IMF Country Report No. 17/361

GEORGIA

December 2017

FIRST REVIEW UNDER THE EXTENDED FUND FACILITY AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA—PRESS RELEASE; AND STAFF REPORT

In the context of the First Review under the Extended Fund Facility and Request for Modification of Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on October 9, 2017 with the officials of Georgia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on November 17.

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

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

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No.17/463
FOR IMMEDIATE RELEASE
December 6, 2017

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes the First Review of the Extended Arrangement under the Extended Fund Facility for Georgia

On December 6, the Executive Board of the International Monetary Fund (IMF) completed the First Review of Georgia's performance under the three-year extended arrangement under the Extended Fund Facility (EFF) on a lapse of time basis.[1] The completion of the review enables the release of SDR 30 million (about $42.4 million), bringing total disbursements under the arrangement to SDR 60 million (about $84.8 million). The extended arrangement for SDR 210.4 million (about $297.5 million or 100 percent of quota) was approved by the Executive Board on April 12, 2017 (see Press Release No. 17/130).

The program is on track with all end-June 2017 performance criteria and structural benchmarks met. Economic activity has strengthened on the back of stronger growth in main trading partners. Fiscal overperformance and efforts to address structural weaknesses have helped boost confidence.

Georgia's economic performance has improved, but risks to the outlook remain. The economic recovery is gaining momentum, inflation is projected to decline starting in early 2018, and the external position has strengthened. Revenue overperformance provides room for additional capital spending and VAT repayments in 2017. The banking sector remains liquid, profitable, and well capitalized. Despite the positive outcomes, the authorities need to remain vigilant and sustain reform efforts to address structural obstacles to growth.

The 2018 budget appropriately targets further fiscal consolidation. The 2018 budget envisages a further decline in the deficit while allowing for an increase in capital spending. To achieve this, efforts to strengthen revenue administration should continue, especially to prevent the buildup of VAT claims. The authorities should also bolster efforts to further contain current spending, for instance, by containing the wage bill, improving the targeting of social programs, and reducing subsidies and equity injections to state-owned enterprises (SOEs).

[1] The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

Medium-term fiscal commitments should be completed as currently envisaged and require progressing with institutional fiscal reforms. Staff welcomes the authorities' commitment to fiscal consolidation while accelerating high-priority infrastructure investment. A stronger framework for managing public investment will help improve efficiency on the use of public resources. The authorities' commitment to comprehensively assess and monitor fiscal risks should be clearly reflected in the 2018 Fiscal Risk Statement. Efforts to improve the budgetary processes and fiscal reporting—for instance, by improving the coverage and measurement of fiscal aggregates to reflect activities of legal entities of public law (LEPLs) and SOEs, elaborating on compliance with fiscal rules, and strengthening macroeconomic and fiscal forecasting—will help improve fiscal transparency and accountability.

Monetary policy remains rightly focused on price stability, supported by the flexible exchange rate and efforts to strengthen the transmission mechanism. The NBG's monetary policy stance is appropriate, but the authorities need to remain vigilant on monetary and financial developments, including related to credit growth. The inflation targeting framework, combined with the floating exchange rate regime, has served Georgia well. Foreign exchange intervention should remain limited to smoothing excessive exchange rate volatility and building reserves. The NBG's steps to strengthen liquidity management, de-dollarize the economy, and improve communication will help strengthen the monetary framework.

The authorities' steps to increase the resilience of the financial sector are welcome. Proposed legal amendments would appropriately expand the role of the central bank in regulating and supervising non-banks and credit bureaus, enhance the bank resolution framework, and supervise banks on a consolidated basis. The authorities' efforts to identify legal amendments to adopt an effective emergency liquidity assistance (ELA) framework are also commendable.

Continued efforts to advance structural reforms are key to achieving higher and more inclusive growth. Upgrading infrastructure and strengthening trade integration will boost growth prospects. The new insolvency law for non-financial corporations and the Business House will help improve the business environment. The pension reform will increase the availability of domestic savings to support investment, as long as contributions are enforced. Improved capital market infrastructure, by facilitating mobilization of funds, will support capital accumulation. To further support growth, Georgia also critically needs to advance on education reform.

INTERNATIONAL MONETARY FUND

GEORGIA

November 17, 2017

FIRST REVIEW UNDER THE EXTENDED FUND FACILITY AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

KEY ISSUES

Recent economic developments. Economic activity has strengthened on the back of stronger growth in main trading partners. Fiscal overperformance and efforts to address structural weaknesses have helped boost confidence.

Program status. The 36-month Extended Fund Facility (EFF) approved on April 12 2017, with access of SDR 210.4 million (100 percent of quota), is on track. All end-June 2017 performance criteria (PCs) were met, some with significant margins. All structural benchmarks were also met. Completion of the review will make available the amount of SDR 30 million.

Program policies. The draft 2018 budget appropriately sustains fiscal consolidation, while providing space for capital spending. Consolidation efforts need to be supported by adhering to the medium-term fiscal commitments, enhancing public investment oversight and fiscal risk monitoring, and addressing the backlog of VAT claims. The stance of monetary policy remains adequate, and the National Bank of Georgia (NBG) remains committed to the flexible exchange rate while building reserves. Reforms to increase the resilience of the financial sector are progressing. The authorities remain committed to a broad set of structural reforms to support medium-term growth. The envisaged pension reform would help mobilize domestic savings and reduce internal imbalances, while a new Public-Private Partnership (PPP) law would help promote investment. Education reform is critical to promote more inclusive growth.

Approved By
Juha Kähkönen and Rupa Duttagupta

Discussions were held in Tbilisi during September 26-October 9, 2017 with Prime Minister Kvirikashvili, First Deputy Prime Minister and Minister of Finance Kumsishvili, NBG Governor Gvenetadze, Minister of Economy and Sustainable Development Gakharia, other senior officials, and representatives of the private sector, civil society, and the diplomatic community. The team comprised Ms. Vera Martin (head), Mr. Painchaud (Resident Representative), Mr. Rodriguez, Mr. Sola and Ms. Sharashidze (local economist) (all MCD), Mr. Jalles (FAD), and Ms. Suphaphiphat (SPR). Mr. Doornbosch (OED) joined the discussions. Mr. Almalik provided research assistance, and Ms. Toshmuhamedova helped in document preparation.

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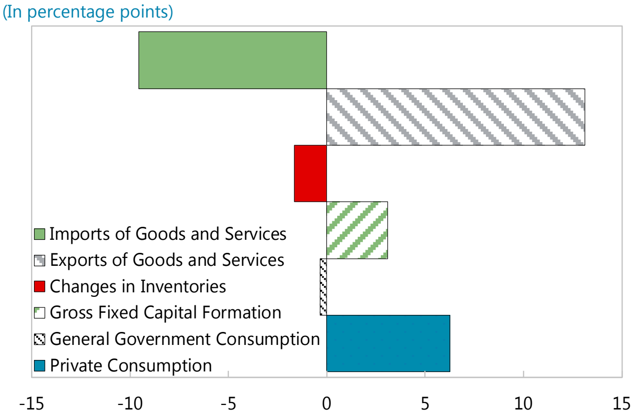
CONTEXT

1. **In April 2017, the Executive Board approved a three-year extended arrangement under the Extended Fund Facility (EFF), supporting the authorities' *Four Point Reform Plan.*** Lower growth in major trading partners exposed structural weaknesses, put the external position under stress and weighed negatively on growth. The authorities' policy agenda, focused on supporting investment and improving education, the business environment, and public administration efficiency, aims to boost potential growth while preserving macro stability and fiscal discipline. Following a government reshuffle in November 2017, the authorities have reaffirmed their commitment to the program.[1]

RECENT ECONOMIC DEVELOPMENTS

2. **Economic activity is gaining momentum.** Growth reached 4.7 percent year-on-year (y–o–y) through September, supported by private consumption and net exports. Construction, trade, and manufacturing have been the most buoyant sectors. After peaking at 7.1 percent in June, inflation declined to 6.2 percent in September. Core inflation has hovered around 3-4 percent. To anchor inflation expectations after a hike in excise taxes, the NBG increased the policy rate by 25 basis points each in both January and May.

Contributions to Nominal Growth, 2017H1
(In percentage points)



3. **The external position has strengthened.** The current account deficit narrowed to 9.4 percent of GDP in 2017H1, from 12.8 percent of GDP in 2016. Through August, goods exports and tourism receipts rose by almost 30 percent y-o-y, remittances 20 percent, and imports 9 percent. Net FDI (9.2 percent of GDP in 2017H1) declined, reflecting the near completion of energy projects. The economic rebound and higher policy rate provided the NBG an opportunity to purchase $130 million, boosting gross international reserves (GIR) to $3 billion at end-September.

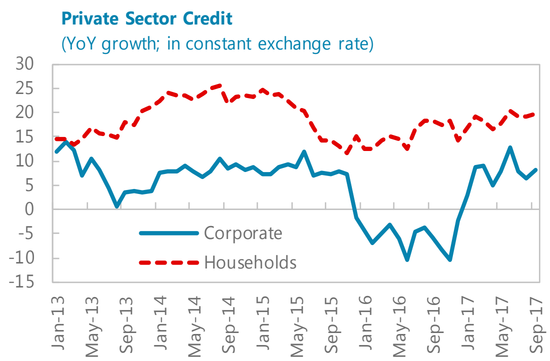
4. **The fiscal outturn through June was better than expected, reflecting stronger-than-expected economic activity.** The augmented deficit was GEL107 million, 0.7 percent of GDP lower than the (adjusted) program ceiling. The favorable outturn resulted primarily from revenue overperformance, but lower budget lending also contributed. The strong revenue outturn was driven by tax revenues (PIT and lower-than-expected losses associated with the CIT reform) on the back of a better–than–expected growth and improved tax administration.[2] As anticipated, capital spending increased (32 percent y-o-y in H1) while current spending remained subdued (7-percent growth y-o-y).

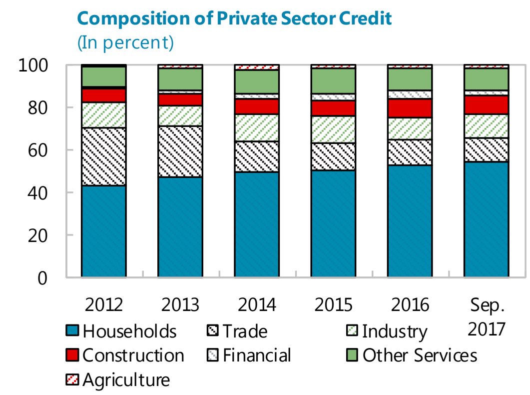
[1] On November 13, Deputy Prime Minister Kumsishvili, formerly also the minister of finance, was named minister of economy and energy (the latter pending parliamentary approval) and the head of the economic team. Mr. Bakhtadze is the new minister of finance.

[2] Revenue losses from the CIT reform are projected at about GEL300 million, compared to GEL460 million at the time of the program approval.

Public debt declined to 42 percent of 2017 GDP by end-September, partly reflecting the lari appreciation.

5. The banking sector remains supportive of the economic rebound. Banks remain profitable and well–capitalized. Non–performing loans are stable at around 3.5 percent of total loans. In May, Bank of Georgia—the second largest bank—issued a GEL500 million international bond. Credit to the private sector (in constant exchange rates) grew 14 percent (y-o-y) in September. Credit to households continues to grow faster than credit to corporations; corporate credit is mostly channeled to retail trade, industry, and construction.





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

PROGRAM PERFORMANCE

6. Quantitative program conditionality and structural benchmarks (SBs) have been met (MEFP, Tables 1-3). The authorities reiterated their commitments to program objectives and targets.

- **All quantitative PCs and indicative targets were observed.** The end-June PCs on Net International Reserves (NIR), the augmented deficit, the cash deficit and new borrowing by the Partnership Fund (PF, a public commercial financial institution) were met by large margins. The government did not incur any external or domestic arrears, nor did it issue any public guarantee. Inflation remained within the inner consultation band.

- **Structural benchmarks were also reached.** The authorities met the end-June SBs on: (i) the increase of the minimum regulatory capital for commercial banks; (ii) the memorandum of understanding between the Ministry of Finance (MoF) and the NBG for information sharing for liquidity forecasting; and (iii) submitting legislation establishing deposit insurance by end-year (the law has already been approved). They also met the end-September SBs on: (i) introducing the liquidity coverage ratio for banks with preferential treatment for GEL deposits; (ii) submitting to Parliament amendments to enhance the resolution framework; and (iii) adopting an action plan to address outstanding VAT claims. The authorities are making progress towards the SBs for the end–year.

OUTLOOK AND RISKS

7. The near-term outlook has improved against the backdrop of higher private consumption and a stronger external environment, with better-than-projected current account and external debt dynamics.

- **Real GDP growth** has been revised up to 4.3 percent in 2017 and 4.2 percent in 2018, compared to 3.5 and 4 percent, respectively, at the time of program approval. The small negative output gap is expected to close gradually by 2019.

- **Inflation** is expected to gradually decline to the 3-percent target by end-2018, as the impact of higher excises dissipates. The GDP deflator is projected to rise by 5.4 percent in 2017 and 3.4 percent in 2018, somewhat higher than at the time of program approval.

- The **current account deficit** is projected to hover around 10.5 percent of GDP in 2017 and 2018, supported by export growth and tourism. The deficit remains largely financed by FDI, as new projects develop. GIR are projected at 99 percent of the IMF metric by 2019.

- **The external debt position** has improved. Total external debt (excluding intercompany loans) is projected at 87 percent of GDP in 2022. Debt remains vulnerable to large macroeconomic shocks (Figures 6-8, Table 10).

8. Risks to the outlook are balanced (Annex I). Upside risks arise from stronger domestic demand and a more supportive external environment. On the downside, Georgia remains vulnerable to regional developments. More inward-oriented policies and weaker economic growth in key advanced and emerging economies could undermine efforts to promote trade and reduce external imbalances. Tighter global financial conditions and a stronger U.S. dollar could deteriorate debt dynamics.

POLICY DISCUSSIONS

A. Fiscal Policy: Consolidating while Creating Space for Capital Spending

9. The 2017 augmented fiscal deficit is projected at 3.6 percent of GDP, in line with the original budget (MEFP, ¶7). Revenue overperformance is estimated at GEL200 million (0.5 percent of GDP). Better revenue outturn masks lower yields from the 2017 budget measures (Text Table). Current primary spending is projected in line with the program as the authorities limit administrative spending to compensate for the smaller-than-expected effects of the expenditure measures. Consistent with program parameters (MEFP, ¶6), the authorities would use the revenue overperformance for high-priority investment (0.4 percent of GDP) and repayments of VAT claims (0.1 percent of GDP, see below).[3] To this end, the authorities will issue a supplementary budget by year-end.

[3] The stock of VAT claims mainly reflects low request for refunds and low percentage of claims that are refunded.

10. The draft 2018 budget accelerates fiscal consolidation efforts while maintaining capital spending (MEFP, ¶8). The augmented deficit is projected at 3 percent of GDP, resulting in a small negative fiscal impulse (0.3 percent of potential GDP). Current spending is projected to remain constant in real terms, except for the costs associated with the pension reform (0.3 percent of GDP). The authorities will contain the wage bill after adopting the remuneration law (**SB end-December 2017**), and pursue efficiency gains. Net acquisition of nonfinancial assets and budget lending are projected at 7.7 percent of GDP. Considering the higher revenue base and the disappointing yield on tobacco excises in 2017, the government decided not to further increase tobacco excises (0.2 percent of GDP) in 2018.[4] That said, the authorities stand ready to take additional measures as needed to meet the fiscal target, including a modernized property tax or a temporary VAT increase.

11. Staff called for maintaining fiscal policy commitments over the medium term (MEFP, ¶10). The authorities remain committed to fiscal consolidation, while accelerating high-priority infrastructure investment. Compression in current spending will provide space to increase capital spending (including budget lending), to 9.4 percent of GDP by 2020. The operational balance (revenues minus current spending) would improve over the medium term. Additional fiscal measures are needed in 2019–20 to reach the fiscal deficit targets. Staff expressed concerns about the recently announced, non-

Text Table 1. Georgia: Fiscal Measures in 2017

(In percent of GDP, impact is shown relative to the previous year)

	2017	
	Prog.	Prel.
Legislated in the Budget	**1.4**	**1.0**
Revenue Measures	**0.7**	**0.4**
Tobacco excise	0.6	0.2
Vehicle and fuel excises	0.9	0.7
Gambling taxes and fees	0.1	0.2
Advance payments and golden list (**)	0.4	0.3
10% of LEPL revenues transferred to budget	0.1	0.1
CIT reform	-1.5	-1.2
Current Expenditure Measures	**0.8**	**0.6**
Central governmment	0.4	0.3
Wage bill cuts	0.4	0.4
Administrative costs savings	0.1	0.1
Efficiency in healthcare	0.2	0.2
End agroland program	0.1	0.1
Other	-0.4	-0.5
Local governments	0.4	0.3
Memo:		
Nominal GDP (EFF Staff Report)	36,227	

Text Table 2. Georgia: General Government Operations, 2017-20

(In percent of GDP, unless specified)

	2017	2018	2019	2020
	Prel.	Projections		
Revenues	**28.9**	**28.6**	**28.5**	**28.3**
Tax Revenues	25.9	25.6	25.9	25.9
Grants	1.0	1.0	0.8	0.7
Other revenue	2.0	2.0	1.8	1.7
Total Expenditure	**30.0**	**30.0**	**30.3**	**30.2**
Expense	24.6	23.9	23.4	22.5
Compensation of employees	4.5	4.3	4.1	3.9
Use of goods and services	3.9	3.7	3.6	3.4
Interest	1.3	1.4	1.4	1.4
Subsidies	2.2	2.1	2.0	1.9
Grants	0.2	0.2	0.2	0.2
Social benefits	9.5	9.3	9.3	9.1
Other expenses	3.0	2.9	2.7	2.6
Net acquisition of nonfinancial assets	5.4	6.2	6.9	7.7
Increase	5.8	6.5	7.2	7.9
Decrease (privatization proceeds)	-0.5	-0.4	-0.3	-0.3
Unidentified measures	0.0	0.0	0.4	0.6
Net lending / borrowing (including unidentified measures)	-1.1	-1.5	-1.4	-1.3
Budget leding	2.5	1.5	1.6	1.5
Augmented net lending / borrowing 1/	**-3.6**	**-3.0**	**-2.9**	**-2.8**
Memorandum items:				
Nominal GDP (in million of GEL)	37,260	40,148	43,289	46,811
Public debt	42.3	42.7	42.8	42.7
Primary Expenses	23.3	22.5	21.9	21.1
End-year government deposits	2.4	2.2	1.5	0.8
Operating balance (excluding unidentified measures)	4.2	4.7	5.1	5.7

Sources: Ministry of Finance; and Fund staff estimates.
1/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing minus budget lending.

[4] The 2017 excise increase shifted consumption towards unfiltered cigarettes and reduce the overall base for the tax.

programmed pension increases, and urged the authorities to identify permanent measures to offset the costs.[5] Staff stressed the importance of adopting a rule-based mechanism for pension increases, as envisaged in the forthcoming pension law, to provide fiscal predictability.

12. The authorities are taking steps to strengthen public investment monitoring (MEFP, ¶13). The MoF has created a dedicated public investment unit to establish a consolidated project pipeline, including for PPP projects. The unit will help evaluate projects, prioritize investments, and identify financing.[6] Staff urged the MoF to have a role in reviewing projects' value for money and budget affordability, while ensuring a competitive tender process.

13. The authorities are advancing with a more complete analysis of fiscal risks (MEFP, ¶9). The 2018 fiscal risk statement (FRS) will expand the coverage of SOEs, including any quasi-fiscal activities, and PPPs (**SB, end-December 2017**). A new PPP law will be submitted to Parliament by end-year, strengthening public oversight of fiscal risks in PPPs and Purchasing Power Agreement (PPAs) (**SB, end-December 2017**). The draft law would establish a requirement for limits on PPPs in the budgetary legislation and a technical PPP unit at the Prime Minister's office. Pending parliamentary approval, the authorities will refrain from signing any PPPs and PPAs, except for two energy projects (subject to project-specific fiscal risk evaluation). Staff called for the PF to continue pursuing only commercial objectives, providing minority equity or loan co-financing; the authorities are committed to limit potential fiscal risks stemming from the PF and the forthcoming export credit agency (ECA, see below).

14. Staff urged the authorities to address the backlog of VAT claims, while continuing to improve revenue administration (MEFP, ¶11).

- With IMF Technical Assistance (TA) support, Georgia's revenue service (GRS) has developed an action plan to address outstanding VAT claims (4.8 percent of GDP, Box 1) (**SB, end-September 2017**). Staff and the authorities agreed on an orderly, gradual, and transparent process to address the backlog. The authorities will expand the risk-based automated system for VAT refunds, propose legal changes to implement the action plan (**new SB, end-March 2018**), and create a specialized VAT unit (**new SB, end-June 2018**). The draft 2018 budget envisages GEL200 million in VAT repayments; and staff proposes an adjuster on the augmented fiscal deficit for any repayment above/below program amounts.

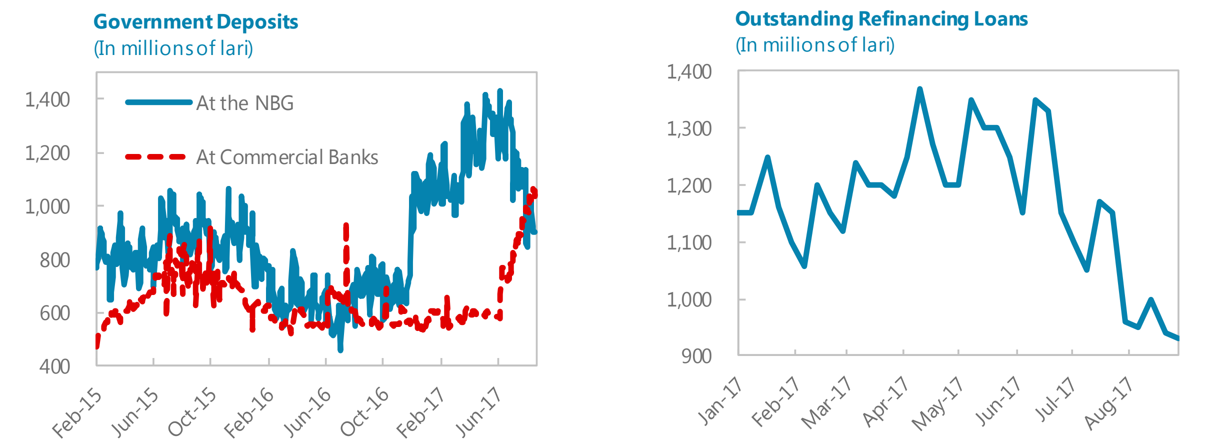
- The MoF is committed to restructure the GRS headquarters into a function-based organization to modernize tax administration (**new SB, end-February 2018**). The restructuring is designed to improve filing compliance and audit capacity, improve the taxpayer register, and enhance compliance risk analysis. The authorities have abolished the alternative audit program, written off uncollectable tax liabilities, introduced single taxpayer accounts, and piloted risk-based automated refunds.

15. The fiscal framework and budgetary processes should be strengthened (MEFP, ¶14). In consultation with the IMF, the authorities will enhance the fiscal rule by incorporating corrective

[5] The monthly basic public pension will increase from GEL180 per month (about $72) to GEL200 and GEL220 in 2019 and 2020, respectively, representing a 10-percent increase each year.

[6] To this end, the authorities have requested IMF TA to conduct a public investment management assessment.

mechanisms, escape clauses, accountability and transparency. The 2019 State Budget will be prepared applying the GFS classification of equity injections and on-lending as envisaged in the upcoming guidelines for new budget lending operations (**SB, December 2017**). The authorities plan to improve the quality of fiscal reports by reconciling in the annual budget revisions to medium-term budget estimates. They plan to incorporate revenues and expenditures of legal entities of public law (LEPLs) in the budget (starting in 2018) and in government finance statistics by 2021.[7] To improve treasury management, the MoF started auctioning its deposits to the banking sector in mid-2017. This has shifted government deposits from the NBG to commercial banks and reduced the demand for NBG's one-week refinancing loans.[8]



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

B. Monetary and Exchange Rate Policies: Solidifying Operational Frameworks

16. The NBG will continue to monitor inflation developments to assess the need for easing policy rates. Following interest rate hikes in 2017H1, the monetary policy stance is broadly neutral. Conditional on the NBG's interest rate path (a decline of about 100 basis points (bps) over the next two years), inflation is projected to decrease sharply in early 2018 before gradually converge to the 3 percent target by end-2018.

17. The authorities are taking further steps to strengthen liquidity management (MEFP, ¶17). The NBG introduced a one-month monetary instrument and broadened the collateral base for monetary operations. In August 2017, the NBG narrowed the policy rate corridor by 100 bps to strengthen the transmission mechanism and reduce the interbank rate volatility.

[7] Information on LEPL activities are provided in a separate statement. Expenditures by LEPLs financed from their revenues are not incorporated into the fiscal aggregates in the annual budget and budget execution reports, understating central government expenditure by around 4 percent of GDP. For details, see Georgia's Fiscal Transparency Evaluation at http://www.imf.org/~/media/Files/Publications/CR/2017/cr17291.ashx

[8] The auctions add a longer-maturity liquidity provision instrument to the financial sector. Auctions have been well coordinated with the NBG, which has ensured a smooth functioning of liquidity provision.

18. The NBG remains committed to exchange rate flexibility, limiting FX intervention to smoothing excessive volatility and/or building up reserves (MEFP, ¶16). Georgia's external position is moderately weaker than suggested by fundamentals and desirable policy settings, reflecting structural rigidities, and calls for accelerating structural reforms (Annex II). In this context, staff argued that lari appreciation pressures would provide room to build reserves. The NBG reiterated its commitment to exchange rate flexibility, and limiting intervention to prevent excessive volatility and cautiously rebuild reserves. The NBG noted that a higher volume in the FX forward market could help smooth exchange rate seasonality. Staff urged the authorities to continue to make progress on regulating derivatives transactions. The NBG and staff agreed to revise up the 2017 end-December NIR target by $40 million to further strengthen the reserve position.

