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# Georgia: Request for a Stand-By Arrangement and an Arrangement Under the Standby Credit Facility—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Georgia.

In the context of the request for a stand-by arrangement and an arrangement under the standby credit facility, the following documents have been released and are included in this package:

- The staff report for the Request for a Stand-By Arrangement and an Arrangement Under the Standby Credit Facility, prepared by a staff team of the IMF, following discussions that ended on February 24, 2012, with the officials of Georgia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 27, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of April 10, 2012 updating information on recent developments.

- A Press Release summarizing the views of the Executive Board as expressed during its April 11, 2012 discussion of the staff report that completed the request and/or review.

- A statement by the Executive Director for Georgia.

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

Letter of Intent sent to the IMF by the authorities of Georgia*
Memorandum of Economic and Financial Policies by the authorities of Georgia*
Technical Memorandum of Understanding*

*Also included in Staff Report

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

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# GEORGIA

## REQUEST FOR STAND-BY ARRANGEMENT AND AN ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY

March 27, 2012

## EXECUTIVE SUMMARY

The objectives of the Stand-By Arrangement (SBA) that expired in June 2011 were largely achieved. Policies under the program contributed to stabilize the economy and restart economic growth, and then to promote fiscal adjustment and enable a return to private market financing. Performance in 2011 was stronger than originally envisaged, with growth of nearly 7 percent, inflation in the low single digits, public debt falling to 34 percent of GDP, and international reserves increasing to $2.8 billion.

Despite these achievements, the unsettled external environment has increased vulnerabilities at a time of large external debt repayments (mostly to the Fund). To guard against these risks and support completion of the adjustment process, the authorities request precautionary access to Fund resources under a 24-month Stand-By Arrangement and Standby Credit Facility. Fund credit of up to SDR 250 million (166.3 percent of quota) would be available in the event of a significant worsening of external conditions. In such an event, the authorities also commit to take additional measures to accelerate external adjustment.

At this juncture, the economic outlook for 2012 remains relatively favorable, with growth projected to slow to 6 percent. In reaction to the expected slowdown in external and private domestic demand, the authorities have shifted some of the planned fiscal consolidation from 2012 to 2013. The fiscal deficit is targeted to decline marginally in 2012 to 3.5 percent of GDP and then to 3 percent in 2013. The public debt ratio would decrease steadily throughout the program period.

Exchange rate flexibility remains a critical instrument of adjustment in response to shocks. At the same time, high financial dollarization may require the central bank to intervene to avoid abrupt, and potentially destabilizing, exchange rate fluctuations. Monetary policy has gained traction as a result of reforms carried out since 2009, but its effectiveness is constrained by dollarization. The banking sector has recovered well from the 2009 slump, enabling the authorities to focus on strengthening the supervisory framework ahead of a possible new credit cycle.

Medium-term challenges remain, notably in terms of lowering the current account deficit (12.7 percent of GDP in 2011) and reducing unemployment (16.3 percent in 2010) and underemployment. To meet both objectives, the authorities are complementing sound macroeconomic policies and strong business environment policies with sector policies to encourage private investment and education and training reforms to improve labor market skills.

Approved By
**David Owen and Vivek Arora**

A staff team comprising Messrs E. Gardner (head and Senior Resident Representative) and E. Martin, Ms. M. Colacelli (All MCD), Mr. M. Gerard (FAD), and Ms. S. Sanya (SPR) visited Tbilisi February 2–14, 2012. The mission met with the Prime Minister, the Minister of Finance, the Vice Governors of the National Bank and other senior officials, as well as representatives of the private sector and the donor community. Mr. D. Lezhava (OED) participated in the discussions. On February 24, Messrs D. Owen (MCD) and E. Gardner met with the Prime Minister and the Governor of the National Bank in Tbilisi to conclude discussions.

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**ANNEX**



**APPENDIX**

# INTRODUCTION

1. **The Georgian authorities have requested support for their economic program under a 24-month Stand-By Arrangement and Standby Credit Facility, which they intend to treat as precautionary.** The main objectives of this arrangement are to support completion of the post-crisis (external and fiscal) adjustment process. A Fund arrangement would also help strengthen market confidence, and provide precautionary access to Fund resources to help cover balance of payments gaps that could emerge from a worsening of international financial and economic conditions.

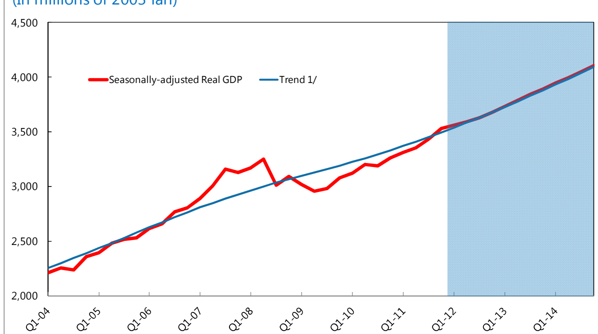
# BACKGROUND AND RECENT DEVELOPMENTS

2. **The objectives of the Stand-By Arrangement (SBA) that expired in June 2011 were largely achieved and Georgia exited from the Fund arrangement in a relatively strong position.** Economic and financial policies under the program were successful, initially in stabilizing the economy and restarting economic growth, and later in promoting fiscal adjustment and enabling a return to private market financing.

3. **Macroeconomic performance in 2011 was stronger than envisaged at the time of the last review under the SBA (see Table 1)**:

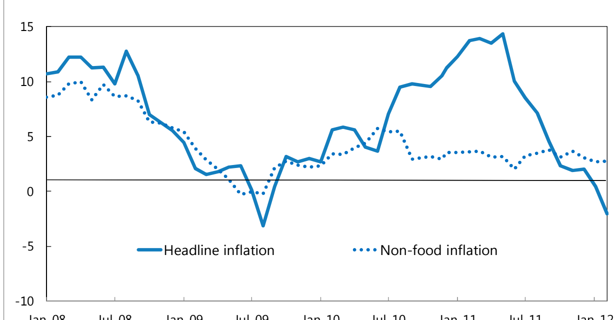
- Economic activity accelerated in the second half of 2011, contributing to a 6.8 percent increase in real GDP in 2011.
- Growth was broad based, and particularly strong in manufacturing, tourism, and the financial sector. While growth is likely to have come mostly from higher labor productivity, unemployment is expected to have declined somewhat from its 2010 level (16.3 percent of the labor force, see Box 1).
- Reflecting a swift deceleration in food prices, CPI inflation dropped sharply in the second half of 2011. Year-on-year inflation was -2.1 percent in February 2012, compared to 14.3 percent in May 2011. Nonfood inflation remained subdued, at 2.7 percent year-on-year in February 2012.

**Georgia: Seasonally-adjusted Real GDP, 2004–14**
(In millions of 2003 lari)




1/ Trend is calculated using the Hodrick-Prescott filter applied to 2004–17 data.
Sources: Georgian authorities; and Fund staff estimates.

**Georgia: Consumer Price Inflation, 2008–12**
(Year-on-year, in percent)

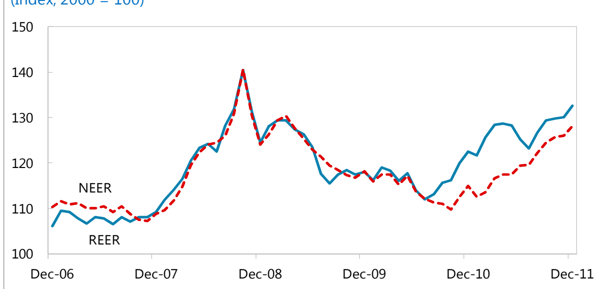



Sources: Georgian authorities; and Fund staff estimates.

- As projected, the current account deficit widened (to an estimated 12.7 percent of GDP, from 11.5 percent of GDP in 2010)[1]. However, this increase was more than offset by higher net private inflows. The deterioration of the current account relative to 2010 primarily reflected the impact of higher commodity prices and the lari's real appreciation on the trade balance, as well as lower transfers to the public sector, which were only partly offset by an increase in tourism inflows. The sector distribution of Foreign Direct Investment (FDI) remains very diverse, with services attracting over half of the inflows, and mining, manufacturing, construction and energy accounting for most of the rest. The strength of private financial inflows allowed the central bank to step up its foreign currency purchases on the foreign exchange (FX) market in the second half of 2011. As a result, gross international reserves increased by about \$550 million in 2011, to \$2.8 billion (4.1 months of imports).

- After appreciating in early 2011, the lari/ USD exchange rate has been fluctuating in a narrow range (GEL/\$ 1.64–1.69), as appreciation pressures (from net inflows) were moderated by central bank intervention. The real effective exchange rate appreciated by 6.3 percent from end-2010 to end-2011.

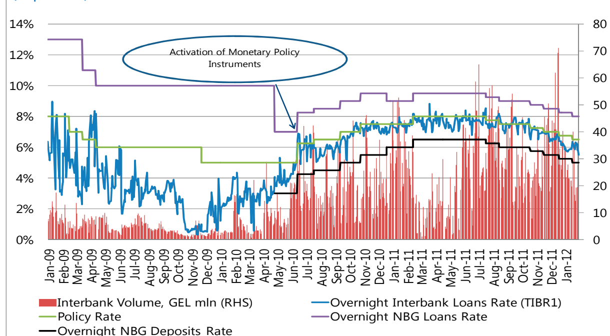
**Georgia: Real and Nominal Effective Exchange Rates, 2006–11**
(Index, 2000 = 100)




Sources: Georgian authorities; and Fund staff estimates.

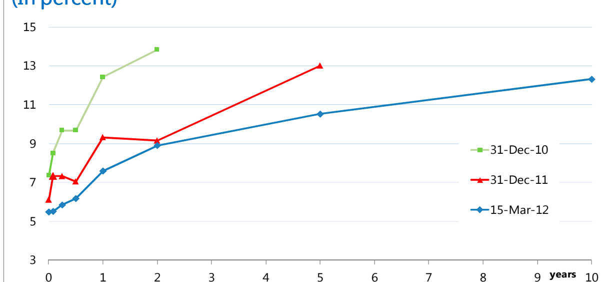
4. **Responding to the more benign inflation outlook, the National Bank of Georgia (NBG) began easing its monetary stance in the second half of 2011.** It reduced its refinancing (policy) rate gradually, from 8 percent in June 2011 to 6.5 percent in January 2012. Government securities' rates followed a similar downward path, with the 2-year T-bill rate declining by 300 bps over the same period. The flattening of the yield curve since the reintroduction of T-bills in 2010 attests to increased confidence in monetary and price stability[2].

**Georgia: Money Market Rates, 2009–12**
(In percent)




Source: Georgian authorities.

**Georgia: Yield Curve, 2010–12**
(In percent)




Note: Rates used are Interbank overnight rate (TIBR-1), 7-day Interbank rate (TIBR-7), NBG Certificates of Deposits rates (3-month and 6-month), and Treasuries rates (6-month,1, 2, 5, and 10-year maturities). 6-month Treasuries used for 2010 curve only.

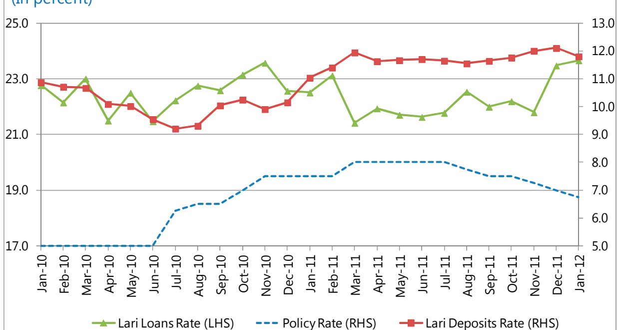
Sources: Georgian authorities; and Fund staff estimates.

[1] The upward revision of the current account deficit for 2010 (from the 9.6 percent of GDP reported in June) essentially reflects an upward revision of both FDI and FDI-related income outflows, based on companies' final financial statements.

[2] 5-year Treasuries were introduced in April 2011 and 10-year Treasuries were introduced in March 2012.

5. **While the traction of monetary policy on market rates has improved since 2009, the recent decline in money market and T-bill rates was not transmitted to lari deposit and lending rates, which actually edged up in the second half of 2011.** The disconnect between falling monetary policy rates and rising bank deposit and lending rates reflects primarily an offsetting increase in banks' liquidity preference. As banks' began anticipating a tightening in external financing conditions, they raised rates to attract deposits and slow down lending in order to build up liquidity buffers. This development points to the limits of monetary policy in a dollarized context, where the price of financial resources is affected by external conditions.

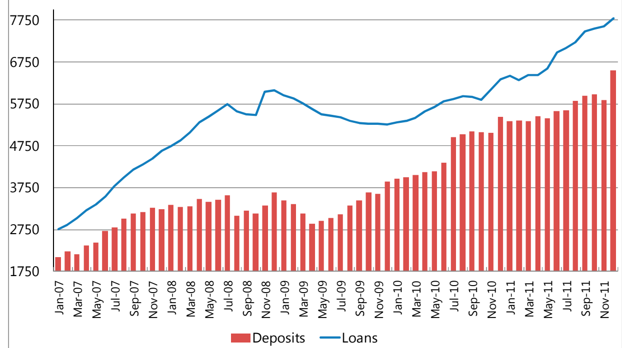
**Georgia: Lari Deposit and Lending Rates and Policy Rate, 2010–12**
(In percent)




Sources: Georgian authorities; and Fund staff estimates.

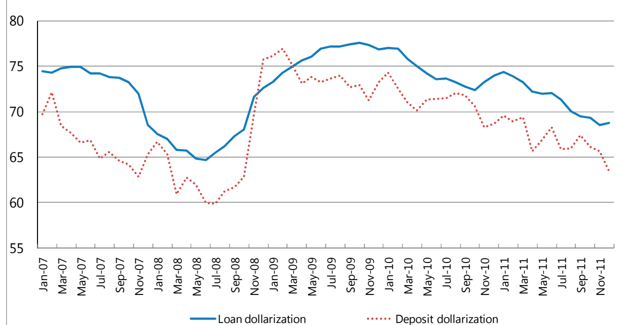
6. **Credit continues to grow at a healthy rate, while deposit and loan dollarization is declining steadily (see Tables 4, 5 and 6).** The banks' financial situation has continued to strengthen in 2011: they remained highly capitalized; their return on equity almost doubled, to 17.3 percent; and NPLs declined to 4.6 percent (IMF definition) by end-2011, reflecting write-offs and loan recovery. To promote long-term funding, the NBG reduced reserve requirements on long-term borrowing.

**Georgia: Total Loans and Deposits, 2007–11**
(In millions of lari)




Source: Georgian authorities.

**Georgia: Loans and Deposits Dollarization, 2007–11**
(In percent)




Sources: Georgian authorities; and Fund staff estimates.

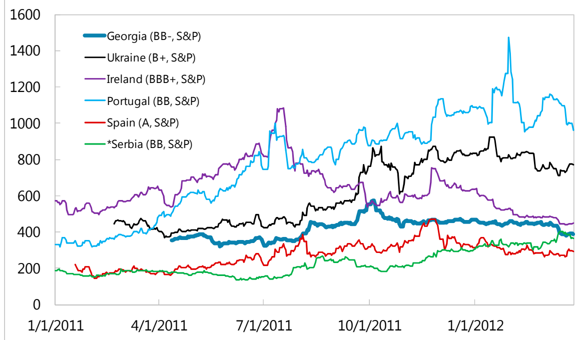
7. **As projected in June 2011, the general government deficit declined to 3.6 percent of GDP in 2011.** Revenues were higher than expected, as stronger tax and nontax revenue were only partly offset by lower grant income. The higher tax and nontax revenue reflected a cyclical upturn in tax buoyancy, but also a number of one-off factors. These additional revenues were used primarily to speed up the implementation of investment projects.

8. **Last July, the parliament adopted the Economic Liberty Act (see Box 2), which significantly dilutes the constraints to fiscal policy created by the referendum requirement on new taxes adopted in 2010.** Under the Act, which will come into effect with the 2014 budget, the government retains the right to introduce or raise any taxes for a period of up to three years without the need

for a referendum—with the option of reintroducing them once they expire. The Act also sets limits on public spending (30 percent of GDP) and the budget deficit (3 percent of GDP). It requires that, if the thresholds are breached, the government submit to parliament a budgetary plan to bring these indicators below their thresholds within a two-year period.

9. **The improvement in macroeconomic fundamentals and the authorities' sound macroeconomic policy management have been recognized by rating agencies, markets, and international institutions.** In November–December 2011, Fitch and Standard & Poor's upgraded Georgia's sovereign rating to BB-. The spread on Georgia's Eurobond has narrowed to 440 basis points as of March 2012 (from a peak of 574 bps in October 2011). Georgia's position in the World Bank's "doing business" and Transparency international's "corruption perception index" rankings also improved, to 16th and 64th (out of 183 countries), respectively.

**Sovereign Eurobond Spreads**
(In basis points over comparable U.S. Treasuries)




*Comparable to 5-Yr U.S. Treasury Bond
Source: Bloomberg.

10. **Parliamentary elections are scheduled for October 2012, followed by presidential election in 2013.** These elections carry considerable importance because they coincide with a constitutional rebalancing of power from the presidency to the parliament and the prime minister. The fact that the opposition is now engaged in the election process represents a favorable development relative to the extra-parliamentary street politics of 2009.

# POLICY DISCUSSIONS AND PROGRAM FOR 2012–14

*The authorities' request for a precautionary Stand-By Arrangement and Standby Credit Facility is intended to support their economic and financial program for 2012–14 aimed at completing Georgia's macroeconomic adjustment process. The program seeks to rebuild fiscal buffers, promote external adjustment, strengthen market confidence, and catalyze continued official financial support. Access to Fund resources would be available in the event downside risks materialize. Fiscal adjustment, a flexible exchange rate, and monetary policy dedicated to price stability will be the key macro policy underpinnings of the program. A combination of strong business environment policies, sector policies to encourage private investment, and education and training policies to improve labor market skills are aimed at reducing unemployment and poverty over the medium term.*

11. **Public balance sheets have improved faster than envisaged in mid-2011, at the conclusion of the last review under the previous SBA.** Reflecting primarily the strength of economic growth and of the local currency and higher privatization receipts, public debt at end-2011 (34 percent of GDP) was 3 percentage points of GDP lower than projected in June. Also, the central bank's

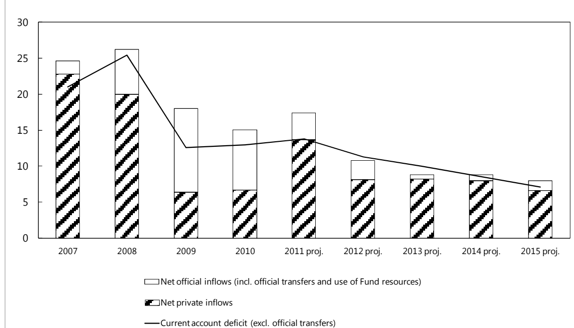
gross international reserves at end-2011 were slightly higher than projected at the time.

12. **The economic outlook for 2012 remains relatively favorable, with real GDP projected to grow by 6 percent.** The slowdown relative to 2011 reflects the dampening effect of weaker global conditions on Georgia's exports and private investment, offset in part by slower fiscal adjustment than in 2011.[3] Inflation is projected to increase moderately to around 5 percent by end-2012, owing to an expected increase in domestic food prices.

13. **To counter the impact of slower external demand, the authorities have opted to shift some of the planned fiscal consolidation from 2012 to 2013, compared with what was envisaged a year ago (see Tables 2a and 2b).** The rebalancing is made possible by the expectation of ample external financing in 2012. The revised fiscal plans would still achieve as strong a debt sustainability objective as under the previous SBA while protecting the economy against a sharper slowdown of growth.

14. **There are no external financing gaps under the baseline scenario (see Table 3).** The current account is projected to narrow gradually over the medium term, in line with a projected decline of official financing and stabilization of private financing. About 70 percent of the current account adjustment over the medium term would take place by the last year of the program (2014). The projected improvement in the current account is driven by a mix of structural reforms and real exchange rate adjustment commensurate with the estimated degree of overvaluation.[4] The authorities consider that the growth potential of the tradable sector can be unlocked through continued improvement in the policy framework, structural reforms and supportive infrastructure spending without the need for real exchange rate adjustment. Also, electricity exports to Turkey are expected to increase as of 2015. External debt declines steadily in the baseline scenario from 53 percent of GDP in 2011 to 40 percent of GDP in 2017. Even under the standard shocks of the debt sustainability analysis (DSA, see Annex I), the external debt ratio would not rise above 60 percent of GDP over the medium term, suggesting that risks under the program are relatively well contained.

**Georgia: Current Account Balance and its Financing, 2007–15**
(In percent of GDP)




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

15. **Downside risks over the program horizon are assessed in an illustrative scenario, which is driven by an assumed worsening of the external environment (see Box 3).** Although Georgia's relatively low debt-roll-over needs (excluding repayments to

[3] Annual real GDP growth of 6 percent in 2012 is based on an assumed growth of 4¼ percent through the year (2012Q4 over 2011Q4), compared with 8 percent in 2011.

[4] Based on the CGER methodology, the exchange rate is estimated to be slightly misaligned, with an overvaluation of up to 9 percent.

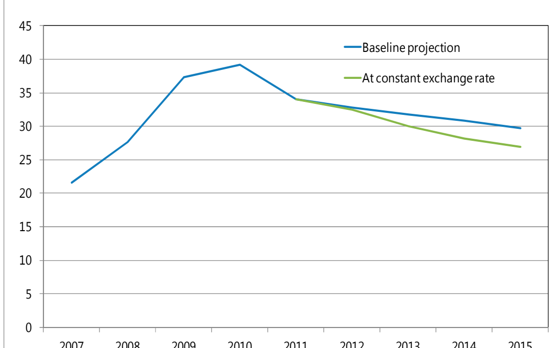
the Fund) limit its exposure to external shocks, under the adverse scenario a cumulative balance of payments gap of around $800 million in 2012–14 would open as a result of lower exports and remittances, and weaker private financing. In such an event, exchange rate flexibility would be the first line of defense. However, given the balance sheet vulnerabilities from financial dollarization, there would be a strong case to blend adjustment with financing in the event of a sharp shock, such as the one described in the box.

16. **Under the program, sound macroeconomic policies will be accompanied by structural and sector policies to address unemployment and underemployment and reduce poverty.** In the authorities' view, future growth and job creation are closely linked to the development of the tradable sector and must rely on private sector investment. The authorities have achieved remarkable success in building a favorable business environment and in reducing corruption. However, they consider that a more proactive approach may be needed to address perceived market failures and promote the development of new activities and markets (MEFP ¶7). Initiatives include: (i) public investments and services to improve productivity and access to markets in agriculture; (ii) provision of risk capital in partnership with the private sector for large scale investments through the newly created Partnership Fund (see below); and (iii) public investments in tourism infrastructure. At the same time, the authorities are working to upgrade skills in the labor force, which are generally recognized as a major impediment to employment creation in the formal sector. In addition to strengthening the education system through teacher training and accreditation, enhanced curricula and computerization of classrooms, the authorities also plan to create new vocational training centers, based on the success of pilot programs.

## A. Fiscal Policy

17. **Fiscal policy under the program will aim at putting public debt firmly on a downward path, while providing for a step adjustment in old-age pensions and maintaining the level of public capital spending roughly constant in real terms.** The general government deficit would go from 3.5 percent of GDP in 2012, to 3.0 percent in 2013, and drop below 3.0 percent in 2014 (MEFP ¶16). As a result, public debt would decline from 34 percent of GDP in 2011 to 31 percent in 2014, and remain on a downward path thereafter. Based on the DSA (see Annex I), the public debt ratio would remain on a downward path under most standard shocks. Even in extreme cases, the policy adjustment needed to restore debt sustainability would be manageable.

**Georgia: Public Debt, 2007–15**
(In percent of GDP)




Source: Ministry of Finance; and Fund staff estimates.

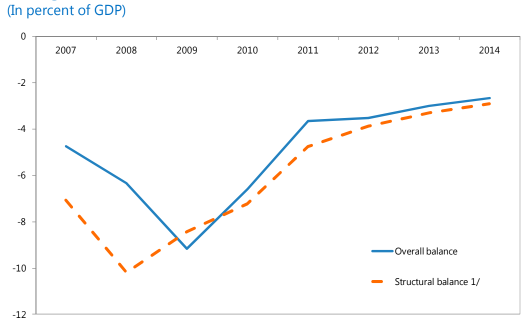
18. **The authorities' decision to shift fiscal adjustment from 2012 to 2013 reflects the following considerations**:

- The desire to slow down the withdrawal of fiscal stimulus in the face of an expected slowdown in external and private domestic demand.

- Related to that, the opportunity to pursue productive capital investments financed by the availability of ample external financing, notably from other IFIs.

- The fiscal space created by the steeper-than-expected decline in public debt in 2011, which ensures that the slower adjustment in 2012 remains consistent with fiscal sustainability.

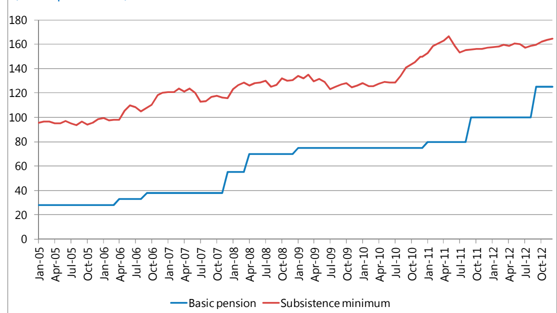
**Georgia: Fiscal Balances, 2007–14**
(In percent of GDP)




Source: Georgian authorities; and Fund staff estimates.
1/ Cyclically-adjusted balance excluding one-off revenues and expenditures and grant revenues.

19. **In line with Fund technical assistance (TA) recommendations, the authorities chose not to overhaul the pension system but to retain the existing basic pension system and to target the increase in old-age pensions so as to contain its fiscal cost (MEFP ¶23).** To bring pensions closer to the subsistence minimum, basic pension benefits (including insurance) were increased by 22 percent in September 2011 and will increase by an additional 27 percent in September 2012 (to the equivalent of about $85 per month). To limit its cost, the latter increase will be limited to pensioners aged 67 and over. Overall, and owing to the projected strong nominal growth of GDP (24 percent), old-age pensions would increase by only 0.5 percentage points of GDP from 2011 to 2013.

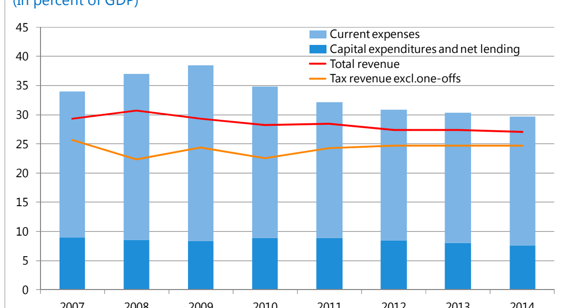
**Georgia: Basic Pension and Subsistence Minimum, 2005–12**
(In lari per month)




Sources: GEOSTAT; and Fund staff estimates.

20. **Revenues are projected to decline over the program period and the medium term, reflecting the phasing out of grant support and non-recurrence of one-off tax intakes.** During the program period, this decline will primarily reflect the fact that the settlement of tax arrears and other one-off factors that boosted revenues in 2011 are not expected to recur. Plans for further reductions in the income tax rate have been put on hold. At the same time, the authorities intend to enhance tax efficiency through measures that promote voluntary compliance and reduce compliance costs (MEFP ¶54–55).

**Georgia: General Government's Revenue and Expenditures, 2007–14**
(In percent of GDP)




Sources: Ministry of Finance; and Fund staff estimates.

21. **The authorities intend to focus their fiscal consolidation efforts on expenditure containment (MEFP ¶18).** Consistent with the limit on government expenditure set in the Economic Liberty Act, which will come into effect in 2014, the authorities' program targets a reduction of the government expenditure-to-GDP ratio from 32 percent in 2011 to 31 percent in 2012 (MEFP ¶17). These efforts will be concentrated on the capital budget and non-pension current spending, which would still grow in real terms during the program period, but at a slower pace than real GDP.

## B. Public Financial Management and the Partnership Fund

22. **Monitoring of public sector extra-budgetary units will be strengthened to ensure that fiscal risks remain well contained.** Currently, the state does not provide guarantees, the State Owned Enterprise (SOE) sector is profitable, and local governments and extra-budgetary agencies (i.e., Legal Entities of Public Law, LEPLs) are not allowed to borrow. Nonetheless, to improve the overall efficiency of public sector activities and prevent the emergence of future risks, the authorities will strengthen the monitoring of the financial flows of the largest LEPLs and SOEs (structural benchmark, MEFP ¶48). An annual report on the financial situation of LEPLs and SOEs will allow the authorities to form a better view of the economic impact of the consolidated public sector and possibly improve its overall efficiency.

23. **In 2011, the authorities set up a Partnership Fund (PF) charged with supporting private investment in key sectors through public minority equity participations and debt financing.** This initiative fills a perceived gap in the state's investment promotion toolkit (MEFP ¶50). In particular, by sharing in the financial risk of a project, the government can mitigate risks related to future policy reversals, which would otherwise deter private investors.

