

**Georgia: Seventh and Eighth Reviews Under the Stand-By Arrangement, and Requests for Waivers of Nonobservance of Performance Criteria and Rephasing of Purchases—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Georgia.**

In the context of the seventh and eighth reviews under the stand-by arrangement, and requests for waivers of nonobservance of performance criteria and rephasing of purchases, the following documents have been released and are included in this package:

- The staff report for the Seventh and Eighth Reviews Under the Stand-By Arrangement, and Requests for Waivers of Nonobservance of Performance Criteria and Rephasing of Purchases, prepared by a staff team of the IMF, following discussions that ended on November 10, 2010, with the officials of Georgia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 23, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff statement of January 12, 2011.
- A Press Release summarizing the views of the Executive Board as expressed during its January 12, 2011 discussion of the staff report.
- A statement by the Executive Director for Georgia.

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

Letter of Intent sent to the IMF by the authorities of Georgia\*  
Technical Memorandum of Understanding\*

\*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

GEORGIA

**Seventh and Eighth Reviews Under the Stand-By Arrangement, and Requests for Waivers of Nonobservance of Performance Criteria and Rephasing of Purchases**

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

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

December 23, 2010

- **Background:** The Sixth Review under the Stand-By Arrangement (SBA) was concluded on July 9, 2010. Access under the SBA is SDR 747.1 million (497.1 percent of quota), of which SDR 577.1 million has been disbursed. The arrangement expires June 14, 2011.
- **Program Strategy:** With the economic recovery gaining ground, policy targets for 2011 emphasize fiscal adjustment and an increase in Net International Reserves (NIR), in order to bolster the exit strategy.
- **Team:** E. Gardner (head and Senior Resident Representative), E. Martin, A. Luca (all MCD), L. Eyraud (FAD), I. Halikias (SPR), and N. Sharashidze (Resident Representative Office).
- **Exchange Rate Regime:** The regime is classified as “floating.” A multiple currency practice (MCP), which preceded the program, arises from the fact that the official exchange rate used by the government may differ by more than 2 percent from freely determined market rates. In practice, the official and market rates have never differed by more than 2 percent since the introduction of foreign exchange auctions in March 2009, when the market rate became more flexible.
- **Statistics:** Economic data are broadly adequate for surveillance and program monitoring. Georgia participates in the GDDS and subscribed to the SDDS in May 2010.

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## EXECUTIVE SUMMARY

**Real GDP growth for 2010 has been revised up to 6.3 percent and annual CPI inflation has increased to around 10 percent**, reflecting a surge in food prices. External developments have been better than expected. Since June, the lari has regained some of the ground it lost to the U.S. dollar in the first half of the year. Banks' balance sheets have strengthened further.

**End-December performance criteria (PCs) are expected to be met, with the exception of the fiscal deficit and general government expenditure targets owing to the late disbursement of budget grants and disbursements under a project loan on-lent by the government, which came in earlier than the authorities anticipated.** The loan disbursements by KfW-EBRD-EIB (0.5 percent of GDP) finance a power project, and were on-lent by the government to the responsible state enterprise. Excluding such net lending, government spending would be in line with the program. The government deficit target is similarly expected to be pushed above the program ceiling by this early loan disbursement, but also by the delay (from 2010 to 2011) in the disbursement of budget grants equivalent to 0.3 percent of GDP. The abatement of exchange rate pressures has enabled the central bank to build NIR well above program targets.

**Sizeable fiscal consolidation will continue in 2011 on the back of ongoing strong growth.** Real GDP is projected to grow by 4.5 percent in 2011, supported by private demand and higher private capital inflows (including FDI). The 2011 budget provides for a reduction of the deficit to 4.3 percent of GDP, from 6.8 percent in 2010, based essentially on expenditure restraint. Tax revenues would be lower relative to GDP than previously envisaged, reflecting lower estimated yields and the partial withdrawal of planned VAT measures.

**Monetary policy in 2011 will aim at supporting disinflation, increasing NIR, and promoting dedollarization.** The monetary program envisages an acceleration of credit and deposits growth, reflecting a resumption of financial deepening, and an increase in NIR. While the monetary program and the recent hikes in policy rates appear consistent with the objective of bringing back inflation toward 6 percent by end-2011, the authorities stand ready to tighten monetary policy further if warranted by inflation, exchange rate, and monetary developments.

**Significant risks remain.** Risks to growth appear balanced and are mainly related to the pace of private capital inflows, notably FDI. There are risks that balance of payment gaps could reemerge over the medium term as the result of lower-than-expected FDI, an inadequate supply response to the recovery of demand, or debt rollover pressures. Staff considers that faster fiscal adjustment in 2011 could be targeted in view of the favorable cyclical conditions and remaining risks.

## I. PROGRAM PERFORMANCE

### Georgia: Quantitative Performance Criteria (PC) and Indicative Targets, 2010

Performance Criteria	Sep-10			Dec-10	
	PC	Adjusted PC	Actual	PC	Proj.
	(Cumulative change since the beginning of 2010, in millions of lari)				
Ceiling on cash deficit of the general government	867		773	1,241	1,397
Ceiling on the general government expenditures	5,023		5,009	7,106	7,206
	(End-period stock, in millions of lari)				
Ceiling on net domestic assets (NDA) of the NBG 1/	506	564	513	714	470
	(End-period stock, in millions of U.S. dollars)				
Floor on net international reserves (NIR) of the NBG 1/	740	705	708	721	825
	(Cumulative change since the beginning of 2010, in millions of U.S. dollars)				
Ceiling on accumulation of external arrears 2/	0		0	0	0
<b>Indicative target</b>	<b>Ind. Target</b>		<b>Actual</b>	<b>Ind. Target</b>	<b>Proj.</b>
	(Cumulative change since the beginning of 2010, in millions of U.S. dollars)				
Ceiling on contracting or guaranteeing of new total external debt by the public sector	1,000		646	1,000	692

Sources: Georgian authorities; and Fund staff estimates.

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

2/ The continuous performance criterion for external arrears is defined in paragraph 21 of the TMU.

#### 1. All end-September PCs were met and end-December PCs are expected to be met, with the exception of the fiscal deficit and general government expenditure targets:

- The end-December PCs on **NIR and NDA** are expected to be observed by wide margins, owing to lower-than-programmed foreign exchange intervention since June, and lower reserve money growth in the case of NDA; their status will be reported separately by January 6.
- The end-December PCs on the **government deficit and general government expenditures** are expected to be missed, owing to a delay (from 2010 to 2011) in the disbursement of budget grants amounting to GEL 56 million (0.3 percent of GDP) and disbursements by KfW-EBRD-EIB of a GEL 100 million loan (0.5 percent of GDP), which came in earlier than the authorities anticipated.<sup>1</sup> These disbursements relate to a power project loan, which is on-lent by the government to a state enterprise. **Waivers of nonobservance are requested (LOI ¶ 29)** on account of these two developments, although the authorities consider that higher other revenues might compensate for the shortfall in grant disbursements.
- **No offsetting action is deemed necessary to offset the increase in net lending in 2010**, since the lending operation simply rephases disbursements under an existing

<sup>1</sup> While these disbursements were in line with contractual obligations, the authorities had anticipated some delays, which did not fully materialize, in meeting all the conditions attached to these loans.

loan agreement, which benefits a state enterprise under commercial terms. Furthermore, the timing of disbursements is not controlled by the government. In essence, government on-lending is equivalent to guaranteeing the external loan to the state enterprise, but, because it is channeled through the budget, it affects the deficit as measured under the program. The power project involves the construction of a high-voltage power transmission line that would enable Georgia to sell electricity to Turkey, and the commercial return from the project is expected to enable full repayment by the state enterprise.

- The end-December indicative target on **the contracting and guaranteeing of external debt** is expected to be met.

## 2. Structural benchmarks under the program have been completed.

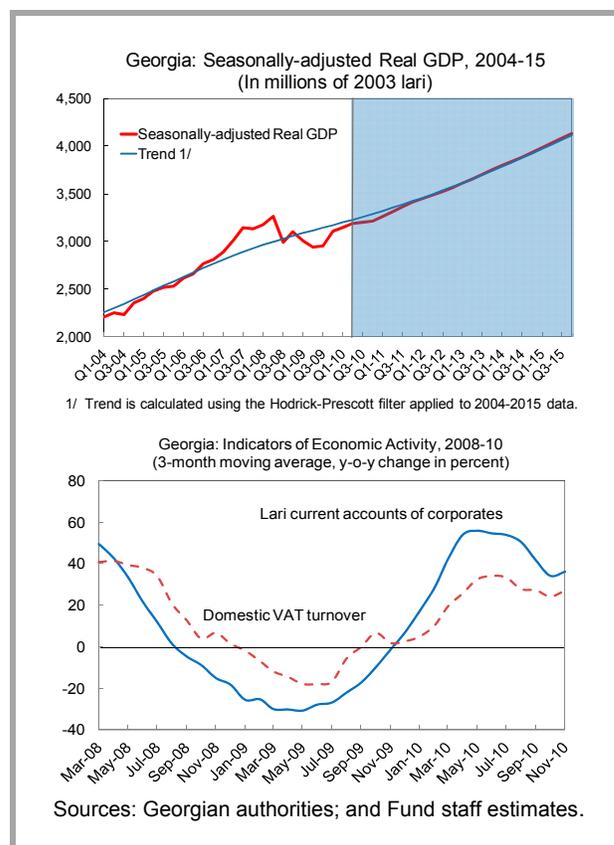
Georgia: Structural Benchmarks for 2010			
Structural Benchmark	Time Frame	Type of Conditionality	Status
Cabinet approval of a new medium-term expenditure framework (Basic Data and Directions) that includes expenditure ceilings applicable to the 2011 budget.	July 31, 2010	Structural Benchmark	Observed
Cabinet approval of guidelines for pilot ministries to introduce a programmatic approach to budgeting, in line with the recommendations of the IMF technical assistance report "Georgia—Advancing Program Budgeting," by D. Radev, S. Flynn, L. Eyraud, and S. Gurr, May 2010.	September 30, 2010	Structural Benchmark	Implemented with delay on October 13.

## II. RECENT DEVELOPMENTS

### 3. Parliament approved a change in the constitution that redistributes powers from the presidency to parliament and the prime minister, effective in 2013.

Parliamentary and presidential elections are scheduled for 2012 and 2013, respectively.

### 4. Real GDP growth for 2010 has been revised up to 6.3 percent, on the back of very strong growth in the first half of the year, moderating somewhat in the second half. While there are no reliable measures of capacity utilization, the authorities consider that the economy may be operating near

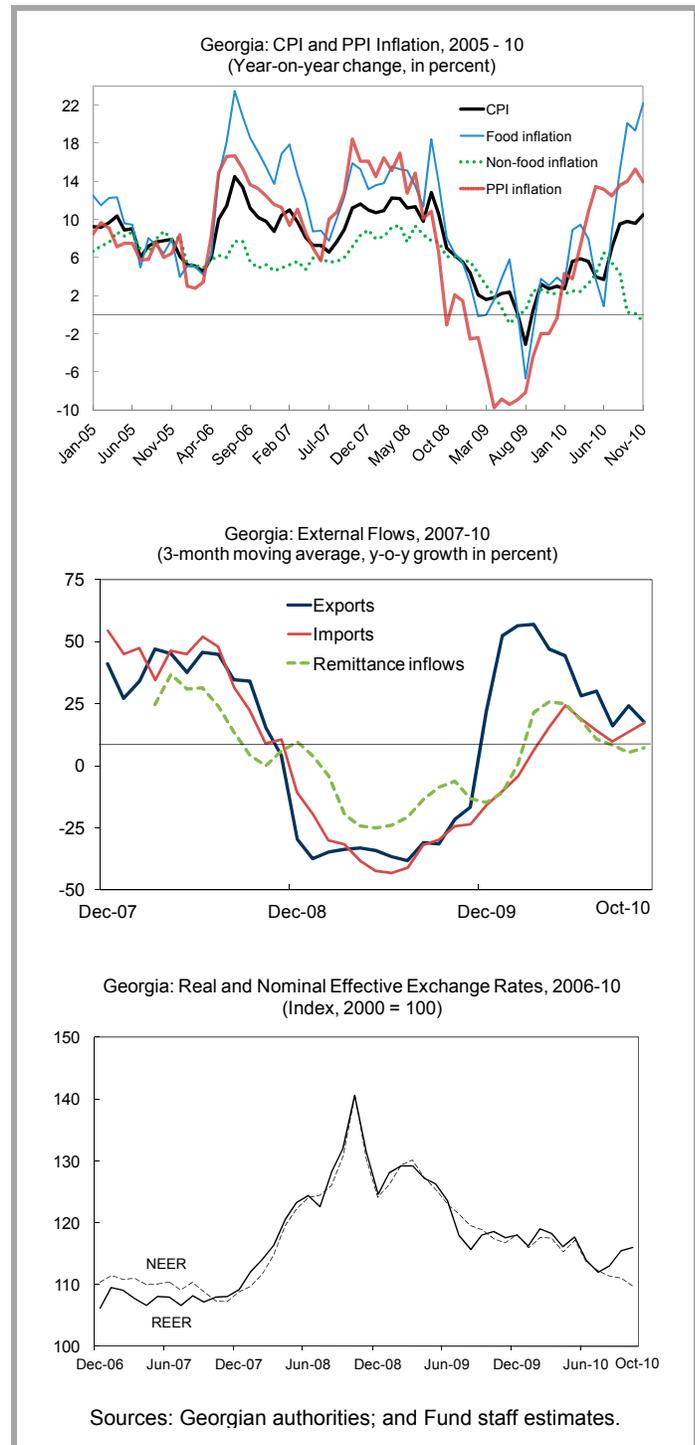


capacity in some sectors, when taking into account the lack of new investment during the last two years.

5. **Annual CPI inflation has surged to around 10 percent, owing to rising food prices.** This large increase in inflation reflects the heavy weight of food in the CPI basket (43 percent). Evidence of inflation in other sectors is mixed: nonfood price inflation remains very low, consistent with regional trends, while the industrial PPI has risen sharply. There is no reliable information on wages to gauge labor market pressures, but unemployment remains high (15 percent).

6. **Deposit and lending rates have declined further, but the growth of monetary and credit aggregates has slowed.** The authorities have continued to tighten monetary policy in response to higher inflation—the policy (refinancing) rate has been raised by 250 bps since June. The disconnect between the (rising) policy rate and the (declining) deposit and lending rates has reflected the lack of traction of the policy rate in a context of ample liquidity and high dollarization.

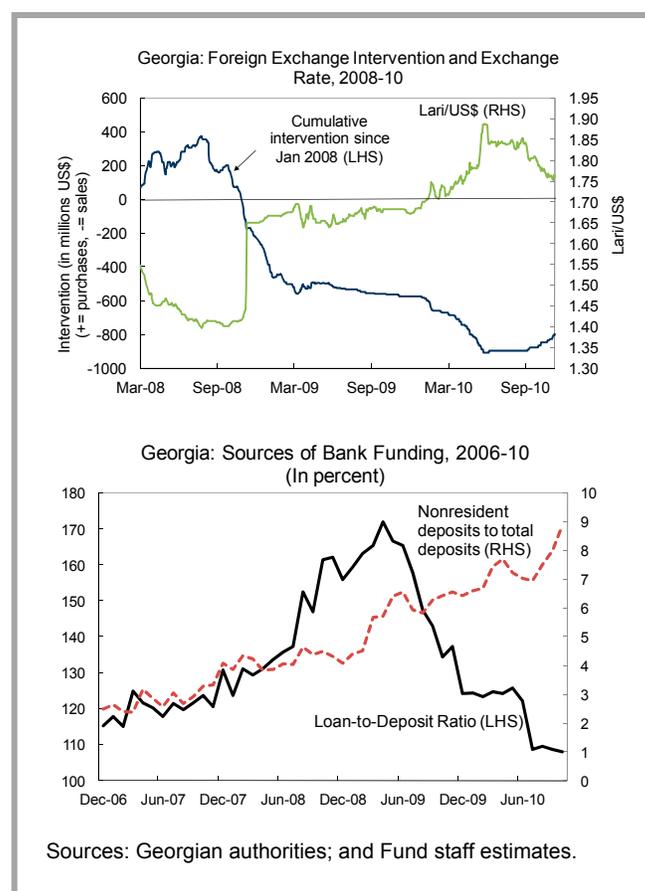
7. **The overall deficit in the 2010 balance of payments has been revised down (by \$159 million) relative to the Sixth Review.** The trade deficit is wider than expected, but the current account deficit is projected to be marginally lower on the heels of buoyant tourism receipts (up 18 percent since 2009). Foreign exchange market developments since June (see below) point to a strong rebound of private capital inflows in the second half of the year, following a disappointing first half. The rebound of private capital inflows includes a \$250 million Georgian Railway Eurobond issue in July, but is also likely to reflect a recovery of FDI inflows—projected at around \$600 million for the year. These inflows should more than offset banking sector net flows, which are now



estimated to be strongly negative in 2010, owing to substantial debt prepayments and the impact of central bank liquidity injections in the first half of the year.

8. **The lari has appreciated relative to the U.S. dollar by 6.5 percent since mid-June.** Since the turnaround in foreign exchange market conditions after June, the central bank has only intervened to purchase dollars in the face of occasionally strong appreciation pressures vis-à-vis the U.S. dollar, linked in part to the weakness of the latter vis-à-vis other currencies. The projected overperformance of NIR relative to the end-December target reflects this change in the direction of intervention.