19. The NBG is strengthening its communication further (MEFP, ¶18). Building on strong communication and transparency, the NBG started issuing press releases with elements of forward guidance after every Monetary Policy Committee (MPC) meeting. A press conference follows every second MPC meeting. The monetary policy report is published on a fixed and pre-announced schedule, and a meeting with experts is held in the context of the launch. The NBG is also working on guidelines for monetary policy operations.

C. Financial Sector Policies: Reinforcing Financial Soundness

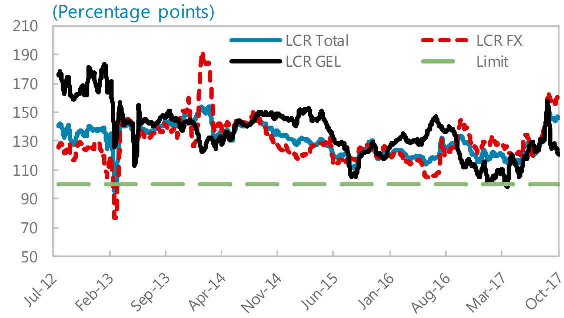
20. Georgia's larization plan has yielded positive results, although dollarization remains elevated (MEFP, ¶23). The authorities adopted a plan to reduce dollarization, focused on increasing long-term lari funding, promoting lari pricing, and reducing FX-related credit risk. Loan dollarization declined from 65 percent in December 2016 to 57 percent in August 2017—despite higher interest rates on GEL loans. Over the same period, deposit dollarization decreased by 6 percentage points, to 66 percent of total deposits.

21. The NBG has taken steps to strengthen banks' resilience (MEFP, ¶20-21).

- Capital buffers. The minimum regulatory capital was increased to GEL50 million for commercial banks, to be phased in by 2019 (**SB for end-June 2017**). Effective December 1, capital requirements will be anchored on loan-to-value and payment-to-income ratios, with favorable treatment for local currency loans. In December, the NBG will publish guidelines to implement Pillar II of Basel III (supervisory review process) and new capital surcharges for domestic systemically important banks (DSIBs) (**SB for end-December 2017**). These two measures will increase Tier-I capital by about 30-40 percent for DSIBs. For this reason, staff concurred with the NBG's proposal, made after consultations with banks, to extend the phase-in period from three to five years. The NBG will also introduce regulations on leverage ratios in line with Basel III principles (**SB end-September 2018**).

- Liquidity buffers. From September 2017, banks are subject to new liquidity coverage ratios (LCRs), compliant with Basel III

Liquidity Coverage Ratios
(Percentage points)



Source: National Bank of Georgia; and IMF staff calculations.

regulations (**SB for end-September 2017**). Banks have adjusted their balance sheets to comply with LCRs since 2013, when this framework was announced. They have also reduced deposit concentration and increased the share of non- withdrawable certificates of deposits, especially for non -resident and FX deposits, thereby strengthening the stability of funding.

- Legislation submitted to Parliament will give the NBG oversight powers over credit bureaus (**SB for end-December 2017**). The NBG plans to introduce prudential regulation, apply fines, protect consumers, and limit business continuity risks.

- Following IMF TA recommendations, the NBG created a new financial stability department to provide forward-looking macro-financial analysis for macroprudential policy formulation, analyze the trade-offs between monetary and macroprudential policies, provide inputs for the implementation of the IFRS9 accounting standards, and prepare financial stability reports.

22. The NBG is advancing with regulation to improve transparency, accounting, governance, and oversight of the banking sector (MEFP, ¶20-21). The NBG has introduced disclosure requirements for commercial banks in accordance to Pillar III of the Basel III framework (market discipline). It is also making progress towards the implementation of the IFRS9 reporting standards, and plans to publish guidelines—by March 2018—for calculating credit losses. It will introduce regulations to align banks' real estate appraisal to International Valuation Standards (**SB for end- June 2018**) and corporate governance guidelines to Basel principles (**SB for end-September 2018**). The authorities have submitted amendments to the NBG's law to allow supervision on a consolidated basis.

23. The authorities plan to enhance crisis preparedness and the bank resolution framework (MEFP, ¶22).

- The deposit insurance agency was created in July 2017, and is expected to start collecting contributions in January 2018. Before end-2018, its board should approve by-laws guiding the operational aspects of the agency, including contributions and sanctions for non-compliant banks, internal controls, and risk management. The agency will also prepare its medium-term strategy by June 2018.

- Parliament received amendments to the NBG law to clarify the definition of a "problem bank" and to have powers to resolve banks, including by enhancing the temporary administration process (**SB for end-September 2017**). The NBG is also working with the D-SIBs to finalize recovery and resolution plans.

- Following the 2014 FSAP recommendations, the authorities requested TA to improve the legal framework for bank resolution, with a view of stating clearly the resolution authority of the NBG, including the right to override shareholders' interests and to allow for resolution tools and powers.

- The authorities and staff agreed on identifying legal amendments to design an effective emergency liquidity assistance (ELA) framework by mid-2018. The key amendments include removing unsecured lending by the NBG, introducing penalty rates for ELA, and clarifying the role of the Ministry of Finance in providing public guarantees during financial stress. An upcoming TA mission will coordinate with the authorities on an action plan.

24. The NBG has taken first steps towards supervising the non-banking sector and improving consumer protection (MEFP, ¶21). In June, the authorities submitted to Parliament legislative changes for the NBG to regulate and supervise microfinance institutions. Staff welcomed these developments and reiterated the need for a light-touch regulation for non-deposit taking institutions. On consumer protection, the NBG has the mandate to protect users of financial services. Consumer protection rules apply to all financial institutions, including non-deposit takers. The NBG sets disclosure requirements and caps fees for early repayments, and the Civil Code establishes maximum effective interest rates and maximum penalties on all loans.

25. The NBG noted some risks to correspondent bank relationships (CBRs). International banks have interrupted direct relationships with some small banks because of additional requirements on CBRs. These banks still have access to the international payment system through the two largest Georgian banks, or—in the case of subsidiaries—through their parent bank. This, however, increases concentration risks. While disruptions in correspondent banking relationships do not represent an immediate threat, they would negatively affect financial intermediation. The authorities should continue to monitor the status of CBRs, strengthen compliance with AML requirements and effectively communicate efforts to address AML concerns.

D. Structural Policies: Keeping the Momentum

26. The authorities remain committed to a comprehensive structural reform agenda to support higher and more inclusive growth (MEFP, ¶25-32). Structural reforms will promote job creation, economic diversification, and more inclusive and sustainable private sector-led growth. They will also help increase the resilience of the economy to external shocks.

27. Investment will help improve productivity, competitiveness, and private sector-led growth (MEFP, ¶13 ¶26). With support from international partners, public investment targets finalizing the East-West highway and the North-South corridor by 2020 and expanding energy production capacity. Road infrastructure will help leverage Georgia's position as a logistic and tourism hub in the region. Efforts continue to mobilize FDI in export-oriented sectors—including tourism, agriculture, and manufacturing—to further improve competitiveness and support job creation and growth. A new PPP framework has been submitted to Parliament (**SB for end-December 2017**) and is expected to facilitate private sector participation in large infrastructure projects while preserving fiscal sustainability. By-laws and regulations should minimize the use of unsolicited proposals (allowing for direct negotiations) and of close tenders by stating narrowly the conditions under which those could be considered (e.g., specific economic activities/sectors/areas).[9]

28. The authorities continue to strengthen the business environment, but more needs to be done to attract investment (MEFP, ¶29-30). Georgia ranks among the top ten performers globally, with improvements in getting electricity, protecting minority shareholders and resolving insolvency. A new insolvency law (**SB for end-September 2018**) will create a stronger restructuring framework for

[9] Rules for direct negotiations should be established in a transparent manner and designed to replicate the outcome of a competitive procurement process.

viable non-financial corporations. The Business House, to be established by 2019, will create a one-stop shop for businesses. The land cadaster, although advancing at a slow pace, will protect property rights, ease transaction costs, and facilitate the use of collateral, particularly in the agricultural sector. While a ban on foreign ownership of agricultural land was issued recently, staff urged the authorities to seek alternative ways to promote FDI in agriculture, for instance, by using long-term lease agreements. Finally, staff reiterated that Georgia needs a modern, efficient, and transparent judiciary system to mobilize long-term investments.

29. Capital market and pension reforms will help mobilize domestic savings and private sector investment (MEFP, ¶24, ¶28). The MoF will publish a multi-year plan of government bond issuance to support price discovery in the bond market (**SB for end-December 2017**), and it has submitted to Parliament amendments to the tax code—to promote adequate taxation of financial instruments. The authorities are upgrading the settlement system for all securities, creating a training institute for financial market dealers, and introducing mandatory third-party vehicle insurance. The pension reform, introducing the second pillar with defined contributions and plans, will be submitted to Parliament by end-2017 (**SB for end-December 2017**). The pension agency will be established by June 2018 (**SB for end-June 2018**) and create an institutional investor for long-term lari assets. The success of the pension reform in mobilizing domestic savings requires enforcing the envisaged 2-percent contributions by employees, employers, and the state each.

30. Education reform is critical to promote higher and more inclusive growth (MEFP, ¶27). The lack of qualified workers is reported as one of the key obstacles to doing business. The authorities' reform plan, developed with the World Bank support, focuses on setting curriculum standards, a new teacher performance evaluation, vocational training, and adult learning.

31. Georgia continues to promote trade integration (MEFP, ¶31). Free trade agreements (FTAs) will help mobilize FDI in tradable sectors, improve competitiveness, reduce external imbalances and generate more balanced growth. In addition to the Deep and Comprehensive Free Trade Area (DCFTA) with the European Union (EU)—where the authorities continue to make progress at implementation, Georgia signed FTAs with the European Free Trade Association (EFTA) and with the People's Republic of China in 2017 (Box 2). The FTA with Hong Kong SAR will be ratified in early 2018. The authorities are also seeking to expand the FTA with Turkey and establish new FTAs with India, the United States, and other countries. To promote market access, the authorities will create an ECA under the PF, to be financed with resources from the PF and a budgetary transfer (0.15 percent of GDP). The authorities agreed that any future support from the government should come through the state budget. The authorities have agreed for ECA to undertake only insurance operations and be subject to insurance supervision and to internal and external annual audits.[10]

PROGRAM MODALITIES

32. Understanding was reached on modifying three quantitative performance criteria in support of the program's objectives. Modifications are proposed to: (i) express the ceiling on the PF's

[10] The regulation envisages prudential requirements to meet solvency indicators, including limits to liability relative to capital and leverage.

new borrowing in net rather than gross terms to contain the PF's borrowing and limit fiscal risks while avoiding compressing its balance sheet when existing debt is repaid; (ii) increase the end-December floor on the NIR target in 2017 by $40 million (to $1,390 million), reflecting stronger-than-projected external sector developments; and (iii) eliminate the reference to implicit guarantees in the ceiling on new public guarantees. Per Georgia's legislation, only the MoF can issue public guarantees; these are only of an explicit nature and remain covered under the continuous PC.

33. Staff proposes to update program conditionality as follows (MEFP, Tables 1-3).

- **Performance criteria** are proposed for end-June 2018, in line with semiannual projections. An adjuster is proposed to reduce (increase) the ceiling on the augmented cash deficit of the general government if actual VAT repayment is less (more) than projected VAT repayments. The cap on the adjustor for the augmented cash deficit related to foreign-financed project loan disbursements is proposed to increase from $30 million to $60 million per year (0.4 percent of GDP).

- **New SBs** are proposed: for **end-February 2018**, on the restructuring of GRS headquarters into a function-based model organization; for **end-March 2018**, on the VAT steering committee submitting a proposal for any legal amendments or ministerial decree required to help address outstanding VAT claims; for **end-June 2018**, on (i) creating a specialized VAT unit, (ii) introducing a regulation on banks' real estate appraisal in line with international valuation standards, and (iii) creating the new pension agency; and for **end-September 2018**, on introducing regulation on (i) banks' leverage ratio, and (ii) banks' corporate governance.

34. Financing assurances are in place for the first review. The improved outlook is expected to reduce financing needs. For the next 12 months, firm financing commitments are in place, with support from the World Bank, the European Union, and Agence Française de Développement, which becomes the largest donor financing for BOP needs in 2018. Good prospects are in place for adequate financing for the remainder of the program.

35. Georgia's capacity to repay the Fund remains adequate. Georgia has a strong record of repayment to the IMF. Georgia's debt profile continues to remain under low scrutiny under the Emerging Market Debt Sustainability Analysis (EM DSA) framework. In the case of a full drawing of the amount under the EFF (Table 8), repayments to the IMF would peak at 0.4 percent of GDP or 1.8 percent of gross reserves in 2018.

36. Risks to the program are manageable. While the improved growth outlook may reduce short-term fiscal and external risks, it could lead to complacency in the implementation of the structural reform agenda. The authorities stand ready to adopt measures to fulfill their program commitments; their program ownership provides safeguards and mitigates those risks.

37. The NBG continues to maintain a strong safeguards framework. The NBG has implemented the safeguards recommendations after submitting the NBG Organic Law to Parliament (MEFP, ¶34). No other significant changes have been identified in staff's safeguard monitoring procedures.

38. Georgia has cleared external arrears with Kazakhstan. Arrears to Kazakhstan and Turkmenistan pre-dated the program and were covered under the Paris Club Agreement. The agreement with Kazakhstan was reached in September 2017. Staff urged the authorities to resolve arrears to Turkmenistan.

STAFF APPRAISAL

39. Georgia's economic performance has improved, but risks to the outlook remain. The economic recovery is gaining momentum, inflation is on a declining path, and the external position has strengthened. Revenue overperformance provides room for additional capital spending and VAT repayments in 2017. The banking sector remains liquid, profitable, and well capitalized. Despite the positive outcomes, the authorities need to remain vigilant and sustain reform efforts to address structural obstacles to growth.

40. The 2018 budget appropriately targets further fiscal consolidation. The 2018 budget envisages a further decline in the deficit while allowing for an increase in capital spending. To achieve this, efforts to strengthen revenue administration should continue, especially to prevent the buildup of VAT claims. The authorities should also bolster efforts to further contain current spending, for instance, by containing the wage bill, improving the targeting of social programs, and reducing subsidies and equity injections to state-owned enterprises.

41. Medium-term fiscal commitments should be completed as currently envisaged, and require progressing with institutional fiscal reforms. Staff welcomes the authorities' commitment to fiscal consolidation while accelerating high-priority infrastructure investment. A stronger framework for managing public investment will help improve efficiency on the use of public resources. The authorities' commitment to comprehensively assess and monitor fiscal risks should be clearly reflected in the 2018 Fiscal Risk Statement. Efforts to improve the budgetary processes and fiscal reporting—for instance, by improving the coverage and measurement of fiscal aggregates to reflect activities of LEPLs and SOEs, elaborating on compliance with fiscal rules, and strengthening macroeconomic and fiscal forecasting—will help improve fiscal transparency and accountability.

42. Monetary policy remains rightly focused on price stability, supported by the flexible exchange rate and efforts to strengthen the transmission mechanism. The NBG's monetary policy stance is appropriate, but the authorities need to remain vigilant on monetary and financial developments, including related to credit growth. The inflation targeting framework, combined with the floating exchange rate regime, has served Georgia well. Foreign exchange intervention should remain limited to smoothing excessive exchange rate volatility and building reserves. The NBG's steps to strengthen liquidity management, de-dollarize the economy, and improve communication will help strengthen the monetary framework.

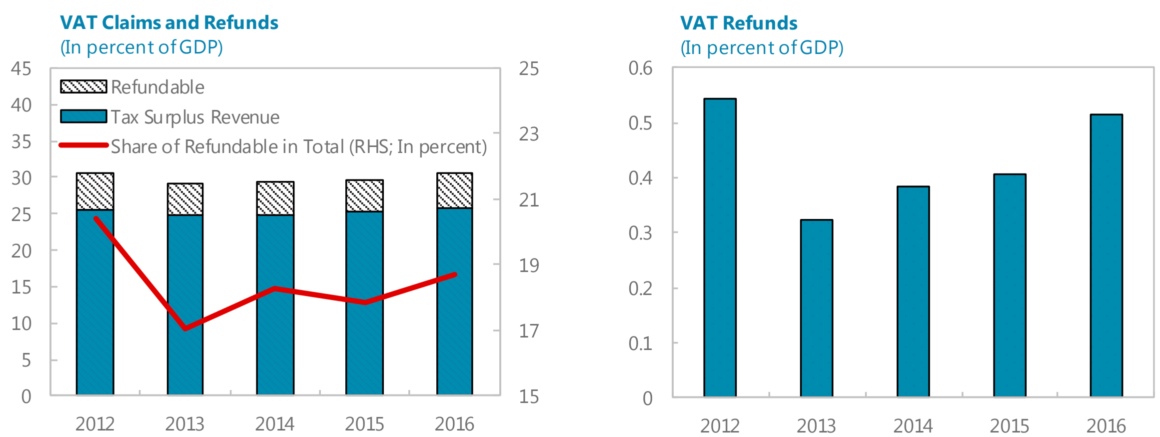
43. The authorities' steps to increase the resilience of the financial sector are welcome. Proposed legal amendments would appropriately expand the role of the central bank in regulating and supervising non-banks and credit bureaus, enhance the bank resolution framework, and supervise banks on a consolidated basis. The authorities' efforts to identify legal amendments to adopt an effective ELA framework are also commendable.

44. Continued efforts to advance structural reforms are key to achieving higher and more inclusive growth. Upgrading infrastructure and strengthening trade integration will boost growth prospects. The new insolvency law for non-financial corporations and the Business House will help improve the business environment. The pension reform will increase the availability of domestic savings to support investment, as long as contributions are enforced. Improved capital market infrastructure, by facilitating mobilization of funds, will support capital accumulation. To further support growth, Georgia also critically needs to advance on education reform.

45. Staff supports the authorities' request for completion of the First Review under the Extended Fund Facility and the modification of three quantitative performance criteria. Strong program implementation in macroeconomic policies and structural reforms provide confidence that the program will meet its objectives. Staff supports eliminating the reference to implicit guarantees in the ceiling on new public guarantees, expressing the ceiling on the PF's new borrowing in net terms, and modifying the 2017 end-December NIR performance criterion.

Box 1. Georgia's VAT Claims

Despite efforts to increase repayment of VAT claims, more needs to be done to reduce the existing stock and prevent accumulation of further claims in the future. Flaws in the design and operation of the VAT refund system, with consequent accumulation of unpaid credits, were among the weaknesses identified in the 2016 Tax Administration Diagnostic Assessment.[1/] VAT claims amounted to 4.8 percent of GDP in 2016 (Figure 1). The stock has been increasing, only a small share is refunded each year (about 0.5 percent of GDP, or 11 percent of the refundable claims).



Sources: Georgia Revenue Service; and IMF staff calculations.

The buildup in VAT claims undermines the tax administration's effectiveness. The buildup of VAT claims reflects several factors. First, the GRS refunds claims only upon taxpayers' requests; hence, the outstanding VAT claims do not constitute arrears. Second, taxpayers reportedly believe that maintaining outstanding balances in their tax accounts with the GRS makes them less likely to be audited. Third, there is no statute of limitations on tax claims. Claims older than 3 years (30 percent of the total stock) cannot be audited (and refunded in cash), but could be compensated with tax liabilities. Finally, the GRS follows overly strict criteria for processing automatic refunds.

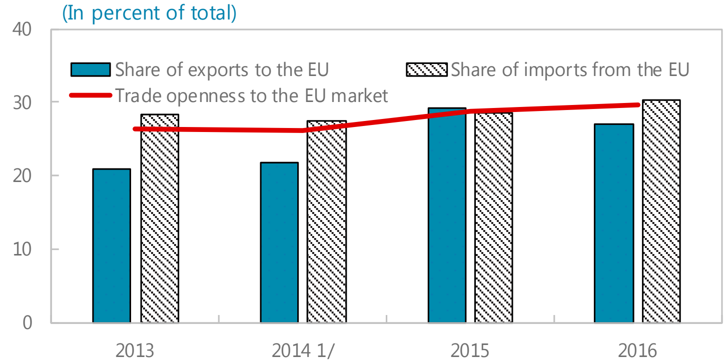
Starting in May 2017, the GRS has embarked on a program to move towards full electronic mode and increase the ability to effectively process tax refunds. With IMF support, the GRS is improving VAT refund processing and building capacity for risk-based tax compliance. An action plan has been developed to address the stock of VAT claims, including repayment of those credit that have been audited and validated, and improving risk-based review and VAT targeted audit to verify claims, preferably via a specialized VAT audit. Implementation requires close cooperation with the Treasury. Reducing the existing credit stock should be accompanied by a change in the VAT refund procedures to prevent further build up.

1/ For details, see http://www.imf.org/~/media/websites/imf/imported-full-text-pdf/external/pubs/ft/scr/2016/_cr16283.ashx

Box 2. Georgia's Trade with the European Union (EU)

Trade with the EU has deepened, but remains limited. Georgia fully opened its market to the European Union after signing the since the Deep and Comprehensive Free Trade Area (DCFTA) in June 2014. Since then, exports to the EU increased from 21 percent of total exports in 2013 to 27 percent in 2016. Georgia only exports a limited set of products to the EU, including minerals and metals, and chemical and agricultural products. The share of imports increased from 28 percent in 2013 to 31 percent of total imports in 2016.

Trade with the European Union
(In percent of total)



Source: Geostat.ge
1/ Launch of the DCFTA.

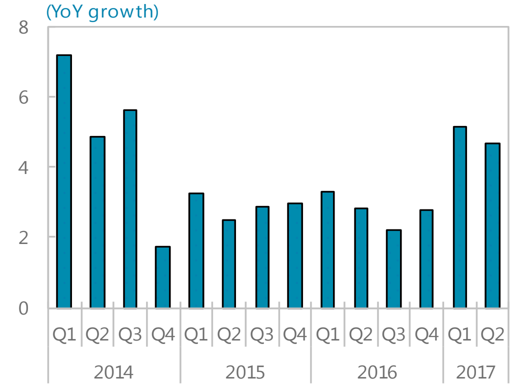
Progress in expanding export potential—through the DCFTA—is on track, but further efforts are needed, especially in reducing non-tariff barriers (NTBs). Georgia's admission to the Pan-Euro-Mediterranean Convention on Rules of Origin in September 2016 was a milestone in expanding market access. The agreement allows Georgia to import raw materials from the member countries and re-export to the EU with "made in Georgia" labels. Georgia has also used the DCFTA as a platform to conclude other FTAs, including with EFTA, China, and Hong Kong SAR (final stage). Nonetheless, efforts, especially in standard compliance, are needed to expand exports potential. Georgia needs to adapt its regulations to EU standards—particularly in food and industrial product safety. For food safety, to date, only two animal-related products—wool and honey—can be exported. Harmonizing food safety standards requires adopting 272 EU directives and regulations by 2026. For industrial product safety, progress has been on schedule—about 7,000 (out of 25,000) standards are now in compliance with international and the EU standards.

In addition to reducing trade barriers, trade promotion could be strengthened through streamlining procedures and capacity development. Key areas include simplifying customs service, providing mutual access to public procurement markets, modernizing and strengthening intellectual property rights protection, and promoting competition. Progress in all areas has been made in line with the EU commitments. Nonetheless, further legal convergence is needed to further enhance trade relations.

Figure 1. Georgia: Real Sector and Inflation Developments

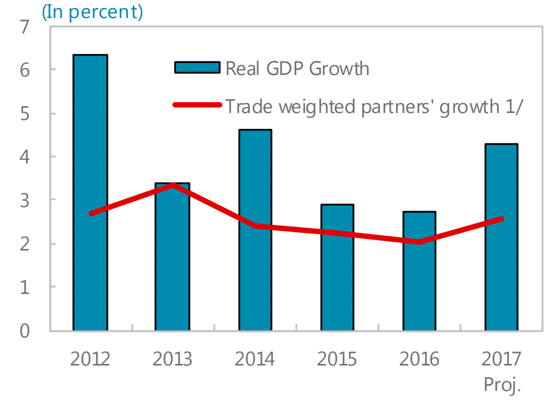
Growth has accelerated…

Real GDP
(YoY growth)



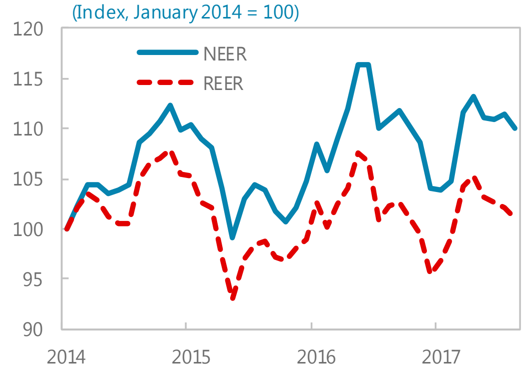
…supported by the recovery of the external environment.

Real GDP and Partner Countries Trade Weighted Growth
(In percent)



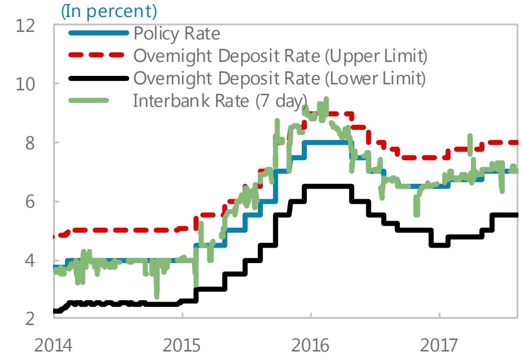
After depreciating in early 2017, the lari has stabilized.

Nominal and Real Effective Exchange Rates
(Index, January 2014 = 100)



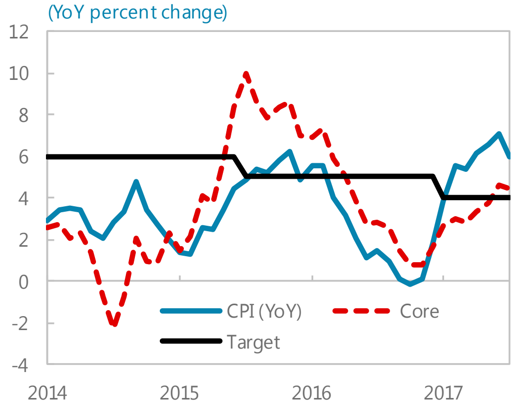
The NBG increased the policy rate in 2017 to 7 percent…

Interest Rates
(In percent)



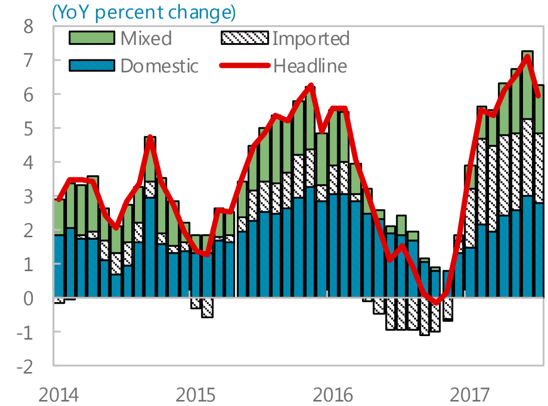
…due to the pick-up in headline inflation…

Inflation: Headline and Core Inflation
(YoY percent change)



…whose acceleration is mostly due to the hike in excises and its second-round effects on food prices.

