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Georgia: Fourth Review Under the Stand-By Arrangement and Request for Modification of Performance Criterion

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on November 12, 2009, with the officials of Georgia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 25, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A supplement to the staff report.

- A Press Release summarizing the views of the Executive Board as expressed during its December 11, 2009, discussion of the staff report that completed the review.

- A statement by the Executive Director for Georgia.

The document(s) listed below will be separately released.

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

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

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INTERNATIONAL MONETARY FUND

GEORGIA

Fourth Review Under the Stand-By Arrangement and Request for Modification of Performance Criterion

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

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

November 25, 2009

- **Background:** On August 6, 2009, the Executive Board completed the Third Review under the Stand-By Arrangement (SBA), and approved an augmentation of access to SDR 747.1 million (497 percent of quota) and an extension of the arrangement to June 14, 2011. SDR 382.5 million have been disbursed to date, and a tranche in the amount of SDR 47.3 million will become available upon the completion of this review.
- **Program Strategy:** The change in strategy approved at the last review remains appropriate, and policy targets and macroeconomic objectives for 2010 are in line with those proposed at the last review.
- **Team:** E. Gardner (head and Senior Resident Representative), A. Luca (both MCD), L. Eyraud (FAD), and I. Halikias (SPR).
- **Exchange Rate Regime:** The regime is classified as "other managed" based on the authorities' policy to allow greater exchange rate flexibility since March 2009. The government uses the official exchange rate for budget and tax accounting purposes as well as for all payments between the government and enterprises and other legal entities. Because the official rate is set as the previous day's market rate, it may differ by more than 2 percent from freely determined market rates, which gives rise to a multiple currency practice.
- **Statistics:** Economic data are broadly adequate for surveillance and program monitoring. Georgia participates in the GDDS and plans to subscribe to SDDS by mid-2010.

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Attachments

Executive Summary

The economy appears to have turned the corner and financial conditions have stabilized, but the outlook remains clouded by weak export market growth, the slow recovery of private capital inflows, and tight credit conditions. Real GDP is projected to contract by 4 percent in 2009, and to grow by 2 percent in 2010. The authorities' policies have been in line with program expectations. All end-September quantitative performance criteria and all structural benchmarks have been met. Improved confidence and stronger liquidity conditions should lead to an easing of credit conditions.

The strategy remains appropriate and program targets for 2010 are in line with those presented at the third review. Fiscal policy will transition from an expansionary stance in 2009 to a path of strong consolidation, with a reduction in the deficit of 2¼ percent of GDP in 2010. Despite sizeable adjustment, a roughly $400 million external financing gap remains in 2010, mostly because of the slow recovery of private capital inflows. By filling this temporary gap, Fund financing will avoid disruptive overshooting of the exchange rate and its attendant adverse balance sheet effects (due to high liability dollarization). The exchange rate will be managed flexibly, allowing it to respond to market forces and to persistent pressures.

The banking sector has weathered the crisis relatively well, and systemic risks have abated. Banks' capitalization, liquidity, and provisioning ratios are comfortable. The larger risk stems from currency-induced credit risk, although stress test results show that capital buffers would be sufficient to withstand all but the most extreme shocks; even then the risk to government finances would be limited. The authorities continue to upgrade the regulatory and supervision framework, and have developed a contingency plan to deal with severe financial sector stress.

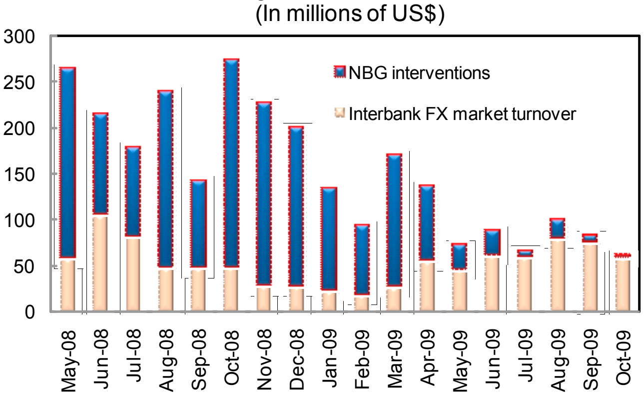
I. Recent Economic Developments and Outlook for the Remainder of 2009

Although economic and political uncertainties remain high, confidence as measured by market conditions has improved and an economic recovery, albeit still fragile, is under way. The authorities' policies have been in line with program expectations. All end-September quantitative performance criteria and all structural benchmarks have been met.

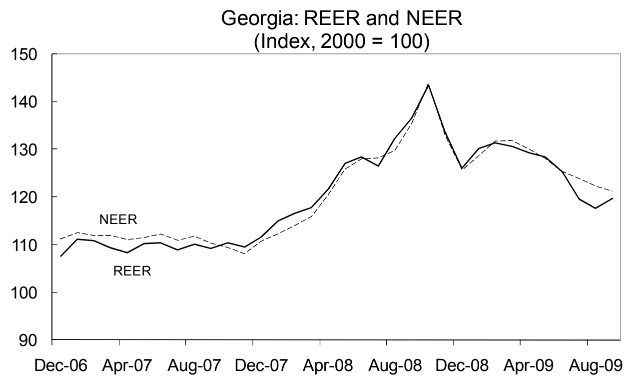
1. **Signs of an economic recovery starting in the third quarter of 2009 confirm the real GDP growth forecast of –4 percent for the year.** The steady rise in deposits since May, higher Value Added Tax receipts, the recovery of remittances, and a stabilization in real estate prices suggest that a turnaround is taking place. However, the recovery remains tentative: September trade data were unexpectedly weak, credit has continued to contract, and FDI inflows have fallen well below the authorities' target. Under these circumstances, another downward revision to 2009 real GDP growth cannot be excluded. CPI inflation has stabilized at 3–4 percent, but a slight increase is projected going forward reflecting rising import prices.

2. **The foreign exchange market has been stable, with only minimal central bank intervention, and the end-September NIR target was met.** The roughly $300 million shortfall of FDI inflows (relative to the initial FDI target of about $1 billion) has been more than offset by a faster-than-expected narrowing of the current account deficit, due mainly to declining imports and other capital inflows. In the absence of any exchange rate pressures, the auction amounts and the frequency of auctions were reduced. In parallel, interbank transactions have increased steadily and now account for the bulk of the foreign exchange (fx) market turnover. Gross international official reserves reached $2,030 billion in October, including about $230 million from the SDR allocations. The end-2009 NIR target should be met comfortably. The exchange rate has been relatively stable relative to the U.S. dollar, which is the main reference currency in the dollarized Georgian economy. As a result of low domestic inflation and the weakening U.S. dollar, the real effective exchange rate has depreciated markedly since March 2009.

Georgia: FX Market, 2008-09
(In millions of US$)



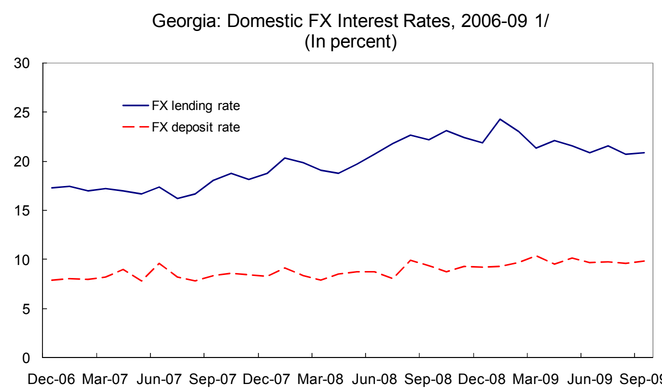
Source: National Bank of Georgia.



Source: INS database.

3. **The end-September fiscal deficit was below the program ceiling and the annual deficit (9.6 percent of GDP) is projected to be within the annual target.**[1] Owing to lower-than-expected expenditures in the third quarter, the end-September deficit target was met by a wide margin (0.7 percent of annual GDP). Overperformance in the third quarter is expected to be offset by underperformance in the fourth quarter due to (i) lower projected tax revenues; and (ii) a likely partial rescheduling of European Commission budget grants from 2009 to 2010. The annual deficit would be little affected by a downward revision of real GDP growth in 2009. On the financing side, shortfalls in expected privatization revenues[2] and, to a lesser extent, in external financing are made up by higher issuance of T-bills. Because of the relatively low interest rates at which the government has been able to place its paper in the market, the authorities intend to increase T-bill issuance considerably (to GEL 260 million, or 1.4 percent of GDP) by end-2009.

4. **Despite an easing of liquidity conditions, deposit and lending rates have remained high.** The average U.S. dollar lending rate stands at around 21 percent—15 percent for prime customers. The steady increase in deposits, supported by improvements in confidence and high real interest rates, has strengthened banks' liquidity position, and banks' excess reserves at the National Bank of Georgia (NBG)



Source: National Bank of Georgia.

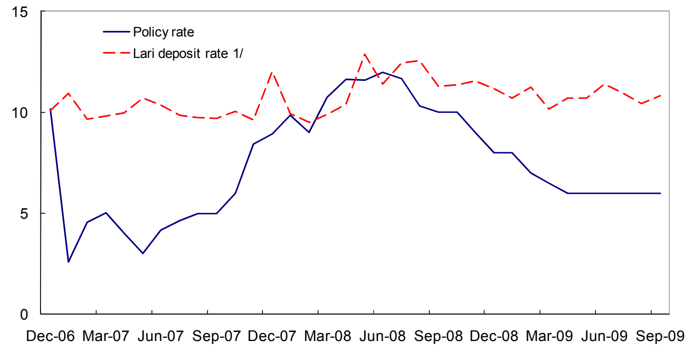
1/ Weighted-average fx rates on new loans/deposits.

[1] In nominal terms, the annual deficit projection is unchanged relative to the third review. However, because of a downward revision in nominal GDP, it has increased slightly in percent of GDP.

[2] Difficulties in attracting foreign investment during the financial crisis and delays in a major housing project on the Tbilisi outskirts (Arsenal city) explain the revision of the 2009 privatization proceeds (down by 0.6 percent of GDP).

have grown to 19 percent of lari broad money at end-October. However, credit to the private sector has continued to contract—by 13 percent in the first 10 months of 2009. Because of dollarization and lack of adequate collateral, the central bank's refinancing rate (in local currency) remains disconnected from overall market conditions.

Georgia: Interest Rates, 2006-09
(In percent)



Source: National Bank of Georgia.

1/ Weighted-average lari rates on new deposits.

Georgia: Monetary Indicators, 2008-09

	2008				2009		
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
	(12-month growth, in percent)						
Broad money (M3)	50.6	28.9	6.9	7.0	-8.7	-14.2	3.2
Domestic currency money (M2)	65.4	46.8	17.1	-13.0	-27.7	-29.3	-15.2
Reserve money	22.6	22.4	25.7	-4.5	-10.4	-4.5	-2.5
Credit to private sector	62.4	53.9	28.3	28.2	13.6	-2.4	-4.0
	(In percent)						
Loan-to-deposit ratio	129.4	135.7	147.0	155.9	165.3	165.4	143.0
Credit-to-GDP ratio	28.5	30.0	29.1	31.9	30.7	30.3	29.6
Deposit dollarization	60.9	60.0	61.7	75.7	75.2	73.2	72.6

Source: National Bank of Georgia.

5. **Banks' capitalization is solid, and nonperforming loans (NPLs) have stabilized as a share of total loans.** Capital adequacy and provisioning have improved steadily since the beginning of the year. The share of external wholesale financing in total liabilities has been reduced to more prudent levels, but remains high—the loan to deposit ratio declined from 172 percent in April to 143 percent in September. Contrary to deposits, loan dollarization has continued to increase. In September, bank profits (before provisioning) were positive for the first time since July 2008.

Georgia: Selected Financial Soundness Indicators, 2008-09

	2008				2009		
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
Capital adequacy ratio (in percent) 1/	17.5	15.7	17.0	13.9	15.2	17.6	20.2
Capital adequacy ratio (in percent) 2/				24.0	23.6	27.1	27.4
Liquidity ratio (in percent) 3/	36.8	33.3	30.4	28.3	30.8	31.4	40.6
Nonperforming loans (in percent of total loans) 4/	3.0	3.4	9.9	12.8	15.2	18.8	18.2
Nonperforming loans (in percent of total loans) 5/				4.1	5.4	7.1	8.3
Loans collateralized by real estate (in percent of total loans)	43.6	40.5	41.6	43.6	46.4	48.0	49.1
Loans in foreign exchange (in percent of total loans)	65.9	64.9	67.5	72.8	75.3	77.3	77.6
Specific provisions (in percent of total loans)	1.9	2.2	4.7	6.0	7.5	9.4	10.2
Net foreign assets (in percent of total assets)	-17.2	-20.2	-21.6	-19.6	-22.5	-24.4	-18.4
Net open foreign exchange position (in percent of regulatory capital)	3.5	1.5	1.5	1.7	9.1	8.8	10.4
Return on equity	10.2	8.9	-2.9	-12.6	-7.6	-8.4	-7.3

Source: Georgian Financial Supervisory Agency.

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.
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.

II. 2010 Outlook, Program Objectives, and Targets

6. **Given the gradual stabilization of economic and financial conditions, the revised strategy approved at the third review under the SBA remains valid.** The objectives are to achieve an orderly transition to a private sector-led recovery and to close the external financing gap through adjustment and a recovery of private financial inflows. To achieve these objectives, the 2010 program is designed to:

- set fiscal policy on a path of steady adjustment;
- support private sector activity through continued structural reforms;
- consolidate improvements in the banking sector to restore credit growth and strengthen confidence; and
- ensure preparedness in the event of unexpected new shocks, a more prolonged slump in economic activity, or an inadequate recovery of private sector financial inflows.

A. Macroeconomic Outlook and Risks

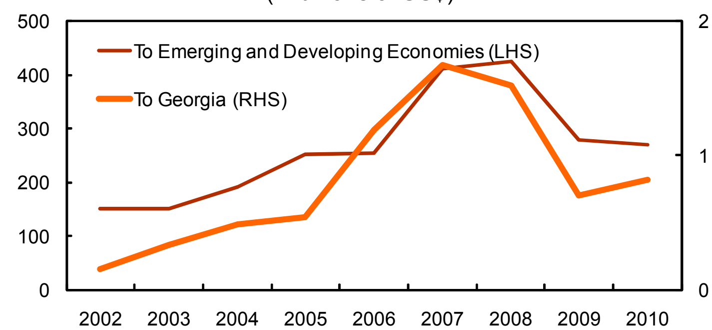
The economy appears to have turned the corner, but the durability of the recovery depends on a sustained improvement in confidence, an easing of credit conditions, and an acceleration of private capital inflows.

7. **Based on the assumption of a moderate recovery of economic activity, real GDP growth is projected at 2 percent in 2010.** The negative fiscal impulse in 2010 (-2 percent of GDP, see Box 1, page 11) is projected to be offset by an increase in private demand of 4 percent in real terms, sustained by a small increase in FDI inflows and a resumption of

bank lending. Although import demand in Georgia's trading partners will remain subdued (3 percent growth in volume terms, following a decline of 16 percent in 2009), net exports are expected to make a positive contribution to growth.

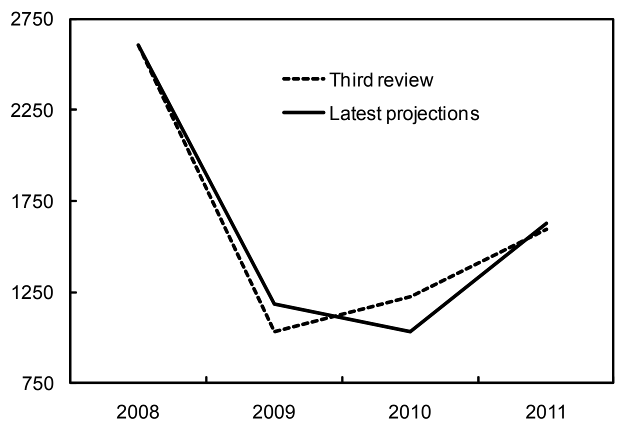
8. **The short-term external outlook has deteriorated slightly relative to the last review.** In particular, FDI, previously a key driver of growth in Georgia, is projected to recover only slowly in 2010, reflecting global conditions. On the current account side, a deterioration in the terms of trade (by some 4½ percent) due to higher oil prices is projected to dominate an underlying improvement in volume terms and a recovery of remittances. As a result, the current account deficit is projected to widen by about 1 percent of GDP relative to 2009.

Georgia: Net Foreign Direct Investment, 2002-10
(In billions of US$)



Source: World Economic Outlook; and Fund staff estimates.

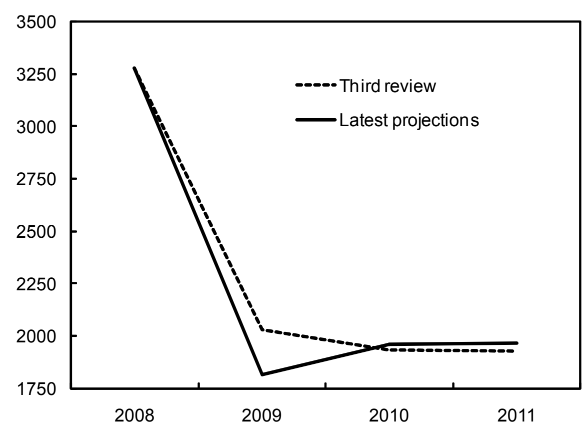
Georgia: Private Capital Inflows, 2008-11 1/
(In millions of US$)



Source: National Bank of Georgia.

1/ For 2008, Eurobond-2013 is included under private capital inflows.

Georgia: Current Account Deficit (Excluding Oficial Transfers), 2008-11
(In millions of US$)



Source: National Bank of Georgia.

9. **The main risks to the outlook lie in the pace of the economic recovery, and in the resumption of private capital inflows.** If the recovery were to stall, pressures would increase on public finances at a time when external resources are already stretched. On the external front, adjustment over the medium term is underpinned by large fiscal consolidation, but it also requires

a resumption of private capital inflows to around $1.7 billion annually in 2011–12, from around $1.1 billion in 2009–10.

B. Fiscal Policy

The authorities consider deficit reduction as key to restoring investor confidence and market access. The sizeable adjustment implied by the 2010 budget (to be voted by parliament by year-end) is fully in line with commitments made under the program.

10. **The fiscal deficit is projected to decrease from 9.6 percent of GDP in 2009 to 7.3 percent in 2010.** The underlying improvement in the structural balance (by 2.2 percent of GDP, see Box 1), is driven by expenditure containment (see table on page 12). Compared with the projections made at the time of the third review, the 2010 budget includes some additional revenues from adjustments to the indirect tax base and higher capital expenditures.[3]

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

	2008	2009	2010
	(In percent of GDP)		
Health programs	1.2	1.6	1.8
Pensions	4.0	4.7	4.7
Social assistance 1/	1.1	1.4	1.3
Other	0.9	0.6	0.8
Total	7.2	8.3	8.5

Source: Ministry of Finance; and Fund staff estimates.

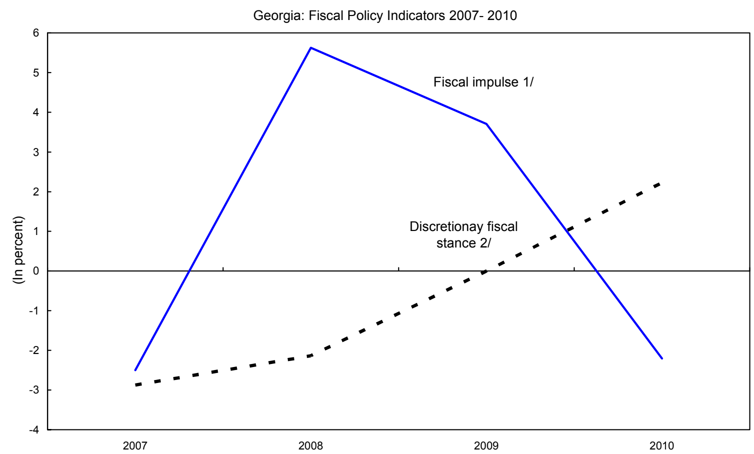
1/ Includes assistance to internally displaced persons (IDP).

[3] In particular, the launching of new projects in Tbilisi and the autonomous Republic of Adjara. Spending on goods and services has also been revised upwards in 2010 but two-thirds of this increase reflects reclassification (from subsidies to use of goods and services and wages) and the recording of arrears penalty paid by the ministry of defense.

Box 1. Georgia: Fiscal Impulse and Discretionary Fiscal Stance in 2007–10

The fiscal indicators presented in this box are intended to (i) assess the impact of the fiscal stance on the economy; and (ii) measure changes in the underlying fiscal position net of cyclical, one off, and external factors. Distinguishing between these two approaches is relevant because some discretionary measures do not contribute to aggregate demand (for instance, government imports), while some factors that impact the economy are not discretionary (for instance, automatic stabilizers).

The fiscal impulse (FI) measures the change in net income injected by the government in the domestic economy. It is constructed by first subtracting from the government balance all government outlays and revenues that do not accrue to or subtract from private income, such as government imports, external interest payments, and grants received from abroad. The FI is then calculated as the change in the adjusted balance, normalized by the previous year's GDP (after correcting for inflation).



Source: Fund staff estimates.
1/ A positive figure indicates a positive impulse.
2/ A positive figure means that the structural balance improves.

The discretionary fiscal stance (DF) measures the change in the structural fiscal balance. The structural balance is constructed by first removing both the cyclical component of revenues[1] and exogenous factors (budget grants, total interest payments, post-war spending)[2] from the standard fiscal balance. The DF is then calculated as the change in the structural balance (as a ratio to GDP).

In principle, a negative DF (i.e., a deterioration in the structural balance) should be associated with a positive FI (i.e., a positive demand impact). However, as the figure shows, this relationship fails to hold in 2007 and again in 2009. In 2007, the large increase in government imports (mainly for defense purposes) worsened the fiscal stance without stimulating the domestic economy. In 2008, the DF remained negative, contributing to a positive FI, which was further boosted by a shift toward domestic spending and post-war foreign-financed expenditures. In 2009, the shift toward domestic spending was even more pronounced; this, plus the fact that tax revenues were low for cyclical reasons, explains why the FI was still positive despite a neutral fiscal stance (zero DF).

[1] In the absence of unemployment compensation or other contingent transfer schemes, there is no cyclical component to be removed from expenditures.

[2] Project grants and the related capital spending are not subtracted from the balance because they offset each other. Post-war spending is measured as the sum of transfers to the internally displaced persons plus the cost of their new housing; these costs are expected to decline over time.

