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Georgia and the IMF

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July 9, 2010

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Georgia: Letter of Intent, Memorandum of Economic Policies, and Technical Memorandum of Understanding

June 24, 2010

GEORGIA: LETTER OF INTENT

June 24, 2010

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

Dear Mr. Strauss-Kahn:

1. In September 2008, the International Monetary Fund (IMF) approved a Stand-By Arrangement (SBA) for Georgia, which was further augmented in August 2009. On March 19, 2010 the IMF's Executive Board completed the fifth review of the SBA allowing for an immediate purchase of an amount equivalent to SDR 97.3 million. We are grateful for the assistance which the IMF provides to Georgia.

2. This letter of intent describes the economic policies that we plan to implement during 2010. As always, we are committed to policies that will maintain macroeconomic stability, protect the economy from shocks associated with the global economic crisis and facilitate the process of macroeconomic adjustment. We, of course, remain committed to implementing the measures contained in previous letters of intent, i.e. those dated September 9, 2008, November 28, 2008, March 10, 2009, July 30, 2009, November 25, 2009, and February 25, 2010.

Recent Economic Developments

3. Growth in 2009 amounted to minus 3.9 percent. In the fourth quarter Real GDP increased by 0.4 percent, after 5 consecutive quarters of negative growth. Positive year-on-year growth in the fourth quarter was achieved in electricity, gas and water supply, financial intermediation, health care.

4. Balance of payments data for the fourth quarter of 2009 show that exports of goods and services increased year-on-year by 21 percent and imports of goods and services declined by 15 percent, which reflects lower demand for imports. Worker remittances increased 22.1 percent, and FDI inflows declined by 11.2 percent year-on-year. As a result, the current account deficit dropped to 13.4 percent of GDP in the fourth quarter of 2009, showing slight improvement relative to the same period of the previous year. In 2009 the current account deficit was11.9 percent of GDP compared to 22.7 percent in the previous year.

5. As a result of a broad decline in economic activity and falling global commodity prices, inflationary pressures have declined. Inflation as of end of 2009 was 3.0 percent, rising to 4 percent in May 2010. Taking into account the recent development of global commodity prices and signs of improvement in economic activity, we expect inflation to stay around 5 percent in 2010.

6. Fiscal performance in the first quarter of 2010 has been stronger than anticipated. Tax collection in Q1 2010 increased by 13.0 percent y-o-y in nominal terms (excluding one-off payments). Expenditures in the same quarter were contained at GEL 1441.0 million (general government, including capital expenditures), or 1.7 percent lower than in Q1 2009. In all, the Q1 fiscal deficit reached 0.5 percent of the projected annual GDP, which is below the program target. We also expect the deficit through the first half of 2010 to be below the program target.

7. Consistent with our commitment to increase exchange rate flexibility, starting from May 25, 2009, the NBG foreign exchange interventions are conducted only through the foreign exchange auctions. Less frequent interventions have increased market participation, thus dampening one-way speculative pressures. In first quarter, the interventions have relatively increased in the FX market because of seasonal pressures. External gap in private sector is being financed by public sector inflows. Because of the above and seasonal factors the NBG is expecting more interventions in the first half of the year than in the second. In the first quarter of 2010 NBG FX intervention amounted to USD 124 million, which is 38% less than IMF program incorporates.

8. Seasonal exchange market pressures continued after March. In anticipation that these pressures would be reversed after the May 30 elections, the NBG increased its intervention in April-May to USD 150 million. However, the persistence of pressures points to weakness in FDI inflows in the first half of the year, which has led to a downward revision of projected FDI inflows for the year. The exchange rate (vis-à-vis the USD) has depreciated by 4.6 percent in the first 9 days of June, and by 10.2 cumulatively since the beginning of the year. Intervention volumes remained elevated in the first ten days of June because of the need to stabilize market expectations, but the foreign exchange market has since stabilized.

9. The banking sector continued its positive performance in the first quarter of 2010. Commercial banks' net profit in the first quarter equaled GEL 15.3 million. Starting from May 2009, the volume of deposits has been growing steadily, posting a 48 percent growth in lari terms by end-May 2010. Bank lending to the economy has picked up, and credit to the economy has increased by nearly 12 percent (4 percent excluding valuation effects) since the beginning of the year (as of June 11). The major part of the increase in credit is attributed to lending in domestic currency. The average capital adequacy was 18.3 at end-March 2010.