Composition of Inflation
(YoY percent change)

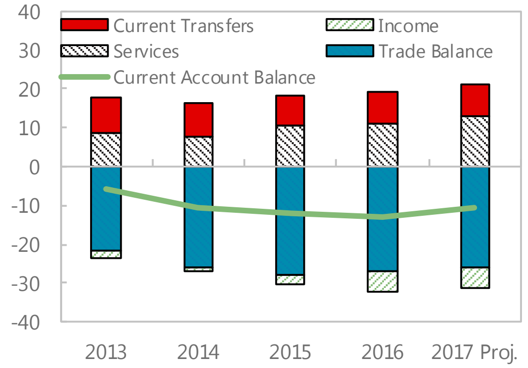


Sources: National authorities; and IMF staff estimates.
1/ Partner counties growth is computed using trade-weighted real GDP growth of the largest 20 partner countries.

Figure 2. Georgia: External Sector and Developments

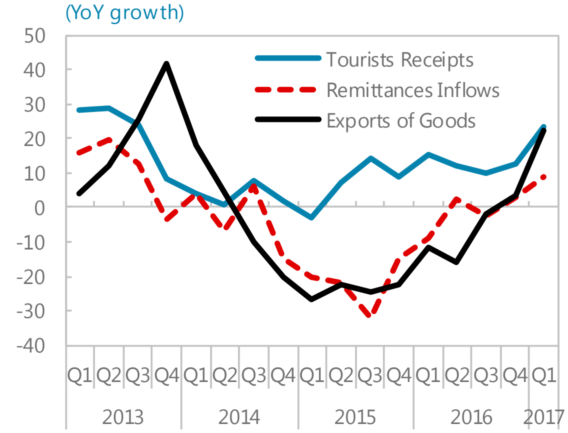
Current account deficit has deteriorated since 2013…

Current Account Balance
(In percent of GDP)



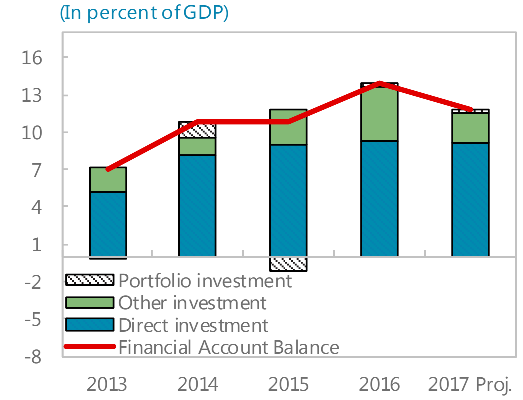
…with recovery in 2017 driven by exports, tourism, and remittances.

Exports, Tourist Receipts, and Remittances
(YoY growth)



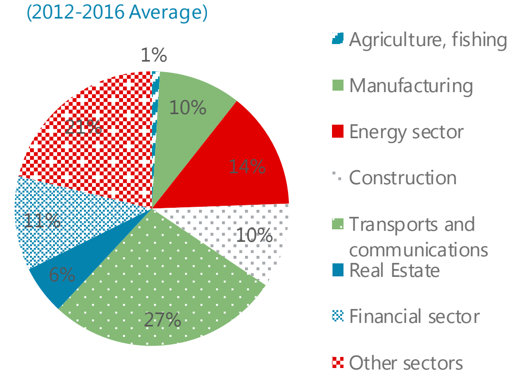
FDI flows continue to dominate financial flows…

Financial Account Components
(In percent of GDP)



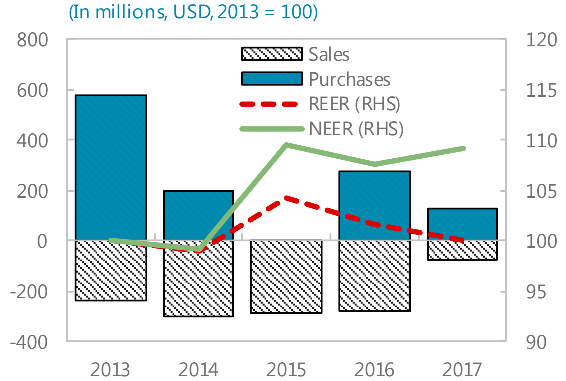
…and were concentrated in transport and energy sectors.

Net FDI Inflows by Industry
(2012-2016 Average)



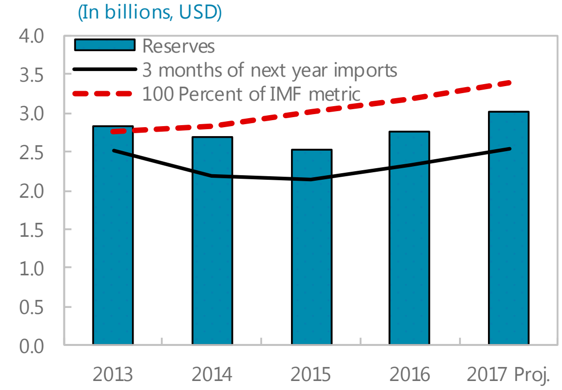
NBG's intervention is mostly two-sided.

Interventions and Effective Exchange Rates 1/
(In millions, USD, 2013 = 100)



Despite increasing, reserves remained low.

Georgia: Reserve Adequacy 2/
(In billions, USD)

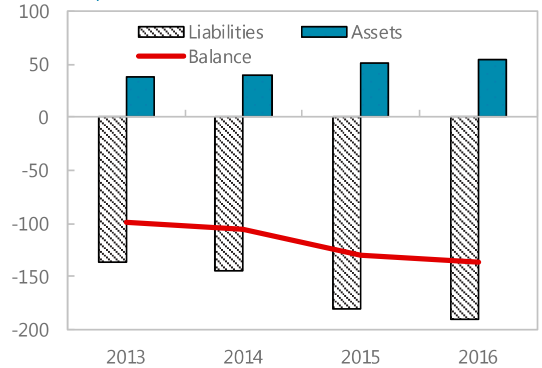


Sources: National authorities; Geostat.ge; and IMF staff estimates.
1/ Interventions for 2017 are as of September. FX sales were due to the loan conversion scheme.
2/ Reserves are as of September, 2017.

Figure 3. Georgia: International Investment Position

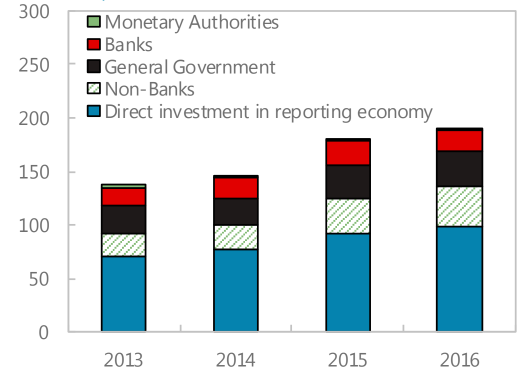
Net IIP continued to deteriorate in 2016…

International Investment Position, Overall
(In percent of GDP)



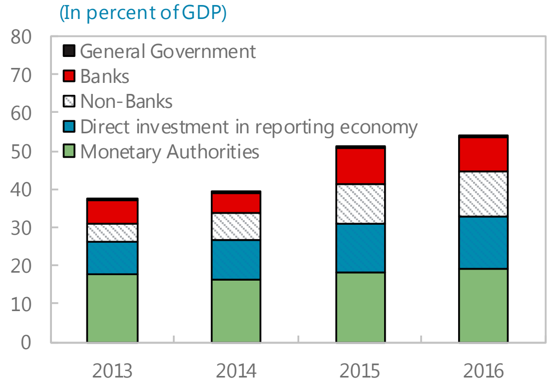
…mostly due to higher FDI, and nonbank liabilities,

Gross Liabilities by Borrower
(In percent of GDP)



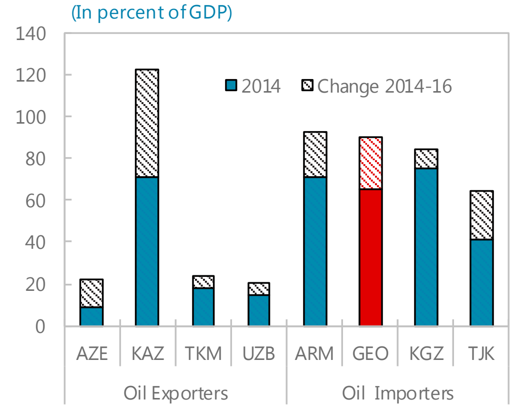
…while foreign assets increased especially in the banking sector and FDI abroad.

Gross Assets by Borrower
(In percent of GDP)



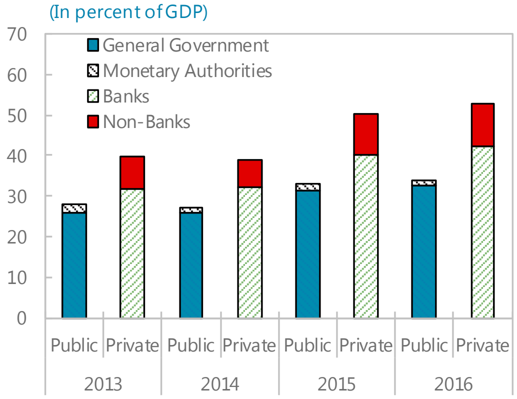
Georgia's external debt has increased in line with other oil importers in the Caucasus.

External Debt
(In percent of GDP)



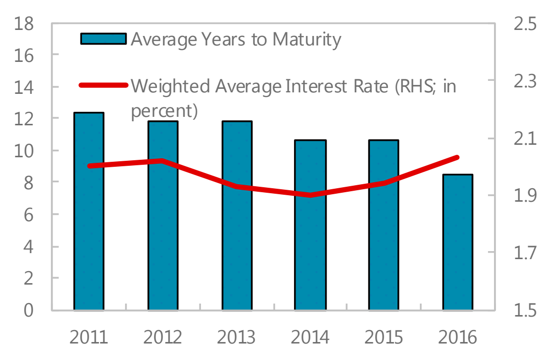
External debt dynamics are driven by the private sector.

Total External Debt
(In percent of GDP)



External public debt has long maturity with relatively low interest rates.

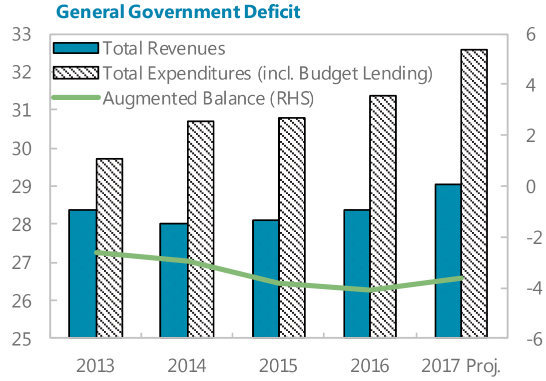
Average Interest Rate and Debt Maturity



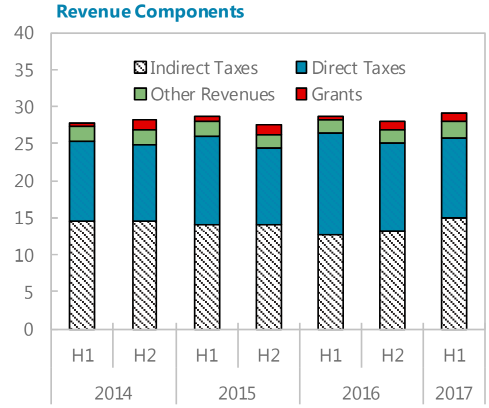
Sources: National authorities; World Economic Outlook; and IMF staff estimates.

Figure 4. Georgia: Fiscal Sector Developments
(In percent of GDP)

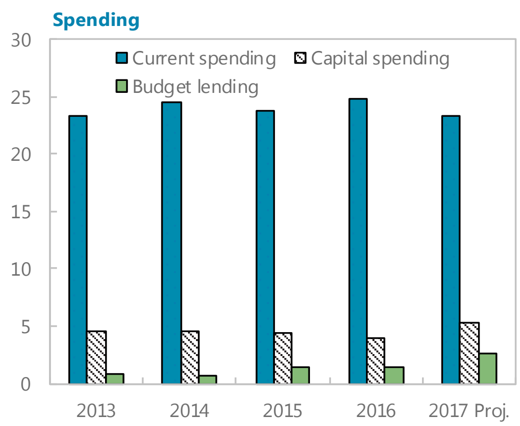
The augmented fiscal balance is projected to improve in 2017…



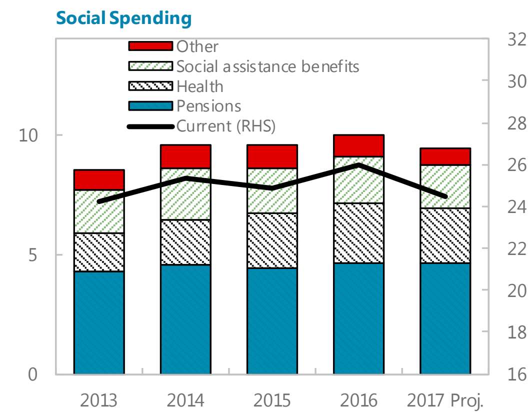
…driven by strong revenue performance.



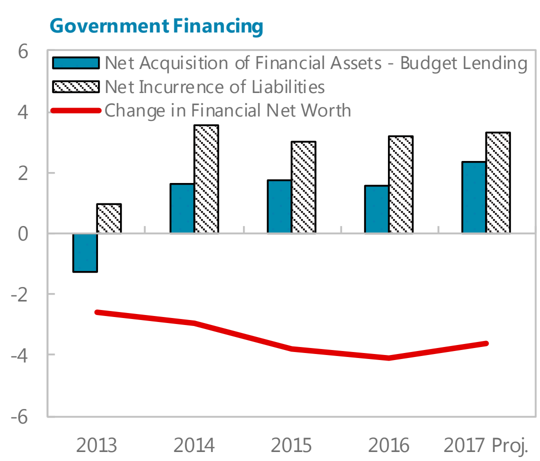
Current spending subdued growth is freeing resources for capital spending.



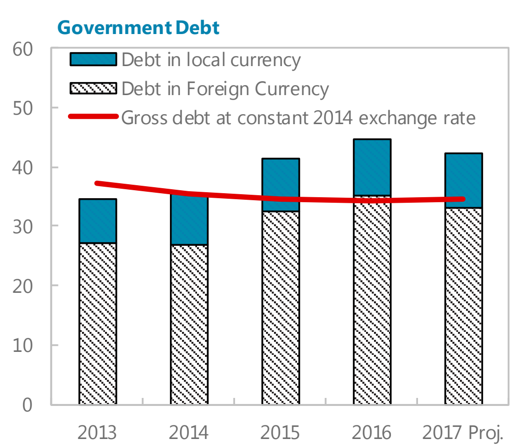
Social spending remains an important component of current spending.



Financing needs have been relatively stable.



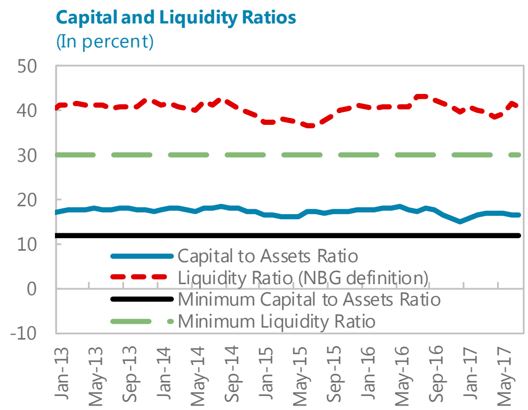
Government debt remains well-anchored.



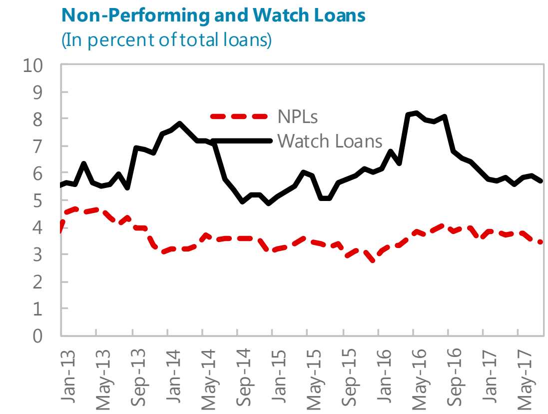
Sources: National authorities; and IMF staff estimates.

Figure 5. Georgia: Financial Sector Developments

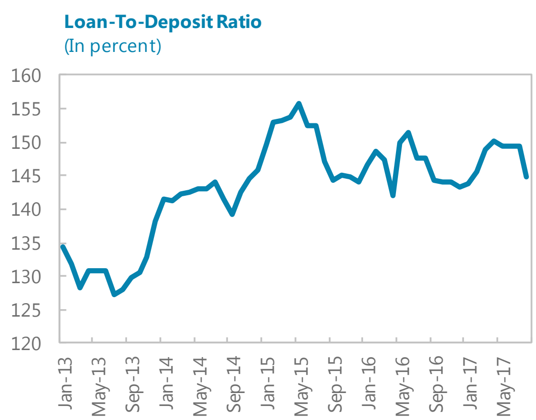
Banks are liquid and well capitalized…



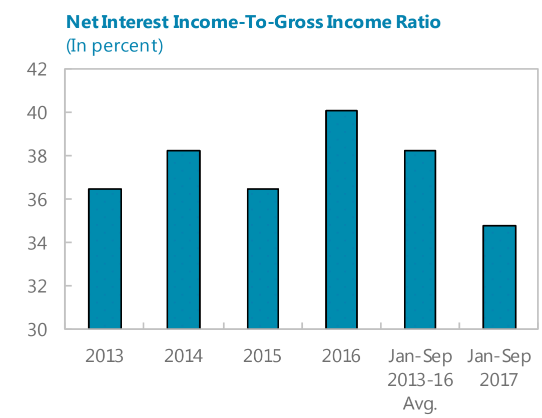
… and NPLs and watch loans remain low.



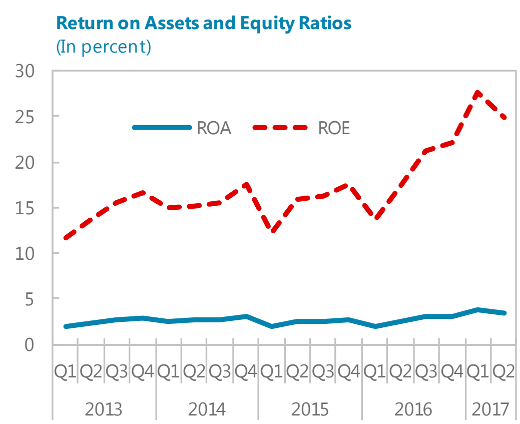
Bank liquidity has been broadly stable.



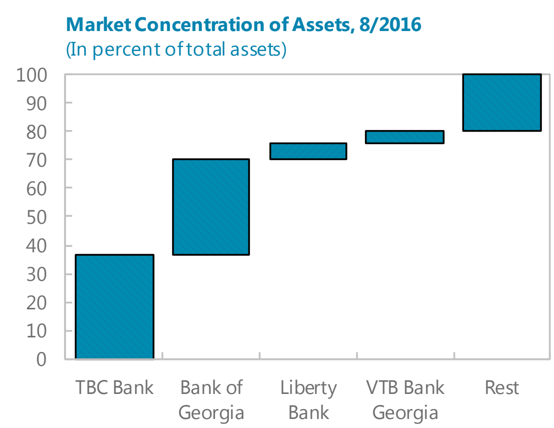
Financial performance continues to be solid…



… supporting high profitability…



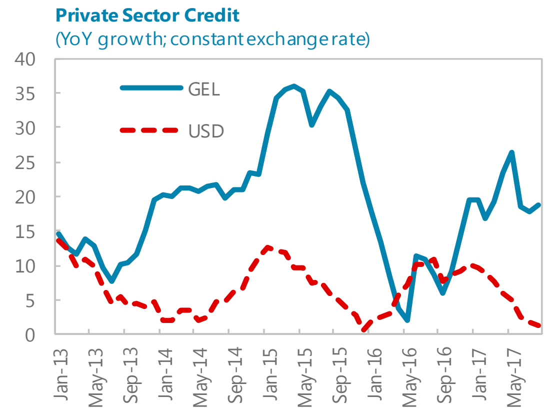
… although banks operate in a highly-concentrated market.



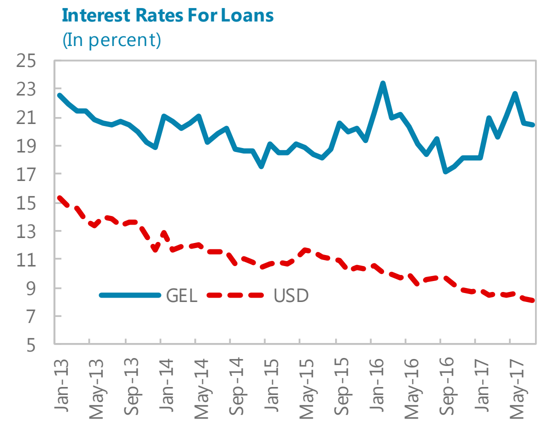
Sources: National Bank of Georgia; and IMF staff estimates.

Figure 5. Georgia: Financial Sector Developments (concluded)

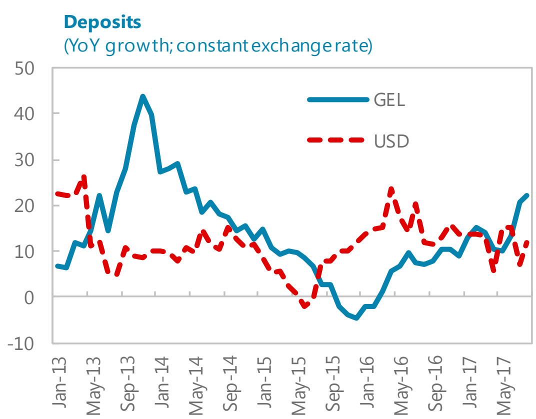
Credit to the private sector has accelerated…



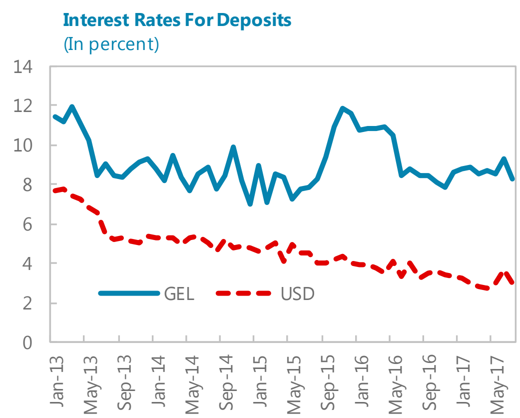
…despite higher interest rates on GEL loans.



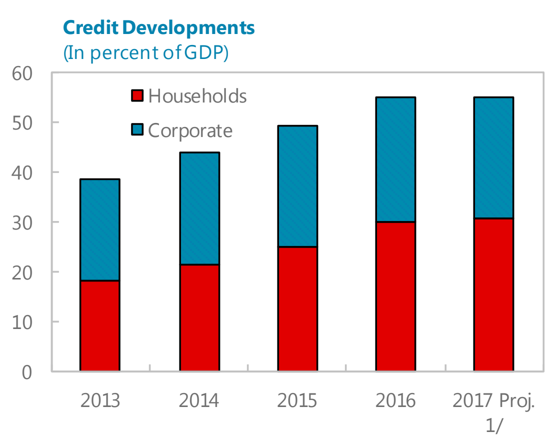
Domestic currency deposits have accelerated…



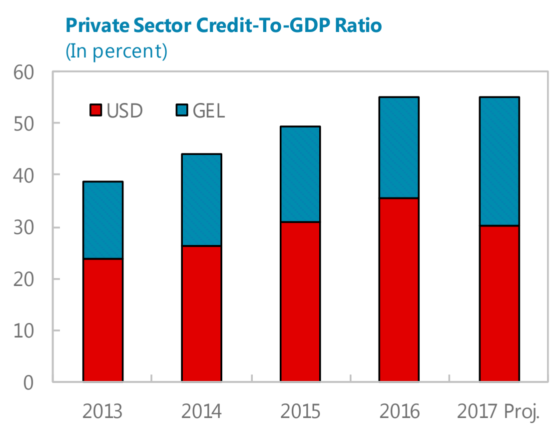
… while interest rates on deposits have continued to decline.



Credit to households continues to drive credit developments…



… as well as credit in foreign currency.



Sources: National Bank of Georgia; and IMF staff calculations.
1/ Based on actual cerdit in August, and 2017 GDP projection.