9. **Banks' balance sheets continue to strengthen, but high NPLs and exposure to currency-induced credit risk remain as vulnerabilities.** Banks' reliance on wholesale external funding has declined significantly since mid-2009, but the decline has been offset in part by increases of nonresident deposits, which now account for about 10 percent of total deposits. Although still high, NPLs have been declining since May owing to an improved environment, write-offs, and repossessed assets.



Georgia: Selected Monetary and Financial Soundness Indicators, 2008-10

	2008				2009				2010			
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Oct.
Deposit dollarization (in percent)	60.9	60.0	61.7	75.7	75.2	73.2	72.6	73.2	71.0	71.4	71.8	70.9
Loan-to-deposit ratio (in percent)	129.4	135.7	147.0	155.9	165.3	165.4	143.0	124.2	124.7	122.2	108.7	108.0
Credit-to-GDP ratio (in percent)	28.5	30.0	29.2	31.9	30.7	30.2	29.6	29.3	29.6	30.6	29.8	29.4
Capital adequacy ratio (in percent) 1/	17.5	15.7	17.0	13.9	15.2	17.6	20.2	19.1	18.3	17.4	18.2	18.5
Capital adequacy ratio (in percent) 2/				24.0	23.6	27.1	27.4	25.6	24.6	23.3	24.4	24.7
Liquidity ratio (in percent) 3/	36.8	33.3	30.4	28.3	30.8	31.4	40.6	39.1	41.6	37.5	37.3	38.8
Nonperforming loans (in percent of total loans) 4/	3.0	3.4	9.9	12.8	15.2	18.8	18.2	17.9	17.1	16.3	15.1	14.9
Nonperforming loans (in percent of total loans) 5/				4.1	5.4	7.1	8.3	6.3	6.6	6.9	7.8	6.8
Loans collateralized by real estate (in percent of total loans)	43.6	40.5	41.6	43.6	46.4	48.0	49.1	55.5	55.5	54.1	52.3	52.6
Loans in foreign exchange (in percent of total loans)	65.9	64.9	67.5	72.8	75.3	77.3	77.6	76.9	75.9	73.7	72.8	72.5
Specific provisions (in percent of total loans)	1.9	2.2	4.7	6.0	7.5	9.4	10.2	9.7	9.4	8.9	8.3	8.1
Net foreign assets (in percent of total assets)	-17.2	-20.2	-21.6	-19.6	-22.5	-24.4	-18.4	-14.9	-15.1	-12.4	-6.2	-6.3
Net open foreign exchange position (in percent of regulatory capital)	3.5	1.5	1.5	1.7	9.1	8.8	10.4	1.8	4.3	5.3	3.3	2.7
Return on equity (cumulative through the year, annualized) 6/	10.2	8.9	-2.9	-12.6	-7.6	-8.4	-7.3	-4.3	4.0	4.8	8.0	9.1

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.

2/ Basel I definition.

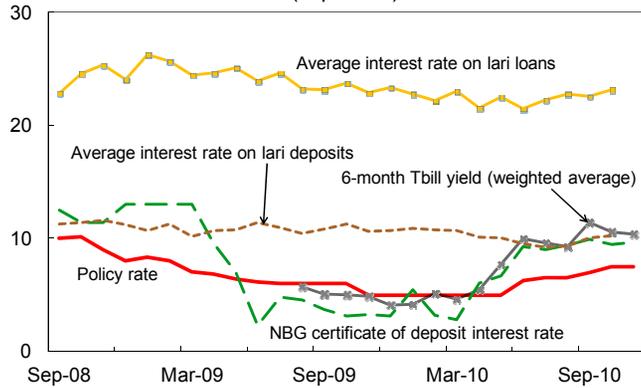
3/ Ratio of liquid assets to 6-month and shorter maturity liabilities.

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

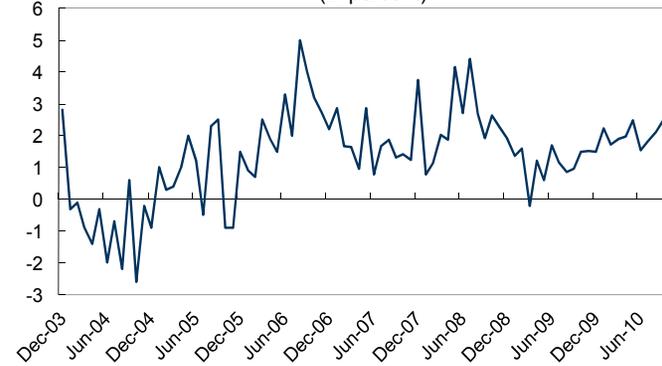
5/ IMF definition.

6/ Pre tax.

Georgia: Lari Interest Rates, 2008-10  
(In percent)

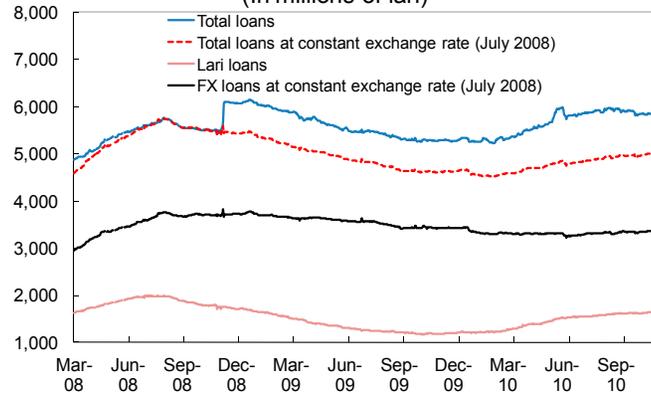


Georgia: Deposit Interest Rate Spread, 2006-10 1/  
(In percent)

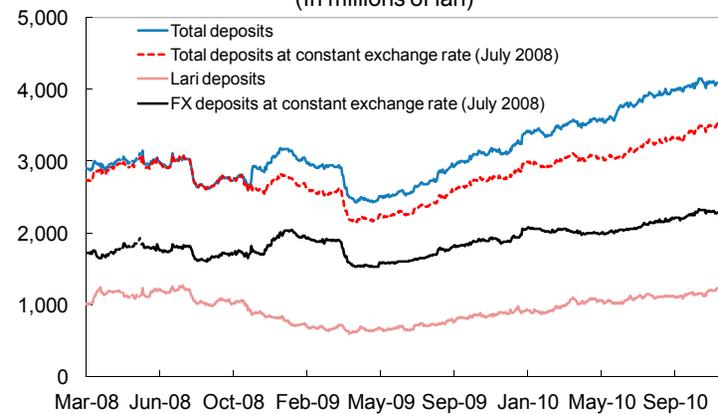


1/ Nominal spread, calculated as the difference between lari and fx weighted-average rates on new deposits.

Georgia: Credit to the Private Sector, 2008-10  
(In millions of lari)



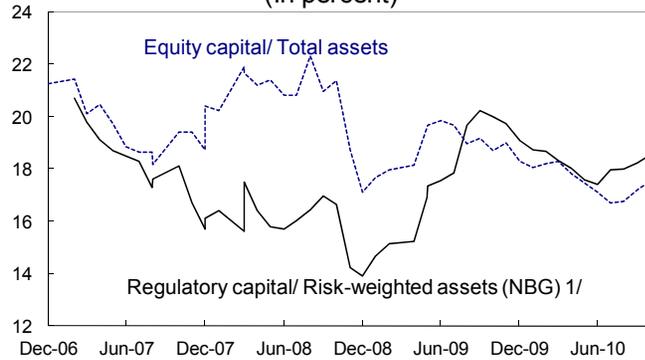
Georgia: Deposits, 2008-10 1/  
(In millions of lari)



1/ The proceedings of the Georgian Railways Eurobond issuance from July 2010, which were placed in local US dollar-denominated accounts, are not included.

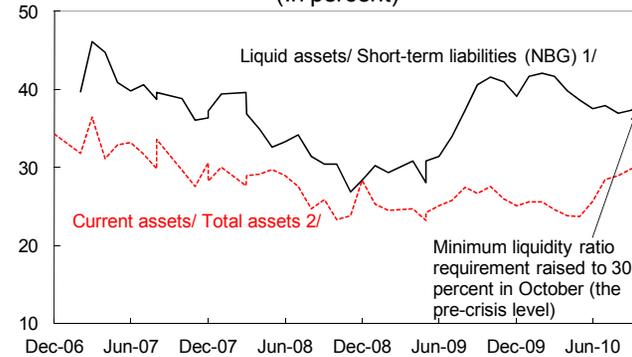
Sources: National Bank of Georgia; and Fund staff estimates.

Georgia: Capitalization Ratios, 2006-10  
(In percent)



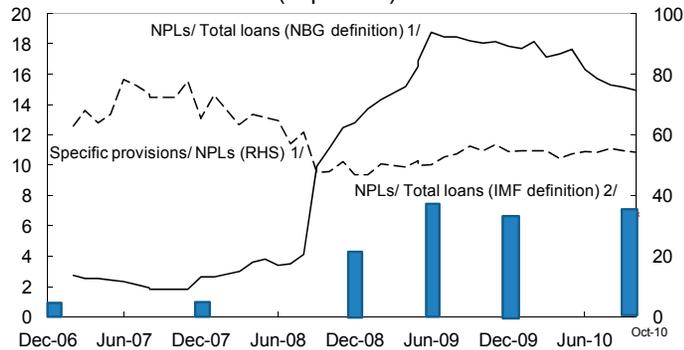
1/ National definition. Risk weight to forex loans was reduced from 200 to 175 percent in September 2008, and to 150 percent in August 2009.

Georgia: Liquidity Ratios, 2006-10  
(In percent)



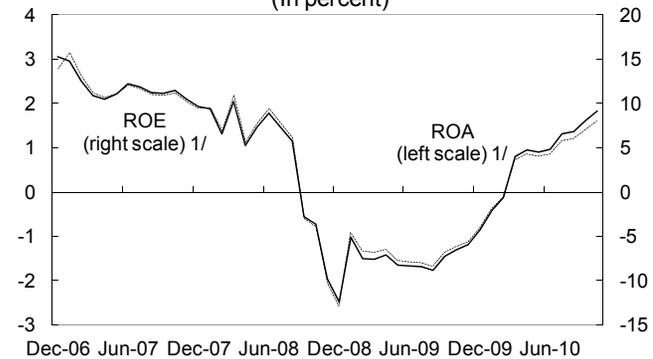
1/ Ratio of liquid assets to six-month and shorter maturity liabilities.  
2/ Current assets are assets of one-month and shorter maturity.

Georgia: Nonperforming Loans and Provisions Ratios, 2006-10  
(In percent)



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

Georgia: Profitability Ratios, 2006-10  
(In percent)



1/ Pre tax. Cumulative through the year and annualized.

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

### III. POLICIES FOR 2011 AND THE EXIT STRATEGY

Based on the strength of the economic recovery, discussions focused on:

- *The pace of fiscal adjustment;*
- *the stance of monetary policy, following its recent tightening;*
- *NIR buildup and exchange rate policy; and*
- *financial regulation in the post-crisis environment.*

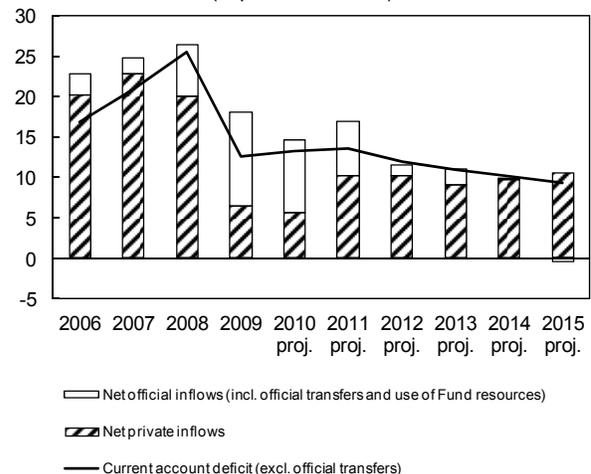
#### A. Outlook for 2011

10. **Real GDP is projected to grow by 4.5 percent in 2011, based on the expectation that private sector demand will strengthen as the fiscal stimulus is withdrawn.** The transition from public to private-led growth is not yet firmly established, however, and the recovery of private investment in particular will depend on continued credit growth and private capital inflows, including FDI.

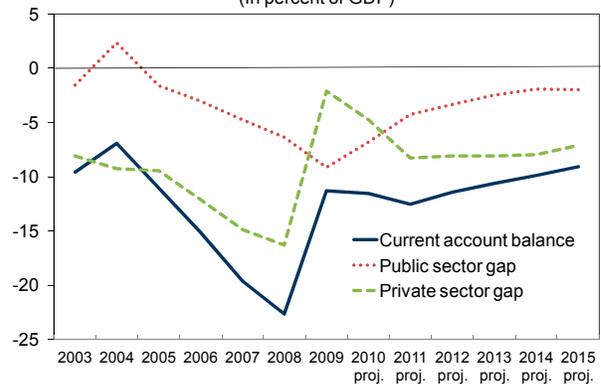
11. **Risks to short-term growth, which were previously perceived to lie mostly on the downside, are now more evenly balanced around the central scenario.** A failure of private capital inflows to pick up as projected, or inadequate credit growth, could still cause growth to falter. On the upside, growth could exceed 5 percent, particularly if fueled by stronger capital inflows.

12. **Inflation is projected to decline (to around 6 percent) by end-2011, with risks mostly on the upside.** The projected decline in inflation is based on monetary and fiscal policies remaining sufficiently restrained. The upside risk reflects the narrowing of the output gap and the possible emergence of capacity constraints. The projection is subject to considerable uncertainty given observed

Georgia: Current Account Balance and its Financing, 2006-15  
(In percent of GDP)



Georgia: Saving-Investment Balances, 2003-15  
(In percent of GDP)



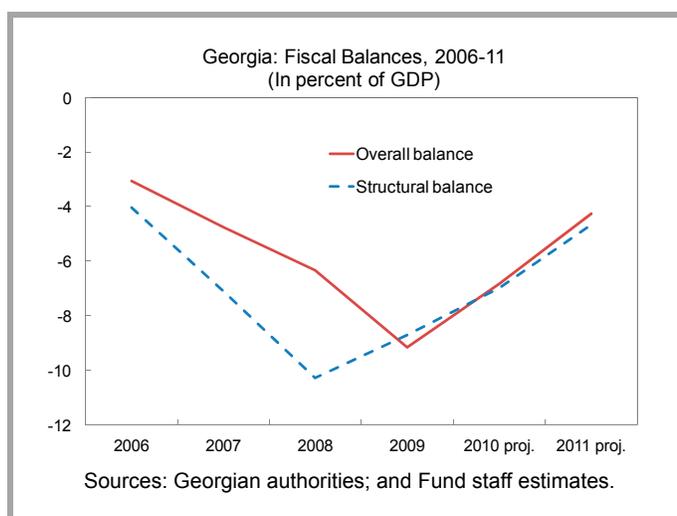
Source: Georgian authorities; and Fund staff estimates.

volatility in inflation and the unknown impact of recent price hikes on expected inflation and wages.

13. **The balance of payments is projected to improve in 2011 (from an overall deficit of \$113 million in 2010 to an overall surplus of \$213 million), owing essentially to the expected recovery of private capital inflows, which also remains the main risk factor.** The current account deficit (in percent of GDP) is projected to widen temporarily owing to a worsening transfer and income balance, but would still be lower than expected at the time of the Sixth Review. On current trends, the deficit should decline steadily over the medium term, reflecting parallel improvements in the fiscal balance and in the private saving-investment balance.

## B. Fiscal Policy

14. **Riding on higher-than-expected economic growth, the authorities target a lower 2011 fiscal deficit (4.3 percent of GDP) than projected at the time of the Sixth Review.** However, the structural adjustment from 2009 to 2011 would be somewhat lower, owing to tax revenue shortfalls. Still, two-thirds of the structural adjustment envisioned from 2009 to 2013 will be achieved in the first two years of the consolidation period.



Georgia: Overall and Structural Deficits, 2009-11  
(In percent of GDP)

	2009	2010		2011	
		6th Rev.	Proj.	6th Rev.	Proj.
Overall deficit	-9.2	-6.3	-6.8	-4.8	-4.3
Structural deficit 1/	-8.7	-6.1	-7.0	-4.4	-4.7

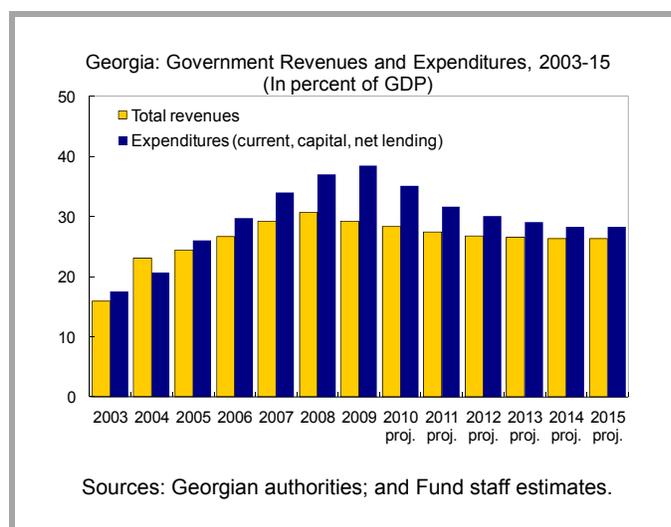
Sources: Ministry of Finance; and Fund staff estimates.

