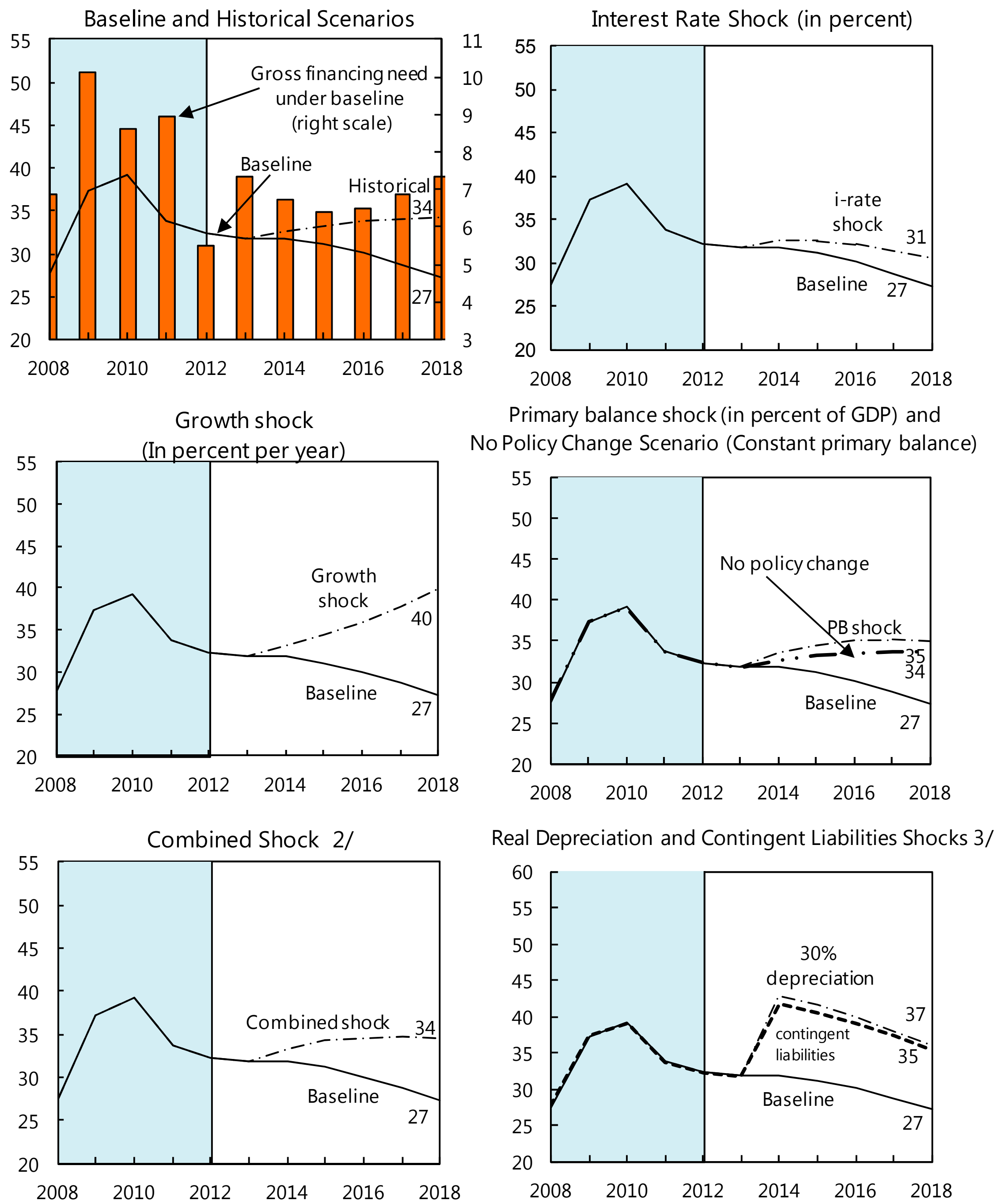
Table 7. Georgia: Public Sector Debt Sustainability Framework, 2008–18