10. In order to enhance the safety and efficiency of the international reserves management process, the NBG is implementing a new portfolio management system. The system will cover front-middle-back office and accounting functionality based on Straight Through Processing (STP) principles. The system will be IFRS compliant and will allow NBG to introduce new, more sophisticated financial instruments and investment techniques in its reserves management process. The new system will help NBG bring its reserves management procedures in line with international best practices. NBG has signed the contract on system supply and implementation with WallstreetSystems, leading portfolio management system supplier who has over 30 central banks clients around the world. The system is expected to become fully operational by the end of 2010.

11. We have in place a Contingency Plan (CP) which provides a framework for policy makers to coordinate their policies and actions to mitigate systemic risks to the financial sector and, in case of realization of such risks, to reduce the social cost of any ensuing financial distress. Although the banking system is adequately capitalized, the NBG continues to conduct regular stress tests on system wide and bank by bank level. In line with changes in legislation, which enable the supervisor to conduct risk-based supervision, a reorganization process is under way to enable the NBG to use more effectively its resources for risk based supervision. The move toward a risk based framework is done gradually, to minimize regulatory risk for the industry and enable smooth transition towards the new regulatory framework.

12. We continue to improve the efficiency and effectiveness of public finances. The Ministry of Finance is broadly on track in implementing the Public Finance Management Reform Policy Vision 2009–2013. The Reform Action Plan for 2009 has been successfully implemented. The draft budget code was one of our key priorities in 2009. The new budget code was adopted in December 2009, providing a sound framework for fiscal planning and efficiency gains in the area. The new budget code seeks to consolidate all legislation related to the budget process into a single law, to better integrate the medium-term economic and fiscal framework (BDD) and the public investment program into the annual budget cycle, and to prepare the ground for results-oriented budgets.

13. Furthermore, in 2009 we progressed significantly in ensuring functionality of the risk assessment tax audit system, streamlining tax and customs codes and developing necessary sub-legislation, establishing electronic information exchange system between banks and the Revenues Service, improving capital budget document forms, establishing a customs audit and progressing towards risk-based customs control, fostering full functionality of the electronic treasury system and inclusion of all taxes into the e-filing system. The implementation of these reforms has enhanced efficiency and effectiveness in the use of public financial resources and shall contribute to the overall resilience of the economy both now, in a time of stress, and over the medium term.

Macroeconomic Policies for 2010

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

15. Economic decline in 2009 amounted to 3.9 percent. Based on available economic data, we anticipate that real economy will increase by 2 percent in annual terms in the first quarter of 2010. Overall in the 2010 real GDP growth is projected at 4½ percent per annum.

16. The current account deficit for 2010 is expected to be around 12.6 percent of GDP. Exports and imports of goods and services are projected to increase by 20 percent and 14½ percent, respectively. Worker remittances are expected to increase by around 10 percent for the year. Conservatively, we project FDI inflows of just under US$700 million in 2010, somewhat lower than in 2009. Overall, gross reserves in 2010 are expected to increase by about US$100 million.

17. We expect a recovery in private capital inflows to begin in the second half of 2010. Despite considerable fiscal adjustment, the current account deficit is expected to widen marginally in 2010, owing to the economic recovery. In view of the continued high uncertainty in the external environment, there is a need to increase the reserve buffer to more comfortable levels. Accordingly, we have sought the Fund's continued support in covering a balance of payments gap of around US$450 million in 2010.

18. We consider that restoring a sound fiscal position is critical for the sustainability of the recovery and also to preserve the stability of Georgia's external accounts. We are therefore committed to an ambitious program of deficit reduction. Based on further expenditure containment, an expected recovery of tax revenues owing to the expected rebound in the GDP growth, as well as new revenue measures to be taken in 2010 and 2011, we are committed to steady reductions in the deficit to 2–3 percent of GDP by 2013. In order to enhance fiscal policy flexibility, the proposed constitutional amendment which introduces a referendum requirement for new taxes would become effective only once the deficit has been brought down below our medium-term deficit ceiling of 3 percent of GDP.