24. **The PF was capitalized through the transfer of shares of four SOEs, which were hitherto fully owned by the state.** The most significant financial transfer was in the form of 24 percent of Georgian Railway and 24 percent of Georgian Oil and Gas Company. Total dividends from these two companies are projected at 0.2 percent of GDP in 2012, and the share accruing to the PF provides the initial cash resources for its operations. Depending on the success of the PF, the government may transfer additional resources to it, but will discuss such transfers with the IMF ahead of time (MEFP ¶52).

25. **The PF's investment mandate, and specifically its focus on commercially viable projects, should limit fiscal risks, but the mission recommended that IMF technical assistance be mobilized to reinforce safeguards around the PF and provide a more transparent framework for the allocation of public resources to it.** According to its investment mandate[5], the PF is concerned with promoting commercially viable projects with a majority participation of a private strategic investor (MEFP ¶51 and MEFP Schedule 1). Its operations are conducted solely on its balance sheet, without any government guarantee. The PF is also subject to reporting and transparency

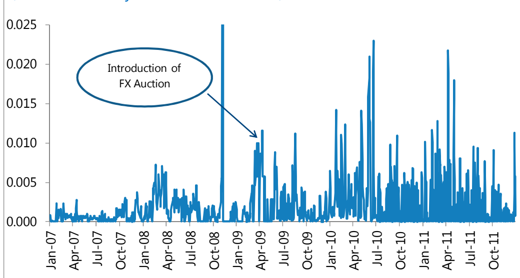
[5] This mandate, set by the PF's supervisory board, is not legally binding. However, as a Joint Stock Company (JSC), the PF is, by nature, a profit maximizing entity.

requirements, including publication of audited IFRS-compliant financial statements (structural benchmark). Its financial operations will also be monitored through a zero deficit ceiling (MEFP ¶52). IMF technical assistance (TA) will advise the authorities on possible ways to strengthen the framework for private-public partnerships, improve governance, ensure that the transfer of resources to the PF reflects best public financial management practices, and avoid the possibility that future liabilities of the PF are borne by the government. As such, TA recommendations could inform future structural conditionality under the program.

## C. Exchange Rate Policy and International Reserves

26. **While the market has played a larger role in determining the exchange rate since 2009, in 2011 the authorities took advantage of sustained appreciation pressures to build up international reserves through occasional sterilized intervention**. Despite the fact that these purchases, conducted through foreign exchange auctions, took place, on average, less than once a week, the volatility of the lari/USD exchange rate declined markedly in the second half of 2011.This possibly reflected market expectations of central bank intervention.

**Georgia: Exchange Rate Volatility, 2007–11**
(GEL/USD, 3-Day Standard Deviation)




Source: Georgian authorities.

27. **The authorities continue to view exchange rate flexibility as an important instrument of external adjustment.** Foreign exchange intervention in 2012 will continue to be guided by the objective of avoiding abrupt (and destabilizing) changes in the exchange rate, but also by the targeted increase of NIR (MEFP ¶26). The 2012 NIR target is set with a view to building up international reserves ahead of the repayments to the Fund in 2013–14. Throughout the program period, gross international reserves would be maintained above $2.5 billion, consistent with coverage ratios of at least 3 months of imports and 100 percent of short-term liabilities (MEFP ¶12).

28. **The authorities are evaluating procedural changes that would eliminate the multiple currency practice.** The practice arises because the official rate[6], used by the government for foreign exchange transactions with the National Bank of Georgia, may, in theory, differ by more than 2 percent from the freely determined market rate[7]. The authorities consider that the transition to a new system could be completed in a few months.

[6] The official rate is defined as the average of the previous day's market transaction rates.

[7] In practice, the official and market rates have never differed by more than 2 percent since the introduction of foreign exchange auctions in March 2009.

## D. Monetary Policy

29. **Price stability is the main objective of the NBG's monetary policy.** To this end, the NBG is gradually transitioning to an inflation targeting (lite) regime, and has set an inflation target of 6 percent for the medium term (MEFP ¶25). The level of the policy rate appears consistent with the inflation objective under present conditions. Future changes in the policy rate will be informed by monetary and credit aggregate developments, together with the inflation forecast models used by the NBG.

30. **High financial dollarization dampens the effectiveness of the monetary transmission mechanism.** Overall monetary conditions in Georgia are affected not only by the central bank's refinancing rate but also by the (actual and expected) cost of external dollar resources. In this context, the NBG may need to complement changes in the policy rate with changes in reserve requirements to affect monetary conditions in the desired direction. At the same time, the authorities confirmed their commitment to the dedollarization agenda that they adopted in April 2010 (MEFP ¶28), which in turn should help strengthen the traction of monetary policy. As part of the broad objective of strengthening confidence in local financial markets, the authorities have improved the payments' settlement infrastructure and will introduce in 2012 a new sweeping law on payments system, drafted with IMF TA. They are also in the process of upgrading payment system oversight functions, based on IMF TA (MEFP ¶30). In addition to developing deeper domestic financial markets, the success of the dedollarization strategy is based on strengthening the economy's resilience to exchange rate volatility. To that end, the NBG is supporting the development of foreign exchange hedging instruments (MEFP ¶29).

## E. Financial Sector Policies

31. **The financial supervisory authorities consider the current rate of credit growth to be healthy, but they are aware of external and domestic risks.** They viewed the capitalization and liquidity of the banking sector as comfortable, with capital adequacy (Basel I definition) and liquidity ratios of 25.6 and 37.3 percent, respectively, at end-2011 (MEFP ¶36–37). In 2011, the authorities observed a narrowing of credit margins which they attributed to excessive competition for market share in the banking sector. However, the process was reversed in the second half of the year. The authorities view the ongoing crisis in Europe as a risk to external financing and currency-induced credit risk as a vulnerability, although to a lesser degree than in 2008–09. Stress tests of the banking system, using general and bank specific shocks, did not raise concerns. The authorities are aware that there is a cost to strong capital and liquidity buffers as they may slow down financial deepening, but they consider that they are striking the right balance between the objectives of financial stability and financial development.

32. **The supervisory authority has started the process of complying with Basel II and Basel III regulations.** In early 2010, the NBG started to reform the organizational structure of its supervision department, to align it to the planned transition to risk-based

supervision and Basel II. As part of this transition, in July 2011, the authorities also started a self-assessment of compliance with the Basel Core Principles. As of February 2012, they had reviewed compliance relative to 16 of the 25 Basel core principles; the remainder 9 principles should be reviewed by July 2012. The authorities consider that the major challenge in complying with Basel II is the implementation of Pillar 2, given its novelty for banks and the supervisory authority[8]. They noted that a countercyclical approach to address systemic risks (in line with Basel III's countercyclical capital buffer) has already been in use by modifying FX risk weights for capital requirements. Financial disclosure rules are in the process of being modified in order to comply with Basel II's Pillar 3 recommendations.

33. **Supervisory reforms are underway to address macroprudential risks, credit risk, liquidity risk, operational risk, and consumer protection.** As one aspect of Pillar 2 and risk-based supervision, bank-by-bank exposure to the business cycle will be assessed based on micro stress tests of the loan portfolio of each bank. The analysis will, in turn, be used to determine bank-specific capital buffer requirements. Information to evaluate liquidity requirements with the liquidity coverage ratio (LCR), as recommended by Basel III, is already being collected from banks. Banks' operational risks are monitored by one of NBG's new divisions, and the Consumer Protection Division at NBG introduced a consumer protection framework in June 2011.

# PROGRAM ISSUES

34. **Access.** The authorities are requesting access of SDR 250 million (166.3 percent of quota), evenly divided between the SBA and the SCF, consistent with Georgia's eligibility to Fund concessional resources (see Table 9). Access is related to the possible call on Fund resources in the event of a sharp deterioration of the external environment, as illustrated in the downside scenario of Box 3.

35. **Duration and phasing.** The 24-month arrangement would cover the whole of 2013 through the adoption of the 2014 budget, thus providing assurances against fiscal backsliding during the 2012–13 election years. Phasing is back-loaded consistent with the rise in risks in 2013–14.

36. **Capacity to repay the Fund.** Georgia has established a record of timely servicing its obligations to the Fund, and its capacity to repay is expected to remain strong.

37. **Safeguards assessment.** An update of the January 2010 safeguards assessment of the National Bank of Georgia (NBG) was completed on September 6, 2011. The update assessment found that the safeguards framework remains broadly adequate. External auditors are appointed for multi-year terms and audited financial statements are published. Governance structures have improved with the reconstitution of the Audit Committee (AC) to include only non-executive members of the Council. In order to safeguard the process of monetary data reporting to the IMF, the continued independent review by

[8] Under Basel II, banks complete an Internal Capital Adequacy Assessment Process and regulators conduct a Supervisory Review and Evaluation Process, both of which demand significant resources and changes to existing practices.

internal audit was recommended. A memorandum of understanding between the NBG and the ministry of finance clarifies the responsibilities of the government in relation to the servicing of Fund credit that was channeled through the budget in 2009-10. Consistent with these obligations, the ministry is setting aside funds intended for IMF debt service in a dedicated sub-account of the Treasury Single Account (MEFP ¶20).

38. **Conditionality and reviews.** Four reviews are proposed based on end-June 2012, end-December 2012, end-June 2013, and end-December 2013 performance criteria (PCs). PCs would cover the general government cash deficit, the cash deficit of the Partnership Fund, net domestic assets of the NBG, net international reserves of the NBG, and external arrears. Structural benchmarks would focus on the financial monitoring of the broader public sector and the financial reporting of the Partnership Fund.

39. **Risks.** The program is subject to a number of external and domestic risks, including the challenge of pursuing fiscal consolidation in an election period. Balance of payments risks lie in a possible deterioration of the external economic and financial environment. To address these risks, the MEFP stipulates the authorities' commitment to take further measures, including allowing for exchange rate depreciation, should external adjustment need to be accelerated (MEFP ¶13).

# STAFF APPRAISAL

40. **Supported by sound macroeconomic and structural policies, economic growth picked up momentum in 2011 and public balance sheets (public debt ratio and gross international reserve coverage) improved, consolidating the gains achieved under the recent SBA.** It is difficult to assess the distance to potential output, but the broad-based nature of GDP growth and the absence of inflationary pressures (including of asset prices) do not point to overheating risks as yet. At the same time, the still large current account deficit points to a need to strengthen competitiveness over the medium term in order to sustain high rates of growth. In the short term, there are downside risks to growth stemming from potentially sharper declines in external demand and external private financing.

41. **Policies under the 2012–14 program target fiscal deficits consistent with a steady reduction of the debt ratio and maintenance of an adequate level of international reserves through a period of large external debt repayments (mostly to the Fund).** The pace of fiscal consolidation accommodates a slower withdrawal of fiscal stimulus in 2012 than originally envisaged in order to counter the projected decline of external and private domestic demand. At the same time, the authorities' commitment to reduce the expenditure-to-GDP ratio relative to 2011 reinforces the medium-term policy anchor of expenditure and deficit limits enshrined in the new Economic Liberty Act.

42. **The structure of government expenditure is appropriately tilted toward productive infrastructure spending, while also accommodating increases in pensions that bring them closer to the established subsistence minimum.** Limited exposure to recurrent spending, as reflected in the operational surplus of the government accounts, eases the task of compressing

overall spending over the medium term. The large share of capital spending in expenditure also creates flexibility to curtail spending quickly in case of need.

43. **Exchange rate flexibility remains critical to the success of the program, particularly in view of the risks from the unsettled external environment.** However, high financial dollarization limits the optimal speed of exchange rate adjustment. Even though stress tests suggest that the financial sector could weather a considerable degree of exchange rate adjustment, large and sudden depreciation could have severe contractionary effects owing to the balance sheet exposure of corporates and households. Therefore, in the event of significant external financing shortfalls, exchange rate adjustment would likely need to be complemented by accelerated fiscal adjustment and exceptional financing. The large capital budget and the enhanced tax flexibility under the revised Liberty Act offer assurances that fiscal policy could respond in a timely manner to such an occurrence.

44. **Sound macroeconomic policies and exchange rate flexibility will need to be accompanied by structural reforms to achieve the competitiveness gains needed for sustained economic growth and job creation.** There are still large pockets of potential growth in the Georgian economy. Government initiatives to address structural impediments to private investment and to upgrade labor force skills are welcome in this regard. As the state assumes a more proactive role, including through public investments in commercial ventures, it is important that it remains within the boundries of facilitating rather than replacing private initiative.

45. **The newly established PF can play a useful role in attracting private investment, but it will be important to set strict governance, monitoring and oversight rules to limit fiscal risks and ensure that public resources are directed to their best use.** Co-financing of private sector projects through this fund can be effective in mitigating risks and correcting market failures. Strict observance of the PF's commercial mandate, backed by clear reporting and oversight rules, should help limit the creation of off-balance sheet risks. Nonetheless, there is scope to strengthen the PF's framework to create stronger safeguards and to ensure the efficient use of public resources. IMF technical assistance will be valuable in this regard. Fiscal risks from SOEs and extra-budgetary state agencies appear limited at present, but the government's decision to strengthen its monitoring is welcome to limit future risks and improve overall public sector efficiency.

46. **The monetary authorities' enhanced policy tool kit places them in a good position to consolidate and preserve the gains achieved in terms of price stability.** The authorities have made significant progress in their analytical capacity and communication strategy, consistent with a gradual transition to an inflation targeting regime. The monetary policy stance is currently appropriate. However, monetary policy will continue to be constrained in its effectiveness by financial dollarization. In this context, quantitative instruments, such as reserve requirements, will remain a useful complement to the interest rate instrument in affecting monetary conditions.

47. **The banking sector is on a solid footing and the authorities are rightly strengthening and attuning the prudential**

**and supervisory framework to risks associated with a possible new credit cycle.** The efforts devoted to assessing and countering systemic risks are particularly welcome, as is the broader agenda for transitioning to Basel II and III standards.

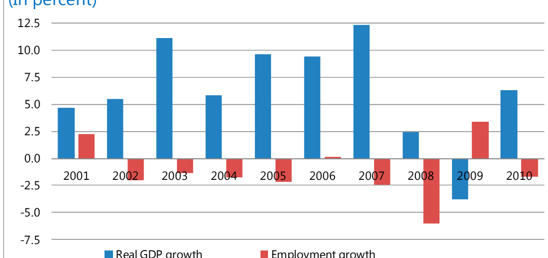
48. **Staff supports the authorities' request for a 24-month SBA and a 24-month SCF and the establishment of end-June 2012 and end-December 2012 performance criteria,** as specified in the Letter of Intent. The policies and targets under the program provide adequate assurances that the SBA/SCF would be an exit program from Fund financial support.

## Box 1. Georgia: Growth, Unemployment, and Social Challenges

Even though Georgia's economic growth averaged more than 6 percent during the last decade, the unemployment rate increased gradually from 10.3 percent in 2000 to 16.3 percent in 2010.[1] Unemployment has been high among highly-educated workers (20.9 percent), the young (36.7 percent), and the urban population (27.2 percent), and it appears to be mostly structural rather than cyclical, as evidenced by the weak relationship between unemployment and real GDP growth over the cycle of 2008–10. Because the labor force actually shrank by 5 percent between 2000 and 2010, persistently high unemployment reflects purely the absence of net job creation (in fact a decline in total employment). The implication is that real GDP growth has come essentially from high rates of labor productivity growth in selected sectors and associated real wage growth for those employed in these sectors. At the same time, large portions of the population, including the unemployed but also much of the rural population engaged in subsistence farming have yet to benefit fully from participation in the market economy. Meanwhile, poverty has declined but remains widespread (24.7 percent of the population was living below Georgia's poverty line in 2009 compared with 28.5 percent in 2003[2])

**Real GDP and Employment Growth, 2001–10**

(In percent)



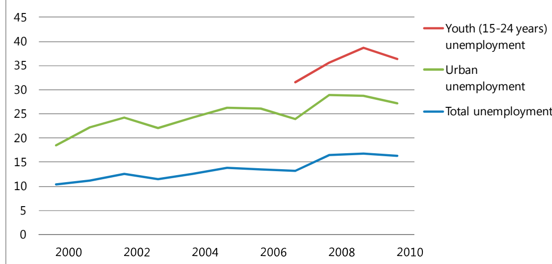

Sources: Georgian authorities; and Fund staff estimates.

[1] Unemployment rate reported by official statistics (Geostat). Non-official sources report higher rates.

[2] World Development Indicators, World Bank.

**Unemployment Rates, 2000–10**

(In percentage points of the labor force)




Sources: Georgian authorities; and Fund staff estimates.

To address this social challenge and to ensure that growth is more inclusive in the future, it is critical to identify the factors that have impeded job growth. In view of Georgia's essentially unregulated labor market, unemployment cannot be attributed to labor market restrictions or benefit-based disincentives to work.[3] The likely factors instead appear to be:

- **Skill mismatches.** While 40 percent of unemployed in Georgia have higher education (beyond secondary), 26.5 percent of Georgian firms report that labor skills are a constraint on doing business.[4] There is also considerable anecdotal evidence of firms being unable to hire craftsmen, managers or technicians with the requisite technical skills.

- **Remittances.** Remittance recipients received on average 166 USD monthly in 2010 (246 USD when including employee compensation of Georgians working abroad),[5] more than the 142 USD subsistence income for an average household in December 2010. Remittances also appear significant when compared with the

[3] There are no unemployment benefits, no minimum wage (except for the public sector), no collective bargaining, and hiring and firing regulations are very liberal by international standards.

[4] Firm survey data from "Enterprise Surveys," World Bank, 2008. 2010 unemployment data from Geostat.

[5] Staff estimate based on official data for 2010 remittances inflows (including workers' remittances and other transfers and excluding compensation of employees) and 2006 number of remittance recipients from "Georgia National Survey of Remittances," EBRD, 2007.

**Box 1. Georgia: Growth, Unemployment, and Social Challenges (continued)**

Georgian average monthly salary (at 335 USD in 2010).[6] Remittances thus could have contributed to an increase in the reservation wage of unemployed, and survey data confirm that Georgian urban households with an absent migrant are significantly more likely to have an unemployed household member than comparable households without an absent migrant.[7]

- **Economic transition**. Similarly to what was observed in the late 1990s in a number of Eastern European countries, the deep structural reforms initiated in Georgia in 2004 likely contributed to the observed high labor productivity gains in market sectors. Employment growth in these sectors was more than offset by employment cuts in the public sector.

- **Small SME sector**. The relatively limited development of the small and medium-sized enterprise (SME) sector (which in 2009 contributed 19 percent of GDP and represented only 42 percent of employment versus the typical two-thirds) may also be a contributing factor.[8] The limited development of the sector appears to possibly reflect credit constraints as sector entrepreneurs report difficulties in securing financing.[9] However, it is not clear that this constraint is more binding in Georgia than in other emerging countries.

The above considerations point to the importance of upgrading skills and better attuning the education system to the needs of the market economy. The government has already taken steps to reform the education system (quality and curriculum), and intends to expand vocational training programs based on the success of pilot programs in creating new jobs. By raising productivity levels, such programs are also likely to increase wages above the reservation wage created by remittances, thus creating stronger incentives to seek employment.

A related social challenge is that of the large share of the population relying on subsistence agriculture: 52.2 percent of 2010 employment is in agriculture where incomes are lower (GDP per worker in the agriculture sector declined by 6.5 percent between 2003 and 2010 while it increased by 76.5 percent in the nonagricultural private sector). The government is working to address this challenge by building road infrastructure and assisting with the development of logistics infrastructure (cold storage and distribution) to better integrate agriculture into the market economy. With a view to increasing productivity in the sector and facilitating access to domestic and foreign markets, the government has also undertaken to promote new technologies, and to disseminate information. While increasing productivity and improving access to markets will help improve standards of living in rural areas, it will not increase employment in agriculture, and, hence, the importance of complementing these policies with job-creating growth in the non-agricultural private sector.

[6] Georgian subsistence income and average salary from Geostat.

[7] "Remittances in Georgia: Correlates, Economic Impact, and Social Capital Formation," Gerber and Torosyan, ISET Working Paper, 2010. Survey data employed by the study come from "Development on the Move Project," IPPR, GDN, 2008.

[8] "Competitiveness and Private Sector Development. Eastern Europe and South Caucasus," OECD, 2011.

[9] "Transition Report," EBRD, 2011.

**Box 2. Georgia: The Economic Liberty Act**

The organic law known as the "Economic Liberty Act", which was adopted by Parliament in July 2011, provides guiding principles and rules for fiscal policy and capital flow management, while leaving the government with the necessary flexibility to face unexpected developments.

The Act is inspired by the principles of "economic freedom" and "handover of the country to every future generation with reduced financial liabilities". In this perspective:

- The introduction of a new national tax (except excise duties) or any increase in the upper rates of existing taxes (except excise duties) shall be submitted to referendum by the government. However, this referendum requirement does not apply to temporary increase in tax rates (for up to three years).

- The budget shall be consistent with two binding "macroeconomic thresholds", namely a limit on consolidated budget spending equivalent to 30 percent of GDP and a public deficit limit of 3 percent of GDP. The government may submit to Parliament for approval a budget inconsistent with these limits under either of the following two conditions: (i) the current year's budget is itself within these limits; or (ii) in the event of "extraordinary or military actions" or "economic recession". If these conditions are not met, submission of a budget inconsistent with the expenditure and/or deficit limits is still possible but needs to be accompanied by a plan to return below the thresholds within two years. The Act also states the objective of keeping the public debt below 60 percent of GDP, but does not set it as a binding commitment.

- The amendment confirms the principle of universality of the budget, according to which all central and local government revenues shall finance the general budget (i.e., no ear-marking), with the exception of financing by international financial organizations.

- The law guarantees free movement of capital but provides for exceptions in "cases otherwise stipulated by law, including by NBG regulations." This provision ensures that the NBG can introduce regulation to restrict capital movements in exceptional circumstances.

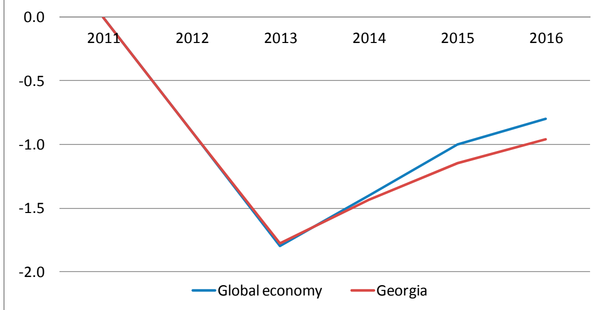
All other provisions from the original draft of the Act were dropped, notably the ban on government shareholding in banks for a period longer than one year, the ban against the creation of new licensing or permit requirements, the general prohibition against progressive income taxes, and the requirement that social support to the most vulnerable be provided by enabling access to private services rather than by developing public institutions.

## Box 3. Georgia: Downside Scenario and Potential External Financing Gap

The downside scenario is built on an assumed deterioration of global growth along the lines of the WEO downside scenario of January 2012, accompanied by lower prices of Georgian commodity exports (metals), lower remittances and lower private capital inflows, including FDI. Under the impact of weaker external demand and lower investment (linked, in part, to lower FDI), the loss of real GDP relative to the baseline would follow a similar pattern as for the rest of the world.

**Downside Scenario - Real GDP Gap, 2011–16**

(In percent of GDP relative to baseline)




Source: Fund staff estimates.

With unchanged policies, the shock would open a cumulative balance of payments gap of US$827 million in 2012–14, and US$108 million in 2015–17, estimated as follows:

| Transmission Channel | Assumed Shock and Estimated Parameters | Cumulative Impact on the Overall External Balance (In millions of USD) | |
|---|---|---|---|
| | | 2012–14 | 2015–17 |
| Export loss due to weaker external demand | Elasticity of export market growth to partner countries real GDP growth estimated at 1.8. | -422 | -156 |
| Net export loss due to lower metal prices | Metal prices fall by 15 percent relative to the WEO baseline in 2012, then converge gradually toward the WEO baseline. | -101 | -7 |
| Import compression due to lower GDP | Elasticity of imports to lower GDP estimated at 1.4. | 424 | 238 |
| Loss of remittances | Impact proportional to the world GDP shortfall. | -33 | -17 |
| Loss of FDI | ½-percent-of-GDP drop compared to baseline in 2012 then gradual convergence toward baseline. | -351 | -117 |
| Loss of other private capital inflows | ¾-percent-of-GDP drop compared to baseline in 2012 then gradual convergence toward baseline. | -344 | -49 |
| Cumulative impact | | -827 | -108 |

The cumulative real exchange rate depreciation that would be required to close the entire gap in 2012–14 is estimated at around 17 percent. Because of financial dollarization and related balance sheet effects, an exchange rate adjustment of this magnitude would likely trigger significant economic and financial disruption and output loss.

Access to Fund resources under such a scenario would allow for smoother real exchange rate adjustment, which would safeguard against excessive output contraction. Under the proposed level of access, the Fund could fill about half of the balance of payments gap of 2012–14 in this scenario. Other IFIs would also be expected to contribute.[1] The balance of payments gap of 2015–17 would be fully filled through policy and exchange rate adjustment with no need to mobilize additional exceptional financing.

[1] For instance, EU exceptional financing of around $70 million could become available in connection with a drawing from the Fund. The World Bank has also set aside additional resources for the region that could be tapped under such a scenario.