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2008	2009	2010	2011	2012			2013	2014	2015	2016	2017	2018	Debt-stabilizing primary balance 9/
1 **Baseline: Public sector debt 1/**	27.6	37.3	39.2	33.8	32.3			**31.8**	**31.8**	**31.1**	**30.1**	**28.8**	**27.3**	**-1.5**
o/w foreign-currency denominated	23.5	31.7	33.6	28.8	27.6			26.8	26.3	25.2	23.9	22.3	20.7	
2 Change in public sector debt	6.0	9.7	1.9	-5.4	-1.5			-0.5	0.0	-0.7	-1.1	-1.3	-1.5	
3 Identified debt-creating flows (4+7+12)	1.0	9.1	2.0	-5.4	-0.6			1.5	-0.9	-1.6	-1.7	-1.8	-1.6	
4 Primary deficit	5.7	8.2	5.6	2.4	2.0			2.2	1.4	0.9	0.6	0.5	0.5	
5 Revenue and grants	30.7	29.3	28.3	28.2	28.8			28.1	27.9	27.9	28.0	28.1	28.0	
6 Primary (noninterest) expenditure	36.4	37.5	33.9	30.7	30.9			30.3	29.2	28.8	28.6	28.5	28.5	
7 Automatic debt dynamics 2/	-1.0	2.9	-2.5	-6.3	-1.6			-0.1	-2.1	-2.3	-2.2	-2.1	-2.0	
8 Contribution from interest rate/growth differential 3/	-1.7	2.6	-4.0	-4.6	-1.3			-0.1	-2.1	-2.3	-2.2	-2.1	-2.0	
9 Of which contribution from real interest rate	-1.3	1.5	-1.9	-2.2	0.6			1.1	-0.2	-0.6	-0.6	-0.5	-0.5	
10 Of which contribution from real GDP growth	-0.4	1.1	-2.0	-2.4	-1.9			-1.2	-1.9	-1.7	-1.7	-1.6	-1.5	
11 Contribution from exchange rate depreciation 4/	0.7	0.3	1.5	-1.7	-0.2			...	...	...	...	...	...	
12 Other identified debt-creating flows	-3.7	-2.0	-1.1	-1.6	-1.1			-0.6	-0.2	-0.2	-0.1	-0.1	0.0	
13 Privatization receipts (negative)	-3.7	-2.0	-1.1	-1.6	-1.1			-0.6	-0.2	-0.2	-0.1	-0.1	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	5.0	0.6	-0.2	0.0	-0.8			-2.0	1.0	0.9	0.7	0.4	0.1	
Public sector debt-to-revenue ratio 1/	89.9	127.4	138.5	119.6	112.0			113.1	114.2	111.6	107.5	102.4	97.4	
Gross financing need 6/	6.9	10.1	8.6	9.0	5.5			7.4	6.7	6.4	6.5	6.9	7.3	
In billions of U.S. dollars	0.8	1.1	1.0	1.3	0.9			1.2	1.1	1.2	1.3	1.5	1.8	
Scenario with key variables at their historical averages 7/								**31.8**	**32.6**	**33.3**	**33.8**	**34.1**	**34.2**	**-2.7**
Scenario with no policy change (constant primary balance) in 2013-2018								**31.8**	**32.6**	**33.2**	**33.5**	**33.8**	**33.8**	**-1.9**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	2.3	-3.8	6.3	7.2	6.1	6.6	4.7	4.0	6.6	6.0	6.0	6.0	6.0	
Average nominal interest rate on public debt (in percent) 8/	3.3	3.3	3.1	3.5	3.1	3.1	0.3	3.7	3.6	3.7	3.8	3.9	4.0	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-6.4	5.3	-5.5	-6.0	1.9	-3.4	4.9	3.5	-0.4	-1.8	-1.7	-1.6	-1.5	
Inflation rate (GDP deflator, in percent)	9.7	-2.0	8.5	9.5	1.2	6.5	4.1	0.2	4.0	5.5	5.5	5.5	5.5	
Growth of real primary spending (deflated by GDP deflator, in percent)	11.4	-0.9	-4.0	-3.0	6.8	13.6	17.3	2.1	2.8	4.6	5.2	5.6	5.9	
Primary deficit	5.7	8.2	5.6	2.4	2.0	3.0	3.5	2.2	1.4	0.9	0.6	0.5	0.5	

1/ Public sector debt includes general government debt and liabilities of NBG to IMF, and it does not include SOE's debt. It is reported on a gross basis.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 7. Georgia: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund; country desk data; and IMF staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2014, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 8. Georgia: External Debt Sustainability Framework, 2008–18 1/