19. Our target is to reduce the deficit to 6.3 percent of GDP in 2010 (SBA definition), well below the 7.4 percent deficit target agreed at the time of the Fifth Review of the program. The revenue gain from the upward revision in GDP growth and an increase in excises coming into effect on August 1, 2010 (with an estimated yield of 0.3 percent of GDP)

will enable us to meet this more ambitious deficit target as well as some urgent spending priorities. The supplementary budget consistent with the new level of spending was submitted to Parliament on June 4, and we expect it to be approved by the end of June 2010. The additional revenue measures will be adopted in July based on a revision of the existing tax code. We also intend to cap government spending through the rest of the year at the level of the supplementary budget, so as to ensure that any additional revenue gains would go toward faster deficit reduction. Furthermore, as part of the new tax and customs code, we intend to introduce a package of new revenue measures effective January 1, 2011, which include harmonization of income tax rates and partial elimination of VAT exemptions. Combined with the excise increases of 2010, this package should yield 1.2 percent of GDP annually.

20. We continue to implement our public finance reform program, which we view as an important prerequisite to ensuring transparency, discipline, efficiency and accountability in the public finance area. We progressed significantly in implementing our public finance reform action plan for 2009, which implies implementation of actions in a large number of areas, including developing liquidity management guidelines, preparing the functional and technical specification for the PFMS, developing a new format of the medium-term framework (Basic Data and Directions) document, improving the format of local budgets.

21. Public Finance Management Reform Action Plan 2010 has been approved and is under implementation. Consistently with the new budget code, by end-July 2010 we will seek cabinet approval of the medium-term expenditure framework (Basic Data and Directions) that includes expenditure ceilings applicable to the 2011 budget (structural benchmark under the program). Also, by end-September 2010 we intend to seek cabinet approval of guidelines for pilot Ministries to introduce a programmatic approach to budgeting, in line with the recommendations of the technical assistance from the IMF's Fiscal Affairs Department (structural benchmark).

22. In pursuance of our reforms aimed at fostering a culture of compliance and streamlining tax and customs administration procedures, we are in the process of discussing legal amendments to achieve cost-efficiency and effectiveness gains within the Revenue Service of the Ministry of Finance. These reforms would enhance the business-friendliness of tax and customs legislation with a view of further promoting private sector-led growth.

23. The monetary policy transmission channel has weakened due to the crises and remains inefficient under current excess liquidity conditions. To restore transmission channel NBG has made reforms to influence short-term interest more effectively. This includes restoring reserve requirements in local currency and activation of standing facilities.

24. In order to increase confidence in the NBG's refinancing loans and promote efficiency of the monetary policy, the NBG started to provide commercial banks with

guaranteed access refinancing loans against collateral at the interest linked to the NBG's key policy rate. The collateral base for refinancing loans is extended by international bank guarantees and long term local currency loans. We expect the meet the end-June NDA target due to lower-than-expected demand for free reserves by banks. The NBG has begun to tighten monetary conditions by raising its refinancing rate from 5 to 6.25 percent on June 16 to maintain price stability as the economy recovers and to counter recent exchange rate pressures. We project end-period inflation to be 5 percent in 2010. This projection is, of course, sensitive to assumptions regarding the money multiplier and, in turn, commercial bank lending to the private sector, as well as international commodity price developments.

25. Intervention in the FX market in May and in June (to stabilize the market after an initial large depreciation) exceeded the room for intervention under the program, and the NIR target of end-June will likely be missed. Corrective measures have since been taken to reduce pressures, including faster exchange rate depreciation, monetary tightening and the fiscal measures described above. The commitment to a flexible exchange rate is unchanged and will be strengthened by reducing the frequency of auctions. The NBG does not target any exchange rate and will intervene only to smooth extreme volatility, to counter speculative pressures and if too fast and too large depreciation threatens financial stability. Should external developments be more favorable than currently projected, we stand ready to raise the NIR targets for future reviews, so as to strengthen our exit strategy from official balance of payments support.

26. Our current strategy is based on the expected recovery of private capital inflows, and FDI in particular, starting in the second half of 2010. To support that process we have corrected some of the administrative problems faced by investors at the beginning of the year. We consider that the successful completion of the elections also removes a major source of uncertainty for investors. At the same time, we are aware that the current strategy is subject to risks, and that a significant shortfall in the recovery of private capital inflows will require a substantial change in policies. In this regard, should we observe a failure of FDI to resume over the summer, we stand ready to further tighten monetary policy and to cut the budget deficit further, while allowing the exchange rate to adjust. In view of the adverse impact of significantly higher depreciation on the balance sheet of banks—through currency induced credit risk—we would rely to a large extent on monetary and fiscal policy tightening to preserve stability. In order to move swiftly and most efficiently on fiscal policy, we would implement budget cuts across the board at the level of ministries, thus allowing ministries to decide how best to implement the cuts within their budgets given their constraints and objectives.