1/ Based on identical potential GDPs for the sixth and seventh reviews.

15. **Adjustment in 2011 is based essentially on expenditure containment.** The authorities are committed to capping expenditure in order to allocate possible gains on the revenue front toward deficit reduction. Staff discussed with the authorities various revenue and expenditure measures consistent with the envisaged fiscal consolidation. The authorities consider that focusing their consolidation efforts on curbing current spending is more

growth-enhancing and thereby ultimately more favorable to improving social conditions. Expenditure containment will reduce social spending in real terms, but the authorities argued that the impact was mitigated by the economic recovery and that social coverage of the most vulnerable was already quite extensive and has been improved through efficiency gains in the health insurance sector. The revenue measures that were supposed to be introduced in 2010 were taken as expected. However, the tax-to-GDP ratio

(for both 2010 and 2011) is lower than anticipated at the time of the Sixth Review. In large part, this reflects a lower yield of all taxes (including new ones),<sup>1</sup> one-off factors, but also the withdrawal of the VAT measures on private health and private education that were to be introduced in 2011—VAT on public health services will, however, come into effect in 2011.



#### Georgia: 2011 Budget

	Change 2010-11	Comments
(In percent of GDP)		
Increase in revenues	-0.9	
Tax revenues	0.5	New excises on beer, spirit, telecommunications (From August and September 2010), harmonization of personal income tax rates, VAT on public healthcare (2011)
Other revenues	-0.2	Loss of railway company dividends, no adjustment in penalties and fees
Grants	-1.2	Decrease in project grants (termination of USAID Millennium Challenge Corporation)
Decrease in expenditures	3.5	
Current spending	2.3	
Compensation for employees	0.4	No new hiring, no indexation of public wages to inflation
Use of goods and services	0.8	Reduction of ministry of defense budget by 11%
Subsidies	0.2	No nominal increase in services provided by local governments
Social expenses	0.8	No pension increase, no change in thresholds of social assistance schemes
Other expenses	0.3	Education spending stable in nominal terms
Interest	-0.2	Higher cost of external debt
Capital spending	1.1	
Domestically financed	0.6	Less domestically-financed capital projects
Externally financed	0.5	
Net lending	0.1	Lower onlending (reflecting lower disbursements by KFW, EBRD, and EIB to finance electricity project)
<b>Reduction in fiscal deficit</b>	<b>2.5</b>	

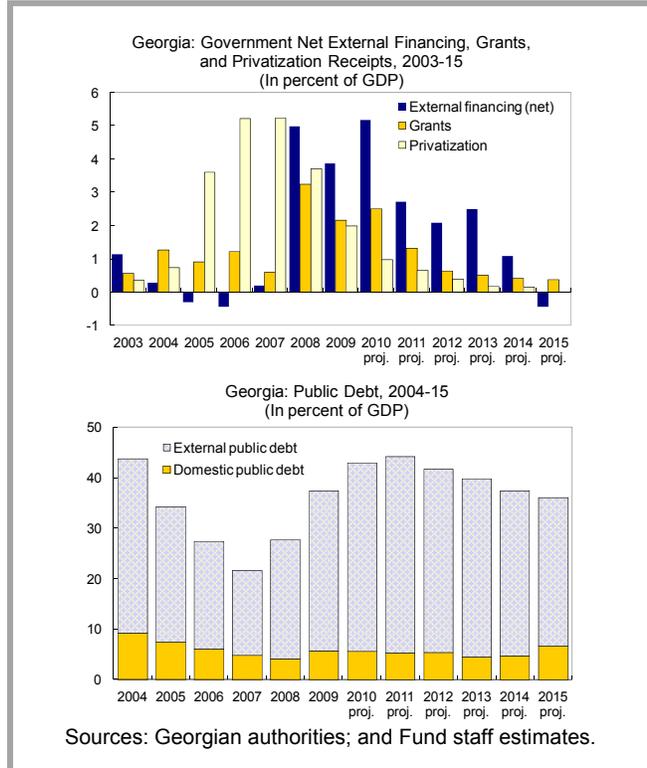
Sources: Ministry of Finance; and Fund staff estimates.

<sup>1</sup> Lower-than-anticipated tax yields reflect mainly low personal income tax receipts resulting from the lagged response of wages to higher GDP, and lower-than-expected proceeds from the new telecommunication turnover tax, owing to a one-month implementation delay and the lowering of the tax base as private operators cut telecommunication prices.

In light of the already significant adjustment being targeted, the authorities considered that taking additional compensatory revenue measures would threaten the recovery. They also stressed that the tax-to-GDP ratio, corrected for one-offs,<sup>2</sup> is still expected to increase by 0.3 percent in 2010 and 0.5 percent in 2011.

**16. The medium-term fiscal framework adopted by the government in July 2010 targets a reduction of the deficit to 2–3 percent of GDP by 2013. The debt-to-GDP ratio is**

expected to peak at 43.6 percent of GDP in 2011, declining to 35.9 percent of GDP by 2015. The mission questioned the sustainability of expenditure containment over the medium term, noting in particular that the spending cuts implemented in 2010 and envisaged in 2011 entail a significant real revenue reduction for public wage-earners and social system beneficiaries. The authorities deemed that, if pressures to reverse these cuts were to emerge, there would be sufficient room to decrease the capital budget further. The World Bank has begun exploring ways in which social spending, half of which is accounted for by pensions, could be better targeted to enhance the effectiveness of social safety nets through the consolidation process. The constitutional amendment requiring that tax increases be subject to referendums was adopted on December 15, 2010. Recognizing the need to preserve adequate policy flexibility in the event of adverse economic developments, the authorities have introduced an escape clause in the referendum requirement. The specific circumstances under which the referendum requirement would be suspended will be specified separately in the Economic Freedom Act, which will also set deficit and debt limits.



<sup>2</sup> In particular, 2009 taxes are inflated by the arrears clearance paid by a line ministry, equivalent to 0.9 percent of GDP.

## Georgia: Social Expenditures (General Government), 2008-11

	2008	2009	2010	2011
	(In percent of GDP)			
Health programs	1.2	1.6	1.7	1.5
Pensions	4.0	4.7	4.3	3.9
Social assistance 1/	1.1	1.4	1.2	1.1
Other	0.9	0.7	0.7	0.6
Total	7.2	8.4	7.9	7.1

Sources: Ministry of Finance; and Fund staff estimates.

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

17. **The authorities plan to move to program budgeting by 2012.** Next steps include conducting training for the ministry of finance and pilot ministries and designing measurable indicators.

### C. Monetary and Exchange Rate Policy

18. **Monetary policy in 2011 will be guided by three objectives:**

- *Supporting gradual disinflation* back toward 6 percent by end-2011;
- *increasing the level of NIR* to reinforce the exit strategy; and
- *raising the credibility of the local currency* to promote dedollarization.

19. **Calibrating monetary policy in pursuit of these objectives is difficult owing to weaknesses in the transmission mechanism,** stemming from:

- *The high degree of dollarization, and the limited leverage the authorities have over the on-shore dollar interest rate.* The authorities are concerned that an excessive increase in local currency interest rates would cause banks to shift to cheaper dollar lending, sourced from abroad.
- *The uncertain transmission of policy interest rate changes.* The policy rate is expected to regain traction on market rates (including longer-term rates) following the normalization of liquidity and credit conditions, and the April reforms of the central bank refinancing window and standing facilities. Evidence of that can be seen in the parallel movements of the policy rate and the lari deposit rate in the last few months. The extension of the yield curve should also facilitate stronger transmission of policy rates to lending rates.
- *Uncertainty about the inflation process and the impact of monetary policy on economic activity.* With technical assistance from the Fund, the National Bank of Georgia (NBG) is building up its modeling capacity with a view to better inform policy decisions.

20. **Subject to these constraints, the authorities stand ready to tighten monetary policy further to meet their objectives.** They indicated that they are considering complementing the recent increase in the policy rate, which contributed to a significant increase in CD and T-bill rates, with an increase in reserve requirements on foreign exchange deposits. Prudential measures recently adopted and planned (see next section) are also effectively tightening the monetary stance. The NBG's current inflation forecast model suggests that the monetary program is consistent with the projected disinflation. Monetary policy decisions will continue to be informed by changes in projected inflation, and developments in monetary aggregates and the exchange rate. The authorities will in particular monitor closely price developments to avoid the emergence of second round effects.

21. **The 2011 monetary program's credit and deposit growth projections are in line with projected economic growth and resumption of financial deepening.** The authorities and staff agreed that credit growth in the 15–20 percent range, which would raise the credit-to-GDP ratio to the pre-crisis level of 30 percent, would not be inflationary.

22. **Consistent with the exit strategy, the authorities are targeting an increase in NIR in 2011.** This increase would begin to reverse the decline observed since 2007, which financed part of the balance of payments gap opened by the war and subsequent financial crisis.

#### D. Financial Sector Policies

23. **Stability concerns have abated, and the authorities are in the process of adjusting the regulatory framework following the normalization of credit market conditions.** The central bank has raised the liquidity ratio back to 30 percent (pre-crisis level) from 20 percent, effective October 1. It is also considering raising the risk weights on foreign exchange loans to unhedged borrowers, which were lowered in the wake of the crisis.<sup>3</sup> Some bankers consider that the combination of monetary and regulatory tightening is premature and could thwart the desired growth in credit, but the NBG projects that the recapitalization needs created by an increase in the capital risk weight of foreign exchange loans would be limited.<sup>4</sup> The relatively large intermediation margins of the Georgian banking sector reflect, in part, the cost of carrying high capital and liquidity buffers. To address this problem, the

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<sup>3</sup> The risk weight to foreign exchange loans was reduced from 200 to 175 percent in September 2008, and to 150 percent in August 2009.

<sup>4</sup> If the risk weights on foreign exchange loans are raised to 175 from 150 percent, recapitalization needs stemming from satisfying the CAR requirement, assuming a 15 percent credit growth and a constant credit dollarization ratio, would amount to GEL 15 million (about \$8 million), i.e., an increase in regulatory capital of less than 1 percent. The increase would be even less if taking into account potential capital increases from retained profits going forward.

authorities are preparing for a gradual move to differentiated risk-based prudential requirements, which would make supervision more efficient and less costly.

24. **The authorities are considering alternative schemes for distressed asset management (DAM), but lack of demand and urgency from banks to sell assets at depressed prices are major impediments.** The authorities consider that specialized firms would manage distressed assets more efficiently than banks, and are evaluating, jointly with IFIs, alternative DAM schemes and regulatory changes. Apart from the lack of interest from banks, however, this initiative is constrained by limited domestic capacity to absorb these assets, and limited interest from foreign investors owing to the small size of the distressed assets pool.

#### E. The Exit Strategy and Risks

25. **Balance of payments risks remain elevated over the medium term.** The program was built on the expectation that a steady recovery of private capital inflows (mainly FDI) would enable Georgia to return to a path of privately financed high economic growth, and that, as of 2012, external financing needs would be covered entirely by private sector inflows and regular official financing. While the improvement in the overall balance of payments since June 2010 is consistent with this scenario, there are risks that balance of payments gaps could reemerge, in which case the adjustment process may have to be prolonged. Such an outcome could be triggered by:

- *A failure of FDI to rebound as projected.* The strength of the balance of payments since the summer would be consistent with increased private capital inflows. However, these flows have proven to be volatile. A shortfall in FDI would not only open a balance of payments gap, but could also adversely affect GDP growth and widen the fiscal deficit, as illustrated in the downside scenario (Box 1).
- *An inadequate supply response to the recovery of demand growth.* The resulting overheating and loss of competitiveness would create new external imbalances down the road.

### Box 1. Georgia: Alternative Scenario with Lower FDI

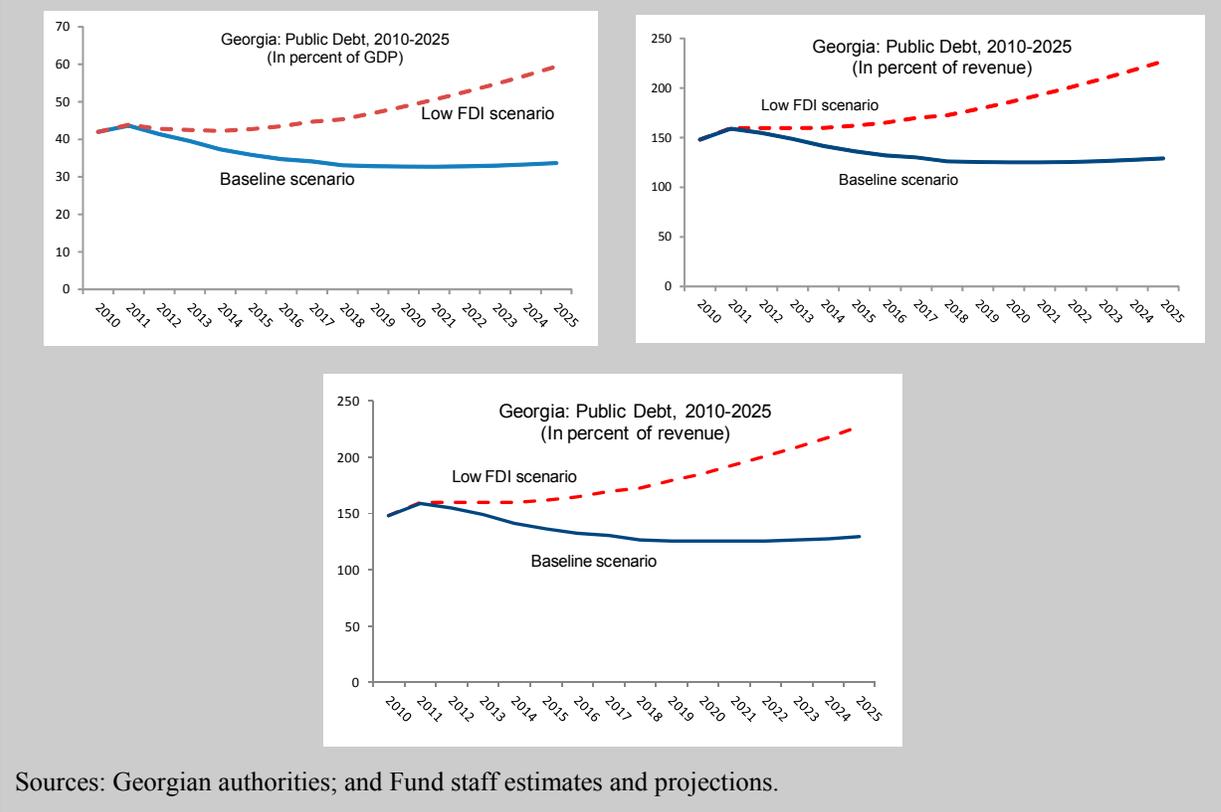
The scenario illustrates the risks associated with a failure of FDI to rebound as projected. The alternative scenario assumes a stabilization of FDI at 5 percent of GDP, slightly below the 2010 level. Assuming an unchanged productivity of capital, but a loss of export competitiveness, real GDP growth would decline to about 3½ percent on average over the next 5 years. The current account deficit would narrow quite sizably, but the balance of payments would deteriorate (relative to the baseline scenario) by the equivalent of 0.9 percent of GDP on average over the period 2011–15, and to 1.1 percent of GDP in 2015; the associated loss of international reserves would come to US\$625 million by 2015.

An imbalance would also appear in the fiscal accounts. Based on the same fiscal policy of the baseline scenario (same level of real expenditure and same tax-to-GDP ratio), the deficit would begin to rise again and reach 3.8 percent of GDP by 2015. The primary fiscal balance would exceed the debt-stabilizing level by 1.1 percentage point of GDP.