Georgia: Fiscal Adjustment, 2009-13

Measures	Change 2009-10	Change 2010-13	Comments
	(In percent of GDP)		
(1) Policy adjustment and automatic stabilizers	2.4	7.4	
Increase in revenues	-0.2	0.2	
Tax revenues 1/	0.3	0.2	Indirect tax increase (2010), improvement in revenue administration offset by possible tax cuts (2012-13).
Other revenues	-0.4	0.0	NBG profit transfer to the budget discontinued after 2009.
Decrease in expenditures	2.5	7.2	
Current spending 2/	1.4	4.8	
Compensation for employees	0.0	0.8	Reduction in defense personnel costs offset by reclassification of legal entities of public law (LEPL) expenditures (2010), constant real wage bill (2011-13).
Use of goods and services	0.1	1.2	Administrative expenditure cuts of 14 percent cumulatively in real terms in 2010-2013 (except in ministries of education, health and agriculture).
Subsidies	0.6	0.6	Reclassification of LEPL expenditures from subsidies to other categories (2010), and cuts of 14 percent cumulatively in real terms (2011-13).
Social expenses	-0.1	0.9	Increase in pensions and social assistance, health reform (2010), efficiency gains and decrease in number of beneficiaries of subsistence minimum (2011-13).
Other expenses	0.8	1.3	Decrease in reserve funds and cofinancing of investment projects (2010-2013), no more construction of houses for IDPs (from 2011 on).
Capital spending	0.5	2.7	Phase-out of road rehabilitation, and reconstruction/renovation of public buildings (2010-13).
Net lending	0.6	-0.3	Termination of subsidized lending program (2010).
(2) Exogeneous factors	-0.1	-2.5	
Increase in revenues	-0.8	-2.1	
Tax arrears clearance	-0.6	-0.2	Belated VAT payment (2009) and penalty (2010) received from the ministry of defense.
External grants	-0.2	-1.9	Reduction in donor support (2010-13).
Decrease in expenditures	0.6	-0.4	
Tax arrears clearance	0.6	0.2	Belated VAT payment (2009) and penalty (2010) paid by the ministry of defense.
Interest payments	0.0	-0.6	Public debt increase (2010-13).
(1)+(2) = Total reduction in fiscal balance	2.3	4.9	

Source: Ministry of Finance; and Fund staff estimates.
Note: Figures may not add up due to rounding.

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

11. **Financing of the 2010 fiscal deficit relies on a mix of T-bill issuance, external borrowing, and privatization**. It has not changed significantly relative to the last review. Subject to completion of all relevant conditions under the SBA, it will be possible for the domestic currency counterpart of the foreign exchange purchased from the IMF in 2010 to be drawn down and used to finance the government's budget deficit with the understanding that it will be reduced as budget support from other donors is confirmed.

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

	2008	2009	2010
Total	1368	1052	987
IMF	257	338	385
WB	126	252	175
Other Multilateral Institutions	135	246	201
Bilateral partners	350	216	226
Eurobond-2013	500	...	...
Memorandum items:			
Grants	388	298	271
Loans 1/ 2/	723	416	331
Budget support financing 2/	426	278	152
Project financing	185	435	450

Source: Georgian authorities; and Fund staff estimates.

1/ Includes Eurobond in 2008.
2/ Excludes SBA purchases.

12. **Beyond 2010, the adjustment strategy will rely on expenditure containment.** As part of the 2010 budget, the authorities submitted to parliament medium-term fiscal targets consistent with reducing the deficit to under 3 percent of GDP by 2013 (end-September structural benchmark). Planned expenditure reductions are based on the winding down of externally financed large scale projects initiated in the wake of the 2008 conflict, the impact of the economic recovery on the cost of social assistance, and potential cuts in military, administrative, and non-essential capital outlays. On the revenue front, the priority of the government is on improving revenue administration and reducing the flat income tax rate from 20 to 15 percent once conditions permit—and not before 2012.

13. **The medium-term fiscal strategy outlined above will be described in greater detail in the medium-term expenditure framework**. The new budget code (which is to be implemented in 2010) will improve medium-term budget planning and better inform discussions on expenditure priorities.[4] The authorities will shift the calendar of the medium-

[4] In addition, the new budget code will: (i) consolidate and simplify budget legislation; (ii) unify central and local budgets; and (iii) accelerate the budget approval and execution process. Additionally, the reform agenda includes (i) implementing the Law on Internal Audit, that regulates the scope, goals, and principles of audit in the public sector; (ii) adopting International Public Sector Accounting Standards (IPSAS) to increase

(continued)

term expenditure framework to coincide with the budget cycle (proposed structural benchmark for end-July 2010). In addition, the authorities plan to move to programmatic budgeting by 2012, and will request Fund technical assistance to develop the necessary methodology (proposed structural benchmark for end-September 2010).

14. **The fiscal rules set out in the Economic Freedom Act presented by the president in October provide additional backing to the authorities' fiscal consolidation objectives** (Box 2). Parliament is expected to pass the Act before the end of 2009. The Act will have the power of an organic law, requiring a two-thirds majority to be revoked or amended. The limit on government expenditure and the referendum requirement for tax increases are intended to limit the role of the state in resource allocation. While the authorities agreed that the referendum requirement on tax increases may complicate macroeconomic management, they considered that it was important to counter a structural bias toward excessive taxation.

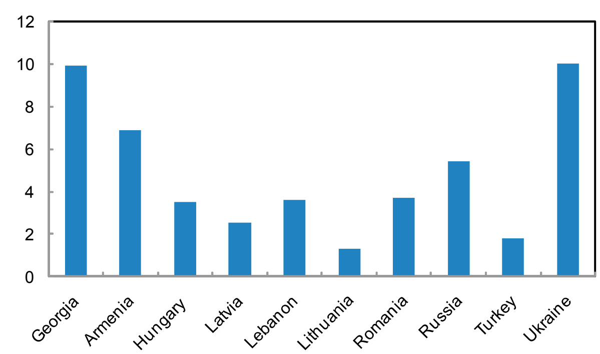
15. **The Debt Sustainability Assessment (DSA) has not changed materially since the last review.** The spike in debt service obligations in 2013 creates rollover/repayment risks, which the fiscal adjustment strategy is intended to address. Over the medium term, solvency ratios stabilize at relatively low levels, and vulnerability to standard shocks is low.

C. Monetary Policy

Credit conditions remain tight, but should ease in 2010. Because of the high level of dollarization, monetary policy instruments are unlikely to regain traction in the near term.

16. **High domestic dollar interest rates have put a damper on economic recovery, but are expected to come down gradually in 2010.** The high level of domestic dollar rates relative to international rates reflects the liquidity shortage created by deposit outflows in 2008–09, and increased demand for precautionary balances on the part of

Georgia and Selected Countries: Short-Term FX Deposit Rates 1/
(Annualized rate, in percent)



Source: IMF country teams.

1/ Latest data available for 3-month USD deposits, except for Georgia (short-term average fx rate), Armenia (average fx rate), Hungary (up to 1-year EUR rate), Latvia (average fx rate), Lithuania (average fx rate), Romania (average EUR rate), Russia (3-6 month USD rate), and Turkey (average USD rate).

transparency and accountability; (iii) creating an integrated information system for budget preparation and execution; (iv) simplifying tax and customs procedure; (v) improving the risk-based audit functions in the revenue service; (vi) expanding the tax dispute resolution system; and (vii) drafting procedural manuals for tax inspectors.

Box 2. Georgia: The Economic Freedom, Opportunity, and Dignity Act

On October 6, President Saakashvili presented to parliament the Act on Economic Freedom, Opportunity, and Dignity (AEFOD), which would amend the constitution to reinforce the country's commitment to liberal economic principles and limit the size of government. The draft law includes the following provisions:

- **Entrepreneurial freedom.** The AEFOD guarantees the freedom of enterprises and foreign investors to operate unimpeded by new labor, trade, and foreign exchange restrictions. In particular, the AEFOD bans any kind of capital control on economic grounds.

- **Independence of the banking sector from the government.** The AEFOD bars government shareholding in banks. However, should the government need to take a stake in a bank, it would have to divest itself of that stake within one year.

- **Tax policy.** The introduction of new state taxes, as well as increases in the rate or widening of the base of existing taxes must be put to a referendum. The AEFOD also prohibits the introduction of progressive income taxes.

- **Regulation.** The AEFOD bars the creation of additional licenses and permits. The adoption of new regulations on economic activities should be subject to a regulatory impact assessment. The Act prohibits the introduction of non-tariff barriers (such as sanitary and regulatory norms) that are more binding than those provided by international agreements.

- **Fiscal rules.** The AEFOD caps budgetary expenditures at 30 percent of GDP, the fiscal deficit at 3 percent, and the public debt at 60 percent. These three rules will be enforced from January 1, 2012. If the ceilings are breached, the Act requires that the government elaborate a plan approved by the parliament to revert to the thresholds within three or four years (depending on the reasons for the initial deviation).

- **Social support.** The government should provide for the most vulnerable by enabling individuals to access private services (e.g., school vouchers and health insurance) rather than by developing public institutions.

banks, which has led to competition for deposits. Deposit growth, including from abroad, has picked up since mid-May as a result of improved confidence and high interest rates. Banks consider that liquidity conditions have returned to comfortable levels and have signaled their intention to reduce deposit and lending rates gradually.

17. **In the highly dollarized economy, monetary authorities have had limited powers to affect credit conditions.** Since one of the constraints on lending is the currency-induced credit risk associated with dollar lending, the central bank has attempted to stimulate credit by auctioning one-year foreign exchange swaps to provide banks with longer-term lari resources. To minimize the risks that local currency liquidity injected through this instrument would be used for speculation, the volume of swaps was capped at GEL 60 million (equivalent to roughly 3.5 percent of reserve money). The cap was reached in September. It is hard to gauge the impact of swaps on banks' behavior: they may have stimulated some additional lending, but were also used to repay central bank advances and to change the currency denomination of existing loans.

18. **In view of the large local currency liquid holdings accumulated by banks at the NBG, the short-term policy concern is to ensure that these balances do not destabilize the foreign exchange market.** Banks have been cautious in extending local currency loans out of these short-term resources. Part of this excess liquidity has been absorbed by T-bills, and the central bank has decided not to inject additional liquidity through swaps. At the end of October, banks held the equivalent of $217 million in excess liquidity. The mission recommended that the NBG increase short-term CD issuance to improve liquidity management and reduce the risks that excess liquidity create speculative pressures in the foreign exchange market. The central bank was concerned that increasing CD issuance would signal a tightening of monetary policy, but given the interest differential between CDs (3.7 percent) and the lending rate in lari (23 percent), it is very unlikely that increasing CD issuance, even at higher rates, would affect lending conditions. To that same end, the authorities also intend to raise reserve requirements back to their pre-war level, and are considering extending reserve requirement to short-term external liabilities.

19. **Credit growth is projected to resume in 2010.** The expected decline in interest rates and the improved growth outlook should increase the demand for borrowing. On the supply side, improved liquidity conditions, the high degree of provisioning against existing NPLs, and reduced loan-to-deposit ratios to more prudent levels should allow banks to expand their loan portfolio.[5] High intermediation margins (between deposit and lending rates) are another factor affecting credit conditions. Although intermediation margins have declined recently, there remains a large structural component which reflects the high capitalization of banks.

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

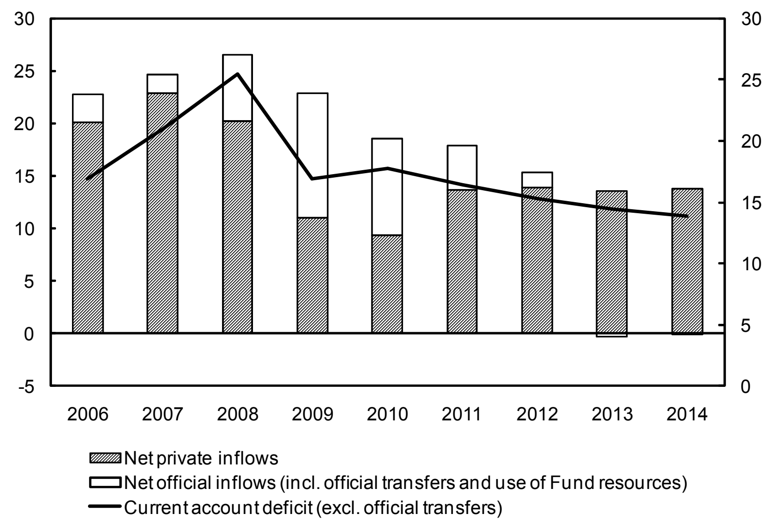
20. **The 2010 monetary program is built on the expectation of a 13 percent increase in broad money, and a 9 percent increase in credit to the private sector.** The NFA of the banking sector is projected to remain roughly unchanged, with a marginal decline in banks' net foreign assets offset by an improvement in the central bank's NFA position. The central bank's gross international reserves are projected to reach $2.1 billion, and NIR would decline to $609 million to cover the projected net financing need of the private sector in 2010.

D. Exchange Rate Policy

The move to foreign exchange auctions has given market forces a greater say in the foreign exchange market, and flexibility remains part of the external adjustment strategy. At the same time, the authorities still envision the need for foreign exchange intervention in 2010 to fill the private sector's external financing gap, and avoid disruptive volatility in the exchange rate.

21. **As in 2009, the central bank stands ready to cover part of the foreign exchange financing needs through foreign exchange auctions.** Given the temporary nature of the private sector financing gap, the auctioning of foreign exchange will help to avoid disruptive overshooting of the exchange rate. In the dollarized Georgian economy, such overshooting could well derail the fragile recovery and put added pressure on public finances.

Georgia: Current Account Balance and its Financing, 2006-14
(In percent of GDP)



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

22. **The aim of exchange rate policy is to smooth out excess volatility, while allowing the exchange rate to respond to underlying fundamental disequilibria.** The auction system, by giving market forces a greater role in the determination of day-to-day exchange rate movements, should facilitate the reading of market signals and the calibration of auction volumes. To further enhance the functioning of the auction system, the authorities have widened the bidding spread from 1 to 2 percent.[6] Market participants surveyed by the mission expect stable market conditions to continue in 2010.

[6] The central auction rate is set at the previous day's market rate, and banks are allowed to bid within a corridor of ± 1.0 percent around the announced auction rate.

23. **Should significant and persistent pressures build up in the foreign exchange market, the authorities stand ready to adjust their strategy to maintain external stability.** They indicated that they would resort to faster expenditure contraction as a first line of defense, but ultimately would allow for faster depreciation. They consider that banks' capital buffers would be sufficient to deal with the deterioration in the dollar loan portfolio of banks related to depreciation within a relatively large range (see below). They did not consider it necessary to address currency-induced credit risk ex-ante through publicly supported restructuring or hedging schemes.

24. **The balance of payments gap is projected to close by 2011–12, as export demand recovers and private capital inflows resume.** The authorities noted that real exchange rate overvaluation (estimated by staff in the range of 6 percent under the ERER approach to 21 percent under the macro-balance approach) could be corrected in large part through the government's structural reform program (privatization, deregulation, and improvements in government efficiency). They did not rule out the need for exchange rate adjustment over the medium term.

E. The Banking Sector

The Georgian banking sector is emerging from the crisis with adequate capital buffers, and banks' balance sheets are improving; however, risks remain, particularly because of balance sheet exposures to currency-induced credit risk, which call for continued vigilance.

25. **Stress tests conducted by the authorities indicate that substantial recapitalization needs would arise only in the case of a large depreciation.**[7] A 10 percent lari depreciation (vis-à-vis the U.S. dollar) combined with a 15 percent decline in real GDP would cause manageable recapitalization needs in some banks, that would not require public intervention. By contrast, a 30 percent lari depreciation, again combined with a 15 percent decline in output, would generate recapitalization needs for most systemic banks, estimated at 3¼ percent of GDP, with a possible need for public financial support—80 percent of the increase in NPLs is estimated to originate from the exchange rate effect alone. The authorities are planning to improve their macro-prudential analysis by developing a macroeconomic credit risk model that better captures real-financial dynamic linkages. They are also requiring systemic banks to carry out stress tests based on an extended Macro Credit Risk Model, intended to capture bank-specific effects.

26. **The authorities have prepared a contingency plan to safeguard the financial sector in the event systemic risks materialize.** The plan (structural benchmark for end-

[7] Stress tests are based on a Macro Credit Risk Model developed with technical assistance from the Fund's Monetary and Capital Market Department.

September) discusses bank-by-bank contingency measures based on stress test results and the potential role of shareholders. In addition, the plan outlines policy options for the containment of liquidity and solvency crises, separately for systemic and non-systemic banks, including options on the use of public funds. The authorities have already played an active role in the restructuring of one systemic bank, first by injecting liquidity through government deposits and providing lending of last resort, and later by facilitating its acquisition by a foreign investor. The mission recommended extending the contingency plan to include exit strategies.

27. **The authorities are planning to move gradually to risk-based and consolidated supervision starting in 2010.** Under the new law on commercial banks, the supervisor is authorized to adjust regulatory requirements based on bank-by-bank risk assessments. The authorities are also considering introducing requirements for dynamic provisioning, fx-denominated provisions for fx loans, and fx-denominated capital for fx-assets in order to reduce balance sheet vulnerability to exchange rate fluctuations.

28. **In all, banks' balance sheets are on the mend, although NPLs could rise further.** Thanks to tight provisioning requirements, the current level of provisions appears sufficient to cover loan losses. However, the recent stabilization of NPLs could be temporary given the lags with which loan quality reacts to economic conditions.

29. **The authorities have been reluctant to introduce regulatory and non-traditional monetary policy instruments to stimulate credit.** They have considered a range of possible measures, including loan guarantees, direct government deposits into the commercial banks, and deposit insurance schemes. However, they have rejected them until now because of the associated distortions and moral hazard. The one exception has been the introduction of a small credit guarantee scheme targeting residential real estate development (roughly $30 million).

III. Program Issues

30. **Performance criteria for end-December 2009 are unchanged except for the NDA ceiling.** The proposed NDA ceiling has been raised to reflect higher reserve money growth. New PCs are proposed through June 2010, with indicative targets covering the rest of 2010.

<table>
<tr><th colspan="3">Georgia: Proposed Structural Benchmarks for 2010</th></tr>
<tr><th>Proposed Structural Benchmark</th><th>Proposed Time Frame</th><th>Rationale</th></tr>
<tr><td>Cabinet approval of a new medium-term expenditure framework (Basic Data and Directions) that includes expenditure ceilings applicable to the 2011 budget.</td><td>July 31, 2010</td><td rowspan="2">Strengthen the efficiency of the adjustment strategy by improving linkages between the medium-term expenditure framework and annual budgets, and building the capacity for program budgeting.</td></tr>
<tr><td>Cabinet approval of the methodology to introduce a programmatic approach to budgeting, identifying the requirements in terms of budget preparation processes and information needs.</td><td>September 30, 2010</td></tr>
</table>

IV. Staff Appraisal

31. **Economic developments and the outlook for 2010 are broadly in line with the expectations of the third review.** Successful program implementation has begun to produce the desired results in terms of restoring confidence and stabilizing the economy. While growth is expected to be positive in 2010, the economic recovery remains fragile.

32. **Policy performance has been good.** Despite weaker-than-expected revenues, budget implementation is on track to meet the 2009 deficit target. The foreign exchange market has been stable, and the end-year NIR target should be met.

33. **The revised strategy approved at the last review remains appropriate.** The strategy is to achieve an orderly external adjustment, by transitioning from the expansionary fiscal policy stance of 2009 to a path of strong fiscal consolidation, while using Fund resources to fill the remaining balance of payments gap.

34. **The fiscal deficit reduction objective for 2010 is ambitious but backed by a realistic budget and a strong policy commitment.** The draft budget is expected to be adopted without further changes. Expenditure pressures will increase ahead of the May municipal elections, but the authorities are confident they can deliver on the budget commitment. The expected gradual easing of credit conditions should also alleviate the countercyclical burden carried by fiscal policy until now.

35. **The Economic Freedom Act presented by the president reinforces the authorities' commitment to fiscal discipline, but, by constraining fiscal policy options, it also creates risks.** Subjecting most tax policy changes to referendum could make the deficit targets more difficult to achieve and appears untimely given the financial constraints faced by Georgia in the next few years. The outright prohibition on the use of capital controls appears similarly unwarranted given the uncertain financial context.

36. **Adoption of the budget code now in parliament will enhance the efficiency of budgetary policy and support the medium-term fiscal adjustment strategy.** The requirement that the budget process be more closely linked to the medium-term expenditure framework and to a programmatic approach should strengthen the sustainability and the efficiency of the adjustment.

37. **Balance of payments financing remains critical to sustain the economic recovery as fiscal policy is tightened.** The balance of payments gap for 2010 originates largely from the expected slow recovery of private capital inflows. By filling this gap, Fund financing will help reduce the risks of an overshooting of the exchange rate in 2010, which would be particularly disruptive in the highly dollarized Georgian economy. Nonetheless, over the medium term some exchange rate adjustment is likely to be needed to improve competitiveness.

38. **The priority for monetary policy in the short run is to reduce the excess balances of banks.** T-bill issuance by the government will mop up only part of the excess local currency liquidity. Additional CD issuance by the central bank is therefore needed to avoid the risk of speculative balance sheet shifts into dollars. Maturing short term CDs can re-inject liquidity into the system as lending resumes.

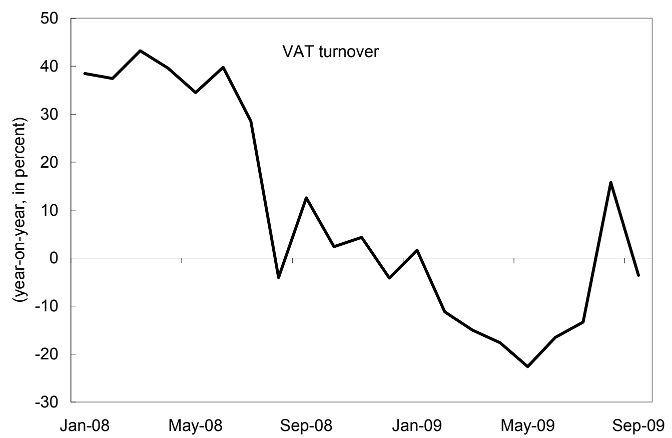
39. **The banking sector has weathered the crisis relatively well, and systemic risks have abated considerably since the beginning of the year**. Banks have retained a solid capital base, reconstituted strong liquidity buffers, and set aside adequate provisions. The relative strength of their balance sheets and improved profitability should place them in a position to begin extending credit. Risks, particularly currency induced, remain pervasive, but stress tests confirm the resilience of banks to a further worsening of their loan portfolio and the relatively small exposure of government finances to banking sector stress. Relatively high capital charges on foreign exchange lending have proven their usefulness, and should not be eased. Financial sector policies have contributed to strengthening the outlook, including the development of a contingency plan, legal reforms to strengthen supervisory powers, and steps taken to move to risk-based supervision. A deposit insurance scheme, possibly limited to lari deposits, should be considered when conditions normalize as a safeguard against future deposit instability. In the absence of deposit insurance, prudential considerations call for the restoration of the (tighter) liquidity requirements that prevailed before September 2008.