## Table 1. Georgia: Selected Macroeconomic Indicators, 2009–17

| | 2009 Act. | 2010 Act. | 2011 Est. | 2012 Proj. | 2013 Proj. | 2014 Proj. | 2015 Proj. | 2016 Proj. | 2017 Proj. |
|---|---|---|---|---|---|---|---|---|---|
| National accounts | | | | | | | | | |
| Nominal GDP (in million lari) | 17,986 | 20,743 | 24,137 | 26,738 | 29,901 | 33,446 | 37,403 | 41,828 | 46,776 |
| Real GDP growth | -3.8 | 6.3 | 6.8 | 6.0 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 |
| Population (in million) 1/ | 4.4 | 4.4 | 4.5 | 4.4 | 4.4 | 4.4 | 4.4 | 4.3 | 4.3 |
| GDP deflator, period average | -2.0 | 8.5 | 9.0 | 4.5 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 |
| Consumer price index, period average | 1.7 | 7.1 | 8.5 | 1.7 | 5.5 | 6.0 | 6.0 | 6.0 | 6.0 |
| Consumer price index, end-of-period | 3.0 | 11.2 | 2.0 | 5.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 |
| GDP per capita (in US$) | 2,455 | 2,623 | 3,198 | 3,583 | 3,894 | 4,159 | 4,548 | 5,064 | 5,645 |
| Unemployment rate (in percent) | 16.9 | 16.3 | ... | ... | ... | ... | ... | ... | ... |
| Investment and saving | | | | | | | | | |
| Investment | 13.0 | 21.6 | 23.3 | 23.0 | 23.0 | 23.0 | 23.0 | 23.0 | 23.0 |
| Public | 8.0 | 8.2 | 7.7 | 7.5 | 7.4 | 7.3 | 7.0 | 6.9 | 6.8 |
| Private | 5.0 | 13.4 | 15.5 | 15.5 | 15.6 | 15.7 | 16.0 | 16.2 | 16.2 |
| Gross national saving | 1.8 | 10.1 | 10.5 | 12.4 | 13.4 | 14.7 | 16.0 | 16.1 | 16.3 |
| Public | -0.8 | 2.3 | 5.2 | 4.9 | 5.0 | 5.0 | 5.1 | 5.5 | 5.6 |
| Private | 2.6 | 7.9 | 5.3 | 7.5 | 8.4 | 9.7 | 10.8 | 10.6 | 10.7 |
| Saving-investment balance | -11.3 | -11.5 | -12.7 | -10.6 | -9.6 | -8.4 | -7.0 | -6.9 | -6.7 |
| Consolidated government operations | | | | | | | | | |
| Public debt | 37.3 | 39.2 | 34.0 | 32.9 | 31.7 | 30.7 | 29.5 | 28.2 | 26.4 |
| *Of which* : foreign-currency denominated | 31.7 | 33.6 | 29.1 | 27.8 | 26.0 | 24.7 | 23.3 | 21.9 | 20.2 |
| Revenue 2/ | 29.3 | 28.3 | 28.5 | 27.4 | 27.3 | 27.1 | 26.9 | 26.8 | 26.7 |
| Current expenditures | 30.1 | 26.0 | 23.3 | 22.5 | 22.3 | 22.1 | 21.8 | 21.3 | 21.1 |
| Operating balance | -0.8 | 2.3 | 5.2 | 4.9 | 5.0 | 5.0 | 5.1 | 5.5 | 5.6 |
| Capital spending and net lending | 8.4 | 8.8 | 8.9 | 8.4 | 8.0 | 7.6 | 7.2 | 6.9 | 6.8 |
| Overall balance | -9.2 | -6.6 | -3.6 | -3.5 | -3.0 | -2.7 | -2.1 | -1.5 | -1.3 |
| Total financing | 9.2 | 6.6 | 3.6 | 3.5 | 3.0 | 2.7 | 2.1 | 1.5 | 1.3 |
| Domestic | 3.3 | 0.0 | -0.2 | -0.1 | 1.7 | 1.7 | 0.8 | 0.5 | 0.8 |
| External | 3.9 | 5.6 | 2.3 | 3.1 | 1.1 | 0.7 | 1.1 | 0.9 | 0.4 |
| Privatization receipts | 2.0 | 1.1 | 1.6 | 0.5 | 0.2 | 0.2 | 0.2 | 0.0 | 0.0 |
| Monetary sector | | | | | | | | | |
| Reserve money | 21.8 | 4.5 | 17.4 | 4.5 | 7.0 | 8.5 | 9.0 | 9.0 | 9.0 |
| Broad money (including fx deposits) 3/ | 8.1 | 28.5 | 22.6 | 22.0 | 22.0 | 20.0 | 20.0 | 20.0 | 20.0 |
| Bank credit to the private sector | -13.5 | 20.5 | 23.0 | 24.4 | 20.3 | 16.6 | 18.7 | 17.3 | 18.7 |
| Deposit interest rate (annual average) | 10.0 | 8.9 | 8.4 | ... | ... | ... | ... | ... | ... |
| Lending interest rate (annual average) | 19.3 | 18.6 | 17.1 | ... | ... | ... | ... | ... | ... |
| External sector | | | | | | | | | |
| Exports of goods and services (percent of GDP) | 29.8 | 34.9 | 37.6 | 35.1 | 34.8 | 35.2 | 35.5 | 34.2 | 33.1 |
| Annual percentage change | -13.0 | 26.6 | 32.4 | 4.0 | 7.1 | 7.4 | 9.4 | 6.8 | 7.2 |
| Imports of goods and services (percent of GDP) | 48.9 | 52.7 | 55.9 | 51.5 | 49.5 | 48.1 | 46.7 | 44.9 | 43.1 |
| Annual percentage change | -29.8 | 16.4 | 30.3 | 2.5 | 4.0 | 3.2 | 5.4 | 6.3 | 6.4 |
| Net imports of oil (in US$) | 555 | 695 | 911 | 971 | 970 | 961 | 977 | 1007 | 1046 |
| Current account balance (in millions of US$) | -1,212 | -1,334 | -1,818 | -1,684 | -1,659 | -1,525 | -1,398 | -1,518 | -1,634 |
| In percent of GDP | -11.3 | -11.5 | -12.7 | -10.6 | -9.6 | -8.4 | -7.0 | -6.9 | -6.7 |
| Gross international reserves (in millions of US$) | 2,111 | 2,265 | 2,818 | 2,734 | 2,528 | 2,590 | 2,752 | 3,161 | 3,456 |
| In months of next year's imports of goods and services | 4.1 | 3.4 | 4.1 | 3.9 | 3.5 | 3.4 | 3.4 | 3.6 | 3.7 |
| Foreign direct investment (percent of GDP) | 6.1 | 7.0 | 6.3 | 6.1 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 |
| Average exchange rate (lari per US$) | 1.67 | 1.78 | 1.69 | ... | ... | ... | ... | ... | ... |

Sources: Georgian authorities; and Fund 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 2a. Georgia: General Government Operations, 2010–17 1/

(In millions of lari)

| | 2010 Act. | 2011 SBA 9th Rev | 2011 Act. | 2012 Proj. | 2013 Proj. | 2014 Proj. | 2015 Proj. | 2016 Proj. | 2017 Proj. |
|---|---|---|---|---|---|---|---|---|---|
| Revenues | 5,866 | 6,713 | 6,870 | 7,314 | 8,175 | 9,053 | 10,070 | 11,214 | 12,501 |
| Taxes | 4,867 | 5,879 | 6,135 | 6,615 | 7,397 | 8,274 | 9,253 | 10,348 | 11,572 |
| Other revenues | 526 | 485 | 516 | 454 | 523 | 585 | 654 | 732 | 819 |
| Grants | 473 | 349 | 220 | 245 | 255 | 193 | 162 | 134 | 110 |
| Current expenditures | 5,399 | 5,681 | 5,613 | 6,008 | 6,681 | 7,394 | 8,150 | 8,930 | 9,887 |
| Compensation of employees | 1,138 | 1,150 | 1,136 | 1,218 | 1,360 | 1,510 | 1,670 | 1,858 | 2,079 |
| Use of goods and services | 1,086 | 1,077 | 1,211 | 1,189 | 1,323 | 1,480 | 1,640 | 1,830 | 2,046 |
| Subsidies and grants | 385 | 395 | 437 | 447 | 500 | 550 | 597 | 668 | 747 |
| Social expenses | 1,612 | 1,700 | 1,656 | 1,821 | 2,099 | 2,281 | 2,480 | 2,699 | 2,959 |
| *Of which :* old-age pensions (including insurance) | ... | ... | 803 | 989 | 1,138 | 1,206 | 1,279 | 1,355 | 1,437 |
| Other expenses | 972 | 1,037 | 886 | 985 | 1,067 | 1,194 | 1,335 | 1,406 | 1,544 |
| Interest | 206 | 322 | 288 | 348 | 332 | 379 | 428 | 469 | 512 |
| To nonresidents | 133 | 217 | 182 | 208 | 165 | 176 | 190 | 196 | 207 |
| To residents | 74 | 105 | 107 | 140 | 167 | 203 | 238 | 273 | 304 |
| Operating balance | 467 | 1,032 | 1,257 | 1,307 | 1,494 | 1,659 | 1,920 | 2,284 | 2,614 |
| Capital spending and net lending | 1,834 | 1,881 | 2,137 | 2,249 | 2,392 | 2,549 | 2,687 | 2,892 | 3,199 |
| Capital | 1,706 | 1,724 | 1,869 | 2,011 | 2,202 | 2,444 | 2,632 | 2,867 | 3,199 |
| Net lending | 128 | 157 | 268 | 239 | 190 | 105 | 55 | 25 | 0 |
| Overall balance | -1,366 | -849 | -880 | -943 | -897 | -890 | -767 | -609 | -585 |
| Statistical discrepancy | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Identified financing | 1,366 | 849 | 880 | 943 | 897 | 890 | 767 | 609 | 585 |
| Domestic | -6 | -67 | -47 | -19 | 500 | 578 | 299 | 227 | 380 |
| Net T-bill issuance | 172 | 200 | 91 | 200 | 375 | 350 | 350 | 350 | 300 |
| Amortization 2/ | -42 | -35 | -43 | -42 | -35 | -35 | -35 | -35 | -35 |
| Use of deposits at the NBG and banks | -136 | -232 | -96 | -177 | 160 | 263 | -16 | -88 | 115 |
| External | 1,152 | 716 | 548 | 822 | 327 | 241 | 398 | 382 | 205 |
| Borrowing | 1,275 | 1,577 | 1,375 | 919 | 777 | 738 | 715 | 646 | 531 |
| *Of which*: IMF | 523 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Amortization | -123 | -861 | -827 | -98 | -450 | -496 | -317 | -264 | -326 |
| *Of which*: IMF | 0 | 0 | 0 | 0 | -246 | -340 | -107 | 0 | 0 |
| Privatization receipts | 220 | 200 | 379 | 140 | 70 | 70 | 70 | 0 | 0 |
| Memorandum items: | | | | | | | | | |
| Nominal GDP | 20,743 | 23,577 | 24,137 | 26,738 | 29,901 | 33,446 | 37,403 | 41,828 | 46,776 |
| End-year government deposits 3/ | 561 | ... | 657 | 834 | 673 | 410 | 426 | 514 | 399 |
| Fiscal deficit excluding grants | 1,839 | 1,198 | 1,100 | 1,188 | 1,152 | 1,083 | 929 | 742 | 696 |
| Total expenditures (current prices) 4/ | 7,232 | 7,561 | 7,750 | 8,257 | 9,072 | 9,942 | 10,837 | 11,822 | 13,086 |
| Total expenditures (constant 2008 prices) 4/ | 6,800 | 6,604 | 6,685 | 6,815 | 7,064 | 7,304 | 7,510 | 7,729 | 8,110 |

(In percent of GDP)

| | 2010 Act. | 2011 SBA 9th Rev | 2011 Act. | 2012 Proj. | 2013 Proj. | 2014 Proj. | 2015 Proj. | 2016 Proj. | 2017 Proj. |
|---|---|---|---|---|---|---|---|---|---|
| Revenues | 28.3 | 28.5 | 28.5 | 27.4 | 27.3 | 27.1 | 26.9 | 26.8 | 26.7 |
| Taxes | 23.5 | 24.9 | 25.4 | 24.7 | 24.7 | 24.7 | 24.7 | 24.7 | 24.7 |
| Other revenues | 2.5 | 2.1 | 2.1 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 |
| Grants | 2.3 | 1.5 | 0.9 | 0.9 | 0.9 | 0.6 | 0.4 | 0.3 | 0.2 |
| Current expenditures | 26.0 | 24.1 | 23.3 | 22.5 | 22.3 | 22.1 | 21.8 | 21.3 | 21.1 |
| Compensation of employees | 5.5 | 4.9 | 4.7 | 4.6 | 4.5 | 4.5 | 4.5 | 4.4 | 4.4 |
| Use of goods and services | 5.2 | 4.6 | 5.0 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 |
| Subsidies and grants | 1.9 | 1.7 | 1.8 | 1.7 | 1.7 | 1.6 | 1.6 | 1.6 | 1.6 |
| Social expenses | 7.8 | 7.2 | 6.9 | 6.8 | 7.0 | 6.8 | 6.6 | 6.5 | 6.3 |
| *Of which :* old-age pensions (including insurance) | ... | ... | 3.3 | 3.7 | 3.8 | 3.6 | 3.4 | 3.2 | 3.1 |
| Other expenses | 4.7 | 4.4 | 3.7 | 3.7 | 3.6 | 3.6 | 3.6 | 3.4 | 3.3 |
| Interest | 1.0 | 1.4 | 1.2 | 1.3 | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 |
| To nonresidents | 0.6 | 0.9 | 0.8 | 0.8 | 0.6 | 0.5 | 0.5 | 0.5 | 0.4 |
| To residents | 0.4 | 0.4 | 0.4 | 0.5 | 0.6 | 0.6 | 0.6 | 0.7 | 0.7 |
| Operating balance | 2.3 | 4.4 | 5.2 | 4.9 | 5.0 | 5.0 | 5.1 | 5.5 | 5.6 |
| Capital spending and net lending | 8.8 | 8.0 | 8.9 | 8.4 | 8.0 | 7.6 | 7.2 | 6.9 | 6.8 |
| Capital | 8.2 | 7.3 | 7.7 | 7.5 | 7.4 | 7.3 | 7.0 | 6.9 | 6.8 |
| Net lending | 0.6 | 0.7 | 1.1 | 0.9 | 0.6 | 0.3 | 0.1 | 0.1 | 0.0 |
| Overall balance | -6.6 | -3.6 | -3.6 | -3.5 | -3.0 | -2.7 | -2.1 | -1.5 | -1.3 |
| Statistical discrepancy | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Identified financing | 6.6 | 3.6 | 3.6 | 3.5 | 3.0 | 2.7 | 2.1 | 1.5 | 1.3 |
| Domestic | 0.0 | -0.3 | -0.2 | -0.1 | 1.7 | 1.7 | 0.8 | 0.5 | 0.8 |
| Net T-bill issuance | 0.8 | 0.8 | 0.4 | 0.7 | 1.3 | 1.0 | 0.9 | 0.8 | 0.6 |
| Amortization 2/ | -0.2 | -0.1 | -0.2 | -0.2 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Use of deposits at the NBG and banks | -0.7 | -1.0 | -0.4 | -0.7 | 0.5 | 0.8 | 0.0 | -0.2 | 0.2 |
| External | 5.6 | 3.0 | 2.3 | 3.1 | 1.1 | 0.7 | 1.1 | 0.9 | 0.4 |
| Borrowing | 6.1 | 6.7 | 5.7 | 3.4 | 2.6 | 2.2 | 1.9 | 1.5 | 1.1 |
| *Of which*: IMF | 2.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Amortization | -0.6 | -3.7 | -3.4 | -0.4 | -1.5 | -1.5 | -0.8 | -0.6 | -0.7 |
| *Of which*: IMF | 0.0 | 0.0 | 0.0 | 0.0 | -0.8 | -1.0 | -0.3 | 0.0 | 0.0 |
| Privatization receipts | 1.1 | 0.8 | 1.6 | 0.5 | 0.2 | 0.2 | 0.2 | 0.0 | 0.0 |
| Memorandum items: | | | | | | | | | |
| Nominal GDP | | | | | | | | | |
| End-year government deposits 3/ | 2.7 | ... | 2.7 | 3.1 | 2.3 | 1.2 | 1.1 | 1.2 | 0.9 |
| Fiscal deficit excluding grants | 8.9 | 5.1 | 4.6 | 4.4 | 3.9 | 3.2 | 2.5 | 1.8 | 1.5 |
| Total expenditures (current prices) 4/ | 34.9 | 32.1 | 32.1 | 30.9 | 30.3 | 29.7 | 29.0 | 28.3 | 28.0 |
| Total expenditures (constant 2008 prices) 4/ | | | | | | | | | |

Sources: Ministry of Finance; and Fund staff estimates.

1/ General government includes central and local governments and the Sovereign Wealth Funds.
2/ Excluding arrears clearance, provisions and T-bill repayment.
3/ Include Treasury single account, Revenue reserve account, and local government deposits.
4/ Including net lending.

## Table 2b. Georgia: Quarterly General Government Operations, 2011–12 1/

| | 2011 | 2012 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Annual | Q1 | Proj. Q2 | | Proj. Q3 | | Proj. Q4 | | Proj. | Annual Proj. |

| | 2011 Annual | 2012 Q1 | Proj. Q2 | Proj. Q3 | Proj. Q4 Proj. | Annual Proj. |
|---|---|---|---|---|---|---|
| | (In millions of lari) | | | | | |
| Revenues | 6,870 | 1,817 | 1,758 | 1,808 | 1,931 | 7,314 |
| Taxes | 6,135 | 1,662 | 1,583 | 1,665 | 1,705 | 6,615 |
| Direct | 2,642 | 705 | 736 | 709 | 722 | 2,872 |
| Indirect | 3,493 | 957 | 846 | 956 | 983 | 3,743 |
| Other revenues | 516 | 124 | 137 | 95 | 98 | 454 |
| Grants | 220 | 31 | 39 | 48 | 128 | 245 |
| Current expenditures | 5,613 | 1,324 | 1,467 | 1,504 | 1,714 | 6,008 |
| Employee compensation | 1,136 | 285 | 305 | 290 | 338 | 1,218 |
| Use of goods and services | 1,211 | 255 | 300 | 310 | 324 | 1,189 |
| Subsidies and grants | 437 | 115 | 112 | 110 | 109 | 447 |
| Social expenses | 1,656 | 430 | 430 | 455 | 506 | 1,821 |
| Other expenses | 886 | 170 | 220 | 265 | 330 | 985 |
| Interest | 288 | 69 | 99 | 74 | 106 | 348 |
| To nonresidents | 182 | 36 | 63 | 36 | 73 | 208 |
| To residents | 107 | 32 | 37 | 38 | 33 | 140 |
| Operating balance | 1,257 | 493 | 292 | 304 | 217 | 1,307 |
| Capital spending and net lending | 2,137 | 446 | 529 | 585 | 689 | 2,249 |
| Capital | 1,869 | 405 | 466 | 520 | 620 | 2,011 |
| Net lending | 268 | 41 | 63 | 65 | 70 | 239 |
| Overall balance | -880 | 47 | -237 | -281 | -472 | -943 |
| Statistical discrepancy | 0 | 0 | 0 | 0 | 0 | 0 |
| Total financing | 880 | -47 | 237 | 281 | 472 | 943 |
| Domestic | -47 | -224 | 1 | 31 | 173 | -19 |
| Net T-Bill issuance | 91 | 46 | 56 | 46 | 52 | 200 |
| Amortization 2/ | -43 | -11 | -11 | -12 | -8 | -42 |
| Use of deposits at the NBG and banks | -96 | -258 | -44 | -3 | 129 | -177 |
| External | 548 | 125 | 215 | 222 | 259 | 822 |
| Borrowing | 1,375 | 143 | 242 | 242 | 292 | 919 |
| *Of which*: IMF | 0 | 0 | 0 | 0 | 0 | 0 |
| Amortization | -827 | -18 | -27 | -20 | -33 | -98 |
| *Of which*: IMF | 0 | 0 | 0 | 0 | 0 | 0 |
| Privatization receipts | 379 | 51 | 21 | 27 | 40 | 140 |
| Memorandum items: | | | | | | |
| Total expenditures 3/ | 7,750 | 1,770 | 1,996 | 2,089 | 2,403 | 8,257 |

Sources: Ministry of Finance; and Fund staff estimates.

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

2/ Excluding arrears clearance, provisions and T-bill repayment.

3/ Including net lending.

## Table 3. Georgia: Summary Balance of Payments, 2009–17
(In millions of U.S. dollars)

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| Current account balance | -1,212 | -1,334 | -1,818 | -1,684 | -1,659 | -1,525 | -1,398 | -1,518 | -1,634 |
| Trade balance | -2,401 | -2,586 | -3,357 | -3,500 | -3,552 | -3,511 | -3,486 | -3,745 | -4,039 |
| Exports | 1,894 | 2,462 | 3,326 | 3,324 | 3,578 | 3,863 | 4,259 | 4,547 | 4,875 |
| Imports | -4,295 | -5,048 | -6,683 | -6,823 | -7,130 | -7,373 | -7,745 | -8,292 | -8,914 |
| Services | 340 | 514 | 739 | 897 | 1,023 | 1,156 | 1,259 | 1,410 | 1,614 |
| Services: credit | 1,314 | 1,599 | 2,052 | 2,268 | 2,412 | 2,571 | 2,776 | 2,965 | 3,174 |
| Services: debit | -974 | -1,085 | -1,313 | -1,371 | -1,389 | -1,415 | -1,517 | -1,555 | -1,560 |
| Income (net) | -118 | -360 | -446 | -423 | -457 | -508 | -556 | -627 | -718 |
| *Of which* : interest payments | -248 | -257 | -290 | -290 | -299 | -329 | -347 | -383 | -420 |
| Transfers (net) | 968 | 1,098 | 1,246 | 1,341 | 1,327 | 1,338 | 1,385 | 1,444 | 1,509 |
| *Of which* : public sector | 141 | 174 | 152 | 115 | 65 | 28 | 16 | 10 | 6 |
| Capital account | 183 | 206 | 149 | 118 | 109 | 92 | 79 | 67 | 58 |
| General government | 170 | 189 | 131 | 100 | 90 | 72 | 57 | 46 | 37 |
| Other sectors | 13 | 17 | 18 | 18 | 19 | 20 | 21 | 21 | 21 |
| Financial account | 1,428 | 1,120 | 2,208 | 1,727 | 1,727 | 1,750 | 1,561 | 1,874 | 1,878 |
| Direct investment (net) | 659 | 809 | 918 | 964 | 1,032 | 1,095 | 1,190 | 1,317 | 1,458 |
| Monetary authorities, net 1/ | 247 | -1 | 4 | 0 | 0 | 0 | 0 | 0 | 0 |
| General government | 386 | 336 | 308 | 452 | 329 | 318 | 268 | 200 | 106 |
| Portfolio investment (net) | 0 | 0 | 36 | 0 | -65 | 0 | 0 | 0 | 0 |
| Long-term loans received | 359 | 335 | 273 | 442 | 394 | 318 | 268 | 200 | 106 |
| Drawing | 428 | 403 | 340 | 500 | 447 | 403 | 379 | 339 | 276 |
| Repayment | -69 | -67 | -67 | -58 | -53 | -85 | -112 | -139 | -169 |
| Other, net | 27 | 1 | -1 | 10 | 0 | 0 | 0 | 0 | 0 |
| Private Sector, excl. FDI | 136 | -25 | 978 | 311 | 366 | 337 | 103 | 357 | 314 |
| Banks | -65 | -210 | 750 | 102 | 206 | 191 | 203 | 225 | 215 |
| Portfolio investment, net | 8 | -10 | 82 | -27 | 10 | 2 | 12 | 3 | 3 |
| *Of which* : equity liabilities | 8 | -22 | -12 | 8 | 10 | 12 | 13 | 14 | 15 |
| Loans received (net) | -243 | 18 | 100 | 73 | 133 | 124 | 124 | 154 | 152 |
| Long-term loans | 8 | 7 | -88 | 51 | 100 | 89 | 93 | 120 | 116 |
| Drawing | 324 | 164 | 210 | 325 | 381 | 404 | 449 | 457 | 486 |
| Repayment | -317 | -157 | -298 | -273 | -281 | -315 | -356 | -337 | -369 |
| Short-term loans | -251 | 11 | 188 | 22 | 33 | 35 | 31 | 34 | 36 |
| Other, net (currency and deposits) | 171 | -218 | 569 | 57 | 63 | 64 | 66 | 68 | 60 |
| Other sectors | 201 | 185 | 228 | 208 | 160 | 146 | -100 | 132 | 99 |
| Portfolio investment, net | 4 | 262 | 0 | 0 | 0 | 0 | -261 | 0 | 0 |
| Long-term loans received (net) | 153 | 33 | 176 | 178 | 160 | 146 | 161 | 132 | 99 |
| Drawing | 250 | 238 | 332 | 322 | 350 | 359 | 390 | 382 | 393 |
| Repayment | -97 | -205 | -156 | -144 | -190 | -213 | -229 | -249 | -294 |
| Other, net | 44 | -111 | 52 | 30 | 0 | 0 | 0 | 0 | 0 |
| Errors and omissions | 52 | -22 | 43 | 0 | 0 | 0 | 0 | 0 | 0 |
| Overall balance | 451 | -30 | 582 | 161 | 177 | 317 | 242 | 424 | 301 |
| Financing | -451 | 30 | -582 | -161 | -177 | -317 | -242 | -424 | -301 |
| Gross International Reserves (-increase) | -616 | -208 | -589 | 84 | 207 | -61 | -162 | -409 | -295 |
| Use of Fund Resources | 313 | 276 | -60 | -245 | -384 | -255 | -80 | -15 | -6 |
| Purchases (SBA) | 340 | 297 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Repayments (SBA and ECF 2/) | -28 | -22 | -60 | -245 | -384 | -255 | -80 | -15 | -6 |
| Exceptional financing | -147 | -38 | 66 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Memorandum items:** | | | | | | | | | |
| Nominal GDP | 10,768 | 11,638 | 14,293 | 15,922 | 17,198 | 18,256 | 19,836 | 21,944 | 24,293 |
| Current account balance (percent of GDP) | -11.3 | -11.5 | -12.7 | -10.6 | -9.6 | -8.4 | -7.0 | -6.9 | -6.7 |
| excluding official transfers (percent of GDP) | -12.6 | -13.0 | -13.8 | -11.3 | -10.0 | -8.5 | -7.1 | -7.0 | -6.8 |
| Trade balance (in percent of GDP) | -22.3 | -22.2 | -23.5 | -22.0 | -20.7 | -19.2 | -17.6 | -17.1 | -16.6 |
| GNFS exports growth (percent) | -13.0 | 26.6 | 32.4 | 4.0 | 7.1 | 7.4 | 9.4 | 6.8 | 7.2 |
| GNFS exports volume growth (percent) | -0.9 | 7.2 | 14.7 | 5.6 | 6.8 | 8.4 | 8.8 | 5.1 | 5.2 |
| GNFS imports growth (percent) | -29.8 | 16.4 | 30.3 | 2.5 | 4.0 | 3.2 | 5.4 | 6.3 | 6.4 |
| GNFS imports volume growth (percent) | -18.7 | 0.8 | 10.2 | 7.1 | 4.7 | 5.3 | 7.1 | 7.1 | 6.9 |
| Net capital inflows to private sector | 796 | 784 | 1,896 | 1,275 | 1,398 | 1,432 | 1,293 | 1,674 | 1,771 |
| (in percent of GDP) | 7.4 | 6.7 | 13.3 | 8.0 | 8.1 | 7.8 | 6.5 | 7.6 | 7.3 |
| Gross international reserves (end of period) | 2,111 | 2,265 | 2,818 | 2,734 | 2,528 | 2,590 | 2,752 | 3,161 | 3,456 |
| (in months of next year GNFS imports) | 4.1 | 3.4 | 4.1 | 3.9 | 3.5 | 3.4 | 3.4 | 3.6 | 3.7 |
| External debt (nominal) 3/ | 6,250 | 7,213 | 7,616 | 8,000 | 8,237 | 8,569 | 8,792 | 9,316 | 9,666 |
| (in percent of GDP) | 58.0 | 62.0 | 53.3 | 50.2 | 47.9 | 46.9 | 44.3 | 42.5 | 39.8 |
| MLT External debt service | 759 | 708 | 855 | 990 | 1,250 | 1,173 | 1,100 | 1,094 | 1,228 |
| (in percent of exports) | 23.7 | 17.4 | 15.9 | 17.7 | 20.9 | 18.2 | 15.6 | 14.6 | 15.3 |
| External public sector debt (nominal) 4/ | 3,382 | 3,937 | 4,201 | 4,404 | 4,348 | 4,409 | 4,597 | 4,782 | 4,882 |
| External public debt service 4/ | 168 | 168 | 225 | 424 | 599 | 436 | 291 | 257 | 283 |
| (in percent of exports) | 5.3 | 4.1 | 4.2 | 7.6 | 10.0 | 6.8 | 4.1 | 3.4 | 3.5 |

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

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

2/ Following the Low Income Countries (LIC) reforms, effective January 7 2010, the PRGF arrangements were renamed Extended Credit Facility (ECF) arrangements.

3/ Excludes intercompany loans.

4/ Excludes SOEs.