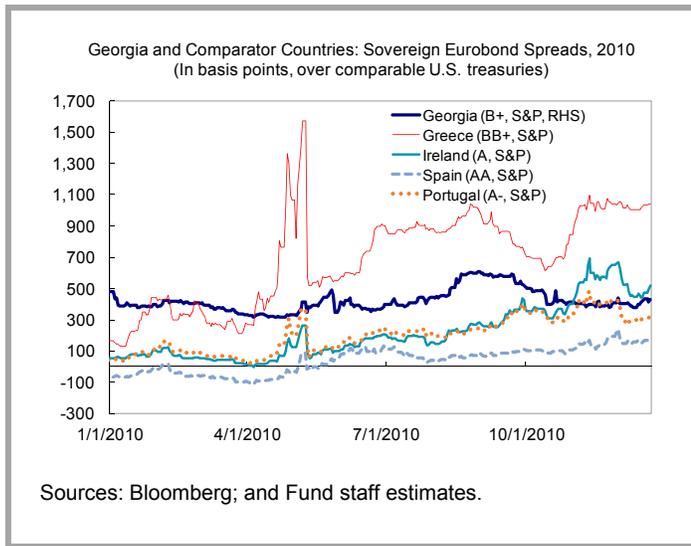
Georgia: Alternative Medium-Term Scenarios (2011–15)				
	2011-15 average		2015	
	central	low case	central	low case
Real GDP growth	4.9	3.6	5.0	3.3
Investment rate (in percent of GDP)	19.8	19.3	21.3	21.3
General government (in percent of GDP)				
Revenues	26.7	26.7	26.3	26.4
Tax revenue	24.2	24.2	24.2	24.2
Current expenditure	22.8	23.7	22.2	23.7
Capital expenditure	6.6	6.8	6.1	6.4
Balance	-2.8	-3.8	-2.0	-3.8
Total Public Debt	39.6	42.8	35.9	42.7
Investment and saving (in percent of GDP)				
Investment 1/	19.8	19.3	21.3	21.3
Public	6.0	6.2	6.0	6.2
Private	13.8	13.2	15.3	15.1
Gross national saving	9.1	10.1	12.2	13.9
Public	3.8	3.0	4.1	2.6
Private	5.2	7.0	8.1	11.2
Saving-investment balance = current account balance	-10.7	-9.3	-9.1	-7.4
External sector				
Exports of goods and services (percent of GDP)	34.1	33.9	34.7	33.7
volume, percentage change	7.8	5.9	7.3	3.9
percent change in volume/percent real GDP growth 2/	1.6	1.6	...	...
Imports of goods and services (percent of GDP)	49.9	33.9	48.4	33.7
volume, percentage change	5.7	3.4	5.7	3.4
percent change in volume/ percent real GDP growth 2/	1.2	1.0	...	...
Gross international reserves (in millions of US\$)	2,547	2,195	2,566	1,940
Gross international reserves (in percent of total external debt)	29	25	28	21
Foreign direct investment (percent of GDP)	7.4	5.0	7.8	5.0

Sources: Georgian authorities; and Fund staff estimates.

1/ Investment is measured on a net basis (acquisitions minus disposals of nonfinancial assets).  
2/ Cumulative 2011–15.



- Debt rollover.* The Debt Sustainability Analysis (DSA) points to low solvency risks, but high rollover risks in 2013 linked to high Fund and Eurobond repayment obligations. Recent rating upgrades should facilitate market rollover, but the amounts involved still pose risks. Although the resilience of the Georgian sovereign bond yield to the recent turbulence in the European markets is encouraging, contagion risks remain.



26. **To mitigate these risks, the authorities have expressed interest in a successor Fund arrangement.** Discussions could begin in April, based on the conclusions of the Article IV consultation (scheduled for March) and the Ex-Post Assessment Update (under preparation).

27. **Meanwhile, the authorities stand ready to tighten policies should foreign exchange depreciation pressures reemerge, beyond seasonal factors.** While continuing to

rely on exchange rate adjustment, the authorities also indicated that they could aim for a lower fiscal deficit.

#### IV. PROGRAM ISSUES

28. **Rephasing of purchases by combining the final two purchases into one purchase upon completion of the Ninth and final Review is requested owing to the delay in completing the Seventh and Eighth Reviews.** The delay stems from the additional time needed to assess exchange rate developments in November-December prior to setting NIR targets for 2011. The rephasing would combine the last two purchases under the program into a single purchase of SDR 70 million, which would become available upon completion of the last review scheduled for early June.

#### V. STAFF APPRAISAL

29. **Policies are on track and have broadly delivered on program objectives.** The economic recovery appears to be on a relatively solid footing, substantial progress has been made toward reestablishing fiscal sustainability, and banking sector indicators have improved markedly. However, net international reserves are still relatively low, which, together with remaining external risks, creates vulnerabilities for the exit strategy.

30. **Fiscal adjustment is largely in line with program objectives, but could have been accelerated in 2011 in view of the favorable cyclical conditions and remaining risks.** The commitment to cap expenditure in 2011 is welcome and provides reassurances that fiscal policy will be countercyclical, and that the deficit would decline further under an upside growth scenario. Faster fiscal adjustment in 2011, ahead of two election years, could have strengthened the exit strategy against external risks without undermining the recovery. Over the medium term, the relatively high share of capital spending in total government spending creates room for additional expenditure compression. However, revenue measures should also be considered if necessary to achieve the medium-term deficit objectives. In this regard, the introduction of an escape clause in the constitutional amendment subjecting tax increases to a referendum is welcome as it increases policy flexibility.

31. **While a pause in monetary tightening through the policy rate is appropriate at this juncture, the authorities should remain ready to tighten monetary policy should inflationary pressures persist.** The gap between the policy rate and the deposit rate has narrowed significantly. This should contribute to strengthen the traction of monetary policy going forward, as evidenced by the recent increase in local currency deposit rates in response to the earlier hikes in the policy rate. Given the uncertain lags in the transmission mechanism of monetary policy, further rate increases should be conditioned on evidence that inflation is not abating as expected. At the same time, reserve requirements on dollar deposits and foreign loans should be increased to complement the increase in domestic interest rates.

32. **Exchange rate flexibility should remain an essential instrument of adjustment in the event of less favorable external developments; moreover, the need to rebuild international reserves will limit considerably the room for intervention.** The program's international reserve target for 2011 also calls for more aggressive purchases of foreign exchange in the market, as those recently conducted by the NBG, when opportunities present themselves. Looking ahead, and consistent with preserving exchange rate flexibility, foreign exchange purchases could be undertaken on a pre-established calendar.

33. **An adjustment in financial regulations, which were loosened during the crisis, is warranted.** Given the impact of higher capital buffers on intermediation margins, ongoing capacity building toward risk-based supervision is welcome, as it will increase the efficiency of the banking system.

34. **In light of the authorities' commitment to reduce the 2011 fiscal deficit by more than envisaged at the time of the Sixth Review, staff supports the authorities' requests for completing the Seventh and Eighth Reviews,** for waivers of nonobservance of performance criteria, the establishment of end-March 2011 PCs, and rephrasing of purchases as specified in the LOI (¶ 29).

Table 1. Georgia: Selected Macroeconomic Indicators, 2008–15

	2008	2009	2010	2011	2012	2013	2014	2015
	Act.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
(Annual percentage change, unless otherwise indicated)								
National accounts								
Nominal GDP (in million lari)	19,075	17,986	20,490	23,018	25,619	28,514	31,737	35,323
Real GDP growth	2.3	-3.8	6.3	4.5	5.0	5.0	5.0	5.0
Population (in million) 1/	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
GDP deflator, period average	9.7	-2.0	7.2	7.5	6.0	6.0	6.0	6.0
Consumer price index, period average	10.0	1.7	7.0	8.8	6.0	6.0	6.0	6.0
Consumer price index, end-of-period	5.5	3.0	10.5	6.0	6.0	6.0	6.0	6.0
GDP per capita (in US\$)	2,937	2,455	2,618	2,880	3,089	3,338	3,607	3,898
Unemployment rate (in percent)	16.5	16.9	...	...	...	...	...	...
(In percent of GDP)								
Investment and saving								
Investment 2/	21.5	14.4	15.0	17.2	18.9	20.3	21.2	21.3
Public	4.3	6.9	7.2	6.4	6.1	5.8	5.8	6.0
Private	17.2	7.6	7.8	10.8	12.8	14.5	15.4	15.3
Gross national saving	-1.2	3.1	3.4	4.6	7.5	9.7	11.3	12.2
Public	2.2	-0.8	1.9	3.3	3.6	4.0	4.2	4.1
Private	-3.4	3.9	1.5	1.3	3.9	5.7	7.1	8.1
Saving-investment balance	-22.7	-11.3	-11.6	-12.6	-11.4	-10.6	-9.9	-9.1
Consolidated government operations								
Total government debt	25.0	37.0	42.0	43.6	41.4	39.5	37.3	35.9
<i>Of which</i> : foreign-currency denominated	20.9	31.4	36.4	38.4	36.1	35.1	32.7	29.3
Revenue 3/	30.7	29.3	28.4	27.4	26.8	26.6	26.4	26.3
Expenses	28.5	30.1	26.4	24.1	23.2	22.6	22.2	22.2
Operating balance	2.2	-0.8	1.9	3.3	3.6	4.0	4.2	4.1
Capital spending and net lending	8.6	8.4	8.8	7.6	6.9	6.5	6.1	6.1
Overall balance	-6.3	-9.2	-6.8	-4.3	-3.3	-2.5	-1.9	-2.0
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total financing	6.3	9.2	6.8	4.3	3.3	2.5	1.9	2.0
Domestic	-2.3	3.3	0.2	0.9	0.8	-0.2	0.7	2.4
External	5.0	3.9	5.6	2.7	2.1	2.5	1.1	-0.4
Privatization receipts	3.7	2.0	1.0	0.7	0.4	0.2	0.2	0.0
(Annual percentage change, unless otherwise indicated)								
Monetary sector								
Reserve money	-4.5	21.8	5.9	6.1	...	...	...	...
Broad money (including fx deposits) 4/	7.0	8.1	22.0	20.0	...	...	...	...
Bank credit to the private sector	28.2	-13.5	12.9	16.4	...	...	...	...
Deposit interest rate (annual weighted average on flows)	9.5	9.8	...	...	...	...	...	...
Lending interest rate (annual weighted average on flows)	21.9	22.4	...	...	...	...	...	...
External sector								
Exports of goods and services (percent of GDP)	28.7	29.7	33.0	33.4	33.8	34.2	34.4	34.7
Annual percentage change	15.9	-13.2	18.5	11.5	8.5	9.2	8.9	9.1
Imports of goods and services (percent of GDP)	58.3	48.9	52.4	52.0	50.6	49.4	48.9	48.4
Annual percentage change	26.7	-29.8	14.3	9.2	4.5	5.6	7.0	7.0
Net imports of oil (in US\$)	762	555	631	679	742	802	847	892
Current account balance (in millions of US\$)	-2,915	-1,216	-1,329	-1,587	-1,551	-1,556	-1,566	-1,559
In percent of GDP	-22.7	-11.3	-11.6	-12.6	-11.4	-10.6	-9.9	-9.1
Gross international reserves (in millions of US\$)	1,480	2,111	2,202	2,615	2,545	2,545	2,465	2,566
In months of next year's imports of goods and services	3.4	4.2	4.0	4.6	4.2	3.9	3.6	3.5
Foreign direct investment (percent of GDP)	12.2	6.1	5.2	6.6	7.1	7.5	7.8	7.8
Average exchange rate (lari per US\$)	1.48	1.67	...	...	...	...	...	...

Sources: Georgian authorities; and Fund staff estimates.

1/ Excludes Abkhazia residents.

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

3/ Includes grants.

4/ The proceeds of the Georgian Railway eurobond issuance from July 2010, which were deposited in accounts with Georgian commercial banks that placed them abroad are not included in broad money.

Table 2. Georgia: Annual General Government Operations, 2009-15 1/

	2009	2010		2011		2012	2013	2014	2015	2009	2010		2011		2012	2013	2014	2015
		6 Rev.	Proj.	6 Rev.	Proj.						6 Rev.	Proj.	6 Rev.	Proj.				
	(In millions of lari)									(In percent of GDP)								
Revenues	5,264	5,865	5,809	6,238	6,315	6,861	7,575	8,367	9,299	29.3	29.8	28.4	29.1	27.4	26.8	26.6	26.4	26.3
Taxes	4,389	4,859	4,860	5,500	5,571	6,201	6,902	7,681	8,549	24.4	24.7	23.7	25.6	24.2	24.2	24.2	24.2	24.2
Other revenues	487	440	440	440	440	500	527	555	618	2.7	2.2	2.1	2.0	1.9	1.9	1.8	1.7	1.7
Grants	389	566	510	297	304	160.4	146	130	131	2.2	2.9	2.5	1.4	1.3	0.6	0.5	0.4	0.4
Current expenditures	5,407	5,441	5,413	5,695	5,550	5,938	6,435	7,033	7,843	30.1	27.7	26.4	26.5	24.1	23.2	22.6	22.2	22.2
Compensation of employees	1,048	1,151	1,151	1,209	1,208	1,280	1,410	1,540	1,714	5.8	5.9	5.6	5.6	5.2	5.0	4.9	4.9	4.9
Use of goods and services	1,105	1,062	1,062	1,100	1,016	1,130	1,220	1,370	1,525	6.1	5.4	5.2	5.1	4.4	4.4	4.3	4.3	4.3
Subsidies	420	384	384	380	380	380	390	430	479	2.3	2.0	1.9	1.8	1.6	1.5	1.4	1.4	1.4
Grants	14	12	12	19	12	20	22	24	27	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Social expenses	1,506	1,611	1,611	1,717	1,631	1,820	2,020	2,220	2,471	8.4	8.2	7.9	8.0	7.1	7.1	7.1	7.0	7.0
Other expenses	1,142	969	969	967	1,013	970	940	1,030	1,146	6.3	4.9	4.7	4.5	4.4	3.8	3.3	3.2	3.2
Interest	171	252	224	303	292	338	433	419	481	1.0	1.3	1.1	1.4	1.3	1.3	1.5	1.3	1.4
To nonresidents	113	171	160	184	191	184	275	254	254	0.6	0.9	0.8	0.9	0.8	0.7	1.0	0.8	0.7
To residents	58	81	64	119	101	154	158	165	228	0.3	0.4	0.3	0.6	0.4	0.6	0.6	0.5	0.6
Operating balance	-143	424	397	542	765	923	1,140	1,334	1,456	-0.8	2.2	1.9	2.5	3.3	3.6	4.0	4.2	4.1
Capital spending and net lending	1,506	1,664	1,794	1,580	1,748	1,770	1,850	1,940	2,159	8.4	8.5	8.8	7.4	7.6	6.9	6.5	6.1	6.1
Capital	1,444	1,702	1,674	1,580	1,630	1,660	1,690	1,890	2,104	8.0	8.7	8.2	7.4	7.1	6.5	5.9	6.0	6.0
Net lending	62	-37	120	0	118	110	160	50	56	0.3	-0.2	0.6	0.0	0.5	0.4	0.6	0.2	0.2
Overall balance	-1,648	-1,241	-1,397	-1,038	-983	-847	-710	-606	-703	-9.2	-6.3	-6.8	-4.8	-4.3	-3.3	-2.5	-1.9	-2.0
Statistical discrepancy	0	0	0	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total financing	1,648	1,241	1,397	1,038	983	847	710	606	703	9.2	6.3	6.8	4.8	4.3	3.3	2.5	1.9	2.0
Domestic	596	-62	42	378	209	216	-49	213	856	3.3	-0.3	0.2	1.8	0.9	0.8	-0.2	0.7	2.4
Net T-bill issuance	260	100	171	293	100	251	-14	248	891	1.4	0.5	0.8	1.4	0.4	1.0	0.0	0.8	2.5
Amortization 2/	-37	-35	-39	-42	-35	-35	-35	-35	-35	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1
Use of deposits at the NBG and banks	373	-127	-91	127	144	0	0	0	0	2.1	-0.6	-0.4	0.6	0.6	0.0	0.0	0.0	0.0
External	694	1,093	1,155	510	624	531	709	343	-152	3.9	5.6	5.6	2.4	2.7	2.1	2.5	1.1	-0.4
Borrowing	787	1,241	1,291	644	761	651	2,220	672	697	4.4	6.3	6.3	3.0	3.3	2.5	7.8	2.1	2.0
of which: IMF	170	524	523	0	0	0	0	0	0	0.9	2.7	2.6	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-133	-148	-136	-134	-137	-120	-1,511	-329	-849	-0.7	-0.8	-0.7	-0.6	-0.6	-0.5	-5.3	-1.0	-2.4
Use of Sovereign Wealth Fund resources	40	0	0	0	0	0	0	0	0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts	358	210	200	150	150	100	50	50	0	2.0	1.1	1.0	0.7	0.7	0.4	0.2	0.2	0.0
Memorandum items:																		
Nominal GDP	17,986	19,657	20,490	21,465	23,018	25,619	28,514	31,737	35,323	11.3	9.2	9.3	6.2	5.6	3.9	3.0	2.3	2.4
Fiscal deficit excluding grants	2,037	1,807	1,907	1,335	1,287	1,008	856	736	834	38.4	36.1	35.2	33.9	31.7	30.1	29.1	28.3	28.3
Total expenditures (current prices) 3/	6,913	7,106	7,206	7,275	7,298	7,708	8,285	8,973	10,002									
Total expenditures (constant 2008 prices)	7,055	...	6,859	...	6,461	6,438	6,528	6,670	7,014									

Sources: Ministry of Finance; and Fund staff estimates.

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

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

3/ Including net lending.