27. Enhancing the competitiveness of the Georgian economy is, of course, of primary importance to us and is a key to reducing Georgia's external current account deficit to more sustainable levels over the medium term. Georgia's sound macroeconomic policies, its extremely favorable business environment and geographic advantages put it in a good

position to benefit from a generalized recovery of FDI flows to emerging markets. We expect that additional structural reforms will be at the root of future competitiveness gains. These include further privatization and reductions of the state's role in the economy.

28. To bring our official statistics in line with international standards, we improved legal framework and reorganized the former State Department of Statistics (new title—Geostat). New Law on State Statistics strengthens the independence of the Geostat and ensures the sustainable production of official statistics. On May 17, 2010, we subscribed to the IMF's Special Data Dissemination Standard (SDDS), with a view to enhancing the availability of timely and comprehensive statistics provided to the public.

29. Based on our expectation of higher than projected budget support disbursements from IFIs in 2010, we will reduce the Government's use of IMF financing for the budget. Accordingly, the purchase that would become available upon completion of the sixth review, would be the last purchase to be used for budget support in 2010.

30. We have implemented the recommendations provided in the recent update of the Safeguards Assessment Report. In particular:

- The new Audit Committee Charter was elaborated based on the best international practice.
- The Audit Committee composition was modified and includes only non-executive members of the Board.
- The oversight function of the Audit Committee was strengthened.
- The assessment of internal audit activities for compliance with the International Standards for Professional Practice of Internal Auditing and The IIA's Code of Ethics was conducted.
- The Internal Audit Service reviewed operations of the newly implemented core banking system.

The internal audit of the new RTGS and reserve management systems will be carried out following their deployment.

Program Monitoring

31. We expect end-June performance criteria under the Stand-By Arrangement to be met, with the exception of the NIR target. Based on the corrective measures taken to reduce exchange rate pressures and to meet the program objectives of 2010, we request a waiver for non-observance of the end-June NIR performance criterion, and request the completion of the Sixth Review. We expect to meet the end-June performance criterion on the cash deficit of the general government but we are requesting a waiver of applicability since data to verify this PC will not become available before July 27. We will maintain our usual close policy dialogue with the Fund and are ready to take additional measures as appropriate to ensure that we meet program objectives. The Government will consult with the Fund on the

adoption of these measures, and in advance of revisions to the policies contained in this letter, in accordance with the Fund's policies on such consultations.

32. We also request: (i) a modification of the end-September PCs on the fiscal deficit, NIR and NDA according to the attached Table 1, which also establishes end-December 2010 PCs; (ii) introduction of a PC on total government expenditure for end-September and End-December 2010; and (iii) rephasing of purchases by combining the seventh and the eighth reviews. The seventh and eighth reviews will be based on end-September 2010 performance criteria and are scheduled for completion by end-December 2010; and the ninth review will be based on end-December 2010 performance criteria and is scheduled for completion by end-March 2011. The revised Technical Memorandum of Understanding clarifies the measurement of the PC on government expenditure and of the indicative target on the contraction and guaranteeing of total government debt. Structural benchmarks under the program are described in Table 2.

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

Sincerely yours,

/s/	/s/
Nika Gilauri	Kakha Baindurashvili
Prime Minister of Georgia	Minister of Finance

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

Table 1. Georgia: Quantitative Performance Criteria (PC) and Indicative Targets, 2010

	Cumulative Change from End-December 2009								
	Mar-10			Jun-10		Sep-10		Dec-10	
	PC	Adjusted PC	Actual	PC	Proj.	PC	Proposed PC	Ind. Target	Proposed PC
	(In millions of lari)								
Ceiling on cash deficit of the general government	333		96	737	467	1,089	867	1,393	1,241
Ceiling on the general government expenditures	…			…	…	…	5,023	…	7,106
	(In millions of lari)								
Ceiling on net domestic assets (NDA) of the NBG 1/	418	397	135	606	553	568	506	653	714
	(In millions of U.S. dollars)								
Floor on net international reserves (NIR) of the NBG 1/	781	793	897	685	639	733	740	706	721
Ceiling on accumulation of external arrears 2/	0		0	0	0	0	0	0	0
	Ind. Target		Actual	Ind. Target	Proj.	Ind. Target	Prop. Ind. Target	Ind. Target	Prop. Ind. Target
	(In millions of U.S. dollars)								
Ceiling on contracting or guaranteeing of new nonconcessional external debt by the public sector 3/	850		226	850	347	850	…	850	…
Ceiling on contracting or guaranteeing of new total external debt by the public sector 3/	…			…	…	…	1,000	…	1,000