Figure 6. Georgia: Public Sector Debt Sustainability Analysis (DSA)

in percent of GDP, unless otherwise indicated

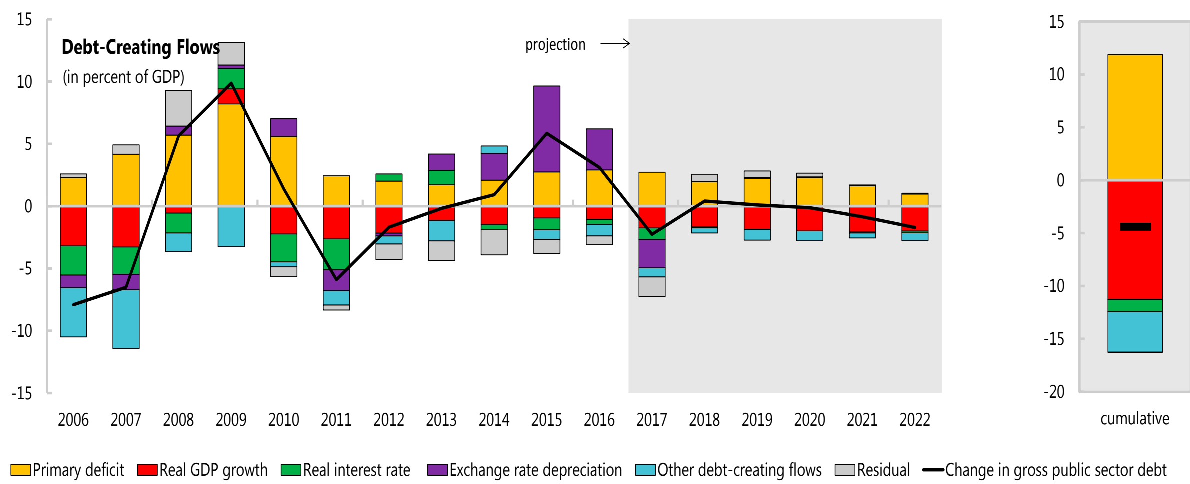
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2006-2014 [2]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	34.9	41.4	44.6	42.3	42.7	42.8	42.7	41.9	40.1
Public gross financing needs	6.8	6.7	7.4	7.7	6.9	7.2	6.9	8.8	5.5
Real GDP growth (in percent)	5.4	2.9	2.7	4.3	4.2	4.7	5.0	5.2	5.2
Inflation (GDP deflator, in percent)	5.3	5.9	4.0	5.4	3.4	3.0	3.0	3.0	3.0
Nominal GDP growth (in percent)	11.1	8.9	6.8	9.9	7.7	7.8	8.1	8.4	8.3
Effective interest rate (in percent) [3]	2.7	3.2	3.1	3.3	3.3	3.3	3.3	3.0	2.8

As of May 12, 2017		
Sovereign Spreads		
EMBIG (bp)		315
5Y CDS (bp)		383
Ratings	Foreign	Local
Moody's	Ba3	Ba3
S&Ps	BB-	BB-
Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [8]
Change in gross public sector debt	-0.5	5.9	3.1	-2.3	0.4	0.1	-0.1	-0.8	-1.7	-4.4	
Identified debt-creating flows	-0.4	7.0	3.8	-0.7	-0.2	-0.4	-0.4	-0.9	-1.8	-4.4	
Primary deficit	3.8	2.8	2.9	2.7	2.0	2.2	2.3	1.6	1.0	11.9	-2.8
Primary (noninterest) revenue and grants	28.5	28.1	28.4	28.9	28.6	28.5	28.3	28.0	27.7	169.9	
Primary (noninterest) expenditure	32.3	30.9	31.3	31.6	30.5	30.7	30.6	29.7	28.7	181.8	
Automatic debt dynamics [4]	-2.4	5.0	1.8	-2.7	-1.7	-1.8	-1.9	-2.1	-2.1	-12.4	
Interest rate/growth differential [5]	-2.6	-1.9	-1.5	-2.7	-1.7	-1.8	-1.9	-2.1	-2.1	-12.4	
Of which: real interest rate	-0.9	-0.9	-0.4	-0.9	-0.1	0.0	0.1	-0.1	-0.1	-1.2	
Of which: real GDP growth	-1.7	-0.9	-1.1	-1.7	-1.6	-1.9	-2.0	-2.1	-2.0	-11.3	
Exchange rate depreciation [6]	0.2	6.9	3.3	…	…	…	…	…	…	…	
Other identified debt-creating flows	-1.9	-0.8	-0.9	-0.7	-0.4	-0.9	-0.8	-0.4	-0.6	-3.8	
GG: Privatization and Drawdown of deposits (negative)	-1.9	-0.8	-0.9	-0.7	-0.4	-0.9	-0.8	-0.4	-0.6	-3.8	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [7]	0.0	-1.1	-0.7	-1.6	0.6	0.5	0.3	0.1	0.1	0.0	



Source: IMF staff.

1 Public sector is defined as general government.

2 Based on available data.

3 Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

4 Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

5 The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

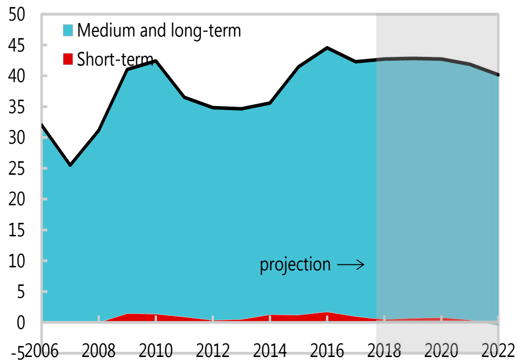
6 The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

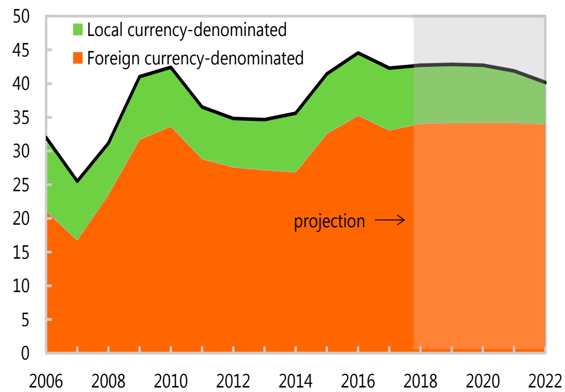
7 Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

8 Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

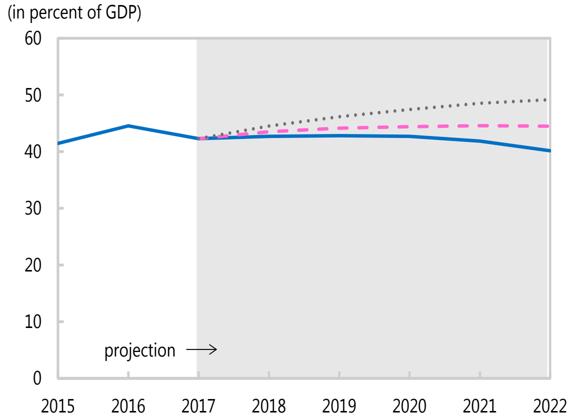
Figure 7. Georgia: Public Debt Sustainability Analysis - Composition of Public Debt and Alternative Scenarios

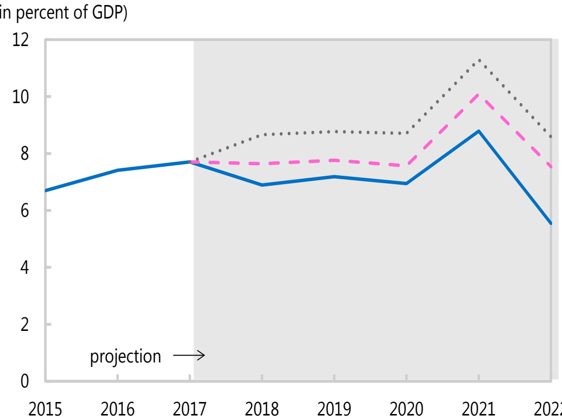
Composition of Public Debt





Alternative Scenarios





Underlying Assumptions

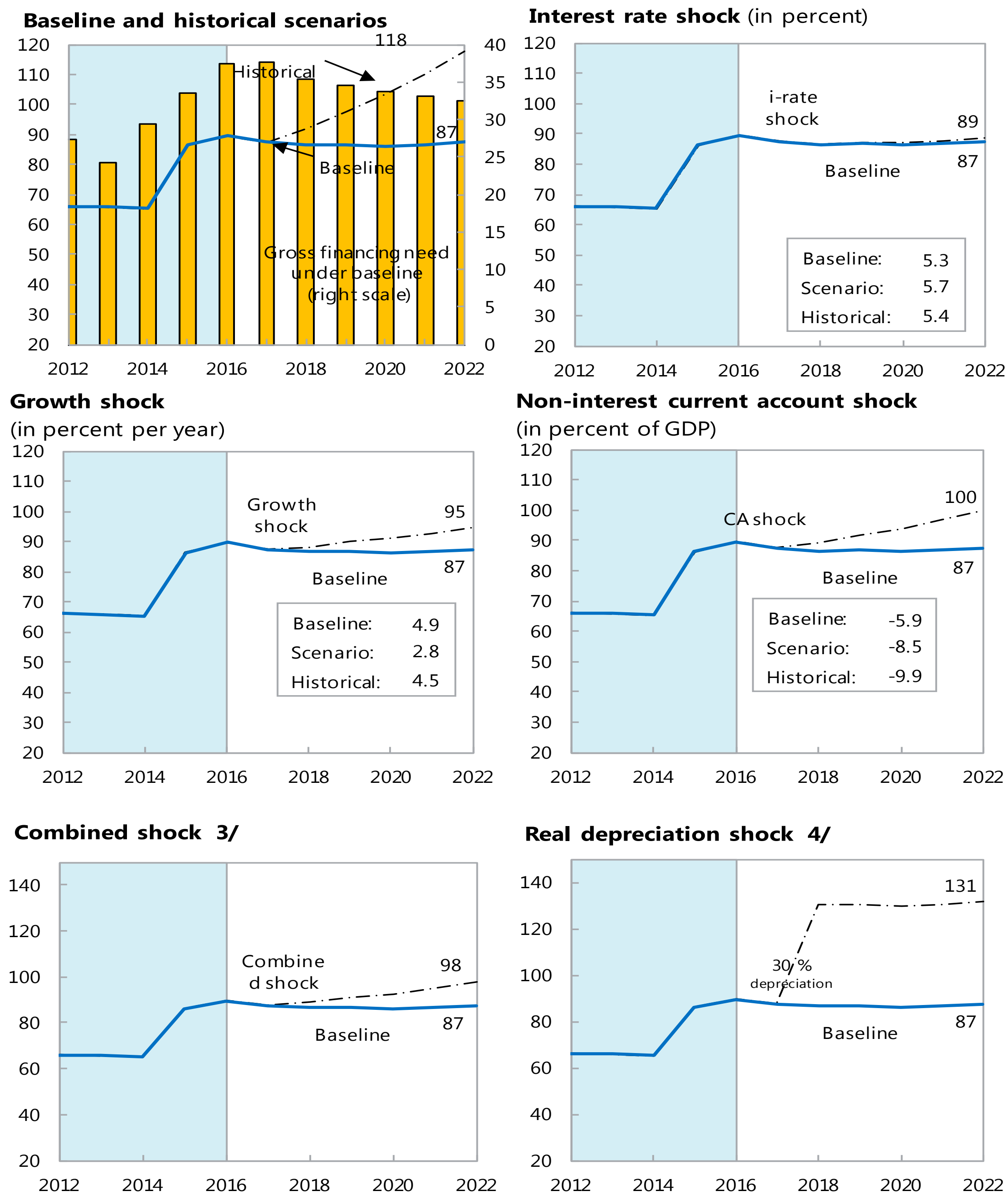
(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	4.3	4.2	4.7	5.0	5.2	5.2
Inflation	5.4	3.4	3.0	3.0	3.0	3.0
Primary Balance	-2.7	-2.0	-2.2	-2.3	-1.6	-1.0
Effective interest rate	3.3	3.3	3.3	3.3	3.0	2.8
Constant Primary Balance Scenario						
Real GDP growth	4.3	4.2	4.7	5.0	5.2	5.2
Inflation	5.4	3.4	3.0	3.0	3.0	3.0
Primary Balance	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7
Effective interest rate	3.3	3.3	3.3	3.3	3.0	2.8

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	4.3	4.5	4.5	4.5	4.5	4.5
Inflation	5.4	3.4	3.0	3.0	3.0	3.0
Primary Balance	-2.7	-3.8	-3.8	-3.8	-3.8	-3.8
Effective interest rate	3.3	3.3	3.0	2.8	2.4	2.0

Source: IMF staff.

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



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

Table 1. Georgia: Selected Economic and Financial Indicators, 2015–22

	2015	2016	2017	2017	2018	2018	2019	2020	2021	2022
	Actual		EFF Request	Prel.	EFF Request	Projections				
National accounts and prices				(annual percentage change; unless otherwise indicated)						
Real GDP	2.9	2.7	3.5	4.3	4.0	4.2	4.7	5.0	5.2	5.2
Nominal GDP (in billion of laris)	31.8	33.9	36.2	37.3	38.8	40.1	43.3	46.8	50.8	55.0
Nominal GDP (in billion of U.S. dollars)	14.0	14.3	13.7	15.0	14.9	16.3	17.5	19.0	20.6	22.3
GDP per capita (in thousand of U.S. dollars)	3.8	3.9	3.7	4.1	4.0	4.4	4.7	5.1	5.6	6.1
GDP deflator, period average	5.9	4.0	4.0	5.4	3.0	3.4	3.0	3.0	3.0	3.0
CPI, Period average	4.0	2.1	5.7	5.8	2.4	2.8	3.1	3.0	3.0	3.0
CPI, End-of-period	4.9	1.8	5.4	5.6	3.0	3.2	3.0	3.0	3.0	3.0
Investment and saving				(in percent of GDP)						
Gross national saving	19.5	19.6	20.5	20.6	22.4	22.5	22.9	23.3	25.4	26.0
Investment	31.5	32.4	33.4	31.0	34.9	33.1	33.3	33.0	34.4	34.7
Public	5.6	5.1	5.8	5.8	6.4	6.5	7.2	7.9	8.2	8.3
Private	25.9	27.4	27.7	25.2	28.4	26.6	26.0	25.1	26.3	26.4
Consolidated government operations				(in percent of GDP)						
Revenue and grants	28.1	28.4	29.3	28.9	28.6	28.6	28.5	28.3	28.0	27.7
o.w. Tax revenue	25.1	25.8	26.2	25.9	25.8	25.6	25.9	25.9	25.8	25.7
Expenditures	31.9	32.5	33.4	33.0	32.4	32.0	32.2	32.0	31.2	30.3
Current expenditures	24.9	26.0	25.3	24.7	24.3	24.0	23.4	22.6	21.6	20.6
Capital spending and budget lending	7.0	6.5	8.0	8.3	8.1	8.1	8.8	9.4	9.6	9.6
Overall balance	-3.8	-4.1	-4.1	-4.1	-3.8	-3.8	-3.5	-3.1	-2.8	-2.5
Net Lending/Borrowing (GFSM 2001)	-1.3	-1.6	-1.4	-1.1	-1.8	-1.5	-1.4	-1.3	-1.1	-0.9
Augmented Net lending / borrowing (Program definition) 1/	-2.7	-3.0	-3.7	-3.6	-3.5	-3.0	-2.9	-2.8	-2.5	-2.3
Public debt	41.4	44.6	45.5	42.3	46.7	42.7	42.8	42.7	41.9	40.1
o.w. NBG debt to the IMF	...	...	0.6	0.5	1.1	1.0	1.4	1.5	1.4	1.2
o.w. Foreign-currency denominated	32.5	35.2	35.9	33.1	37.3	34.0	34.1	34.1	34.2	34.0
Money and credit				(in percent; unless otherwise indicated)						
Credit to the private sector (annual percentage change)	22.1	19.6	10.5	10.1	11.2	14.3	13.2	13.0	13.0	12.7
In constant exchange rate	4.3	12.0	12.0	15.5	11.2	14.3	13.2	13.0	13.0	12.7
Broad money (annual percentage change)	19.2	20.4	10.1	9.8	14.5	15.0	16.0	16.9	16.3	14.3
Broad money (incl. fx deposits, annual percentage change)	23.4	19.1	8.6	7.9	13.0	13.4	14.6	15.4	14.9	13.6
In constant exchange rate	5.1	13.3	11.3	14.7	14.6	15.0	16.0	16.9	16.3	14.3
Deposit dollarization (in percent of total)	66.8	69.9	69.0	64.8	68.1	64.1	63.5	62.3	61.5	60.2
Credit dollarization (in percent of total)	63.1	64.6	61.5	54.7	60.0	54.1	53.0	52.0	51.0	50.0
External sector				(in percent of GDP; unless otherwise indicated)						
Current account balance	-12.0	-12.8	-12.9	-10.4	-12.5	-10.6	-10.3	-9.7	-9.0	-8.7
Trade balance	-28.1	-27.0	-44.4	-25.8	-40.3	-26.4	-25.8	-25.5	-25.0	-24.8
Terms of trade (ratio)	103.1	103.0	101.2	102.2	101.9	102.4	102.2	102.9	103.9	105.0
Gross international reserves (in billions of US$)	2.5	2.8	3.1	3.2	3.4	3.4	3.7	4.2	4.8	5.4
In percent of IMF Composite measure (floating)	83.5	86.6	92.5	93.3	96.3	95.2	98.9	105.1	113.1	120.2
Gross external debt	103.0	107.8	119.3	106.9	118.6	106.4	107.0	107.0	107.8	108.7
Gross external debt, excl. intercompany loans	86.2	89.5	91.7	87.4	90.4	86.5	86.6	86.2	86.7	87.4
Laris per U.S. dollar (period average) 2/	2.27	2.37	...	2.48	...	...	...	...	...	...
Laris per euro (period average) 2/	2.52	2.62	...	2.78	...	...	...	...	...	...
REER (period average; CPI based, 2010=100)	104.0	107.5	...	...	...	...	...	...	...	...

Sources: Georgian authorities; and Fund staff estimates.

1/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.

2/ For 2017 is average January - October.

Table 2. Georgia: Summary Balance of Payments, 2015–22
(In millions of U.S. dollars)

	2015	2016	2017	2017	2018	2018	2019	2020	2021	2022
			EFF		EFF					
	Actual		Request	Prel.	Request			Projections		
					(in millions of U.S. dollars)					
Current account balance	-1,680	-1,840	-1,775	-1,563	-1,849	-1,729	-1,815	-1,841	-1,855	-1,940
Trade balance	-3,935	-3,869	-4,098	-3,881	-4,382	-4,292	-4,522	-4,841	-5,141	-5,531
Exports	3,099	2,931	3,226	3,495	3,395	3,810	4,156	4,480	4,884	5,265
Imports	-7,034	-6,800	-7,324	-7,376	7,777	-8,102	-8,678	-9,321	-10,024	-10,795
Services	1,458	1,620	1,789	1,966	1,940	2,174	2,322	2,596	2,868	3,161
Services: credit	3,133	3,351	3,693	3,874	3,955	4,253	4,548	4,971	5,418	5,902
Services: debit	-1,675	-1,731	-1,905	-1,908	-2,014	-2,079	-2,226	-2,376	-2,551	-2,741
Income	-323	-713	-547	-834	-564	-848	-931	-1,003	-1,084	-1,173
Of which : interest payments	-489	-519	-532	-503	-568	-561	-593	-639	-665	-729
Transfers	1,120	1,122	1,081	1,186	1,157	1,237	1,317	1,408	1,502	1,602
Of which : remittances credit	588	579	638	653	683	699	748	801	857	921
Capital account	64	58	61	86	60	60	59	58	57	55
General government	59	54	59	61	58	60	59	58	57	55
Financial account	1,509	2,006	1,762	1,575	1,882	1,761	1,950	2,166	2,419	2,465
Direct investment (net)	1,267	1,333	1,408	1,377	1,493	1,459	1,602	1,746	1,887	2,029
Portfolio investment (net)	-154	41	-80	36	-80	50	48	45	42	39
Equity	5	-15	1	-40	1	0	0	0	0	0
Debt securities	-158	56	-81	75	-81	50	48	45	42	39
Loans (net)	727	904	444	380	429	551	432	512	654	566
Short-term loans (net)	-3	269	31	24	34	35	34	38	41	45
Public	1	2	4	2	5	2	2	2	2	2
Private	-4	267	27	22	29	33	32	36	39	43
Medium and long-term loans (net)	730	635	413	356	410	515	397	474	613	521
Public 1/	344	281	219	217	332	358	266	328	476	436
Private	386	353	194	140	78	157	132	145	138	85
Bank	103	139	201	105	18	76	56	60	99	76
Non-bank	283	215	-7	34	60	81	76	85	39	9
Others (net) 2/	-331	-272	-10	-217	40	-298	-131	-137	-164	-169
Errors and omissions	-93	-29	0	7	0	0	0	0	0	0
Overall balance	-201	194	48	106	93	93	195	383	620	580
Financing	201	-194	-304	-369	-315	-255	-330	-476	-617	-563
Gross International Reserves (-increase)	99	-245	-304	-384	-315	-251	-330	-476	-617	-563
Use of Fund Resources 3/	-73	-14	...	...	...	...	...	...	...	...
Rescheduled debts and arrears clearance	175	64	0	15	0	-5	0	0	0	0
Financing gap	...	...	257	264	222	163	135	93	-4	-18
Proposed use of Fund Resources	...	...	69	70	27	28	35	43	-4	-18
Proposed IMF EFF	...	...	81	83	81	85	85	43	0	0
Repayment 3/	...	...	-12	-13	-54	-56	-49	0	-4	-18
Official creditors	...	...	188	193	195	135	100	50	0	0
World Bank	...	...	100	107	100	0	0	0	0	0
EU	...	...	26	15	45	18	0	0	0	0
Others (ADB and AFD)	...	...	62	72	50	117	100	50	0	0
Memorandum items:					(In percent of GDP)					
Current account balance	-12.0	-12.8	-12.9	-10.4	-12.5	-10.6	-10.3	-9.7	-9.0	-8.7
Trade balance	-28.1	-27.0	-29.9	-25.8	-29.5	-26.4	-25.8	-25.5	-25.0	-24.8
Financial account	10.8	14.0	12.8	10.5	12.7	10.8	11.1	11.4	11.8	11.1
Foreign direct investment (net)	9.1	9.3	10.3	9.2	10.1	9.0	9.1	9.2	9.2	9.1
External financing requirement	-36.4	-38.7	-39.6	-35.6	-38.9	-35.8	-35.2	-34.4	-33.4	-33.1
Gross international reserves (in billions of USD)	2,521	2,756	3,061	3,167	3,376	3,418	3,748	4,224	4,841	5,403
in months of next year GNFS imports	3.5	3.6	3.0	3.7	3.0	3.8	3.8	4.0	4.3	4.5
in percent of short-term debt at remaining maturity	75	77	83	82	86	83	86	91	96	100
in percent of broad money and non-resident deposits	37	37	38	37	37	35	34	34	35	36
in percent of IMF Composite measure (floating)	83	87	92	93	96	95	99	105	113	120
Reserve cover (percent) 4/	40.4	39.5	43.9	45.7	46.8	46.1	47.4	50.4	54.5	56.9

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

1/ Including general government and monetary authorities

2/ Including currency and deposits from banks and other financial instruments

3/ Repayment for exisitng Fund resources from 2017 onwards will be recorded as a part of financing gap.

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

Table 3a. Georgia: General Government Operations, GFSM 2001, 2015–22
(In millions of GEL)

	2015	2016	2017	2017	2018	2018	2019	2020	2021	2022
			EFF		EFF					
	Actual		Request	Prel.	Request		Projections			
Revenue	8,923	9,623	10,608	10,760	11,075	11,470	12,338	13,230	14,225	15,246
Taxes	7,971	8,750	9,504	9,634	9,997	10,260	11,209	12,101	13,096	14,134
Taxes on income, profits, and capital gains	3,207	3,535	3,276	3,625	3,450	3,712	4,007	4,394	4,827	5,265
Payable by individuals	2,182	2,479	2,681	2,910	2,870	3,112	3,356	3,629	3,934	4,261
Payable by corporations	1,025	1,056	594	715	580	600	652	766	893	1,004
Taxes on property	264	363	365	395	373	426	459	497	539	583
Taxes on goods and services	4,404	4,756	5,758	5,456	6,074	5,869	6,468	6,913	7,410	7,939
General taxes on goods and services (VAT)	3,533	3,686	4,137	4,046	4,268	4,419	4,980	5,385	5,839	6,324
Excises	871	1,070	1,621	1,410	1,806	1,450	1,488	1,528	1,571	1,614
Taxes on international trade	69	70	80	69	77	64	71	76	81	87
Other taxes	26	25	25	89	24	190	204	221	240	259
Grants	319	282	380	368	381	410	329	329	329	312
Other revenue	634	592	725	758	697	800	800	800	800	800
Total Expenditure	9,325	10,168	11,115	11,174	11,789	12,061	13,111	14,132	14,934	15,762
Expense	7,904	8,817	9,181	9,180	9,439	9,590	10,114	10,548	10,916	11,313
Compensation of employees	1,602	1,753	1,687	1,675	1,735	1,710	1,764	1,817	1,871	1,928
Use of goods and services	1,203	1,394	1,451	1,450	1,460	1,505	1,552	1,599	1,647	1,696
Interest	330	403	513	495	534	560	618	658	729	822
External	174	195	247	221	255	265	298	309	339	407
Domestic	156	208	265	274	279	294	320	350	390	415
Subsidies	671	701	802	830	755	855	882	908	935	963
Grants	84	82	77	80	85	80	83	85	88	90
Social benefits	3,037	3,394	3,503	3,550	3,695	3,730	4,029	4,260	4,387	4,519
Other expense	978	1,090	1,148	1,100	1,175	1,150	1,186	1,221	1,258	1,295
Net acquisition of nonfinancial assets	1,421	1,351	1,934	1,995	2,350	2,472	2,997	3,584	4,018	4,449
Increase (capital spending)	1,776	1,718	2,094	2,180	2,500	2,622	3,137	3,714	4,148	4,569
Decrease (privatization proceeds)	-355	-367	-160	-185	-150	-150	-140	-130	-130	-120
Net lending / borrowing before adjustment	-402	-545	-506	-415	-714	-592	-772	-902	-709	-517
Unidentified measures	0	0	0	0	0	0	170	295	170	0
Net lending / borrowing	-402	-545	-507	-415	-714	-592	-602	-607	-539	-517
Change in net financial worth, transactions	-402	-545	-507	-415	-714	-592	-602	-607	-539	-517
Net acquisition of financial assets ("+": increase in assets)	552	533	822	825	662	599	438	465	648	503
Domestic	552	533	822	825	662	599	438	465	648	503
Budget lending	447	481	822	913	624	614	674	704	724	724
Deposits (NBG and commercial banks)	105	54	0	-88	38	-15	-236	-239	-76	-221
Financial privatization	0	-2	0	0	0	0	0	0	0	0
Net incurrence of liabilities ("+": increase in liabilities)	954	1,078	1,328	1,240	1,376	1,190	1,041	1,072	1,187	1,020
Domestic	289	331	286	255	143	113	260	138	19	-26
Securities other than shares	298	345	296	295	153	153	270	148	29	-16
Loans	-9	-14	-10	-10	-10	-10	-10	-10	-10	-10
Foreign	665	747	1,042	984	1,234	1,078	781	934	1,168	1,046
Loans	665	747	1,042	984	1,234	1,078	781	934	1,168	1,046
Memorandum items:										
Nominal GDP	31,756	33,922	36,227	37,260	38,782	40,148	43,289	46,811	50,754	54,974
Public debt	13,161	15,113	16,482	15,757	18,099	17,145	18,533	19,985	21,241	22,068
End-year government deposits	919	973	973	885	1,011	870	634	395	319	98
Operating balance	1,019	806	1,427	1,580	1,636	1,880	2,225	2,682	3,310	3,932
Net lending / borrowing (excluding privatization)	-757	-912	-666	-600	-864	-742	-912	-1,032	-839	-637
Augmented Net lending / borrowing (Program definition) 1/	-849	-1,025	-1,328	-1,328	-1,338	-1,206	-1,276	-1,311	-1,263	-1,241
Cyclically-adjusted primary balance (Program definition)	-533	-545	-769	-810	-774	-776	-720	-652	-590	-485

Sources: Ministry of Finance; and Fund staff estimates.