40. **In all, the program is on track to deliver the desired stabilization and adjustment, but risks remain.** While fiscal consolidation in 2010 will withdraw fiscal stimulus, it should also help to strengthen confidence and stabilize exchange rate expectations, which are key to macroeconomic stability in the highly dollarized Georgian economy. At the same time, a gradual easing of credit conditions should start promoting new lending. Risks lie mostly in the pace at which lending interest rates will decline, credit will expand, and FDI inflows will resume.

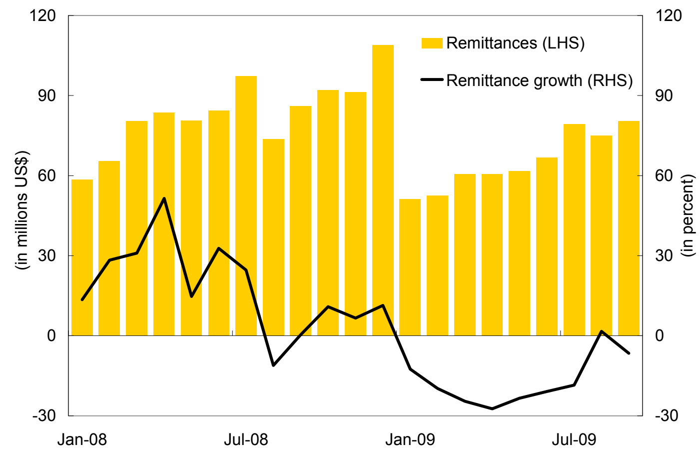
41. On the basis of Georgia's performance under the SBA, **staff supports the authorities' request for completing the fourth review**, and modifying program conditionality, as specified in the Letter of Intent (¶28, and Tables 1 and 2).

Figure 1. Georgia: Real Sector Developments

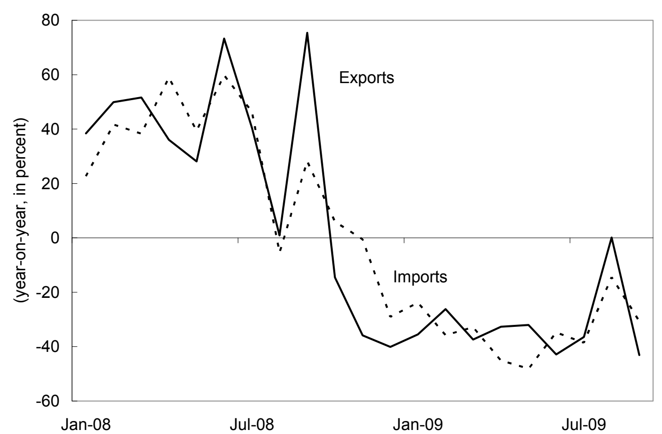
VAT turnover…



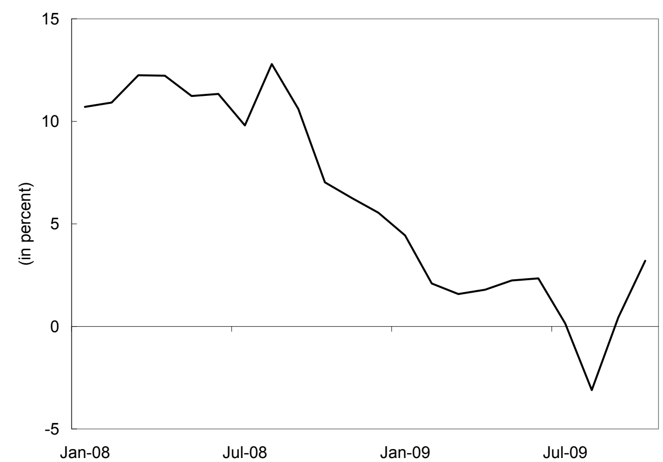
…and remittances have stabilized…



…but trade data remain weak.



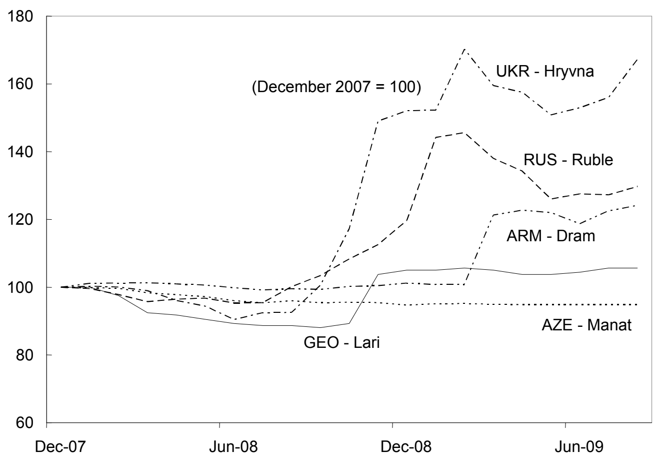
Inflation has increased recently, but remains low.



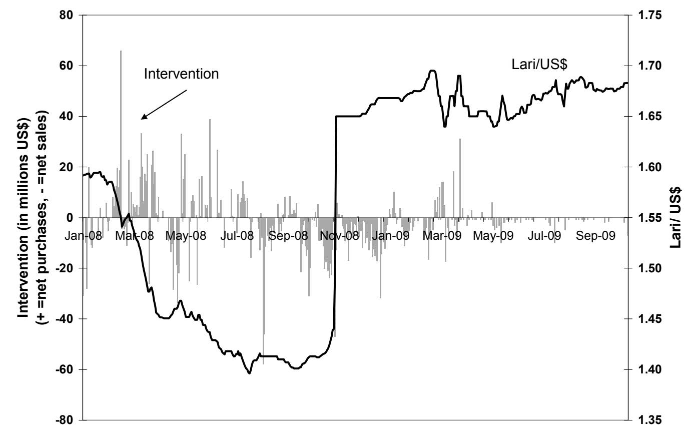
Source: Department of Statistics of Georgia.

Figure 2. Georgia: Exchange Rate Developments

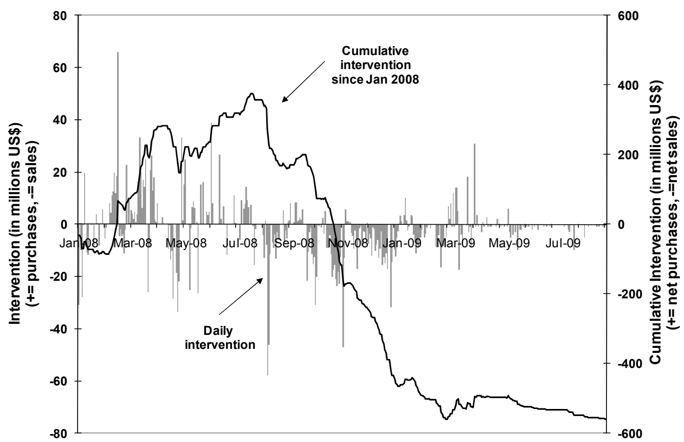
The USD exchange rate has been remarkably stable…



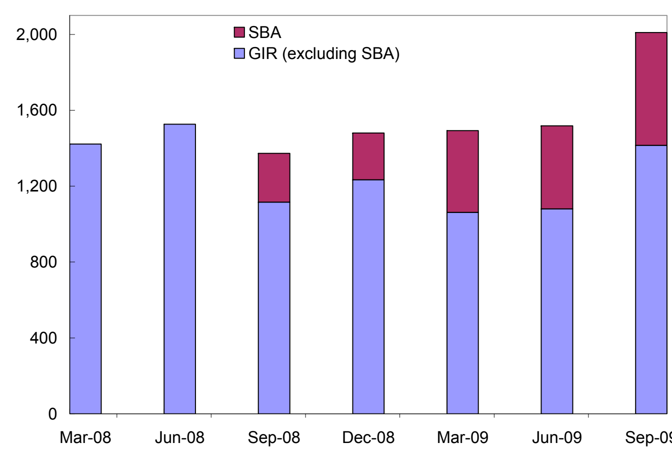
…while displaying some short-term volatility,…



…and fx intervention has been limited…



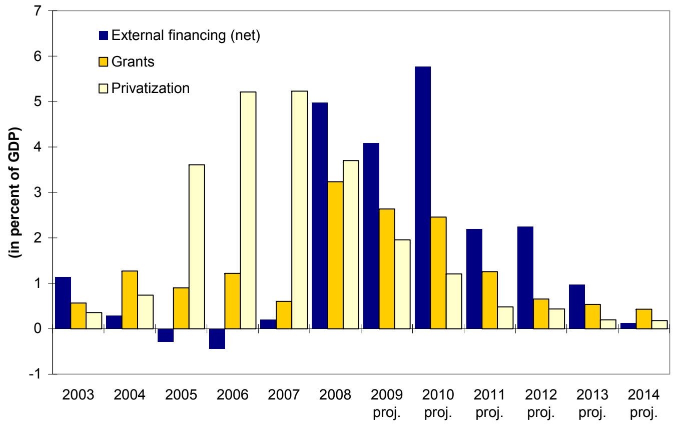
…with the reserve cushion likely contributing to stabilize expectations.



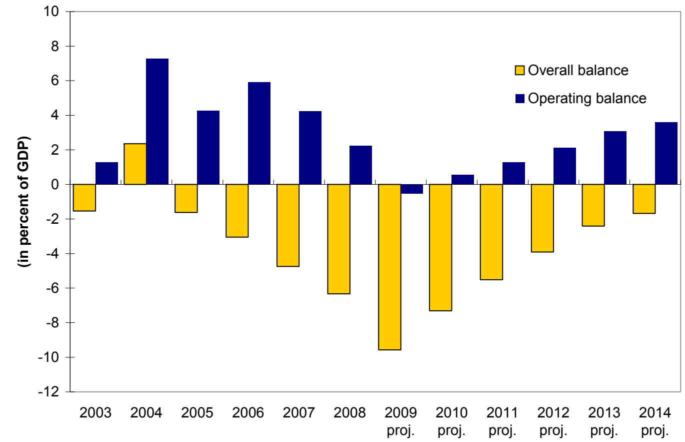
Source: National Bank of Georgia.

Figure 3. Georgia: Fiscal Sector Developments and Outlook

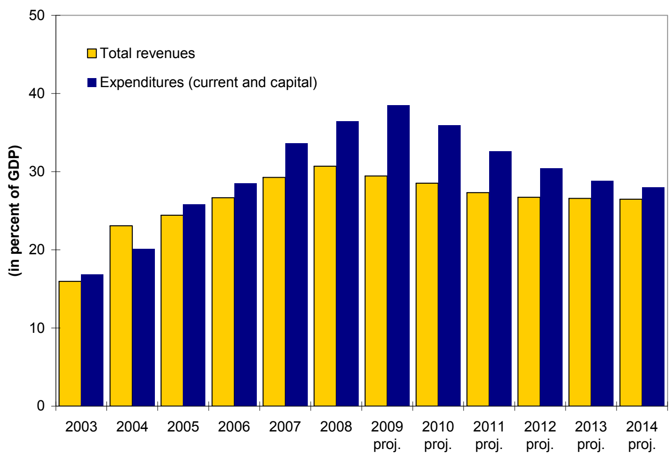
In 2008, external borrowing outstripped privatization proceeds as the main source of financing.



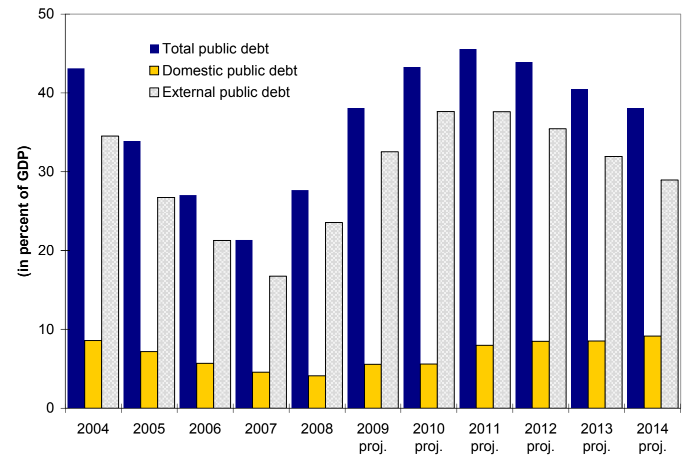
The fiscal deficit is expected to peak in 2009.



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



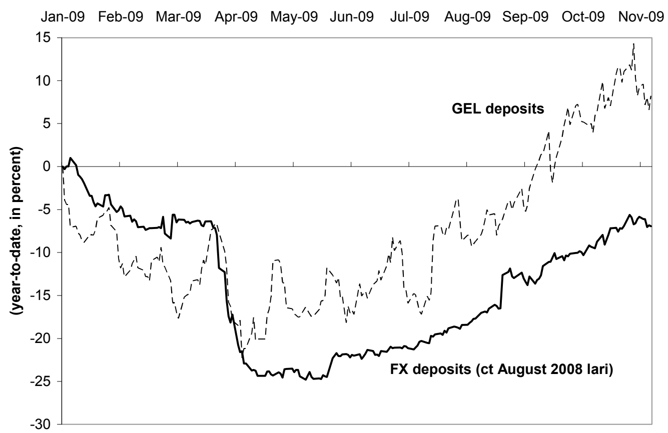
Owing to the accumulation of deficits, Georgia's public debt will increase through 2011.



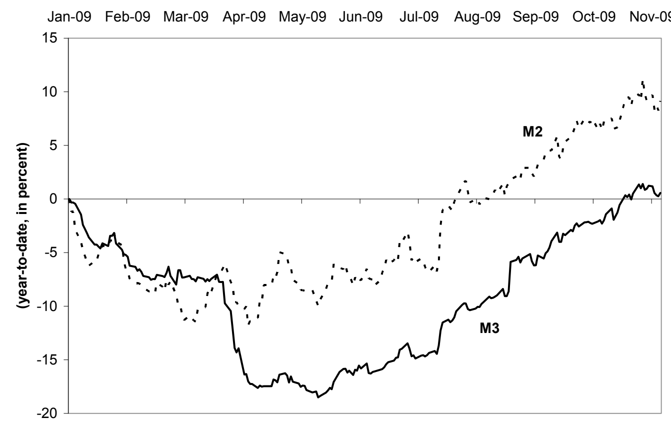
Source: Georgian authorities; and Fund staff estimates.

Figure 4. Georgia: Monetary Sector Developments

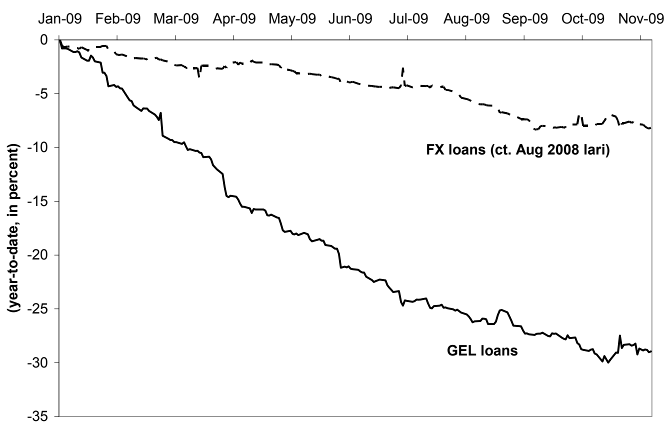
Lari and foreign currency-denominated deposits…



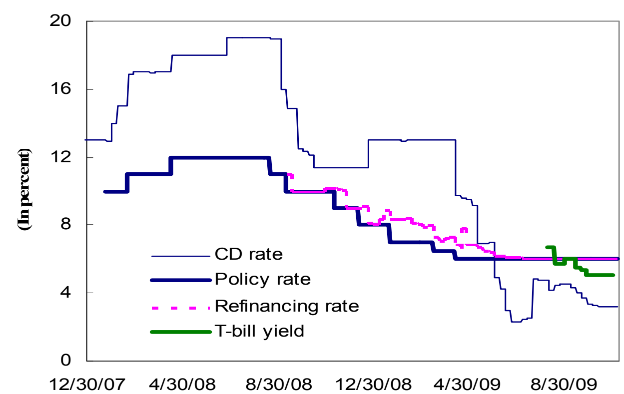
…and broad monetary aggregates have been growing since June.



Private credit, however, continues to contract.



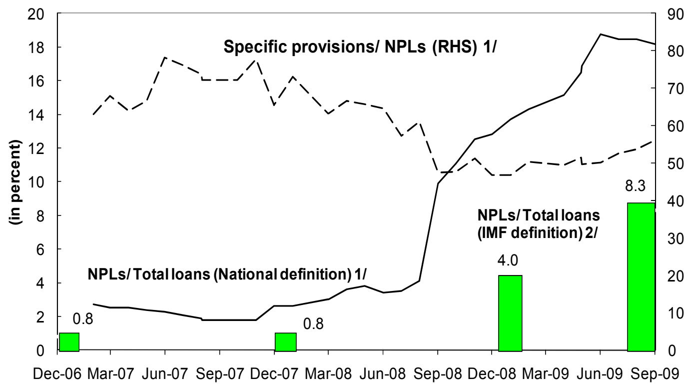
Reductions in the policy rate, although not passed through to deposit and lending rates, have been reflected in the T-bill and CD rates.



Source: National Bank of Georgia.

Figure 5. Georgia: Banking Sector Developments

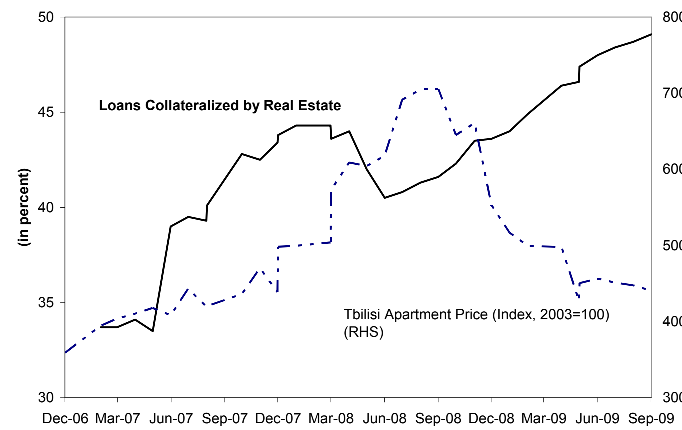
Nonperforming loans have stabilized…



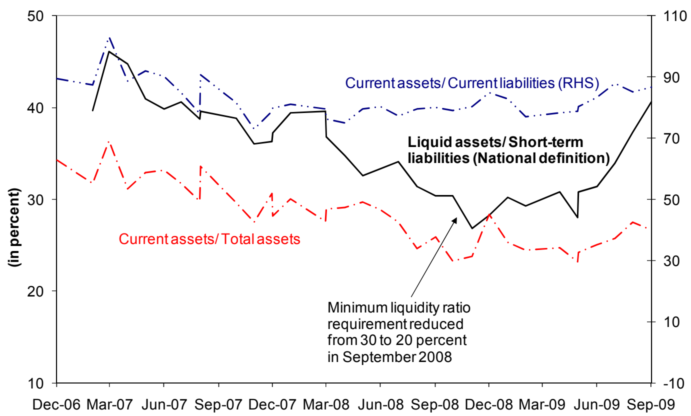
Source: Georgian Financial Supervisory Agency

1/ NPLs are defined as loans in substandard, doubtful, and loss loan categories.
2/ NPLs are defined as loans with overdue payments (principle and/or interest) over 90 days.

…but the share of loans collateralized by real estate trends upward, while the collateral price remains depressed.

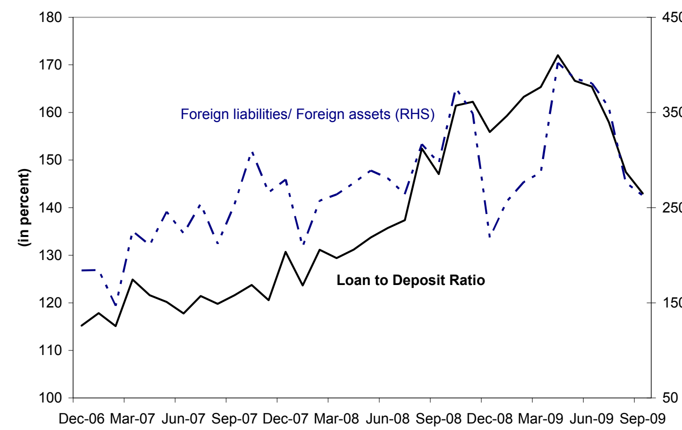


Liquidity indicators continue to improve…



1/ Current assets/ liabilities are of one-month or shorter maturity.

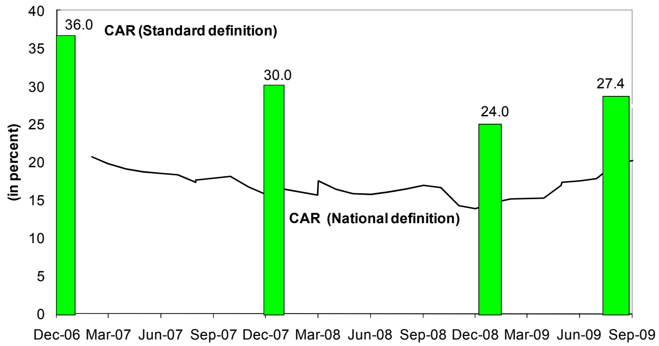
…and banks' reliance on external wholesale financing, although high, has dropped.



Source: Georgian authorities; and Fund staff estimates.

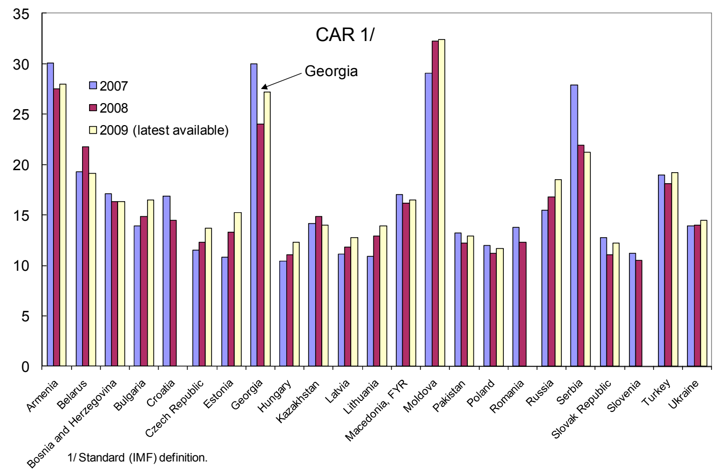
Figure 5. Georgia: Banking Sector Developments (continued)

Georgian banks are highly capitalized...