Table 3. Georgia: Quarterly General Government Operations, 2009-11 1/

	2009					2010					2011				
	Q1 Act.	Q2 Act.	Q3 Act.	Q4 Act.	Annual Act.	Q1 Act.	Q2 Act.	Q3 Act.	Q4 Proj.	Annual Proj.	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Annual Proj.
	(In millions of lari)														
Revenues	1,267	1,118	1,292	1,588	5,264	1,318	1,436	1,481	1,574	5,809	1,383	1,550	1,624	1,758	6,315
Taxes	1,139	996	1,094	1,159	4,389	1,130	1,229	1,229	1,273	4,860	1,247	1,395	1,449	1,480	5,571
Direct	458	452	475	473	1,858	511	515	479	500	2,004	532	569	586	567	2,253
Indirect	681	544	619	687	2,531	619	714	750	773	2,856	715	826	863	913	3,318
Other revenues	79	84	107	217	487	97	147	120	76	440	71	81	99	189	440
Grants	48	38	90	212	389	92	60	133	225	510	65	73	77	89	304
Current expenditures	1,296	1,300	1,282	1,529	5,407	1,208	1,380	1,343	1,481	5,413	1,254	1,379	1,411	1,506	5,550
Employee compensation	248	260	251	289	1,048	263	288	268	333	1,151	270	290	295	353	1,208
Use of goods and services	207	273	260	365	1,105	203	273	286	300	1,062	202	248	275	291	1,016
Subsidies	87	105	104	125	420	85	99	90	110	384	90	95	97	98	380
Grants	7	3	2	3	14	5	2	3	2	12	3	3	3	3	12
Social expenses	352	377	377	400	1,506	399	408	402	402	1,611	408	408	408	408	1,631
Other expenses	370	226	259	288	1,142	220	246	256	248	969	225	248	273	267	1,013
Interest	26	56	30	59	171	33	65	39	87	224	56	87	60	88	292
To nonresidents	13	40	16	45	113	17	48	21	74	160	33	60	33	65	191
To residents	13	16	14	15	58	16	18	18	13	64	23	28	28	23	101
Operating balance	-30	-182	9	59	-143	110	56	138	93	397	129	171	213	252	765
Capital spending and net lending	199	338	474	495	1,506	206	412	459	717	1,794	299	441	461	547	1,748
Capital	169	333	452	490	1,444	233	422	402	619	1,674	256	413	441	521	1,630
Net lending	30	5	22	5	62	-27	-10	57	98	120	43	28	21	26	118
Overall balance	-228	-520	-464	-436	-1,648	-96	-356	-321	-624	-1,397	-170	-270	-248	-295	-983
Statistical discrepancy	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total financing	228	520	464	436	1,648	96	356	321	624	1,397	170	270	248	295	983
Domestic	63	375	103	55	596	-348	283	-60	167	42	72	153	35	-51	209
Net T-Bill issuance	0	0	68	192	260	67	41	63	0	171	9	9	38	45	100
Amortization 2/	-9	-11	-12	-5	-37	-12	-14	-9	-4	-39	-5	-12	-10	-8	-35
Use of deposits at the NBG and banks	72	386	48	-132	373	-403	255	-115	172	-91	69	156	7	-88	144
External	64	40	301	289	694	411	45	304	396	1,155	71	91	170	292	624
Borrowing	37	60	377	313	787	424	65	370	431	1,291	94	117	225	324	761
Of which: IMF	0	0	0	170	170	385	0	138	0	523	0	0	0	0	0
Amortization	-13	-20	-76	-24	-133	-13	-20	-67	-36	-136	-23	-27	-56	-31	-137
Use of Sovereign Wealth Fund resources	40	0	0	0	40	0	0	0	0	0	0	0	0	0	0
Privatization receipts	101	106	60	91	358	33	29	78	61	200	26	27	43	54	150
Memorandum items:															
Nominal GDP	3,971	4,275	4,590	5,149	17,986	4,294	5,044	5,429	5,723	20,490	4,862	5,647	5,991	6,519	23,018
Total expenditures 3/	1,495	1,638	1,756	2,024	6,913	1,414	1,792	1,802	2,198	7,206	1,553	1,820	1,872	2,053	7,298

Sources: Ministry of Finance; and Fund staff estimates.

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

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

3/ Including net lending.

Table 4. Georgia: Summary Balance of Payments, 2008–15  
(In millions of U.S. dollars)

	2008	2009		2010		2011	2012	2013	2014	2015
		6th Review	6th Review	6th Review	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-2,915	-1,274	-1,216	-1,355	-1,329	-1,587	-1,551	-1,556	-1,566	-1,559
Trade balance	-3,833	-2,400	-2,399	-2,446	-2,630	-2,847	-2,851	-2,893	-3,028	-3,195
Exports	2,428	1,893	1,894	2,452	2,339	2,592	2,802	3,060	3,342	3,632
Imports	-6,261	-4,293	-4,293	-4,898	-4,969	-5,439	-5,653	-5,953	-6,369	-6,827
Services	23	332	333	261	402	501	569	648	727	845
Services: credit	1,260	1,306	1,308	1,395	1,455	1,638	1,789	1,955	2,123	2,329
Services: debit	-1,238	-974	-975	-1,134	-1,053	-1,137	-1,220	-1,307	-1,396	-1,484
Income (net)	-165	-158	-118	-285	-177	-282	-300	-355	-354	-344
Of which: interest payments	-248	-246	-247	-323	-311	-383	-402	-452	-449	-450
Transfers (net)	1,060	952	967	1,115	1,075	1,041	1,031	1,044	1,089	1,134
Of which: public sector	365	134	140	225	187	128	82	56	55	54
Capital account	105	178	183	231	221	116	97	88	80	81
General government	87	168	170	224	203	91	60	50	40	39
Other sectors	18	11	13	7	18	25	37	38	40	42
Financial account	2,808	1,545	1,431	853	923	1,684	1,627	1,850	1,744	1,788
Direct investment (net)	1,523	765	659	694	603	835	964	1,095	1,218	1,317
Monetary authorities, net 1/	21	247	247	0	0	0	0	0	0	0
General government	651	384	386	324	367	431	287	571	251	30
Portfolio investment (net)	501	0	0	0	0	0	0	800	0	0
of which: liabilities	508	0	0	0	0	0	0	800	0	0
Long-term loans received	191	358	359	324	366	431	287	-229	251	30
Drawing	227	427	428	404	440	506	345	343	336	339
Repayment	-36	-69	-69	-80	-75	-75	-58	-572	-85	-308
Other, net	-41	26	27	0	1	0	0	0	0	0
Private Sector, excl. FDI	612	149	139	-165	-46	417	376	184	275	440
Banks	403	37	-60	46	-175	315	146	126	191	254
Portfolio investment, net	109	7	8	1	52	5	2	13	12	12
Of which: equity liabilities	101	7	8	1	52	5	7	10	12	13
Loans received (net)	596	-228	-239	-46	-51	-110	57	88	149	210
Other, net (currency and deposits)	-302	258	171	92	-176	420	87	25	30	32
Other sectors	209	112	199	-211	129	102	230	58	84	186
Portfolio investment, net	14	-2	4	-2	247	0	10	11	22	24
Long-term loans received (net)	59	97	152	-73	-91	46	100	25	25	30
Other, net	137	17	43	-136	-27	56	120	22	36	132
Errors and omissions	-49	13	55	0	72	0	0	0	0	0
Overall balance	-51	462	451	-271	-113	213	173	383	258	310
Financing	51	-462	-451	271	113	-213	-173	-383	-258	-310
Gross International Reserves (-increase)	-131	-616	-616	-154	-158	-413	70	0	80	-100
Use of Fund Resources	222	313	313	425	277	200	-243	-383	-338	-209
Purchases (SBA)	257	340	340	446	298	258	0	0	0	0
Of which: augmentation	...	...	...	301	303	258	...	...	...	...
Repayments (SBA and ECF 2/)	-35	-28	-28	-21	-21	-58	-243	-383	-338	-209
Exceptional financing	-39	-159	-148	0	-7	0	0	0	0	0
<b>Memorandum items:</b>										
Nominal GDP	12,870	10,745	10,768	10,745	11,491	12,647	13,576	14,683	15,879	17,173
Current account balance (percent of GDP)	-22.7	-11.9	-11.3	-12.6	-11.6	-12.6	-11.4	-10.6	-9.9	-9.1
excluding official transfers (percent of GDP)	-25.5	-13.1	-12.6	-14.7	-13.2	-13.6	-12.0	-11.0	-10.2	-9.4
Trade balance (in percent of GDP)	-29.8	-22.3	-22.3	-22.8	-22.9	-22.5	-21.0	-19.7	-19.1	-18.6
GNFS exports growth (percent)	15.9	-13.3	-13.2	20.2	18.5	11.5	8.5	9.2	8.9	9.1
GNFS exports volume growth (percent)	-1.0	0.4	0.4	4.4	5.0	8.7	7.9	7.8	7.6	7.3
GNFS imports growth (percent)	26.7	-29.8	-29.8	14.5	14.3	9.2	4.5	5.6	7.0	7.0
GNFS imports volume growth (percent)	8.3	-17.5	-17.5	5.4	3.6	7.5	4.5	5.3	5.7	5.7
Net capital inflows to private sector	2,135	913	798	529	556	1,253	1,340	1,279	1,493	1,757
(in percent of GDP)	16.6	8.5	7.4	4.9	4.8	9.9	9.9	8.7	9.4	10.2
Gross international reserves (end of period)	1,480	2,110	2,111	2,213	2,202	2,615	2,545	2,545	2,465	2,566
(in months of next year GNFS imports)	3.4	4.2	4.2	4.1	4.0	4.6	4.2	3.9	3.6	3.5
External debt (nominal)	5,664	6,274	6,254	7,391	7,397	8,238	8,515	8,831	9,099	9,082
(in percent of GDP)	44.0	58.4	58.1	68.8	64.4	65.1	62.7	60.1	57.3	52.9
MLT External debt service	590	768	758	719	758	881	1,270	1,906	1,257	1,426
(in percent of exports)	16.0	24.0	23.7	18.7	20.0	20.8	27.7	38.0	23.0	23.9
External public sector debt (nominal)	2,691	3,382	3,382	4,366	4,186	4,855	4,903	5,150	5,185	5,037
(in percent of GDP)	20.9	31.5	31.4	40.6	36.4	38.4	36.1	35.1	32.7	29.3
External public debt service	125	168	168	197	193	252	434	1,131	586	683
(in percent of exports)	3.4	5.2	5.3	5.1	5.1	6.0	9.4	22.5	10.7	11.5

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

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

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

Table 5. Georgia: Accounts of the National Bank of Georgia, 2009–11

	2009				2010				2011			
	Mar. Act.	Jun. Act.	Sep. Act.	Dec. Act.	Mar. Act.	Jun. Act.	Sep. Act.	Dec. Proj.	Mar. Proj.	Jun. Proj.	Sep. Proj.	Dec. Proj.
	(In millions of lari)											
Net foreign exchange position	1,313	1,303	1,489	1,842	2,117	1,698	1,961	2,124	2,027	2,068	2,143	2,321
Gross International Reserves	2,493	2,517	3,371	3,558	3,847	3,438	3,812	3,920	4,340	4,606	4,711	4,865
Other foreign assets	35	14	15	5	6	5	5	5	5	5	5	5
Foreign currency liabilities	-1,215	-1,228	-1,896	-1,722	-1,736	-1,746	-1,856	-1,801	-2,318	-2,543	-2,572	-2,549
<i>Of which</i> : use of Fund resources	-1,040	-1,068	-1,330	-1,149	-1,143	-1,165	-1,186	-1,142	-1,410	-1,614	-1,618	-1,568
<i>Of which</i> : compulsory reserves in USD	-125	-109	-122	-127	-142	-148	-242	-247	-491	-508	-529	-550
<i>Of which</i> : swap liabilities	0	-30	-61	-61	-63	-33	0	0	0	0	0	0
Net domestic assets	-47	226	201	-98	-484	-37	-265	-277	-245	-232	-277	-361
Net claims on general government	-34	398	441	173	-194	52	-73	36	82	175	116	-19
Claims on general government (incl. T-bills)	777	778	764	758	746	733	718	711	704	699	687	677
Nontradable govt. debt	641	641	641	641	601	601	601	601	553	553	553	553
Securitized debt (marketable)	136	137	123	118	146	132	117	110	151	146	134	124
Deposits	-812	-380	-323	-585	-940	-681	-790	-674	-621	-523	-570	-695
Claims on rest of economy	4	4	4	3	3	3	2	2	2	2	2	2
Claims on banks	90	-17	-41	-114	-89	57	-7	-127	-117	-174	-136	-62
Bank refinancing	204	102	45	45	45	217	185	185	185	185	185	185
Certificates of deposits and bonds	-114	-148	-146	-219	-194	-190	-192	-312	-302	-359	-321	-247
Other items, net	-106	-160	-203	-160	-204	-149	-188	-189	-213	-236	-259	-283
Reserve money	1,267	1,529	1,691	1,744	1,633	1,661	1,696	1,848	1,781	1,836	1,866	1,959
Currency in circulation	1,141	1,201	1,286	1,458	1,399	1,460	1,501	1,650	1,575	1,625	1,650	1,750
Bank lari reserves 1/	126	328	405	286	235	127	150	152	161	166	171	164
Overnight deposits	0	0	0	0	0	74	45	45	45	45	45	45
	(Percent contribution, compared to reserve money at the end of previous year)											
Net foreign exchange position	-15.0	-15.7	-2.7	21.9	15.8	-8.2	6.8	16.2	-5.3	-3.0	1.0	10.6
Net domestic assets	3.4	22.5	20.8	-0.1	-22.2	3.5	-9.6	-10.3	1.7	2.4	0.0	-4.6
Net claims on general government	4.8	35.0	38.0	19.3	-21.1	-7.0	-14.1	-7.8	2.5	7.5	4.3	-3.0
Claims on rest of economy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on banks	-2.9	-10.4	-12.1	-17.2	1.4	9.8	6.1	-0.7	0.5	-2.6	-0.5	3.5
Other items, net	1.6	-2.2	-5.1	-2.2	-2.5	0.7	-1.6	-1.7	-1.3	-2.5	-3.8	-5.1
	(Percentage change, relative to end of previous year)											
Reserve money	-11.5	6.8	18.1	21.8	-6.3	-4.8	-2.8	5.9	-3.6	-0.6	1.0	6.1
Currency in circulation	-11.6	-6.9	-0.4	13.0	-4.1	0.2	2.9	13.2	-4.5	-1.5	0.0	6.1
Bank lari reserves 1/	-11.0	132.0	186.9	102.5	-18.0	-55.8	-47.7	-46.7	5.8	8.9	12.1	7.8
<b>Memorandum items:</b>												
Net international reserves												
(in millions of USD, at prog. exchange rates) 2/	777	775	876	987	897	647	708	825	757	771	805	885
Net domestic assets (in millions of lari, at prog. exchange rate) 2/	-66	189	228	95	135	579	513	470	516	548	521	481
Reserve money (in percent, 12-month growth)	-10.4	-4.5	-2.5	21.8	28.9	8.6	0.3	5.9	9.1	8.5	12.4	6.1

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

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

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

Table 6. Georgia: Monetary Survey, 2009–11

	2009				2010				2011			
	Mar. Act.	Jun. Act.	Sep. Act.	Dec. Act.	Mar. Act.	Jun. Act.	Sep. Act.	Dec. Proj.	Mar. Proj.	Jun. Proj.	Sep. Proj.	Dec. Proj.
	(In millions of lari)											
Net foreign assets	-356	-357	240	789	1,067	800	1,249	1,340	1,343	1,357	1,455	1,563
NBG	1,438	1,442	1,672	2,030	2,323	1,880	2,203	2,371	2,518	2,576	2,671	2,871
Commercial banks 1/	-1,794	-1,800	-1,432	-1,241	-1,256	-1,079	-954	-1,031	-1,175	-1,219	-1,216	-1,307
<i>Of which: liabilities</i>	-2,760	-2,446	-2,319	-2,229	-2,197	-2,303	-2,157	-2,216	-2,129	-2,184	-2,192	-2,293
Net domestic assets	4,031	3,952	3,852	3,814	3,669	4,242	4,139	4,275	4,577	4,794	5,010	5,175
Domestic credit	5,644	5,733	5,676	5,539	5,418	6,041	6,125	6,253	6,586	6,832	7,077	7,272
Net claims on general government	-114	270	387	280	-5	230	206	316	370	472	451	361
<i>Of which: government deposits at NBG</i>	-812	-380	-323	-585	-940	-681	-790	-674	-621	-523	-570	-695
<i>Of which: T-bills at commercial banks</i>			68	260	326	368	431	431	439	448	486	531
Credit to the rest of the economy	5,758	5,462	5,289	5,259	5,423	5,811	5,919	5,937	6,216	6,360	6,626	6,911
Other items, net	-1,613	-1,781	-1,824	-1,725	-1,749	-1,799	-1,986	-1,978	-2,008	-2,037	-2,067	-2,097
Broad money (M3) 1/	3,675	3,594	4,092	4,603	4,736	5,042	5,388	5,615	5,920	6,152	6,465	6,738
Broad money, excl. forex deposits (M2)	1,634	1,709	1,914	2,133	2,215	2,347	2,458	2,630	2,676	2,789	2,910	3,073
Currency held by the public	960	1,020	1,093	1,229	1,187	1,269	1,307	1,456	1,381	1,431	1,456	1,556
Total deposit liabilities	2,715	2,574	2,999	3,373	3,549	3,773	4,081	4,159	4,539	4,721	5,009	5,182
	(Percent contribution, compared to broad money at the end of previous year)											
Net foreign assets	-10.2	-10.3	3.8	16.7	6.0	0.3	10.0	12.0	0.1	0.3	2.0	4.0
Net domestic assets	-3.5	-5.3	-7.7	-8.6	-3.1	9.3	7.1	10.0	5.4	9.2	13.1	16.0
Domestic credit	-6.5	-4.4	-5.8	-9.0	-2.6	10.9	12.7	15.5	5.9	10.3	14.7	18.1
Net claims on general government	1.0	10.0	12.7	10.2	-6.2	-1.1	-1.6	0.8	1.0	2.8	2.4	0.8
Credit to the rest of the economy	-7.5	-14.4	-18.5	-19.2	3.6	12.0	14.3	14.7	5.0	7.5	12.3	17.3
Other items, net	3.0	-0.9	-1.9	0.4	-0.5	-1.6	-5.7	-5.5	-0.5	-1.1	-1.6	-2.1
	(Percentage change, relative to end of previous year)											
Broad money (M3)	-13.7	-15.6	-3.9	8.1	2.9	9.6	17.1	22.0	5.4	9.6	15.1	20.0
Broad money, excl. forex deposits (M2)	-11.9	-7.8	3.2	15.0	3.9	10.1	15.3	23.3	1.7	6.1	10.6	16.9
Currency held by the public	-11.3	-5.7	1.0	13.6	-3.5	3.3	6.3	18.4	-5.2	-1.7	0.0	6.9
Total deposit liabilities	-14.5	-19.0	-5.6	6.2	5.2	11.8	21.0	23.3	9.1	13.5	20.4	24.6
Credit to the rest of the economy	-5.2	-10.1	-13.0	-13.5	3.1	10.5	12.5	12.9	4.7	7.1	11.6	16.4
<b>Memorandum items:</b>												
M3 (in percent, 12-month growth)	-8.7	-14.2	3.2	8.1	28.9	40.3	31.7	22.0	5.4	9.6	15.1	20.0
M2 (in percent, 12-month growth)	-27.7	-29.3	-15.2	15.0	35.6	37.3	28.5	23.3	1.7	6.1	10.6	16.9
Credit to the economy (in percent, 12-month growth)	13.6	-2.4	-4.0	-13.5	-5.8	6.4	11.9	12.9	4.7	7.1	11.6	16.4
Ratio of bank lari reserves to lari deposits 2/	18.6	47.6	49.4	31.7	22.8	18.6	16.9	16.8	15.9	15.5	14.9	13.8
M3 multiplier	2.64	2.19	2.26	2.46	2.67	2.79	2.89	2.78	2.78	2.81	2.88	2.87
M3 velocity	5.13	5.06	4.40	3.91	3.87	4.06	3.70	3.65	3.56	3.52	3.44	3.42
Foreign exchange deposits in percent of total deposits	75.2	73.2	72.6	73.2	71.0	71.4	71.8	71.8	71.5	71.2	71.0	70.7