1/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.

Table 3b. Georgia: General Government Operations, GFSM 2001, 2015–22
(In percent of GDP)

	2015	2016	2017	2017	2018	2018	2019	2020	2021	2022
	Actual		EFF Request	Prel.	EFF Request			Projections		
Revenue	28.1	28.4	29.3	28.9	28.6	28.6	28.5	28.3	28.0	27.7
Taxes	25.1	25.8	26.2	25.9	25.8	25.6	25.9	25.9	25.8	25.7
Taxes on income, profits, and capital gains	10.1	10.4	9.0	9.7	8.9	9.2	9.3	9.4	9.5	9.6
Payable by individuals	6.9	7.3	7.4	7.8	7.4	7.8	7.8	7.8	7.8	7.8
Payable by corporations	3.2	3.1	1.6	1.9	1.5	1.5	1.5	1.6	1.8	1.8
Taxes on property	0.8	1.1	1.0	1.1	1.0	1.1	1.1	1.1	1.1	1.1
Taxes on goods and services	13.9	14.0	15.9	14.6	15.7	14.6	14.9	14.8	14.6	14.4
General taxes on goods and services (VAT)	11.1	10.9	11.4	10.9	11.0	11.0	11.5	11.5	11.5	11.5
Excises	2.7	3.2	4.5	3.8	4.7	3.6	3.4	3.3	3.1	2.9
Taxes on international trade	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other taxes	0.1	0.1	0.1	0.2	0.1	0.5	0.5	0.5	0.5	0.5
Grants	1.0	0.8	1.0	1.0	1.0	1.0	0.8	0.7	0.6	0.6
Other revenue	2.0	1.7	2.0	2.0	1.8	2.0	1.8	1.7	1.6	1.5
				23.3						
Total Expenditure	29.4	30.0	30.7	30.0	30.4	30.0	30.3	30.2	29.4	28.7
Expense	24.9	26.0	25.3	24.6	24.3	23.9	23.4	22.5	21.5	20.6
Compensation of employees	5.0	5.2	4.7	4.5	4.5	4.3	4.1	3.9	3.7	3.5
Use of goods and services	3.8	4.1	4.0	3.9	3.8	3.7	3.6	3.4	3.2	3.1
Interest	1.0	1.2	1.4	1.3	1.4	1.4	1.4	1.4	1.4	1.5
External	0.5	0.6	0.7	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Domestic	0.5	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.8	0.8
Subsidies	2.1	2.1	2.2	2.2	1.9	2.1	2.0	1.9	1.8	1.8
Grants	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social benefits	9.6	10.0	9.7	9.5	9.5	9.3	9.3	9.1	8.6	8.2
Other expense	3.1	3.2	3.2	3.0	3.0	2.9	2.7	2.6	2.5	2.4
Net acquisition of nonfinancial assets	4.5	4.0	5.3	5.4	6.1	6.2	6.9	7.7	7.9	8.1
Increase (capital spending)	5.6	5.1	5.8	5.8	6.4	6.5	7.2	7.9	8.2	8.3
Decrease (privatization proceeds)	-1.1	-1.1	-0.4	-0.5	-0.4	-0.4	-0.3	-0.3	-0.3	-0.2
Net lending / borrowing before adjustment	-1.3	-1.6	-1.4	-1.1	-1.8	-1.5	-1.8	-1.9	-1.4	-0.9
Unidentified measures	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.6	0.3	0.0
Net lending / borrowing	-1.3	-1.6	-1.4	-1.1	-1.8	-1.5	-1.4	-1.3	-1.1	-0.9
Change in net financial worth, transactions	-1.3	-1.6	-1.4	-1.1	-1.8	-1.5	-1.4	-1.3	-1.1	-0.9
Net acquisition of financial assets ("+": increase in assets)	1.7	1.6	2.3	2.2	1.7	1.5	1.0	1.0	1.3	0.9
Domestic	1.7	1.6	2.3	2.2	1.7	1.5	1.0	1.0	1.3	0.9
Budget lending	1.4	1.4	2.3	2.5	1.6	1.5	1.6	1.5	1.4	1.3
Deposits (NBG and commercial banks)	0.3	0.2	0.0	-0.2	0.1	0.0	-0.5	-0.5	-0.1	-0.4
Financial privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities ("+": increase in liabilities)	3.0	3.2	3.7	3.3	3.5	3.0	2.4	2.3	2.3	1.9
Domestic	0.9	1.0	0.8	0.7	0.4	0.3	0.6	0.3	0.0	0.0
Securities other than shares	0.9	1.0	0.8	0.8	0.4	0.4	0.6	0.3	0.1	0.0
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	2.1	2.2	2.9	2.6	3.2	2.7	1.8	2.0	2.3	1.9
Loans	2.1	2.2	2.9	2.6	3.2	2.7	1.8	2.0	2.3	1.9
Memorandum items:										
Nominal GDP	31,756	33,922	36,227	37,260	38,782	40,148	43,289	46,811	50,754	54,974
Public debt	41.4	44.6	45.5	42.3	46.7	42.7	42.8	42.7	41.9	40.1
End-year government deposits	2.9	2.9	2.7	2.4	2.6	2.2	1.5	0.8	0.6	0.2
Operating balance (before adjustment)	3.2	2.4	3.9	4.2	4.2	4.7	5.1	5.7	6.5	7.2
Net lending / borrowing (excluding privatization)	-2.4	-2.7	-1.8	-1.6	-2.2	-1.8	-2.1	-2.2	-1.7	-1.2
Augmented Net lending / borrowing (Program definition) 1/	-2.7	-3.0	-3.7	-3.6	-3.5	-3.0	-2.9	-2.8	-2.5	-2.3
Cyclically-adjusted primary balance (Program definition)	-1.7	-1.6	-2.1	-2.2	-2.0	-1.9	-1.7	-1.4	-1.2	-0.9

Sources: Ministry of Finance; and Fund staff estimates.

1/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.

Table 4. Georgia: Monetary Survey, 2013–18

	2013	2014	2015	2016		2017		2018	
	Dec. Act.	Dec. Act.	Dec. Act.	June Act.	Dec Prel.	June Proj.	Dec Proj.	June Proj.	Dec Proj.
Central Bank	(In billions of lari)								
Net foreign assets	3.2	3.2	3.5	3.7	3.8	3.6	4.0	3.9	4.1
Gross international reserves	4.9	5.0	6.0	6.7	7.3	7.1	7.8	7.9	8.4
Other foreign assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign currency liabilities	-1.7	-1.8	-2.5	-3.0	-3.5	-3.5	-3.8	-4.0	-4.3
Of which : use of Fund resources	-0.2	-0.1	0.0	0.0	0.0	-0.1	-0.2	-0.3	-0.4
Of which : compulsory reserves in USD	-1.0	-1.2	-1.7	-2.3	-2.8	-2.6	-2.8	-2.9	-3.1
Net domestic assets	-0.3	-0.1	-0.6	-0.9	-0.4	-0.3	-0.2	-0.1	0.3
Net claims on general government	0.0	-0.1	-0.4	0.0	-0.5	-0.9	-0.4	-0.4	-0.3
Claims on general government (incl. T-bills)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.6
Nontradable govt. debt	0.5	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3
Securitized debt (marketable)	0.0	0.1	0.1	0.2	0.1	0.2	0.2	0.2	0.3
Deposits	-0.5	-0.6	-0.9	-0.5	-1.0	-1.4	-0.9	-0.9	-0.9
Claims on rest of economy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on banks	-0.3	0.2	0.7	0.2	1.6	1.8	1.4	1.5	1.8
Bank refinancing	0.4	0.7	1.1	0.4	1.8	1.8	1.5	1.6	1.9
Certificates of deposits and bonds	-0.7	-0.5	-0.4	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1
Other items, net	-0.1	-0.2	-0.9	-1.0	-1.4	-1.2	-1.3	-1.3	-1.3
Banking System	(In billions of lari)								
Net foreign assets	1.0	0.6	1.0	0.8	1.9	1.8	1.5	1.5	1.6
NBG	4.2	4.4	5.2	6.1	6.6	6.1	6.8	6.8	7.2
Commercial banks	-3.2	-3.8	-4.3	-5.2	-4.7	-4.3	-5.3	-5.2	-5.6
Net domestic assets	8.8	10.6	12.4	12.5	14.2	13.8	16.1	16.5	18.6
Domestic credit	11.0	13.5	16.4	17.2	19.6	19.7	21.6	22.3	24.7
Net claims on general government	0.6	0.7	0.7	1.0	0.9	0.6	1.0	1.0	1.2
Of which : government deposits at NBG	-0.5	-0.6	-0.9	-0.5	-1.0	-1.4	-0.9	-0.9	-0.9
Of which : T-bills at commercial banks	0.7	1.3	1.6	1.7	2.0	2.1	2.3	2.4	2.5
Private credit	10.4	12.8	15.6	16.2	18.7	19.1	20.6	21.2	23.5
Other items, net	-2.1	-2.9	-4.0	-4.6	-5.4	-6.0	-5.5	-5.8	-6.1
Broad money (M3)	9.8	11.2	13.3	13.3	16.1	15.6	17.6	18.0	20.3
(Broad money, percent change year on year)	24.4	13.8	19.2	13.3	20.4	16.6	9.8	15.8	15.0
Lari Broad money (M2)	5.4	5.9	5.7	6.0	6.5	6.9	8.1	8.2	9.5
Currency held by the public	1.9	1.9	2.0	2.0	2.4	2.3	2.8	2.8	3.4
Lari resident deposits	3.5	4.0	3.8	4.0	4.1	4.6	5.2	5.4	6.1
Resident foreign exchange deposits	4.4	5.3	7.6	7.3	9.6	8.6	9.6	9.8	10.8
Sources of funds of commercial banks	12.7	14.5	18.7	19.0	21.7	21.3	24.5	25.0	27.0
Resident deposits	7.9	9.2	11.4	11.3	13.7	13.2	14.8	15.2	16.9
Non-resident deposits	1.7	2.1	3.1	3.1	3.5	3.6	3.5	3.6	3.6
Other foreign liabilities	3.1	3.1	4.2	4.6	4.5	4.5	6.3	6.3	6.5
Uses of funds of commercial banks	12.7	14.5	18.7	19.0	21.7	21.3	24.5	25.0	27.0
Reserves	3.4	3.5	4.9	4.8	6.3	6.2	7.1	7.3	7.6
Domestic credit	10.9	13.6	16.7	17.2	20.1	20.6	21.9	22.6	25.0
Lari domestic credit	4.5	5.9	6.9	6.8	8.0	9.7	10.7	11.1	12.2
Fx domestic credit	6.4	7.6	9.9	10.4	12.1	11.0	11.3	11.6	12.7
Other foreign assets	0.2	0.3	0.6	0.5	0.4	0.4	0.4	0.4	0.4
Other items, net	-1.5	-2.5	-3.0	-3.1	-4.7	-5.5	-4.5	-5.0	-5.5
Memorandum items:	(Percent of GDP, unless otherwise indicated)								
Broad money (M3)	36.6	38.4	42.0	40.6	47.3	43.7	47.3	41.0	39.9
Lari Broad money (M2)	20.2	20.3	18.1	18.4	19.1	19.4	21.6	18.7	18.6
Currency held by the public	7.0	6.6	6.2	6.1	7.0	6.6	7.6	6.5	6.7
Non-resident deposits (percent of total deposits)	15.5	16.2	17.1	16.2	16.6	17.7	15.6	15.6	14.6
Private credit (Percent change, year on year)	19.5	23.3	22.1	11.5	19.6	18.5	10.1	11.0	14.3
Private credit	38.7	43.9	49.2	49.2	55.1	53.8	55.2	48.3	46.3
Nominal GDP (billions of lari)	26.8	29.2	31.8	32.8	33.9	35.6	37.3	44.0	50.8

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

Table 5. Georgia: Selected Monetary and Financial Soundness Indicators, 2008–August 2017

	2008	2009	2010	2011	2012	2013	2014	2015	2016	Aug 2017
Deposit dollarization (residents, in percent)	72.6	68.8	65.0	58.6	60.4	55.7	57.1	66.8	69.9	65.2
Loan-to-deposit ratio (in percent)	155.9	124.2	107.6	105.3	106.7	102.9	105.3	103.9	103.6	105.5
Credit-to-GDP ratio (in percent)	31.7	29.0	29.9	31.7	33.2	38.7	43.9	49.2	55.1	53.8
Capital adequacy ratio (in percent) 1/	13.9	19.1	17.4	17.1	17.0	17.2	17.4	17.5	15.0	16.5
Capital adequacy ratio (in percent) 2/	24.0	25.6	23.6	25.6	25.3	25.2	25.5	26.0	23.2	24.5
Liquidity ratio (in percent) 3/	28.3	39.1	38.7	37.3	39.8	41.8	38.7	41.2	39.7	41.9
Nonperforming loans (in percent of total loans) 4/	12.8	17.9	12.5	8.6	9.3	7.5	7.6	7.5	7.3	6.6
Nonperforming loans (in percent of total loans) 5/	4.1	6.3	5.4	4.6	3.7	3.1	3.1	2.7	3.5	3.4
Loans collateralized by real estate (in percent of total loans)	43.6	55.5	47.5	53.4	50.6	52.5	51.2	54.8	59.2	58.1
Loans in foreign exchange (in percent of total loans)	72.8	76.9	74.0	68.8	67.5	62.1	60.4	64.3	65.4	57.1
Specific provisions (in percent of total loans)	6.0	9.7	6.5	4.6	4.6	3.8	3.6	3.7	3.6	3.2
Net foreign assets (in percent of total assets)	-19.6	-14.9	-8.2	-13.7	-19.7	-17.4	-17.7	-13.2	-15.0	-13.4
Net open foreign exchange position (in percent of regulatory capital)	1.7	1.8	8.1	5.9	3.3	2.1	2.0	-0.6	4.4	3.6
Return on equity (cumulative through the year, annualized) 6/	-12.4	-4.3	9.6	17.3	5.8	14.6	14.8	15.4	19.2	20.3
Borrowed funds from abroad-to-GDP ratio 7/	12.7	11.6	12.2	9.4	11.4	11.1	11.7	14.1	15.3	14.6

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

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

2/ Basel I definition.

3/ Ratio of liquid assets to 6-month and shorter maturity liabilities.

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

5/ IMF definition.

6/ Pre tax.

7/ Borrowed funds include Subordinated Debt.

Table 6. Georgia: External Vulnerability Indicators, 2015–22

	2015	2016	2017	2018	2019	2020	2021	2022
	Actual	Prel.	Projections					
Value of exports of goods and services, percent change	-12.1	0.8	17.3	9.4	8.0	8.6	9.0	8.4
Value of imports of goods and services, percent change	-13.5	-2.0	8.8	9.7	7.1	7.3	7.5	7.6
Terms of trade (deterioration -)	3.4	-0.1	-0.8	0.2	-0.2	0.6	1.0	1.0
Current account balance (percent of GDP)	-12.0	-12.8	-10.4	-10.6	-10.3	-9.7	-9.0	-8.7
Capital and financial account (percent of GDP)	11.2	14.4	12.3	12.0	12.0	12.0	12.0	11.3
External public debt (percent of GDP)	32.9	33.5	35.5	36.4	36.4	36.2	36.0	35.5
(in percent of exports of goods and services)	73.8	76.5	72.4	73.4	73.4	72.7	71.9	70.8
Debt service on external public debt								
(in percent of exports of goods and services)	4.3	3.9	3.6	5.0	5.3	5.1	5.2	5.8
External debt (percent of GDP)[1]	86.2	89.5	87.4	86.5	86.6	86.2	86.7	87.4
(in percent of exports of goods and services)	193.7	204.2	178.4	174.5	174.6	173.0	173.0	174.3
Debt service on MLT external debt								
(in percent of exports of goods and services)	21.4	20.7	19.0	19.8	19.2	18.6	18.1	18.5
Gross international reserves								
in millions of USD	2,521	2,756	3,167	3,418	3,748	4,224	4,841	5,403
in months of next year's imports of goods and services	3.5	3.6	3.7	3.8	3.8	4.0	4.3	4.5
in percent of external debt	20.9	21.5	24.1	24.3	24.7	25.8	27.2	27.8
in percent of short-term external debt (remaining maturity)	75	77	82	83	86	91	96	100

Source: Fund staff estimates and projections.
[1] Excluding intercompany loans.

Table 7. Georgia: Gross External Requirements, 2017–22
(In millions of U.S. dollars)

	2017	2018	2019	2020	2021	2022
			Projections			
Total financing requirement	2,716	3,039	3,020	3,155	3,273	3,503
Current account deficit	1,563	1,729	1,815	1,841	1,855	1,940
Medium and long-term debt	972	1,062	1,122	1,222	1,295	1,432
Private	819	844	838	886	897	972
Banks	270	322	299	323	317	375
Corporates	549	522	540	562	580	597
Public	152	218	283	336	398	460
Others (net)	181	248	83	92	122	130
Total financing sources	2,814	3,132	3,214	3,538	3,893	4,083
Capital transfers	86	60	59	58	57	55
Direct investment, net	1,377	1,459	1,602	1,746	1,887	2,029
Medium and long-term debt	1,328	1,578	1,519	1,696	1,908	1,954
Private	959	1,001	970	1,031	1,035	1,057
Banks	376	398	355	384	416	451
Corporates	583	603	615	647	618	606
Public (only project loans)	369	577	549	665	874	897
Short-term debt (net)	24	35	34	38	41	45
Increase in gross reserves	384	251	330	476	617	563
Rescheduled debt and arrears clearance	-15	5	0	0	0	0
Errors and omissions	7	0	0	0	0	0
Total financing needs	264	163	135	93	-4	-18
Official financing	264	163	135	93	-4	-18
IMF	70	28	35	43	-4	-18
Prospective purchases	83	85	85	43	0	0
Repurchases	-13	-56	-49	0	-4	-18
Official creditors	193	135	100	50	0	0
World Bank	107	0	0	0	0	0
EU	15	18	0	0	0	0
Others	72	117	100	50	0	0
Memorandum items:						
Gross international reserves	3,167	3,418	3,748	4,224	4,841	5,403
in months of next year GNFS imports	4	4	4	4	4	5
in percent of short-term debt at remaining maturity	82	83	86	91	96	100
in percent of IMF Composite measure (floating)	93	95	99	105	113	120
EFF in percent of total official financing	27	17	26	46	…	…

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

Table 8. Georgia: Indicators of Fund Credit, 2014–22
(In millions of SDR)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Actual			Projections					
Existing Fund credit									
Stock 1/	146.2	94.0	84.2	105.0	65.0	30.0	30.0	27.5	22.5
ECF 2/	29.4	14.0	4.2	0.0	0.0	0.0	0.0	0.0	0.0
SBA and EFF	116.8	80.0	80.0	105.0	65.0	30.0	30.0	27.5	22.5
Obligations	168.3	53.2	10.7	10.9	41.5	35.9	0.5	3.0	5.4
ECF 2/	18.2	15.4	9.8	4.2	0.0	0.0	0.0	0.0	0.0
SBA and EFF	150.1	37.8	0.8	6.7	41.5	35.9	0.5	3.0	5.4
Principal (repurchases)	148.6	36.8	0.0	5.0	40.0	35.0	0.0	2.5	5.0
Interest charges	1.6	1.0	0.8	1.7	1.5	0.9	0.5	0.5	0.4
Prospective purchases									
Disbursements	0.0	0.0	0.0	30.0	60.0	60.0	30.4	0.0	0.0
Stock 1/	0.0	0.0	0.0	30.0	90.0	150.0	180.4	180.4	172.9
Obligations 3/	0.0	0.0	0.0	0.2	1.0	2.1	2.9	2.9	10.4
Principal (repurchases)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	7.5
Interest charges	0.0	0.0	0.0	0.2	1.0	2.1	2.9	2.9	2.9
Stock of existing and prospective Fund credit 1/	146.2	94.0	84.2	135.0	155.0	180.0	210.4	207.9	195.4
In percent of quota 4/	97.3	62.5	40.0	64.2	73.7	85.5	100.0	98.8	92.9
In percent of GDP	1.3	0.9	0.8	1.2	1.3	1.4	1.6	1.4	1.2
In percent of exports of goods and nonfactor services	3.1	2.1	1.9	2.5	2.7	2.9	3.1	2.8	2.5
In percent of gross reserves	8.2	5.2	4.2	5.9	6.4	6.8	7.0	6.1	5.1
In percent of public external debt	4.9	2.9	2.4	3.5	3.7	4.0	4.3	4.0	3.5
Obligations to the Fund from existing and prospective Fund credit	168.3	53.2	10.7	11.0	42.5	38.0	3.4	5.9	15.9
In percent of quota	112.0	35.4	5.1	5.2	20.2	18.0	1.6	2.8	7.5
In percent of GDP	1.5	0.5	0.1	0.1	0.4	0.3	0.0	0.0	0.1
In percent of exports of goods and nonfactor services	3.6	1.2	0.2	0.2	0.7	0.6	0.1	0.1	0.2
In percent of gross reserves	9.5	3.0	0.5	0.5	1.7	1.4	0.1	0.2	0.4
In percent of public external debt service	58.9	27.5	6.1	5.7	14.8	11.5	1.0	1.6	3.5

Source: Fund staff estimates and projections.

1/ End of period.

2/ Following the Low Income Countries (LIC) reforms, effective January 7 2010, the PRGF arrangements were renamed Extended Credit Facility (ECF) Arrangements. ECF interest is based on 0 percent through end December 2018.

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

4/ Quota increased to SDR 210.4 million in February, 2016.

Table 9. Georgia: Schedule of Reviews and Available Purchases

Availability Date	Condition	Amount of Purchase (SDR millions)	Amount of Purchase (Percent of quota)
12-Apr-17	Approve the 36-month EFF	30	14.3
27-Oct-17	Complete the first review based on end-June 2017 performance criteria and other relevant performance criteria	30	14.3
13-Apr-18	Complete the second review based on end-December 2017 performance criteria and other relevant performance criteria	30	14.3
26-Oct-18	Complete the third review based on end-June 2018 performance criteria and other relevant performance criteria	30	14.3
12-Apr-19	Complete the fourth review based on end-December 2018 performance criteria and other relevant performance criteria	30	14.3
25-Oct-19	Complete the fifth review based on end-June 2019 performance criteria and other relevant performance criteria	30	14.3
20-Mar-20	Complete the sixth review based on end-December 2019 performance criteria and other relevant performance criteria	30.4	14.4
Total available		210.4	100

Source: Fund staff estimates and projections.