## Table 4. Georgia: Accounts of the National Bank of Georgia, 2011–17

| | 2011 | | | | 2012 | | | | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Mar. Act. | Jun. Act. | Sep. Act. | Dec. Act. | Mar. Proj | Jun. Proj | Sep. Proj | Dec. Proj | Proj. | Proj. | Proj. | Proj. | Proj. |
| | | | | | (In millions of lari) | | | | | | | | |
| Net foreign exchange position | 2,354 | 2,336 | 2,306 | 2,595 | 2,605 | 2,549 | 2,677 | 2,676 | 2,749 | 2,960 | 3,110 | 3,685 | 3,997 |
| Gross International Reserves | 4,636 | 4,598 | 4,576 | 4,707 | 4,708 | 4,579 | 4,660 | 4,616 | 4,523 | 4,856 | 5,218 | 6,056 | 6,686 |
| Other foreign assets | 3 | 3 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Foreign currency liabilities | -2,285 | -2,265 | -2,272 | -2,114 | -2,104 | -2,032 | -1,984 | -1,941 | -1,776 | -1,898 | -2,109 | -2,372 | -2,691 |
| *Of which*: use of Fund resources | -1,116 | -1,097 | -1,059 | -981 | -923 | -818 | -713 | -601 | -202 | -82 | -38 | -12 | 0 |
| *Of which*: compulsory reserves in USD | -771 | -780 | -720 | -752 | -803 | -835 | -891 | -960 | -1,170 | -1,393 | -1,643 | -1,928 | -2,256 |
| Net domestic assets | -821 | -672 | -548 | -456 | -689 | -586 | -656 | -441 | -357 | -365 | -282 | -602 | -636 |
| Net claims on general government | -368 | -372 | -463 | -74 | -332 | -376 | -379 | -285 | -160 | 69 | 18 | -106 | -26 |
| Claims on general government (incl. T-bills) | 709 | 696 | 689 | 685 | 685 | 685 | 685 | 650 | 615 | 580 | 545 | 510 | 475 |
| Nontradable govt. debt | 561 | 561 | 561 | 561 | 521 | 521 | 521 | 521 | 481 | 441 | 401 | 361 | 321 |
| Securitized debt (marketable) | 148 | 135 | 128 | 124 | 164 | 164 | 164 | 129 | 134 | 139 | 144 | 149 | 154 |
| Deposits | -1,078 | -1,068 | -1,152 | -759 | -1,017 | -1,061 | -1,064 | -935 | -775 | -512 | -528 | -616 | -501 |
| Claims on rest of economy | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| Claims on banks | -354 | -285 | -127 | -429 | -392 | -236 | -297 | -167 | -51 | -153 | 15 | -146 | -223 |
| Bank refinancing | 95 | 150 | 335 | 14 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| Certificates of deposits and bonds | -449 | -435 | -462 | -442 | -492 | -336 | -397 | -267 | -151 | -253 | -85 | -246 | -323 |
| Other items, net | -100 | -17 | 40 | 44 | 33 | 25 | 18 | 9 | -148 | -283 | -316 | -352 | -390 |
| Reserve money | 1,533 | 1,663.6 | 1,757.4 | 2,139.2 | 1,916 | 1,963 | 2,021 | 2,235 | 2,392 | 2,595 | 2,829 | 3,083 | 3,361 |
| Currency in circulation | 1,395 | 1,467 | 1,596 | 1,754 | 1,683 | 1,693 | 1,718 | 1,885 | 1,985 | 2,085 | 2,185 | 2,265 | 2,345 |
| Bank lari reserves | 128 | 178 | 160 | 155 | 227 | 245 | 272 | 306 | 392 | 492 | 616 | 779 | 982 |
| Banks Overnight deposits | 10 | 18 | 1 | 230 | 6 | 25 | 31 | 45 | 14 | 18 | 28 | 39 | 34 |
| | | | | | (Percent contribution, compared to reserve money at the end of previous year) | | | | | | | | |
| Net foreign exchange position | 7.4 | 6.4 | 4.8 | 20.7 | 0.5 | -2.2 | 3.9 | 3.8 | 3.3 | 8.8 | 5.8 | 20.3 | 10.1 |
| Net domestic assets | -23.3 | -15.2 | -8.4 | -3.3 | -10.9 | -6.1 | -9.4 | 0.7 | 3.7 | -0.3 | 3.2 | -11.3 | -1.1 |
| Net claims on general government | -15.0 | -15.2 | -20.2 | 1.2 | -12.1 | -14.1 | -14.3 | -9.9 | 5.6 | 9.5 | -2.0 | -4.4 | 2.6 |
| Claims on rest of economy | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Claims on banks | -10.4 | -6.6 | 2.1 | -14.5 | 1.7 | 9.0 | 6.1 | 12.2 | 5.2 | -4.2 | 6.5 | -5.7 | -2.5 |
| Other items, net | 2.1 | 6.6 | 9.8 | 10.0 | -0.5 | -0.9 | -1.2 | -1.7 | -7.0 | -5.6 | -1.3 | -1.3 | -1.2 |
| | | | | | (Percentage change, relative to end of previous year) | | | | | | | | |
| Reserve money | -15.9 | -8.7 | -3.6 | 17.4 | -10.4 | -8.2 | -5.5 | 4.5 | 7.0 | 8.5 | 9.0 | 9.0 | 9.0 |
| Currency in circulation | -13.8 | -9.3 | -1.4 | 8.4 | -4.0 | -3.4 | -2.0 | 7.5 | 5.3 | 5.0 | 4.8 | 3.7 | 3.5 |
| Bank lari reserves | -11.4 | 23.8 | 11.2 | 7.8 | 46.4 | 57.7 | 75.1 | 97.1 | 28.3 | 25.5 | 25.1 | 26.5 | 26.0 |
| **Memorandum items:** | | | | | | | | | | | | | |
| Net international reserves | | | | | | | | | | | | | |
| (in millions of USD, at prog. exchange rates) 1/ | 942 | 957 | 969 | 1,152 | 1,155 | 1,116 | 1,189 | 1,196 | 1,291 | 1,519 | 1,638 | 1,922 | 2,064 |
| Net domestic assets (in millions of lari) 1/ | -40 | 65 | 140 | 216 | -12 | 99 | 35 | 238 | 236 | 58 | 93 | -127 | -87 |
| Reserve money (in percent, 12-month growth) | -6.1 | 0.2 | 3.6 | 17.4 | 25.0 | 18.0 | 15.0 | 4.5 | 7.0 | 8.5 | 9.0 | 9.0 | 9.0 |

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

1/ Based on 2012 program definition as defined in the TMU.

## Table 5. Georgia: Monetary Survey, 2011–17

| | 2011 | | | | 2012 | | | | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Mar. Act. | Jun. Act. | Sep. Act. | Dec. Act. | Mar. Proj | Jun. Proj | Sep. Proj | Dec. Proj | Proj. | Proj. | Proj. | Proj. | Proj. |
| | (In millions of lari) | | | | | | | | | | | | |
| Net foreign assets | 1,574 | 1,468 | 1,575 | 1,749 | 1,784 | 1,735 | 1,847 | 1,886 | 1,813 | 1,899 | 2,021 | 2,541 | 2,838 |
| NBG | 3,125 | 3,116 | 3,026 | 3,347 | 3,408 | 3,384 | 3,568 | 3,636 | 3,919 | 4,353 | 4,754 | 5,613 | 6,252 |
| Commercial banks 1/ | -1,552 | -1,648 | -1,451 | -1,598 | -1,624 | -1,649 | -1,721 | -1,750 | -2,105 | -2,454 | -2,733 | -3,073 | -3,414 |
| *Of which*: liabilities | -2,448 | -2,393 | -2,501 | -2,674 | -2,717 | -2,760 | -2,803 | -2,825 | -3,232 | -3,621 | -3,897 | -4,233 | -4,569 |
| Net domestic assets | 4,741 | 5,209 | 5,630 | 6,236 | 5,983 | 6,411 | 6,943 | 7,856 | 10,071 | 12,363 | 15,092 | 17,996 | 21,805 |
| Domestic credit | 6,262 | 6,792 | 7,249 | 7,912 | 7,671 | 8,108 | 8,647 | 9,573 | 11,976 | 14,421 | 17,186 | 20,126 | 23,974 |
| Net claims on general government | -169 | -184 | -233 | 115 | -147 | -203 | -227 | -129 | 302 | 807 | 1,031 | 1,181 | 1,484 |
| *Of which*: government deposits at NBG | -1,078 | -1,068 | -1,152 | -759 | -1,017 | -1,061 | -1,064 | -935 | -775 | -512 | -528 | -616 | -501 |
| *Of which*: T-bills at commercial banks | 443 | 497 | 504 | 522 | 569 | 624 | 670 | 722 | 1,097 | 1,447 | 1,797 | 2,147 | 2,447 |
| Credit to the rest of the economy | 6,431 | 6,976 | 7,482 | 7,797 | 7,818 | 8,311 | 8,875 | 9,702 | 11,674 | 13,613 | 16,155 | 18,945 | 22,490 |
| Other items, net | -1,521 | -1,584 | -1,619 | -1,676 | -1,688 | -1,697 | -1,705 | -1,717 | -1,905 | -2,058 | -2,094 | -2,131 | -2,169 |
| Broad money (M3) 1/ | 6,314 | 6,677 | 7,205 | 7,985 | 7,767 | 8,146 | 8,790 | 9,741 | 11,885 | 14,261 | 17,114 | 20,536 | 24,644 |
| Broad money, excl. forex deposits (M2) | 2,753 | 2,970 | 3,257 | 3,827 | 3,640 | 3,825 | 4,121 | 4,628 | 5,594 | 6,694 | 8,031 | 9,741 | 11,848 |
| Currency held by the public | 1,183 | 1,249 | 1,344 | 1,439 | 1,369 | 1,379 | 1,404 | 1,571 | 1,671 | 1,771 | 1,871 | 1,951 | 2,031 |
| Total deposit liabilities | 5,131 | 5,428 | 5,861 | 6,546 | 6,398 | 6,767 | 7,386 | 8,171 | 10,214 | 12,491 | 15,243 | 18,586 | 22,613 |
| | (Percent contribution, compared to broad money at the end of previous year) | | | | | | | | | | | | |
| Net foreign assets | 2.8 | 1.1 | 2.8 | 5.4 | 0.4 | -0.2 | 1.2 | 1.7 | -0.7 | 0.7 | 0.9 | 3.0 | 1.4 |
| Net domestic assets | -5.8 | 1.4 | 7.8 | 17.1 | -3.2 | 2.2 | 8.9 | 20.3 | 22.7 | 19.3 | 19.1 | 17.0 | 18.6 |
| Domestic credit | -3.8 | 4.3 | 11.3 | 21.5 | -3.0 | 2.5 | 9.2 | 20.8 | 24.7 | 20.6 | 19.4 | 17.2 | 18.7 |
| Net claims on general government | -5.2 | -5.5 | -6.2 | -0.9 | -3.3 | -4.0 | -4.3 | -3.0 | 4.4 | 4.3 | 1.6 | 0.9 | 1.5 |
| Credit to the rest of the economy | 1.4 | 9.8 | 17.5 | 22.4 | 0.3 | 6.4 | 13.5 | 23.9 | 20.2 | 16.3 | 17.8 | 16.3 | 17.3 |
| Other items, net | -2.0 | -2.9 | -3.5 | -4.4 | -0.2 | -0.3 | -0.4 | -0.5 | -1.9 | -1.3 | -0.2 | -0.2 | -0.2 |
| | (Percentage change, relative to end of previous year) | | | | | | | | | | | | |
| Broad money (M3) | -3.1 | 2.5 | 10.6 | 22.6 | -2.7 | 2.0 | 10.1 | 22.0 | 22.0 | 20.0 | 20.0 | 20.0 | 20.0 |
| Broad money, excl. forex deposits (M2) | -7.7 | -0.4 | 9.2 | 28.3 | -4.9 | -0.1 | 7.7 | 20.9 | 20.9 | 19.7 | 20.0 | 21.3 | 21.6 |
| Currency held by the public | -13.8 | -9.0 | -2.1 | 4.8 | -4.9 | -4.2 | -2.4 | 9.1 | 6.4 | 6.0 | 5.6 | 4.3 | 4.1 |
| Total deposit liabilities | -0.2 | 5.6 | 14.0 | 27.3 | -2.3 | 3.4 | 12.8 | 24.8 | 25.0 | 22.3 | 22.0 | 21.9 | 21.7 |
| Credit to the rest of the economy | 1.4 | 10.0 | 18.0 | 23.0 | 0.3 | 6.6 | 13.8 | 24.4 | 20.3 | 16.6 | 18.7 | 17.3 | 18.7 |
| **Memorandum items:** | | | | | | | | | | | | | |
| M3 (in percent, 12-month growth) | 33.3 | 32.4 | 33.7 | 22.6 | 23.0 | 22.0 | 22.0 | 22.0 | 22.0 | 20.0 | 20.0 | 20.0 | 20.0 |
| M2 (in percent, 12-month growth) | 24.3 | 26.6 | 32.5 | 28.3 | 32.2 | 28.8 | 26.5 | 20.9 | 20.9 | 19.7 | 20.0 | 21.3 | 21.6 |
| Credit to the economy (in percent, 12-month growth) | 18.6 | 20.1 | 26.4 | 23.0 | 21.6 | 19.1 | 18.6 | 24.4 | 20.3 | 16.6 | 18.7 | 17.3 | 18.7 |
| Ratio of bank lari reserves to lari deposits 2/ | 8.8 | 11.4 | 8.4 | 16.1 | 10.3 | 11.0 | 11.1 | 11.5 | 10.4 | 10.4 | 10.4 | 10.5 | 10.3 |
| M3 multiplier | 3.11 | 3.07 | 3.10 | 2.93 | 3.11 | 3.17 | 3.28 | 3.29 | 3.61 | 3.87 | 4.12 | 4.40 | 4.70 |
| M3 velocity | 3.37 | 3.46 | 3.36 | 3.18 | 3.12 | 3.16 | 3.05 | 3.02 | 2.77 | 2.56 | 2.38 | 2.22 | 2.07 |
| Foreign exchange deposits in percent of total deposits | 69.4 | 68.3 | 67.4 | 63.5 | 64.5 | 63.9 | 63.2 | 62.6 | 61.6 | 60.6 | 59.6 | 58.1 | 56.6 |

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

1/ The proceeds of the Georgian Railway eurobond issuance from July 2010, which were deposited in accounts with Georgian commercial banks that placed them abroad, are subtracted from commercial banks' foreign assets and domestic fx deposits.

2/ Comprises required and excess reserves on lari-denominated deposits (excess reserves include overnight deposits with NBG).

## Table 6. Georgia: Selected Monetary and Financial Soundness Indicators, 2007–11

| | 2007 | 2008 | 2009 | 2010 | | | | 2011 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Dec. | Dec. | Dec. | Mar. | Jun. | Sep. | Dec. | Mar. | Jun. | Sep. | Dec |
| Deposit dollarization (in percent) | 65.4 | 75.7 | 73.2 | 71.0 | 71.4 | 71.8 | 68.7 | 69.4 | 68.3 | 67.4 | 63.5 |
| Loan-to-deposit ratio (in percent) | 130.7 | 155.9 | 124.2 | 124.7 | 122.2 | 108.7 | 107.6 | 106.9 | 109.0 | 110.2 | 105.3 |
| Credit-to-GDP ratio (in percent) | 27.9 | 31.9 | 29.2 | 29.6 | 30.5 | 29.8 | 30.5 | 29.7 | 31.2 | 32.1 | 32.3 |
| Capital adequacy ratio (in percent) 1/ | 16.0 | 13.9 | 19.1 | 18.3 | 17.4 | 18.2 | 17.4 | 17.3 | 16.5 | 16.2 | 17.1 |
| Capital adequacy ratio (in percent) 2/ | 30.0 | 24.0 | 25.6 | 24.6 | 23.3 | 24.4 | 23.6 | 27.5 | 25.9 | 24.9 | 25.6 |
| Liquidity ratio (in percent) 3/ | 37.2 | 28.3 | 39.1 | 41.6 | 37.5 | 37.3 | 38.7 | 42.3 | 39.0 | 34.6 | 37.3 |
| Nonperforming loans (in percent of total loans) 4/ | 2.6 | 12.8 | 17.9 | 17.1 | 16.3 | 15.1 | 12.5 | 11.9 | 10.3 | 9.4 | 8.6 |
| Nonperforming loans (in percent of total loans) 5/ | 0.8 | 4.1 | 6.3 | 6.6 | 6.9 | 7.8 | 5.4 | 5.0 | 4.4 | 5.1 | 4.6 |
| Loans collateralized by real estate (in percent of total loans) | 43.8 | 43.6 | 55.5 | 55.5 | 54.1 | 52.3 | 47.5 | 46.7 | 44.8 | 43.0 | 53.4 |
| Loans in foreign exchange (in percent of total loans) | 68.6 | 72.8 | 76.9 | 75.9 | 73.7 | 72.8 | 74.0 | 73.4 | 72.2 | 69.7 | 68.8 |
| Specific provisions (in percent of total loans) | 1.7 | 6.0 | 9.7 | 9.4 | 8.9 | 8.3 | 6.5 | 6.3 | 5.4 | 4.9 | 4.6 |
| Net foreign assets (in percent of total assets) | -17.7 | -19.6 | -14.9 | -15.1 | -12.4 | -6.2 | -8.2 | -13.2 | -14.0 | -12.7 | -13.7 |
| Net open foreign exchange position (in percent of regulatory capital) | 5.0 | 1.7 | 1.8 | 4.3 | 5.3 | 3.3 | 8.1 | 1.9 | 5.3 | 5.7 | 5.9 |
| Return on equity (cumulative through the year, annualized) 6/ | 9.6 | -12.6 | -4.3 | 4.0 | 4.8 | 8.0 | 9.6 | 10.0 | 13.3 | 17.5 | 17.3 |
| Borrowed funds from abroad-to-GDP ratio 7/ | 9.5 | 12.7 | 11.6 | 11.7 | 12.2 | 11.6 | 12.2 | 9.4 | 8.6 | 8.5 | 9.4 |

Sources: National Bank of Georgia; and Fund 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 6-month and shorter maturity liabilities.
4/ National definition: NPLs are defined as loans in substandard, doubtful, and loss loan categories.
5/ IMF definition.
6/ Pre tax.
7/ Borrowed funds include Subordinated Debt.

## Table 7. Georgia: External Vulnerability Indicators, 2008–17

| | 2008 Act. | 2009 Act. | 2010 Act. | 2011 Act. | 2012 Proj. | 2013 Proj. | 2014 Proj. | 2015 Proj. | 2016 Proj. | 2017 Proj. |
|---|---|---|---|---|---|---|---|---|---|---|
| Value of exports of goods and services, percent change | 15.9 | -13.0 | 26.6 | 32.4 | 4.0 | 7.1 | 7.4 | 9.4 | 6.8 | 7.2 |
| Value of imports of goods and services, percent change | 26.8 | -29.8 | 16.4 | 30.3 | 2.5 | 4.0 | 3.2 | 5.4 | 6.3 | 6.4 |
| Terms of trade (deterioration - ) | 1.0 | 1.5 | 2.3 | -2.4 | 2.9 | 1.0 | 1.1 | 2.1 | 2.3 | 2.4 |
| Current account balance (percent of GDP) | -22.6 | -11.3 | -11.5 | -12.7 | -10.6 | -9.6 | -8.4 | -7.0 | -6.9 | -6.7 |
| Capital and financial account (percent of GDP) | 22.5 | 15.0 | 11.4 | 16.5 | 11.6 | 10.7 | 10.1 | 8.3 | 8.8 | 8.0 |
| External public debt (percent of GDP) | 23.5 | 31.7 | 33.6 | 29.1 | 27.7 | 26.1 | 24.8 | 23.5 | 22.1 | 20.4 |
| (in percent of exports of goods and services) | 73.0 | 105.4 | 96.9 | 78.1 | 78.8 | 72.6 | 68.5 | 65.3 | 63.7 | 60.7 |
| Debt service on external public debt | | | | | | | | | | |
| (in percent of exports of goods and services) | 3.4 | 5.3 | 4.1 | 4.2 | 7.6 | 10.0 | 6.8 | 4.1 | 3.4 | 3.5 |
| External debt (percent of GDP) | 44.0 | 58.0 | 62.0 | 53.3 | 50.2 | 47.9 | 46.9 | 44.3 | 42.5 | 39.8 |
| (in percent of exports of goods and services) | 153.6 | 194.9 | 177.6 | 141.6 | 143.1 | 137.5 | 133.2 | 125.0 | 124.0 | 120.1 |
| Debt service on MLT external debt | | | | | | | | | | |
| (in percent of exports of goods and services) | 16.0 | 23.7 | 17.4 | 15.9 | 17.7 | 20.9 | 18.2 | 15.6 | 14.6 | 15.3 |
| Gross international reserves | | | | | | | | | | |
| in millions of USD | 1,480 | 2,111 | 2,265 | 2,818 | 2,734 | 2,528 | 2,590 | 2,752 | 3,161 | 3,456 |
| in months of next year's imports of goods and services | 3.4 | 4.1 | 3.4 | 4.1 | 3.9 | 3.5 | 3.4 | 3.4 | 3.6 | 3.7 |
| in percent of external debt | 26.1 | 33.8 | 31.4 | 37.0 | 34.2 | 30.7 | 30.2 | 31.3 | 33.9 | 35.8 |
| in percent of short-term external debt (remaining maturity) | 101 | 163 | 141 | 151 | 130 | 125 | 131 | 144 | 150 | 148 |

Source: Fund staff estimates and projections.

## Table 8. Georgia: Indicators of Fund Credit, 2008–17
(In millions of SDR)

| | 2008 | 2009 | 2010 | 2011 | 2012 Proj. | 2013 Proj. | 2014 Proj. | 2015 Proj. | 2016 Proj. | 2017 Proj. |
|---|---|---|---|---|---|---|---|---|---|---|
| **Existing Fund credit** | | | | | | | | | | |
| Stock 1/ | 298.8 | 501.6 | 682.1 | 644.0 | 484.1 | 233.0 | 66.2 | 14.0 | 4.2 | 0.0 |
| ECF 2/ | 137.1 | 119.1 | 105.0 | 87.1 | 67.2 | 47.6 | 29.4 | 14.0 | 4.2 | 0.0 |
| SBA | 161.7 | 382.5 | 577.1 | 556.9 | 416.9 | 185.4 | 36.8 | 0.0 | 0.0 | 0.0 |
| Obligations | 23.3 | 22.5 | 21.7 | 48.9 | 167.5 | 255.2 | 168.4 | 52.5 | 9.8 | 4.2 |
| ECF 2/ | 22.8 | 18.6 | 14.1 | 17.9 | 19.9 | 19.6 | 18.3 | 15.5 | 9.8 | 4.2 |
| SBA | 0.5 | 3.7 | 7.5 | 31.0 | 147.6 | 235.6 | 150.1 | 37.0 | 0.0 | 0.0 |
| **Prospective purchases under the SBA/SCF Blend** | | | | | | | | | | |
| Disbursements | ... | ... | ... | 0.0 | 70.0 | 120.0 | 60.0 | 0.0 | 0.0 | 0.0 |
| SCF | ... | ... | ... | 0.0 | 35.0 | 60.0 | 30.0 | 0.0 | 0.0 | 0.0 |
| SBA | ... | ... | ... | 0.0 | 35.0 | 60.0 | 30.0 | 0.0 | 0.0 | 0.0 |
| Stock 1/ | ... | ... | ... | 0.0 | 70.0 | 190.0 | 250.0 | 244.1 | 206.3 | 135.7 |
| Obligations 4/ | ... | ... | ... | 0.0 | 1.3 | 1.2 | 2.1 | 8.0 | 39.6 | 71.9 |
| Principal (repurchases) | ... | ... | ... | 0.0 | 0.0 | 0.0 | 0.0 | 5.9 | 37.8 | 70.6 |
| Interest charges | ... | ... | ... | 0.0 | 1.3 | 1.2 | 2.1 | 2.0 | 1.9 | 1.3 |
| **Stock of existing and prospective Fund credit 1/** | 298.8 | 501.6 | 682.1 | 644.0 | 554.1 | 423.0 | 316.2 | 258.1 | 210.5 | 135.7 |
| In percent of quota | 198.8 | 333.7 | 453.8 | 428.5 | 368.7 | 281.4 | 210.4 | 171.7 | 140.0 | 90.3 |
| In percent of GDP | 3.7 | 7.2 | 8.9 | 7.1 | 5.3 | 3.8 | 2.7 | 2.0 | 1.5 | 0.9 |
| In percent of exports of goods and nonfactor services | 12.8 | 24.1 | 25.6 | 18.9 | 15.2 | 10.8 | 7.5 | 5.6 | 4.3 | 2.6 |
| In percent of gross reserves | 31.9 | 36.7 | 45.9 | 36.1 | 31.0 | 25.6 | 18.7 | 14.3 | 10.2 | 6.0 |
| In percent of public external debt | 17.5 | 22.9 | 26.4 | 24.2 | 19.3 | 14.9 | 11.0 | 8.6 | 6.7 | 4.2 |
| **Obligations to the Fund from existing and prospective Fund credit 3/** | 23.3 | 22.5 | 21.7 | 48.9 | 168.9 | 256.4 | 170.4 | 60.4 | 49.5 | 76.1 |
| In percent of quota | 15.5 | 15.0 | 14.4 | 32.5 | 112.3 | 170.6 | 113.4 | 40.2 | 32.9 | 50.6 |
| In percent of GDP | 0.3 | 0.3 | 0.3 | 0.5 | 1.6 | 2.3 | 1.4 | 0.5 | 0.3 | 0.5 |
| In percent of exports of goods and nonfactor services | 1.0 | 1.1 | 0.8 | 1.4 | 4.6 | 6.6 | 4.1 | 1.3 | 1.0 | 1.4 |
| In percent of gross reserves | 2.5 | 1.6 | 1.5 | 2.7 | 9.5 | 15.5 | 10.1 | 3.4 | 2.4 | 3.4 |
| In percent of public external debt service | 29.3 | 20.6 | 19.7 | 34.4 | 61.0 | 65.5 | 59.8 | 31.8 | 29.5 | 41.0 |

Source: Fund staff estimates and projections.

1/ End of period.

2/ Following the Low Income Countries (LIC) reforms, effective January 7 2010, the PRGF arrangements were renamed Extended Credit Facility (ECF) Arrangements. ECF interest is based on 0 percent through end December 2013 and 0.25 percent thereafter.

3/ Projected obligations under the ECF do not take into account the temporary waiver of interest payments and new interest rate structure.

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

## Table 9. Georgia: Schedule of Prospective Reviews and Available Purchases and Loans, 2012–14

| Availability Date | Condition | Available Purchases under the SBA | | Available Loans under the SCF | | Total Available Purchases and Loans | |
|---|---|---|---|---|---|---|---|
| | | (SDR millions) | (Percent of quota) | (SDR millions) | (Percent of quota) | (SDR millions) | (Percent of quota) |
| 15-Mar-12 | Approve the 24-month arrangement | 12.5 | 8.3 | 12.5 | 8.3 | 25.0 | 16.6 |
| 15-Aug-12 | Complete the first review based on end-June 2012 performance criteria and other relevant performance criteria | 22.5 | 15.0 | 22.5 | 15.0 | 45.0 | 29.9 |
| 15-Feb-13 | Complete the second review based on end-December 2012 performance criteria and other relevant performance criteria | 30.0 | 20.0 | 30.0 | 20.0 | 60.0 | 39.9 |
| 15-Aug-13 | Complete the third review based on end-June 2013 performance criteria and other relevant performance criteria | 30.0 | 20.0 | 30.0 | 20.0 | 60.0 | 39.9 |
| 15-Feb-14 | Complete the fourth review based on end-December 2013 performance criteria and other relevant performance criteria | 30.0 | 20.0 | 30.0 | 20.0 | 60.0 | 39.9 |
| Total available | | 125.0 | 83.2 | 125.0 | 83.2 | 250.0 | 166.3 |

## Table 10. Georgia: External Financing Requirements and Sources, 2008–17

(In millions of U.S. dollars)

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total requirements | -3,275 | -1,723 | -1,785 | -2,399 | -2,404 | -2,631 | -2,393 | -2,174 | -2,258 | -2,473 |
| Current account deficit | -2,912 | -1,212 | -1,334 | -1,818 | -1,684 | -1,659 | -1,525 | -1,398 | -1,518 | -1,634 |
| Capital outflows: Repayments of MLT loans | -363 | -511 | -451 | -581 | -720 | -972 | -868 | -776 | -740 | -839 |
| Total sources | 3,275 | 1,723 | 1,785 | 2,399 | 2,404 | 2,631 | 2,393 | 2,174 | 2,258 | 2,473 |
| Capital flows | 3,188 | 2,146 | 1,734 | 2,921 | 2,320 | 2,424 | 2,454 | 2,336 | 2,666 | 2,768 |
| Public sector | 795 | 872 | 593 | 510 | 610 | 537 | 474 | 437 | 385 | 313 |
| Project grants | 87 | 170 | 189 | 131 | 100 | 90 | 72 | 57 | 46 | 37 |
| Long-term loan disbursements to public sector | 227 | 428 | 403 | 340 | 500 | 447 | 403 | 379 | 339 | 276 |
| Other | 482 | 274 | 1 | 39 | 10 | 0 | 0 | 0 | 0 | 0 |
| Private sector | 2,392 | 1,274 | 1,140 | 2,411 | 1,711 | 1,887 | 1,980 | 1,899 | 2,281 | 2,456 |
| Foreign direct investment in Georgia | 1,564 | 658 | 814 | 906 | 964 | 1,032 | 1,095 | 1,190 | 1,317 | 1,458 |
| Long-term loan disbursements to private sector | 759 | 575 | 402 | 543 | 646 | 730 | 763 | 839 | 838 | 878 |
| Other net inflows 1/ | 69 | 41 | -76 | 963 | 100 | 125 | 122 | -130 | 126 | 120 |
| Financing | 218 | 193 | 259 | 66 | 0 | 0 | 0 | 0 | 0 | 0 |
| IMF 2/ | 257 | 340 | 297 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in arrears, net (- decrease) | -9 | 28 | 12 | 39 | 0 | 0 | 0 | 0 | 0 | 0 |
| Debt rescheduling, pre-payment (net) | 0 | 11 | 11 | 28 | 0 | 0 | 0 | 0 | 0 | 0 |
| Advance Repayments | -29 | -186 | -61 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in reserves (- increase) | -131 | -616 | -208 | -589 | 84 | 207 | -61 | -162 | -409 | -295 |
| **Memorandum items** (in percent of GDP): | | | | | | | | | | |
| Total financing requirements | -25.4 | -16.0 | -15.3 | -16.8 | -15.1 | -15.3 | -13.1 | -11.0 | -10.3 | -10.2 |
| Total sources | 25.4 | 16.0 | 15.3 | 16.8 | 15.1 | 15.3 | 13.1 | 11.0 | 10.3 | 10.2 |
| Capital inflows | 24.8 | 19.9 | 14.9 | 20.4 | 14.6 | 14.1 | 13.4 | 11.8 | 12.2 | 11.4 |
| Exceptional financing | 1.7 | 1.8 | 2.2 | 0.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Change in reserves (- increase) | -1.0 | -5.7 | -1.8 | -4.1 | 0.5 | 1.2 | -0.3 | -0.8 | -1.9 | -1.2 |

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

1/ Including errors and omissions.

2/ SBA, including augmentation in 2010.

# ANNEX I. Georgia: Debt Sustainability Analysis

*Georgia's external and public debts fell significantly in 2011 and are projected to decline further over the medium term. Even when subjected to standard shocks, external and public debts would converge toward moderate levels.*

**Georgia's external debt ratio contracted sharply in 2011 and it is projected to continue to decrease to 40 percent of GDP by 2017.** The contraction observed in 2011, which primarily reflected high nominal growth and non-debt creating inflows (mostly FDI), began to reverse the increase that took place during the crisis (external debt increased from 38 percent of GDP in 2007 to 62 percent of GDP in 2010). Gross external financing needs are projected to decrease steadily, from 24 percent of GDP in 2011 to 15 percent of GDP in 2017.