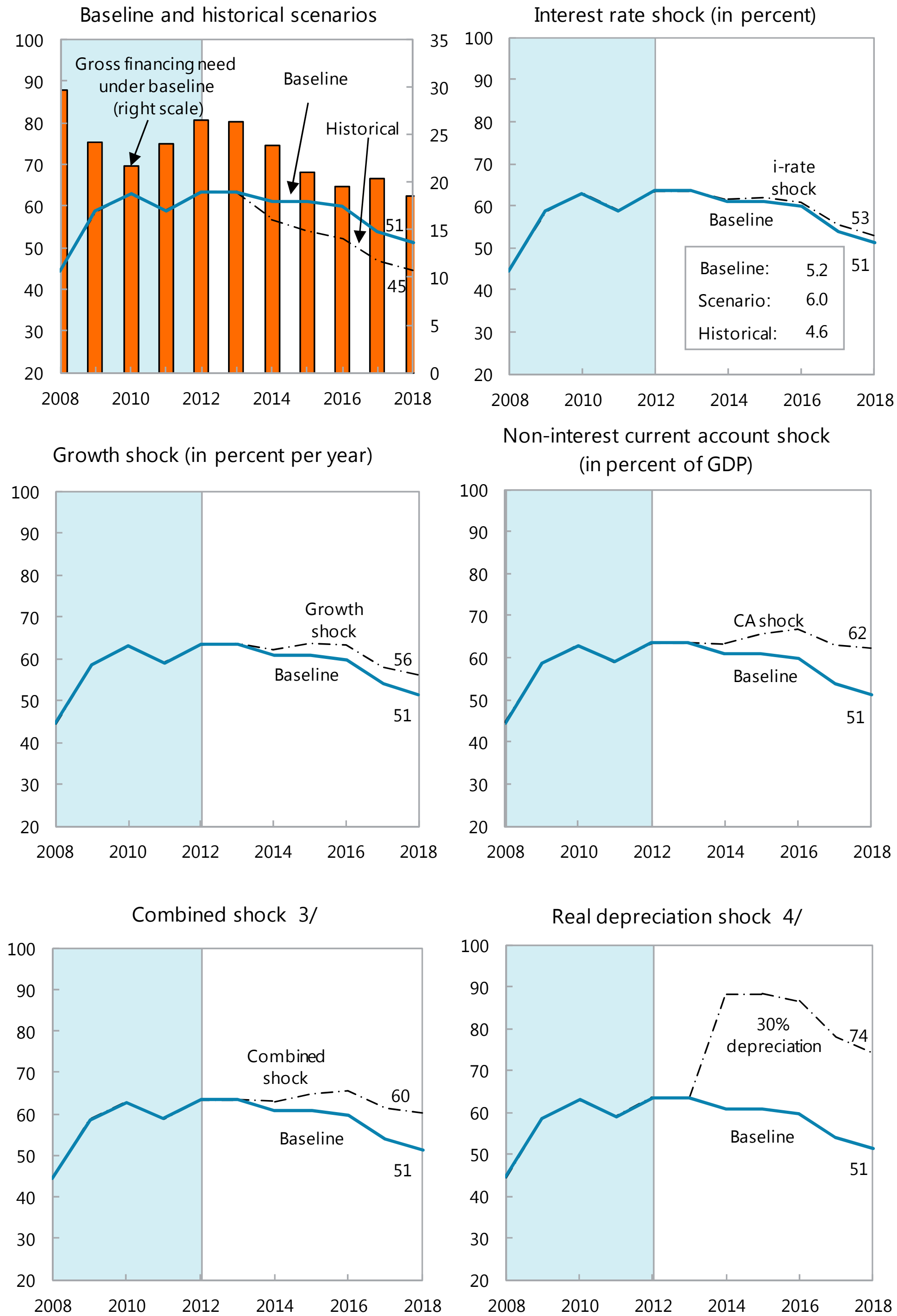
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2008	2009	2010	2011	2012			2013	2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 7/
1 **Baseline: External debt**	44.5	58.7	62.9	58.9	63.4			**63.5**	**61.0**	**61.0**	**59.7**	**53.9**	**51.2**	**-7.4**
2 Change in external debt	5.7	14.2	4.2	-4.0	4.5			0.0	-2.5	0.0	-1.3	-5.8	-2.7	
3 Identified external debt-creating flows (4+8+9)	3.0	12.6	0.0	-5.7	2.7			2.5	-0.7	-1.4	-2.0	-2.2	-2.2	
4 Current account deficit, excluding interest payments	19.8	7.6	7.5	10.2	8.4			5.9	4.4	4.1	3.5	3.5	3.6	
5 Deficit in balance of goods and services	29.8	19.1	17.8	19.0	19.7			17.1	15.3	14.5	13.2	12.5	11.8	
6 Exports	28.8	29.8	34.9	36.5	38.2			40.4	40.5	40.7	40.3	39.9	39.5	
7 Imports	58.6	48.9	52.7	55.5	57.8			57.5	55.8	55.2	53.5	52.3	51.3	
8 Net non-debt creating capital inflows (negative)	-11.1	-6.3	-5.8	-6.2	-3.6			-4.2	-4.4	-5.0	-5.1	-5.2	-5.3	
9 Automatic debt dynamics 2/	-5.7	11.3	-1.7	-9.6	-2.1			0.8	-0.6	-0.4	-0.4	-0.5	-0.5	
10 Contribution from nominal interest rate	2.2	2.9	2.7	2.6	3.1			3.3	3.3	3.0	2.9	2.8	2.5	
11 Contribution from real GDP growth	-0.7	2.0	-3.4	-3.6	-3.3			-2.4	-3.9	-3.4	-3.4	-3.3	-3.0	
12 Contribution from price and exchange rate changes 3/	-7.2	6.4	-1.0	-8.6	-1.9			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 4/	2.7	1.6	4.2	1.7	1.8			-2.5	-1.8	1.4	0.8	-3.6	-0.4	
External debt-to-exports ratio (in percent)	154.3	197.1	180.3	161.6	166.2			157.0	150.4	149.7	148.3	135.2	129.7	
Gross external financing need (in billions of US dollars) 5/	3.8	2.6	2.5	3.5	4.2			4.3	4.1	3.9	4.0	4.5	4.5	
in percent of GDP	29.7	24.2	21.6	24.0	26.6	10-Year	10-Year	26.4	23.8	21.1	19.6	20.4	18.5	
Scenario with key variables at their historical averages 6/								**63.5**	**56.7**	**53.9**	**52.0**	**47.0**	**44.7**	**-13.9**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.3	-3.8	6.3	7.2	6.1	6.6	4.7	4.0	6.6	6.0	6.0	6.0	6.0	
GDP deflator in US dollars (change in percent)	22.9	-12.5	1.7	15.7	3.3	10.0	10.7	-1.0	-0.3	0.7	2.9	3.1	3.2	
Nominal external interest rate (in percent)	7.2	5.5	5.0	5.1	5.7	4.6	1.4	5.3	5.6	5.2	5.3	5.1	5.0	
Growth of exports (US dollar terms, in percent)	15.9	-13.0	26.6	29.6	14.8	20.3	13.3	9.0	6.6	7.2	7.8	8.2	8.4	
Growth of imports (US dollar terms, in percent)	26.8	-29.8	16.5	30.5	14.3	22.0	19.5	2.3	3.2	5.6	5.6	7.0	7.2	
Current account balance, excluding interest payments	-19.8	-7.6	-7.5	-10.2	-8.4	-11.0	4.8	-5.9	-4.4	-4.1	-3.5	-3.5	-3.6	
Net non-debt creating capital inflows	11.1	6.3	5.8	6.2	3.6	9.1	4.1	4.2	4.4	5.0	5.1	5.2	5.3	

1/ The external debt does not include inter-company loans.
2/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
3/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).
4/ For projection, line includes the impact of price and exchange rate changes.
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
6/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 8. Georgia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and IMF staff estimates.

1/ The external debt does not include inter-company loans. Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2014.

INTERNATIONAL MONETARY FUND

GEORGIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 24, 2013

Prepared By

Middle East and Central Asia Department
(In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of May 31, 2013)

Membership Status

Date of membership: May 5, 1992.

General Resources Account

	SDR Million	Percent of Quota
Quota	150.30	100.00
Fund Holdings of Currency	513.46	341.63
Reserve Tranche Position	0.01	0.01

SDR Department

	SDR Million	Percent Allocation
Net Cumulative Allocation	143.96	100.00
Holdings	144.36	100.28

Outstanding Purchases and Loans

	SDR Million	Percent of Quota
Stand-By Arrangements	363.16	241.63
ECF Arrangements	58.80	39.12

Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Apr. 11, 2012	Apr. 10, 2014	125.00	0.00
SCF	Apr. 11, 2012	Apr. 10, 2014	125.00	0.00
Stand-By	Sept. 15, 2008	June 14, 2011	747.10	577.10

Projected Payments to the Fund

(SDR million; based on existing use of resources and present holdings of SDRs)

			Forthcoming		
	2013	2014	2015	2016	2017
Principal	188.99	166.75	52.23	9.80	4.20
Charges/Interest	1.64	1.45	0.22	0.02	0.00
Total	**190.62**	**168.20**	**52.45**	**9.82**	**4.20**

Safeguard Assessments

An update of the January 2010 safeguards assessment of the National Bank of Georgia (NBG) was completed in September 2011. The NBG continues to publish financial statements that comply with International Financial Reporting Standards, and are externally audited by an international firm in accordance with International Standards on Auditing. In response to the safeguards assessment of 2010, the authorities implemented recommendations including the appointment of an external audit firm for a multi year term beginning with financial year 2010.