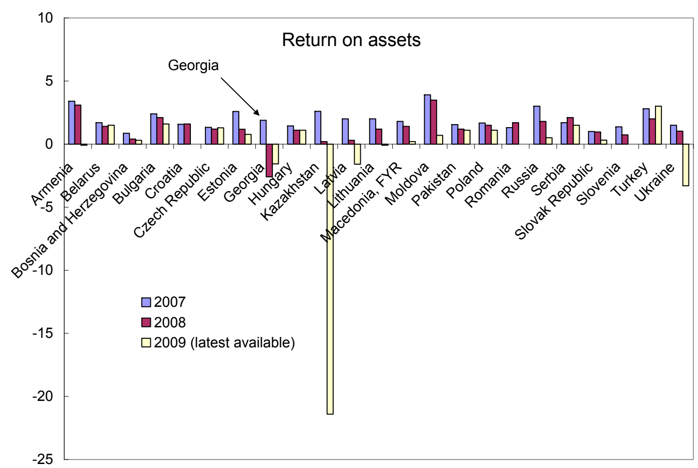
Source: Georgian Financial Supervisory Agency

… compared to those in other countries…



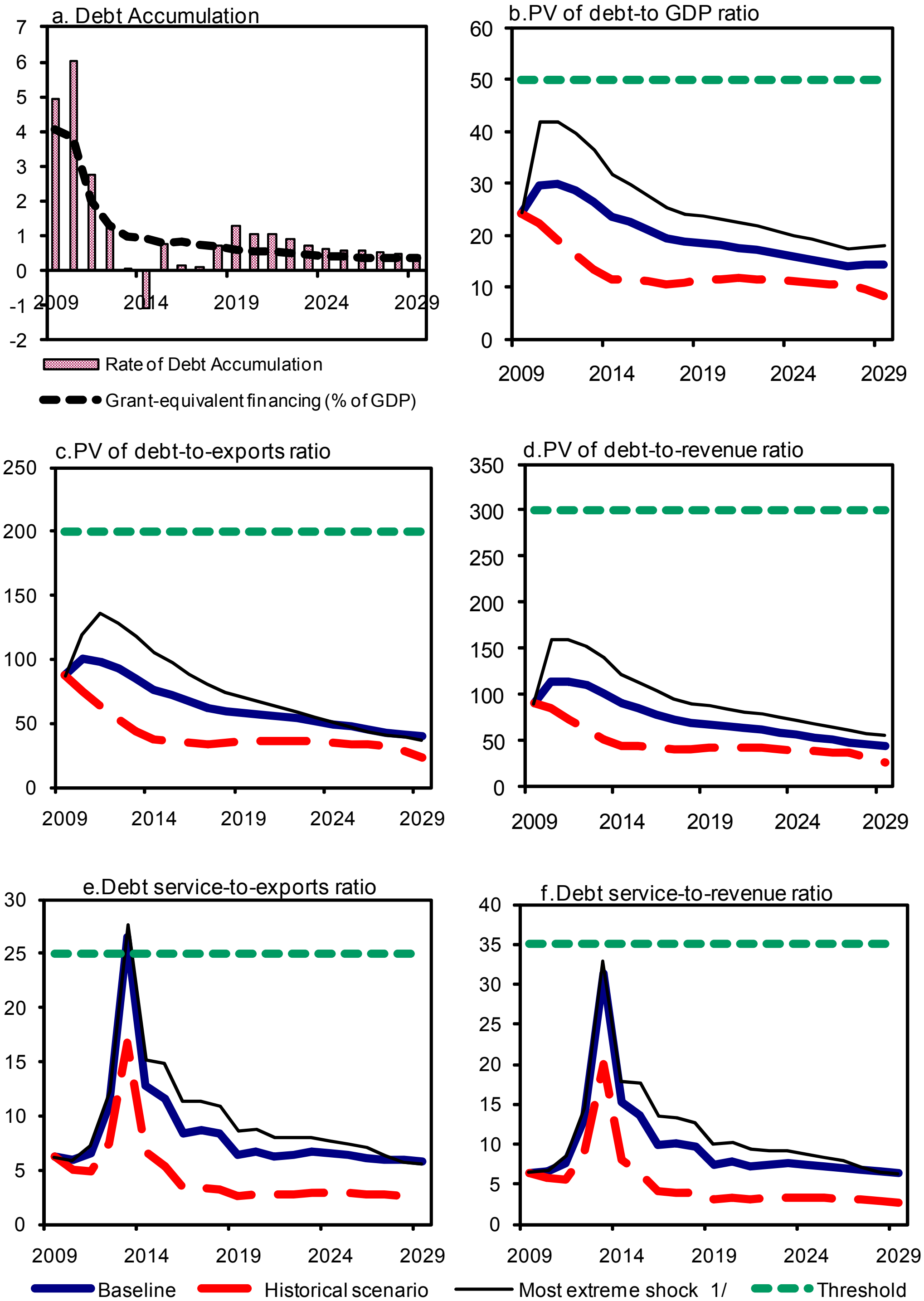
1/ Standard (IMF) definition.

…but incurred large losses in 2008 and early-2009.



Source: Georgian authorities; and Fund staff estimates.

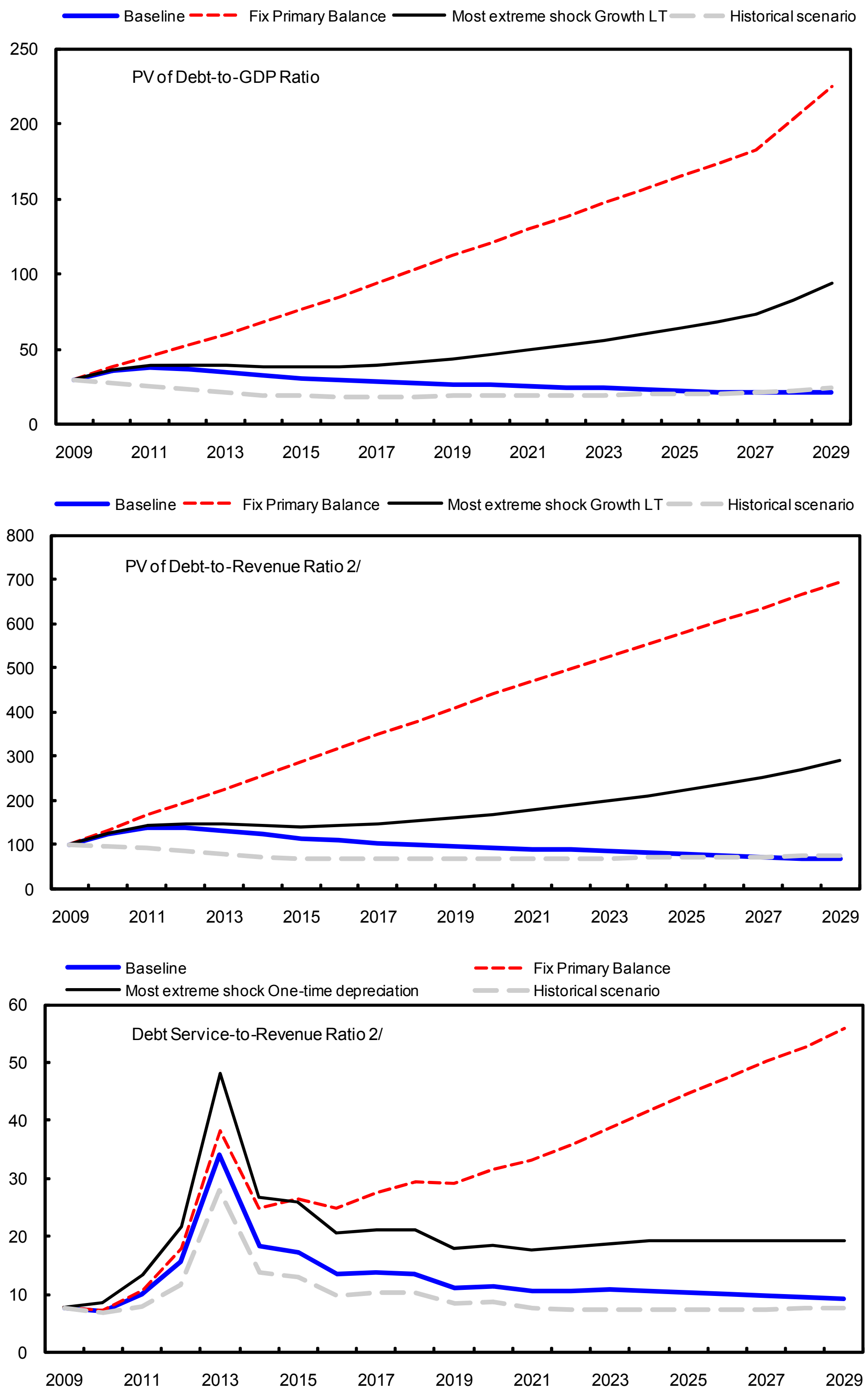
Figure 6a. Georgia: Indicators of Public and Publicly-Guaranteed External Debt under Alternatives Scenarios, 2009-2029 1/



Source: Staff projections and simulations.

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

Figure 6b. Georgia: Indicators of Public Debt Under Alternative Scenarios, 2009-2029 1/ 2/ 3/



Sources: Country authorities; and Fund staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2019.
2/ Fix Primary balance scenario corresponds to the scenario that maintains the primary balance unchanged at 2009 level.
3/ Revenues are defined inclusive of grants.

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

	2007	2008 Prel.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.
	(Annual percentage change, unless otherwise indicated)							
National accounts								
Nominal GDP (in million lari)	16,994	19,070	18,028	19,042	20,794	22,925	25,275	27,866
Real GDP growth	12.3	2.1	-4.0	2.0	4.0	5.0	5.0	5.0
Population (in million) 1/	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
GDP deflator, period average	9.7	9.9	-1.5	3.6	5.0	5.0	5.0	5.0
Consumer price index, period average	9.2	10.0	1.8	4.8	5.0	5.0	5.0	5.0
Consumer price index, end-of-period	11.0	5.5	3.5	5.0	5.0	5.0	5.0	5.0
GDP per capita (in US$)	2,324	2,924	2,445	2,505	2,723	2,959	3,200	3,460
Poverty rate (in percent)	23.7	...	...	...	...	...	...	...
Unemployment rate (in percent)	13.3	16.5	...	...	...	...	...	...
	(In percent of GDP)							
Investment and saving								
Investment 2/	25.7	22.5	19.0	20.5	21.5	22.0	22.0	22.0
Public	3.4	4.3	7.4	6.8	6.1	5.4	5.1	5.0
Private	22.3	18.2	11.6	13.7	15.4	16.6	16.9	17.0
Gross national saving	6.1	-0.1	3.9	4.5	6.1	7.3	7.9	8.5
Public	4.2	2.2	-0.5	0.6	1.3	2.1	3.1	3.6
Private	1.8	-2.4	4.4	3.9	4.8	5.2	4.9	4.8
Saving-investment balance	-19.7	-22.7	-15.1	-16.0	-15.4	-14.7	-14.1	-13.5
Consolidated government operations								
Revenue	29.3	30.7	29.4	28.5	27.3	26.7	26.6	26.5
Expenses	25.0	28.5	30.0	27.9	26.0	24.6	23.5	22.9
Operating balance	4.2	2.2	-0.5	0.6	1.3	2.1	3.1	3.6
Capital spending and net lending	9.0	8.6	9.0	7.9	6.8	6.0	5.5	5.3
Overall balance	-4.7	-6.3	-9.6	-7.3	-5.5	-3.9	-2.4	-1.7
Statistical discrepancy	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Total financing	4.6	6.2	9.6	7.3	5.5	3.9	2.4	1.7
Domestic	-0.8	-2.5	3.5	0.3	2.8	1.2	1.2	1.4
External	0.2	5.0	4.1	5.8	2.2	2.2	1.0	0.1
Privatization receipts	5.2	3.7	2.0	1.2	0.5	0.4	0.2	0.2
	(Annual percentage change, unless otherwise indicated)							
Monetary sector								
Reserve money	25.6	-4.5	18.0	-2.0	…	…	…	…
Broad money (including fx deposits)	49.6	7.0	2.0	13.0	…	…	…	…
Bank credit to the private sector	71.3	31.0	-13.3	9.4	…	…	…	…
Deposit interest rate (annual weighted average on	8.5	9.5	…	…	…	…	…	…
Lending interest rate (annual weighted average on	18.8	21.9	…	…	…	…	…	…
External sector								
Exports of goods and services (percent of GDP)	31.1	28.7	27.9	29.4	30.5	30.7	30.9	30.9
Annual percentage change	24.7	15.9	-18.7	7.9	12.8	9.4	9.0	8.2
Imports of goods and services (percent of GDP)	57.9	58.3	50.5	53.0	52.7	51.7	50.8	50.3
Annual percentage change	34.1	26.7	-27.6	7.6	8.0	6.6	6.4	7.0
Net imports of oil (in US$)	556	762	503	588	636	677	729	774
Current account balance (in millions of US$)	-2,009	-2,915	-1,626	-1,765	-1,850	-1,911	-1,980	-2,062
In percent of GDP	-19.7	-22.7	-15.1	-16.0	-15.4	-14.7	-14.1	-13.5
Gross international reserves (in millions of US$)	1,361	1,480	2,005	2,086	2,259	2,268	2,094	2,057
In months of next year's imports of goods and ser	2.2	3.3	4.1	4.0	4.0	3.8	3.3	3.0
Foreign direct investment (percent of GDP)	17.1	12.2	6.5	7.4	9.5	10.3	11.0	11.8
Average exchange rate (lari per US$)	1.66	1.48	…	…	…	…	…	…

Sources: Georgian authorities; and Fund staff estimates.

1/ Excludes Abkhazia residents.

2/ Investment is measured on a net basis (acquisitions minus disposals of non-financial assets).

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

	2008	2009		2010		2011	2012	2013	2014	2008	2009		2010		2011	2012	2013	2014
		3 Rev.	Proj.	3 Rev.	Proj						3 Rev.	Proj.	3 Rev.	Proj.				
	(In millions of lari)									(In percent of GDP)								
Revenues	5,854	5,426	5,308	5,115	5,429	5,678	6,122	6,719	7,378	30.7	29.6	29.4	26.9	28.5	27.3	26.7	26.6	26.5
Taxes	4,753	4,457	4,412	4,507	4,601	5,024	5,539	6,106	6,732	24.9	24.4	24.5	23.7	24.2	24.2	24.2	24.2	24.2
Other revenues	484	414	421	331	360	393	433	478	527	2.5	2.3	2.3	1.7	1.9	1.9	1.9	1.9	1.9
Grants	617	554	475	277	468	262	150	135	119	3.2	3.0	2.6	1.5	2.5	1.3	0.7	0.5	0.4
Current expenditures	5,427	5,455	5,405	5,203	5,322	5,411	5,638	5,940	6,372	28.5	29.8	30.0	27.3	27.9	26.0	24.6	23.5	22.9
Compensation for employees	1,008	1,118	1,088	1,091	1,141	1,198	1,258	1,321	1,428	5.3	6.1	6.0	5.7	6.0	5.8	5.5	5.2	5.1
Use of goods and services	1,607	971	981	891	1,055	1,000	1,000	1,050	1,130	8.4	5.3	5.4	4.7	5.5	4.8	4.4	4.2	4.1
Subsidies	512	465	465	457	384	380	370	360	369	2.7	2.5	2.6	2.4	2.0	1.8	1.6	1.4	1.3
Grants	12	16	16	10	12	14	16	18	20	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social expenses	1,379	1,499	1,499	1,586	1,611	1,692	1,793	1,900	2,067	7.2	8.2	8.3	8.3	8.5	8.1	7.8	7.5	7.4
Other expenses	789	1,204	1,174	942	934	850	875	900	964	4.1	6.6	6.5	4.9	4.9	4.1	3.8	3.6	3.5
Of which: arrears clearance and provisions	22	220	220	25	29	0	0	0	0	0.1	1.2	1.2	0.1	0.2	0.0	0.0	0.0	0.0
Interest	121	183	183	226	185	278	326	391	395	0.6	1.0	1.0	1.2	1.0	1.3	1.4	1.5	1.4
To nonresidents	64	123	124	133	160	169	182	227	206	0.3	0.7	0.7	0.7	0.8	0.8	0.8	0.9	0.7
To residents	56	60	60	94	25	109	144	164	188	0.3	0.3	0.3	0.5	0.1	0.5	0.6	0.6	0.7
Operating balance	427	-29	-97	-88	107	267	484	779	1,006	2.2	-0.2	-0.5	-0.5	0.6	1.3	2.1	3.1	3.6
Capital spending and net lending	1,636	1,698	1,629	1,305	1,501	1,415	1,380	1,390	1,473	8.6	9.3	9.0	6.9	7.9	6.8	6.0	5.5	5.3
Capital	1,524	1,605	1,537	1,301	1,526	1,375	1,340	1,350	1,433	8.0	8.8	8.5	6.8	8.0	6.6	5.8	5.3	5.1
Net lending	111	92	92	4	-25	40	40	40	40	0.6	0.5	0.5	0.0	-0.1	0.2	0.2	0.2	0.1
Overall balance	-1,208	-1,726	-1,726	-1,393	-1,393	-1,148	-896	-611	-467	-6.3	-9.4	-9.6	-7.3	-7.3	-5.5	-3.9	-2.4	-1.7
Statistical discrepancy	36	0	0	0	0	0	0	0	0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total financing	1,173	1,726	1,726	1,393	1,393	1,148	896	611	467	6.2	9.4	9.6	7.3	7.3	5.5	3.9	2.4	1.7
Domestic	-483	511	636	0	65	592	281	314	383	-2.5	2.8	3.5	0.0	0.3	2.8	1.2	1.2	1.4
Net T-bill issuance	0	160	258	106	100	633	325	363	437	0.0	0.9	1.4	0.6	0.5	3.0	1.4	1.4	1.6
Amortization 2/	-33	-37	-37	-35	-35	-40	-45	-49	-54	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Use of deposits at the NBG and banks	-450	388	415	-71	0	0	0	0	0	-2.4	2.1	2.3	-0.4	0.0	0.0	0.0	0.0	0.0
External	950	765	737	1,211	1,098	456	515	247	34	5.0	4.2	4.1	6.4	5.8	2.2	2.2	1.0	0.1
Borrowing	1,073	909	839	1,343	1,236	567	608	1,514	616	5.6	5.0	4.7	7.1	6.5	2.7	2.7	6.0	2.2
of which IMF		166	169	664	665						0.9	0.9	3.5	3.5				
Amortization	-66	-185	-143	-132	-138	-111	-92	-1,267	-581	-0.3	-1.0	-0.8	-0.7	-0.7	-0.5	-0.4	-5.0	-2.1
Use of Sovereign Wealth Fund resources	-57	40	40	0	0	0	0	0	0	-0.3	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts	706	451	353	182	230	100	100	50	50	3.7	2.5	2.0	1.0	1.2	0.5	0.4	0.2	0.2
Memorandum items:																		
Nominal GDP	19,070	18,303	18,028	19,042	19,042	20,794	22,925	25,275	27,866									
Fiscal deficit excluding grants	1,790	2,281	2,201	1,670	1,862	1,410	1,046	745	586	9.4	12.5	12.2	8.8	9.8	6.8	4.6	2.9	2.1
Total expenditures (current prices)	6,951	7,060	6,942	6,504	6,848	6,786	6,978	7,290	7,805	36.5	38.6	38.5	34.2	36.0	32.6	30.4	28.8	28.0
Total expenditures (constant 2008 prices)	6,951	6,841	7,049	6,354	6,715	6,338	6,206	6,175	6,297									

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.

Table 3. Georgia: Quarterly General Government Operations, 2009 -10 1/

	2009					2010				
	Q1 Act.	Q2 Act.	Q3 Act.	Q4 Proj.	Annual Proj.	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Annual Proj.
	(In millions of lari)									
Revenues	1,267	1,118	1,292	1,632	5,308	1,112	1,234	1,458	1,625	5,429
Taxes	1,139	996	1,094	1,182	4,412	995	1,105	1,225	1,275	4,601
Direct	458	452	475	402	1,788	438	499	484	455	1,876
Indirect	681	544	619	780	2,624	557	607	740	820	2,724
Other revenues	79	84	107	151	421	48	60	104	149	360
Grants	48	38	90	299	475	69	69	129	202	468
Current expenditures	1,296	1,300	1,282	1,527	5,405	1,209	1,292	1,326	1,494	5,322
Compensation for employees	248	260	251	329	1,088	270	280	280	311	1,141
Use of goods and services	207	273	260	241	981	230	250	270	305	1,055
Subsidies	87	105	104	170	465	80	95	105	104	384
Grants	7	3	2	5	16	3	3	3	3	12
Social expenses	352	377	377	393	1,499	400	400	400	411	1,611
Other expenses	370	226	259	319	1,174	197	205	237	295	934
Of which: arrears clearance and provisions	171	5	19	25	220	2	5	7	15	29
Interest	26	56	30	71	183	29	59	31	66	185
To nonresidents	13	40	16	55	124	28	53	25	54	160
To residents	13	16	14	16	60	2	7	5	12	25
Operating balance	-30	-182	9	104	-97	-97	-58	132	131	107
Capital spending and net lending	199	338	474	618	1,629	271	319	447	464	1,501
Capital	169	333	452	583	1537	275	325	450	476	1,526
Net lending	30	5	22	35	92	-4	-7	-3	-12	-25
Overall balance	-228	-520	-464	-513	-1,726	-368	-376	-315	-333	-1,393
Statistical discrepancy	0	0	0	0	0	0	0	0	0	0
Total financing	228	520	464	513	1,726	368	376	315	333	1,393
Domestic	63	375	103	95	636	26	154	-76	-39	65
Net T-Bill issuance	0	0	68	190	258	0	100	0	0	100
Amortization 2/	-9	-11	-12	-5	-37	-12	-10	-6	-7	-35
Use of deposits at the NBG and banks	72	386	48	-91	415	38	64	-70	-32	0
External	64	40	301	332	737	328	192	321	257	1,098
Borrowing	37	60	377	366	839	343	216	394	283	1,236
Of which: IMF	0	0	0	169	169	262	134	134	134	665
Amortization	-13	-20	-76	-34	-143	-15	-23	-73	-26	-138
Use of Sovereign Wealth Fund resources	40	0	0	0	40	0	0	0	0	0
Privatization receipts	101	106	60	86	353	15	30	70	115	230
Memorandum items:										
Nominal GDP	3,846	4,272	4,650	5,261	18,028	4,112	4,626	4,970	5,334	19,042

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.