**The external debt ratio is most sensitive to the standard real exchange rate depreciation and current account shocks, but even in those cases it would converge to under 60 percent over the medium term.** Under the combined shock, the debt ratio would converge to under 50 percent. The other standard shocks (interest rate and growth) would not affect materially the debt path.

**Georgia's public debt ratio also contracted significantly in 2011 and is projected to keep decreasing over the medium term.** The decline observed in 2011 resulted largely from high nominal growth, the appreciation of the lari, and privatization receipts. Georgia's public debt is now projected to decline from 34 percent of GDP in 2011 to 26 percent of GDP in 2017. Gross financing needs are projected to remain below the levels observed over the last three years (between 6 and 7.5 percent of GDP between 2012 and 2017).

**Standard shocks (interest rate, growth, fiscal deficit, contingent liabilities, and exchange rate) would cause a moderate to significant increase in the debt ratio, but in all cases public debt would still converge to under 40 percent by 2017.** Only in the case of the standard growth shock, would debt fail to return to a declining path. However, the size of the growth shock (a permanent decline of growth of nearly 2½ percentage points) appears to be rather extreme, since it is based on the historical standard deviation of growth which was exceptionally high in 2002–11, a period of post-transition rebound, crisis and recovery.

## Table I.1. Georgia: External Debt Sustainability Framework, 2007–17

(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | **Debt-stabilizing non-interest current account 7/** |
| 1 **Baseline: External debt 1/** | 38.5 | 44.0 | 58.0 | 62.0 | 53.3 | **50.2** | **47.9** | **46.9** | **44.3** | **42.5** | **39.8** | **-8.5** |
| 2 Change in external debt | 0.7 | 5.5 | 14.0 | 3.9 | -8.7 | -3.0 | -2.3 | -1.0 | -2.6 | -1.9 | -2.7 | |
| 3 Identified external debt-creating flows (4+8+9) | -6.1 | 3.5 | 12.7 | 1.8 | -11.5 | 0.1 | 0.0 | -1.1 | -2.1 | -2.0 | -1.9 | |
| 4 Current account deficit, excluding interest payments | 18.2 | 20.4 | 8.3 | 8.7 | 10.2 | 8.4 | 7.5 | 6.2 | 5.0 | 4.9 | 4.7 | |
| 5 Deficit in balance of goods and services | 26.7 | 29.6 | 19.1 | 17.8 | 18.3 | 16.3 | 14.7 | 12.9 | 11.2 | 10.6 | 10.0 | |
| 6 Exports | 31.1 | 28.7 | 29.8 | 34.9 | 37.6 | 35.1 | 34.8 | 35.2 | 35.5 | 34.2 | 33.1 | |
| 7 Imports | 57.9 | 58.3 | 48.9 | 52.7 | 55.9 | 51.5 | 49.5 | 48.1 | 46.7 | 44.9 | 43.1 | |
| 8 Net non-debt creating capital inflows (negative) | -16.7 | -11.2 | -7.2 | -5.3 | -12.7 | -7.6 | -7.1 | -6.9 | -6.8 | -6.7 | -6.5 | |
| 9 Automatic debt dynamics 2/ | -7.6 | -5.7 | 11.6 | -1.6 | -9.0 | -0.7 | -0.5 | -0.3 | -0.3 | -0.2 | -0.1 | |
| 10 Contribution from nominal interest rate | 1.5 | 2.3 | 3.0 | 2.8 | 2.5 | 2.2 | 2.1 | 2.1 | 2.1 | 2.0 | 2.0 | |
| 11 Contribution from real GDP growth | -3.5 | -0.7 | 2.0 | -3.4 | -3.4 | -2.9 | -2.6 | -2.5 | -2.4 | -2.2 | -2.1 | |
| 12 Contribution from price and exchange rate changes 3/ | -5.5 | -7.2 | 6.6 | -1.0 | -8.1 | ... | ... | ... | ... | ... | ... | |
| 13 Residual, incl. change in gross foreign assets (2-3) 4/ | 6.8 | 2.0 | 1.4 | 2.1 | 2.8 | -3.2 | -2.4 | 0.1 | -0.5 | 0.1 | -0.7 | |
| External debt-to-exports ratio (in percent) | 123.7 | 153.6 | 194.9 | 177.6 | 141.6 | 143.1 | 137.5 | 133.2 | 125.0 | 124.0 | 120.1 | |
| **Gross external financing need (in billions of US dollars) 5/** | 2.7 | 3.9 | 2.7 | 2.6 | 3.4 | 3.5 | 3.8 | 3.6 | 3.4 | 3.4 | 3.7 | |
| In percent of GDP | 26.6 | 30.3 | 24.9 | 22.6 | 24.0 | 22.3 | 21.9 | 19.5 | 17.0 | 15.7 | 15.4 | |
| **Scenario with key variables at their historical averages 6/** | | | | | | **50.2** | **43.5** | **39.0** | **35.3** | **33.0** | **30.2** | **-14.0** |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | | | | | | | |
| Real GDP growth (in percent) | 12.3 | 2.4 | -3.8 | 6.3 | 6.8 | 6.0 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | |
| GDP deflator in US dollars (change in percent) | 17.2 | 22.9 | -13.0 | 1.7 | 15.0 | 5.1 | 2.4 | 0.6 | 3.0 | 4.9 | 4.9 | |
| Nominal external interest rate (in percent) | 5.2 | 7.4 | 5.6 | 5.1 | 4.9 | 4.6 | 4.5 | 4.8 | 4.8 | 5.1 | 5.2 | |
| Growth of exports (US dollar terms, in percent) | 24.7 | 15.9 | -13.0 | 26.6 | 32.4 | 4.0 | 7.1 | 7.4 | 9.4 | 6.8 | 7.2 | |
| Growth of imports (US dollar terms, in percent) | 34.1 | 26.8 | -29.8 | 16.4 | 30.3 | 2.5 | 4.0 | 3.2 | 5.4 | 6.3 | 6.4 | |
| Current account balance, excluding interest payments | -18.2 | -20.4 | -8.3 | -8.7 | -10.2 | -8.4 | -7.5 | -6.2 | -5.0 | -4.9 | -4.7 | |
| Net non-debt creating capital inflows | 16.7 | 11.2 | 7.2 | 5.3 | 12.7 | 7.6 | 7.1 | 6.9 | 6.8 | 6.7 | 6.5 | |

1/ Excludes intercompany 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.

## Table I.2. Georgia: Public Sector Debt Sustainability Framework, 2007–17

(In percent of GDP, unless otherwise indicated)

| | | Actual | | | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 | | | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Debt-stabilizing primary balance 9/ |
| 1 **Baseline: Public sector debt 1/** | 21.5 | 27.6 | 37.3 | 39.2 | 34.0 | | | **32.9** | **31.7** | **30.7** | **29.5** | **28.2** | **26.4** | **-1.6** |
| o/w foreign-currency denominated | 16.8 | 23.5 | 31.7 | 33.6 | 29.1 | | | 27.8 | 26.0 | 24.7 | 23.3 | 21.9 | 20.2 | |
| 2 Change in public sector debt | -5.8 | 6.1 | 9.7 | 1.9 | -5.2 | | | -1.2 | -1.2 | -0.9 | -1.2 | -1.3 | -1.8 | |
| 3 Identified debt-creating flows (4+7+12) | -7.0 | 1.0 | 9.1 | 2.0 | -5.1 | | | -0.3 | -0.7 | -0.9 | -1.4 | -1.7 | -1.7 | |
| 4 Primary deficit | 4.2 | 5.7 | 8.2 | 5.6 | 2.5 | | | 2.2 | 1.9 | 1.5 | 0.9 | 0.3 | 0.2 | |
| 5 Revenue and grants | 29.3 | 30.7 | 29.3 | 28.3 | 28.5 | | | 27.4 | 27.3 | 27.1 | 26.9 | 26.8 | 26.7 | |
| 6 Primary (noninterest) expenditure | 33.4 | 36.4 | 37.5 | 33.9 | 30.9 | | | 29.6 | 29.2 | 28.6 | 27.8 | 27.1 | 26.9 | |
| 7 Automatic debt dynamics 2/ | -6.0 | -1.0 | 2.9 | -2.5 | -6.0 | | | -2.0 | -2.4 | -2.2 | -2.1 | -2.0 | -1.9 | |
| 8 Contribution from interest rate/growth differential 3/ | -4.6 | -1.7 | 2.6 | -4.0 | -4.3 | | | -2.0 | -2.4 | -2.2 | -2.1 | -2.0 | -1.9 | |
| 9 Of which contribution from real interest rate | -1.8 | -1.3 | 1.5 | -1.9 | -2.0 | | | -0.2 | -0.7 | -0.7 | -0.6 | -0.5 | -0.5 | |
| 10 Of which contribution from real GDP growth | -2.7 | -0.5 | 1.1 | -2.0 | -2.3 | | | -1.8 | -1.6 | -1.6 | -1.5 | -1.5 | -1.4 | |
| 11 Contribution from exchange rate depreciation 4/ | -1.4 | 0.7 | 0.3 | 1.5 | -1.7 | | | ... | ... | ... | ... | ... | ... | |
| 12 Other identified debt-creating flows | -5.2 | -3.7 | -2.0 | -1.1 | -1.6 | | | -0.5 | -0.2 | -0.2 | -0.2 | 0.0 | 0.0 | |
| 13 Privatization receipts (negative) | -5.2 | -3.7 | -2.0 | -1.1 | -1.6 | | | -0.5 | -0.2 | -0.2 | -0.2 | 0.0 | 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/ | 1.3 | 5.1 | 0.5 | -0.2 | 0.0 | | | -0.8 | -0.5 | 0.0 | 0.2 | 0.4 | -0.1 | |
| Public sector debt-to-revenue ratio 1/ | 73.6 | 90.0 | 127.4 | 138.5 | 119.5 | | | 120.1 | 115.8 | 113.5 | 109.6 | 105.2 | 98.8 | |
| **Gross financing need 6/** | 5.7 | 6.9 | 10.1 | 8.6 | 9.0 | | | 6.0 | 7.0 | 7.5 | 6.9 | 6.5 | 6.6 | |
| In billions of U.S. dollars | 0.6 | 0.9 | 1.1 | 1.0 | 1.3 | | | 1.0 | 1.2 | 1.4 | 1.4 | 1.4 | 1.6 | |
| **Scenario with key variables at their historical averages 7/** | | | | | | | | **32.9** | **31.6** | **31.0** | **30.6** | **30.7** | **30.3** | **-2.8** |
| **Scenario with no policy change (constant primary balance) in 2012-2017** | | | | | | | | **32.9** | **31.1** | **31.0** | **31.5** | **32.0** | **32.0** | **-1.9** |
| **Key Macroeconomic and Fiscal Assumptions Underlying Baseline** | | | | | | 10-Year Historical Average | 10-Year Standard Deviation | | | | | | | |
| Real GDP growth (in percent) | 12.3 | 2.4 | -3.8 | 6.3 | 6.8 | 6.5 | 4.7 | 6.0 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | |
| Average nominal interest rate on public debt (in percent) 8/ | 2.6 | 3.3 | 3.2 | 3.1 | 3.5 | 3.0 | 0.4 | 4.2 | 3.8 | 4.0 | 4.2 | 4.2 | 4.3 | |
| Average real interest rate (nominal rate minus change in GDP deflator, in percent) | -7.1 | -6.3 | 5.2 | -5.4 | -5.5 | -4.3 | 4.3 | -0.3 | -2.2 | -2.0 | -1.8 | -1.8 | -1.7 | |
| Nominal appreciation (increase in US dollar value of local currency, in percent) | 8.7 | -4.5 | -1.1 | -4.9 | 6.1 | 2.7 | 6.6 | ... | ... | ... | ... | ... | ... | |
| Inflation rate (GDP deflator, in percent) | 9.7 | 9.6 | -2.0 | 8.5 | 9.0 | 6.9 | 3.6 | 4.5 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | |
| Growth of real primary spending (deflated by GDP deflator, in percent) | 29.7 | 11.5 | -0.9 | -4.0 | -2.6 | 16.7 | 18.0 | 1.4 | 4.2 | 3.2 | 2.7 | 2.9 | 4.5 | |
| Primary deficit | 4.2 | 5.7 | 8.2 | 5.6 | 2.5 | 2.8 | 3.6 | 2.2 | 1.9 | 1.5 | 0.9 | 0.3 | 0.2 | |

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.

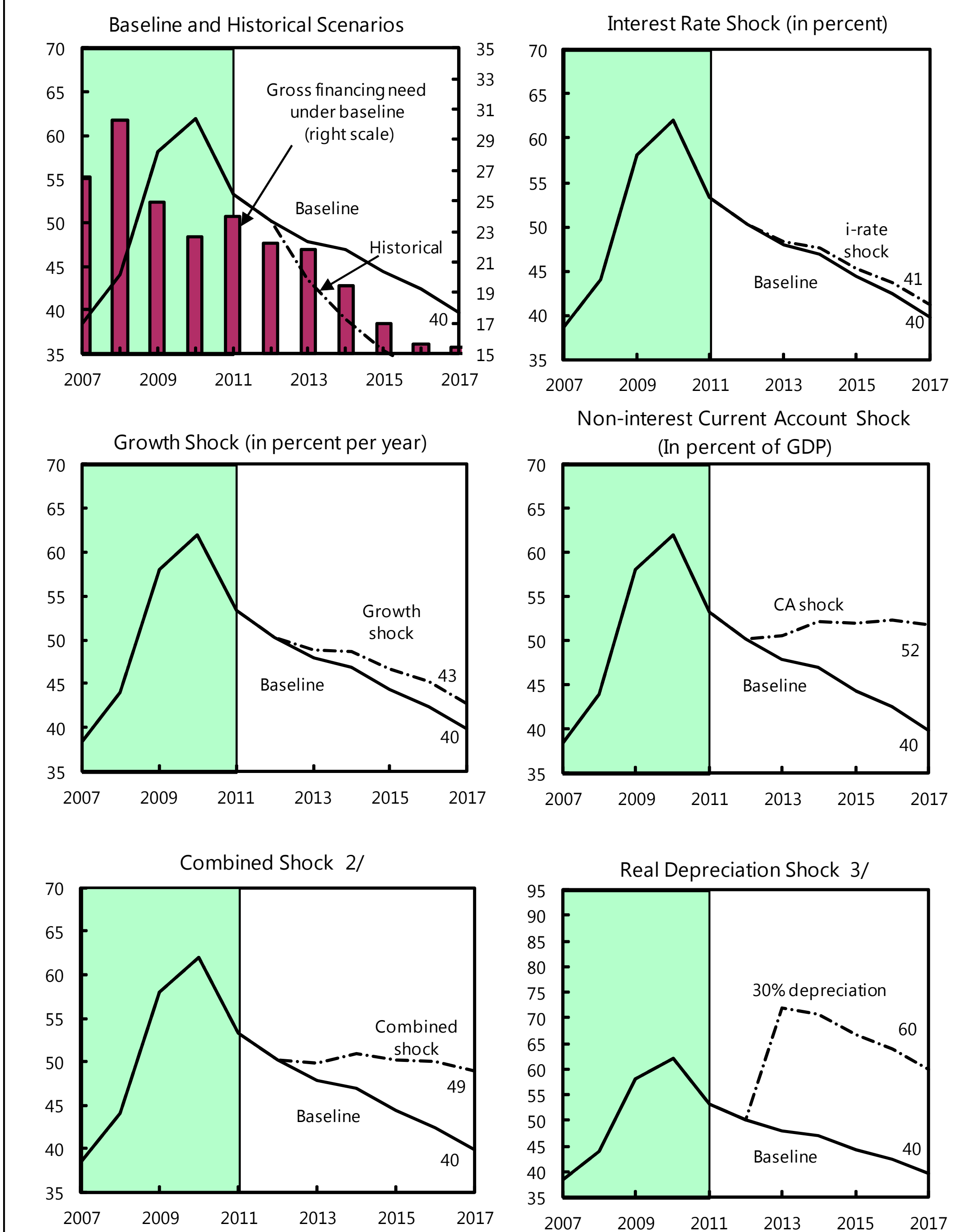
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

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 I.1. Georgia: External Debt Sustainability: Bound Tests 1/

(External debt in percent of GDP)




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

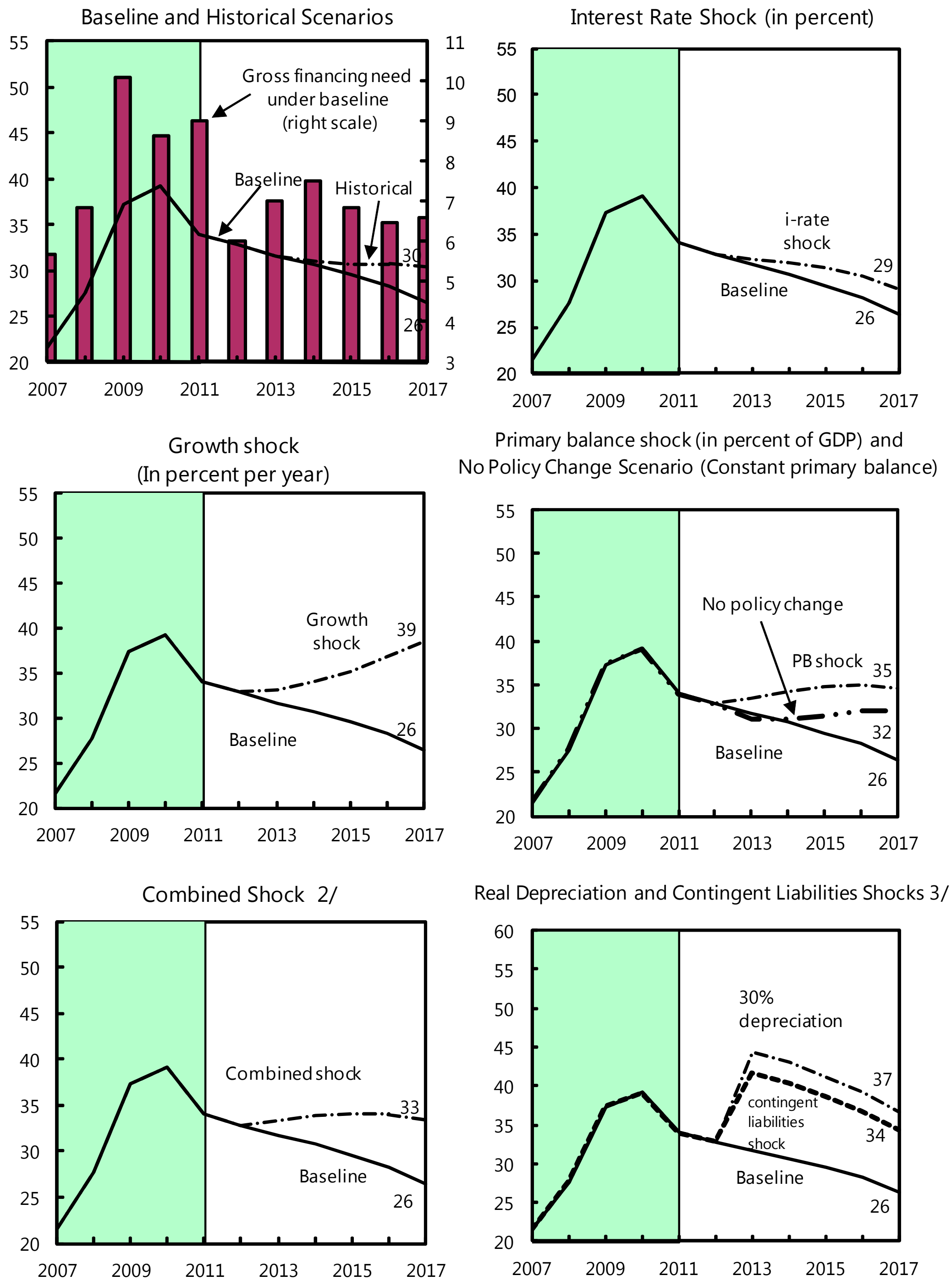
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

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

3/ One-time real depreciation of 30 percent occurs in 2013.

**Figure I.2. Georgia: Public Debt Sustainability: Bound Tests 1/**

(Public debt in percent of GDP)




Sources: International Monetary Fund, country desk data, and staff estimates.
1/ 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/ 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 2013, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

# APPENDIX I. LETTER OF INTENT

March 27, 2012

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C.

Dear Ms. Lagarde:

1. The attached Memorandum of Economic and Financial Policies (MEFP) outlines the economic and financial policies that the Georgian government and the National Bank of Georgia will implement in 2012–2013 to improve macroeconomic balances and strengthen the resilience of the economy to shocks.

2. The government is fully committed to the policies stipulated in the MEFP and its attachments. These policies are designed to bring the fiscal deficit to 3.5 percent of GDP in 2012, 3.0 percent in 2013 and to below 3 percent in 2014, to facilitate external adjustment through a flexible management of the exchange rate, and to maintain an adequate international reserve cushion against external financing risks.

3. On the basis of these policies and to signal our continued commitment to macroeconomic stability, the Georgian government requests that the Fund support this multi-year program under a Stand-By Arrangement (SBA) for a period of 24 months in the amount of SDR 125 million (83.2 percent of quota) and a Standby Credit Facility for a period of 24 months in the amount of SDR 125 million (83.2 percent of quota). We project our program to be fully financed and intend to treat the SBA and SCF as precautionary.

4. The implementation of the program will be monitored through quantitative performance criteria and structural benchmarks as described in Tables 1 and 2 of the attached Memorandum of Economic and Financial Policies and in the Technical Memorandum of Understanding. There will be four reviews to assess progress in implementing the program and reach understandings on any additional measures that may be needed to achieve its objectives. The first review will be based on

end-June 2012 performance criteria and is scheduled for completion by end-October 2012; the second review will be based on end-December 2012 performance criteria and is scheduled for completion by end-April 2013; the third review will be based on end-June 2013 performance criteria and is scheduled for completion by end-October 2013, and the fourth review will be based on end-December 2013 performance criteria and is scheduled for completion by April 10 2014. The government and the National Bank of Georgia will provide the Fund with the data and information necessary to monitor performance under the program.

5. The Georgian authorities believe that the policies set forth in the attached memorandum are adequate to achieve the objectives of the economic program, and stand ready to take any further measures that may become appropriate for this purpose, in consultation with the Fund in advance of changing any policies set forth in the LOI/MEFP.

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

Sincerely yours,

/s/
Nika Gilauri
Prime Minister of Georgia

/s/
Dimitri Gvindadze
Minister of Finance of Georgia

/s/
Giorgi Kadagidze
Governor of the National Bank of Georgia

# ATTACHMENT I. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES (MEFP)

## March 27, 2012

1. The economic and financial program supported by a Stand-By Arrangement with the IMF over the period September 2008–June 2011 was successful in stabilizing the economy in the wake of the conflict with Russia and the global financial crisis, and in restoring conditions for strong economic growth. A sizable fiscal stimulus package helped mitigate the economic impact of the crisis and was used to increase the overall productivity of the economy through public infrastructure investment, and to provide housing and social assistance to the Internally Displaced Persons (IDPs). Consistent with the temporary nature of the stimulus package, we have moved rapidly to consolidate Georgia's public finances as the economy began to recover. The government deficit was reduced from 9.2 percent of GDP in 2009 to 3.6 percent of GDP in 2011 and the government debt-to-GDP ratio is back on a declining trend. Supported by prudent macroeconomic policies, economic growth has accelerated to around 7 percent in 2011, while inflation has come down in the low single digits. Flexible management of the exchange rate contributed to the correction of the current account deficit (from 22.6 percent of GDP in 2008 to an estimated 12½ percent of GDP in 2011).

2. In the wake of the crisis the domestic banking sector faced difficulties accessing international capital markets, while also facing loss of deposits—29 percent decline in exchange rate-adjusted terms from peak to trough. This liquidity shock was compounded by a deterioration in the quality of the loan portfolio, with NPLs (IMF definition) increasing from 0.8 percent of the loan portfolio before the crisis to 8.6 percent by mid-2009. Notwithstanding these difficulties, the banking sector was able to weather the crisis well, owing to the strong capitalization of the banks, timely liquidity injections by the central bank, the support of IFIs, and, ultimately, the recovery of confidence. As of December 2011, the deposit base had more than doubled relative to the pre-crisis peak, credit has been growing at a healthy pace, NPLs have declined markedly (to 4.6 percent of the loan portfolio as of December 2011), and financial indicators point to solid capital and liquidity buffers.

3. The strength of the recovery and the credibility of our economic policies also contributed to a marked improvement of international investor confidence. On April 12, 2011, Georgia issued a 10-year $500-million Eurobond at very favorable terms (7.125 percent yield), establishing an

excellent sovereign benchmark in the international capital markets. The proceeds of the issue were used to buy back most of the $500 million Eurobond maturing in 2013, easing considerably rollover risks. The Georgia Eurobonds trade above par in secondary markets. In December 2011, Georgia's sovereign rating was upgraded to BB- by Fitch and S&P's, and the spread on Eurobonds has narrowed to 450 basis points as of February 2012 (from a peak of 574 basis points in October 2011).

4. Notwithstanding the improvements in the economic and financial situation since 2008, challenges remain:

- Fiscal buffers against potential future shocks need to remain strong through continued fiscal consolidation, while taking into account pressing needs for government spending to upgrade infrastructure and raise pensions closer to the established subsistence minimum.

- Despite strong economic growth over the last decade, the unemployment rate has remained high (16.3 percent at end-2010), warranting additional government action to promote private investment and job creation.

- Balance of payments conditions are stable, but the financing need created by the large current account deficit is a source of vulnerability. While we remain committed to exchange rate flexibility, in the event large external financing shortfalls were to emerge it would be difficult to counter balance of payments pressures through the exchange rate alone, given high financial dollarization.

## I. THE ECONOMIC AND FINANCIAL PROGRAM FOR 2012–13

5. The ultimate objective of our economic policies is to promote the creation of jobs and improve the living standards of all Georgians through sustained and inclusive economic growth. Our program for 2012–14 focuses on mutually reinforcing macroeconomic and structural policies to achieve these objectives, consistent with the priorities laid out in October 2011 in the Government's Ten-Point Medium-Term Plan.

6. We believe that the factors that contributed to Georgia's strong rate of economic growth from 2004 to 2008 remain valid today: Georgia consistently ranks near the top of business environment, governance, and reform indicators; it is strategically located as a gateway to the Caucasus and Central Asia; it has a demonstrated track record of sound macroeconomic management; and still has an untapped growth potential from unrealized productivity gains. We

view macroeconomic stability as a cornerstone of our growth strategy. Hence, our program targets a further reduction of the fiscal deficit and the stabilization of inflation in the single digits. Maintaining a flexible exchange rate will also facilitate external adjustment and lessen vulnerabilities to external shocks.

7. We believe that, in addition to providing macroeconomic stability, the government has a role to play in unlocking the growth potential in a number of sectors of the economy, including tourism, energy (hydropower generation, including for export) and agriculture. To unleash this potential and create jobs, we will persist in our endeavor to make Georgia the most attractive investment destination, notably through:

- Continued improvements in the business environment, including by making the tax and customs administrations even more responsive to the needs of taxpayers.
- Public financial support to private investment through the newly created Partnership Fund (PF).
- Ongoing and new initiatives to upgrade job seekers' skills and better attune the education system to the needs of the market economy.
- Public intervention to address market failures and structural impediments in agriculture.
- Public investments to promote tourism and regional integration.

## A. Macroeconomic Framework

8. In 2012, annual real GDP growth is projected to remain elevated at at least 5 percent as the result of the high growth observed in the second half of 2011. Reflecting the strength of the macroeconomic framework and the structural policies targeted under the program, we conservatively expect that economic growth will average at least 5½ percent over the medium term, with a significant upward potential.

9. We expect CPI inflation to remain within the National Bank of Georgia's (NBG) target of 6 percent in 2012. However, because of the large weight of basic commodities in the CPI basket, headline inflation will remain inherently vulnerable to commodity price shocks that are outside the control of the monetary authorities.

10. The overall balance of payments was in surplus in 2011, and we expect this to continue in 2012. However, because of the uncertainty of private capital inflows, we have built our medium-

term macroeconomic framework on the conservative assumption that private capital inflows will grow only moderately in USD terms, and converge to around 7–8 percent of GDP in the medium term, compared to 11.4 percent in 2011.

11. [1] Consistent with this assumption and with an anticipated gradual decline of official financial inflows, we project that the current account deficit will also decline to around 7 percent of GDP by 2015–16, from 12½ percent in 2011. This current account adjustment is brought about by the combination of fiscal consolidation, a flexible management of the exchange rate, and structural policies to strengthen competitiveness.

## B. External Adjustment and International Reserve Target.

12. Notwithstanding the envisaged external adjustment effort, our external financing needs will remain sizeable in 2013–14, owing to a rise in external debt servicing obligations, mostly to the IMF, which will peak in 2013. The service of the external public debt is projected to reach the equivalent of 10 percent of exports in 2013. Under the program, the repayment of the SBA obligations to the Fund would be made possible by current account adjustment (which would outpace projected financial and capital inflows) and some drawdown of gross international reserves from their current ample level.