Table 10. Georgia: External Debt Sustainability Framework, 2012–2022
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
Baseline: External debt	66.1	65.8	65.2	86.2	89.5			**87.4**	**86.5**	**86.6**	**86.2**	**86.7**	**87.4**	**-12.1**
Change in external debt	4.8	-0.3	-0.6	21.1	3.3			-2.1	-0.9	0.1	-0.5	0.5	0.7	
Identified external debt-creating flows (4+8+9)	2.6	-0.6	1.0	14.7	1.4			-1.0	-2.0	-2.7	-3.4	-3.9	-4.4	
Current account deficit, excluding interest payments	8.7	2.8	7.5	7.6	8.7			7.7	6.6	6.3	5.9	5.7	5.2	
Deficit in balance of goods and services	19.7	12.9	18.1	17.7	15.2			15.2	15.0	14.8	14.5	14.3	13.8	
Exports	38.2	44.7	42.9	44.5	43.6			47.4	47.8	48.1	47.9	47.9	47.7	
Imports	57.8	57.6	61.0	62.2	58.8			62.6	62.8	62.9	62.4	62.2	61.5	
Net non-debt creating capital inflows (negative)	-3.7	-5.2	-8.3	-9.0	-9.9			-9.4	-9.6	-9.6	-9.6	-9.6	-9.6	
Automatic debt dynamics 1/	-2.4	1.9	1.7	16.2	2.7			0.7	1.0	0.6	0.3	0.0	0.1	
Contribution from nominal interest rate	3.0	3.1	3.2	4.4	4.7			4.3	4.4	4.3	4.3	4.2	4.2	
Contribution from real GDP growth	-3.5	-2.2	-3.0	-2.2	-2.3			-3.7	-3.4	-3.8	-4.0	-4.2	-4.1	
Contribution from price and exchange rate changes 2/	-1.9	1.0	1.5	13.9	0.3			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.2	0.3	-1.6	6.4	1.9			-1.1	1.1	2.9	3.0	4.4	5.1	
External debt-to-exports ratio (in percent)	173.2	147.2	151.7	193.7	205.4			184.5	180.8	180.2	179.9	181.0	183.3	
Gross external financing need (in billions of US dollars) 4/	4.3	3.9	4.9	4.7	5.3			5.7	5.7	6.1	6.4	6.8	7.3	
in percent of GDP	27.4	24.3	29.5	33.5	37.3	10-Year	10-Year	37.6	35.3	34.5	33.6	33.0	32.6	
Scenario with key variables at their historical averages 5/								**87.4**	**91.9**	**97.4**	**103.1**	**110.2**	**117.9**	**-10.2**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	6.4	3.4	4.6	2.9	2.7	4.5	4.2	4.3	4.2	4.7	5.0	5.2	5.2	
GDP deflator in US dollars (change in percent)	3.2	-1.5	-2.2	-17.6	-0.3	2.6	12.8	0.6	3.8	3.0	3.0	3.0	3.0	
Nominal external interest rate (in percent)	5.4	4.7	4.9	5.8	5.5	5.4	0.7	5.1	5.4	5.4	5.4	5.2	5.3	
Growth of exports (US dollar terms, in percent)	14.9	19.2	-1.6	-12.1	0.2	10.4	15.9	14.1	9.3	8.4	7.8	8.4	7.8	
Growth of imports (US dollar terms, in percent)	14.4	1.5	8.4	-13.5	-3.2	8.6	20.3	11.7	8.5	8.0	7.4	8.1	7.0	
Current account balance, excluding interest payments	-8.7	-2.8	-7.5	-7.6	-8.7	-9.9	5.2	-7.7	-6.6	-6.3	-5.9	-5.7	-5.2	
Net non-debt creating capital inflows	3.7	5.2	8.3	9.0	9.9	8.2	3.7	9.4	9.6	9.6	9.6	9.6	9.6	

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

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

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

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

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

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex I. Risk Assessment Matrix[1]

Source of risk	Relative Likelihood/ Time Horizon	Expected impact on the economy if risk is realized
Global Shocks		
Retreat from cross-border integration. A fraying consensus about the benefits of globalization lead to protectionism and economic isolationism, resulting in reduced global and regional policy collaboration with negative consequences for trade, capital and labor flows, sentiment, and growth.	Medium **Short to Medium Term**	**Staff assessment: High** Protectionism could jeopardize Georgia's plans to become a transit hub. It could reduce Georgia's exports and—possibly—capital inflows. Economic growth could be lower and lower external financing would put pressure on the lari.
Financial conditions: • **Tighter global financial conditions.** Fed normalization and tapering by ECB increase global rates and term premia, strengthen the U.S. dollar and the euro vis-à-vis the other currencies, and correct market valuations. Adjustments could be disruptive if there are policy surprises. Higher debt service and refinancing risks could stress leveraged firms, households, and vulnerable sovereigns, including through capital account pressures in some cases.	High **Short Term**	**Staff assessment: Medium** Higher lari volatility and depreciating pressures could generate negative balance-sheet effects and negatively affect financial stability.
• **European bank distress:** Strained bank balance sheets amid a weak profitability outlook could lead to financial distress in one or more major banks with possible knock-on effects on the broader financial sector and for sovereign yields in vulnerable economies.	Medium **Short Term**	
• **Reduced financial services by correspondent banks ("de-risking").** Significant curtailment of cross-border financial services in emerging and developing economies.	High **Short to Medium Term**	De-risking would likely affect smaller banks more forcefully, likely resulting in further concentration in the financial sector. Concetration of CBRs through the two largest banks after international banks curtailed relationships with some smaller domestic banks. Pressures on CBRs of large Georgian banks would negatively affect financial intermediation.
Weaker than expected global growth: • **Significant China slowdown and its spillovers:** Efforts to rein in financial sector risks, though desirable, expose vulnerabilities of indebted entities and reduce near-term growth. Over the medium term, overly ambitious growth targets lead to unsustainable policies, reducing fiscal space, and further increasing financial imbalances. Should a sharp adjustment occur, this would entail weak domestic demand, which in turn would lower commodity prices, roil global financial markets, and reduce global growth.	Medium **Short to Medium Term**	**Staff assessment: Medium** Weaker demand in other emerging economies and potential spillovers to Georgia's main trading partners would risk the envisaged economic recovery. Lower economic growth could reduce the buying-in on much-needed structural reforms for economic diversification and more inclusive economic growth.
• **Significant slowdown in other large EMs/frontier economies.** Resource misallocation and policy missteps exacerbate the impact of declining productivity and potential growth. In addition, turning of the domestic credit cycle generates disorderly household and corporate deleveraging, with potential spillbacks to advanced economies.	Medium **Short Term**	
• **Structurally weak growth in key advanced economies:** Low productivity growth (U.S., the Euro Area, and Japan), a failure to fully address crisis legacies and undertake structural reforms, and persistently low inflation (the Euro Area, and Japan) undermine medium-term growth in advanced economies.	High **Medium Term**	
Lower energy prices, driven by stronger-than-expected U.S. shale and/or recovery of oil production in the African continent.	Low **Short to Medium Term**	**Staff assessment: High** Worsening regional growth prospects will lower remittances and exports hampering Georgia's growth.
Cyber-attacks on interconnected financial systems and broader private and public institutions that trigger systemic financial instability or widely disrupt socio-economic activities.	Medium **Short to Medium Term**	**Staff assessment: Medium** Georgia has adopted cybersecurity legislation, but its effectivenes could prove challenging depending on the nature of the attack.
Georgia-Specific Shocks		
Financial risks. Reduced financial buffers, especially for unhedged borrowers, will limit the capacity to absorb further exchange rate depreciation. Risks could stem also from the non-banking sector.	Medium	**Staff assessment: High**
Fiscal risks. Materialization of contingent liabilities, together with possible off-balance sheet spending, could deteriorate public debt dynamics.	High	**Staff assessment: Medium**
Political risks. Political backlash or/and reform fatigue could undermine structural reforms.	Low	**Staff assessment: Medium**

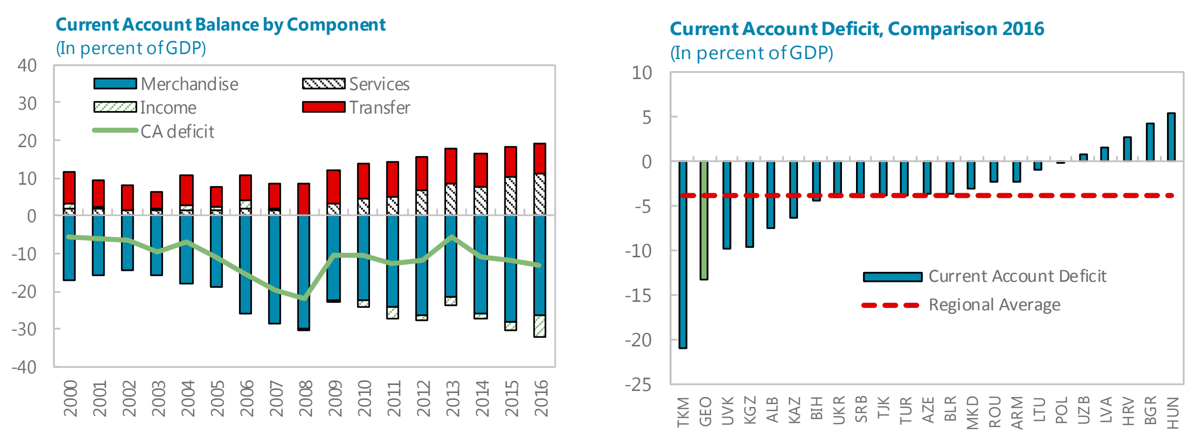
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex II. Georgia: External Sector Developments and Assessment[1]

Current Account Developments

1. **Despite an improvement in 2017, Georgia's external position has been weak, driven by large trade deficits, worsening income account, and small transfer balances (Figure 1.)** Except for 2013, Georgia's current account deficit has been in double digits since 2005, and the second highest in 2016, compared to its peers. Trade deficits are largely contributed to the CA deficit, averaging around 25 percent of GDP since 2005, due to a narrow export base and high import dependence. The income account has worsened over time, and deteriorated to -5.8 percent of GDP in 2016 due to exceptionally high profit repatriation. Finally, the transfer surplus, as a percent of GDP, has declined in recent years. For 2017, the latest data suggests an improvement in the current account balance, supported by significant growth in exports of goods and services especially in the tourism sector while imports were subdued. Continued repatriation of profit has led to slight deterioration of the income account.

Annex Figure 1. Georgia: Current Account Developments



Sources: National Bank of Georgia; and World Economic Outlook.

2. **Large trade deficits during 2013-16 were driven by both weak exports and high imports (Figure 2).** During 2013-16, the exports-to-GDP ratio declined by 6 percentage point of GDP, to 20 percent of GDP in 2016. Weak export performance is caused by both external and domestic factors. These include low export prices, weak economic growth in the main trading partners, and a limited export base. During the same period, while low international fuel prices contributed to the saving of about 0.5 percent of GDP per year, Georgia's imports had been persistently high, averaging almost 50 percent of GDP.

- **Weak economic growth in main trading partners explained weak export performances though it has recovered in 2017.** During 2013-16, low commodity prices adversely affected Russia

[1] Prepared by N. Suphaphiphat (SPR).

and CCA's economies. European Union has not fully recovered. China rebalancing drove down metal exports. Finally, political difficulty and conflict have posed challenges for Turkey. In 2017, however, growth in the partner countries have recovered and consequently helped boosted Georgia's exports.

- **A narrow export base increases external vulnerabilities.** Exports are concentrated in a few products, making it vulnerable to external shocks. For example, new environmental restrictions of used cars imposed by Azerbaijan resulted in a decline of transport equipment exports to the country almost 4 times in 2016, compared to that of 2013.

3. Strong FDI inflows may partially explain high real import growth during 2013-16. A surge in FDI inflows may explain the increase in capital goods imports. Since 2013, FDI inflows more than doubled, to 11.5 percent of GDP in 2016. In 2017, imports have been subdued so far as FDI has slightly declined due to near completion of large energy projects.

4. Remittances have recovered but remained low in percent of GDP. Although recovered slightly in 2016, remittances during 2013-16 had been relatively low compared to the periods before 2013. This is because economic challenges from Russia and Greece – the major sources of remittances in Georgia.

5. Higher profit repatriation led to a worsening income account, particularly in 2016. In 2016, the income account declined from an average of -2 percent of GDP during 2013-15 to - 5.8 percent of GDP. The large decline is driven by higher profit repatriation especially from foreign direct investment.

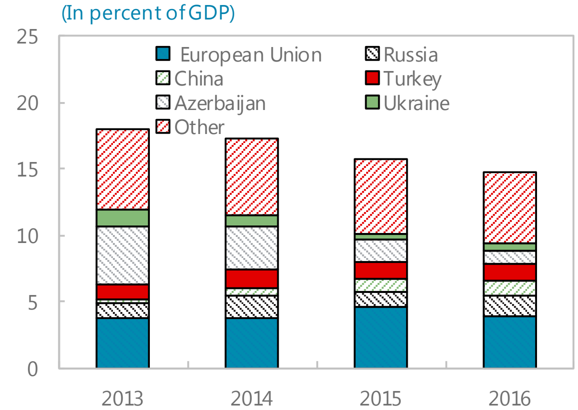
6. Service account, led by tourism, supported the CA balance. Service account had improved by more than 3 percentage point of GDP during 2013-16, owing largely to travel receipts which grew about 12 percent per year. Major tourists are from the CIS region, Turkey, as well as the Middle East, notably Iran. In 2017, tourism remains robust, with the estimated revenue growth of 30 percent in the first 8 months (y-o-y).

Savings, Investments, and IIP

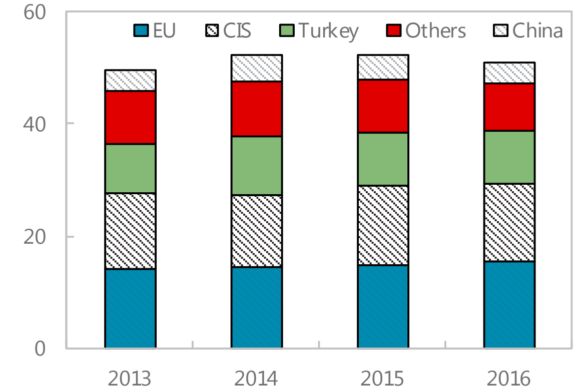
7. Georgia's current account deficit is driven by low domestic savings (Figure 4). During 2013-16, Georgia's investment had increased while gross national saving had remained flat. Compared to other countries in the CIS, Georgia's investment was relatively high while saving was slightly below regional average, warranting the need for reforms, including policies to develop a financial sector and pension reforms.

Annex Figure 2. Georgia: Merchandise Trade Developments

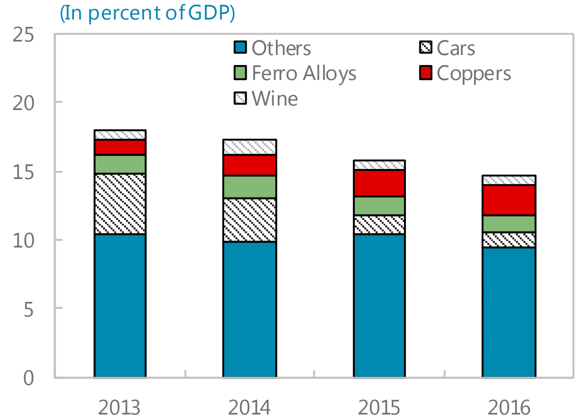
Georgia's Main Exports Markets, 2013-16
(In percent of GDP)



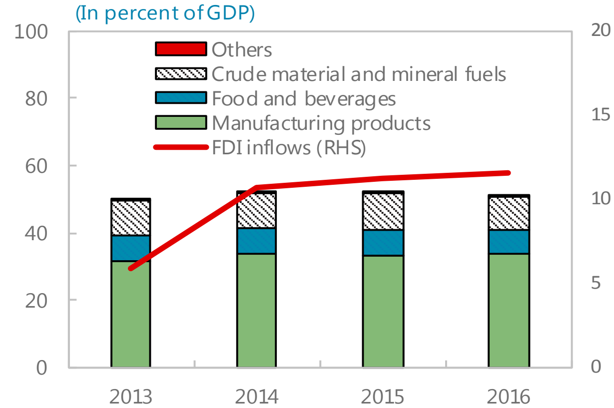
Georgia's Main Imports Markets, 2013-16
(In percent of GDP)



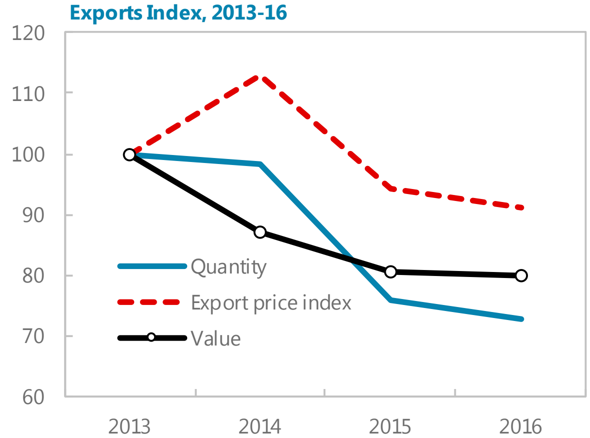
Georgia's Main Exports, 2013-16
(In percent of GDP)



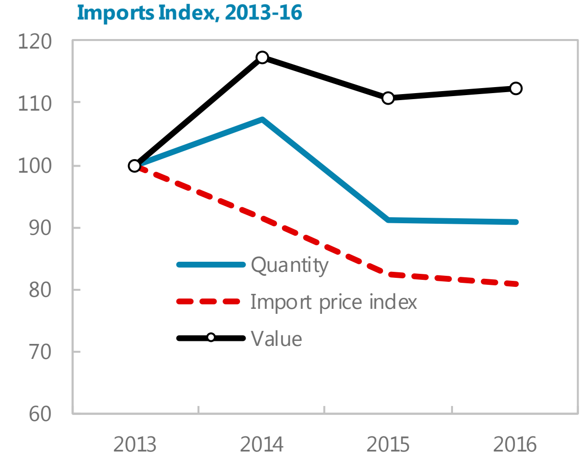
Imports by products and FDI inflows, 2013-16
(In percent of GDP)



Exports Index, 2013-16

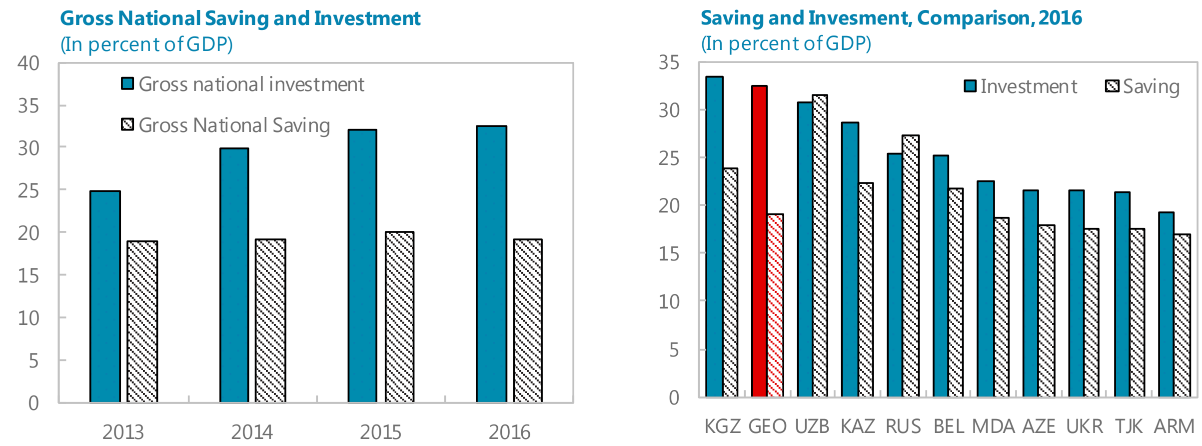


Imports Index, 2013-16



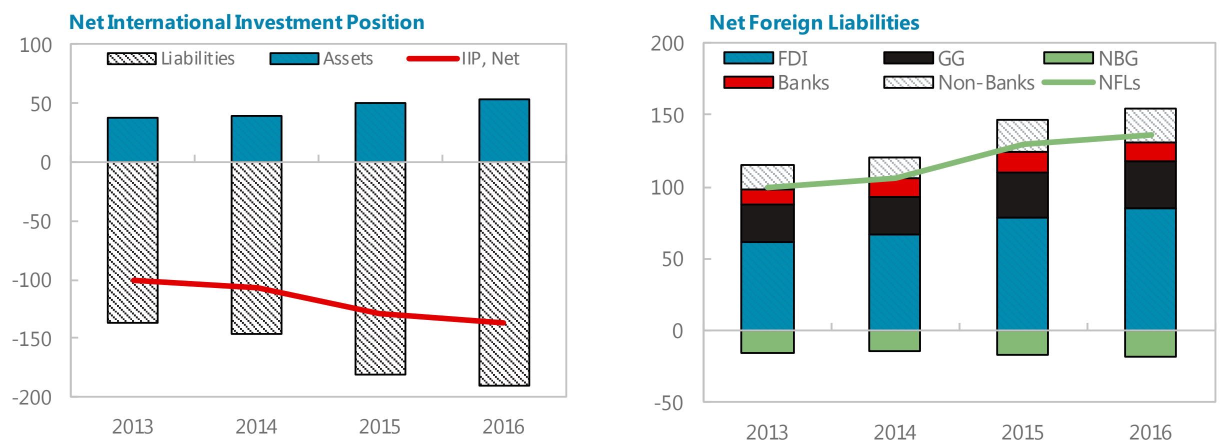
Source: Geostat.ge

Annex Figure 3. Georgia: Saving and Investment Developments



Sources: National Bank of Georgia; and World Economic Outlook.

Annex Figure 4. Georgia: International Investment Position
(In percent of GDP)



Sources: National Bank of Georgia.

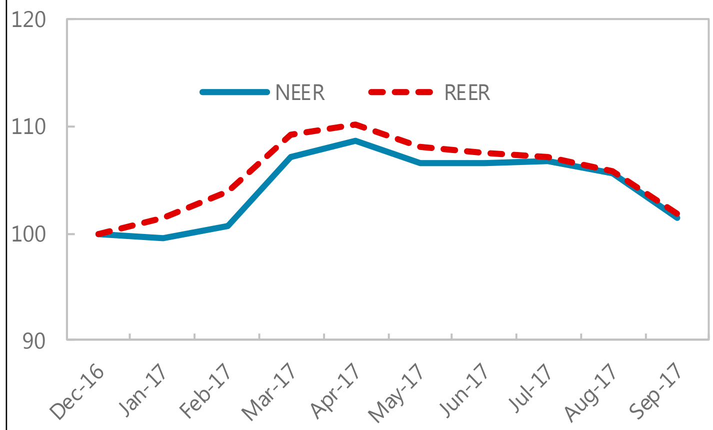
8. Current account deficits have resulted in a deteriorated IIP (Figure 4.) Net IIP reached 137.2 percent of GDP in 2016; driven by exchange rate depreciation. Foreign liabilities increased by 53 percentage point of GDP during 2013–16, to 190 percent of GDP in 2016. Half of the increase is explained by FDI, and the rest can be explained by non-bank and general government loans.

External Sector Assessment

9. Nominal and real effective exchange rates had been stablized (text table). Compared to end-2016, an improvement in the current account balance resulted in appreciation of NEER and REER but the trend has reversed since April and now stabilized around the same level as of end-2016.

10. Georgia's external position is moderately weaker than suggested by the fundamentals and desirable policy settings. The EBA-lite current account and external sustainability approaches suggest an REER overvaluation, while the real effective exchange rate (REER) model suggests no misalignment.

Nominal and Effective Exchange Rates 1/
(December 2016 = 100)



Source: National Bank of Georgia
1/ Decline means depreciation of the effective exchange rate.

11. The current account model suggests REER overvaluation of 5.1 percent (text table). The 2017 CA balance was projected at 10.4 percent. The EBA-lite CA norm (cyclically adjusted) is estimated at -8.5 percent of GDP, and thus suggests a CA gap of 2 percent below the norm, or equivalent to a 5.1 percent overvaluation. This gap mainly explained by residuals reflecting structural rigidities, among others, a still underdeveloped financial system that unable to deploy household savings efficiently and a weak education system. This highlights the importance of structural reforms implementation to enhance external competitiveness and raise net private savings. Over the medium term, planned fiscal consolidation and reserves accumulation should also help narrow the CA gap.

Georgia: External Balance Assessment, 2017
(In percent)

CA-Projected	-10.4
Cyclical Contributions (from model)	0.1
Additional temporary/statistical factors	0.0
Cyclically adjusted CA	-10.5
CA-Norm	-8.4
Additional adjustments to the norm	0.0
Cyclically adjusted CA Norm	-8.5
CA-Gap	-2.0
o/w Policy gap	1.5
Elasticity	-0.39
REER Gap	5.1

Source: IMF staff calculations.

- **The external sustainability approach suggests an overvaluation of 9 percent**. Based on the net IIP at 137.2 percent of GDP in 2016, the ES model suggested that to anchor the NIIP at -60 percent of GDP, a CA norm needs to be -5.5 percent of GDP. Hence, the REER is currently overvalued by 9 percent. Nonetheless, it should be noted that this estimate is very sensitive to the net foreign assets benchmark used.[2]

- **The REER approach suggested there is no external misalignment.** However, this approach is subject to considerable uncertainty due to data limitation on real interest rate.

12. Despite increasing, gross international reserves were assessed to be relatively low. Gross international reserves (GIR) increased by $245 million, to $2.8 billion in 2016. This was largely explained

[2] For example, anchoring the NIIP at -80 percent of GDP would result in a CA norm of -7 percent of GDP, or equivalent to a 5-percent overvaluation.

by an increase in minimum foreign reserve requirements in June 2016.[3] The GIR in 2016—at 87 percent of the Reserve Adequacy (ARA) metric—was assessed to be below adequate. Given that increasing GIR was mostly led by the increase in liabilities, net international reserves (NIR) declined by $40 million from 2015 to $1.3 billion in 2016. In 2017, an improvement in the current account balance led to further accumulation of GIR by $270 million to $3 billion as of September 2017, compared to end-2016. However, more reserves are needed to ensure an adequate buffer to external shocks.

13. National Bank of Georgia (NBG)'s foreign exchange intervention has been two-sided. NBG's intervention did not target a specific value of the exchange rate. However, to fulfil conditionality on the floor of NIR under the program—along with a recent appreciation of lari—the authorities have purchased the foreign exchange at the amount of $130 million as of end-September 2017.

[3] Minimum reserve requirements were raised from 15 percent to 20 percent for foreign-currency liabilities with maturity less than 1 year, and from 5 percent to 10 percent for the liabilities with maturity between 1–2 years.

Appendix I. Letter of Intent

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

Tbilisi, November 17, 2017

Dear Ms. Lagarde:

1. **We remain committed to the policies set forth in our original Letter of Intent and Memorandum of Economic and Financial Policies of March 27, 2017.** Our policy agenda is based upon the Government's Four Point Reform Plan, which focuses on the following strategic directions: (i) reforming education to promote adequate skills development, labor productivity and job creation; (ii) accelerating core infrastructure to leverage Georgia's strategic geographic location as a transit and tourism hub as well as improving connectivity between regions; (iii) improving the governance and efficiency of the government; and (iv) enhancing the role of the private sector as an engine for growth. The central bank's reforms plan aims at strengthening monetary policy and enhancing the supervisory and regulatory framework and financial safety nets. Together with this ambitious reform package, we are committed to preserve macroeconomic and financial stability, as pre-requisites for sustainable and more inclusive economic growth.

2. **The rebound of our economy offers a window of opportunity to decisively implement our reform program.** Annual growth through September averaged 4.7 percent, higher than the 3.5 percent expected for the whole year under the program. As anticipated, inflation has started to abate. The current account deficit has narrowed to 9.4 percent of GDP in 2017H1, from 12.8 percent of GDP in 2016, driven by strong growth in good exports, tourism and remittances. Amid a better economic performance, however, we acknowledge no time for complacency and remain fully committed to steadfast implementation of reforms.

3. **We have hitherto met all the conditionality under our IMF-supported program**. We have met all end-June quantitative performance criteria, and inflation has remained within the inflation bands proposed under the inflation consultation bands (ICC). Structural benchmarks for end-June and end-September have also been fully implemented.