Implementation of Multilateral Debt Relief Initiative (MDRI)

Not applicable.

Implementation of HIPC Initiative

Not applicable.

Exchange Arrangements

The de jure exchange rate arrangement of Georgia is floating. In line with the official policy, NBG has remained committed to improving functioning of the foreign exchange market and enhancing exchange rate flexibility since the introduction in March 2009 of multiple-price foreign exchange auctions. While the NBG intervenes in the foreign exchange market through the FX auctions, the NBG does not make any explicit or implicit commitment with respect to an exchange rate target or path. In the first half of 2012, the FX purchase auctions moderated with a cumulative volume of USD 75 million. However, since July 2012, the NBG has intensified the FX auctions both in volume and frequency and has been active on both sides of the market, with total purchases of USD 340 million and total sales of USD 65 million through April 2013. FX purchase auctions have been directed toward rebuilding foreign exchange reserves; an objective of the authorities' economic program that is supported by the IMF SBA/SCF arrangement. With respect to intervention data, the volume sold at NBG's FX auctions and the average exchange rates are posted on the NBG website immediately after each auction. Based on these data, most of the activity took place since December 2012, coinciding with increased appreciation pressures on the lari. Although FX interventions account for a small portion of annual foreign exchange market turnover, the size of these interventions on any given day is substantial. Since July 2012, the lari has remained stable against the U.S. dollar in a 2% band. Market supply and demand play a role in determining the exchange rate, as does official action based on the observed path of the exchange rate and the discretionary nature of the FX auctions. Therefore, as of end-April 2013, the de facto exchange rate arrangement has been reclassified to a stabilized arrangement against the U.S. dollar from floating, effective July 1, 2012.

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 and for foreign exchange transactions with the NBG. The official rate is defined as the average of the previous day's market transaction rates, and may thus differ by more than two percent from the freely determined market rate, which had caused a multiple currency practice in the past. However, in March 2013, an amendment was introduced to the 2010 agreement between the NBG and Treasury Service of the Ministry of Finance on the Participation in the Real Time Gross Settlement (RTGS) System that eliminates Georgia's multiple currency practice. The 2013 amendment insures that foreign exchange transactions between the government and the NBG are priced with the market exchange rate of the day when the foreign exchange order is submitted to NBG.

Article IV Consultation

The 2011 Article IV consultation was concluded on March 23, 2011.

FSAP Participation

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

Technical Assistance

See Table 1 of this Annex.

Resident Representative

The seventh resident representative, Mr. Azim Sadikov, took up his post on July 9, 2012.

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.

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.

Georgia: Technical Assistance Missions, 2008–13			
Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Tax Administration	Expert assistance (Woodley)	Jan/Feb and Apr/May 2008	Ministry of Finance
Public Financial Management	Expert assistance	Apr. 6-19, 2010	Ministry of Finance
Pension Reform	Expert assistance	Apr. 21-27, 2011	Ministry of Finance
Public Financial Management	Advisory	May 14-24, 2012	Ministry of Finance, Partnership Fund
Tax Administration	Advisory	Aug. 15-28, 2012	Ministry of Finance, Revenue Service
Monetary and Capital Markets Department (MCM)			
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
Macroeconomic Modeling for Monetary Policy Formulation	Advisory	June 2-10, 2010	National Bank of Georgia
Macroeconomic Modeling for Monetary Policy Formulation	Advisory	October 4-13, 2010	National Bank of Georgia
Payment Systems Oversight	Advisory	May 3–12, 2011	National Bank of Georgia
Statistics Department (STA)			
Monetary and Financial Statistics	Advisory	Mar. 18-31, 2009	National Bank of Georgia
Evaluation of Technical Assistance	Follow-up assistance	Jul. 14–16, 2010	National Statistics Office, National Bank of Georgia, Ministry of Finance
External Sector Statistics	Follow-up assistance	Oct. 4–15, 2010	National Bank of Georgia
ROSC Data Module	ROSC	Oct. 4–17, 2011	National Statistics Office, National Bank of Georgia, Ministry of Finance
External Sector Statistics	Follow-up assistance	Oct. 17-26, 2012	National Bank of Georgia
National Accounts Statistics	Follow-up assistance	Jan. 14-25, 2013	National Statistics Office
Legal Department (LEG)			
Payment Systems	Advisory	May 25–Jun. 5, 2010	National Bank of Georgia
Payment Systems	Follow-up assistance	Nov. 8–14, 2010	National Bank of Georgia
Legislative Drafting	Advisory	Feb. 28–Mar. 7, 2011	National Bank of Georgia
International tax policy	Advisory	June 6-7, 2012	Ministry of Finance

RELATIONS WITH THE WORLD BANK

(As of June 13, 2013)

Title	Product	Tentative Timing of Mission	Expected Delivery of Report
Bank	*Operations*		
	DPO-2 to support reforms to sustain growth, promote job creation, strengthen social safety nets, and deepen public financial management reforms.	February–June 2013	Second half of 2013
	Statistics Capacity Building Trust Fund grant to support preparation work for national population census.	Periodic 2012–13	Ongoing, closing in 2013
	Institutional Development Fund grant for strengthening capital budgeting in Tbilisi municipality	Periodic 2012–13	Ongoing, closing in 2013
	Analytical Work		
	Sources of Growth Study	Quarterly	July 2013
	Programmatic PER; PER-1 follow-up and PER-2	Quarterly	December 2012 March 2014
	Programmatic Poverty Assessment	Periodic	Periodic
	PEFA 2012 Repeat Assessment	Periodic	September 2013
Fund	*Missions and Technical Assistance*		
	1st and 2nd reviews under the SBA/SCF blend	Nov. 28– Dec. 12, 2012	February 27, 2013
	3rd review under the SBA/SCF blend	Fall 2013	December 2013
	TA: Improving national account and external sector statistics	FY 2014	FY 2014
	TA: Strengthening tax administration	FY 2014	FY 2014
	4th review under the SBA/SCF blend	1st quarter of 2014	April 2014
Joint Bank-Fund	Joint Debt Sustainability Analysis	Ongoing collaboration	June/July 2013

RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

(As of June 2013)

Since 1994, the EBRD has been active in supporting Georgia's transformation toward a market economy. The bank's current country strategy for Georgia, approved in February 2010, outlines the following main strategic directions:

- Supporting stabilization and restructuring of the financial sector, strengthening risk and portfolio management practices and increasing the share of local currency operations;
- Helping rehabilitate and modernize the country's road, energy and municipal infrastructure to strengthen energy security and promote energy efficiency, help Georgia benefit from its potential as a transit country, and improve efficiency and long-term financial sustainability of its municipal services;
- Provide financing to the enterprise sector with the view of supporting innovation, competition and export potential, in particular in manufacturing and agribusiness.