13. The increase in net international reserves projected under the program would ensure that the gross international reserve (GIR) coverage of imports and short-term liabilities remain at a safe level. Specifically, we consider that GIR should remain above $2.5 billion during the program period, which would provide coverage for at least 3 months of imports and at least 100 percent of short-term external debt.

## C. Possible Financing Need and Access to IMF Resources

14. Even though our macroeconomic framework is based on prudent assumptions, economic and financial developments are subject to considerable uncertainty, particularly with regard to private capital inflows, export market growth and the price of our commodity exports. We will continue relying on exchange rate flexibility as the first line of defense against unforeseen developments and financing shortfalls. However, in the dollarized domestic context, we also need to avoid disruptive movements in the exchange rate, as they could compromise financial stability. We

[1] Excluding bank inflows related to increase in fx reserve requirements

also stand ready to accelerate fiscal consolidation in the event of financing shortfalls, notably by slowing down capital spending.

15. While we intend to treat the SBA and SCF as precautionary, we would consider drawing under the arrangements in the face of large adverse shocks, which could not be handled solely through exchange rate adjustment, faster fiscal consolidation, and a drawdown of international reserves without compromising financial stability.

16. We consider that our request for total access of SDR 250 million under the SBA and SCF is consistent with these risks.

## D. Fiscal Policy

17. The purpose of fiscal policy is to safeguard adequate fiscal buffers and keep the government debt-to-GDP ratio on a steady declining trend by maintaining low deficits, consistent with our commitment under the Economic Liberty Act. Accordingly, we will reduce the fiscal deficit to no more than 3.5 percent of GDP in 2012 and no more than 3.0 percent of GDP in 2013. In nominal terms, this implies that the cash deficit of the general government, as defined in the Technical Memorandum of Understanding (TMU), will not exceed GEL 943 million in 2012 (performance criterion).

18. Consistent with our commitment (under the Economic Liberty Act) to keep current and capital expenses of the government under 30 percent of GDP from 2014 onward, we also intend to maintain expenditures of the general government at around 31 percent of GDP in 2012.

19. Consistent with our pro-growth strategy, medium-term fiscal consolidation efforts will rely essentially on containing government spending. Given the projected increase in the net budgetary cost of pensions (see below), we will control very tightly other government expenditure categories.

20. To strengthen our commitment to sound public finances, we have amended the Economic Liberty Act so as to provide the government with sufficient tax policy flexibility and autonomy to allow it to react properly to unforeseen fiscal shocks, notably if we encounter difficulties in implementing our expenditure-based consolidation strategy.

21. In order to facilitate settlement of the government’s external debt service obligations in 2012–14, the ministry of finance has set aside in a dedicated sub-account of the Treasury Single Account sums dedicated to future IMF debt service.

22. To further improve debt management and help develop local financial markets, we have extended the maturity structure of Treasury paper by issuing our first 5-year notes in April 2011 and our first 10-year notes in March 2012. As a sign of our enhanced credibility, foreign investors have also entered into the T-bill market.

23. Public external debt is projected to come down gradually. Since the bulk of the foreign public debt is in the form of long-term official loans on soft terms, the government's external debt servicing costs will remain well within prudent levels (i.e., below 3 percent of GDP) over the medium term and will only increase significantly in 2021, when the US$500 million Eurobond matures.

24. We have decided to increase pension benefits in two steps to narrow the gap relative to subsistence levels. We will also broaden the coverage of health insurance, so as to cover all pensioners, in September 2012. To limit the budgetary impact of these measures, the second pension increase, coming into effect in September 2012, will be provided only to pensioners aged 67 and above.

## E. Monetary and Exchange Rate Policies

25. Price stability continues to be the main objective of our monetary policy and the experience of 2011 points to the success we have achieved in anchoring inflationary expectations. Owing to soaring global commodity prices, headline inflation peaked at 14.3 percent (year-on-year) in May 2011, but core inflation (excluding food, beverages, tobacco, and energy) remained subdued throughout the period, at under 2 percent. When the impact of the commodity price hike on headline inflation began to wane, and the risks of second-round effects declined, we began easing the monetary policy rate, from 8 percent to 6.5 percent presently.

26. For 2012, the monetary policy objective is to keep inflation at or below our 6 percent objective. We consider that the policy rate is currently consistent with this objective. Changes in the monetary policy stance will be guided by developments in credit and monetary aggregates complemented by our inflation forecast model. At the same time, to reduce the risks of excessive money creation, we will maintain the net domestic assets of the NBG (TMU definition) below GEL 238 million by end-2012 (performance criterion). While the refinancing (policy) rate remains our primary monetary policy instrument, reserve requirements could also be used, reflecting the fact that the effectiveness of the policy rate is limited by high dollarization levels and thin money and financial markets.

27. We remain committed to a flexible exchange rate, and consider that daily fluctuations of the exchange rate are desirable to prevent the formation of speculative expectations in the foreign exchange market. As was the case in 2011, foreign exchange intervention will be motivated by the need to dampen excess volatility in a thin market, and by our objective of increasing net international reserves (TMU definition) to $1,196 million by end-2012 (performance criterion).

28. As part of our gradual move to a (lite) inflation targeting regime, we have improved the quality of our price statistics and have strengthened the communication with the public. After each monetary policy committee meeting, we provide information to the public on the rationale behind our policy choices. Building on technical assistance and training provided by the IMF, we have developed a general equilibrium model to inform the NBG's decision-making process. Meanwhile, we continue to work to enrich the model to better capture important features of the Georgian economy.

29. Since April 2010, we have implemented a broad agenda of monetary and macroprudential measures to promote the use of the local currency (the lari) and the development of local currency markets in Georgia. These measures include the activation of the lari standing facilities and the reform of the refinancing window, the tightening of capital adequacy requirements for unhedged foreign currency lending, the extension of the reserve requirement coverage to external borrowing, and the disclosure requirements for risks associated with foreign currency borrowing. These actions have contributed to deposit and credit dedollarization in 2011–12, and we expect this trend to continue over the medium term.

30. Domestic agents' need for foreign exchange hedging instruments has increased since the introduction of foreign exchange auctions in 2009, which led to higher short-term exchange rate volatility. We plan to support the launching and development of the interbank hedging market by conducting educational activities among financial institutions and their clients, building necessary infrastructure to support pricing, trading and settlement of fx market instruments and further opening up access for international investors to domestic financial markets.

31. To further pursue the objective of interbank market development, we have introduced the integrated Real Time Gross Settlement (RTGS) and Central Security Depository (CSD) systems that enable Delivery-vs-Payment (DvP) transactions with securities. We have further improved the settlement infrastructure and finalized the integration of the Bloomberg and CSD systems for repo operations in 2011. The new law on payment systems, drafted with technical assistance from the

IMF, will be adopted in 2012. It regulates E-payments and financial collateral among other issues. We are also in the process of upgrading payment system oversight functions within the National Bank, based on technical assistance received from the IMF.

32. In order to enhance the safety and efficiency of the international reserves management process, we have implemented a new portfolio management system, covering the front-middle-back office and accounting functionality based on Straight through Processing (STP) principles. The system is IFRS compliant and will allow us to introduce new and more sophisticated financial instruments and investment techniques in the reserves management process, bringing it in line with international best practices. The system became fully operational in June 2011.

33. To bring our official statistics in line with international standards, the NBG will start reporting Financial Soundness Indicator data and metadata to the IMF's Statistics Department for dissemination on the IMF's website. The NBG also aims to improve the quality of data on private loans from non-residents. For that purpose, since the first quarter of 2011, NBG has been receiving information from GEOSTAT on the identity of resident entities holding foreign loans, enabling it to cross-check GEOSTAT and ITRS data and improve quality control.

## F. Financial Sector Policies

34. Following losses in 2008–09, the Georgian banking sector returned to profitability in the last quarter of 2009. In 2011, net profits of the banking system (GEL 323 million) more than doubled relative to 2010 (GEL 156 million), resulting in a 2.85 percent return on assets and a 17.3 percent return on equity. Decreasing asset yields (which accounted for negative 43 percent of the increase in net profits) were compensated by improved credit quality (accounting for 56 percent of the increase in net profits). Change in composition of liquid assets and improved cost efficiency contributed by 34 percent and 30 percent of the increase in net profits respectively. Loan portfolio growth had a relatively smaller, but still noticeable effect of 24 percent on profit increase, part of which was driven by decreasing overall liquidity (effect of 3.5 percent).

35. In the post-recession period, the economic recovery and intensified lending activity combined with write-offs and repossessions led to major improvements in the asset quality indicators. Lending activity was initially spurred by inventory build-up in the real economy followed by growth in retail lending and fixed investments. As a result, the share of NPLs in total loans decreased from 18.8 percent (based on the national definition) in June 2009 to 8.62 percent in December 2011 (from 8.3 percent to 4.6 percent based on IMF 90 days overdue definition).

36. Credit growth was accompanied by a slight easing of lending standards following the over tightening during financial distress and intense competition. This drew interest rates on loans down until second half of 2011, when turmoil in the Eurozone began.

37. Capitalization and liquidity are high enough to support further lending growth. The level of financial depth remains low, especially when taking into account the central role played by banks in providing funding to the economy. However, any rapid financial deepening would have to be accompanied by lengthening of loan maturities, decrease in interest rates, and increase in the sectoral/regional financial penetration for the process to be sustainable. Moreover, currency-induced credit risk remains high though covered by capital requirements. At the same time dollarization has decreased noticeably both for loans and deposits.

38. We consider that the banking sector currently has comfortable levels of liquidity. There are no significant repayments due in the short run. Major repayments due in 2012 have already been repaid in February. But the recent turmoil in Europe has affected the local financial system as well, in the sense that only limited amount of additional inflows are expected in 2012, owing to higher cost of borrowing and external resource supply scarcity.

39. To make the liquidity risk management and supervision more risk based NBG has recently adopted the LCR (liquidity coverage ratio) reporting form and started collecting data for performing a quantitative impact study with a view to making LCR the core liquidity monitoring tool in the future. The current form already allows calculation of LCR under Basel III standardized methodology.

40. We have embarked on a gradual transition to risk-based forward-looking supervision. High capital and liquidity requirements pre-crisis proved to be a good buffer against shocks, but they also led to higher intermediation margins. Moreover, system-wide conservative requirements were not always sufficient as the shock absorption capacity of the banks differed according to their respective risk management practices. To facilitate the transition towards risk-based supervision, we have changed the organizational structure of the NBG to enable a more efficient use of limited human resources by creating divisions that assess system-wide risks (credit, financial/macroprudential, operational) and assist the Banking Supervision Department in evaluating commercial banks' overall risk profile. To ensure the adequacy and consistency of bank evaluations, we developed benchmarking procedures, according to which all risk areas are benchmarked by the (same) relevant specialists. The exercise has already been done for several banks.

41. We have initiated, through the Operational Risk and Information Processing Division, the development of an operational risk assessment framework for banks. For the first time, NBG's operational risk assessment includes detailed examination reports and assessment of the commercial banks' overall operational risk profile. The initial operational risk assessment of banks is to be completed by the end of June, 2012. The framework covers, inter alia, IT-related supervisory topics such as business continuity and contingency planning, as well as risks associated with outsourcing and offshoring of critical business processes. The new framework aims to ensure convergence to the Basel principles for the effective management of operational risk.

42. In order to reduce information costs and promote cross-product and cross-bank comparability of the financial products, we have introduced, in June 2011, a consumer protection framework. The Georgian banks are now obliged to disclose to borrowers more information on loans, such as the effective interest rate, currency induced credit risk, contract amendment rights and other information. Additionally, bank customers are now able to submit complaints straight to the NBG. Some of the identified shortcomings on the retail market are going to be addressed through legislative changes, which will be drafted by the end of 2012. Analysis of the consumer complaints data also contributes to strengthen supervision through the identification of related operational and retail credit risks.

43. In the medium term, we aim to converge to the Basel II/III framework consistent with our move to risk-based supervision. In this regard we have collected data from each bank and performed quantitative impact study of Basel II/III compliance on regulatory capital. Preliminary findings show that the industry has enough quality capital to comply with even Basel III requirements. The major challenge in the transition process will be adoption of Pillar 2, since this will be new both for the banks and the regulators. After implementing Basel II there will be limited additional effort needed to move to Basel III, since the three major differences of Basel III compared to Basel II (capital amount/definition, treatment of trading book, and liquidity coverage ratio) are not an obstacle for Georgia: (i) all of Georgian banks' core capital already qualifies under Basel III definition (even after Basel III deductions from Common Equity Tier 1 (CET 1) capital); (ii) the trading book is virtually nil in banks' balances; and (iii) liquidity requirements are already quite conservative and their adaptation to Basel III requirements would not require much additional effort as the LCR reporting form is already in place.

44. Substantial work has been performed to harmonize current disclosure rules and make them Basel compliant, but the regulatory infrastructure for Pillar 3 still needs further fine-tuning.

45. To facilitate macroprudential supervision and transition to Basel III, we are currently developing a new framework that utilizes microprudential data for macroeconomic policy, and evaluates the effects of macroeconomic shocks on microprudential regulation. In particular a framework that defines the need for countercyclical buffers according to Basel III has already become operational (countercyclical policy measures have already been taken previously by adjusting FX risk weights). The guidelines from the Basel Committee on Banking Supervision for identifying Global Systemically Important Banks (G-SIBs) have slightly been adapted to the local environment (by adding, for example, geographical outreach and sector coverage as systemic indicators). Calculation of countercyclical and systemic risk buffers is currently only performed for monitoring purposes.

46. The macroprudential framework will be further updated by the end of March-2012 and it will integrate macroeconomic scenarios with a micro-level borrower assessment. The macroprudential division will define stress scenarios according to the state of the economy (for example, just after a negative shock the scenarios will be milder compared with overheating phases). The scenario will typically assume stress on exchange rate and collateral values with varying degrees of output stress for different sectors of the economy. This information will be used by the Credit Risk division which will perform the micro-level stress tests. These inputs will be used by the bank supervisors to conduct stress tests on the bank portfolio and to assign ratings to the borrowers according to their resilience to stress. This exercise will improve upon the existing framework by differentiating standard loans in three different categories. The rating of the portfolio will be used in Pillar 2 within the new regulatory framework and additional capital requirements will be required for the banks with less stress-resilient portfolios. The banks themselves will be familiar with the methodology and will be required to perform micro-level stress tests deriving from macro scenarios.

47. We intend to preserve a "light touch supervision" approach towards the non-banking sector, which is at its initial stage of development. However, for the insurance sector, we envisage further harmonization of the legislation and of the supervisory methods with the Solvency I/II principles.

48. Following the intense upgrade of our supervisory structures and approach, we consider that a stock taking exercise is helpful in evaluating our framework and practices relative to international standards. To that end, we started a self-assessment of the supervisory framework and practices in

July 2011. We have completed drafts for 16 out of the 25 Basel core principles. The anticipated date of completion of the self-assessment is July 2012.

## G. Public Financial Management

49. In order to improve the efficiency of the overall public sector and limit risks to public finances, we intended to reinforce our monitoring of state-owned enterprises (SOEs) and state agencies (Legal Entities of Public Law, or LEPLs) at the level of the ministry of finance. The ministry will collect this information and produce an annual report of the financial flows for each of the 5 largest SOEs as well as an annual report consolidating the financial flows of the 5 largest LEPLs. The first reports will cover 2011 financial accounts and will be completed by June 30, 2012 (structural benchmark). Starting in 2013, reports will include an assessment of fiscal risks in relation to the SOE and LEPL operations.

50. We have also made significant progress in our long-term public financial management reform agenda by improving public finance and debt management information systems and harmonizing reporting and accounting standards among central government spending entities.

## H. Partnership Fund

51. In order to promote private investment, we have established a partnership fund (PF), with the objective of providing co-financing (in the form of minority equity or debt financing) in situations in which the private sector cannot mobilize sufficient funding from the market without some form of state participation. State participation can help address market failures and mitigate perceived risks. As such, we consider that the PF can help unlock private investment into new greenfield projects, consistent with our private sector-led growth strategy. PF commenced co-financing projects in 2011, based on already identified potential investments in hydropower and on completed and ongoing feasibility studies for projects in agriculture, manufacturing and real estate.

52. The PF is incorporated as a joint stock company and thus has a profit maximizing objective. It is intended to contribute to the financing of private sector projects, through minority equity participations, lending or guarantees. It can also initiate feasibility studies for projects that can attract foreign investors. Its operations will be undertaken without any state guarantees and solely on its own account. We have taken steps to ensure proper accountability and oversight. In particular, we will publish and transmit to the Supervisory Board, which is chaired by the Prime Minister, the audited financial statements of the PF on a semiannual basis, starting with the publication of the end-2011 statements by end-September 2012 (structural benchmark). Financial statements will be

IFRS-compliant and audited by a reputable auditor. We also intend to have the PF rated by credit rating agencies. We have requested technical assistance from the IMF to identify ways in which we can further strengthen governance, oversight and transparency of the PF, consistent with best financial management practices. The current organizational structure, investment mandate, reporting and accountability obligations of the PF are explained in Schedule 1.

53. The PF has been capitalized through the transfer of government shares in state enterprises. The following shares have been or are in the process of being transferred to the PF: 24 percent of Georgian Railway (GR); 24 percent of Georgian Oil and Gas Corporation (GOGC), 49 percent of Georgian State Electrosystems (GSE), and 49 percent of Electricity System Commerical Operator (ESCO). We estimate the total value of assets held by the PF to exceed GEL 400 million ($240 million). While we consider that the resources of the PF are currently sufficient for its operations, we might consider transferring additional resources or assets to the PF. We will discuss with the IMF any such transfer ahead of time. The financial operations of the PF will be monitored through a zero deficit ceiling, as defined in the TMU (performance criterion).

## I. Tax Policy and Revenue Administration

54. The reform of tax and customs administration has been part of our broader fight against corruption, with a view to replacing arbitrary payments with a healthy tax payment culture. We consider that even treatment under the tax law is essential to maintaining a level playing field in the private sector, which ultimately promotes competition and growth. For this reason, we have placed considerable effort into fighting tax evasion, which has contributed to higher voluntary compliance rates.

55. At the same time, it is important for the private sector to be able to rely on a transparent and fair system. Accordingly, our objective is to transform state institutions from watchdog structures focused on identifying violations, into entities that that help businesses operate in a fair and lawful environment. To that end, we will continue to consult intensively with business representatives. As an innovative approach, taxpayers are provided with a draft tax assessment letter before the tax is formally assessed, so that they can sort out issues with the Revenue Service's Audit Department. We have also made progress toward simplifying dispute resolution through streamlined mediation process, which now allows the taxpayer to review and to change the draft tax assessment letter by presenting adequate evidence. By easing the burden of tax compliance, we expect to increase overall tax collection.

56. The following reforms have been recently introduced, or are under way, to foster tax and customs compliance and further improve confidence in the tax and customs system:

- Electronic tax payment services (the bulk of taxpayers now rely on the web portal). Electronic services include filing tax returns, issuing tax invoice, filing tax appeal etc.
- Establishment of customs clearance zones with capacity to process large volumes of cross-border trade in a time-efficient manner.
- Creation of tax ombudsman office for better protection of taxpayers' rights.
- Regional tax inspectors/advisors to provide well tailored and timely guidance to taxpayers throughout the country.
- Introduction of electronic (rather than paper) excise stamps.
- Advance tax ruling practice–taxpayers can obtain an advance tax ruling for the interpretation of the tax code provisions, which will be binding for the tax authority.
- Private tax audit option–tax audit may be carried out by qualified tax consulting firms or individual tax consultants.
- Private tax agent to assist with tax compliance.
- Introduction of GPRS-equipped cash registers to improve monitoring of retail transactions and alleviate the need for tax audit.
- Introduction of "Good Faith" principle which allows to waive sanctions for mistakes resulting from the lack of knowledge rather than willful tax avoidance.

## J. Poverty Reduction and Development Vision

57. The sum of the policies described above is intended not only to solidify macroeconomic stability but also to set the foundations for sustainable growth, enhanced competitiveness and poverty reduction. In 2003–11, Georgia sustained broad-based growth dynamics, with average annual real GDP growth rate of around 7 percent. Combined with a strengthening of the national currency, this growth has resulted in an impressive increase in per capita income from $919 in 2003 to $3,215 in 2011. The path toward reducing poverty in Georgia is through creation of job opportunities by promoting and rewarding private sector initiative, building infrastructure, and providing quality education and access to basic services. We shall continue our reforms to further reinforce Georgia's function as a 'Regional Hub Economy'. In this respect, we are firmly committed

to maintaining: (a) solid sovereign balance sheet, (b) business-friendly environment with low levels of taxation, efficient tax and customs administration and a level-playing field for private businesses, fostering our competitive edge and development of the private enterprise, (c) efficient and pro-business government; (d) stable and conservatively managed banking sector, and (e) multi-modal maritime, land and air access infrastructure for trade logistics and manufacturing. These policies and the structural reforms that we implemented in Georgia create excellent preconditions for transforming Georgia into a full-fledged hub economy which would be attractive to investors—domestic and foreign alike—who wish to do business in Georgia, through Georgia, and from Georgia with the region and the world.

**Table 1. Georgia: Quantitative Performance Criteria (PC) and Indicative Target, 2012**

| | Jun-12 | Dec-12 |
|---|---|---|
| | PC | PC |
| | (Cumulative change since the beginning of the year, in millions of lari) | |
| Ceiling on the cash deficit of the general government | 190 | 943 |
| Ceiling on the cash deficit of the Partnership Fund | 0 | 0 |
| | (End-period stock, in millions of lari) | |
| Ceiling on the net domestic assets (NDA) of the NBG 1/ | 99 | 238 |
| | (End-period stock, in millions of U.S. dollars) | |
| Floor on the net international reserves (NIR) of the NBG 1/ | 1,116 | 1,196 |
| | (Cumulative change since the beginning of the year, in millions of U.S. dollars) | |
| Ceiling on the accumulation of external arrears 2/ | 0 | 0 |
| | Ind. Target | Ind. Target |
| | (Cumulative change since the beginning of the year, in millions of U.S. dollars) | |
| Ceiling on contracting or guaranteeing of external debt by the public sector | 800 | 1,100 |

Sources: Georgian authorities; and Fund staff estimates.

1/ Actual figures and quantitative targets are based on program exchange rates.

2/ The continuous performance criterion for external arrears is defined in paragraph 22 of the TMU.

**Table 2. Georgia: Structural Benchmarks, 2012**

| Action | Proposed Time Frame |
|---|---|
| The Ministry of Finance will provide to the IMF an annual report of the financial flows for each of the 5 largest SOEs as well as an annual report consolidating the financial flows of the 5 largest LEPLs. | The reports covering 2011 will be provided to the IMF by end-June 2012 |
| The Partnership Fund will publish and transmit to its Supervisory Board its audited IFRS-compliant financial statements for 2011. | End-September 2012 |

# Schedule 1 to the MEFP: The Partnership Fund

## I. ORGANIZATION AND OPERATIONAL STRUCTURE

### A. Legal Structure

The Partnership Fund (PF) is incorporated as a Joint Stock Company (JSC). Under civil law, JSCs are profit maximizing entities, organized with value creation as their main objective.

### B. Corporate Governance

The PF is organized as a commercial financial institution. Its governance structure includes:

- An investment board, currently composed of internal members (CEO, CIO, portfolio officers) and can add external members (like experts and private sector representatives), which approves business cases and initiates projects;
- A risk management committee, composed of internal members (CFO, Chief Legal Officer, and Chief Accountant), which advises on project risks to be reflected in project implementation agreements;
- A supervisory board (i.e. board of directors), which approves projects (based on the feasibility studies, risk assessments, and business cases presented by the investment board and risk committee) and approves budget for project development needs. The supervisory board includes members of the government and is chaired by the Prime Minister; and
- In cases of equity participation in projects, the PF needs government approval.

## II. CORPORATE MANDATE AND PORTFOLIO MANAGEMENT

### A. Corporate Mandate

The corporate mandate of the PF is approved by the supervisory board and the government. The PF will provide project financing through equity participations, senior loan, quasi-equity through subordinated convertible debt, and performance bonds/guarantees. Investments will focus on the following sectors: energy, agriculture, manufacturing, and real estate. Under its corporate mandate, the PF is not allowed to provide financing to the service industry. The PF will charge market rates for services provided.

## B. Portfolio Management Strategy

The PF's portfolio management strategy has been developed. It sets portfolio limits, performance management objectives, and project evaluation guidelines, and will be based on the following principles:

- The PF will participate only in commercially viable projects; and
- The PF's performance will be monitored on the basis of the following evaluation criteria: IRR, APV, sharp ratio, and risk adjusted return.

## C. Project Development Methodology

The PF will only participate in projects in which a corporate investor, with sufficient experience in industry, expresses its willingness to take an equity participation that represents at least 51 percent of the project's total equity and 25 percent of the total necessary financing. The PF's financial participation will be limited to 49 percent of the project's total equity and 25 percent of the total necessary financing, since most projects would also attract debt financing. In rare instances in which debt-financing cannot be mobilized (e.g., owing to long project gestation periods before positive cash flow can be generated) and all of the financing is in the form of equity, the share of the PF's in total financing can rise to 49 percent, equivalent to its contribution to start-up equity.

Investment projects can be initiated either by a corporate investor or by the PF:

- In the former case, the corporate investor commits to provide a majority equity participation representing more than 25 percent of the project's total financing need and requests the PF to provide a financial participation sufficient to ensure that the senior lender will be willing to provide the senior loan. The PF can consider participating in such arrangements, within the aforementioned limits, on the condition that the project's business plan has been validated by a third-party consultant. The project's feasibility and risks are assessed by the investment board and the risk management committee, before being approved by the supervisory board; and
- In the latter case, the PF hires a reputable consulting organization, either from corporate finance or industry specific advisory services, to assess the feasibility of the project. On this basis, the investment board decides whether to bring the project to the supervisory board for approval, while the risk committee assesses the associated risks. If the project is approved, the consulting organization is charged to find a private partner willing to take a majority equity

participation in the project. If such a partner can be found, the project is presented to potential senior lenders.

## III. REPORTING AND AUDITING

The PF will engage an internationally recognized auditing company to conduct semi-annual IFRS audits of its financial statements.

The PF will hire on a permanent basis the services of rating agencies, which will prepare regular ratings reports—there will no minimum rating requirement for the PF.

The PF’s audited financial statements, as well as the ratings reports will be available on permanent basis to a broad audience.

Fiscal risks associated with the PF will be limited since:

- The PF projects don’t create any kind of contingent liability for the sovereign balance sheet, as the government as no legal obligation to bail out the PF, should it become illiquid or insolvent;
- All liabilities of the PF are limited to its own balance sheet;
- The PF has its own revenue sources, namely: the dividends from its investments, the interest earnings from the loans its provides, the fees it charges on the guarantees it provides, and the proceeds of asset sales; and
- The PF may decide to borrow from credible financial institution with recourse to its balance sheet facility and without state guarantee.

# ATTACHMENT 2. TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

### March 27, 2012

1. This memorandum sets out the understandings between the Georgian authorities and the IMF staff regarding the definitions of quantitative performance criteria and indicative targets, as well as respective reporting requirements for the Stand-By Arrangement and Standby Credit Facility.

2. These performance criteria and indicative targets are reported in Table 1 attached to the Letter of Intent dated March 27, 2012. The exchange rate for the purposes of the program of the Georgian lari to the U.S. dollar is set at GEL1.67 = $1. The corresponding cross exchange rates are provided in Table 1.

## I. GENERAL GOVERNMENT AND THE PUBLIC SECTOR

3. **Definition:** The general government is defined as the central government and local governments. It does not include Legal Entities of Public Law, State-Owned Enterprises or the Partnership Fund. The public sector consists of the general government and the National Bank of Georgia (NBG).

4. **Supporting material:** The Treasury Department of the Ministry of Finance (MOF) will provide to the IMF detailed information on monthly revenues of the general government within two weeks of the end of each month, and monthly expenditures and arrears of the central government within four weeks of the end of each month. In addition, the Treasury will provide, on a daily basis, the cash balances in all the accounts of the general government as of the previous business day.

# II. QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE TARGETS, AND CONTINUOUS PERFORMANCE CRITERIA: DEFINITIONS AND REPORTING STANDARDS

## A. Quantitative Performance Criteria and Indicative Targets

5. The quantitative performance criteria and indicative targets specified in Table 1 attached to the Memorandum of Economic and Financial Policies (MEFP) are:

- a performance criterion (ceiling) on the cash deficit of the general government;
- a performance criterion (ceiling) on the cash deficit of the Partnership Fund;
- a performance criterion (ceiling) on the net domestic assets (NDA) of the NBG;
- a performance criterion (floor) on the net international reserves (NIR) of the NBG;
- a continuous performance criterion (zero ceiling) on the accumulation of external arrears; and
- an indicative target (ceiling) on the contracting and guaranteeing of new total external debt by the public sector.