4. **We request the completion of the First Review under the Extended Fund Facility and the release of the related purchase.** Given the performance under the program so far, and the policies described in the enclosed Memorandum of Economic and Financial Policies (MEFP), we intend to purchase a further SDR 30 million from the Fund, bringing our drawings under this program to SDR 60 million. Our program will continue to be monitored through quantitative performance criteria for

end-June and end-December test dates, a continuous performance criterion, an indicative target, and an inflation consultation clause. Consistent with our reform agenda, our program also envisages structural benchmarks. These are set out in Tables 1–3, and described with definitions in the attached Technical Memorandum of Understanding (TMU). Reviews will be conducted semi-annually. The Second Review will be based on end-December 2017 performance criteria and is expected to be completed on or after April 13, 2018. The Third Review will be based on end-June 2018 performance criteria and is expected to take place on or after October 26, 2018.

5. The attached MEFP, which updates and extends the previous one, will enable us to achieve the objectives of our economic program. We will monitor progress continuously in consultation with the IMF, and we stand ready to take further measures if needed to reach our objectives. We will continue to consult with the IMF on the adoption of measures, and in advance of any revisions to policies included in this Letter of Intent in accordance with the IMF's policies on such consultation. We will also provide the IMF with the information it requests for monitoring program implementation. We authorize the IMF to publish this Letter of Intent and its attachments (including the MEFP and TMU), as well as the related Staff Report. These documents will also be posted on the official websites of the Georgian government after the approval by the IMF Board.

Very truly yours,

/s/
Dimitri Kumsishvili
First Deputy Prime Minister and
Minister of Economy

/s/
Mamuka Bakhtadze
Minister of Finance

/s/
Koba Gvenetadze
Governor of the National Bank of Georgia

Attachments:
1. Memorandum of Economic and Financial Policies (MEFP)
2. Technical Memorandum of Understanding (TMU)

Attachment I. Memorandum of Economic and Financial Policies (MEFP)

1. This memorandum reports on recent economic developments and updates the economic and financial policy agenda of the National Bank of Georgia (NBG) and the Government of Georgia to address the Georgia's medium-term economic challenges.

Macroeconomic Framework

2. Our economy has performed well this year, supported by our prudent policies and a strengthening of economic activity in our main trading partners. Through September, real GDP has increased by 4.7 percent year-on-year (y-o-y), higher than the 3.5 percent expected for the whole year under the program. Goods exports, tourism receipts, and remittances (in lari terms) have increased almost 30 percent y-o-y. This has led to a significant improvement in our trade and current account balances. Inflation peaked in June at 7.1 percent y-o-y and has started to come down, remaining well within the program's consultation bands. A stronger-than-envisaged current account balance has allowed us the opportunity to boost our FX reserves, which have remained well above the program ceiling. Our larization policy has led to a decline in both deposit and loan dollarization. These positive economic developments and our commitment to continue prudent policies have resulted in an upgrade of Georgia's sovereign rating by Moody's. We are among the top 10 performers in the 2018 Doing Business Report, with improvements in getting electricity, protecting minority shareholders and resolving insolvency.

3. The vibrancy of economic activity and our commitment to steadfast implementation of our program call for positive revisions to our economic outlook.

- We expect economic growth to stay robust in 2018, higher than in our main trading partners, driven by higher investment, consumption and net exports. Because of important reforms, we believe that growth of over 4.5 percent is achievable in 2018. However, considering potential risks, including from the external environment, our program is purposefully based on a cautious growth assumption of 4.2 percent. Growth is projected to gradually accelerate over the medium term because of higher investment, structural reforms and an expected improved external environment.

- Stronger-than-expected economic activity has resulted in higher government revenues, which will allow for higher infrastructure spending and for rebuilding fiscal buffers faster than initially considered under the program (see below).

- Robust exports of goods and services and remittances will improve the current account deficit in 2017 by 2.4 percentage points of GDP compared to 2016. The current account deficit is projected at 10.4 percent of GDP in 2017 and 10.6 percent of GDP in 2018. External financing will continue to rely mostly on FDI. International reserves will continue to increase over the medium term.

4. Our program will improve external competitiveness. Ambitious structural reforms, together with the continued implementation of the EU-Georgia Association Agreement and free trade agreements with China and other countries, will support access to new markets and economic diversification. Improving further the business environment will help mobilize FDI in tradable sectors, improve competitiveness and reduce external vulnerabilities.

5. Risks to the outlook are balanced. Upside risks stem from stronger domestic demand and a more supportive external environment. Downside risks include inward-looking policies in some countries and weaker-than-expected growth in advanced and emerging economies. However, as a first line of defense against downside risks, we have a flexible exchange rate and a well-capitalized and liquid banking system. We stand ready to further adjust policies as necessary. The IMF arrangement would provide an additional anchor to help us cope with negative shocks.

Economic Policies

A. Fiscal Policy

6. Stronger-than-expected revenues will allow us to rebuild fiscal buffers faster than originally expected, while still providing fiscal space for capital investment. We will reduce the augmented cash deficit of the general government (TMU definition) to 2.8 percent of GDP by 2020. Rebuilding fiscal buffers will allow for some countercyclical policies in the future, if needed. We aim to reduce primary current spending (excluding budget lending activities) from almost 25 percent of GDP in 2016 to 21.1 percent of GDP by 2020. This will generate the fiscal space required to substantially scale-up public investment to address infrastructure bottlenecks. In consultation with the IMF, we are committed to use revenue over-performance or additional savings in current spending toward high priority growth-enhancing capital spending, and any under-execution in investment towards a lower deficit.

7. We are committed to keep the 2017 augmented fiscal deficit as planned. Our 2017 augmented deficit is projected at GEL1,328 million or 3.6 percent of GDP, below the program ceiling (GEL1,335 million, performance criterion). Measures envisaged under the 2017 budget (detailed in the previous MEFP) and stronger fiscal revenues helped keep the deficit below this ceiling. Through end-June, we met our augmented deficit ceiling by a wide margin, mostly due to higher revenues. Consistent with our commitment under the program, 75 percent of the revenue overperformance in 2017 will be used to increase public investment by 0.4 percent of GDP. The remaining revenue overperformance will be used to repay VAT claims. We will strive to keep primary current expenses below GEL8,685 million (indicative target), while increasing net acquisition of nonfinancial assets and net lending to GEL2,908 million (7.8 percent of GDP).

8. We will maintain fiscal consolidation efforts in 2018, while generating space for higher capital spending. Consistent with the Fund-supported program, the 2018 budget projects the augmented fiscal deficit at GEL1,206 million (3.0 percent of GDP) (structural benchmark, December 2017). We will continue to contain current primary spending (indicative target), by keeping them constant in real terms. However, social security expenses are expected to increase above inflation due to the upcoming pension reform. The budget includes a GEL200 million in repayment of value-added tax (VAT) credits, which will be subject to an adjustor under the program (see Technical Memorandum of Understanding (TMU, ¶14)). We stand ready to adopt contingency measures, if needed, to bring the augmented deficit below the 2018 program ceiling.

9. We aim to reduce fiscal risks.

- We will not (i) accumulate any general government's external debt payment arrears outside those under negotiation (performance criterion); (ii) accumulate net domestic expenditure arrears of the general government (indicative target); and (iii) issue new public guarantees (performance criterion), or comfort letters. Given that only the MoF is authorized to issue public guarantee, and that these are explicit in nature, we request the elimination of the reference to implicit guarantees in the ceiling on new public debt.

- The Partnership Fund (PF) will continue to pursue only commercial objectives (providing minority equity or loan co-financing), will not run a cash deficit (performance criterion), or issue any guarantees. In order to avoid reducing the balance sheet size of the PF when debt is repaid, we request that the ceiling on the PF's new borrowing be expressed in net rather than gross terms. The new net borrowing of the Partnership Fund will be limited to $20 million in 2017 (performance criterion). We remain committed to maintain a non-negative cash position at the Partnership Fund by end-June 2018 and will limit its net borrowing to $20 million by June 2018 (cumulative from the beginning of the EFF program, performance criterion).

- We will refrain from initiating any Public-Private Partnerships (PPPs), including Power-Purchasing Agreements (PPAs), until the PPP law and institutional framework is operationalized. We are committed to reassess and implement, if needed, additional fiscal adjustment based on our fiscal risk profile.

- Taking into consideration existing fall-winter period power deficit, and except for the PPAs described in the next bullet, partial PPAs currently under negotiation will be permitted to proceed (prior to the new PPP law) only under the following terms:

- The guaranteed purchase period shall not be more than 8 months in each year;

- The guaranteed purchase tariff shall not be more than US 6c kWh; and

- The cumulative installed capacity of these projects under negotiations will not exceed MW500.

- Additionally, we have two PPAs under negotiation (the Namakhavani HPP Cascade Project and Koromkheti Hydro Project) —with cumulative capacity of MW600—outside of the terms mentioned above. These projects will only be allowed to proceed under the following conditions:

- The government will not sign these projects before having conducted a thorough fiscal risk analysis for the projects itself and comprehensively for all fiscal risks, in consultation with the energy expert of the World Bank and the IMF.

- The risk assessment will update the analysis of gross exposure of all signed PPA projects and these two large projects; and analyze the net risk exposure with different demand, price and exchange rate assumptions. The scenario analysis will be defined in coordination with the IMF.
- For these two last projects, the risk assessment will describe and quantify other risk-sharing contractual obligations (including, for instance, termination risk or construction risk).
- We will limit the fiscal risks stemming from our proposed export credit agency (ECA). We will coordinate with the IMF on the preparation of the charter creating the ECA to ensure that the agency will (i) only provide guarantees and insurances related to export operations; (ii) be subject to insurance regulation and supervision; and (iii) not receive explicit government guarantees. ECA's capital will be constituted by a $20-million equity injection by the Partnership Fund distributed over 3 years. A revolving fund for potential losses, totaling GEL50 million, will come from the state budget.

10. We remain committed to increasing capital spending while achieving medium-term fiscal consolidation. Under our program, capital spending is expected to increase significantly over the coming years, especially investment in major road infrastructure projects financed by IFIs and bilateral donors. Such increase may result in deviations from the program due to the natural uncertainty related to project execution. We therefore request an increase in our adjustor related to foreign-financed project loan disbursements for the augmented cash deficit from $30 million to $60 million (0.4 percent of GDP, TMU, ¶13). We will continue rationalizing current spending, mostly based on improving the efficiency of the public administration including by (i) containing the wage bill and administrative expenses; (ii) improving the targeting of subsidies and of social assistance programs; (iii) reducing transfers and privatizing loss-making state-owned enterprises (SOEs); and (iv) improving performance-based budgeting. To support the vulnerable population, the existing social safety net will be maintained and the basic public pension will be increased (see below). In addition, we do not plan to extend the dividend distribution model to financial institutions and insurance companies in 2019, which would limit the revenue loss (up to 0.5 percent of GDP). To achieve our deficit target, we will identify additional contingency measures, if needed, in coordination with the IMF, including on the revenue side within the scope of our fiscal framework.

B. Structural Fiscal Policies

11. We will strengthen our revenue administration to secure full and equitable compliance by all taxpayers and improve taxpayer services. Following the 2016 Tax Administration Diagnostic Assessment, we will enhance the efficiency of revenue administration. The plan, to be implemented under a 3-year program, includes revising the organizational structure of Georgia's Revenue Services (GRS), improving risk and compliance management, and improving automatic tax refunds and the taxpayer register. We will initially focus on the following steps:

- **Organizational structure.** We will restructure the GRS headquarters into a function-based organization to modernize tax administration (new structural benchmark, February 2018). For this, the GRS will structure its work in logical groupings of core functions – such as taxpayer service, returns filing and payment, audit, appeals, arrears management, policy and interpretations and compliance management. This structure relies on a strong headquarters (HQ) department providing operational policy and ensuring consistency.

- **Improve filing compliance.** In consultation with the IMF, we have established key performance indicators to help improve filing compliance, especially to provide for early and effective action where returns are overdue. Initially developed for VAT, the program could expand to all tax categories. The GRS will also improve the taxpayer register, and submit legal amendments so that an unfiled declaration is no longer deemed to be a nil declaration where the GRS requires a declaration, and set up an organizational unit that deals with filing default and late filing.

- **VAT refunds.** We are committed to expand a risk-based automated system to check VAT refund claims by September 2018, replacing the resource-intensive manual system currently in place. This will improve efficiency and allow resources to be directed towards auditing. With IMF TA support, we approved an action plan to address outstanding VAT claims in an orderly manner over time (including analysis, refund, set-offs, and write-offs as appropriate) (structural benchmark, September 2017). We will create a steering committee with representatives from the MoF, GRS, and GTS by end-2017. The committee will propose any necessary legal amendments or ministerial decrees to facilitate the implementation of the plan (new structural benchmark: The steering committee will propose any necessary legal amendments or ministerial decrees to facilitate the implementation of the action plan to address outstanding VAT claims, March 2018). A new specialized VAT unit in the GRS will focus on validating VAT claims (new structural benchmark: create a new specialized VAT unit focusing on validating VAT claims, June 2018).

- **Tax Audits.** We have received IMF TA on enhancing compliance risk analysis and improving data management for new risk models. We are committed to increase audit capacity, efficiency, and impact on compliance. To that end, we plan to use risk-based audits to identify non-compliant cases that are likely to produce higher yields. We will better manage the audit scope and develop audit plans to give a balanced coverage of tax categories. We will introduce an audit case management system to enhance audit timeliness and productivity, and implement a systematic approach to terminate non-productive audits.

12. We are reforming the civil service to contain costs, increase efficiency, and improve the link between performance and pay. A new Civil Service Law introduced grade structures. We submitted to Parliament a civil service remuneration law (structural benchmark, December 2017). This law will set salary ceilings for different grades of civil service (compensation grid) and consolidate current bonuses and supplements into the base salary structure. These ceilings and provisions will ensure that our wage bill will be consistent with the projected medium-term wage bill under the program.

13. We are committed to contain fiscal risks to safeguard fiscal sustainability. We understand that key sources of fiscal risk in Georgia, in addition to those associated with macroeconomic risks, could arise from state-owned enterprises (SOEs) and PPPs, including PPAs in the energy sector. At the same time, we recognize that PPPs and PPAs can play a pivotal role in Georgia's development by attracting investment, including FDI. In this vein, improvements in the relevant legislation are required to reap the benefits of further PPPs and PPAs.

Hence, we are committed to:

- **Adopt a new PPP law and associated regulations**, with assistance from the World Bank (WB) the Asian Development Bank (ADB), the EBRD, and the IMF. We are committed to ensure that the law will include sound elements following best international practice: (i) a wide institutional and sectoral coverage of PPPs (including PPAs in the energy sector) and a clear definition focused on optimal risk sharing; (ii) a strong integration of PPP projects with the overall investment strategy and budget cycle; (iii) a strong role for the MoF in the approval process (using cost-benefit and VfM analysis), checking budget affordability, and assessing fiscal risks (Fiscal Risk Management Unit); (iv) transparent and competitive procurement processes (e.g. restricting narrowly direct agreements); and (v) providing for transparent reporting, accounting, and auditing of all PPP arrangements, including a ceiling on government exposure from such partnerships. We have submitted the PPP Law to Parliament (structural benchmark, December 2017). The law calls for the establishment of a ceiling on PPP and PPA obligations to be included in the budget law; and we will set up a PPP unit at the Prime Minister office to provide technical support. We will consult with the IMF on secondary legislations that we plan to develop by March 2018.

- **Widening the coverage of fiscal risks in the Fiscal Risk Statement (FRS) accompanying the 2018 budget.** Our 2017 FRS reported on PPA and SOE liabilities. In the 2018 Budget, the FRS will report more comprehensively all existing PPP-associated firm and contingent liabilities; include a quantitative reporting of quasi-fiscal relationships; and expand the analysis of SOE's contingent liabilities (structural benchmark, December 2017). Specifically, we will (i) expand the historical analysis of SOEs' contingent liabilities by up to five years; (ii) describe historical trends of the size of the SOE sector relative to the economy; (iii) have conclusive analysis of the factors driving the SOEs' aggregate and individual financial performance and position; (iv) identify and evaluate quasi-fiscal relationships; (v) develop the methodology for sensitivity analysis and stress tests examining the impact of changes in key variables on SOE's financial performance and fiscal risks.

- **Improve the Public Investment Management Framework (PIMF).** We will strengthen MoF's role in public investment management. To this end, we have created a dedicated public investment unit at the MoF, where information on public investment projects will be centralized. This unit will evaluate investment projects based on cost/benefit analysis and other relevant analyses. This will help establish a single project pipeline, support adequate project evaluations, help prioritize investments and identify their financing, and integrate them within the multi-annual budget process. The PIMF will cover PPP-type projects to ensure they are prioritized and assessed alongside traditionally-procured projects. We have requested IMF TA to conduct a Public Investment Management Assessment to help strengthen our PIMF.

14. We believe that accurate and transparent public financial management is a cornerstone of fiscal stability. Accordingly, we are committed to:

- **Improve our fiscal rule to safeguard fiscal sustainability.** With IMF support, we have initiated a review of our fiscal framework, including our fiscal rules, with the aim of ensuring that they support our medium-term fiscal objectives toward sustainability while also granting flexibility in formulating fiscal policy over the economic cycle. We will explore, in consultation with the IMF, enhancements to our fiscal framework, including improving corrective mechanisms, escape clauses, accountability and transparency. Within the context of reviewing the fiscal rule, we will upgrade the presentation of public finances from GFSM 2001 to GFSM 2014 classification.

- **Issue guidelines for new budget lending operations,** requiring reasonable expectation of repayment (structural benchmark, December 2017). We will prepare the 2019 State Budget applying the GFS classification of equity injections and on-lending, per the reasonable commercial return test and, if not met, these will be treated as subsidies or transfers.

- **Comply with international accounting standards**. In our efforts to improve fiscal transparency, we will produce an annual consolidated general government sector financial report on an International Public Sector Accounting Standards (IPSAS) basis starting in 2021.

- **Improve the quality of fiscal reports.** We will explain revisions to the medium-term budget estimates in the annual budget document. We will also include LEPLs' revenues and expenditures in the budget documentation starting in the 2018 state budget. To expand the institutional coverage of fiscal reports, we will assess existing LEPLs by end-2018 and create rules for classifying them as general government units or non-general government units, based on international statistical standards.

- **Improve our treasury account management**. To this end, the MoF has started auctioning its deposits to the banking sector.

C. Monetary Policy

15. We are committed to our inflation targeting (IT) framework to maintain price stability. We lowered our inflation target to 4 percent in 2017 and 3 percent from 2018 onwards. While inflation has been above the target during 2017 due to a one-off price increase resulting from higher excises and import prices, we project inflation to return to the target in 2018. We will continue to abide by the Inflation Consultation Clause (ICC) under the program. As such, inflation developments will be monitored via dual consultation bands set symmetrically around the central point for headline CPI (Table 1). Should actual inflation be higher or lower than the inner consultation band of ± 2 percent, the NBG will consult with IMF staff on the reasons for the deviation and the policies to return to target. Should actual inflation be higher or lower than the outer consultation band of ± 3 percent, a consultation with the IMF Board will be triggered.

16. We will maintain a flexible exchange rate regime to protect the economy against external shocks. Foreign exchange interventions will be limited to smoothing excessive exchange rate volatility. While the current level of gross international reserves is still below the level recommended by the IMF-composite metric (ARA), we will buildup international reserves throughout the program, which will be monitored by a floor on net international reserves (performance criterion). Positive external developments earlier this year allowed us to accumulate more reserves than envisaged under the end-June program floor. This has enabled us to strengthen our external buffers and we therefore increase the end-December 2017 NIR performance criterion by $40 million to $1,390 million.

17. We will continue strengthening the monetary policy transmission mechanism. We have made progress in implementing our larization plan (see below). We have improved our lari liquidity facilities and monetary instruments by introducing a one-month liquidity instrument and broadening the eligible collateral pool. This will help provide confidence in NBG's liquidity management, facilitating maturity transformation in the banking sector. The interbank market is working well, and interbank interest rates are close to the policy rate. Since August 2017, we have narrowed the interest rate corridor, which will reduce the volatility of interbank interest rates. We signed a memorandum of understanding on information sharing for liquidity forecasting purposes between the MoF and the NBG (structural benchmark, June 2017). We will also submit to Parliament legal amendments to allow for derivatives and repo transactions, including netting and close-out netting provisions by March-2018. We plan to strengthen lari liquidity management by extending open market operations to outright sales and purchases of treasury securities by mid-2018.

18. Monetary policy will be enhanced by improving our communication. We will continue publishing our quarterly monetary policy reports on a fixed pre-announced schedule in par with associated meeting with experts. Every second monetary-policy meeting will also continue to be followed by a press conference. While being at the frontier of monetary policy making among emerging market economies, by introducing forward guidance, we will further strengthen our communications by issuing a manual for monetary policy operations with the help of IMF TA.

D. Financial Sector Policy

19. Our policies will strengthen financial sector stability. This will support the banking sector's ability to cope with shocks and improve financial intermediation. We will (i) further strengthen the supervisory and regulatory framework; (ii) improve the safety nets and the bank resolution framework, enhancing our crisis preparedness; (iii) step-up efforts to incentivize the use of the domestic currency, aiming at reducing dollarization in the economy; and (iv) develop capital market and implement pension reform.

20. We have made progress on strengthening financial regulation and supervision.

- We introduced (i) liquidity coverage ratios (LCRs) for commercial banks, with preferential treatment for GEL deposits (structural benchmark, September 2017); and (ii) limits on loan-to-value and debt-service capacity ratios, with a preferential treatment for local currency. We also submitted to Parliament legal amendments giving to the NBG oversight power for credit information bureaus (structural benchmark, December 2017);

- We adopted regulations to increase the minimum regulatory capital for commercial banks to GEL 50 million to be phased in by 2019 (structural benchmark, June 2017) and introduced Basel's Pillar 3 disclosure requirements seeking to promote market discipline through regulatory disclosure requirements.

- We have submitted to Parliament amendments to the NBG Organic Law to allow NBG's supervision of banking groups. This will allow the NBG to set requirements on an individual as well as consolidated basis on (i) minimum capital and liquidity; (ii) leverage ratios; (iii) corporate governance; and (iv) disclosure, accounting, and reporting. Furthermore, the NBG and the State Insurance

Supervision Agency are working together on developing a supervision framework for financial conglomerates.

- We established a financial stability analysis department at the NBG. The main responsibilities of this department are: (i) macro-financial analyses, including macro-stress testing and analytical support for macro-prudential policy; (ii) work on the publication of our forthcoming financial stability report with forward-looking analysis; and (iii) support implementing new IFRS9 standards by the financial sector. With IMF TA support, we started calibrating a macro-financial model tailored to the Georgian economy, to help analyze policy trade-offs.

- We are making progress toward implementing IFRS-reporting standards. By March 2018, we plan to introduce impairment guidelines to help the financial sector to establish proper credit loss calculation system following IFRS 9. A roadmap to transition to IFRS regulatory reporting will be prepared by June 2018. Ultimately, NBG aims to transfer regulatory reporting in commercial banks to IFRS framework through EU FINREP/COREP forms.

21. We will continue strengthening financial regulation and supervision. Our banking system has remained resilient after the 2014 external shocks due, in large part, to good regulation and supervision by the NBG.

- In line with FSAP recommendations, we will issue regulations to phase-in additional capital requirements for systematically important banks (structural benchmark, December 2017). In close consultation with the banking sector, we have significantly overhauled the overall capital adequacy framework, including Pillar II. To facilitate a smoother transition, we consider it appropriate to extend the phase-in period from 2020 to 2022. Banks' existing high capitalization and solid profitability further supports this decision.

- We are making progress towards the implementation of the Pillar II of Basel III regulation. To increase transparency of Pillar 2 capital requirements, we are working on General Risk Assessment Program (GRAPE) guidelines, describing the general principles of risk-based supervision and the rationale behind capital add-ons. We expect to publish these guidelines by December 2017.

- We will introduce regulations on (i) leverage ratios based on Basel Principles and relevant EU regulations (new structural benchmark, September 2018); (ii) credit information bureaus with the support of WB TA – set requirements and limits, issue guidelines and apply fines, protect consumers and limit business-continuity risks– following parliamentary approval of NBG's powers to regulate credit information bureaus; (iii) bank's real estate appraisal of collateral in line with International Valuation Standards (new structural benchmark, June 2018) and (iv) corporate governance guidelines in line with Basel Principles (new structural benchmark, September 2018).

- With the help of IMF TA, we will enhance regulation, supervision and oversight of non-banks. Ultimately, all non-bank lending institutions will be brought under prudential regulation or non-prudential oversight depending of the source of their funding. We have already submitted to the Parliament a package of legislative amendments which will empower NBG to ultimately supervise and regulate micro-financial institutions (MFIs). NBG has also initiated legislative amendments to oversee currently unregulated lenders, focusing on consumer protection rights in the financial sector. We expect these changes to be approved by Parliament by the end of 2017. This will allow regulations regarding MFIs and other lenders to be introduced by end-June 2018 and end-September 2018, respectively.

- To improve consumer protection in the financial sector, we have created a consumer protection and financial literacy department within the NBG, and amended regulations on product disclosure requirements and effective interest rates calculations. The framework was substantially strengthened by extending the regulatory perimeter to micro finance institutions and credit unions.

22. While the banking sector is healthy, we are strengthening financial safety nets.

- Consistent with FSAP recommendations, we have submitted amendments to the NBG Organic Law that gives NBG the authority to resolve a bank through a temporary administration at an early stage, facilitating the application of resolution tools and reinforcing safeguards in the resolution process (structural benchmark, September 2017).

- With the support of the World Bank and ADB, we submitted to Parliament a law to introduce deposit insurance (structural benchmark, June 2017). The Deposit Insurance Agency was established in July 2017 and is expected to become operational on January 1, 2018. By June 2018, we will approve a medium-term strategy for the deposit insurance system.

- Consistent with the FSAP recommendations, we will request the largest banks to strengthen recovery plans based on Financial Stability Board's principles. We will also strengthen the bank resolution framework in line with best international practices. This will include revising the NBG law to state clearly NBG's resolution authority, including the set-up and control of bridge banks, and override shareholders' economic interests.

- We will strengthen our capacity to act as lender of last resort by identifying required legal amendments to remove the possibility to give unsecured lending, mandate a penalty rate for emergency liquidity assistance (ELA), and clarify the role of the Ministry of Finance to ensure an effective ELA framework, following international best practices.