As of end-May 2013, the bank signed 155 investments in Georgia with the cumulative commitment totaling €1.8 billion. Its outstanding portfolio stood at €604 million. Almost one half of the portfolio is in the financial sector, followed by the energy and infrastructure sectors with one fifth each and corporate sector accounting for 13 percent. The ratio of private sector projects in the portfolio currently stands at around 80 percent. The bank gives preference to non-sovereign operations. Where sovereign guarantees are required, donor co-funding on a grant basis is sought.

Banks overall investment in 2012 reached €97 million with 13 projects. It was active in continuing to support the agribusiness sector directly and through provision of credit lines to local partner banks. The Georgian Agriculture Financing Facility (GAFF), a €40 million framework launched in 2011, made credit lines available to local commercial banks, nonbank microfinance institutions and leasing companies for on-lending to farmers and other agricultural entities. Additional credit lines were extended to Bank of Georgia, VTB Bank Georgia, Bank Republic and TBC Bank, most of them were provided in lari. The bank has also supported the enterprise sector by investing €18.2 million across various industries.

With the Bank's assistance, Georgia has become an electricity exporting country. The Bank played a critical role in strengthening access to the international market through financing of the Black Sea Transmission line, which is expected to be operational by end-2013. The Bank has been actively pursuing viable small, medium and large renewable energy projects. The Bank has financed Paravani, the first Independent Power Producer (IPP) in the hydroelectricity sector. In 2011, the Bank extended USD 52 million debt financing and invested USD 5 million as equity in the company while USD 23 million has been syndicated as a B-loan and IFC co-invested as a lender. The project is expected to deliver energy to Turkey for nine months per year.

Georgia is part of the EBRD's 'Early Transition Countries' (ETC) initiative. Launched in April 2004, the initiative aims to increase investments in the bank's then 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 accepts higher risk in the projects it finances in the ETCs, while respecting the principles of sound banking. Since the launch of the ETC initiative, the bank's annual business volume in Georgia has increased five-fold.

The bank's country strategy for the period of 2013–15 is currently under preparation and expected to be approved in July 2013. It is expected to focus the bank on fostering private investments, completing the restructuring and modernization of the energy sector, supporting Georgia's transformation into a regional economic hub, and promoting broad-based growth.

Going forward, the EBRD will also:

- Continue to support the authorities' goal of developing local capital market and reducing dollarization by providing synthetic local currency loans and offering technical cooperation and policy advice, particularly in the legal and regulatory area and on debt and equity capital market infrastructure. The bank is actively engaged in promoting local currency lending and de-dollarization of the Georgian banking system in cooperation with other IFIs. Georgia was one of the first countries to undergo a joint EBRD-IMF-World Bank assessment of the economic policy, regulatory and legal frameworks for development of the local currency capital markets, and sign a framework agreement with the authorities on policy reforms required to support de-dollarization.

- Actively pursue viable renewable energy projects, while promoting energy efficiency across the country and leading policy dialogue on improving the regulatory framework for energy efficiency and renewable energy.

- Invest in the development of the agribusiness sector and modernization of the food distribution sector supported by intensive policy dialogue.

- Support policy and regulatory developments in Georgia by providing further legal transition assistance, including improvements to the laws on secured transactions and insolvency, reform of concession laws, improved corporate governance, and judiciary reforms.

- Maintain dialogue with the government to ensure fair and transparent implementation of tax policies and audits as well as the independence of the judiciary in dealings with businesses.

STATISTICAL ISSUES

Data provision has some shortcomings but is broadly adequate for surveillance. There is some room for improving the compilation and dissemination of price, national accounts, and external sector statistics. Insufficient price and economic activity indicators to assess underlying inflation and output trends partly hamper the development of an effective inflation targeting framework. To support the authorities' effort to improve the compilation of macroeconomic statistics, the Fund has provided a significant amount of technical assistance (TA) (Annex I, Table1.) The data module of the Report on the Observance of Standards and Codes (ROSC), prepared in October 2011, indicated that since the previous 2002 ROSC, the authorities have made significant institutional and methodological improvements in macroeconomic statistics. Georgia graduated to the IMF's Special Data Dissemination Standard (SDDS) on May 17, 2010, after participating in GDDS since 2006.

A. Real Sector Statistics

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 2011 data ROSC mission found serious source data deficiencies owing to: absence of an economic census; under-reporting in the business survey and household budget survey; shortcomings in the business register; and incomplete coverage of some activities (trade, other community, social and personal activities). Also, a better method could be used to benchmark quarterly national accounts (QNA) data to annual estimates. Volume measures of GDP by the expenditure approach are not compiled. During the national accounts TA mission in January 2013, actions on several issues were either initiated or partly implemented (benchmarking of QNA in current and constant prices, new methodology for estimating volume of taxes on products, compilation of unit values for imports). 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, the scope of the consumer price index (CPI) is limited to only urban areas while the treatment of owner-occupied housing is conceptually imprecise. The structure of producer price index (PPI) relies on turnover rather than output concept while product based PPIs are not compiled. The export and import price indices are not compiled. Despite important progress achieved in the development of agricultural price indices, inadequate funding was causing delays in implementation. The accuracy of the CPI and PPI weights, with respect to actual household consumption and market turnover, suffers from the same HBS and business register shortcomings as the national accounts. The imputation methods for both CPI and PPI, while recently improved, need to be enhanced to ensure coherent long-term treatment of seasonal goods.