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 17 of the TMU.
3/ It is proposed to replace the indicative targets on nonconcessional external public debt by indicative targets on total external public debt from the end-June test date on.

Table 2. Georgia: Structural Benchmarks

Action	Proposed Time Frame	Type of Conditionality	Status
FSA and NBG to sign and implement a memorandum of understanding to strengthen cooperation.	End-Oct-08	Structural Benchmark	Observed
NBG to introduce revised LOLR facility.	End-Dec-08	Structural Performance Criterion	Observed
Submission to parliament of a state budget for 2009 with an overall fiscal deficit of no more than 3¾ percent of projected GDP (subject to an adjustor of at most 3 percent of GDP as set out in the TMU).	End-Dec-08	Structural Benchmark	Observed
NBG to develop and publish a liquidity management framework, including the introduction of a refinancing mechanism as the main instrument to provide liquidity.	End-Mar-09	Structural Benchmark	Not observed. Implemented with delay
The NBG, the FSA, and the government to develop a financial stability plan that will contain policy actions to respond to potential situations of stress by defining the roles and responsibilities of the different players—the NBG, the FSA and the government—under each circumstance.	End-Jun-09	Structural Performance Criterion	Observed
Appointment of the remaining members to the FSA board.	End-Jun-09	Structural Benchmark	Not observed, became redundant with elimination of FSA board
Submission of a new budget code to the cabinet to make the budget preparation process more inclusive, enhance the budget execution monitoring process, and move to performance driven policy by improving strategic planning.	End-Jul-09	Structural Benchmark	Observed
Status report on the implementation of the action plan described in the Financial Stability Plan, including bank-by-bank contingency measures based on stress test results and assurances of support from foreign shareholders.	End-Sep-09	Structural Benchmark	Observed

Submission to parliament of the Law on Internal Audit.	End-Sep-09	Structural Benchmark	Observed
Submission to parliament of a state budget for 2010 that: (i) is consistent with the program targets and assumptions, and an overall deficit of no more than 7.3 percent of GDP (program definition); (ii) contains a medium-term fiscal framework consistent with the program's medium-term deficit reduction targets; and (iii) describes the medium-term policies underlying the fiscal deficit objectives through 2013.	October 1, 2009	Structural Benchmark	Observed
Cabinet approval of a new medium-term expenditure framework (Basic Data and Directions) that includes expenditure ceilings applicable to the 2011 budget.	July 31, 2010	Structural Benchmark	
Cabinet approval of guidelines for pilot Ministries to introduce a programmatic approach to budgeting in line with the recommendations of the IMF technical assistance report, "Georgia – Advancing Program Budgeting," by D. Radev, S. Flynn, L. Eyraud, and S. Gurr, May 2010.	September 30, 2010	Structural Benchmark	

GEORGIA: REVISED TECHNICAL MEMORANDUM OF UNDERSTANDING

June 24, 2010

1. This memorandum sets out the understandings between the Georgian authorities and the IMF staff regarding the definitions of quantitative performance criteria and indicative targets, as well as respective reporting requirements for the Stand-By Arrangement (SBA). It replaces the technical memorandum of understanding dated February 25, 2010.

2. These performance criteria and indicative targets are reported in Tables 1 attached to the Letter of Intent dated June 24, 2010. The exchange rate for the purposes of the program of the Georgian lari to the U.S. dollar is set at GEL 1.67 = $1. The corresponding cross exchange rates are provided in Table 1.

I. GENERAL GOVERNMENT AND THE PUBLIC SECTOR

3. **Definition:** The general government is defined as the central government, local governments, and extra-budgetary funds. 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 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. Ceiling on the Cash Deficit of the General Government

1. **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 “GEL TSA state budget” 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 from the IMF), and project financing (capital expenditure and net lending), net change in external arrears, change in the accounts of the general government abroad, minus amortization. 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.