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

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

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

Table 7. Georgia: External Vulnerability Indicators, 2008-15

	2008	2009	2010	2011	2012	2013	2014	2015
	Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Value of exports of goods and services, percent change	15.9	-13.2	18.5	11.5	8.5	9.2	8.9	9.1
Value of imports of goods and services, percent change	26.7	-29.8	14.3	9.2	4.5	5.6	7.0	7.0
Terms of trade (deterioration - )	0.1	1.5	2.4	1.0	0.5	1.0	0.1	0.5
Current account balance (percent of GDP)	-22.7	-11.3	-11.6	-12.6	-11.4	-10.6	-9.9	-9.1
Capital and financial account (percent of GDP)	22.6	15.0	10.0	14.2	12.7	13.2	11.5	10.9
External public debt (percent of GDP)	20.9	31.4	36.4	38.4	36.1	35.1	32.7	29.3
in percent of exports of goods and services	73.0	105.6	110.3	114.8	106.8	102.7	94.9	84.5
Debt service on external public debt (in percent of exports of goods and services)	3.4	5.3	5.1	6.0	9.4	22.5	10.7	11.5
External debt (percent of GDP)	44.0	58.1	64.4	65.1	62.7	60.1	57.3	52.9
in percent of exports of goods and services	153.6	195.3	194.9	194.7	185.5	176.1	166.5	152.4
Debt service on MLT external debt (in percent of exports of goods and services)	16.0	23.7	20.0	20.8	27.7	38.0	23.0	23.9
Gross international reserves								
in millions of USD	1,480	2,111	2,202	2,615	2,545	2,545	2,465	2,566
in months of next year's imports of goods and services	3.4	4.2	4.0	4.6	4.2	3.9	3.6	3.5
in percent of external debt	26.1	33.7	29.8	31.7	29.9	28.8	27.1	28.2
in percent of short-term external debt (remaining maturity)	101	162	156	141	107	157	135	114

Source: Fund staff estimates and projections.

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

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
			Proj.							
<b>Existing Fund credit</b>										
Stock 1/	298.8	501.6	682.1	644.0	484.1	233.0	66.2	14.0	4.2	0.0
ECF 2/	137.1	119.1	105.0	87.1	67.2	47.6	29.4	14.0	4.2	0.0
SBA	161.7	382.5	577.1	556.9	416.9	185.4	36.8	0.0	0.0	0.0
Obligations	23.3	22.5	21.6	46.2	167.6	256.4	168.8	52.5	9.8	4.2
ECF 2/	22.8	18.6	14.1	17.9	20.1	19.7	18.3	15.5	9.8	4.2
SBA 3/	0.5	3.9	7.5	28.3	147.5	236.6	150.5	37.1	0.0	0.0
<b>Prospective purchases under the SBA</b>										
Disbursements	...	...	0.0	170.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	...	...	0.0	170.0	170.0	170.0	115.0	30.0	0.0	0.0
Obligations 3/	...	...	0.0	1.6	2.4	2.4	57.2	86.2	30.1	0.0
Principal (repurchases)	...	...	0.0	0.0	0.0	0.0	55.0	85.0	30.0	0.0
GRA charges	...	...	0.0	1.6	2.4	2.4	2.2	1.2	0.1	0.0
<b>Surcharges</b>	...	...	1.4	4.8	5.0	2.0	0.0	0.0	0.0	0.0
<b>Stock of existing and prospective Fund credit 1/</b>	298.8	501.6	682.1	814.0	654.1	403.0	181.2	44.0	4.2	0.0
In percent of quota	198.8	333.7	453.8	541.6	435.2	268.1	120.6	29.3	2.8	0.0
In percent of GDP	3.7	7.2	9.0	9.8	7.3	4.2	1.7	0.4	0.0	0.0
In percent of exports of goods and nonfactor services	12.8	24.2	27.3	29.2	21.7	12.2	5.1	1.1	0.1	0.0
In percent of gross reserves	31.9	36.7	47.0	47.3	39.1	24.1	11.2	2.6	0.2	0.0
In percent of public external debt	17.5	22.9	24.7	25.5	20.3	11.9	5.3	1.3	0.1	0.0
<b>Obligations to the Fund from existing and prospective Fund credit 3/</b>	23.3	22.5	23.0	52.6	175.0	260.8	226.0	138.7	40.0	4.2
In percent of quota	15.5	15.0	15.3	35.0	116.5	173.5	150.4	92.3	26.6	2.8
In percent of GDP	0.3	0.3	0.3	0.6	2.0	2.7	2.2	1.2	0.3	0.0
In percent of exports of goods and nonfactor services	1.0	1.1	0.9	1.9	5.8	7.9	6.3	3.6	1.0	0.1
In percent of gross reserves	2.5	1.6	1.6	3.1	10.5	15.6	14.0	8.3	2.2	0.2
In percent of public external debt service	29.4	20.7	18.1	31.7	61.4	35.1	58.8	31.0	10.7	1.2

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.

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

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

Availability Date	Condition	Available Purchases	
		(In millions of SDR)	(In percent of quota)
15-Sep-08	Approve the 18-month arrangement	161.7	107.6
15-Dec-08	Complete the first review based on end-September 2008 performance criteria and other relevant performance criteria 2/	63.1	42.0
23-Mar-09	Complete the second review based on end-December 2008 performance criteria and other relevant performance criteria 2/	63.1	42.0
6-Aug-09	Complete the third review based on end-June 2009 performance criteria and other relevant performance criteria	94.6	62.9
15-Nov-09	Complete the fourth review based on end-September 2009 performance criteria and other relevant performance criteria	47.3	31.5
15-Feb-10	Complete the fifth review based on end-December 2009 performance criteria and other relevant performance criteria	97.3	64.7
9-Jul-10	Complete the sixth review based on end-June 2010 performance criteria and other relevant performance criteria	50.0	33.3
15-Nov-10	Complete the seventh and eighth reviews based on end-December 2010 performance criteria and other relevant performance criteria	100.0	66.5
15-May-11	Complete the ninth review based on end-March 2011 performance criteria and other relevant performance criteria	70.0	46.6
Total available		747.1	497.1

1/ Reflects the augmentation of access by SDR270 million and the extended arrangement through June 2011.

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

Table 10. Georgia: External Financing Requirements and Sources, 2008–15

(In millions of U.S. dollars)

	2008	2009	2010	2011	2012	2013	2014	2015
Total requirements	-3,278	-1,727	-1,791	-2,104	-2,437	-3,023	-2,385	-2,548
Current account deficit	-2,915	-1,216	-1,329	-1,587	-1,551	-1,556	-1,566	-1,559
Capital outflows: Repayments of MLT loans	-362	-511	-461	-517	-886	-1,467	-819	-988
Total sources	3,278	1,727	1,790	2,104	2,437	3,023	2,385	2,548
Capital flows	3,191	2,151	1,656	2,259	2,367	3,023	2,305	2,648
Public sector	795	872	645	597	405	1,193	376	378
Project grants	87	170	203	91	60	50	40	39
Long-term loan disbursements to public sector	227	428	440	506	345	343	336	339
Other 1/	482	274	1	0	0	800	0	0
Private sector	2,396	1,279	1,012	1,662	1,962	1,830	1,929	2,270
Foreign direct investment in Georgia	1,564	658	602	835	964	1,095	1,243	1,345
Long-term loan disbursements to private sector	757	578	240	320	745	626	570	711
Other net inflows 2/	75	43	169	507	253	109	115	215
Financing	217	193	292	258	0	0	0	0
IMF 3/	257	340	298	258	0	0	0	0
Change in arrears, net (- decrease)	-10	27	0	0	0	0	0	0
Advance Repayments	-29	-186	-18	0	0	0	0	0
Change in reserves (- increase)	-131	-616	-158	-413	70	0	80	-100
<b>Memorandum items (in percent of GDP):</b>								
Total financing requirements	-25.5	-16.0	-15.6	-16.6	-18.0	-20.6	-15.0	-14.8
Total sources	25.5	16.0	15.6	16.6	18.0	20.6	15.0	14.8
Capital inflows	24.8	20.0	14.4	17.9	17.4	20.6	14.5	15.4
Exceptional financing	1.7	1.8	2.5	2.0	0.0	0.0	0.0	0.0
Change in reserves (- increase)	-1.0	-5.7	-1.4	-3.3	0.5	0.0	0.5	-0.6

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

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

2/ Including errors and omissions.

3/ ECF (formerly known as PRGF) disbursements in 2006 and 2007, SBA purchases from 2008 on, including augmentation in 2010-11.

Table 11. Georgia: Public External Debt, 2008-09

	Dec-08	Jun-09	Dec-09	Dec-08	Jun-09	Dec-09
	(In millions of U.S. dollars)			(In percent of GDP)		
Total	2,691	2,925	3,382	20.9	27.2	31.4
Multilateral	1,648	1,879	2,321	12.8	17.4	21.6
WB - IDA	988	1,016	1,252	7.7	9.4	11.6
IMF	465	647	786	3.6	6.0	7.3
Other	195	216	282	1.5	2.0	2.6
Bilateral	535	538	560	4.2	5.0	5.2
Paris Club	446	412	466	3.5	3.8	4.3
Non-Paris Club	89	127	94	0.7	1.2	0.9
Commercial	508	508	501	3.9	4.7	4.7

Source: Ministry of Finance of Georgia.

Table 12. Georgia: Private External Debt, 2008-09

	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
	(In millions of U.S. dollars)					(In percent of GDP)				
Total Private debt 1/	2,974	2,830	2,763	2,772	2,873	23.1	22.0	21.5	21.5	22.3
Banks	1,875	1,737	1,621	1,558	1,503	14.6	13.5	12.6	12.1	11.7
Short-term	566	404	390	370	354	4.4	3.1	3.0	2.9	2.7
<i>Of which</i> : Loans	355	214	200	140	104	2.8	1.7	1.6	1.1	0.8
<i>Of which</i> : Currency and deposits 2/	209	187	186	229	250	1.6	1.5	1.4	1.8	1.9
Long-term	1,309	1,333	1,231	1,188	1,149	10.2	10.4	9.6	9.2	8.9
<i>Of which</i> : Loans	1,309	1,333	1,231	1,188	1,149	10.2	10.4	9.6	9.2	8.9
Other Sectors	1,099	1,094	1,142	1,214	1,370	8.5	8.5	8.9	9.4	10.6
Short-term	390	366	395	442	491	3.0	2.8	3.1	3.4	3.8
<i>Of which</i> : Trade credits	324	292	315	325	373	2.5	2.3	2.4	2.5	2.9
Long-term	709	727	747	772	879	5.5	5.7	5.8	6.0	6.8
<i>Of which</i> : Loans	709	727	747	772	879	5.5	5.7	5.8	6.0	6.8
Direct Investment: Intercompany Lending	2,102	2,108	2,148	2,174	2,139	16.3	16.4	16.7	16.9	16.6

Source: National Bank of Georgia.

1/ Excluding intercompany debt from foreign direct investors.

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

Table 13a. Georgia: External Debt Sustainability Framework, Baseline Scenario, 2007-2030 1/  
(In percent of GDP, unless otherwise indicated)