B. Monetary and Financial Statistics

The NBG compiles monetary data broadly in line with the recommendations of the *Monetary and Financial Statistics Manual 2000*. Data are compiled based on STA's Standardized Report Forms and reported to STA on a regular and timely basis for publication in the *International Financial Statistics (IFS)*.

C. Government Finance Statistics

The Ministry of Finance is well advanced on a program of reform to their central and local government budget and accounting systems to fully adopt the *Government Finance Statistics Manual 2001 (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. The reform includes the implementation of accrual accounting by 2020. 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). Since 2008, the budget classification follows the *GFSM 2001*. However, there are deficiencies in the sectorization of Legal Entities of Public Law (LEPLs) and securities are not recorded at market value. The authorities report annual and monthly government finance statistics (GFS) compiled on a cash basis in the *GFSM 2001* framework for publication in the *GFS Yearbook* and *IFS*, respectively.

D. External Sector Statistics

The NBG began to take the responsibility in the compilation of balance of payments statistics in January 2007. It received extensive technical assistance from STA, including the STA Resident Statistics Advisor who, stationed in Baku, undertook six peripatetic TA missions to Georgia during April 2007–October 2008.

Balance of payments data are compiled broadly in accordance with the definitions set out in the fifth edition of the *Balance of Payments Manual* (*BPM5*) and elements of the sixth edition (*BPM6*). The scope of the balance of payments statistics includes transactions of institutional units resident in Georgia with the rest of the world. However, data do not cover the territories of Abkhazian Autonomous Republic and Tskhinvali Region, a part of Georgian territory not controlled by the central authorities. Source data used for compiling the balance of payments are generally adequate and timely. However, the accuracy of the data received from the enterprises survey should be improved. Moreover, foreign direct investment (FDI) data are subject to significant revisions and the classification of some inflows as FDI (rather than other capital flows) has been the subject of prolonged debates between the statistical office and the NBG. Some data sources for balance of payments need strengthening, notably the International Transactions Reporting System (ITRS) and the private nonfinancial external debt compilation program. For the balance of payments, statistical techniques are adequate, except for the estimation of import and export of cars which should be further improved.

Georgia: Table of Common Indicators Required for Surveillance

(As of June 6, 2013)

	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]	Memo Items: Data Quality—Accuracy and reliability[9]
Exchange Rates	Apr. 2013	5/10/13	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Apr. 2013	5/7/13	D	D	M		
Reserve/Base Money	Apr. 2013	5/21/13	D	D	M	O, O, LO, O	LO,O,O,O,O
Broad Money	Apr. 2013	5/21/13	D	D	M		
Central Bank Balance Sheet	Apr. 2013	5/21/13	D	D	M		
Consolidated Balance Sheet of the Banking System	Apr. 2013	5/21/13	M	M	M		
Interest Rates[2]	Apr. 2013	5/21/13	D	D	D		
Consumer Price Index	Apr. 2013	5/16/13	M	M	M	O,LO,O,O	LO,O,LO,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Mar. 2013	5/10/2013	M	M	M	O,O,LO,LO	O,O,O,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Mar. 2013	5/10/2013	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec. 2011	02/15/12	Q	Q	Q		
External Current Account Balance	Q1 2012	7/12/12	Q	Q	Q	O,O,O,O	LO, O, LO ,O, LO
Exports and Imports of Goods and Services	Q1 2012	7/12/12	Q	Q	Q		
GDP/GNP	Q4 2011	4/19/12	Q	Q	Q	O,LO,LO,LO	LNO, O, LO, O, LO
Gross External Debt	Dec. 2011	02/15/12	Q	Q	Q		
International Investment Position[6]	Q1 2012	8/10/12	A	A	A		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[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 March 19, 2012, and based on the findings of the mission that took place from October 4–17, 2011) 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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July 23, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes the 2013 Article IV Consultation with Georgia

On July 10, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Georgia.[1]

Last October's general elections saw the peaceful and democratic transfer of power to a new government, for the first time in Georgia's recent history. These elections also marked the start of a period of cohabitation between the new government, led by Prime Minister Ivanishvili, and President Saakashvili, who will leave office after the October 2013 presidential election. Georgia's economic performance continues to be strong, despite a recent slowdown. Real GDP growth averaged 6½ percent in 2011–12, about 1½ percentage points more than projected at the 2011 Article IV consultation. Inflation has declined steadily, reflecting lower food prices, lagged effects of exchange rate appreciation, and cuts in administered energy prices. The exchange rate has faced appreciation pressures, but has been kept stable against the U.S. dollar. However, the economy has slowed down markedly since mid-2012 and unemployment remains high at 15 percent, with half of the labor force in small-scale agriculture.

Georgia's current account deficit and external indebtedness remain high. Despite tourism receipts increasing to 9 percent of GDP and remittances to 4½ percent of GDP, the current account deficit has persisted at around 11½ percent of GDP from 2010 to 2012, one of the highest in the region. Georgia's trade deficit rose to more than 25 percent of GDP, owing to increased imports of machinery, transport equipment, and manufactures. Georgia's high current account deficits reflect low national savings relative to the investment needed to support high growth. The current account deficits have been financed by capital inflows. While initially these inflows were mainly foreign direct investments, in recent years their composition has shifted towards less stable sources of

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

financing, including Eurobond issuance and increases in nonresident deposits (now 15 percent of total deposits). These inflows have contributed to keeping net external liabilities close to 100 percent of GDP.

Fiscal consolidation has continued, with the fiscal deficit declining from 6.6 percent of GDP in 2010 to 3.0 percent in 2012, reflecting higher tax revenues and lower current expenditures. The 2013 budget law aims at reducing the deficit to 2.8 percent of GDP in 2013, with greater emphasis on social expenditure, while maintaining critical capital spending. Although the economic slowdown meant revenues were lower than projected in the first quarter of 2013, the government's overall balance was higher than expected due to procedural delays in government spending.