2. **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.

B. Ceiling on the General Government Expenditures

3. **Definition:** The ceiling applies to total expenditures of the general government. Total expenditures include all current and capital spending as well as net lending: (i) current expenditures comprise compensation of employees, purchases of goods and services, subsidies, grants, social expenses, other expenses, other account payables and domestic and external interest payments; (ii) capital expenditures include projects financed by foreign loans and grants; (iii) net lending is defined as lending minus repayments to the general government. The Performance Criterion is monitored quarterly on a cumulative basis from the beginning of the year.

4. **Supporting material:** Data for monitoring expenditures will be derived from the accounts of the general government covered under the ceiling (based on state, local authority, and autonomous republics budgets). The ministry of finance is responsible for such reporting according to the above definition. Data on general government expenditures should be reported within four weeks after the end of the quarter.

C. Floor on the Net International Reserves of the NBG

5. **Definition:** For the program purposes, net international reserves (NIR) of the NBG in U.S. dollars are defined as foreign assets of the NBG minus the sum of foreign liabilities of the NBG. Foreign assets of the NBG include gold, gross foreign exchange reserves, Georgia's SDR holdings, and the reserve position in the IMF. Gross foreign exchange reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents, including cash holdings of foreign exchange that are readily available. Pledged or otherwise encumbered assets, including (but not limited to) assets used as collateral (or guarantee for third party external liabilities) are excluded from foreign assets. Foreign liabilities of the NBG shall be defined as the sum of Georgia's outstanding liabilities to the IMF, Georgia's SDR allocation, and any other liabilities of the NBG, excluding the foreign exchange balances in the government's account with the NBG. Thus defined, the definition of NIR excludes foreign assets stemming from foreign currency deposits of financial institutions at the NBG and foreign assets arising from the currency swaps with financial institutions. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the NBG shall be valued at program exchange rates as

described in paragraph 2 above. The stock of NIR amounted to $879.8 million as of December 31, 2008 (at the program exchange rate).

6. **Adjustors:**

- The floor on the NIR of the NBG will be adjusted:
- (a) upward/downward by 50 percent for any excess/shortfall in the balance-of-payments support loans and balance-of-payments support grants relative to the projected amounts presented in Table 2.
- (b) upward/downward by 50 percent for any excess/shortfall in the disbursements of the project loans and project grants to the Treasury Single account at the NBG relative to the projected amounts presented in Table 2.
- (c) upward 100 percent for any shortfall in the amount of conversion for government imports relative to the projected amounts presented in Table 2.

7. **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.

D. Ceiling on Net Domestic Assets of the NBG

8. **Definition:** Net domestic assets of the NBG are defined as the difference between reserve money and NIR as defined above in paragraph 9. Therefore, the ceiling on NDA is defined as projected reserve money (as defined in Table 3) minus the target NIR.

9. **Adjustors:**

- The ceiling on the NDA of the NBG will be adjusted:
- (a) 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 2.
- (b) 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 2.
- (c) downward 100 percent for any shortfall in the amount of conversion for government imports relative to the projected amounts presented in Table 2.

10. **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.

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

11. **Definition:** External debt, based on the notion of the residency of the creditor, is defined as debt contracted by the public sector from lenders other than the IMF. This indicative target applies to debt as defined in point No. 9 of the IMF's Guidelines on Performance Criteria with Respect to External Debt as amended effective December 1, 2009 (Decision No. 12274-(00/85) August 24, 2000).[1] Previously disbursed external debt that has been rescheduled will be excluded from the definition of "new debt" for the purposes of this performance criterion.

12. **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.

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[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."

F. Continuous Performance Criterion on Nonaccumulation of External Arrears

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

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

Table 1. Program Exchange Rates

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

Table 2. Projected Balance-of-Payments Support Financing 1/
(In millions of U.S. dollars)

	Balance-of-payments support loans and balance-of-payments support grants	Project loans and project grants	Conversion for government imports
June 30, 2010	19.2	117.4	115.0
September 30, 2010	155.3	198.7	162.4
December 31, 2010	219.6	238.8	243.4

1/ Cumulative from the beginning of the calendar year.

Table 3. Projected Reserve Money
End-of-period stock in millions of lari)

June 30, 2010	1,750.4
September 30, 2010	1,741.4
December 31, 2010	1,918.3