Table 4. Georgia: Summary Balance of Payments, 2007-14

(In millions of U.S. dollars)

	2007	2008	2009		2010		2011	2012	2013	2014
			3rd Review	Proj.	3rd Review	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-2,009	-2,915	-1,768	-1,626	-1,782	-1,765	-1,850	-1,911	-1,980	-2,062
Trade balance	-2,896	-3,833	-2,733	-2,656	-2,888	-2,898	-3,021	-3,147	-3,285	-3,491
Exports	2,088	2,428	1,717	1,770	1,915	1,855	2,101	2,294	2,492	2,691
Imports	-4,984	-6,261	-4,450	-4,426	-4,804	-4,752	-5,121	-5,442	-5,778	-6,182
Services	161	23	211	222	307	291	361	417	486	546
Income (net)	37	-166	-99	-74	-52	-103	-104	-97	-113	-92
Of which: interest payments	-121	-249	-271	-266	-295	-309	-330	-347	-375	-363
Transfers (net)	688	1,061	853	882	851	945	913	917	933	975
Of which: public sector	138	365	265	189	151	196	117	78	53	52
Capital account	128	105	211	198	140	206	90	77	68	59
Financial account	2,323	2,807	1386	1,696	1,522	1,277	1,884	2,091	2,156	2,335
Direct investment (net)	1,675	1,523	907	700	1,046	817	1,132	1,342	1,553	1,772
Monetary authorities, net 1/	-101	21	5	241	0	0	0	0	0	0
General government	116	651	376	353	309	251	263	299	274	254
Private Sector, excl. FDI	634	611	98	401	167	209	489	450	330	309
Banks	569	402	31	97	69	97	327	320	253	264
Portfolio investment, net	21	109	-2	7	58	10	95	100	105	95
Of which: equity liabilities	34	101	-2	7	8	0	30	30	30	30
Loans received (net)	653	595	-312	-127	-53	-53	72	110	58	89
Other, net (currency and deposits)	-105	-302	345	217	65	140	160	110	90	80
Other sectors	64	208	67	304	98	112	161	130	77	45
Portfolio investment, net	0	14	17	13	38	48	31	44	48	63
Long-term loans received (net)	95	58	122	100	31	26	27	-1	-8	-31
Other, net	-30	137	-72	192	28	38	103	87	37	13
Errors and omissions	-34	-48	20	69	0	0	0	0	0	0
Overall balance	408	-51	-151	337	-120	-282	123	257	244	332
Financing	-408	51	151	-337	120	282	-123	-257	-244	-332
Gross International Reserves (-increase)	-377	-131	-230	-503	-234	-81	-173	-9	174	37
Use of Fund Resources	3	222	381	311	354	363	50	-248	-418	-370
Purchases (SBA)	43	257	408	338	375	385	109	0	0	0
Of which: augmentation	…	…	…	…	303	311	109	…	…	…
Repayments (SBA and PRGF)	-39	-35	-27	-27	-21	-22	-59	-248	-418	-370
Exceptional financing	-34	-39	1	-145	0	0	0	0	0	0
Memorandum items:										
Nominal GDP	10,224	12,867	10,981	10,759	10,761	11,023	11,979	13,017	14,078	15,226
Current account balance (percent of GDP)	-19.7	-22.7	-16.1	-15.1	-16.6	-16.0	-15.4	-14.7	-14.1	-13.5
excluding official transfers (percent of GDP)	-21.0	-25.5	-18.5	-16.9	-18.0	-17.8	-16.4	-15.3	-14.4	-13.9
Trade balance (in percent of GDP)	-28.3	-29.8	-24.9	-24.7	-26.8	-26.3	-25.2	-24.2	-23.3	-22.9
GNFS exports growth (percent)	24.7	15.9	-20.1	-18.7	12.0	7.9	12.8	9.4	9.0	8.2
GNFS exports volume growth (percent)	4.7	-2.1	-8.2	-9.1	9.1	5.4	8.5	7.7	7.7	7.0
GNFS imports growth (percent)	34.1	26.7	-27.1	-27.6	7.5	7.6	8.0	6.6	6.4	7.0
GNFS imports volume growth (percent)	11.9	6.6	-14.6	-15.5	2.1	1.6	4.7	4.8	4.9	5.0
Net capital inflows to private sector	2,308	2,134	1,005	1,102	1,213	1,026	1,621	1,792	1,883	2,081
(in percent of GDP)	22.6	16.6	9.1	10.2	11.3	9.3	13.5	13.8	13.4	13.7
Gross international reserves (end of period)	1,361	1,480	1,708	2,005	1,942	2,086	2,259	2,268	2,094	2,057
(in months of next year GNFS imports)	2.2	3.3	3.5	4.1	3.7	4.0	4.0	3.8	3.3	3.0
External debt (nominal)	3,652	5,401	6,016	5,926	6,868	6,729	7,229	7,388	7,388	7,423
(in percent of GDP)	35.7	42.0	54.8	55.1	63.8	61.0	60.3	56.8	52.5	48.8
MLT External debt service	378	591	949	713	782	808	937	1,168	2,071	1,419
(in percent of exports)	11.9	16.0	32.2	23.8	23.7	25.0	25.7	29.2	47.6	30.1
External public sector debt (nominal)	1,790	2,691	3,509	3,394	4,306	4,150	4,484	4,567	4,455	4,365
(in percent of GDP)	17.5	20.9	32.0	31.5	40.0	37.6	37.4	35.1	31.6	28.7
External public debt service	111	125	221	186	181	207	244	440	1,156	608
(in percent of exports)	3.5	3.4	7.5	6.2	5.5	6.4	6.7	11.0	26.5	12.9

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

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

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

	2008				2009				2010			
	Mar.	Jun.	Sep.	Dec.	Mar. Act.	Jun. Act.	Sep. Act.	Dec. Proj.	Mar. Proj.	Jun. Proj.	Sep. Proj.	Dec. Proj.
	(In millions of lari)											
Net foreign exchange position	1,500	1,594	1,266	1,528	1,313	1,303	1,489	1,719	1,676	1,590	1,747	1,881
Gross International Reserves	2,099	2,164	1,930	2,467	2,493	2,517	3,371	3,464	3,412	3,324	3,471	3,604
Other foreign assets	76	70	87	41	35	14	15	15	15	15	15	15
Foreign liabilities	-675	-640	-750	-981	-1,215	-1,228	-1,896	-1,760	-1,750	-1,749	-1,738	-1,738
Of which: use of Fund resources	-361	-342	-655	-769	-1,040	-1,068	-1,329	-1,174	-1,163	-1,157	-1,142	-1,135
Of which: compulsory reserves in USD	-282	-296	-88	-121	-125	-109	-122	-128	-130	-134	-138	-145
Of which: swap liabilities	0	0	0	0	0	-30	-61	-62	-62	-62	-62	-62
Net domestic assets	-87	6	468	-96	-47	226	201	-29	27	31	-107	-225
Net claims on general government	315	149	400	-103	-34	398	441	346	372	426	350	311
Claims on general government (incl. T-bills)	776	776	778	777	777	778	764	759	747	737	731	724
Nontradable govt. debt	689	689	689	689	641	641	641	641	641	641	641	641
Securitized debt (marketable)	87	87	89	88	136	137	123	118	106	96	90	83
Deposits	-461	-627	-377	-880	-812	-380	-323	-413	-375	-311	-381	-413
Claims on rest of economy	3	3	3	4	4	4	4	4	4	4	4	4
Claims on banks	-392	-180	-18	132	90	-17	-41	-189	-158	-209	-271	-350
Certificates of deposits and bonds	-467	-180	-143	-77	-114	-148	-146	-294	-263	-314	-376	-455
Other items, net	-13	34	82	-129	-106	-160	-203	-190	-190	-190	-190	-190
Reserve money	1,414	1,600	1,734	1,432	1,267	1,529	1,691	1,690	1,704	1,620	1,640	1,656
Currency in circulation	1,287	1,413	1,399	1,291	1,141	1,201	1,286	1,350	1,375	1,400	1,425	1,450
Bank lari reserves 1/	126	187	335	141	126	328	405	340	329	220	215	206
	(Percent contribution, compared to reserve money at the end of previous year)											
Net foreign assets	2.7	8.9	-13.0	4.5	-15.0	-15.7	-2.7	13.4	-2.5	-7.6	1.7	9.6
Net domestic assets	-8.3	-2.2	28.7	-8.9	3.4	22.5	20.8	4.6	3.4	3.5	-4.6	-11.6
Net claims on general government	-0.9	-12.0	4.8	-28.8	4.8	35.0	38.0	31.3	1.5	4.7	0.2	-2.1
Claims on rest of economy	-6.6	-6.6	-6.6	-6.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on banks	-5.9	8.2	19.1	29.1	-2.9	-10.4	-12.1	-22.4	1.8	-1.2	-4.8	-9.5
Other items, net	5.1	8.2	11.5	-2.6	1.6	-2.2	-5.1	-4.2	0.0	0.0	0.0	0.0
	(Percentage change, relative to end of previous year)											
Reserve money	-5.7	6.8	15.7	-4.5	-11.5	6.8	18.1	18.0	0.8	-4.1	-2.9	-2.0
Currency in circulation	-1.8	7.8	6.8	-1.5	-11.6	-6.9	-0.4	4.6	1.9	3.7	5.6	7.4
Bank lari reserves 1/	-32.4	0.0	79.3	-24.5	-11.0	132.0	186.9	140.6	-3.2	-35.1	-36.7	-39.4
Memorandum items:												
Net international reserves												
(in millions of USD, at prog. exchange rates) 2/	747	1,055	848	909	777	775	876	890	713	587	605	609
Net domestic assets (in millions of lari, at prog. exchange rate) 2/	-87	6	452	116	-66	189	228	206	515	642	631	641
Reserve money (in percent, 12-month growth)	22.6	22.4	25.7	-4.5	-10.4	-4.5	-2.5	18.0	34.5	6.0	-3.0	-2.0

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

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

2/ Based on program definition as defined in the TMU.

Table 6. Georgia: Monetary Survey, 2008–10

	2008				2009				2010			
	Mar.	Jun.	Sep.	Dec.	Mar. Act.	Jun. Act.	Sep. Act.	Dec. Proj.	Mar. Proj.	Jun. Proj.	Sep. Proj.	Dec. Proj.
	(In millions of lari)											
Net foreign assets	481	256	-306	79	-356	-357	240	406	352	212	315	412
NBG	1,783	1,890	1,355	1,649	1,438	1,442	1,672	1,909	1,868	1,786	1,947	2,088
Commercial banks	-1,301	-1,634	-1,660	-1,570	-1,794	-1,800	-1,432	-1,503	-1,516	-1,574	-1,633	-1,676
Of which: liabilities	-2,096	-2,538	-2,504	-2,901	-2,760	-2,446	-2,319	-2,386	-2,366	-2,391	-2,416	-2,426
Net domestic assets	3,545	3,932	4,272	4,179	4,031	3,952	3,852	3,937	4,058	4,353	4,391	4,496
Domestic credit	5,336	5,682	5,846	5,921	5,644	5,733	5,676	5,748	5,869	6,164	6,202	6,307
Net claims on general government	265	85	339	-155	-114	270	387	482	507	661	586	547
Of which: government deposits at NBG	-461	-627	-377	-880	-812	-380	-323	-413	-375	-311	-381	-413
Of which: T-bills at commercial banks							68	258	258	358	358	358
Credit to the rest of the economy	5,071	5,598	5,507	6,076	5,758	5,462	5,289	5,267	5,361	5,502	5,616	5,761
Other items, net	-1,791	-1,750	-1,574	-1,742	-1,613	-1,781	-1,824	-1,811	-1,811	-1,811	-1,811	-1,811
Broad money (M3)	4,027	4,188	3,966	4,258	3,675	3,594	4,092	4,344	4,410	4,565	4,706	4,908
Broad money, excl. forex deposits (M2)	2,259	2,417	2,257	1,854	1,634	1,709	1,914	2,050	2,094	2,165	2,231	2,316
Currency held by the public	1,123	1,235	1,196	1,083	960	1,020	1,093	1,158	1,183	1,208	1,233	1,258
Total deposit liabilities	2,904	2,952	2,769	3,176	2,715	2,574	2,999	3,186	3,227	3,357	3,473	3,650
	(Percent contribution, compared to broad money at the end of previous year)											
Net foreign assets	5.2	-0.5	-14.6	-4.9	-10.2	-10.3	3.8	7.7	-1.3	-4.5	-2.1	0.1
Net domestic assets	-4.0	5.7	14.2	11.9	-3.5	-5.3	-7.7	-5.7	2.8	9.6	10.4	12.9
Domestic credit	7.6	16.3	20.4	22.3	-6.5	-4.4	-5.8	-4.1	2.8	9.6	10.4	12.9
Net claims on general government	-0.7	-5.2	1.1	-11.3	1.0	10.0	12.7	15.0	0.6	4.1	2.4	1.5
Credit to the rest of the economy	8.3	21.6	19.3	33.6	-7.5	-14.4	-18.5	-19.0	2.2	5.4	8.0	11.4
Other items, net	-11.7	-10.7	-6.2	-10.5	3.0	-0.9	-1.9	-1.6	0.0	0.0	0.0	0.0
	(Percentage change, relative to end of previous year)											
Broad money (M3)	1.2	5.2	-0.4	7.0	-13.7	-15.6	-3.9	2.0	1.5	5.1	8.3	13.0
Broad money, excl. forex deposits (M2)	6.0	13.4	5.9	-13.0	-11.9	-7.8	3.2	10.6	2.2	5.6	8.9	13.0
Currency held by the public	-2.5	7.2	3.9	-6.0	-11.3	-5.7	1.0	6.9	2.2	4.3	6.5	8.6
Total deposit liabilities	2.7	4.4	-2.1	12.3	-14.5	-19.0	-5.6	0.3	1.3	5.4	9.0	14.6
Credit to the rest of the economy	7.0	18.1	16.2	28.2	-5.2	-10.1	-13.0	-13.3	1.8	4.5	6.6	9.4
Memorandum items:												
M3 (in percent, 12-month growth)	50.6	28.9	6.9	7.0	-8.7	-14.2	3.2	2.0	20.0	27.0	15.0	13.0
M2 (in percent, 12-month growth)	65.4	46.8	17.1	-13.0	-27.7	-29.3	-15.2	10.6	28.2	26.7	16.6	13.0
Credit to the economy (in percent, 12-month growth)	62.4	53.9	28.3	28.2	13.6	-2.4	-4.0	-13.3	-6.9	0.7	6.2	9.4
Ratio of bank lari reserves to M2	5.59	7.74	14.85	7.61	7.69	19.17	21.17	16.57	15.70	10.18	9.63	8.89
M3 multiplier	2.20	2.07	2.13	2.61	2.49	2.10	2.16	2.27	2.29	2.46	2.50	2.57
M3 velocity	4.41	4.46	4.78	4.48	5.10	5.01	4.37	4.15	4.15	4.09	4.03	3.88
Foreign exchange deposits in percent of total deposits	60.9	60.0	61.7	75.7	75.2	73.2	72.6	72.0	71.8	71.5	71.3	71.0

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

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

	2007 Act.	2008 Act.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.
Value of exports of goods and services, percent change	24.7	15.9	-18.7	7.9	12.8	9.4	9.0	8.2
Value of imports of goods and services, percent change	34.1	26.7	-27.6	7.6	8.0	6.6	6.4	7.0
Terms of trade (deterioration -)	-0.5	-0.4	4.3	-3.2	0.9	-0.1	-0.1	-0.7
Current account balance (percent of GDP)	-19.7	-22.7	-15.1	-16.0	-15.4	-14.7	-14.1	-13.5
Capital and financial account (percent of GDP)	24.0	22.6	17.6	13.4	16.5	16.7	15.8	15.7
External public debt (percent of GDP)	17.5	20.9	31.5	37.6	37.4	35.1	31.6	28.7
in percent of exports of goods and services	56.2	73.0	113.2	128.2	122.8	114.3	102.3	92.7
Debt service on external public debt								
(in percent of exports of goods and services)	3.5	3.4	6.2	6.4	6.7	11.0	26.5	12.9
External debt (percent of GDP)	35.7	42.0	55.1	61.0	60.3	56.8	52.5	48.8
in percent of exports of goods and services	114.7	146.4	197.7	207.9	198.0	184.9	169.6	157.6
Debt service on MLT external debt								
(in percent of exports of goods and services)	11.9	16.0	23.8	25.0	25.7	29.2	47.6	30.1
Gross international reserves								
in millions of USD	1,361	1,480	2,005	2,086	2,259	2,268	2,094	2,057
in months of next year's imports of goods and services	2.2	3.3	4.1	4.0	4.0	3.8	3.3	3.0
in percent of external debt	37.3	27.4	33.8	31.0	31.2	30.7	28.3	27.7
in percent of short-term external debt	218	155	…	…	…	…	…	…
in percent of short-term external debt 1/	660	369	…	…	…	…	…	…

Sources: Fund staff estimates and projections.

1/ Excluding currency and deposit liabilities of banks.

Table 8. Georgia: Indicators of Fund Credit, 2007-2017

(In millions of SDR)

	2007	2008	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.
Existing Fund credit											
Stock 1/	159.2	298.8	501.6	487.5	449.4	301.3	158.0	29.4	14.0	4.2	0.0
PRGF	159.2	137.1	119.1	105.0	87.1	67.2	47.6	29.4	14.0	4.2	0.0
SBA		161.7	382.5	382.5	362.3	234.1	110.4	0.0	0.0	0.0	0.0
Obligations	26.7	23.3	22.2	18.6	42.6	151.8	145.1	34.3	15.5	9.8	4.2
PRGF 2/	26.7	22.8	18.6	14.7	18.4	20.3	19.9	18.4	15.5	9.8	4.2
SBA 3/		0.5	3.6	3.8	24.0	131.4	125.2	15.9	0.0	0.0	0.0
Prospective purchases under the SBA											
Disbursements	…	…	0.0	247.3	70.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	…	…	0.0	247.3	317.3	305.5	226.6	116.5	13.1	0.0	0.0
Obligations 3/	…	…	0.0	3.1	4.6	16.5	130.6	207.6	104.3	13.2	0.0
Principal (repurchases)	…	…	0.0	0.0	0.0	11.8	126.2	204.7	103.4	13.1	0.0
GRA charges	…	…	0.0	3.1	4.6	4.6	4.4	2.9	0.9	0.1	0.0
Surcharges	…	…	0.0	1.8	5.3	5.0	2.0	0.0	0.0	0.0	0.0
Stock of existing and prospective Fund credit 1/	159.2	298.8	501.6	734.8	766.7	606.8	384.6	145.9	27.1	4.2	0.0
In percent of quota	105.9	198.8	333.7	488.9	510.1	403.7	255.9	97.1	18.0	2.8	0.0
In percent of GDP	2.4	3.7	7.1	10.4	9.9	7.2	4.2	1.5	0.3	0.0	0.0
In percent of exports of goods and nonfactor services	7.7	12.8	25.6	35.3	32.6	23.6	13.7	4.8	0.8	0.1	0.0
In percent of gross reserves	17.9	31.9	38.3	54.8	52.7	41.5	28.5	11.0	1.9	0.3	0.0
In percent of public external debt	13.6	17.5	22.6	27.6	26.6	20.6	13.4	5.2	0.9	0.1	0.0
Obligations to the Fund from existing and prospective Fund credit 3/	26.7	23.3	22.2	23.5	52.5	173.3	277.7	241.9	119.8	23.0	4.2
In percent of quota	17.8	15.5	14.8	15.6	34.9	115.3	184.8	160.9	79.7	15.3	2.8
In percent of GDP	0.4	0.3	0.3	0.3	0.7	2.1	3.1	2.5	1.1	0.2	0.0
In percent of exports of goods and nonfactor services	1.3	1.0	1.1	1.1	2.2	6.7	9.9	8.0	3.6	0.6	0.1
In percent of gross reserves	3.0	2.5	1.7	1.8	3.6	11.9	20.6	18.2	8.3	1.4	0.2
In percent of public external debt service	36.9	29.4	18.3	17.7	33.5	61.1	37.3	61.6	31.3	7.6	1.2

Sources: Fund staff estimates and projections.

1/ End of period.

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

3/ Repayment schedule based on repurchase obligations and GRA charges. Excludes service charges and surcharges.

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

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

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

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

Table 10. Georgia: External Financing Requirements and Sources, 2007–14
(In millions of U.S. dollars)

	2007	2008	2009	2010	2011	2012	2013	2014
Total requirements	-2,277	-3,278	-2,094	-2,277	-2,474	-2,755	-3,704	-3,149
Current account deficit	-2,009	-2,915	-1,626	-1,765	-1,850	-1,911	-1,980	-2,062
Capital outflows: Repayments of MLT loans	-268	-363	-468	-512	-624	-844	-1,724	-1,087
Total sources	2,277	3,278	2,094	2,277	2,474	2,755	3,704	3,149
Capital flows	2,645	3,192	2,404	1,973	2,538	2,764	3,530	3,112
Public sector	128	795	857	530	409	405	893	376
Project grants	68	87	187	199	83	60	50	40
Long-term loan disbursements to public sector	156	227	416	331	327	345	343	336
Other 1/	-96	482	254	0	0	0	500	0
Private sector	2,518	2,396	1,546	1,443	2,128	2,359	2,637	2,735
Foreign direct investment in Georgia	1,750	1,564	700	817	1,132	1,342	1,553	1,797
Long-term loan disbursements to private sector	849	756	543	425	500	594	717	715
Other net inflows 2/	-82	76	303	200	496	423	367	223
Financing	9	218	193	385	109	0	0	0
IMF 3/	43	257	338	385	109	0	0	0
Change in arrears, net (- decrease)	-29	-10	0	0	0	0	0	0
Advance Repayments	-14	-29	-148	0	0	0	0	0
Change in reserves (- increase)	-377	-131	-503	-81	-173	-9	174	37
Memorandum items (in percent of GDP):								
Total financing requirements	-22.3	-25.5	-19.5	-20.7	-20.7	-21.2	-26.3	-20.7
Total sources	22.3	25.5	19.5	20.7	20.7	21.2	26.3	20.7
Capital inflows	25.9	24.8	22.3	17.9	21.2	21.2	25.1	20.4
Exceptional financing	0.1	1.7	1.8	3.5	0.9	0.0	0.0	0.0
Change in reserves (- increase)	-3.7	-1.0	-4.7	-0.7	-1.4	-0.1	1.2	0.2

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

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

2/ Including errors and omissions.