In response to the sharp decline in inflation and more recently to the economic slowdown, the National Bank of Georgia (NBG) has loosened its monetary stance. It cut its policy rate from 8 percent in mid-2011 to 4 percent in June 2013. While, at least until recently, commercial bank lari deposit rates have fallen more or less in line, lending rates have decreased less, suggesting some room for strengthening monetary policy transmission. The NBG has increased its foreign currency purchases, already buying US$335 million so far this year, which has helped resist appreciation pressures and the risk of further deflation. Despite looser monetary policy, private credit growth has declined from around 20 percent to 12–15 percent since October 2012.

Despite the slowdown, growth could still reach 4 percent in 2013, rising to around 6 percent in 2014 and beyond, while inflation would gradually realign with NBG's medium-term target (5 percent for 2015), provided the authorities take strong policy action.

Executive Board Assessment

Executive Directors noted that heightened domestic uncertainty, government underspending, and a difficult external environment have contributed to a marked economic slowdown. Against this background, Directors encouraged Georgia's policymakers to recalibrate policies to revive economic activity, accelerate job creation, and promote lasting and equitable growth.

Directors generally concurred that supportive fiscal and monetary policies are needed in the near term. They encouraged the government to address the causes of recent budget underspending and to allow a higher budget deficit if revenues are undercut by the slowdown. Most Directors agreed that further monetary easing is necessary at present and that it should be supported by measures to strengthen policy transmission.

Directors noted that the financial system appears sound, with comfortable levels of capital and liquidity in banks. They supported steps underway to discourage foreign-currency lending and deposits, including those held by nonresidents, which pose risks to the system and undermine the effectiveness of monetary policy. Directors welcomed the authorities' intention to participate again in the Financial Stability Assessment Program.

Directors considered that improved communication of economic policies would help reduce business uncertainty and stimulate private investment. In particular, they welcomed the greater transparency of the inflation targeting framework and encouraged the government to clarify the role and governance of the investment funds it intends to establish. Directors also noted that greater coordination between the government and the central bank, while preserving central bank independence, would improve the overall policy response.

Directors agreed that a critical medium-term priority is to bolster external stability by reducing the current account deficit in relation to GDP. This will require continued fiscal consolidation, higher private saving, exchange rate adjustment, and structural reforms to improve competitiveness.

Welcoming the authorities' focus on inclusive growth, Directors supported their efforts to strengthen and appropriately target social programs. They endorsed the authorities' plans to lift potential growth by addressing skill mismatches, promoting trade and competition, and boosting property rights and the rule of law. Directors also encouraged the government to upgrade the regulatory framework for the energy sector and safeguard the independence of the regulator.

Georgia: Selected Economic Indicators, 2010–14

	2010	2011	2012	2013 Proj.	2014 Proj.
Output					
Real GDP growth (in percent, at market prices)	6.3	7.2	6.1	4.0	6.6
Nominal GDP (in billions of U.S. dollars)	11.6	14.4	15.8	16.3	17.3
GDP per capita (in thousands of U.S. dollars)	2.6	3.2	3.5	3.6	3.9
Unemployment rate (in percent)	16.3	15.1	15.0	...	...
Inflation			(in percent)		
Period average	7.1	8.5	-0.9	-0.8	4.5
End-of-period	11.2	2.0	-1.4	1.5	5.5
Consolidated government operations			(in percent of GDP)		
Revenue 1/	28.3	28.2	28.8	28.1	27.9
o.w. Tax revenue	23.5	25.2	25.4	25.7	25.5
Expenditures	34.9	31.8	31.8	31.5	30.3
Overall balance	-6.6	-3.6	-3.0	-3.3	-2.4
Public debt	39.2	33.8	32.3	31.8	31.8
Of which: foreign-currency denominated	33.6	28.8	27.6	26.8	26.3
Money and credit					
Credit to the private sector (annual percentage change, end of period)	18.8	24.3	12.8	14.3	22.6
Broad money (incl. fx deposits, annual percentage change, end of period)	23.9	20.3	11.4	15.5	18.5
Deposit dollarization (in percent)	68.6	63.3	66.0	65.5	62.3
Policy rate (in percent, end-of-period)	7.5	6.8	5.3	...	...
Deposit interest rate (in percent, annual average)	7.9	9.4	8.6	...	...
Lending interest rate (in percent, annual average)	19.5	18.7	19.0	...	...
External sector					
Imports of goods and nonfactor services (percentage change, in U.S. dollars)	26.6	29.6	14.8	9.0	6.6
Exports of goods and nonfactor services (percentage change, in U.S. dollars)	16.5	30.5	14.3	2.3	3.2
Gross international reserves (in billions of US$)	2.3	2.8	2.9	2.8	2.7
In months of next year's imports of goods and services	3.4	3.7	3.7	3.4	3.2
Current account balance (in billions of US$)	-1.2	-1.8	-1.8	-1.5	-1.3
In percent of GDP	-10.2	-12.7	-11.5	-9.1	-7.7
Foreign direct investment (inflows, in percent of GDP)	7.0	7.3	5.5	5.8	6.0
Gross external debt (in percent of GDP)	84.1	77.8	81.4	81.8	79.0
Gross external debt, excl. intercompany loans (in percent of GDP)	62.9	58.9	63.4	63.5	60.9

Sources: Georgian authorities; and IMF staff estimates.

1/ Includes grants.

Statement by Menno Snel, Executive Director for Georgia and Metodij Hadzi-Vaskov, Advisor to the Executive Director
July 10, 2013

The Georgian authorities would like to thank the Fund team for fruitful discussions during the mission visit. They broadly agree with staff's assessment of the main risks facing the Georgian economy, especially those related to vulnerabilities stemming from external spillovers. The authorities continue to attach great importance to making use of Fund advice. They have implemented most of the recommendations from the 2011 Article IV consultation, including in public financial management, monetary policy and ensuring financial stability. The authorities value the sustained support they receive in the process of transformation and modernization of the Georgian economy.