6. The performance criteria and indicative targets are monitored semi-annually on a cumulative basis from the beginning of the calendar year (with the exception of the NIR and NDA targets, which are monitored in terms of stock levels), while the continuous performance criterion is monitored on a continuous basis.

## B. Ceiling on the Cash Deficit of the General Government

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

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

  (i) Net lending (borrowing net of repayments) provided by commercial banks to the general government plus the use of deposits held by the general government at commercial banks. Monitoring of net lending and government accounts will be based on the NBG's monetary survey and Treasury data. The change in cash balances of the local government at commercial banks for budget financing purposes will be monitored based on the "budget of territorial unit" account data provided by the Treasury Department. Any securities issued by the general government and purchased by commercial banks (for example, T-Bills, are also included in domestic financing.

(ii) Net lending (borrowing net of repayments) provided by the NBG to the general government plus the use of deposits of the general government held at the NBG. Monitoring of net lending and government accounts will be based on the Central Bank survey and Treasury data. The change in cash balances of the central government at the NBG for budget financing purposes will be monitored based on the "State budget's Treasury single account (TSA)" and "Revenue reserve account" data provided by the Treasury Department. Any securities issued by the general government and purchased by the NBG (for example, T-Bills) are also included in domestic financing.

(iii) Any securities issued by the general government and purchased by the nonbanks (for example, T-Bills or securitized claims on the government sold by the NBG) are also included in domestic financing.

- Net external financing is defined as the total of loans disbursed to the general government for budget support (including the financing from the IMF whose domestic counterpart is used to finance the budget), and project financing (capital expenditure and net lending), net change in external arrears, change in the accounts of the general government abroad, minus amortization and net deposit accumulation in the state budget's foreign currency account. Amortization includes all external debt-related payments of principal by the general government.

- Privatization receipts consist of all transfers of monies received by the central and local governments in connection with the sale of central or local government assets. This includes receipts from the sale of shares, the sale of non-financial assets as well as leases and the sale of licenses with duration of 10 years and longer.

8. **Adjustor:** The ceiling on the cash deficit of the general government will be adjusted upward/downward by 100 percent for any excess/shortfall in on-lending by the government of the disbursements of the Black Sea Transmission Network project loans relative to the projected amounts presented in Table 2.

9. **Supporting Material:**

- Data on domestic bank and nonbank financing will be provided to the IMF by the NBG and the Treasury Department of the MOF within four weeks after the end of the month.
- Data on external project financing as well as other external borrowing will be provided to the IMF monthly by the Debt Unit at the MOF (specifying projects by creditor) within two weeks of the end of each month.
- Data will be provided at the actual exchange rates.
- Data on privatization receipts of the general government will be provided by the Treasury Department of the MOF to the IMF on a monthly basis within two weeks of the end of each month.
- Data on securitized debt sold by the NBG, including the securities that have been purchased by nonbanks, will be reported by the NBG on a monthly basis within two weeks of the end of each month.

## C. Ceiling on the Cash Deficit of the Partnership Fund

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

11. The PF's revenues comprise the dividends from its assets and investments, the interest earnings from the loans it provides, the fees it charges for the services and guarantees it provides, and any other income earned from its assets.

12. The PF's expenditures comprise all current and capital expenditures. Current expenditures comprise compensation of employees, use of goods and services, transfers to other entities, other account payables and domestic and external interest payments. Capital expenditures will comprise the net acquisition of nonfinancial assets, as defined under GFSM 2011. The PF's purchases of financial assets (e.g. lending and equity participations) will not be considered part of its expenditures.

13. **Supporting Material:** The MoF will provide to the IMF detailed information on the PF's quarterly revenue, expenditures, and financial operations within four weeks of the end of each quarter.

## D. Floor on the Net International Reserves of the NBG

14. **Definition:** Net international reserves (NIR) of the NBG in U.S. dollars are defined as foreign assets of the NBG minus the sum of foreign liabilities of the NBG. Foreign assets of the NBG include gold, gross foreign exchange reserves, Georgia's SDR holdings, and the reserve position in the IMF. Gross foreign exchange reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents, including cash holdings of foreign exchange that are readily available. Pledged or otherwise encumbered assets, including (but not limited to) assets used as collateral (or guarantee for third party external liabilities) are excluded from foreign assets. Foreign liabilities of the NBG shall be defined as the sum of Georgia's outstanding liabilities to the IMF (at face value), Georgia's SDR allocation, and any other liabilities of the NBG (including foreign currency deposits of financial institutions at the NBG and currency swaps and foreign exchange forward contracts with financial institutions), excluding the foreign exchange balances in the government's account with the NBG. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the NBG shall be valued at program exchange rates as described in paragraph 2 above. The stock of NIR amounted to $1,152 million as of December 31, 2011 (at the program exchange rate).

15. **Adjustors:** The floor on the NIR of the NBG will be adjusted:

- Upward/downward by 50 percent for any excess/shortfall in the balance of payments support loans and balance of payments support grants relative to the projected amounts presented in Table 3.
- Upward/downward by 50 percent for any excess/shortfall in the disbursements of the project loans and project grants to the Treasury Single account at the NBG relative to the projected amounts presented in Table 3.

16. **Supporting Material:** Data on net international reserves (both at actual and program exchange rates); net foreign financing (balance of payments support loans, cash grants to the general government, amortization (excluding repayments to the IMF), interest payments on external debt by the MOF and the NBG); conversions for government imports and transfers of receipts from the Sovereign Wealth Funds will be provided to the IMF in a foreign exchange cash flow table (which include details of inflows, outflows, and net international reserves) on a weekly basis within three working days following the end of the week.

## E. Ceiling on Net Domestic Assets of the NBG

17. **Definition:** Net domestic assets of the NBG are defined as the difference between reserve money and NIR as defined above in paragraph 14. Therefore, the ceiling on NDA is defined as projected reserve money (as defined in Table 4) minus the target NIR.

18. **Adjustors:** The ceiling on the NDA of the NBG will be adjusted:

- Upward/downward by 50 percent for any shortfall/excess in the balance of payments support loans and balance of payments support grants relative to the projected amounts presented in Table 3.

- Upward/downward by 50 percent for any shortfall/excess in the disbursements of the project loans and project grants to the Treasury Single account at the NBG relative to the projected amounts presented in Table 3.

19. **Supporting Material**: The NBG will provide to the IMF its balance sheet, which includes data on reserve money and net domestic assets on a weekly basis within three working days following the end of the week. Data will be provided using both actual and program exchange rates.

## F. Ceiling on Contracting or Guaranteeing of New External Debt by the Public Sector

20. **Definition:** External debt is defined as set forth in point No. 9 of the Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009 (Decision No. 14416-(09/91)).[1] External

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

debt is defined as debt contracted by the public sector with nonresidents other than the IMF. Previously disbursed external debt that has been rescheduled will be excluded from the definition of "new debt" for the purposes of this performance criterion.

21. **Supporting Material:** Details of all new contracted debt and government guarantees for external borrowing, with detailed explanations, will be provided by the MOF to the IMF on a quarterly basis within thirty days of the end of each quarter. Data will be provided using actual exchange rates.

## G. Continuous Performance Criterion on Accumulation of External Arrears

22. **Definition:** External arrears are defined as unpaid debt service by the public sector to official and private creditors beyond 30 days after the due date.

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

| Table 1. Program Exchange Rates | | |
|---|---|---|
| | **Currency Name** | **Currency/US$** |
| SDR | Special Drawing Rights | 0.65 |
| GEL | Georgian lari | 1.67 |
| EUR | Euro | 0.77 |

| Table 2. Projected On-Lending by the Government of the Disbursements of the Black Sea Transmission Network Project Loans 1/ (In millions of lari) | |
|---|---|
| | On-Lending by the Government of the Disbursements of the Black Sea Transmission Network Project Loans |
| June 30, 2012 | 50.9 |
| December 31, 2012 | 151.8 |

1/ Cumulative from the beginning of the calendar year.

| Table 3. Projected Balance of Payments Support Financing 1/ (In millions of U.S. dollars) | | |
|---|---|---|
| | Balance of payments support loans and balance of payments support grants | Project loans and project grants |
| June 30, 2012 | 0.0 | 109.2 |
| December 31, 2012 | 85.4 | 234.0 |

1/ Cumulative from the beginning of the calendar year.

| Table 4. Projected Reserve Money (End-of-period stock, in millions of lari) | |
|---|---|
| June 30, 2012 | 1,963.0 |
| December 31, 2012 | 2,235.4 |

INTERNATIONAL MONETARY FUND

# GEORGIA

March 27, 2012

## REQUEST FOR STAND-BY ARRANGEMENT AND AN ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY—INFORMATIONAL ANNEX

Prepared By

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

## CONTENTS

# ANNEX I. RELATIONS WITH THE FUND

(As of February 29, 2012)

## 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 | 707.19 | 470.52 |
| Reserve Tranche Position | 0.01 | 0.01 |

## SDR Department

| | SDR Million | Percent Allocation |
|---|---|---|
| Net Cumulative Allocation | 143.96 | 100.00 |
| Holdings | 144.01 | 100.04 |

## Outstanding Purchases and Loans

| | SDR Million | Percent of Quota |
|---|---|---|
| Stand-By Arrangements | 556.89 | 370.52 |
| ECF Arrangements | 82.05 | 54.59 |

## Latest Financial Arrangements

| Type | Approval Date | Expiration Date | Amount Approved (SDR Million) | Amount Drawn (SDR Million) |
|---|---|---|---|---|
| Stand-By | Sept. 15, 2008 | June 14, 2011 | 747.10 | 577.10 |
| ECF [1] | July 4, 2004 | Sept. 30, 2007 | 98.00 | 98.00 |
| ECF [1] | Jan. 12, 2001 | Jan. 11, 2004 | 108.00 | 49.50 |

## Projected Payments to the Fund

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

| | Forthcoming | | | | |
|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 |
| Principal | 154.85 | 251.11 | 166.75 | 52.23 | 9.8 |
| Charges/Interest | 5.50 | 4.22 | 1.67 | 0.24 | 0.02 |
| **Total** | **160.35** | **255.34** | **168.42** | **52.47** | **9.82** |

## 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.

[1] Formerly PRGF.

### Exchange Arrangements

From 1993 to 2009, the National Bank of Georgia conducted foreign exchange market interventions through daily fixing sessions at the Tbilisi Interbank Currency Exchange (TICEX). A temporary de facto exchange rate peg to the U.S. dollar was introduced in the wake of the early August 2008 armed conflict. During the second week of November 2008, the authorities allowed a 17 percent depreciation of the lari. In March 2009, the authorities introduced an auction-based system for the foreign exchange market. This mechanism was intended to allow more flexibility and give market forces a greater role in setting the price, with a view to reaching faster and smoother convergence toward equilibrium in the foreign exchange market and giving the market greater clarity about the authorities' policies. At end-May 2009, the authorities officially ended foreign exchange market interventions on TICEX. The exchange rate arrangement of Georgia is classified as floating.

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 National Bank of Georgia (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 gives rise to a multiple currency practice. In practice, the official and market rates have never differed by more than 2 percent since the introduction of foreign exchange auctions in March 2009. The NBG and the Ministry of Finance are considering moving to a system whereby the government would conduct a single foreign exchange transaction with the NBG at the end the day, at that days' market price, calculated as the average rate of that day's market transactions. This system would eliminate the multiple currency practice. The NBG and the Ministry of Finance are evaluating all the necessary procedural changes needed to move to such a system. They expect that the transition could be completed in a few months.

### 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 sixth resident representative, Mr. Edward Gardner, took up his post on March 15, 2009.

### 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, 2007–11 | | | |
|---|---|---|---|
| Subject | Type of Mission | Timing | Counterpart |
| **Fiscal Affairs Department (FAD)** | | | |
| Tax Administration | Follow-up mission | Jan. 17–30, 2007 | Ministry of Finance |
| Tax Administration | Expert assistance (Woodley) | Jan/Feb and Apr/May 2008 | Ministry of Finance |
| Budget Classification and Accounting Reforms | Expert assistance (Swarap) | Jun. 11-22, 2007 | Ministry of Finance |
| Budget Classification and Accounting Reforms | Expert assistance (Swarap) | Jun. 11-22, 2007 | 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 |
| **Monetary and Capital Markets Department (MCM)** | | | |
| Monetary Operations/Monetary Policy/Foreign Exchange | Advisory | Feb. 16–Mar. 2, 2007 | National Bank of Georgia |
| Consolidated Supervision | Advisory | Dec. 4–14, 2007 | National Bank of Georgia |
| Lender of Last Resort Framework | Advisory | Dec. 11-17, 2008 | National Bank of Georgia |
| Stress Testing and Foreign Exchange Market | Advisory | Apr. 21-30, 2009 | Financial Supervisory Agency; National Bank of Georgia |
| 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)** | | | |
| Balance of Payments | Follow-up assistance | Jul. 9-20, 2007 | National Bank of Georgia |
| Monetary and Financial Statistics | Advisory | Mar. 18-31, 2009 | National Bank of Georgia |
| 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 |
| **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 |

# ANNEX II. RELATIONS WITH THE WORLD BANK

(As of March 15, 2012)

| Title | Product | Tentative Timing of Mission | Expected Delivery of Report |
|---|---|---|---|
| **Bank** | *Operations* | | |
| | New DPO program to support reforms to sustain growth, promote job creation, strengthen social safety nets, and deepen public financial management reforms. | March–June 2012 | Second half of 2012 |
| | 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 | December 2012 |
| | Programmatic PER | Quarterly | May 2012 |
| | Programmatic Poverty Assessment | Periodic | Periodic |
| **Fund** | *Missions and Technical Assistance* | | |
| | TA Strengthening the Partnership Fund's institutional framework | April 25–May 2, 2012 | June 2012 |
| | 1st review under the SBA/SCF blend | August 15–28, 2012 | Sept. 6, 2012 (draft) |
| | Staff visit on 2013 budget and macroeconomic framework update | October 17-25, 2012 | Oct. 31, 2012 (draft) |
| | 2nd review under the SBA/SCF blend | February 6-19, 2013 | March 1, 2013 (draft) |
| | TA: follow-up mission on program budgeting | FY 2013 | FY 2013 |
| | TA: Improving national account and external sector statistics | FY 2013 | FY 2013 |
| | TA: Strengthening tax administration | FY 2013 | FY 2013 |
| | TA: building a framework for business continuity/contingency planning for the central bank | FY 2013 | FY 2013 |
| **Joint Bank-Fund** | Joint Debt Sustainability Analysis | Ongoing collaboration | April 2013 |

# ANNEX III. RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

(As of March 12, 2012)

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-2011, the Bank had signed 187 investments in Georgia with the cumulative commitment totaling €1.6 billion. Its outstanding portfolio stood at €681 million. One half of the portfolio is in the financial sector, one third—in the energy sector, with the corporate sector and infrastructure accounting for 13 and 5 percent respectively. The ratio of private sector projects in the portfolio currently stands at 82 percent. The Bank gives preference to non-sovereign operations. Where sovereign guarantees are required, donor co-funding on a grant basis is sought.

After Georgia stabilized from the dual security and financial crisis of 2008–9, the EBRD has focused its operations on the infrastructure and energy sectors. In 2010, the Bank signed several large projects, including a sovereign guaranteed loan to finance the Black Sea Transmission Line (€80 million), the second stage of the rehabilitation of the Enghuri hydro power plant (€20 million) as well as a berth rehabilitation project at the Poti port (€8 million) and Adjara solid waste landfill project (€3 million). In 2011, the Bank invested $5 million in the equity of an independent power producer (Paravani) and participated in a syndicated loan ($52 million) to the company. The various energy sector projects are helping transform Georgia into an energy exporter.

The Bank has pursued a number of smaller projects in the financial and industrial sectors. In 2010, it increased equity investment in Bank Republic and provided SME credit lines to TBC Bank and Bank of Georgia (€5.6 million and €15 million, respectively). It enhanced its Medium-sized Co-Financing Facility (MCFF) and signed four sub-projects in the manufacturing, agriculture and health sectors (totaling €16 million). MCFF has been working successfully for several years. The Bank also expanded its efforts in promoting the Energy Efficiency Initiative by providing €3.7 million facility to Bank of Georgia for on-lending to residential and industrial borrowers. In 2011, the Bank launched Georgian Agriculture Financing Facility (GAFF), a €40 million framework providing credit lines to local commercial banks, non-bank microfinance institutions and leasing companies for on-lending to farmers and other agricultural entities. Credit lines, extended in lari to Bank of Georgia, TBC Bank and ProCredit Bank Georgia and in US dollars to VTB, have fomented Georgian banks' focus on longer-term lari financing and the agricultural sector. Several banks are establishing agricultural financing units.

Georgia is part of the '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.

Going forward, the EBRD will:

- 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.
- Actively pursue viable renewable energy projects, in line with the authorities' strategy of developing the country's largely untapped hydro electricity potential.
- Invest in the development and modernization of the food distribution sector.
- Support policy and regulatory developments in the Georgian telecoms and communications sector in order to accelerate investments in the essential infrastructure and to enable a more comprehensive access to modern communications services, including in the more remote areas of the country.

# ANNEX IV. STATISTICAL ISSUES

Data provision to the Fund is broadly adequate for surveillance, but there appears to be some room for improving the compilation and dissemination of price, national accounts, and external sector statistics. Georgia has embarked on the transition to inflation targeting as a strategic policy to keep inflation under control. The MCD team indicated that 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. All macroeconomic statistics broadly follow international methodological standards and dissemination standards. Further improvements are required in: the methodology for national accounts, price and external sector statistics, source data for national accounts and price statistics, and metadata for most 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 data to annual estimates. Volume measures of GDP by the expenditure approach are not compiled. 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 an important progress achieved in the development of agricultural price indices, an 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 2011 ROSC mission found that the NBG had implemented many of the recommendations of the 2009 monetary and financial statistics mission. It also found that most elements in the data quality assessment framework for monetary statistics were fully or largely observed in accordance to international standards. However, it recommended that improvement on data accuracy be made in the classification of financial instruments and the application of accrual accounting principle. Accordingly, the NBG has already implemented these recommendations and submitted the revised information to STA. The NBG compiles monetary data using the framework of the STA's Standardized Report Forms (SRF). Data are provided on a regular basis and published 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 sectorization of Legal Entities of Public Law (LEPLs) and securities are not recorded at market value in central government debt. Annual and monthly government finance statistics (GFS) compiled on a cash basis in accordance with the methodology of the GFSM 2001 is reported to STA for publication in the GFS Yearbook and International Financial Statistics, 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 Payment 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 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 non-financial external debt compilation program. For the balance of payments, statistical techniques are adequate, except for the calculation of the c.i.f./f.o.b. adjustment to imports which should be further improved.

| Georgia: Technical Assistance Missions Delivered by STA, 2005–11 | | | |
|---|---|---|---|
| **No.** | **Topic** | **Dates** | **Duration** |
| **Data Dissemination Standards** | | | |
| 1 | GDDS: Metadata development mission | November 8-23, 2006 | 2 weeks |
| 2 | SDDS Assessment mission | October 21-November 3, 2009 | 2 weeks |
| 3 | Assessment/Evaluation of TA program (Georgia and Albania) | July 7-16, 2010 | 1 week |
| **National Accounts** | | | |
| 1 | National Accounts mission | April 18-29, 2005 | 2 weeks |
| **Price Statistics** | | | |
| 1 | Consumer Price/Producer Price Statistics mission | May 23-June 3, 2005 | 2 weeks |
| 2 | Producer Price Statistics mission | May 29-June 13, 2006 | 2 weeks |
| 3 | Producer Price Statistics mission | August 27-September 7, 2007 | 2 weeks |
| **External Sector Statistics** | | | |
| 1 | Balance of Payments Statistics mission | June 15-28, 2005 | 2 weeks |
| 2 | Balance of Payments Statistics mission | September 6-19, 2006 | 2weeks |
| 3 | External Sector Statistics Regional advisor | April 23-May 4, 2007 | 2 weeks |
| 4 | External Sector Statistics Regional advisor | July 9-20, 2007 | 2 weeks |
| 5 | External Sector Statistics Regional advisor | October 1-12, 2007 | 2 weeks |
| 6 | External Sector Statistics Regional advisor | April 14-25, 2008 | 2 weeks |
| 7 | External Sector Statistics Regional advisor | July 15-25, 2008 | 2 weeks |
| 8 | External Sector Statistics Regional advisor | October 20-31, 2008 | 2 weeks |
| 9 | Balance of Payments Statistics mission | October 4-15, 2010 | 2 weeks |
| **Monetary and Financial Statistics** | | | |
| 1 | Monetary and Financial Statistics mission | March 18-31, 2009 | 2 weeks |
| **Government Finance Statistics** | | | |
| 1 | Government Finance Statistics mission | November 8-21, 2006 | 2 weeks |

**Georgia: Table of Common Indicators Required for Surveillance**

**(As of March 16, 2012)**

| | 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 | 03/17/12 | 03/16/12 | D | D | D | | |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1] | Jan. 2012 | 02/09/12 | D | D | M | | |
| Reserve/Base Money | Dec. 2011 | 01/30/12 | D | D | M | O, O, LO, O | LO,O,O,O,O |
| Broad Money | Dec. 2011 | 01/30/12 | D | D | M | | |
| Central Bank Balance Sheet | Dec. 2011 | 01/30/12 | D | D | M | | |
| Consolidated Balance Sheet of the Banking System | Dec. 2011 | 01/30/12 | M | M | M | | |
| Interest Rates[2] | 03/15/12 | 03/16/12 | D | D | D | | |
| Consumer Price Index | Feb. 2012 | 03/14/12 | M | M | M | O,LO,O,O | LO,O,LO,O,O |
| Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4] | Dec. 2011 | 02/15/12 | M | M | M | O,O,LO,LO | O,O,O,O,O |
| Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government | Dec. 2011 | 02/15/12 | 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 | Q3 2011 | 01/04/12 | Q | Q | Q | O,O,O,O | LO, O, LO ,O, LO |
| Exports and Imports of Goods and Services | Q3 2011 | 01/04/12 | Q | Q | Q | | |
| GDP/GNP | Q3 2011 | 01/13/12 | 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] | Q3/11 | 01/13/12 | A | A | A | | |

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

[8] Reflects the assessment provided in the data ROSC (published on 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.

# GEORGIA

April 10, 2012

## REQUEST FOR STAND-BY ARRANGEMENT AND AN ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY—SUPPLEMENTARY INFORMATION

Prepared By

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

*This supplement provides an update on recent developments. It does not alter the thrust of the staff appraisal*

1. The authorities have released new data for the 2009–11 current accounts and an official estimate for external private debt as of end-2011. These revisions do not alter the policy assessment of the staff report.

2. As concerns the current account, private inflows that had previously been classified as unidentified financial inflows have been reclassified as income from Georgian private direct investments abroad. This improves the current account deficit by 0.9 percent of GDP in 2011 and by 0.5 percent of GDP by 2017.

3. At the same time, private external debt for end-2011 has been revised up by $694 million (4.8 percent of GDP), reflecting a mix of corrections and updates.

4. These revisions (to the current account and external debt) have offsetting effects as illustrated in the updated external debt sustainability analysis (DSA). Whereas the initial stock of external debt is now higher, the lower net external financing need going forward implies that the external debt ratio declines at a faster pace, and by 2017 it is roughly where it was under the previous DSA. The response of external debt to the standardized shocks is virtually unchanged.

## Table 1. Georgia: Selected Macroeconomic Indicators, 2009–17

| | 2009 Act. | 2010 Act. | 2011 Est. | 2012 Proj. | 2013 Proj. | 2014 Proj. | 2015 Proj. | 2016 Proj. | 2017 Proj. |
|---|---|---|---|---|---|---|---|---|---|
| National accounts | | | | | | | | | |
| Nominal GDP (in million lari) | 17,986 | 20,743 | 24,137 | 26,738 | 29,901 | 33,446 | 37,403 | 41,828 | 46,776 |
| Real GDP growth | -3.8 | 6.3 | 6.8 | 6.0 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 |
| Population (in million) 1/ | 4.4 | 4.4 | 4.5 | 4.4 | 4.4 | 4.4 | 4.4 | 4.3 | 4.3 |
| GDP deflator, period average | -2.0 | 8.5 | 9.0 | 4.5 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 |
| Consumer price index, period average | 1.7 | 7.1 | 8.5 | 1.7 | 5.5 | 6.0 | 6.0 | 6.0 | 6.0 |
| Consumer price index, end-of-period | 3.0 | 11.2 | 2.0 | 5.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 |
| GDP per capita (in US$) | 2,455 | 2,623 | 3,198 | 3,583 | 3,894 | 4,159 | 4,548 | 5,064 | 5,645 |
| Unemployment rate (in percent) | 16.9 | 16.3 | ... | ... | ... | ... | ... | ... | ... |
| Investment and saving | | | | | | | | | |
| Investment | 13.0 | 21.6 | 23.3 | 23.0 | 23.0 | 23.0 | 23.0 | 23.0 | 23.0 |
| Public | 8.0 | 8.2 | 7.7 | 7.5 | 7.4 | 7.3 | 7.0 | 6.9 | 6.8 |
| Private | 5.0 | 13.4 | 15.5 | 15.5 | 15.6 | 15.7 | 16.0 | 16.2 | 16.2 |
| Gross national saving | 2.4 | 11.3 | 11.5 | 13.3 | 14.1 | 15.4 | 16.6 | 16.7 | 16.9 |
| Public | -0.8 | 2.3 | 5.2 | 4.9 | 5.0 | 5.0 | 5.1 | 5.5 | 5.6 |
| Private | 3.2 | 9.1 | 6.3 | 8.4 | 9.1 | 10.4 | 11.5 | 11.3 | 11.3 |
| Saving-investment balance | -10.6 | -10.3 | -11.8 | -9.7 | -8.9 | -7.6 | -6.4 | -6.3 | -6.2 |
| Consolidated government operations | | | | | | | | | |
| Total government debt | 37.3 | 39.2 | 34.0 | 32.9 | 31.7 | 30.7 | 29.5 | 28.2 | 26.4 |
| *Of which*: foreign-currency denominated | 31.7 | 33.6 | 29.1 | 27.8 | 26.0 | 24.7 | 23.3 | 21.9 | 20.2 |
| Revenue 2/ | 29.3 | 28.3 | 28.5 | 27.4 | 27.3 | 27.1 | 26.9 | 26.8 | 26.7 |
| Current expenditures | 30.1 | 26.0 | 23.3 | 22.5 | 22.3 | 22.1 | 21.8 | 21.3 | 21.1 |
| Operating balance | -0.8 | 2.3 | 5.2 | 4.9 | 5.0 | 5.0 | 5.1 | 5.5 | 5.6 |
| Capital spending and net lending | 8.4 | 8.8 | 8.9 | 8.4 | 8.0 | 7.6 | 7.2 | 6.9 | 6.8 |
| Overall balance | -9.2 | -6.6 | -3.6 | -3.5 | -3.0 | -2.7 | -2.1 | -1.5 | -1.3 |
| Total financing | 9.2 | 6.6 | 3.6 | 3.5 | 3.0 | 2.7 | 2.1 | 1.5 | 1.3 |
| Domestic | 3.3 | 0.0 | -0.2 | -0.1 | 1.7 | 1.7 | 0.8 | 0.5 | 0.8 |
| External | 3.9 | 5.6 | 2.3 | 3.1 | 1.1 | 0.7 | 1.1 | 0.9 | 0.4 |
| Privatization receipts | 2.0 | 1.1 | 1.6 | 0.5 | 0.2 | 0.2 | 0.2 | 0.0 | 0.0 |
| Monetary sector | | | | | | | | | |
| Reserve money | 21.8 | 4.5 | 17.4 | 4.5 | 7.0 | 8.5 | 9.0 | 9.0 | 9.0 |
| Broad money (including fx deposits) 3/ | 8.1 | 28.5 | 22.6 | 22.0 | 22.0 | 20.0 | 20.0 | 20.0 | 20.0 |
| Bank credit to the private sector | -13.5 | 20.5 | 23.0 | 24.4 | 20.3 | 16.6 | 18.7 | 17.3 | 18.7 |
| Deposit interest rate (annual average) | 10.0 | 8.9 | 8.4 | ... | ... | ... | ... | ... | ... |
| Lending interest rate (annual average) | 19.3 | 18.6 | 17.1 | ... | ... | ... | ... | ... | ... |
| External sector | | | | | | | | | |
| Exports of goods and services (percent of GDP) | 29.8 | 34.9 | 36.6 | 34.2 | 33.9 | 34.3 | 34.5 | 33.3 | 32.3 |
| Annual percentage change | -13.0 | 26.6 | 28.9 | 3.9 | 7.2 | 7.4 | 9.4 | 6.8 | 7.2 |
| Imports of goods and services (percent of GDP) | 48.9 | 52.7 | 55.4 | 50.9 | 49.0 | 47.7 | 46.2 | 44.5 | 42.7 |
| Annual percentage change | -29.8 | 16.4 | 29.1 | 2.5 | 4.0 | 3.2 | 5.4 | 6.4 | 6.4 |
| Net imports of oil (in US$) | 555 | 695 | 911 | 971 | 970 | 961 | 977 | 1007 | 1046 |
| Current account balance (in millions of US$) | -1,144 | -1,197 | -1,682 | -1,551 | -1,526 | -1,394 | -1,266 | -1,379 | -1,495 |
| In percent of GDP | -10.6 | -10.3 | -11.8 | -9.7 | -8.9 | -7.6 | -6.4 | -6.3 | -6.2 |
| Gross international reserves (in millions of US$) | 2,111 | 2,265 | 2,818 | 2,734 | 2,528 | 2,590 | 2,752 | 3,161 | 3,456 |
| In months of next year's imports of goods and services | 4.1 | 3.4 | 4.2 | 3.9 | 3.5 | 3.4 | 3.4 | 3.7 | 3.7 |
| Foreign direct investment (percent of GDP) | 6.1 | 7.0 | 6.8 | 6.1 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 |
| Average exchange rate (lari per US$) | 1.67 | 1.78 | 1.69 | ... | ... | ... | ... | ... | ... |