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

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

	Dec-07	Dec-08	Jun-09	Dec-09 1/	Dec-07	Dec-08	Jun-09	Dec-09 1/
	(In millions of U.S. dollars)				(In percent of GDP)			
Total	1,790	2,691	2,925	3,394	17.5	20.9	27.2	31.5
Multilateral	1,263	1,648	1,879	2,320	12.4	12.8	17.5	21.6
WB - IDA	883	988	1,016	1,220	8.6	7.7	9.4	11.3
IMF	249	465	647	782	2.4	3.6	6.0	7.3
Other	130	195	216	318	1.3	1.5	2.0	3.0
Bilateral	519	535	538	566	5.1	4.2	5.0	5.3
Paris Club	429	446	412	465	4.2	3.5	3.8	4.3
Non-Paris Club	91	89	127	101	0.9	0.7	1.2	0.9
Commercial	8	508	508	508	0.1	3.9	4.7	4.7

Source: Ministry of Finance of Georgia.

1/ IMF staff projections.

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

	Dec-06	Dec-07	Dec-08	Mar-09	Jun-09	Dec-06	Dec-07	Dec-08	Mar-09	Jun-09
	(In millions of U.S. dollars)					(In percent of GDP)				
Total Private debt 1/	992	2,373	2,829	2,757	2,764	12.8	23.2	22.0	21.4	21.5
Banks	549	1,509	1,684	1,656	1,622	7.1	14.8	13.1	12.9	12.6
Short-term	221	400	566	404	390	2.9	3.9	4.4	3.1	3.0
Of which: Loans	83	164	355	214	200	1.1	1.6	2.8	1.7	1.6
Of which: Currency and deposits 2/	139	233	209	187	186	1.8	2.3	1.6	1.5	1.4
Long-term	327	895	1,308	1,332	1,231	4.2	8.8	10.2	10.4	9.6
Of which: Loans	327	895	1,308	1,332	1,231	4.2	8.8	10.2	10.4	9.6
Other Sectors	443	863	1,146	1,102	1,142	5.7	8.4	8.9	8.6	8.9
Short-term	204	224	389	361	390	2.6	2.2	3.0	2.8	3.0
Of which: Trade credits	165	158	324	292	315	2.1	1.5	2.5	2.3	2.4
Long-term	239	639	757	740	752	3.1	6.3	5.9	5.8	5.8
Of which: Loans	239	639	757	740	752	3.1	6.3	5.9	5.8	5.8
Direct Investment: Intercompany Lending	827	1,669	1,992	2,019	2,044	10.6	16.3	15.5	15.7	15.9

Source: National Bank of Georgia.

1/ Excluding intercompany debt from foreign direct investors.

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

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

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009-2014 Average	2019	2029	2015-2029 Average
External debt (nominal) 1/	**34.6**	**35.7**	**42.0**			**55.1**	**61.0**	**60.3**	**56.8**	**52.5**	**48.8**		**39.5**	**31.1**	
o/w public and publicly guaranteed (PPG)	21.9	17.5	20.9			31.5	37.6	37.4	35.1	31.6	28.7		23.0	16.9	
Change in external debt	2.0	1.1	6.3			13.1	6.0	-0.7	-3.6	-4.3	-3.7		-1.1	0.7	
Identified net debt-creating flows	-5.8	-4.8	3.9			11.2	7.9	4.0	1.9	0.7	-0.2		-0.1	1.0	
Non-interest current account deficit	**14.3**	**18.2**	**20.4**	**10.6**	**5.7**	**12.2**	**13.0**	**12.5**	**11.8**	**11.2**	**11.0**		**10.0**	**9.0**	9.4
Deficit in balance of goods and services	24.0	26.7	29.6			22.6	23.6	22.2	21.0	19.9	19.3		16.6	13.9	
Exports	32.9	31.1	28.7			27.9	29.4	30.5	30.7	30.9	30.9		31.5	36.0	
Imports	56.8	57.9	58.3			50.5	53.0	52.7	51.7	50.8	50.3		48.0	49.9	
Net current transfers (negative = inflow)	-6.7	-6.7	-8.2	-6.5	1.3	-8.2	-8.6	-7.6	-7.0	-6.6	-6.4		-5.2	-4.0	-4.7
o/w official	-1.8	-1.4	-2.8			-1.8	-1.8	-1.0	-0.6	-0.4	-0.3		-0.2	-0.1	
Other current account flows (negative = net inflow)	-2.9	-1.9	-1.0			-2.2	-2.1	-2.1	-2.1	-2.1	-2.0		-1.4	-0.9	
Net FDI (negative = inflow)	**-15.3**	**-16.4**	**-11.8**	**-9.1**	**4.7**	**-6.5**	**-7.4**	**-9.5**	**-10.3**	**-11.0**	**-11.6**		**-10.5**	**-8.5**	-9.9
Endogenous debt dynamics 2/	**-4.8**	**-6.6**	**-4.6**			**5.5**	**2.3**	**1.0**	**0.4**	**0.6**	**0.5**		**0.4**	**0.5**	
Contribution from nominal interest rate	0.9	1.8	2.7			3.5	3.4	3.3	3.2	3.2	2.9		2.3	2.0	
Contribution from real GDP growth	-2.5	-3.3	-0.6			2.0	-1.1	-2.2	-2.8	-2.6	-2.4		-1.9	-1.5	
Contribution from price and exchange rate changes	-3.2	-5.1	-6.8			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**7.7**	**5.9**	**2.3**			**1.9**	**-1.9**	**-4.7**	**-5.5**	**-5.0**	**-3.5**		**-1.0**	**-0.3**	
o/w exceptional financing	1.0	0.3	0.3			1.4	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	36.4			47.8	53.0	52.7	50.3	47.3	43.5		34.9	28.7	
In percent of exports	...	...	127.0			171.5	180.4	172.8	163.7	152.9	140.7		110.8	79.6	
PV of PPG external debt	**...**	**...**	**15.3**			**24.3**	**29.6**	**29.7**	**28.6**	**26.5**	**23.5**		**18.4**	**14.4**	
In percent of exports	**...**	**...**	**53.5**			**87.1**	**100.7**	**97.6**	**93.1**	**85.6**	**75.8**		**58.4**	**40.0**	
In percent of government revenues	**...**	**...**	**55.8**			**90.5**	**113.5**	**114.2**	**109.8**	**101.6**	**90.1**		**68.0**	**44.6**	
Debt service-to-exports ratio (in percent)	**11.8**	**13.2**	**17.7**			**25.9**	**25.8**	**26.9**	**30.5**	**48.8**	**31.4**		**22.4**	**18.3**	
PPG debt service-to-exports ratio (in percent)	**8.0**	**3.5**	**3.4**			**6.2**	**5.9**	**6.6**	**11.0**	**26.5**	**12.8**		**6.4**	**5.8**	
PPG debt service-to-revenue ratio (in percent)	**10.3**	**3.8**	**3.6**			**6.4**	**6.7**	**7.7**	**12.9**	**31.4**	**15.2**		**7.5**	**6.5**	
Total gross financing need (Billions of U.S. dollars)	0.4	1.0	2.4			2.3	2.1	1.9	2.1	2.9	2.2		2.3	4.2	
Non-interest current account deficit that stabilizes debt ratio	12.3	17.1	14.1			-0.9	7.0	13.2	15.4	15.5	14.7		11.1	8.3	
Key macroeconomic assumptions															
Real GDP growth (in percent)	9.4	12.4	2.1	6.5	3.8	-4.0	2.0	4.0	5.0	5.0	5.0	2.8	5.0	5.0	5.0
GDP deflator in US dollar terms (change in percent)	10.7	17.1	23.3	11.7	8.8	-12.9	0.4	4.5	3.5	3.0	3.0	0.3	3.0	-3.4	2.1
Effective interest rate (percent) 5/	3.3	6.7	9.6	3.3	3.1	6.9	6.3	5.8	5.8	6.1	6.0	6.1	6.2	6.8	6.4
Growth of exports of G&S (US dollar terms, in percent)	16.6	24.7	15.9	18.6	14.8	-18.7	7.9	12.8	9.4	9.0	8.2	4.8	8.5	7.1	8.3
Growth of imports of G&S (US dollar terms, in percent)	33.0	34.1	26.7	19.1	17.0	-27.6	7.6	8.0	6.6	6.4	7.0	1.3	7.2	6.8	7.2
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	19.4	17.9	19.7	21.3	6.9	20.3	17.6	14.1	11.3	13.6
Government revenues (excluding grants, in percent of GDP	25.5	28.7	27.5			26.8	26.1	26.1	26.1	26.1	26.1		27.1	32.3	28.0
Aid flows (in Billions of US dollars) 7/	0.2	0.2	0.6			0.7	0.6	0.5	0.4	0.4	0.4		0.4	0.4	
o/w Grants	0.1	0.1	0.4			0.3	0.3	0.2	0.1	0.1	0.1		0.1	0.1	
o/w Concessional loans	0.1	0.2	0.2			0.4	0.3	0.3	0.3	0.3	0.3		0.3	0.4	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			4.1	3.8	2.0	1.3	1.0	1.0		0.6	0.3	0.5
Grant-equivalent financing (in percent of external financing)	...	...	...			40.6	37.8	39.5	35.2	14.1	31.5		22.1	16.0	20.7
Memorandum items:															
Nominal GDP (Billions of US dollars)	7.8	10.2	12.9			10.8	11.0	12.0	13.0	14.1	15.2		22.5	43.4	
Nominal dollar GDP growth	21.1	31.7	25.9			-16.4	2.5	8.7	8.7	8.2	8.1	3.3	8.2	1.4	7.3
PV of PPG external debt (in Billions of US dollars)			2.0			2.6	3.3	3.6	3.7	3.7	3.6		4.1	6.3	
(PVt-PVt-1)/GDPt-1 (in percent)						5.0	6.0	2.8	1.3	0.0	-1.1	2.3	1.3	0.4	0.7

Source: Staff simulations.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

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

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

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

	Projections							
	2009	2010	2011	2012	2013	2014	**2019**	2029
PV of debt-to GDP ratio								
Baseline	24	30	30	29	26	23	**18**	14
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	24	22	19	16	13	12	**11**	8
A2. New public sector loans on less favorable terms in 2009-2029 2/	24	31	31	30	27	25	**22**	21
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	24	29	29	28	26	22	**17**	13
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	24	30	33	32	29	26	**18**	13
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	24	29	29	28	25	22	**16**	13
B4. Net non-debt creating flow s at historical average minus one standard deviation in 2010-2011 4/	24	35	41	39	37	33	**22**	13
B5. Combination of B1-B4 using one-half standard deviation shocks	24	28	29	27	25	22	**16**	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	24	42	42	40	36	32	**24**	18
PV of debt-to-exports ratio								
Baseline	87	101	98	93	86	76	**58**	40
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	87	75	63	53	44	37	**36**	23
A2. New public sector loans on less favorable terms in 2009-2029 2/	87	104	102	97	87	80	**69**	57
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	87	100	96	91	82	72	**52**	35
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	87	107	124	117	107	94	**66**	40
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	87	100	96	91	82	72	**52**	35
B4. Net non-debt creating flow s at historical average minus one standard deviation in 2010-2011 4/	87	119	135	128	118	106	**70**	37
B5. Combination of B1-B4 using one-half standard deviation shocks	87	101	105	99	90	80	**56**	35
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	87	100	96	91	82	72	**52**	35
PV of debt-to-revenue ratio								
Baseline	91	114	114	110	102	90	**68**	45
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	91	85	73	62	52	44	**42**	26
A2. New public sector loans on less favorable terms in 2009-2029 2/	91	117	120	114	103	95	**80**	64
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	91	112	113	107	98	85	**61**	39
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	91	116	128	122	112	99	**68**	40
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	91	110	111	106	97	84	**61**	39
B4. Net non-debt creating flow s at historical average minus one standard deviation in 2010-2011 4/	91	134	158	151	141	125	**82**	41
B5. Combination of B1-B4 using one-half standard deviation shocks	91	107	110	105	96	85	**59**	35
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	91	160	160	152	139	121	**87**	56

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

	Projections							
	2009	2010	2011	2012	2013	2014	2019	2029
Debt service-to-exports ratio								
Baseline	6	6	7	11	26	13	**6**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	6	5	5	7	17	7	**3**	2
A2. New public sector loans on less favorable terms in 2009-2029 2/	6	6	6	8	19	6	**6**	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	6	6	7	11	26	13	**6**	5
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	6	6	8	13	30	15	**8**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	6	6	7	11	26	13	**6**	5
B4. Net non-debt creating flow s at historical average minus one standard deviation in 2010-2011 4/	6	6	7	12	28	15	**9**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	6	6	7	11	26	13	**7**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	6	6	7	11	26	13	**6**	5
Debt service-to-revenue ratio								
Baseline	6	7	8	13	31	15	**7**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	6	6	6	9	20	8	**3**	3
A2. New public sector loans on less favorable terms in 2009-2029 2/	6	7	7	9	23	8	**7**	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	6	7	8	13	31	15	**7**	6
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	6	7	8	13	32	16	**8**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	6	6	8	13	31	15	**7**	6
B4. Net non-debt creating flow s at historical average minus one standard deviation in 2010-2011 4/	6	7	8	14	33	18	**10**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	6	6	7	12	28	14	**7**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	6	9	11	18	45	21	**10**	8
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	11	11	11	11	11	11	**11**	11

Source: Staff projections and simulations.

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

(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Projections									
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009-14 Average	2019	2029	2015-29 Average
Public sector debt 1/	27.6	22.1	25.0			37.1	43.3	45.4	43.6	40.2	37.8		31.2	24.1	
o/w foreign-currency denominated	21.9	17.5	20.9			31.5	37.6	37.4	35.1	31.6	28.7		23.0	16.9	
Change in public sector debt	-6.7	-5.5	2.9			12.1	6.1	2.2	-1.8	-3.4	-2.4		-1.0	0.4	
Identified debt-creating flows	-8.0	-6.8	-1.5			12.0	5.1	1.6	-0.3	-1.2	-1.7		-1.2	0.2	
Primary deficit	2.2	4.1	5.6	0.8	2.8	8.5	6.3	4.1	2.4	0.8	0.2	3.7	0.0	-0.6	-0.2
Revenue and grants	26.7	29.3	30.7			29.4	28.5	27.3	26.7	26.6	26.5		27.3	32.4	
of which: grants	1.2	0.6	3.2			2.6	2.5	1.3	0.7	0.5	0.4		0.3	0.1	
Primary (noninterest) expenditure	28.8	33.4	36.3			37.9	34.8	31.4	29.1	27.4	26.7		27.3	31.8	
Automatic debt dynamics	-5.0	-5.7	-3.4			5.4	0.0	-2.0	-2.2	-1.8	-1.7		-1.2	0.8	
Contribution from interest rate/growth differential	-3.3	-3.4	-0.7			2.2	-0.3	-1.0	-1.7	-1.6	-1.5		-0.7	0.1	
of which: contribution from average real interest rate	-0.4	-0.3	-0.2			1.2	0.4	0.7	0.5	0.5	0.4		0.9	1.2	
of which: contribution from real GDP growth	-2.9	-3.0	-0.4			1.0	-0.7	-1.7	-2.2	-2.1	-1.9		-1.5	-1.1	
Contribution from real exchange rate depreciation	-1.7	-2.3	-2.7			3.2	0.3	-1.0	-0.5	-0.3	-0.2		…	…	
Other identified debt-creating flows	-5.2	-5.2	-3.7			-2.0	-1.2	-0.5	-0.4	-0.2	-0.2		0.0	0.0	
Privatization receipts (negative)	-5.2	-5.2	-3.7			-2.0	-1.2	-0.5	-0.4	-0.2	-0.2		0.0	0.0	
Residual, including asset changes	1.3	1.3	4.4			0.1	1.1	0.6	-1.6	-2.2	-0.7		0.2	0.1	
Other Sustainability Indicators															
PV of public sector debt	5.7	4.6	19.4			29.8	35.2	37.7	37.1	35.0	32.6		26.6	21.6	
o/w foreign-currency denominated	0.0	0.0	15.3			24.3	29.6	29.7	28.6	26.5	23.5		18.4	14.4	
o/w external	...	...	15.3			24.3	29.6	29.7	28.6	26.5	23.5		18.4	14.4	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	5.7	5.7	7.1			10.8	8.3	6.8	6.6	9.8	5.1		3.0	2.4	
PV of public sector debt-to-revenue and grants ratio (in percent)	21.3	15.6	63.3			101.3	123.4	138.2	138.9	131.7	123.2		97.5	66.6	
PV of public sector debt-to-revenue ratio (in percent)	22.4	15.9	70.8			111.3	135.1	144.8	142.3	134.4	125.2		98.5	66.9	
o/w external 3/	…	…	55.8			90.5	113.5	114.2	109.8	101.6	90.1		68.0	44.6	
Debt service-to-revenue and grants ratio (in percent) 4/	13.4	5.5	4.7			7.7	7.2	10.0	15.7	34.0	18.3		11.0	9.3	
Debt service-to-revenue ratio (in percent) 4/	14.0	5.6	5.3			8.4	7.9	10.5	16.1	34.7	18.6		11.1	9.3	
Primary deficit that stabilizes the debt-to-GDP ratio	8.8	9.6	2.7			-3.6	0.2	1.9	4.2	4.2	2.6		1.0	-0.9	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	9.4	12.4	2.1	6.5	3.8	-4.0	2.0	4.0	5.0	5.0	5.0	2.8	5.0	5.0	5.0
Average nominal interest rate on forex debt (in percent)	1.8	1.6	3.0	1.6	1.2	3.0	2.9	2.7	2.6	3.0	2.6	2.8	2.8	3.4	3.1
Average real interest rate on domestic debt (in percent)	-0.3	-2.0	-2.5	-0.1	2.3	9.3	-1.0	5.0	3.5	3.3	3.6	3.9	5.0	12.0	6.1
Real exchange rate depreciation (in percent, + indicates depreciation)	-6.8	-12.2	-15.8	-7.4	7.0	14.2	...	...	...	...	...	…	…	…	…
Inflation rate (GDP deflator, in percent)	8.5	9.7	9.9	7.5	2.2	-1.5	3.6	5.0	5.0	5.0	5.0	3.7	5.0	-1.5	4.1
Growth of real primary spending (deflated by GDP deflator, in percent)	0.3	0.3	0.1	0.3	0.1	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	19.4	17.9	19.7	21.3	6.9	20.3	17.6	14.1	11.3	...

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

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

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

3/ Revenues excluding grants.

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

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

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

	Projections							
	2009	2010	2011	2012	2013	2014	2019	2029
PV of Debt-to-GDP Ratio								
Baseline	30	35	38	37	35	33	27	22
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	30	27	25	23	21	19	19	24
A2. Primary balance is unchanged from 2009	30	38	46	53	60	68	112	225
A3. Permanently lower GDP growth 1/	30	36	39	40	39	38	44	94
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-20'	30	35	38	37	35	33	28	25
B2. Primary balance is at historical average minus one standard deviations in 2010-201'	30	32	34	33	31	29	23	18
B3. Combination of B1-B2 using one half standard deviation shocks	30	30	30	28	25	22	12	-6
B4. One-time 30 percent real depreciation in 2010	30	46	48	48	47	45	41	46
B5. 10 percent of GDP increase in other debt-creating flows in 2010	30	47	50	49	47	45	38	34
PV of Debt-to-Revenue Ratio 2/								
Baseline	101	123	138	139	132	123	98	67
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	101	96	93	86	78	73	69	76
A2. Primary balance is unchanged from 2009	101	133	168	197	226	256	411	694
A3. Permanently lower GDP growth 1/	101	125	143	148	146	143	160	289
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-20'	101	122	139	140	133	126	103	77
B2. Primary balance is at historical average minus one standard deviations in 2010-201'	101	112	125	125	118	110	85	55
B3. Combination of B1-B2 using one half standard deviation shocks	101	104	109	106	95	83	43	-18
B4. One-time 30 percent real depreciation in 2010	101	162	177	180	177	170	151	141
B5. 10 percent of GDP increase in other debt-creating flows in 2010	101	166	183	185	177	168	138	104
Debt Service-to-Revenue Ratio 2/								
Baseline	8	7	10	16	34	18	11	9
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	8	7	8	12	28	14	8	8
A2. Primary balance is unchanged from 2009	8	7	11	18	38	25	29	56
A3. Permanently lower GDP growth 1/	8	7	10	16	35	20	15	25
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-20'	8	7	10	16	34	18	11	10
B2. Primary balance is at historical average minus one standard deviations in 2010-201'	8	7	9	14	33	17	10	8
B3. Combination of B1-B2 using one half standard deviation shocks	8	7	9	13	31	16	8	2
B4. One-time 30 percent real depreciation in 2010	8	8	13	22	48	27	18	19
B5. 10 percent of GDP increase in other debt-creating flows in 2010	8	7	13	20	37	21	14	13

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

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

2/ Revenues are defined inclusive of grants.

November 25, 2009

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

Dear Mr. Strauss-Kahn:

1. In September 2008, the International Monetary Fund (IMF) approved a Stand-By Arrangement (SBA) for Georgia. On August 6, 2009 the IMF's Executive Board completed the third review of the SBA and approved an increase in the credit available under the SBA of SDR 270 million, and an extension of the program until June 14, 2011. This support has been valuable in dealing with the many economic challenges facing Georgia and we are grateful for IMF assistance.

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

Recent Economic Developments

3. Growth in H1 2009 amounted to minus 8.5 percent, as the impact of the global economic crisis on the Georgian economy exacerbated. Most of the sectors contracted, with trade, manufacturing, and construction worth particular mentioning. Plummeted private capital inflows as well as shrinking external trade and commercial bank lending contributed to the contraction of economic activity.

4. As a result of a broad decline in economic activity and falling global commodity prices, inflationary pressures have declined. End-period inflation was 5.5 percent for 2008 and twelve-month inflation was only 2.3 percent as of end-June 2009 but picked up to 3.2 percent as of end-October 2009. Taking into account the recent increase of global commodity prices and signs of improvement in economic activity, we expect inflation to reach 3.5 percent by the end of 2009. Year-on-year growth of reserve money and lari broad money has been negative since November 2008 but turned positive in the third quarter of 2009.

5. Fiscal performance has been adversely affected by the ongoing economic decline. Tax collection in the first three quarters of 2009 declined by 9.6 percent in nominal terms, compared with the same period of last year. Expenditures in the same period were contained at GEL 4,637 million (general government, including capital expenditures), or 6.1 percent

lower than the same period of last year (excluding one-off effects). In all, the fiscal deficit reached 6.7 percent of projected annual GDP in the first three quarters of the year, in line with program projections.