	Actual			Historical 0 Standard		Projections					2010-2015		2016-2030		
	2007	2008	2009	Average	0 Deviation	2010	2011	2012	2013	2014	2015	Average	2020	2030	Average
<b>External debt (nominal) 1/</b>	<b>38.5</b>	<b>44.0</b>	<b>58.1</b>			<b>64.4</b>	<b>65.1</b>	<b>62.7</b>	<b>60.1</b>	<b>57.3</b>	<b>52.9</b>		<b>44.6</b>	<b>31.3</b>	
o/w public and publicly guaranteed (PPG)	17.5	20.9	31.4			36.4	38.4	36.1	35.1	32.7	29.3		22.2	13.9	
Change in external debt	0.7	5.5	14.1			6.3	0.8	-2.4	-2.6	-2.8	-4.4		-1.4	-0.9	
Identified net debt-creating flows	-5.5	3.3	14.4			3.4	3.8	1.7	0.6	-0.3	-0.9		0.7	3.4	
<b>Non-interest current account deficit</b>	<b>18.2</b>	<b>20.4</b>	<b>8.3</b>	<b>9.0</b>	<b>7.0</b>	<b>8.4</b>	<b>9.1</b>	<b>8.1</b>	<b>7.2</b>	<b>6.7</b>	<b>6.2</b>		<b>7.0</b>	<b>8.3</b>	<b>7.3</b>
Deficit in balance of goods and services	26.7	29.6	19.2			19.4	18.6	16.8	15.3	14.5	13.7		12.9	12.2	
Exports	31.1	28.7	29.7			33.0	33.4	33.8	34.2	34.4	34.7		33.7	32.8	
Imports	57.9	58.3	48.9			52.4	52.0	50.6	49.4	48.9	48.4		46.6	45.0	
Net current transfers (negative = inflow)	-6.7	-8.2	-9.0	-5.5	3.2	-9.4	-8.2	-7.6	-7.1	-6.9	-6.6		-5.5	-3.9	-5.0
o/w official	-1.4	-2.8	-1.3			-1.6	-1.0	-0.6	-0.4	-0.3	-0.3		-0.2	-0.1	
Other current account flows (negative = net inflow)	-1.9	-1.0	-1.9			-1.6	-1.2	-1.1	-1.0	-0.9	-0.9		-0.4	0.0	
<b>Net FDI (negative = inflow)</b>	<b>-16.4</b>	<b>-11.8</b>	<b>-6.1</b>	<b>-8.0</b>	<b>5.6</b>	<b>-5.2</b>	<b>-6.6</b>	<b>-7.1</b>	<b>-7.5</b>	<b>-7.7</b>	<b>-7.7</b>		<b>-6.9</b>	<b>-5.6</b>	<b>-6.5</b>
<b>Endogenous debt dynamics 2/</b>	<b>-7.3</b>	<b>-5.2</b>	<b>12.2</b>			<b>0.2</b>	<b>1.3</b>	<b>0.7</b>	<b>0.9</b>	<b>0.7</b>	<b>0.6</b>		<b>0.7</b>	<b>0.7</b>	
Contribution from nominal interest rate	1.8	2.7	3.6			3.6	3.9	3.8	3.8	3.5	3.2		2.8	2.2	
Contribution from real GDP growth	-3.5	-0.7	2.0			-3.4	-2.6	-3.0	-2.9	-2.8	-2.6		-2.1	-1.5	
Contribution from price and exchange rate changes	-5.5	-7.2	6.6			...	...	...	...	...	...		...	...	
<b>Residual (3-4) 3/</b>	<b>6.2</b>	<b>2.2</b>	<b>-0.3</b>			<b>2.9</b>	<b>-3.0</b>	<b>-4.1</b>	<b>-3.2</b>	<b>-2.6</b>	<b>-3.5</b>		<b>-2.1</b>	<b>-4.3</b>	
o/w exceptional financing	0.3	0.3	1.4			0.1	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	52.5			57.3	57.7	56.6	56.4	54.9	52.0		44.5	32.0	
In percent of exports	...	...	176.4			173.6	172.6	167.3	165.0	159.6	149.7		132.0	97.5	
<b>PV of PPG external debt</b>	<b>...</b>	<b>...</b>	<b>25.8</b>			<b>29.4</b>	<b>31.0</b>	<b>30.0</b>	<b>31.3</b>	<b>30.3</b>	<b>28.4</b>		<b>22.1</b>	<b>14.6</b>	
In percent of exports	...	...	86.7			89.0	92.6	88.6	91.6	88.0	81.8		65.7	44.4	
In percent of government revenues	...	...	95.1			113.6	118.6	114.6	120.1	116.6	109.4		85.2	54.6	
<b>Debt service-to-exports ratio (in percent)</b>	<b>13.2</b>	<b>17.7</b>	<b>25.9</b>			<b>21.8</b>	<b>22.2</b>	<b>27.6</b>	<b>36.0</b>	<b>19.3</b>	<b>20.6</b>		<b>26.8</b>	<b>23.0</b>	
<b>PPG debt service-to-exports ratio (in percent)</b>	<b>3.5</b>	<b>3.4</b>	<b>5.3</b>			<b>5.2</b>	<b>5.7</b>	<b>7.9</b>	<b>19.2</b>	<b>5.8</b>	<b>7.0</b>		<b>6.0</b>	<b>5.2</b>	
<b>PPG debt service-to-revenue ratio (in percent)</b>	<b>3.8</b>	<b>3.6</b>	<b>5.8</b>			<b>6.7</b>	<b>7.2</b>	<b>10.2</b>	<b>25.2</b>	<b>7.8</b>	<b>9.4</b>		<b>7.8</b>	<b>6.4</b>	
Total gross financing need (Billions of U.S. dollars)	1.0	2.4	2.0			2.0	2.2	2.4	2.7	1.7	1.8		3.2	6.6	
Non-interest current account deficit that stabilizes debt ratio	17.5	14.9	-5.7			2.1	8.4	10.5	9.7	9.6	10.6		8.3	9.2	
<b>Key macroeconomic assumptions</b>															
Real GDP growth (in percent)	12.3	2.3	-3.8	5.9	4.9	6.3	4.5	5.0	5.0	5.0	5.0	5.1	5.0	5.0	5.0
GDP deflator in US dollar terms (change in percent)	17.2	23.0	-13.1	8.9	11.6	0.4	5.3	2.2	3.0	3.0	3.0	2.8	3.0	2.0	2.8
Effective interest rate (percent) 5/	6.1	8.8	6.8	5.0	2.3	6.7	6.7	6.2	6.6	6.2	6.1	6.4	6.6	7.2	6.8
Growth of exports of G&S (US dollar terms, in percent)	24.7	15.9	-13.2	18.9	15.4	18.5	11.5	8.5	9.2	8.9	9.1	11.0	7.6	7.5	7.5
Growth of imports of G&S (US dollar terms, in percent)	34.1	26.7	-29.8	22.7	23.3	14.3	9.2	4.5	5.6	7.0	7.0	7.9	7.4	7.5	7.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	25.3	27.5	24.3	-1.5	22.6	22.4	20.1	12.6	8.0	11.3
Government revenues (excluding grants, in percent of GDP)	28.7	27.5	27.1			25.9	26.1	26.2	26.1	26.0	26.0		26.0	26.7	26.1
Aid flows (in Billions of US dollars) 7/	0.2	0.6	0.7			0.7	0.7	0.4	0.4	0.4	0.4		0.4	0.4	
o/w Grants	0.1	0.4	0.2			0.3	0.2	0.1	0.1	0.1	0.1		0.1	0.0	
o/w Concessional loans	0.2	0.2	0.4			0.4	0.5	0.3	0.3	0.3	0.3		0.4	0.4	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			4.4	3.0	1.3	0.4	1.0	0.9		0.5	0.2	0.4
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			43.8	40.1	37.7	4.5	33.5	33.0		20.3	12.7	18.1
<b>Memorandum items:</b>															
Nominal GDP (Billions of US dollars)	10.2	12.9	10.8			11.5	12.6	13.6	14.7	15.9	17.2		25.4	54.1	
Nominal dollar GDP growth	31.6	25.9	-16.3			6.7	10.1	7.3	8.1	8.1	8.1	8.1	8.1	7.1	7.9
PV of PPG external debt (in Billions of US dollars)	...	...	2.8			3.4	3.9	4.1	4.6	4.8	4.9		5.6	7.9	
(PVt-PVt-1)/GDPt-1 (in percent)	...	...	...			5.6	4.7	1.2	3.9	1.4	0.4	2.9	0.9	0.4	0.7
Gross remittances (Billions of US dollars)	0.2	0.3	0.3			0.4	0.4	0.4	0.5	0.5	0.5		0.7	1.1	
PV of PPG external debt (in percent of GDP + remittances)	...	...	25.0			28.4	30.0	29.0	30.3	29.4	27.6		21.6	14.3	
PV of PPG external debt (in percent of exports + remittances)	...	...	78.9			80.5	84.3	80.9	83.9	80.7	75.3		61.0	41.9	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	4.8			4.7	5.1	7.2	17.6	5.4	6.5		5.6	4.9	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

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

Table 13b. Georgia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2010-2030  
(In percent)

	Projections								
	2010	2011	2012	2013	2014	2015	2020	2030	
<b>PV of debt-to GDP ratio</b>									
<b>Baseline</b>	29	31	30	31	30	28	<b>22</b>	15	
<b>A. Alternative Scenarios</b>									
A1. Key variables at their historical averages in 2010-2030 1/	29	28	24	25	24	22	<b>16</b>	-4	
A2. New public sector loans on less favorable terms in 2010-2030 2	29	32	32	33	33	32	<b>27</b>	23	
<b>B. Bound Tests</b>									
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	29	32	31	32	31	29	<b>21</b>	14	
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	29	33	35	36	34	32	<b>23</b>	13	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	29	33	33	34	33	30	<b>23</b>	14	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	29	40	48	48	46	43	<b>30</b>	14	
B5. Combination of B1-B4 using one-half standard deviation shocks	29	37	41	42	40	37	<b>27</b>	14	
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	29	43	41	42	40	37	<b>28</b>	18	
<b>PV of debt-to-exports ratio</b>									
<b>Baseline</b>	89	93	89	92	88	82	<b>66</b>	44	
<b>A. Alternative Scenarios</b>									
A1. Key variables at their historical averages in 2010-2030 1/	89	83	72	72	68	63	<b>48</b>	-12	
A2. New public sector loans on less favorable terms in 2010-2030 2	89	97	94	97	96	91	<b>81</b>	69	
<b>B. Bound Tests</b>									
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	89	91	86	88	84	77	<b>59</b>	38	
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	89	106	117	118	112	104	<b>78</b>	45	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	89	91	86	88	84	77	<b>59</b>	38	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	89	120	141	140	133	124	<b>89</b>	43	
B5. Combination of B1-B4 using one-half standard deviation shocks	89	109	114	115	109	101	<b>74</b>	40	
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	89	91	86	88	84	77	<b>59</b>	38	
<b>PV of debt-to-revenue ratio</b>									
<b>Baseline</b>	114	119	115	120	117	109	<b>85</b>	55	
<b>A. Alternative Scenarios</b>									
A1. Key variables at their historical averages in 2010-2030 1/	114	106	93	95	91	85	<b>62</b>	-15	
A2. New public sector loans on less favorable terms in 2010-2030 2	114	124	122	127	127	122	<b>105</b>	85	
<b>B. Bound Tests</b>									
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	114	121	120	124	120	111	<b>82</b>	51	
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	114	126	134	137	132	123	<b>89</b>	49	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	114	127	127	131	126	117	<b>87</b>	54	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	114	153	182	184	177	166	<b>116</b>	53	
B5. Combination of B1-B4 using one-half standard deviation shocks	114	143	157	160	154	144	<b>102</b>	52	
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	114	163	156	162	155	144	<b>107</b>	66	

Table 13b.Georgia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2010-2030 (continued)  
(In percent)

<b>Debt service-to-exports ratio</b>								
<b>Baseline</b>	5	6	8	19	6	7	6	5
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2010-2030 1/	5	5	7	15	5	5	4	1
A2. New public sector loans on less favorable terms in 2010-2030 2	5	5	8	18	6	5	6	7
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	5	5	8	18	6	7	6	5
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	5	5	9	21	7	9	8	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	5	5	8	18	6	7	6	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	5	5	9	20	8	9	9	6
B5. Combination of B1-B4 using one-half standard deviation shocks	5	5	8	18	7	8	8	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	5	5	8	18	6	7	6	5
<b>Debt service-to-revenue ratio</b>								
<b>Baseline</b>	7	7	10	25	8	9	8	6
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2010-2030 1/	7	6	9	19	6	7	5	1
A2. New public sector loans on less favorable terms in 2010-2030 2	7	6	10	24	8	6	8	8
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	7	7	11	25	8	10	8	6
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	7	6	10	24	8	10	9	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	7	7	11	27	9	11	8	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	7	6	11	26	10	12	12	7
B5. Combination of B1-B4 using one-half standard deviation shocks	7	7	11	26	9	11	10	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	7	9	14	33	11	13	10	8
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	6	6	6	6	6	6	6	6

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 14a.Georgia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2007-2030  
(In percent of GDP, unless otherwise indicated)

	Actual			Average	Standard Deviation	Estimate					Projections				
	2007	2008	2009			2010	2011	2012	2013	2014	2015	2010-15 Average			2016-30 Average
<b>Public sector debt 1/</b>	22.3	25.0	37.0			42.0	43.6	41.4	39.5	37.3	35.9		32.7	37.7	
o/w foreign-currency denominated	17.5	20.9	31.4			36.4	38.4	36.1	35.1	32.7	29.3		22.2	13.9	
Change in public sector debt	-5.6	2.7	12.0			5.0	1.6	-2.2	-1.9	-2.2	-1.4		-0.1	1.1	
Identified debt-creating flows	-6.9	-1.5	11.5			3.2	-0.3	-0.2	-0.9	-1.3	-0.9		-0.4	0.8	
Primary deficit	4.1	5.6	8.2	1.4	3.6	5.7	2.9	1.9	0.9	0.6	0.6	2.1	0.6	0.8	
Revenue and grants	29.3	30.7	29.3			28.4	27.4	26.8	26.6	26.4	26.3		26.2	26.8	
of which: grants	0.6	3.2	2.2			2.5	1.3	0.6	0.5	0.4	0.4		0.2	0.1	
Primary (noninterest) expenditure	33.4	36.3	37.5			34.0	30.3	28.6	27.5	26.9	26.9		26.8	27.6	
Automatic debt dynamics	-5.8	-3.4	5.3			-1.5	-2.6	-1.7	-1.7	-1.7	-1.5		-1.0	0.0	
Contribution from interest rate/growth differential	-3.4	-0.7	2.0			-1.8	-1.1	-1.4	-1.2	-1.3	-1.2		-0.7	0.1	
of which: contribution from average real interest rate	-0.4	-0.2	1.0			0.4	0.7	0.7	0.8	0.6	0.6		0.8	1.8	
of which: contribution from real GDP growth	-3.1	-0.5	1.0			-2.2	-1.8	-2.1	-2.0	-1.9	-1.8		-1.6	-1.7	
Contribution from real exchange rate depreciation	-2.3	-2.7	3.3			0.3	-1.5	-0.3	-0.5	-0.4	-0.3		...	...	
Other identified debt-creating flows	-5.2	-3.7	-2.0			-1.0	-0.7	-0.4	-0.2	-0.2	0.0		0.0	0.0	
Privatization receipts (negative)	-5.2	-3.7	-2.0			-1.0	-0.7	-0.4	-0.2	-0.2	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	1.3	4.2	0.5			1.8	2.0	-2.0	-1.0	-0.9	-0.5		0.3	0.3	
<b>Other Sustainability Indicators</b>															
<b>PV of public sector debt</b>	4.8	4.1	31.4			35.0	36.2	35.3	35.7	34.9	35.0		32.6	38.4	
o/w foreign-currency denominated	0.0	0.0	25.8			29.4	31.0	30.0	31.3	30.3	28.4		22.1	14.6	
o/w external	...	...	25.8			29.4	31.0	30.0	31.3	30.3	28.4		22.1	14.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	5.7	7.1	10.3			7.9	5.4	5.3	8.1	3.2	3.8		3.8	5.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	16.3	13.4	107.2			123.3	132.0	131.8	134.5	132.5	132.8		124.6	143.3	
PV of public sector debt-to-revenue ratio (in percent)	16.7	14.9	115.7			135.1	138.7	134.9	137.2	134.6	134.7		125.7	143.8	
o/w external 3/	...	...	95.1			113.6	118.6	114.6	120.1	116.6	109.4		85.2	54.6	
Debt service-to-revenue and grants ratio (in percent) 4/	5.5	4.7	7.1			7.9	9.0	12.7	27.3	10.0	12.1		12.4	16.3	
Debt service-to-revenue ratio (in percent) 4/	5.6	5.3	7.7			8.6	9.5	13.0	27.8	10.2	12.3		12.5	16.3	
<b>Key macroeconomic and fiscal assumptions</b>															
Real GDP growth (in percent)	12.3	2.3	-3.8	5.9	4.9	6.3	4.5	5.0	5.0	5.0	5.0	5.1	5.0	5.0	
Average nominal interest rate on forex debt (in percent)	1.6	3.0	2.6	2.2	0.5	2.8	2.8	2.3	3.1	2.6	2.5	2.7	2.5	3.1	
Average real interest rate on domestic debt (in percent)	-2.4	-2.5	9.6	1.1	5.0	-0.9	1.2	6.4	5.3	6.6	8.8	4.6	6.8	7.7	
Real exchange rate depreciation (in percent, + indicates depreciation)	-12.2	-15.6	14.6	3.2	28.5	1.0	...	...	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	9.7	9.7	-2.0	6.4	3.8	7.2	7.5	6.0	6.0	6.0	6.0	6.5	6.0	5.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	0.3	0.1	0.0	-1.8	5.5	0.0	-0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.1	
Grant element of new external borrowing (in percent)	...	...	...	...	...	25.3	27.5	24.3	-1.5	22.6	22.4	20.1	12.6	8.0	

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

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

3/ Revenues excluding grants.

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

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

Table 14b. Georgia: Sensitivity Analysis for Key Indicators of Public Debt 2010-2030

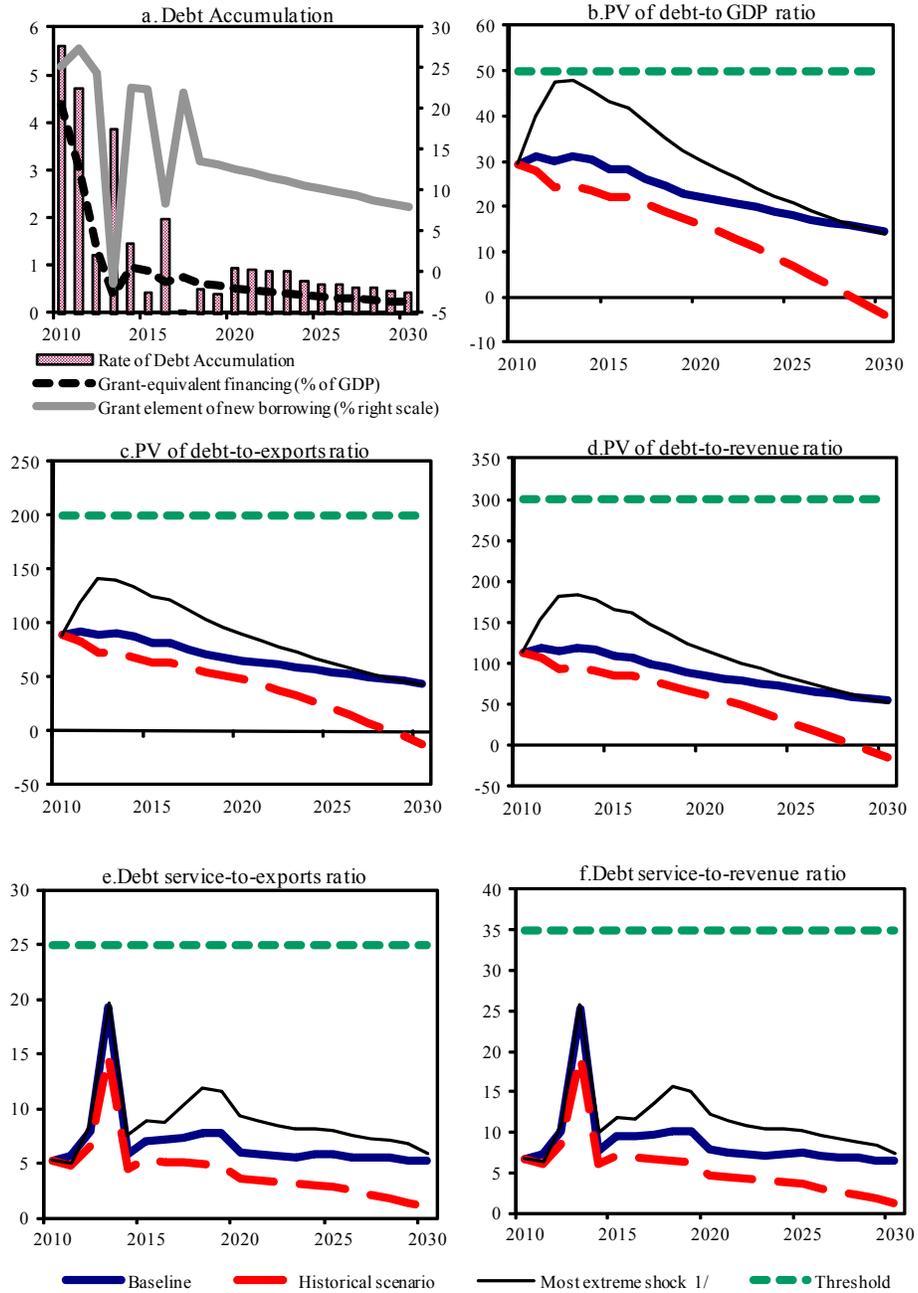
	Projections							
	2010	2011	2012	2013	2014	2015	2020	2030
<b>PV of Debt-to-GDP Ratio</b>								
<b>Baseline</b>	35	36	35	36	35	35	33	38
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	35	34	33	34	33	34	35	42
A2. Primary balance is unchanged from 2010	35	39	42	47	51	55	73	110
A3. Permanently lower GDP growth 1/	35	37	37	38	39	41	50	100
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-2012	35	38	41	43	44	46	51	70
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	35	38	41	41	40	40	37	41
B3. Combination of B1-B2 using one half standard deviation shocks	35	37	38	39	39	39	39	49
B4. One-time 30 percent real depreciation in 2011	35	48	47	48	48	48	45	50
B5. 10 percent of GDP increase in other debt-creating flows in 2011	35	46	45	45	44	44	40	43
<b>PV of Debt-to-Revenue Ratio 2/</b>								
<b>Baseline</b>	123	132	132	135	133	133	125	143
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	123	125	122	127	127	130	133	158
A2. Primary balance is unchanged from 2010	123	142	156	176	192	210	280	411
A3. Permanently lower GDP growth 1/	123	134	137	145	148	155	192	372
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-2012	123	140	152	163	167	174	195	261
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	123	140	152	154	151	151	140	154
B3. Combination of B1-B2 using one half standard deviation shocks	123	135	141	147	147	149	150	184
B4. One-time 30 percent real depreciation in 2011	123	176	177	182	181	182	170	188
B5. 10 percent of GDP increase in other debt-creating flows in 2011	123	168	168	170	167	166	152	162
<b>Debt Service-to-Revenue Ratio 2/</b>								
<b>Baseline</b>	8	9	13	27	10	12	12	16
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	8	9	12	26	9	12	12	16
A2. Primary balance is unchanged from 2010	8	9	13	28	12	15	18	32
A3. Permanently lower GDP growth 1/	8	9	13	28	11	13	15	29
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-2012	8	9	14	30	12	14	16	24
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	8	9	13	28	11	13	13	17
B3. Combination of B1-B2 using one half standard deviation shocks	8	9	13	28	11	13	14	19
B4. One-time 30 percent real depreciation in 2011	8	10	17	38	14	17	17	22
B5. 10 percent of GDP increase in other debt-creating flows in 2011	8	9	14	29	11	13	13	18