Sources: Georgian authorities; and Fund 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, 2009–17
(In millions of U.S. dollars)

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Act. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| Current account balance | -1,144 | -1,197 | -1,682 | -1,551 | -1,526 | -1,394 | -1,266 | -1,379 | -1,495 |
| Trade balance | -2,400 | -2,586 | -3,408 | -3,551 | -3,609 | -3,574 | -3,558 | -3,824 | -4,127 |
| Exports | 1,894 | 2,462 | 3,254 | 3,251 | 3,500 | 3,778 | 4,165 | 4,447 | 4,768 |
| Imports | -4,293 | -5,048 | -6,663 | -6,802 | -7,108 | -7,351 | -7,723 | -8,271 | -8,895 |
| Services | 340 | 513 | 726 | 881 | 1,004 | 1,133 | 1,236 | 1,386 | 1,587 |
| Services: credit | 1,314 | 1,599 | 1,980 | 2,190 | 2,330 | 2,485 | 2,684 | 2,871 | 3,077 |
| Services: debit | -974 | -1,085 | -1,253 | -1,309 | -1,326 | -1,351 | -1,449 | -1,485 | -1,490 |
| Income (net) | -51 | -222 | -302 | -324 | -354 | -400 | -441 | -502 | -588 |
| *Of which* : interest payments | -248 | -257 | -309 | -316 | -318 | -341 | -348 | -370 | -398 |
| Transfers (net) | 968 | 1,098 | 1,302 | 1,443 | 1,432 | 1,447 | 1,498 | 1,562 | 1,633 |
| *Of which* : public sector | 141 | 174 | 134 | 112 | 62 | 25 | 12 | 7 | 2 |
| Capital account | 183 | 206 | 151 | 113 | 103 | 86 | 72 | 61 | 52 |
| General government | 170 | 189 | 136 | 100 | 90 | 72 | 57 | 46 | 37 |
| Other sectors | 13 | 17 | 15 | 13 | 14 | 14 | 15 | 15 | 15 |
| Financial account | 1,361 | 976 | 2,065 | 1,599 | 1,601 | 1,624 | 1,435 | 1,741 | 1,745 |
| Direct investment (net) | 677 | 682 | 828 | 964 | 1,032 | 1,095 | 1,190 | 1,317 | 1,458 |
| Monetary authorities, net 1/ | 247 | 0 | 2 | 0 | 0 | 0 | 0 | 0 | 0 |
| General government | 386 | 336 | 301 | 452 | 329 | 318 | 268 | 200 | 106 |
| Portfolio investment (net) | 0 | 0 | 26 | 0 | -65 | 0 | 0 | 0 | 0 |
| Long-term loans received | 359 | 335 | 274 | 442 | 394 | 318 | 268 | 200 | 106 |
| Drawing | 428 | 403 | 340 | 500 | 447 | 403 | 379 | 339 | 276 |
| Repayment | -69 | -67 | -66 | -58 | -53 | -85 | -112 | -139 | -169 |
| Other, net | 27 | 1 | 1 | 10 | 0 | 0 | 0 | 0 | 0 |
| Private Sector, excl. FDI | 52 | -41 | 934 | 183 | 240 | 211 | -22 | 224 | 181 |
| Banks | -65 | -212 | 779 | 102 | 206 | 191 | 203 | 225 | 215 |
| Portfolio investment, net | 8 | -10 | 89 | -27 | 10 | 2 | 12 | 3 | 3 |
| *Of which* : equity liabilities | 8 | -22 | -7 | 8 | 10 | 12 | 13 | 14 | 15 |
| Loans received (net) | -243 | 18 | 157 | 73 | 133 | 124 | 124 | 154 | 152 |
| Long-term loans | 8 | 7 | -1 | 47 | 100 | 89 | 93 | 120 | 117 |
| Drawing | 324 | 164 | 268 | 345 | 409 | 437 | 463 | 473 | 504 |
| Repayment | -317 | -157 | -269 | -299 | -309 | -348 | -369 | -353 | -388 |
| Short-term loans | -251 | 11 | 158 | 26 | 33 | 35 | 31 | 34 | 36 |
| Other, net (currency and deposits) | 171 | -220 | 533 | 57 | 63 | 64 | 66 | 68 | 60 |
| Other sectors | 116 | 171 | 155 | 80 | 35 | 21 | -225 | -1 | -34 |
| Portfolio investment, net | 4 | 262 | 1 | 0 | 0 | 0 | -261 | 0 | 0 |
| Long-term loans received (net) | 152 | 31 | 240 | 130 | 75 | 51 | 56 | 9 | -34 |
| Drawing | 249 | 237 | 418 | 297 | 284 | 275 | 286 | 240 | 224 |
| Repayment | -97 | -206 | -179 | -167 | -209 | -225 | -230 | -231 | -258 |
| Other, net | -40 | -122 | -86 | -50 | -40 | -30 | -20 | -10 | 0 |
| Errors and omissions | 52 | -17 | -22 | 0 | 0 | 0 | 0 | 0 | 0 |
| Overall balance | 451 | -31 | 512 | 161 | 178 | 317 | 242 | 424 | 301 |
| Financing | -451 | 31 | -512 | -161 | -178 | -317 | -242 | -424 | -301 |
| Gross International Reserves (-increase) | -616 | -208 | -572 | 84 | 206 | -61 | -162 | -409 | -295 |
| Use of Fund Resources | 313 | 276 | -59 | -245 | -384 | -255 | -80 | -15 | -6 |
| Purchases (SBA) | 340 | 297 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Repayments (SBA and ECF 2/) | -28 | -22 | -59 | -245 | -384 | -255 | -80 | -15 | -6 |
| Exceptional financing | -147 | -37 | 119 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Memorandum items:** | | | | | | | | | |
| Nominal GDP | 10,768 | 11,638 | 14,293 | 15,922 | 17,198 | 18,256 | 19,836 | 21,944 | 24,293 |
| Current account balance (percent of GDP) | -10.6 | -10.3 | -11.8 | -9.7 | -8.9 | -7.6 | -6.4 | -6.3 | -6.2 |
| excluding official transfers (percent of GDP) | -11.9 | -11.8 | -12.7 | -10.4 | -9.2 | -7.8 | -6.4 | -6.3 | -6.2 |
| Trade balance (in percent of GDP) | -22.3 | -22.2 | -23.8 | -22.3 | -21.0 | -19.6 | -17.9 | -17.4 | -17.0 |
| GNFS exports growth (percent) | -13.0 | 26.6 | 28.9 | 3.9 | 7.2 | 7.4 | 9.4 | 6.8 | 7.2 |
| GNFS exports volume growth (percent) | -0.9 | 7.2 | 11.8 | 5.5 | 6.8 | 8.5 | 8.8 | 5.1 | 5.2 |
| GNFS imports growth (percent) | -29.8 | 16.4 | 29.1 | 2.5 | 4.0 | 3.2 | 5.4 | 6.4 | 6.4 |
| GNFS imports volume growth (percent) | -18.8 | 0.8 | 9.1 | 7.1 | 4.7 | 5.3 | 7.1 | 7.2 | 7.0 |
| Net capital inflows to private sector | 729 | 640 | 1,762 | 1,147 | 1,272 | 1,307 | 1,168 | 1,541 | 1,639 |
| (in percent of GDP) | 6.8 | 5.5 | 12.3 | 7.2 | 7.4 | 7.2 | 5.9 | 7.0 | 6.7 |
| Gross international reserves (end of period) | 2,111 | 2,265 | 2,818 | 2,734 | 2,528 | 2,590 | 2,752 | 3,161 | 3,456 |
| (in months of next year GNFS imports) | 4.1 | 3.4 | 4.2 | 3.9 | 3.5 | 3.4 | 3.4 | 3.7 | 3.7 |
| External debt (nominal) 3/ | 6,246 | 7,223 | 8,310 | 8,685 | 8,866 | 9,144 | 9,315 | 9,730 | 10,027 |
| (in percent of GDP) | 58.0 | 62.1 | 58.1 | 54.5 | 51.6 | 50.1 | 47.0 | 44.3 | 41.3 |
| MLT External debt service | 759 | 709 | 863 | 1,059 | 1,312 | 1,224 | 1,108 | 1,074 | 1,183 |
| (in percent of exports) | 23.7 | 17.5 | 16.5 | 19.5 | 22.5 | 19.5 | 16.2 | 14.7 | 15.1 |
| External public sector debt (nominal) 4/ | 3,382 | 3,937 | 4,201 | 4,404 | 4,348 | 4,409 | 4,597 | 4,782 | 4,882 |
| External public debt service 4/ | 169 | 168 | 214 | 424 | 599 | 436 | 291 | 257 | 283 |
| (in percent of exports) | 5.3 | 4.1 | 4.1 | 7.8 | 10.3 | 7.0 | 4.2 | 3.5 | 3.6 |

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

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

2/ Following the Low Income Countries (LIC) reforms, effective January 7 2010, the PRGF arrangements were renamed Extended Credit Facility (ECF) arrangements.

3/ Excludes intercompany loans.

4/ Excludes SOEs.

## Table 3. Georgia: External Debt Sustainability Framework, 2007–17

(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Debt-stabilizing non-interest current account 7/ |
| 1 **Baseline: External debt 1/** | 38.5 | 44.0 | 58.0 | 62.1 | 58.1 | **54.5** | **51.6** | **50.1** | **47.0** | **44.3** | **41.3** | **-8.2** |
| 2 Change in external debt | 0.7 | 5.5 | 14.0 | 4.1 | -3.9 | -3.6 | -3.0 | -1.5 | -3.1 | -2.6 | -3.1 | |
| 3 Identified external debt-creating flows (4+8+9) | -6.1 | 2.1 | 12.8 | 0.3 | -5.5 | 0.5 | 0.0 | -1.1 | -2.2 | -2.1 | -2.1 | |
| 4 Current account deficit, excluding interest payments | 18.2 | 19.7 | 7.7 | 7.5 | 9.2 | 7.2 | 6.5 | 5.3 | 4.2 | 4.2 | 4.1 | |
| 5 Deficit in balance of goods and services | 26.7 | 29.6 | 19.1 | 17.8 | 18.8 | 16.8 | 15.1 | 13.4 | 11.7 | 11.1 | 10.5 | |
| 6 Exports | 31.1 | 28.7 | 29.8 | 34.9 | 36.6 | 34.2 | 33.9 | 34.3 | 34.5 | 33.3 | 32.3 | |
| 7 Imports | 57.9 | 58.3 | 48.9 | 52.7 | 55.4 | 50.9 | 49.0 | 47.7 | 46.2 | 44.5 | 42.7 | |
| 8 Net non-debt creating capital inflows (negative) | -16.7 | -11.9 | -6.4 | -5.7 | -5.7 | -6.1 | -6.1 | -6.1 | -6.1 | -6.1 | -6.1 | |
| 9 Automatic debt dynamics 2/ | -7.6 | -5.7 | 11.6 | -1.6 | -8.9 | -0.6 | -0.4 | -0.3 | -0.3 | -0.2 | -0.1 | |
| 10 Contribution from nominal interest rate | 1.5 | 2.3 | 3.0 | 2.8 | 2.6 | 2.5 | 2.4 | 2.4 | 2.2 | 2.1 | 2.1 | |
| 11 Contribution from real GDP growth | -3.5 | -0.7 | 2.0 | -3.4 | -3.4 | -3.1 | -2.8 | -2.7 | -2.5 | -2.3 | -2.2 | |
| 12 Contribution from price and exchange rate changes 3/ | -5.5 | -7.2 | 6.6 | -1.0 | -8.1 | … | … | … | … | … | … | |
| 13 Residual, incl. change in gross foreign assets (2-3) 4/ | 6.8 | 3.4 | 1.2 | 3.8 | 1.6 | -4.1 | -3.0 | -0.3 | -0.9 | -0.5 | -1.0 | |
| External debt-to-exports ratio (in percent) | 123.7 | 153.6 | 194.7 | 177.9 | 158.8 | 159.6 | 152.1 | 146.0 | 136.0 | 133.0 | 127.8 | |
| **Gross external financing need (in billions of US dollars) 5/** | 2.7 | 3.8 | 2.6 | 2.5 | 3.3 | 3.8 | 4.1 | 3.9 | 3.7 | 3.9 | 4.2 | |
| in percent of GDP | 26.6 | 29.6 | 24.2 | 21.7 | 23.0 | 23.9 | 23.7 | 21.3 | 18.8 | 17.6 | 17.2 | |
| **Scenario with key variables at their historical averages 6/** | | | | | | **54.5** | **48.2** | **44.2** | **41.0** | **38.9** | **36.7** | **-13.3** |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | | | | | | | |
| Real GDP growth (in percent) | 12.3 | 2.4 | -3.8 | 6.3 | 6.8 | 6.0 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | |
| GDP deflator in US dollars (change in percent) | 17.2 | 22.9 | -13.0 | 1.7 | 15.0 | 5.1 | 2.4 | 0.6 | 3.0 | 4.9 | 4.9 | |
| Nominal external interest rate (in percent) | 5.2 | 7.4 | 5.6 | 5.2 | 5.2 | 4.8 | 4.7 | 4.9 | 4.8 | 5.0 | 5.1 | |
| Growth of exports (US dollar terms, in percent) | 24.7 | 15.9 | -13.0 | 26.6 | 28.9 | 3.9 | 7.2 | 7.4 | 9.4 | 6.8 | 7.2 | |
| Growth of imports (US dollar terms, in percent) | 34.1 | 26.8 | -29.8 | 16.4 | 29.1 | 2.5 | 4.0 | 3.2 | 5.4 | 6.4 | 6.4 | |
| Current account balance, excluding interest payments | -18.2 | -19.7 | -7.7 | -7.5 | -9.2 | -7.2 | -6.5 | -5.3 | -4.2 | -4.2 | -4.1 | |
| Net non-debt creating capital inflows | 16.7 | 11.9 | 6.4 | 5.7 | 5.7 | 6.1 | 6.1 | 6.1 | 6.1 | 6.1 | 6.1 | |

1/ Excludes intercompany loans

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

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

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

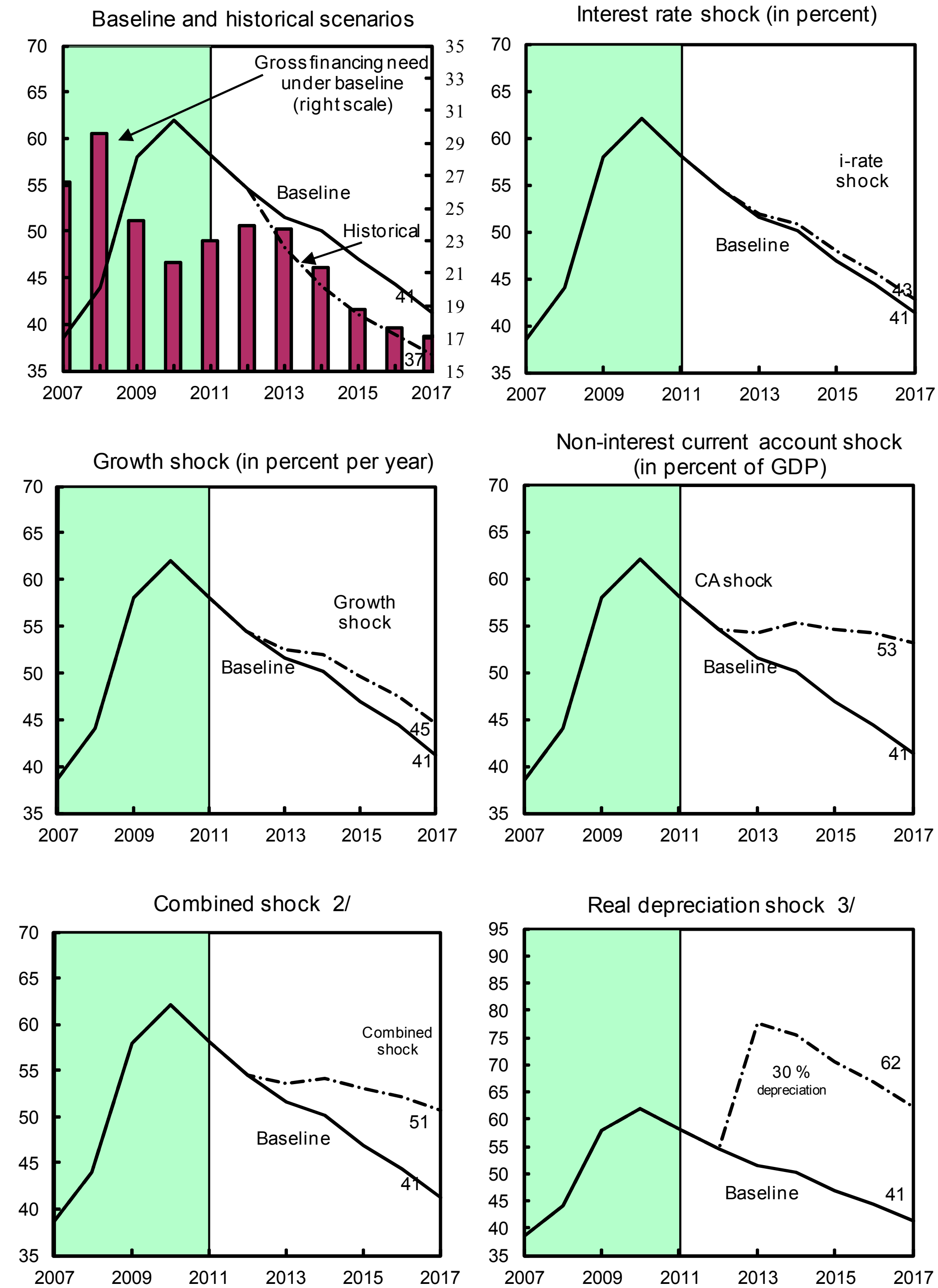
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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 1. Georgia: External Debt Sustainability: Bound Tests 1/**

(External debt in percent of GDP)




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

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

3/ One-time real depreciation of 30 percent occurs in 2013.

Press Release No. 12/131
FOR IMMEDIATE RELEASE
April 12, 2012

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Executive Board Approves Stand-By Arrangement and Stand-By Credit Facility for Georgia with Total Access of up to US$385.6 Million**

On April 11, 2012, the Executive Board of the International Monetary Fund (IMF) approved a 24-month Stand-By Arrangement (SBA) and Stand-By Credit Facility (SCF) for Georgia in support of the government's economic and financial program for 2012–13. The total access under the blend of SBA and SCF will be up to SDR 250 million (about US$385.6 million), evenly divided between the two arrangements. The authorities intend to treat the arrangements as precautionary. The approved SBA and SCF follow the successful completion of the 33-month SBA that expired on June 14, 2011 (see Press Release No.11/224).

Following the Executive Board discussion on Georgia, Mr. Min Zhu, Deputy Managing Director and Acting Chair, said:

"Georgia largely achieved the objectives of the previous Fund-supported program. Economic performance in 2011 was stronger than envisaged, inflation dropped to single digits, government debt declined, and international reserves increased. However, the unsettled global economic and financial conditions have increased risks.

"The authorities' economic program, supported by the precautionary Stand-By Arrangement and Stand-By Credit Facility, aims at completing the macroeconomic adjustment process initiated under the last program. The program seeks to rebuild fiscal buffers, promote external adjustment, strengthen market confidence, and catalyze continued official financial support.

"The authorities' commitment to pursue fiscal consolidation during the 2012–13 election period and their intention to focus these efforts on expenditure containment are welcome. The Economic Liberty Act reinforces the fiscal policy framework by providing the government with additional flexibility to introduce revenue-enhancing measures and by anchoring policies to medium-term sustainability objectives.

“The progress made in enhancing the monetary policy toolkit will help consolidate the gains made in price stability. Exchange rate flexibility will continue to be a critical element of the authorities’ economic strategy.

“Continued structural reforms to strengthen competitiveness are essential to sustain high and inclusive growth and create employment. The newly established Partnership Fund can play a useful role in attracting private investment, but it will be important to strengthen its institutional framework so as to limit the accumulation of contingent fiscal liabilities and ensure that public resources are optimally allocated.

“The banking sector is well capitalized and has adequate liquidity. The authorities’ efforts to strengthen the prudential and supervisory framework ahead of a possible new credit cycle are welcome, as is the development of new tools to better assess and counter potential systemic risks.”

**Background and Program Summary**

Georgia’s economic performance in 2011 was stronger than originally envisaged, with growth reaching 7.0 percent, inflation converging to the low single digits, government debt falling to 34 percent of GDP, and international reserves increasing to US$2.8 billion.

Despite these achievements, the unsettled external environment has increased external risks. At this juncture, the economic outlook for 2012 remains relatively favorable, with growth projected to slow to 6 percent and inflation remaining subdued. However, access to IMF resources would become available under the program in the event of a significant worsening of external economic and financial conditions.

The program’s objectives are to rebuild fiscal buffers, promote external adjustment, strengthen market confidence, and catalyze continued official financial support. Fiscal adjustment, a flexible exchange rate, and monetary policy dedicated to price stability will be the key macro policy underpinnings of the program. The fiscal deficit is targeted to decline to 3.5 percent of GDP in 2012 and to 3 percent in 2013, consistent with a steady reduction of the government debt ratio.

Medium-term challenges remain, notably in terms of lowering the current account deficit (11.8 percent of GDP in 2011) and reducing unemployment (16.3 percent in 2010). To address these challenges, sound macroeconomic policies and strong business environment policies will be complemented with sector policies to encourage private investment and education and training reforms to improve labor-market skills.

**Statement by Yuriy Yakusha, Alternate Executive Director for Georgia**
**and David Lezhava, Advisor to the Executive Director**
**April 11, 2012**

The SBA arrangement that expired on June 14, 2011 was instrumental in dampening the downturn due to exogenous shocks. Subsequent stabilization and restored market confidence allowed the country to meet its financing needs without drawing down available Fund resources for almost the entire last year of the program. On April 7, 2011, a few months before the end of the program, Georgia successfully priced its 10-year Eurobond. The authorities were thus able to largely address the challenge of a public debt service spike in 2013 as a result of coinciding old Eurobond and Fund debt repayment.

While in 2011 the domestic economy recovered better than anticipated, demonstrating annual real growth of 7.0 percent, the global economic and financial landscape remains challenging. Georgia is in a position to repay the debt, despite the spike in the repayment schedule in 2012-2013, in part drawing from the international reserve buffer that has been built up since the crisis. Nevertheless, lower than expected private capital inflows, lower demand for Georgia's export or lower commodity prices on main exporting goods, if materialized in a substantive and parallel manner, may raise the need for additional external financing.

The authorities are requesting a new precautionary arrangement to have a cushion in case of adverse developments and to maintain the fruitful policy dialogue with the Fund. A new program will also be important in order to maintain market confidence in electoral years (2012 parliamentary and 2013 presidential elections), and to benefit from continuous Fund advice. At the conclusion of the last SBA, Executive Directors had indeed concluded that a successor arrangement could be useful.

**Economic Developments**

There was no program with the Fund in the second half of 2011, with the authorities continuing to exercise fiscal restraint, and implementing conservative supervision of the financial sector and broad-based structural reforms. Since the end of the previous arrangement the Fund's staff remained in close cooperation with the authorities providing continuous advice. This was a not insignificant factor in the success, which was recognized by rating agencies. Georgia appeared on the list of a limited number of countries whose rating was upgraded. Both S&P and Fitch, in December 2011, gave the country a new sovereign rating of BB-.

Growth in 2011 was higher than expected at 7.0 percent – one of the highest compared to peers – and was broad based. At the same time it should be noted that most (93 percent) of the output comes on account of large and medium-size enterprises. The agricultural sector, which employs around half of the population, is producing 8.0 percent of the total value added. Unemployment remained elevated at 16.3 percent in 2010 (preliminary data for 2011 suggests a marginal reduction; official data will become available in May).

Inflation is the major target for the central bank. Exogenous food volatility adds a challenge to the monetary policy. Food is mainly responsible for negative 2.2 percent annual inflation in March 2012, compared to 14.3 percent in June 2011. However core inflation remains quite stable, attesting to the absence of second round inflationary effects and providing a reference point for monetary policy.

Fiscal consolidation proceeded at a very fast pace. The fiscal deficit was reduced from 9.2 percent in 2009 to 3.6 percent in 2011. Given the improvement in fiscal buffers and the need for continued improvement in infrastructure, the authorities are phasing out fiscal stimulus in an incremental manner, with the deficit expected to decrease to 3 percent of GDP in 2013.

In 2011, the revised current account deficit was 11.7 percent of GDP. Although the authorities consider the current account to be one of the challenges to be addressed, for the sake of objectivity it should be noted that a major part of the current account deficit is defined by capital inflows, mostly FDI, which is traditionally higher than the regional average. Another factor contributing to the current account deficit is infrastructure development schemes which have an import component. On balance, in 2011, the surplus on the capital and financial account exceeded the deficit on the side of the current account, hence the country accumulated FX reserves.

Exchange rate policy increasingly became more flexible during the program. In 2011 the National Bank intervened only occasionally in the foreign exchange market, mostly to purchase foreign exchange in line with the commitment to accumulate net international reserves and to mitigate appreciation pressure on the exchange rate.

Confidence in the local currency is increasing, indicated by a steadily declining level of dollarization, though it remains at 60 percent. High dollarization remains one of the major impediments for the banking sector. The financial stability indicators point to the good health of the banking sector with a gradually reducing trend of non-performing loans (4.6 percent), increasing profits (ROE=17.3 percent), and comfortable liquidity and capital levels (37.3 and 25.6 percent respectively).

**Policies ahead**

Since 2003 most of the economic reforms have been focused on deregulation, privatization, less government involvement in the economy, eradicating corruption, and creating conditions for private sector development and ease of doing business. These strategies broadly defined the path for Georgia's economic development. The authorities are proud of their achievements and will remain devoted to these strategies. The structural reforms that Georgia implemented in the recent years have contributed to the resilience of the economy in coping with global exogenous shocks. Georgia continued its climb in the World Bank's "Doing Business" ranking and now ranks 16$^{th}$ out of 183 countries.

The authorities intend to complement reforms with sectoral and infrastructural projects, and filling gaps. In 2011 a Partnership Fund (PF) was created with the capital of state-owned enterprises. The aim of the PF will be to leverage its capital, attract private investment to address market failures and mitigate perceived risks.

To correct for the current account deficit, the authorities will continue to rely on flexible exchange rate. The authorities are aware of the limited margins of flexibility that can be deployed in a highly dollarized economy due to the potential effect on the financial sector. Flexible exchange rate policy is therefore accompanied by vigilant banking supervision and close monitoring of the developments in the system. In the medium term Georgia aims to converge to the Basel II and Basel III standards.

The Ministry of Finance is committed to a conservative public debt management vision. The planned budget for the coming years strikes a balance between the social responsibility of the authorities, needed economic stimulus, and the goal of debt reduction. The Ministry of Finance is constantly implementing business-friendly tax administration measures, works with bilateral donors and IFIs to attract concessional funds, and grants and also remains active in the local market, by gradually increasing the maturity of government papers. The target, established during the previous program, to lower the budget deficit to 3.0 percent of GDP in 2013, remains unchanged.

The Georgian authorities are thankful to the IMF board members for their comments and suggestions expressed during the Board discussions. These inputs received serious attention and were reflected in policy decisions taken during the program. Clear evidence of that is a modified Liberty Act. The main intention behind the act was to foster fiscal discipline and provide markets with long-term confidence in the business environment, which remains quite relevant from today's perspective. However the board rightly mentioned rigidities in the act, and the authorities took those comments into consideration, with the final edition striking a balance between fiscal rigor and needed flexibility.

Going forward, lowering the current account deficit, keeping public debt on a sustainable path, creating conditions for inclusive growth, and lowering unemployment are the major medium-term challenges. The authorities are committed to conducting prudent macroeconomic policies in consultation with the Fund.

The previous program was a remarkable success, of which both the Fund and the authorities could be proud. The authorities are looking forward to continued fruitful cooperation and dialogue under a new arrangement. Commitment to the above mentioned fiscal and monetary strategic principles will continue to guide policy decisions going forward.