6. On September 24th, 2009, the Parliament approved the new Organic Law of Georgia "On the National Bank of Georgia", effective December 1, 2009. According to this new law, the Financial Supervision Agency (FSA) has been merged with the NBG, giving the central bank authority to supervise the entire financial sector. The merger will improve coordination between macro and supervisory teams of the NBG and will increase the effectiveness of macro-prudential oversight. In the new law, the NBG is given responsibility for maintaining price stability over the medium term. This change allows for introduction of a soft inflation targeting regime.

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. Along with the weak demand for foreign currency, foreign exchange auctions allowed for less NBG intervention. From March to the end of October, the NBG's net sales of foreign currency were less than USD 15 million on average per month. Furthermore, starting from October, the NBG expanded the deviation band for auction bids from 0.5 percent to 1 percent of the official exchange rate.

8. Balance of payments data for the second quarter of 2009 show that exports and imports of goods and services declined by 26.6 percent and 35.9 percent, respectively, which reflects both a drop in commodity prices and lower demand for imports. Worker remittances dropped by 22 percent, whereas FDI inflows declined by 81 percent compared with the same period in 2008. As a result, the current account deficit dropped to 13.6 percent of GDP for H1 of 2009, showing an improvement of 15.1 percentage points from the previous year (28.7% in H1, 2008).

9. The banking sector not only proved to be resilient, but also shows signs of improvement. Commercial banks' net profit in September 2009 turned out positive for the first time since July 2008. Meanwhile the share of non-performing loans has been slowly decreasing since July 2009. Over the last six months, the volume of deposits has shown steady growth. Average capital adequacy at the end-September increased by almost 3 percentage points since May, currently at 20.2 percent. Credit to the private sector has contracted sharply since the beginning of the year, however it has stabilized in the recent period.

10. Since June 3, 2009, the total volume of foreign exchange swaps reached GEL 60 million. Pricing of the swaps suggest that, the market did not anticipate exchange rate depreciation. Commercial banks used swaps for converting existing FX denominated loans into lari loans, thus decreasing the credit risk for the unhedged borrowers. However, given high lari liquidity position of the banks demand for swaps was limited. As committed in the

previous LOI, at this moment, NBG is not intending to increase the volume of swaps beyond the existing level.

11. 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. The project is scheduled to be launched in November, following the signing of the contract with the preferred vendor, and the system is expected to become fully operational by the end of 2010.

12. Based on the results of the stress tests carried out by the FSA, we have prepared a Contingency Plan (CP) which sets out 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. The members of the Contingency Working Group have discussed the results of the stress tests and agreed to the coordination and policy modalities laid out in the Contingency Plan, including the division of responsibilities among the MOF, and the NBG-FSA. Although the banking system is adequately capitalized, the FSA continues to conduct regular stress tests on system wide and bank by bank level. We have also upgraded the legislation to enable the supervisor to conduct risk-based supervision, and we are in the process of introducing risk-based supervision. The new NBG Organic law also fills some of the legal gaps in the power of the regulator to intervene in the event of stress.

13. 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, including substantive progress in implementing the Reform Action Plan for 2009. In 2009, one of our key priorities has been the review of the existing budget legislation and preparation of the new budget code. The draft budget code has been submitted to the cabinet (structural benchmark for end-July 2010) and it is being discussed in the Parliament, with adoption expected for November 2009. 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 the prepare the ground for results-oriented budgets. By end-September 2010 we intend to seek cabinet approval of the methodology to introduce a programmatic approach to budgeting (structural benchmark).

Macroeconomic Policies for 2009 and 2010

14. Our major macroeconomic challenge continues to be the restoration of economic growth. This will, of course, require the resumption of private capital inflows and domestic

lending in support of investment projects. At the same time, we recognize that many of the extraordinary actions undertaken in response to the economic crisis are not sustainable in the medium term. Hence, our efforts to enhance macroeconomic stability will concentrate on intensifying economic reforms, refining policy instruments and achieving a sustainable fiscal and external balance as quickly as possible.

15. The available economic data suggests a slowdown in the annual rates of economic contraction, due to recovery of certain economic activity as well as the base year effect. The 8.5 percent contraction of real GDP in H1 2009 will decrease in the second half of the year, with our moderate projections pointing to approximately 4 percent real GDP contraction in 2009, precluding any further external shocks. In 2010, we anticipate economic recovery with real GDP growth projected at 2% and we target inflation rate of 6% per annum.

16. The current account deficit for this year is expected to moderate to around 15 percent of GDP from a record high level of nearly 21.6 percent in 2008. Exports and imports of goods and services are projected to decline by 19 percent and 28 percent, respectively. Worker remittances are expected to drop by around 10 percent for the year. We project FDI inflows in the amount of around US$700 million for 2009, which is 54 percent lower than in 2008 and deprives the economy of an important source of growth. Overall, we expect an accumulation of gross reserves in 2009 of about US$525 million, excluding the purchase of SDR 47.3 million that will be available to us upon completion of the fourth review.

17. Our fiscal stance for the remainder of 2009 will continue to sustain demand, with a significant contribution from donor-financed spending. While revenues are lower and spending is reduced, the overall deficit is in line with program targets. The shortfall in revenue linked to the deterioration in economic activity will widen the fiscal deficit to 9.6 percent of GDP for the year.

18. In 2010-11, we expect a recovery in private capital inflows to begin. Despite considerable fiscal adjustment, the current account deficit is expected to widen marginally in 2010, owing to adverse terms of trade developments, and to narrow again in 2011. Also, in view of the continued high uncertainty in the external environment, there is a need to increase the reserve buffer to more comfortable levels. Accordingly, we have sought Fund's support in covering a financing gap of around $400 million in 2010.

19. We realize that the fiscal stimulus measures currently deployed by the Government are essential for minimizing the impact of the global financial downturn on Georgia; we also believe that this stimulus must not jeopardize Georgia's longer-term fiscal sustainability. We consider that restoring a sound fiscal position is also critical in view of external debt repayment obligations falling due in 2013-14. Starting in 2010, we are therefore committed to an ambitious program of deficit reduction. Our target is to reduce the deficit to 7.3 percent of GDP in 2010 (SBA definition). The draft budget for 2010 submitted to the Parliament on November 1, 2009 envisages sustainment of social expenditures as a share of GDP while

tapping the donor funding for the bulk of infrastructure spending. Based on further expenditure containment, as well as an expected recovery of tax revenues and expected rebound in the GDP growth, we are committed to steady reductions in the deficit to 2-3 percent of GDP by 2013. These targets have been presented to parliament on November 1, as part of our 2010 budget submission.

20. In the third quarter of 2009, domestic debt instruments (treasury bills) were introduced. T-bill issuance responds to a market development need—not least so as to provide the NBG with another monetary policy tool and allow the banks to diversify their portfolio to include an important class of risk-free assets. At the same time, the cost of financing from this source has been unexpectedly low. The NBG has supported the development of a secondary market for T-bills by introducing an electronic trading platform. Consequently, we plan to increase issuance of T-bills in 2009 to around GEL 270 million. However, due to limits in the capacity of the banking sector to absorb additional T-Bills, we will need to rely on external balance of payments support to finance a portion of our budgetary needs in 2010. In the context of sustaining the agreed cap on the fiscal deficit, we expect to be able to mobilize additional budgetary support in 2010, and the Government's use of IMF resources for deficit financing will be reduced as such commitments are finalized. We intend to continue the issuance of T-bills in 2010. Treasury Bills issued in year 2009 will be entirely rolled over in 2010 and, depending on interest rates and other market conditions, approximately GEL 100 million of T-Bills will be issued in addition. In 2010 Ministry of Finance of Georgia plans to introduce 2-year Treasury Notes as well.

21. 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 have 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, ensuring functionality of the risk assessment tax audit system, further streamlining tax and customs codes and developing necessary sub-legislation, establishing electronic information exchange system between banks and the Revenues Service, improving capital budget 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. We believe that implementation of these reforms will enhance efficiency and effectiveness in the use of public financial resources and will contribute to the overall resilience of the economy both now, in a time of stress, and over the medium term.

22. The monetary policy transmission channel has weakened due to the crises and remains ineffective under current excess liquidity conditions. NBG will increase issuance of CDs with due attention not to increase interest rates to a contractionary stance. As market conditions allow, the NBG will take further measures to restore monetary policy transmission

channel. We continue to project end-period inflation to be 3.5 percent in 2009 and 6 percent in 2010. These projections are, 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.

23. We remain fully committed to a flexible exchange rate policy. Continuation with the foreign exchange auctions will further contribute to determining the exchange rate through market forces, and all efforts are made to make this process as efficient as possible. The NBG will intervene to smooth extreme volatility, to counter speculative pressures and if large depreciation threatens financial stability.

24. Enhancing the competitiveness of the Georgian economy is, of course, of primary importance to us and is key to reducing Georgia's external current account deficit to more sustainable levels over the medium term. Georgia's extremely favorable business environment and geographic advantages 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.

25. To bring our official statistics in line with international standards, we intent to finish reorganizing the State Department of Statistics (SDS) by the end of H1 of 2010. New Law on State Statistics will strengthen the independence of the SDS and ensure the sustainable production of official statistics. To enhance the availability of timely and comprehensive statistics provided to the public, in H1 of 2010 we intend to become a subscriber of the IMF's Special Data Dissemination Standard (SDDS).

26. In order to ensure stable, long-term economic growth, the Liberty Act was introduced in 2009, which creates prudent limitations on government expenditures, budget deficits, debt levels and taxation, as well as guaranteeing many civil protections, such as freedom of labor and capital within Georgia's territory. Upon approval, this amendment will enact structural reforms to establish the following fiscal limitations, effective 2012: the consolidated budget at 30% of GDP, the consolidated budget deficit at 3% of GDP and the public debt at 60% of GDP.

Program Monitoring

27. All end-September performance criteria under the Stand-By Arrangement were met. We, therefore, request the completion of the Fourth Review. We intend to treat as precautionary the purchase of SDR 47.3 million that will be available to us upon completion of the fourth review. 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. In particular, if the pressures on Georgia stemming from the global economic crisis are

greater than anticipated, the Government would adjust its fiscal and exchange rate policies to maintain external stability.

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

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

Sincerely yours,

/s/

Nika Gilauri
Prime Minister of Georgia

/s/

Kakha Baindurashvili
Minister of Finance

/s/

Giorgi Kadagidze
President of the National Bank of Georgia

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

	Cumulative Change from End-December 2008					Cumulative Change from End-December 2009				
	Sep-09			Dec-09		Mar-10	Jun-10	Sep-10	Dec-10	
	Third review	Adjusted PC	Actual	Third review	Proposed PC	Proposed PC	Proposed PC	Ind. Target	Third review	Ind. Target
	(In millions of laris)									
Ceiling on cash deficit of the consolidated government	1,255		1,124	1,638	1,638	368	745	1,060	1,393	1,393
	(In millions of U.S. dollars)									
Ceiling on contracting or guaranteeing of new nonconcessional external debt by the public sector	850		0	850	850	850	850	600	600	600
	(In millions of laris)									
Ceiling on net domestic assets (NDA) of the NBG 1/	344	258	228	413	456	515	642	631	829	641
	(In millions of U.S. dollars)									
Floor on net international reserves (NIR) of the NBG 1/	813	858	876	740	740	713	587	605	609	609
Ceiling on accumulation of external arrears 2/	0		0	0	0	0	0	0	0	0

Sources: Georgian authorities; and Fund staff estimates.

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

Table 2. 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 the methodology to introduce a programmatic approach to budgeting, identifying the requirements in terms of budget preparation processes and information needs.	September 30, 2010	Structural Benchmark	

ATTACHMENT II. GEORGIA: REVISED TECHNICAL MEMORANDUM OF UNDERSTANDING

November 25, 2009

1. This memorandum sets out the understandings between the Georgian authorities and the IMF staff regarding the definitions of quantitative performance criteria and indicative targets, as well as respective reporting requirements for the Stand-By Arrangement (SBA). It replaces the technical memorandum of understanding dated July 30, 2009.

2. These performance criteria and indicative targets are reported in Tables 1 and 2 attached to the Letter of Intent dated July 30, 2009 and Tables 1 and 2 attached to the Letter of Intent dated November 25, 2009. The exchange rate for the purposes of the program of the Georgian lari to the U.S. dollar is set at GEL 1.67 = $1. The corresponding cross exchange rates are provided in Table 1.

Consolidated Government and the Public Sector

3. **Definition:** The consolidated government is defined as the central government, local governments, extrabudgetary funds, and LEPLs (Legal Entities of Public Law) that provide general government services. In case the government establishes extrabudgetary funds, they will be consolidated within the consolidated government. The public sector consists of the consolidated government and the National Bank of Georgia (NBG).

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

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

I. Ceiling on the Cash Deficit of the Consolidated Government

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

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

    (i) Net lending (borrowing net of repayments) provided by commercial banks to the consolidated government plus the use of deposits held by the consolidated 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 consolidated 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 consolidated government plus the use of deposits of the consolidated 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 consolidated government and purchased by the NBG (for example, T-Bills) are also included in domestic financing.

(iii) Any securities issued by the consolidated 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 consolidated 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 consolidated government abroad, minus amortization. Amortization includes all external debt-related payments of principal by the consolidated 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.

6. **Supporting material:**

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

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

- Data will be provided at the actual exchange rates.

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

- Data on 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.

II. Floor on the Net International Reserves of the NBG

7. **Definition:** For the program purposes, net international reserves (NIR) of the NBG in U.S. dollars are defined as foreign assets of the NBG minus the sum of foreign liabilities of the NBG. Foreign assets of the NBG include gold, gross foreign exchange reserves, Georgia's SDR holdings, and the reserve position in the IMF. Gross foreign exchange reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents, including cash holdings of foreign exchange that are readily available. Pledged or otherwise encumbered assets, including (but not limited to) assets used as collateral (or guarantee for third party external liabilities) are excluded from foreign assets. Foreign liabilities of the NBG shall be defined as the sum of Georgia's outstanding liabilities to the IMF, Georgia's SDR allocation, and any other liabilities of the NBG, excluding the foreign exchange balances in the government's account with the NBG. Thus defined, the definition of NIR excludes foreign assets stemming from foreign currency deposits of financial institutions at the NBG and foreign assets arising from the currency swaps with financial institutions. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the NBG shall be valued at program exchange rates as described on paragraph 2 above. The stock of NIR amounted to $879.8 million as of December 31, 2008 (at the program exchange rate).

8. **Adjustors:**

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

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

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

III. Ceiling on Net Domestic Assets of the NBG

10. **Definition:** Net domestic assets of the NBG are defined as the difference between reserve money and NIR as defined above, and as adjusted according to paragraph 8.

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

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

12. **Definition:** Nonconcessional external loans are defined as loans from lenders other than the IMF with a grant element of less than 35 percent of the value of the loan. The grant element is to be calculated by using currency-specific discount rates reported by the OECD (CIRRs).[8] For maturities of less than 15 years, the grant element will be calculated based on six-month averages of commercial interest rates. For maturities longer than 15 years, the grant element will be calculated based on 10-year averages. This performance criterion applies not only to debt as defined in point No. 9 of the IMF's Guidelines on Performance Criteria with Respect to External Debt (Decision No. 12274-(00/85) August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received.[9]

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

[2] Point No. 9 of the IMF's guidelines reads as follows: "(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase

(continued)

Previously contracted nonconcessional external debt that has been rescheduled will be excluded from the definition of "new debt" for the purposes of this performance criterion.

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

V. Continuous Performance Criterion on Nonaccumulation of External Arrears

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

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

Table 1. Program Exchange Rates

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

agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the leaser retains the title to the property. For the purpose of the Guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt."

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

	Balance-of-payments support loans and balance-of-payments support grants	Project loans and project grants	Conversion for government imports
December 31, 2009	278.4	188.1	257.1
March 31, 2010	0.0	44.7	62.5
June 30, 2010	0.0	89.3	125.0
September 30, 2010	94.9	156.3	187.5
December 31, 2010	151.7	237.5	250.0

1/ Cumulative from the beginning of the calendar year.

INTERNATIONAL MONETARY FUND

GEORGIA

Fourth Review Under the Stand-By Arrangement and Request for Modification of Performance Criteria

Informational Annex

Prepared by the Middle East and Central Asia Department

November 25, 2009

Contents Page

ANNEX I. GEORGIA: RELATIONS WITH THE FUND

(As of October 31, 2009)

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

II. **General Resources Account:**	**SDR Million**	**Percent of Quota**
Quota	150.30	100.00
Fund holdings of currency	532.80	354.49
Reserve position in Fund	0.01	0.01

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Holdings	142.27	98.83

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
Stand-by Arrangements	382.50	254.49
PRGF Arrangements	120.50	80.17

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn SDR Million)
Stand-By	9/15/08	6/14/11	747.10	382.50
PRGF	6/4/04	9/30/07	98.00	98.00
PRGF	1/12/01	1/11/04	108.00	49.50

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

	Forthcoming				
	2009	**2010**	**2011**	**2012**	**2013**
Principal	1.40	14.10	38.11	159.90	190.64
Charges/interest	1.34	5.47	5.38	4.72	2.60
Total	2.74	19.57	43.50	164.62	193.24

VII. **Safeguard Assessments:**

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

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

Not Applicable.

IX. **Implementation of HIPC Initiative:**

Not Applicable.

X. **Exchange Arrangements:**

(a) Since April 29, 1993, the Tbilisi Interbank Currency Exchange (TICEX), established by the NBG and a group of commercial banks, has conducted periodic auctions to determine the exchange rate of the domestic currency vis-à-vis the U.S. dollar. These auctions are conducted daily. Foreign exchange bureaus are allowed to buy and sell foreign currency bank notes. A temporary de facto exchange rate peg to the U.S. dollar was introduced in the wake of the early August armed conflict. During the second week of November, the authorities allowed a 17 percent depreciation of the lari. In March 2009, the authorities introduced an auction-based system for the foreign exchange market. The new mechanism is intended to allow more flexibility and give market forces a greater role in setting the price, with a view to reaching faster and smoother convergence toward equilibrium in the foreign exchange market and giving the market greater clarity about the authorities' policies. In end-May 2009, the authorities officially ended foreign exchange market interventions on TICEX.

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

XI. **Article IV Consultation:**

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

XII. **FSAP Participation:**

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

XIII. **Technical Assistance:**

See Table 1 of this Annex.

XIV. **Resident Representative:**

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

XV. **National Bank of Georgia Resident Advisors:**

Ms. Vance, MAE peripatetic banking supervision advisor to the NBG, commenced a series of visits to Tbilisi in September 1997. Mr. Nielsen, an MAE advisor, provided technical assistance to the NBG in May 1998. Mr. Viksnins was an MAE peripatetic advisor to the NBG president starting in October 1999. Mr. Fish was resident advisor on banking supervision from August 10, 1999 to January 31, 2002. Mr. Bernard Thompson provided peripatetic technical assistance in accounting and internal audit in March and August 2000. Mr. Wellwood Mason provided technical assistance on payment system issues on a peripatetic basis in 2002 and 2003. Mr. Howard C. Edmonds served from September 2004 to October 2007 as a resident advisor on banking supervision issues.

XVI. **Ministry of Finance Resident Advisors:**

Mr. Sharma was an FAD resident advisor and assisted the authorities in the development of a Treasury beginning in May 1997. Mr. Sainsbury, an FAD advisor, assisted the ministry of finance from June 1998 to November 1999. Mr. Chaturvedi was FAD resident advisor in 2001 and 2002 to assist the authorities in continuing the development of the Treasury and the Treasury Single Account, in revising the legislative framework, expenditure control systems, and budgeting issues. Between 2001 and 2003, Mr. Welling was an FAD peripatetic advisor to assist the State Customs Department in preparing and introducing measures for the custom reform and modernization program. In March 2005, Mr. Zohrab started advising the authorities on treasury-related reforms, and his term ended in November 2006.

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

Subject	Type of Mission	Timing	Counterpart
	Fiscal Affairs Department (FAD)		
Tax Policy	Review of tax policy	Jun. 8–21, 2004	Ministry of Finance
Public Expenditure Management	Assessment of Treasury system.	Nov. 8–23, 2004	Ministry of Finance
Public Financial Management	Expert assistance (Zohrab)	Mar. 2005–Nov. 2006	Ministry of Finance
Tax Administration	Mission—review of modernization program	Nov. 8-21, 2005	Ministry of Finance
Tax Administration	Expert assistance	Jul. 9–14, 2006	Ministry of Finance
Tax Administration	Expert assistance (Bosch)	Oct. 9–25, 2006	Ministry of Finance
Tax Administration	Follow-up mission	Jan. 17–30, 2007	Ministry of Finance
Tax Administration	Expert assistance (Woodley)	Jan/Feb and Apr/May 2008	Ministry of Finance
Budget Classification and Accounting Reforms	Expert assistance (Swarap)	Jun. 11-22, 2007	Ministry of Finance
Budget Classification and Accounting Reforms	Expert assistance (Swarap)	Oct. 8-19, 2007	Ministry of Finance
	Monetary and Capital Markets Department (MCM)		
Government Securities Market, Deposit Insurance, Anti-Money Laundering	Advisory	Apr. 20–30, 2004	National Bank of Georgia
Monetary Operations, Banking Sector Competition	Advisory	Oct. 24–Nov. 5, 2004	National Bank of Georgia
Liquidity Management; Trends in Securities and Insurance Sectors	Advisory	Apr. 18–29, 2005	National Bank of Georgia
FSAP Update	Assessment	Feb. 15–28, 2006	National Bank of Georgia
Monetary Operations/Monetary Policy/Foreign Exchange	Advisory	Feb. 16–Mar. 2, 2007	National Bank of Georgia
Consolidated Supervision	Advisory	Dec. 4–14, 2007	National Bank of Georgia

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

Subject	Type of Mission	Timing	Counterpart
Lender of Last Resort Framework	Advisory	Dec. 11-17, 2008	National Bank of Georgia
Stress Testing and Foreign Exchange Market	Advisory	Apr. 21-30, 2009	Financial Supervisory Agency; National Bank of Georgia
	Statistics Department (STA)		
National Accounts	Follow-up assistance	Apr. 26–May 7, 2004	State Department of Statistics
National Accounts	Follow-up assistance	Apr. 18–29, 2005	State Department of Statistics
Price Statistics	Follow-up assistance	May 23–Jun. 3, 2005	State Department of Statistics
Balance of Payments Statistics/International Investment Position	Follow-up assistance	Jun. 15–28, 2005	State Department of Statistics and National Bank of Georgia
Price Statistics	Follow-up assistance	Jun. 20–Jul. 13, 2006	State Department of Statistics
Balance of Payments	Follow-up assistance	Sep. 6–19, 2006	National Bank of Georgia
GDDS/Government Finance Statistics	Follow-up assistance	Nov. 8–22, 2006	State Department of Statistics, National Bank of Georgia, Ministry of Finance
Balance of Payments	Follow-up assistance	Jul. 9-20, 2007	National Bank of Georgia
Monetary and Financial Statistics	Advisory	Mar. 18-31, 2009	National Bank of Georgia
	Legal Department (LEG)		
Tax Code	Follow-up assistance	Jan. 28–Feb. 9, 2001	Ministry of Finance, Tax Inspectorate of Georgia
Tax Code	Follow-up assistance	Jul. 13–24, 2001	Ministry of Finance, Tax Inspectorate of Georgia

ANNEX II. GEORGIA: RELATIONS WITH THE WORLD BANK

(As of November 24, 2009)

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

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

3. A new CPS for Georgia for FY10-13 was approved by the World Bank Board in September 2009 against the backdrop of twin crises – the August conflict followed by the global economic downturn. As a result, the joint World Bank/IFC strategy focuses on key post-conflict and vulnerability issues in the near term, as well as strengthening the foundations for medium term competitiveness and growth. The CPS envisages Bank Group financing of about $740-900 million over the four year period underpinned by a strong program of knowledge services. The financing envelope includes full use of the remaining IDA-15 envelope (projected at about $130 million), indicative IBRD lending (of about $266 million), disbursements under ongoing IDA/IBRD projects (of about $135 million), and IFC investments and lending (of about $210-360 million).