23. We will continue to implement our larization strategy to reduce foreign-exchange risks and improve monetary policy transmission mechanisms. We adopted a comprehensive plan consisting of measures to (i) increase long-term lari funding; (ii) reduce foreign-exchange credit risks; and (iii) promote pricing in lari. The mortgage conversion program, which provided incentives for shifting towards lari-denominated currency, resulted in conversion of mortgages amounting to $80 million. Since July 2017, prices must be displayed in lari.

24. Capital market development will support larization while reducing external vulnerabilities. The non-banking financial system is shallow in Georgia, limiting competition for savings and their efficient use within the economy.

- We will upgrade our exchange infrastructure by having a single settlement system for all Georgian securities with two participating central security depositories (CSDs), one for commercial bonds and shares, and another one for government bonds. The new system will allow for delivery-versuspayments settlements for all securities and full integration with the Georgian Stock Exchange and OTC trading platforms. We expect the system to be fully operational by the summer of 2018.

- In consultation with IMF TA, we submitted to Parliament amendments to the tax code to help the development of local capital markets. This will ensure taxation of financial instruments including securities interest, dividend and capital gains, REPOs, securities lending and derivatives, in line with international best practices.

- To facilitate price discovery for private-sector bonds, in addition to our current publication of a quarterly calendar, we will publish a multi-year plan of government bond issuance to develop benchmarks along the yield curve (structural benchmark, December 2017).

- A law establishing investment funds will be submitted to Parliament in early 2018. We will also help develop a primary dealer institute and introduce mandatory third-party vehicle insurance to help develop the insurance sector. We will continue to align the legal framework with EU directives, including on securities holding, insolvency and securities market.

E. Structural Reforms

25. Achieving more robust and inclusive growth will require implementing a comprehensive structural reform agenda. We are counting on our partners to support our reform program, including the World Bank (WB), the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the European Commission. Our reforms aim at scaling-up infrastructure spending, and improving education and vocational training, the business environment, foreign trade relations, and land reform. We firmly believe that our reform program will boost long-term growth, diversify the economy, strengthen our external position, created jobs and reduce poverty. At the same time, targeted social assistance and health care will continue protect the most vulnerable.

26. Scaling-up infrastructure and spatial planning is key to Georgia's development. With our international partners, we aim to finalize the East-West highway and the South-North corridor by 2020. Additional infrastructure projects, including ports, airports, and railways, will transform Georgia into a transport and logistics hub connecting Europe with Asia. We are also developing radial roads to better connect regions and urban and rural areas. To improve public investment efficiency and transparency, we have brought our public procurement process closer to international standards. Combined with the government's support for tourism development (including water and electricity infrastructure), Georgia will turn into a four-season touristic destination.

27. Job creation is a central element of our economic policies. Our planned education reform, including vocational training, is crucial to improve job creation, productivity and wages. The lack of qualified labor force is repeatedly reported as one of the most problematic factors for doing business in Georgia. At the same time, unemployment and underemployment remains high. This suggests that the skills of our labor force are not well aligned with employers' demands. In line with our Four-Point Plan, we are committed to reforming the education system by, among other things, setting curriculum standards and a new teacher policy framework, and introducing vocational training and adult learning. We will encourage the participation of employers in the design of curriculum to better prepare the young for labor market demands. Finally, we will support job seekers with guidance on job selection, preparation and retraining.

28. We are committed to introducing a funded pension pillar in 2018, which will promote savings and create an institutional investor for long-term lari assets. With the assistance of the World Bank and the Asian Development Bank, we will submit a pension law to Parliament establishing a Pilar II pension system (structural benchmark, December 2017), to be followed by the creation of an independent pension agency (new structural benchmark, June 2018). In parallel, we are committed to develop a private pension savings system (Pillar 3) in 2018. Our basic public pension, amounts to GEL180 per month, is marginally higher than the subsistence minimum. Hence, we are committed to increase the basic monthly pension to GEL200 and GEL220 per month in 2019 and 2020, respectively. Further increases will be followed by the indexation rule envisaged in our pension reform.

29. We will continue improving the business environment. We have improved the tax system, our tax dispute resolution mechanism and the taxation environment, to promote savings and investments. Bank accounts of taxpayers are no longer garnished without a court ruling and the tax audit timeframe is regulated. We will establish a Business House by 2019 to provide public services to enterprises under a one-stop shop. We also plan to introduce IFRS for corporations and to submit to Parliament a new insolvency law to support an adequate restructuring for viable non-financial corporations. In addition, we will widely apply regulatory impact assessments on businesses to analyze the possible impact of major policy decisions and protect them from undue costs.

30. Land registration will be pivotal for rural and agricultural development. Land cadasters are important to protect property rights, simplify land transactions and provide collateral for borrowing. We have simplified land registration, especially for agricultural land plots, through a fee waiver program. We will assist citizens in searching for property ownership documents and facilitate dispute resolution through mediation. Since the launch of the project, the number of citizens' applications has increased by 57 percent.

31. Deepening trade relations with the rest of the world is one of Georgia's key priorities. As a small open economy, free trade agreements (FTAs) will help Georgia mobilize FDI in tradable sectors to improve competitiveness, reduce external vulnerabilities, and generate balanced growth. In addition to the Deep and Comprehensive Free Trade Area (DCFTA) with the EU, Georgia signed a FTA with the European Free Trade Association (EFTA) in June, 2016. A FTA with the People's Republic of China will become effective in early 2018. FTA negotiations were concluded with Hong Kong Special Administrative Region and an agreement is expected to be signed in the first half of 2018. At the same time, we are negotiating with Turkey aiming at expanding the current FTA. We remain committed to pursue other FTAs with priority countries, including the United States and India.

32. We are committed to strengthening our statistics as they serve as a precondition for strong economic policy-making. We are grateful for the technical assistance provided by the IMF in the areas of national accounts external sector statistics and financial and sectoral accounts. Unfortunately, due to technical issues related to the new census, we have not been able to start publishing quarterly unemployment figures in May 2017, but we will do so by September 2018. We will also broaden the coverage of employment statistics by publishing hours worked. In 2018, we will conduct an earnings survey to have a detailed view of the population's living standards. In the first half of 2018 we will complete back-calculations for population figures to reconcile the differences between the 2014 and the 2002 census results. We will also start publishing national accounts based on the NACE 2 sectoral classification by November 2019. Along with the migration to NACE 2 classification, we will compute GDP-based on supply and use tables (capitalizing on the TA provided by the IMF) and publish quarterly GDP by expenditure in constant prices. This will provide a more detailed picture of the structural transformations in our economy.

F. Program Monitoring and Safeguards

33. The program will be monitored through quantitative performance criteria, indicative targets, an inflation consultation clause and structural benchmarks. Semi-annual program reviews will be based on December and June test dates. All quantitative performance criteria and indicative targets are listed in Table 2, and structural benchmarks are set out in Table 3. The Technical Memorandum of Understanding is also attached to describe the definitions of quantitative PCs and the inflation consultation clause as well as data provision requirements.

34. The NBG continues to maintain a strong safeguards framework and internal controls environment. Since the last assessment and in line with IMF recommendations, we have submitted to Parliament amendments to the NBG Organic Law on (i) Audit Committee's definition and mandate; (ii) specifying the Chief Internal Auditor eligibility criteria and grounds for dismissal and (iii) early appointment of external auditor for NBG. As required by the safeguards policy, we will continue to engage independent external audit firms to conduct the audit of the NBG in accordance with international standards.

Table 1. Georgia: Inflation Consultation Targets and Bands for 2017–18

	2017			2018	
	End June	Outturn	End Dec.	End June	End Dec.
Inflation Consultation Bands for CPI (in percent)					
Central point	6	7.1	5	3	3
Inner band, upper limit/lower limit	8/4	…	7/3	5/1	5/1
Outer band, upper limit/lower limit	9/3	…	8/2	6/0	6/0

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets for 2017 and end-June 2018

(Unless otherwise indicated: cumulative from the beginning of the calendar year, millions of GEL)

	2017				2017	2018
	End-June Target	Adjusted Target	Outturn	End-Dec.	Proposed revised End-Dec targets	End June
Performance Criteria						
Ceiling on augmented General Government deficit (in mn lari, cash basis)	330	359	102	1,335	1,335	430
In Percent of GDP	*0.9*	*1.0*	*0.3*	*3.7*	*3.7*	*0.7*
Floor on NIR of NBG[1] (End-period stock, in mn US$)	1,210	1,247	1,366	1,350	1,390	1,450
Ceiling on the accumulation of external debt arrears of the Public Sector (continuous criterion) (in mn US$)	0	…	0	0	0	0
Ceiling on new public guarantees (continuous criterion) (in mn lari)	0	…	0	0	0	0
Ceiling on the cash deficit of the Partnership Fund (in mn lari)	0	…	0	0	0	0
Ceiling on the new net borrowing of the Partnership Fund (in mn US$, cumulative from the beginning of the EFF program)	20	…	0	20	20	20
Indicative Targets						
Ceiling on the accumulation of net domestic expenditure arrears of the General Government (in mn lari)	0	…	0	0	0	0
Ceiling on Primary Current Expenditures of the General Government (in mn lari)	…	…	…	8,685	8,685	4,675

[1] The NIR target is set at a program rate defined as the exchange rate on December 31, 2016, which for the GEL/US$ was 2.6468.

Table 3. Georgia: Structural Benchmarks

Measure	Date	Status
Financial Sector		
Financial Stability		
Introduction of LCR for commercial banks, with preferential treatment of GEL-deposits (MEFP ¶19)	End-September 2017	Met
Adoption of regulation on capital add-ons in CAR for systemically important banks, (MEFP ¶20)	End-December 2017	In progress
Submit to Parliament legislation giving NBG oversight power over credit information bureaus, (MEFP ¶19)	End-December 2017	Met
Increase in minimum regulatory capital for commercial banks to GEL50 million, phased in by 2019 (MEFP ¶19)	End-June 2017	Met
Capital Markets Development		
Publication of a multi-year calendar for government benchmark bonds (MEFP ¶23)	End-December 2017	In progress
Monetary policy operations and communication		
Signing of a Memorandum of Understanding between the Ministry of Finance and the NBG on information sharing for liquidity forecasting purposes (MEFP ¶16)	End-June 2017	Met
Deposit insurance		
Submission to Parliament legislation establishing deposit insurance as of January 1, 2018 (MEFP ¶21)	End-June 2017	Met
Bank Resolution Framework		
Submit to Parliament amendments to NBG Law that will give it the authority to resolve a bank through a temporary administration at an early stage of a bank's financial difficulty, in line with good international practices as identified in the 2014 FSAP recommendations (MEFP ¶21)	End-September 2017	Met
Fiscal		
Submission to Parliament a 2018 budget consistent with the fiscal deficit in the Fund-supported program (MEFP ¶7)	End-December 2017	In progress
Adopt a remuneration law for public civil service (MEFP ¶11)	End-December 2017	In progress (expected Fall 2017)
Action plan to address accumulated outstanding VAT refunds in an orderly manner over time (including analysis, refund, set-offs, and write-offs) (MEFP ¶10)	End-September 2017	In progress
Public-Private Partnership and Fiscal Risk		
Submission of a public-private partnership law to Parliament, establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships (MEFP ¶12)	End-December 2017	In progress (expected Fall 2017)
Include all PPP and PPA liabilities, and expand the analysis of contingent liabilities from state-owned enterprises, reporting quasi-fiscal activity in the 2018 Annual Fiscal Risk Statement (MEFP ¶12)	End-December 2017	In progress
Public Financial Management		
Issue guidelines for new budget lending operations requiring reasonable expectation of commercial returns (MEFP ¶13)	End-December 2017	In progress
Pension Reform		
Submission of a pension law establishing a 2nd pillar pension system, and introducing indexation of basic public pensions (MEFP ¶27)	End-December 2017	In progress

Table 3. Georgia: Structural Benchmarks (concluded)

Measure	Date
Restructure the GRS headquarters into a function-based organization (MEFP ¶11).	Feb-18
The steering committee will propose any necessary legal amendments or ministerial decrees to facilitate the implementation of the action plan to address outstanding VAT claims (MEFP ¶11).	Mar-18
Create a new specialized VAT unit focusing on validating VAT claims (MEFP ¶11).	Jun-18
Introduce regulation on bank's real estate appraisal in line with International Valuation Standards (MEFP ¶21).	Jun-18
Establishing an independent pension agency (MEFP ¶28).	Jun-18
Introduce regulation on leverage ratio based on Basel Principles and relevant EU regulation (MEFP ¶21).	Sep-18
Introduce regulation on banks corporate governance in line with Basel Principles (MEFP ¶21).	Sep-18

Attachment II. Technical Memorandum of Understanding (TMU)

1. This Technical Memorandum of Understanding (TMU) defines the variables subject to quantitative targets (performance criteria, inflation consultation mechanism and indicative targets) and describes the reporting requirements used to monitor developments under the Extended Fund Facility and methods to be used in assessing the program performance with respect to these targets. To this effect, the authorities will provide the necessary data to the IMF as soon as it becomes available.

A. Program Assumptions

2. For the purposes of the program monitoring, all foreign currency-related assets will be valued in lari at program exchange rates as specified below. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross-rates as of December 31, 2016, published on the IMF web site http://www.imf.org/.

Table 1. Program Exchange Rates

	Currency Name	Currency/U$
SDR	Special Drawing Rights	0.7439
GEL	Georgian lari	2.6468
AUD	Australian dollar	0.7227
CAD	Canadian dollar	0.7419
EUR	Euro	1.0556

B. Institutional Definition

3. The **general government** is defined as comprising the central government and local governments, excluding Legal Entities of Public Law (LEPLs). The definition of the general government includes any new funds, or other special budgetary or extra-budgetary entities that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's Manual on Government Finance Statistics 2001 (GFSM 2001). The authorities will inform IMF staff on the creation of any such entities without delay. The general government coverage excludes state-owned companies and the Partnership Fund. The **public sector** consists of the general government, LEPLs and public financial and non-financial corporations, including the National Bank of Georgia.

4. **Supporting material:** The Treasury Department of the Ministry of Finance will provide to the IMF detailed information on monthly revenues of the general government within two weeks of the end of each month and monthly expenditures and arrears of the central government within four weeks of the end of each month. The Ministry of Finance will provide the stock of general government debt, broken down by currency and original maturity within one month from the end of each quarter. The Treasury will provide, on a daily basis, the cash balances in all the accounts of the general government as of the end of the previous business day.

C. Quantitative Program Targets

5. The program will be assessed through performance criteria and an indicative target (Tables 2 attached to the Letter of Intent). Performance criteria are set with respect to:

- a performance criterion (ceiling) on the augmented cash deficit of the general government;
- an indicative target (ceiling) on the primary current spending of the general government;
- a performance criterion (floor) on the net international reserves (NIR) of the NBG;
- a continuous performance criterion (ceiling) on the accumulation of external debt arrears by the general government;
- an indicative target (ceiling) on new domestic expenditure arrears by the general government;
- a performance criterion (ceiling) on the new guarantees issued by the public sector;
- a performance criterion (ceiling) on the cash deficit of the Partnership Fund;
- a performance criterion (ceiling) on new net borrowing by the Partnership Fund.

In addition, the program will include a consultation clause on the 12-month rate of inflation.

6. Performance criteria and indicative targets have been set for end-December 2017 and end-June 2018 (the next two test dates). They are monitored on a cumulative basis from the beginning of the calendar year (except for (i) the NIR target, which is monitored in term of stock levels and (ii) the new net borrowing by the Partnership Fund, which is monitored since program approval), while continuous performance criteria are monitored on a continuous basis.

D. Inflation Consultation Mechanism

7. Inflation consultation bands around the projected path for inflation are set for each test date under the program. Inflation is identified as the 12-month percentage change of the consumer price index (CPI) as measured and published by the National Statistics Office of Georgia (GEOSTAT).

8. If the observed year-on-year inflation for the test dates falls outside the outer bands specified in Table 1 of the MEFP, the authorities will complete a consultation with the IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for the deviation; and (iii) the proposed policy response. When the consultation with the IMF Executive Board is triggered, access to Fund resources would be interrupted until the consultation takes place and the relevant program review is completed. In addition, if the observed year-on-year inflation falls outside the inner bands specified in Table 1 for the test dates, the authorities will complete a consultation with IMF staff on the reasons for the deviation and the proposed policy response.

E. Program Definitions, Adjustors, and Reporting Requirements

General Government

Ceiling on the augmented cash deficit of the general government

9. Definition: The **augmented cash balance of the general government** is defined as: revenues minus expense, minus net acquisition of non-financial assets (as defined by GFSM 2001) minus net budget lending (as defined below). A negative augmented cash balance is a deficit.

10. The **augmented cash balance of the general government** will be measured from the financing side at current exchange rates established by the NBG at the date of the transaction. Accordingly, augmented cash deficit of the general government will be measured by: i) net acquisition of financial assets (including changes in balances of the revenue reserve account), excluding net budget lending as defined by GFSM 2001; minus ii) net incurrence in domestic and foreign liabilities as defined in GFSM 2001.

11. Definition: Consistent with GFSM 2001, **net budget lending** is defined net acquisition of financial assets for policy purposes by the general government.

12. Adjustor: The ceiling on augmented cash deficit of the general government will be adjusted upward (higher deficit)/downward (lower deficit) by the cumulative total amount of foreign-financed project loan disbursements above/below the program amounts (Table 2), subject to a cap of $60 million per year.

13. Adjustor: The ceiling on the augmented cash deficit of the general government will be adjusted downward (lower deficit) by the cumulative amount of receipts from sale of non-financial assets above the program amounts (Table 2).

14. Adjustor: The ceiling on the augmented cash deficit of the general government will be adjusted upward (higher deficit)/downward (lower deficit) by the amount of VAT refunds above/below the program amounts (Table 2).

Table 2. Projected Financing for Cash Deficit of the General Government
(in millions of GEL, cumulative from the beginning of the calendar year)

	December 31, 2017	June 30, 2018
Disbursements of foreign-financed project loans	915	673
Receipts from sale of non-financial assets	185	69
VAT refunds	180	50

15. Supporting Material:

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

b. Data on external project financing as well as other external borrowing will be provided to the IMF monthly by the Ministry of Finance (specifying projects by creditor) within two weeks of the end of each month.

c. Data will be provided at actual exchange rates.

d. Data on receipts from sales of non-financial and financial assets of the general government will be provided by the Treasury Department of the Ministry of Finance to the IMF on a monthly basis within two weeks of the end of each month.

e. Data on securitized debt sold by the NBG, including the securities that have been purchased by nonbanks, will be reported by the NBG to the IMF on a monthly basis within two weeks of the end of each month.

f. Data on repayments of VAT claims.

Ceiling on the Current Primary Expenditures of the General Government

16. Definition: primary current expenditures is defined as expense (as defined by GFSM 2001) on a cash basis, minus interest payments.

17. Supporting material: Data for monitoring expenditures will come from the accounts of the general government covered under the ceiling on the augmented cash deficit of the general government (including autonomous regions). The Ministry of Finance is responsible for providing reporting according to the above definition. Data on expense and net acquisition of non-financial assets of the general government should be reported to the IMF within four weeks after the end of the quarter.

Continuous Performance Criterion on Accumulation of General Government External Debt Arrears

18. Definition: Debt is defined as set forth in point No. 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements (Decision No. 15688-(14/107) adopted on December 5, 2014. External debt is defined by the residency of the creditor.

19. For the program, **external payment arrears** will consist of all overdue debt service obligations (i.e. payments of principal or interest, taking into account contractual grace periods) arising in respect of any debt contracted or guaranteed or assumed by the central government, or the NBG, or any agency acting on behalf of the general government. The ceiling on new external payments arrears shall apply on a continuous basis throughout the period of the arrangement. It shall not apply to external payments arrears arising from external debt being renegotiated with external creditors, and more specifically, to external payments arrears in respect to which a creditor has agreed that no payment needs to be made pending negotiations.[1]

20. **Supporting Material.** The accounting of non-reschedulable external arrears by creditor (if any), with detailed explanations, will be transmitted on a monthly basis, within two week of the end of each month.

Continuous indicative target on Accumulation of General Government Domestic Expenditure Arrears

21. **Definition:** For program purposes, domestic expenditure arrears are defined as non-disputed (in or out-of-court) payment obligations whose execution term has expired and became overdue. They can arise on any expenditure item, including debt service, wages, pensions, and goods and services. Arrears will arise from non-debt liabilities that are not paid after 60 days of the contractual payment date or—if there is no contractual payment date—after 60 days of the receivable. Any wage, pension or other entitlement obligation of the general government that is not paid after a 30-day period from the date that they are due, is in arrears.

22. **Supporting Material**: The accounting of new domestic expenditure arrears (if any) will be transmitted within four weeks after the end of each month.

Guarantees

23. For the purpose of the program, a **guarantee** of a debt arises from any explicit legal obligation of the public sector to service such a debt in the event of nonpayment by the recipient (involving payments in cash or in kind).

Partnership Fund

Ceiling on the Cash Deficit of the Partnership Fund

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

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

26. The Partnership Fund's expenditures comprise all current and capital expenditures. Current expenditures comprise compensation of employees, the purchase of goods and services, transfers to other entities, other account payables and domestic and external interest payments. Capital expenditures comprises the net acquisition of nonfinancial assets as defined under GFSM 2001. The

[1] Arrears to Turkmenistan.

Partnership Fund's purchase of financial assets (e.g. lending and equity participation) will not be considered part of its expenditures.

Ceiling on New Net Borrowing by the Partnership Fund

27. Definition: Net borrowing by the Partnership Fund is defined as contracted debt liabilities minus principal repayments.

28. Supporting Material: The Ministry of Finance will provide to the IMF detailed information on the Partnership Fund's quarterly revenue, expenditure, and amounts related to new contracted debt and principal repayments, within four weeks of the end of each quarter.

Net International Reserves

Floor on the Net International Reserves of the NBG

29. Definition: Net international reserves (NIR) of the NBG in U.S. dollars are defined as foreign assets of the NBG minus the sum of foreign liabilities of the NBG, including all of Georgia's liabilities to the IMF. **Foreign assets of the NBG** include gold, gross foreign exchange reserves, Georgia's SDR holdings, and the reserve position in the IMF. Gross foreign exchange reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents, including cash holdings of foreign exchange that are readily available. Pledged or otherwise encumbered assets, including (but not limited to) assets used as collateral (or guarantee for third party external liabilities) are excluded from foreign assets. **Foreign liabilities of the NBG** shall be defined as the sum of Georgia's outstanding liabilities to the IMF (at face value), Georgia's SDR allocation, and any other liabilities of the NBG (including foreign currency deposits of financial institutions at the NBG and currency swaps and foreign exchange forward contracts with financial institutions), excluding the foreign exchange balances in the government's account with the NBG. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the NBG shall be valued at program exchange rates as described in paragraph 2 above. The stock of NIR amounted to $1,366 million as of June 30, 2017 (at program exchange rates).

30. For the purpose of the program, **budget support grants to the general government** are defined as grants received by the general government for direct budget support from external donors and not related to project financing. **Budget support loans to the general government** are defined as disbursements of commercial loans and loans from bilateral and multilateral donors for budget support.

31. Adjustors. For program purposes, the floor on NIR will be adjusted

- Upward (downward) by the cumulative amount of any excess (shortfall) by any FX privatization revenue in foreign exchange above (below) the programmed amounts. Privatization receipts are defined in this context as the proceeds from sale, lease, or concessions of all or portions of entities and properties held by the public.

- Upward (downward) by the cumulative amount of any excess (shortfall) of budget support grants and loans compared to program amounts (Table 3).

- Upward/downward for any excess/shortfall related to net issuance of the Eurobond from the general government relative to program amounts (Table 3).

- Upward/downward by 75 percent for any excess/shortfall related to disbursements of the project loans and grants to the treasury single account at the NBG relative to the projected amounts (Table 3).

Table 3. Projected Balance of Payment Support Financing
(in millions of U.S. dollars, cumulative from the beginning of the calendar year)

	December 31, 2017	June 30, 2018
Projected privatization revenue	0	0
Budget support grants from external donors and not related to project financing	73.2	6
Budget support loans, including bilateral and multilateral donors for budget support	193.3	58.4
Net issuance of the Eurobond from the general government	0	0
Disbursements of project loans and grants	204.1	114.1

32. Supporting material: Data on net international reserves (both at actual and program exchange rates); net foreign financing (balance of payment support loans, cash grants to the general government, amortization (excluding repayments to the IMF), interest payments on external debt by the Ministry of Finance and the NBG; and conversions for government imports will be provided to the IMF in a foreign exchange cash flow table (which includes details of inflows, outflows and net international reserves) on a weekly basis within three working days following the end of the week.

Appendix to the TMU: The Partnership Fund

A. Organization and Operational Structure

Legal Structure and Corporate Governance

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

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

- An investment board, currently composed of internal members (CEO, CIO, portfolio officers) and can add external members (like experts and private sector representatives), which approves business cases and initiates projects;

- A risk management committee, composed of internal members (CFO, Chief Legal Officer, and Chief Accountant), which advises on project risks to be reflected in project implementation agreements;

- A supervisory board (i.e. board of directors), which approves projects (based on the feasibility studies, risk assessments, and business cases presented by the investment board and risk committee) and approves budget for project development needs. The supervisory board includes members of the government and is chaired by the Prime Minister; and

- In cases of equity participation in projects, the PF needs government approval.

B. Corporate Mandate and Portfolio Management

Corporate Mandate

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

Portfolio Management Strategy

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

- The PF will participate only in commercially viable projects; and

- The PF's performance will be monitored on the basis of the following evaluation criteria: IRR, adjusted present value, sharp ratio, and risk adjusted return.

Project Development Methodology

The PF will only participate in projects in which a corporate investor, with sufficient experience in industry, expresses its willingness to take an equity participation that represents at least 51 percent of the project's total equity. PF financing (debt plus equity plus guarantees) will not be allowed to exceed 100 percent of the equity of the private partner in the project. The PF will pursue only commercial objectives.

Reporting and Auditing

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

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

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

Fiscal risks associated with the PF will be limited since:

- All liabilities of the PF are limited to its own balance sheet;
- The PF has its own revenue sources, namely: the dividends from its investments, the interest earnings from the loans its provides, the fees it charges on the guarantees it provides, and the proceeds of asset sales; and the PF may decide to borrow from credible financial institution with recourse to its balance sheet facility and without state guarantee.