Following the first peaceful democratic transfer of power in recent history, the authorities are strongly committed to sustaining rapid economic growth, and making it more socially inclusive and broad-based. Strengthened social protection, further support of private initiatives through the establishment of investment funds, and focus on modernizing the agricultural sector are high on the authorities' policy agenda. At the same time, they are committed to preserving fiscal sustainability, pursuing prudent monetary and exchange rate policies, maintaining financial stability, and reducing vulnerabilities in the external position.

Fiscal policy

The authorities remain committed to meeting the fiscal consolidation targets, while reprioritizing government expenditure toward social spending and maintaining key infrastructure projects. To make growth more inclusive the government aims at redirecting public spending from capital investment, which as a share of GDP is one of the highest in the region, to social expenditures, which is one of the lowest among peers.

The authorities are committed to gradually reducing the fiscal deficit to 1.5 percent of GDP by 2017, implying a modest annual reduction of the primary structural balance by ¼ to ½ percent of GDP over the period 2014-2017. The authorities emphasize that the under-execution of the budget this year is mainly due to temporary factors related to the public procurement procedures. This underspending is expected to disappear.

A universal health care system is being introduced. Targeted social assistance allowances will be doubled. The government will increase investment in the quality of education. This being said, capital spending is expected to stay above 6 percent of GDP, comparable with regional peer countries. In order to support agriculture, an Agriculture Fund has been established and the government has increased budget allocations to support this sector.

Monetary and exchange rate policies

Since November 2012 the National Bank of Georgia (NBG) has gradually cut its policy rate from 5.5 to 4 percent in June 2013, in line with staff advice. This gradual easing of monetary policy has been implemented in response to persistent deflationary pressures and some signs of slowing economic activity. Nonetheless, the authorities remain cautious in light of some indications that inflation might soon pick up with a rebound in economic growth.

The NBG has continued to improve its inflation targeting framework, increased transparency, promoted initiatives to strengthen the monetary policy transmission mechanism, and encouraged steps leading to further de-dollarization. The NBG has also continued to improve its forecasting capacities and promote transparency by strengthening its communications strategy with the introduction of an upgraded inflation report that better explains monetary policy performance and deviations from established inflation targets.

The NBG aims at further strengthening the monetary policy transmission mechanism by encouraging long-term lari lending and floating-rate lari lending by domestic banks. In particular, together with the Ministry of Finance they are considering depositing long-term the proceeds from new treasury bills with commercial banks in order to stimulate further long-term lari lending. The NBG also aims at supporting floating-rate lending by easing collateral standards. These measures should also help fulfill the authorities' goal of further developing the domestic corporate bond and equity market.

The central bank has resisted appreciation pressures with significant foreign exchange purchases that have helped further build up reserves. Because of large uncertainties and specific assumptions included in the staff's methodology, the authorities are not fully convinced about the staff's assessment that the exchange rate is overvalued. The authorities reiterate their commitment in principle to a floating exchange rate regime. They emphasize that improved cooperation between the NBG and the government is helpful and that the institutional independence of the central bank strengthens the credibility and effectiveness of monetary policy.

Financial system

The financial system remains profitable, adequately capitalized, and liquid. The capital adequacy ratio further increased to 26.4 percent according to the Basel definition. Liquid assets, excluding short-term loans, account for 28.1 percent of total assets and 51.2 percent of client deposits. While nonperforming loans increased recently, from 3.7 percent to 4.5 percent according to the standard 90-day overdue definition, the authorities do not expect that this small rise represents a risk for financial stability or profitability of the banking sector.

The authorities are fully aware of the potential risks related to recent increases in nonresident deposits and the high level of dollarization. They continue to undertake appropriate measures to contain these risks. In particular, new supervisory measures have tightened the liquidity requirement for nonresident deposits. The new liquidity coverage ratio assumes higher outflow rates for FX deposits than what it would be without taking into account currency denomination. Together with capital add-ons for FX lending risks, these prudential measures are expected to discourage nonresident deposits and FX lending. The NBG's actions to stimulate long-term and floating-rate lari lending should also help in containing risks.

The NBG has recently developed a framework for monitoring systemically important banks. The NBG also continues to closely monitor developments in the banking system. A Basel III draft framework has been developed and major banks are reporting Basel III capital adequacy ratios on a monthly basis for monitoring purposes. The banks have already shown substantial progress in submitting their first ICAAPs. The authorities have asked the Fund to conduct an FSAP.

Structural reforms

Georgia's current account position makes implementing a strategy to decisively improve external competitiveness a key priority. Rather than relying on nominal exchange rate depreciation, the government is determined to implement a broad array of structural reforms to improve productivity and competitiveness. Making progress towards the completion of a deep and comprehensive free trade agreement with the EU is a priority.

The revised Labor code, which has been passed by Parliament in June 2013, incorporates comments from businesses and assures a better balance between the interests of employers and employees to improve welfare and enhance productivity. Georgia's competitiveness in manufacturing will be upgraded by improving education quality in general and vocational training to reduce skill-mismatches in particular. Investment funds with significant resources will actively promote foreign direct investment in Georgia. The agriculture sector has comparative advantages, particularly if its capital base and infrastructure can be improved. The government's policy will aim at higher productivity for the agriculture sector.

The Universal Health Care (UHC) reform was designed and launched in close consultation with all stakeholders concerned, including the WHO, the World Bank and private insurance companies. The program was designed based on the evidence from the Catastrophic Health Expenditure and Utilization Survey (2010) to tackle the lead causes of impoverishment due to healthcare related costs (hospitalization, chronic diseases and acute conditions) and to reduce inequalities due to health conditions. Drug co-payments are already in place under disease-specific programs (e.g. diabetes) and ongoing for emergency, oncology and maternity services and will be expanded upon creation of stronger regulations for drug utilization control. Concerns about social spending will be adequately addressed within ongoing and planned reforms.

Hydro power sector development in particular has good prospects. To attract foreign investment in this sector and promote regional trading, the regulatory framework will be enhanced in cooperation with the World Bank. Developing domestic capital markets and creating a contributory pension system will facilitate the allocation of capital from savers to investors. Lastly, a vibrant economy, based on investment and employment creation, requires the enforcement of the rule of law and strengthening of property rights.