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

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

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

6. Development policy lending has been a core element of Bank strategy and will continue to be so in the new CPS. Following past successful reform track record under the Poverty Reduction Support Operations, a programmatic series of three Development Policy Operations (DPOs) is planned under the new CPS. The first DPO in amount of USD 85 million was approved on July 2, 2009. The DPO program aims at (i) mitigating the economic downturn; and (ii) facilitating recovery and preparing Georgia for post-crisis growth. It promotes policy and institutional reforms in (i) public finances, including improving efficiency and effectiveness of public expenditures, and public investment strengthening; (ii) social protection strengthening, including targeting and scaling up of the safety net system, pensions, and improving health coverage for the poor, and (iii) on specific measures to further improve the investment climate, including actions to modernize tax and customs administration.

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

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

- In **education,** IDA credits are supporting education system realignment and strengthening which address a broad spectrum of educational reform issues, aimed at improving learning outcomes of primary and secondary students, and in rehabilitating schools.
- I**n health,** an IDA-financed project is supporting the government in improving provision of primary health care services through the new Medical Insurance Program (MIP), providing training and equipment, and supporting the health information system as well as management capacity building.
- In **rural development**, IDA credits have supported development of private sector farming and agro-processing improvements, agricultural credit, irrigation and drainage, and agricultural research. IDA credits have also been supporting creation of local institutions, such as rural credit unions and water users associations.

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

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

10. A key part of the Bank Group assistance has been to the private sector where IFC has financed projects in banking, infrastructure, oil and gas, and manufacturing sectors. IFC's committed portfolio in Georgia as of June 2009 stood at about $298 million, of which $240 million is disbursed. The portfolio includes 9 clients, primarily in the banking sector but also including several real sector clients. In the financial sector, IFC has focused on providing investment and technical assistance to three leading banks—TBC Bank, the Bank of Georgia, and Bank Republic. To reach small and medium enterprises, IFC helped to establish ProCredit Bank of Georgia, the country's first bank specializing in lending to micro and small enterprises. IFC has also provided a credit line to TBC Leasing to support the rapid growth of their portfolio of SME clients.

11. More recently, IFC has also mobilized its investment assistance to provide stability to the Georgian banking system in the wake of the global financial crisis. In the real sector, IFC continues to look for opportunities to support the growth of the private sector, particularly in export-oriented companies or those that support overall private sector development. Sectors of interest include agrobusiness, infrastructure, manufacturing, and the development of natural resources. IFC has also provided technical assistance to strengthen its client banks and introduce new financial products (including leasing and housing finance), and to improve the business climate and corporate governance practices. The World Bank-IFC Doing Business report has ranked Georgia as a top reformer in its Doing Business report, and the government is actively engaged with IFC to make further progress on reforms to improve the business environment.

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

ANNEX III. GEORGIA: RELATIONS WITH THE EBRD

(As of June 30, 2009)

1. As of June 30, 2009 the European Bank for Reconstruction and Development (EBRD) had signed 120 investments in Georgia with cumulative commitments totaling $975.4 million.[1] Current Portfolio Stock equals to $696.3 million. The EBRD's first operation, a power rehabilitation project, was signed in December 1994. Since then, the pace and composition of portfolio growth has varied significantly from year to year.

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

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

4. As at 30 June 2009 the Bank has signed eight projects in private sector arriving at the business volume of USD 84.4 million. As a response to the global financial crisis, EBRD, IFC and FMO joined forces to provide TBC Bank, with a funding package of $161 million in

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

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

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

6. Georgia is part of the 'Early Transition Countries' (ETC) initiative. Launched in April 2004, the initiative aims to increase investments in the Bank's seven poorest countries. The initiative builds on international efforts to address poverty in these countries. Through this initiative, the EBRD focuses its efforts on private sector business development and selected public sector interventions. It aims to stimulate market activity by using a streamlined approach to financing, focusing on smaller projects, mobilizing more investment, and encouraging ongoing economic reform. The Bank will accept higher risk in the projects it finances in the ETCs, while still respecting the principles of sound banking. Since launch of the ETC initiative, the Bank's annual business volume in Georgia has been increased five times.

Table 1. Georgia: EBRD Portfolio for Georgia (In millions of US$)
(As of June 30, 2009)

Project Name	Date of Agreement	Outstanding Amount
Bank Republic - MSE Loan	27-Apr 2006	1.7
Bank Republic - MSME	12-Dec 2008	10.0
Bank Republic Equity	15-Sep 2006	8.3
Bank Republic Equity (Capital Increase)	23-Apr 2008	1.4
Bank Republic Mortgage Loan	20-Dec 2006	7.8
Bank Republic Mortgage Loan II	22-Aug 2008	14.0
Bank Republic Subordinated Debt	07-Jul 2008	5.0
Bank of Georgia - convertible subordinated debt	30-Dec 2008	26.0
Bank of Georgia - subordinated debt	30-Dec 2008	24.0
Bank of Georgia Senior Loan	30-Dec 2008	50.0
Basis Bank Equity Investment - Georgian Financial Sector F/W	19-May 2008	4.1
Batumi Public Transport Project	02-Sep 2008	3.5
Borjomi Water Project	01-Dec 2008	2.1
CEEP - Bank Republic	19-Dec 2008	5.0
CEEP - Cartu Bank	20-Dec 2007	5.0
CEEP - TBC	30-Nov 2007	5.0
Cartu Bank SME Loan II	30-Mar-09	5.0
DIF - Alfapet	08-Dec 2007	0.1
DIF - Delidor	17-Jun 2005	1.5
DIF - Georgian Hazelnut Production Ltd.	26-Oct 2006	0.8
DIF - Iberia Refreshments	25-Sep 2003	3.3
DIF - Imedi L	30-Dec 2006	1.6
DLF - BTM TEKSTIL	21-Dec 2006	2.0
DLF - Georgian Hazelnut Production Ltd	26-Oct 2006	3.1
DLF- Populi	31-Dec 2008	13.1
ETC Non-Bank MFI Framework II - Constanta	28-Nov 2006	2.3
ETC Non-Bank MFI Framework II - WV Credo	07-Mar 2008	1.5
Enguri Hydro power Plant Rehabilitation project	22-Dec 1998	23.2
Geo Steel	20-Oct 2008	14.0
Georgia: Trans-Caucasian Rail Link Project	22-Dec 1998	3.3
Georgian Financial Sector F/W - Basis Bank (MSME Loan)	21-Sep 2007	6.0
Georgian Financial Sector F/W-Bank Republic MSE Loan	21-Dec 2007	12.0
Georgian Financial Sector F/W-Cartu Bank SME Loan	20-Dec 2007	7.0
Georgian Financial Sector FW-TBC Bank Mortgage Line II	21-Dec 2007	12.0
Georgian Property Debt FW - Tbilisi Central Train Station	28-Dec 2007	8.5
Georgian Property Debt Facility - Green Building	19-Mar 2007	2.6
Georgian Property Equity Investment	29-Aug 2007	15.2
Georgian Wines & Spirits Ltd.	10-Mar 2005	4.8
JSC Channel Energy Poti Port	19-Mar 2002	3.0
Kobuleti Water	27-Jun 2008	2.1
Kutaisi Water Project	15-Sep 2006	4.2
MCFF - Bank Republic - Begi Co. II	28-Dec 2007	5.1
MCFF - Bank Republic - Begi Company	28-Dec 2007	0.9
MCFF - Bank Republic - Full Recourse	05-Dec 2008	10.0
MCFF - Bank of Georgia Full Recourse Portion	14-Jun 2005	4.0
MCFF - BoG Iberia Refreshments Sub-Loan (NRP)	27-Sep 2006	2.7

MCFF - TBC - Tsiskvilkombinati II	21-Nov 2007	0.2
MCFF - TBC Bank - Jaokeni Company JSC	04-Aug 2008	2.8
MCFF - TBC Bank EMBAWOOD Sub Loan	13-Jun 2007	0.7
MCFF - TBC Bank JSC Full Recourse Portion	13-Jun 2005	2.1
MCFF - TBC Bank Lomisi Ltd Sub-Loan (NRP)	03-Aug 2005	1.0
MCFF - TBC Bank Tegeta Motors	01-Apr 2008	6.7
MCFF - TBC Bank Wissol Sub-Loan (NRP)	10-Oct 2007	4.9
MCFF - TBC Coca Cola Ltd. sub-loan	02-Feb 2007	4.5
MCFF - TBC Tsiskvilkombinati	21-Nov 2007	1.9
MCFF BOG - Renewable Energy Program - Okami SHPP NRP	21-Dec 2006	0.1
MCFF BOG - Renewable Energy Program Lopota SHPP NRP	21-Dec 2006	0.2
MCFF Bank Republic - Mediclub Georgia	30-Oct 2007	2.5
MCFF TBC Bank - Goodwill	31-Oct 2007	7.0
MCFF-Bank Republic - BCFS	18-May-09	1.5
Poti Water Supply Project	15-Sep 2006	3.5
Power Rehabilitation Project	20-Dec 1994	0.8
ProCredit Georgia - Syndicated Loan	21-Jun 2007	8.0
Regional TFP Basisbank (Guarantee & Pre-export)	06-Nov 2007	0.5
Regional TFP: Bank Republic (Guarantee & Pre-export)	15-Feb 2006	0.0
Regional TFP: Bank of Georgia (Guarantee & Pre-export)	29-Jul 1999	19.0
Regional TFP: Cartu Bank	28-Apr 2006	2.5
Regional TFP: TBC Bank (guarantee & pre-export)	17-Aug 1999	21.9
Regional TFP: VTB Bank Georgia	24-Dec 2000	0.0
Rustavi Solid Waste Management Project	02-Jun 2009	2.2
TBC Bank - SME Credit Line	19-Dec 2003	0.7
TBC Bank - Senior Loan	14-Apr 2009	14.7
TBC Bank Mortgage Loan	29-Jun 2006	11.7
TBC Bank SME Credit Line III	26-Sep 2005	2.5
TBC Bank SME Line	29-Jul 2008	7.5
TBC Bank: Subordinated Loan	14-Apr 2009	18.5
TBC Bank: investment in ordinary shares	7-Apr 2009	38.7
TBC Leasing - Equity Investment	01-Mar 2006	0.1
TBC Leasing, Senior Debt	21-Dec 2005	1.7
Tbilisi International Airport	17-May 2006	23.6
Tbilisi Public Transport Project	29-Jul 2005	1.9
VTB Bank Georgia	09-Oct 2006	8.9
VTB Bank Georgia (debt, equity)	20-Nov 1997	2.5
VTB Bank Georgia Capital Increase	09-Oct 2006	2.5
	TOTAL	**578.1**
Aureos Central Asia Fund LLC	01-Dec 2008	0.8
BIH	18-Dec 2006	0.0
BSR Europe Co-Investment Facility	14-Aug 2006	9.8
Baku-Tbilisi-Ceyhan (BTC) Pipeline	03-Feb 2004	49.2
Baring Vostok Private Equity Fund	13-Dec 2000	0.0
Caucasus Online	22-Dec 2008	30.6
Lukoil Overseas : South Caucasus Gas Pipeline	28-Jul 2005	27.7
	TOTAL REGIONAL	**118.2**
	GRAND TOTAL	**696.3**

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 09/456
FOR IMMEDIATE RELEASE
December 11, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth Review Under the Stand-by Arrangement for Georgia and Modifies Performance Criterion

The Executive Board of the International Monetary Fund (IMF) today completed the fourth review of Georgia's performance under an 18-month Stand-By Arrangement (SBA) for an amount equivalent to SDR 477.1 million (about US$ 759.3 million) approved on September 15, 2008 (see Press Release No. 08/208). On August 6, 2009, the Executive Board approved an augmentation of access under the SBA to an amount equivalent to SDR 747.1 million (about US$1,189 million) and an extension of the SBA until June 14, 2011 (see Press Release No. 09/277). The completion of the fourth review allows for the immediate purchase of an amount equivalent to SDR 47.3 million (about US$ 75.3 million).

The Executive Board also modified the end-December 2009 performance criterion on the ceiling for net domestic assets to reflect higher reserve money growth and introduced two new structural benchmarks: the government approval of a new medium-term expenditure framework by July 31, 2010 and government approval of a methodology to introduce a programmatic approach to budgeting by September 30, 2010. The new structural benchmarks are aiming at strengthening the efficiency of the adjustment strategy by improving linkages between the medium-term expenditure framework and annual budgets, and building the capacity for program budgeting.

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

"The Georgian economy shows tentative signs of recovery, but the external environment remains weak in terms of export market growth, and uncertain in terms of the recovery of private capital inflows. Furthermore, domestic credit conditions are still very tight, although interest rates have started coming down. For these reasons, risks remain elevated.

"The authorities' economic strategy has succeeded in stabilizing financial conditions and market confidence, as witnessed in the steady reflow of deposits into commercial banks, the stabilization of the foreign exchange market, and the narrowing of Eurobond spreads. The large fiscal stimulus associated with the widening of the fiscal deficit was instrumental in averting a deeper economic contraction.

"The sizeable fiscal adjustment targeted by the authorities for 2010 is intended to place public finances on a path toward a sustainable position over the medium term, thereby strengthening confidence as the economy emerges out of the recession. The adjustment strategy is supported by structural reforms to enhance the efficiency of government spending and to improve an already very strong business environment. These policies will place Georgia in a good position to take advantage of a global recovery and to restore its access to capital markets ahead of the large external debt repayment obligations coming due in 2013.

"Foreign exchange market pressures have all but abated since May 2009, and intervention in support of the lari has been very limited. The stabilization of the foreign exchange market, reflects improved confidence and the contraction of imports due to the recession. Even though the external current account deficit has narrowed markedly, it remains structurally high. In this regard, the exchange rate will remain an important instrument of adjustment over the medium term.

"Credit conditions, as reflected by the level of real interest rates, remain tight, mostly as a result of the liquidity squeeze experienced by the banking sector in the wake of the war and during the subsequent domestic political uncertainty. Presently, banks have returned to comfortable liquidity conditions and interest rates have begun to decline. As traditional monetary policy tools regain traction and the economy recovers, monetary policy will be geared to preserving the gains made in terms of disinflation.

"The banking sector has weathered the crisis relatively well, and systemic risks have abated considerably since the beginning of 2009. Banks have retained a solid capital base, reconstituted strong liquidity buffers, and set aside adequate provisions. Risks, particularly related to indirect foreign currency exposures, remain pervasive, but the authorities have responded by upgrading their monitoring and response capacity, including through stress testing and the gradual adoption of more flexible regulatory and supervisory approaches. "

Statement by Age Bakker, Executive Director for Georgia
December 11, 2009

The authorities' commitment to the program continues to be very strong. Despite challenging circumstances, all end-September quantitative performance criteria were met, and all structural benchmarks were observed on time. On the latter, the authorities successfully elaborated a contingency plan to guide policy options in the event of financial sector stress, and submitted to parliament a 2010 budget consistent with program targets, and a law to improve the internal audit of public expenditure management. The final version of the 2010 budget, which was recently approved by parliament, is fully consistent with the program target.

Recent developments and prospects
Georgia has been hit hard by the global crisis. Real GDP shrank by 8.5 percent in the first half of this year. The output contraction was led by falling FDI, exports and domestic bank lending. As a result of the recession, inflation slowed. End-October CPI inflation was 3.2 percent on an annual basis, compared to 5.5 percent at the end of last year. Fiscal revenues also tumbled in the face of the downturn. However, owing to lower than expected expenditures in the third quarter, the end-September deficit target in the program was met by a wide margin.

As a result of subdued domestic demand, the current account deficit further declined to 13.6 percent of GDP in the first half of 2009, down from the peak of 28.7 percent in the first half of 2008. Helped by lower imports, foreign exchange market conditions remained stable. The banking sector has proved to be resilient, despite shocks in the liability and asset side of banks' balance sheet. Non-performing loans (NPLs) remain high at 18 percent of total loans in October, according to the authorities' more conservative and forward-looking definition. However, both liquidity and capital buffers remain strong. Moreover, conditions in the banking sector seem to stabilize, as the share in NPLs has been gradually decreasing since the summer, and both deposits and banks' profitability have improved from their low levels.

While credit retrenchment and lower than expected inflows of FDI continue to weigh on the economy, there are indications that the recession is bottoming out. Also helped by a more stable political situation and improved confidence, VAT receipts and housing prices have picked up somewhat over the last months. Moreover, remittances have risen whereas the latest trade data shows some signs of stabilization. In this context, the authorities believe that a modest recovery is now underway, supported by accommodative macroeconomic policies. For the year as a whole, real GDP is expected to contract by 4 percent in 2009, with risks tilted towards the downside. Recognizing that uncertainties are large, the authorities expect 2010 GDP growth to return to positive numbers, reflecting a further easing in credit conditions and somewhat higher private capital inflows. Inflation is not projected to exceed the inflation target of 6 percent due to the negative output gap. Owing mostly to adverse terms of trade developments (higher energy prices), the improvement in the current account is projected to be reversed slightly in 2010.

Macroeconomic and financial policies

As stressed in the LOI, the authorities' main challenge in the short-term continues to be the restoration of growth, without undermining medium-term macroeconomic and external stability.

Monetary and exchange rate

The central bank considerably lowered its policy rate, as both inflation and inflation expectations remain substantially below target. Last week the central bank cut interest rates further by 100 basis points to 5 percent. However, the transmission of monetary policy changes to market rates remains hampered largely by high dollarization. Even so, interest rates on deposits and loans have started to drop due to improved liquidity conditions. The interest rate channel is further undermined by banks' excess liquidity in local currency. To increase the effectiveness of this channel, and to avoid that ample liquidity risks fueling pressures in the foreign exchange market, the authorities have stepped up the issuance of CDs to mop up excess liquidity, in line with staff recommendations.

The authorities remain fully committed to a flexible exchange rate policy. Improvements in exchange rate management have allowed for a greater role of market forces in determining the exchange rate. In this spirit, the authorities have widened the deviation band for auction bids, and, in absence of exchange rate pressures, reduced the frequency of foreign exchange auctions. If persistent downward pressures in the foreign exchange market would arise, due to for example a more persistent external financing gap, the authorities are committed to allow for faster depreciation.

Fiscal

With monetary transmission hampered, the authorities' response to this crisis has hinged strongly on a fiscal stimulus, supported by substantial donor financing. To cushion the impact of the recession and protect the country's vulnerable groups, capital and social spending has been frontloaded. In line with the program, the 2009 fiscal deficit is expected to widen to 9.6 percent of GDP. External public debt is expected to climb fast, although at 30 percent of GDP (and 24 percent in NPV terms), the level remains manageable. The authorities fully realize that deficit reduction over the next years is key to preserve fiscal sustainability, and to secure investor confidence and market access. As from next year, they will implement an ambitious fiscal adjustment strategy. The 2010 budget is aiming to reduce the fiscal deficit by around 2¼ percentage points. As revenues are expected to remain subdued, most of the adjustment is borne by expenditure cuts in mostly subsidies and capital projects. Social spending will not be lowered in terms of GDP.

Beyond 2010, the authorities are strongly committed to further reduce the deficit to 2-3 percent of GDP by 2013. This improvement will be largely driven by the phasing out of capital spending, and as the economy gathers momentum, by lower social expenditures and higher revenues. The authorities' commitment to fiscal sustainability has recently been anchored in the Economic Freedom Act, which includes clear fiscal rules that will become effective in 2012.

A combination of external budget support, privatization and treasury bills will be used to finance the 2009 and 2010 deficit. For this year, the portion covered by treasury bills will be increased to make up for the shortfalls in privatization receipts. For next year, the contribution of external budget support will be higher, as issuance of treasury bills could crowd out the private sector in an environment of higher credit demand and lower excess liquidity. The Fund is expected to cover 45 percent of the required financing. However, the authorities are expecting additional financing from the World Bank and ADB, on which negotiations will begin soon. Once this additional financing has been secured, the expected budget support from the Fund will be reduced accordingly.

In the meantime, the authorities are making headway in implementing their public finance reform action plan. As mentioned in the LOI, this plan contains a wide range of steps to improve transparency, discipline, efficiency and the accountability of public finances. All of these steps will help make government spending more efficient as consolidation takes place.

Banking Sector

Conservative prudential policies have served Georgia well in the crisis. Banks' balance sheet are improving, but the authorities are still reinforcing their stress testing framework to better assess the risks posed by a more protracted economic slump or a substantial exchange rate depreciation. Results of the stress tests, developed with Fund assistance, show that the banking sector as a whole is resilient to shocks. Even under extreme scenarios, the recapitalization need would be manageable, reflecting both high initial capital buffers and a modest degree of financial deepening.

To mitigate the impact of systemic risks, the authorities have prepared and discussed among responsible parties a contingency plan which spells out possible measures on a bank-by-bank basis, and the division of responsibilities between relevant stakeholders. Demonstrating the authorities' preparedness, they recently effectively restructured one of Georgia's systemically-relevant banks. Further steps are being taken to introduce risk-based supervision and to make balance sheet less susceptible to exchange rate shocks.

Request

Against the backdrop of the strong performance under the SBA and the commitment to further policy adjustments, the authorities request the Board's approval of the completion of the 4^{th} review, and new program conditionality.