Sources: Country authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

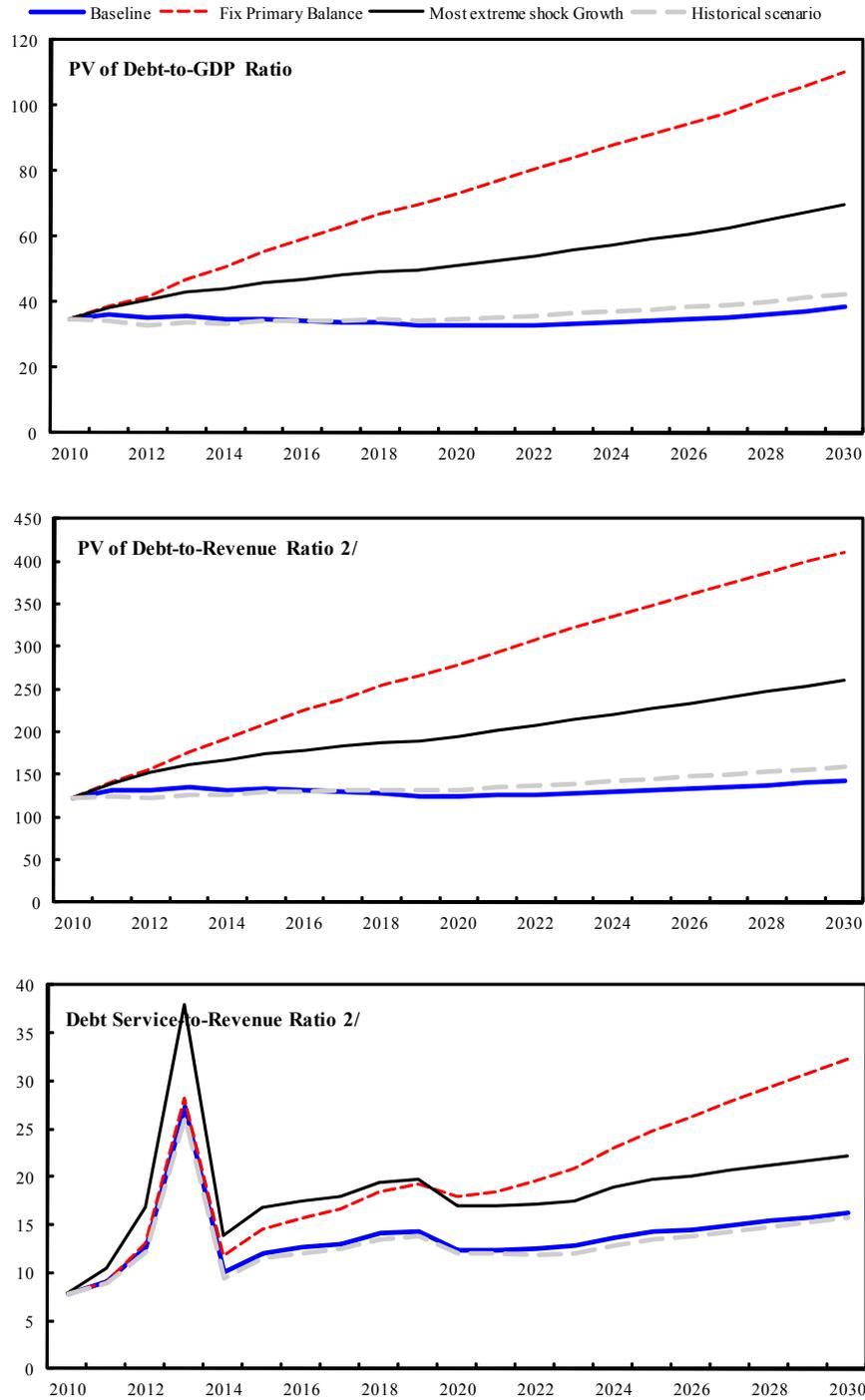
Figure 1a. Georgia: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2010-2030 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2020. In figure b. it corresponds to a Non-debt flows shock; in c. to a Non-debt flows shock; in d. to a Non-debt flows shock; in e. to a Non-debt flows shock and in figure f. to a Non-debt flows shock

Figure 1b.Georgia: Indicators of Public Debt Under Alternative Scenarios, 2010-2030



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2020.

2/ Revenues are defined inclusive of grants.

**ATTACHMENT I. GEORGIA: LETTER OF INTENT**

December 22, 2010

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

Dear Mr. Strauss-Kahn:

1. In September 2008, the International Monetary Fund (IMF) approved a Stand-By Arrangement (SBA) for Georgia, which was further augmented in August 2009. On July 9, 2010 the IMF's Executive Board completed the sixth review of the SBA allowing for an immediate purchase of an amount equivalent to SDR 50 million. We are grateful for the assistance which the IMF provides to Georgia.

2. This letter of intent describes the economic policies that we plan to implement during 2010 and 2011. As always, we are committed to policies that will maintain macroeconomic stability, protect the economy from shocks associated with the global economic crisis and facilitate the process of macroeconomic adjustment. We, of course, remain committed to implementing the measures contained in previous letters of intent, i.e. those dated September 9, 2008, November 28, 2008, March 10, 2009, July 30, 2009, November 25, 2009, February 25, 2010, and June 24, 2010.

**Recent Economic Developments****Macroeconomic developments**

3. From the beginning of 2010 economy started to recover. In the first half of 2010 real growth of the economy reached 6.5 percent. Significant growth was achieved in manufacturing (19.6%), transport (14.6%), trade (12.9%), and construction (12.5%).

4. Balance of payments data for the first half of 2010 show that exports of goods and services increased year-on-year by 25.3 percent and imports of goods and services increased by 13.7 percent; FDI inflows declined by 6.9 percent year-on-year. The current account deficit dropped to 9.5 percent of GDP in the first half of 2010, showing significant improvement relative to the same period of the previous years. In 2009, the current account deficit was 11.3 percent of GDP and 22.7 percent in 2008. In the second quarter of 2010, FDI increased compared to Q1, 2010.

5. As a result of recent developments in global commodity markets, particularly soaring wheat prices, prices of several key CPI basket components have also increased, which pushed inflation rate up to 10.5% year-to-year in November, 2010. Higher inflation figure,

especially for food products lead to the increased inflation expectations. In order to bring inflation back to target NBG has tightened monetary policy for the last four Monetary Policy Committee (MPC) meetings, increasing the refinancing rate from 5 to 7.5 percent. As part of the tightening policy, NBG also extended the coverage of reserve requirements to external borrowing of commercial banks.

6. Fiscal performance in the first three quarters of 2010 has been stronger than anticipated. Tax collection in Q1-3 2010 increased by 17.0 percent y-o-y in nominal terms (excluding one-off payments). Expenditures in the first three quarters of 2010 were contained at GEL 4988.0 million (general government, including capital expenditures), or 3 percent higher than in the same period of 2009 and in line with the program target. In all, the Q1-3 fiscal deficit reached 3.8 percent of the projected annual GDP, which is consistent with the program target.

7. Consistent with our commitment to increase exchange rate flexibility, starting from May 25, 2009, the NBG foreign exchange interventions are conducted only through the foreign exchange auctions. Less frequent interventions have increased flexibility of the Lari. During the first half of the year, the Lari currency depreciated against the U.S. dollar by 11.5%, and has since appreciated by 6.4%.

8. In order to cover part of the FX financing gap of the private sector, in the first half of the year NBG sold at the FX market \$321 million. Since June demand for FX has weakened and NBG has intervened occasionally to buy foreign exchange in the market. Since September exchange rate started to appreciate mainly due to mix of factors, including increase in non-resident FX deposits and market expectation. The depreciation of US Dollar vis-a-vis other major currencies contributed to its depreciation against Lari as well.

9. The banking sector continued its positive performance in the third quarter of 2010. Commercial banks' net profits in the third quarter equaled GEL 58 million. In October Commercial banks' net profits increased by GEL 26 million. Starting from May 2009, the volume of deposits has been growing steadily, posting a 44.9 percent annual growth in Lari terms by end-October 2010. Bank lending to the economy has picked up, and credit to the economy has increased by 10.8 percent (6.5 percent excluding FX valuation effects) annually as of end-October. The major part of the increase in credit is attributed to lending in domestic currency. Banking sector remains highly capitalized; with the average capital adequacy ratio of 18.5 at end-October 2010. Since October NBG increased minimum liquidity ratio from 20% to 30%, to the level that existed before the crisis.

### **Structural reforms**

10. To increase efficiency of monetary policy NBG has made a number of reforms, that include raising reserve requirements in local currency, activation of standing facilities, more active use of refinancing instrument and widening the base for reserve requirement by including borrowed funds by commercial banks in FX. NBG started to provide commercial

banks with guaranteed access to refinancing loans against collateral at the interest linked to the NBG's key policy rate. The collateral base for refinancing loans is extended to include international bank guarantees and long term local currency loans.

11. We continue to improve the efficiency and effectiveness of public finances. The Ministry of Finance is broadly on track in implementing the Public Finance Management Reform Policy Vision 2009–2013, which we view as an important prerequisite to ensuring transparency, discipline, efficiency and accountability in the public finance area. The Reform Action Plan for 2010 is being successfully implemented. Consistently with the new budget code, by end-July 2010 cabinet endorsed the medium-term expenditure framework (Basic Data and Directions) that included expenditure ceilings applicable to the 2011 budget (structural benchmark under the program). Also, in October 2010 the cabinet endorsed guidelines for pilot Ministries to introduce a programmatic approach to budgeting, in line with the recommendations of the technical assistance from the IMF's Fiscal Affairs Department (structural benchmark).

12. In pursuance of our reforms aimed at fostering a culture of compliance and streamlining tax and customs administration procedures, we seek achievement of further cost-efficiency and effectiveness gains within the Revenue Service of the Ministry of Finance, with a view to enhance business-friendliness of tax and customs processes and legislation and thus to promote private sector-led growth. In 2010, we have progressed significantly in establishing electronic information exchange system between banks and the Revenues Service, establishing a customs post-clearance audit, integrating all taxes into the e-filing system, introducing advance ruling in the customs and tax field, establishing the commodity expertise within the Revenue Service and the institute of personal tax agent, introducing electronic VAT invoices and one stop shop at the land customs crossing point for commercial vehicles, elaborating procedures manuals for Revenue Service officers, introducing web-based e-services, web applications, video help and centralized consultative correspondence via e-mails. The implementation of these reforms has enhanced efficiency and effectiveness in the use of public financial resources and shall contribute to the overall resilience of the economy both now and over the medium term.

## **Macroeconomic Outlook and Policies for the remainder of 2010 and for 2011**

### **Macroeconomic outlook and risks**

13. Our major macroeconomic challenge continues to be further increase in the pace of economic growth while promoting balance of payments adjustment. This will, of course, require increase of private capital inflows and domestic lending in support of investment projects. Our efforts to enhance macroeconomic stability concentrate on intensifying economic reforms, and achieving a sustainable fiscal and external balance as quickly as possible.

14. Economic growth remains strong, in the first two quarters of 2010 economy increased by 3.9 and 8.7 percent respectively. Overall in the 2010 real GDP growth is projected at 5.5 – 6.0 percent per annum. Growth is expected to be strong in 2011, at 4.5 percent.

15. The current account deficit for 2010 is expected to be around 11.6 percent of GDP. Exports and imports of goods and services are projected to increase by 18.5 percent and 14.3 percent, respectively. Worker remittances are expected to increase by around 26.9 percent for the year. We expect the recovery in private capital inflows to accelerate in the second half of 2010. Conservatively, we project FDI inflows of about US\$603 million in 2010, slightly less than in 2009. Overall, gross reserves in 2010 are expected to increase by about US\$92 million. In 2011, the current account deficit would increase to 12.6 percent of GDP, as the slowdown in export growth (which would grow by 11.5 percent) would be more marked than that of imports (which would grow by 9.2 percent). Capital flows would increase substantially, contributing to a further increase in gross international reserves of about \$413 million.

16. There are substantial risks to this outlook, notably related to the uncertainty surrounding future capital inflows. In particular, a failure of FDI to resume could lower growth and reopen an external financing gap. On the upside, based on recent inflation and appreciation pressures, there are also risks of overheating, which could be further fueled in the future by stronger-than-expected capital inflows.

### **Policies**

17. We consider that sound fiscal position is critical for the sustainability of the recovery and also to preserve the stability of Georgia's external accounts. We are therefore committed to the deficit reduction. Based on further expenditure containment, an expected recovery of tax revenues owing to sustained GDP growth as well as the revenue measures taken in 2010 and 2011, we are committed to steady reductions in the deficit to 2–3 percent of GDP by 2013. Moreover, in order to increase policy flexibility in the event of adverse economic developments, we have introduced an escape clause in the constitutional amendment requiring that tax increases be subject to referendums. The conditions under which the referendum requirement would be suspended will be defined by the Economic Freedom Act, which will be resubmitted to parliament in 2011. The constitutional amendment, which was adopted on December 15, 2010, will only come into effect once the Economic Freedom Act is also approved.

18. In 2010, spending is expected to be in line with what was agreed at the time of the sixth review, except for the on-lending operation which is described below, in ¶28. Revenues are likely to be lower than projected, reflecting a shortfall in budget-support grants of GEL 56 million. The shortfall is due to the late disbursement of budget grants, which we now expect to come in 2011. Tax revenue projections remain unchanged, but other domestic revenues could make up for the shortfall in budget grants. As a result of these two factors

(on-lending operation and shortfall in budget grants), the deficit is anticipated to be at most GEL 156 million higher than envisaged at the time of the sixth review (GEL 1,397 million, compared with GEL 1,241 million). However, the deficit would decline significantly in 2010, to 6.8 percent of GDP from 9.2 percent of GDP in 2009.

19. In 2011, we will pursue our fiscal consolidation efforts so as to reduce demand pressures in the economy, while facilitating the return to international capital markets through strengthening medium-term fiscal sustainability. Consistent with these objectives, the fiscal deficit will be reduced further to 4.3 percent of GDP. This reduction would reflect measures aimed at curbing spending, such as restraining public sector wage bill in nominal terms, reduction of defense budget, stable education spending in nominal terms, no increase in pensions and no change in thresholds of social assistance schemes. The tax-to-GDP ratio is projected to increase relative to 2010 owing to the full year effect of the measures taken in 2010 (excises on telecommunications and certain beverages), as well as the new measures coming into effect in 2011 (harmonization of personal income tax rates and VAT on public health services).

20. Monetary policy will aim at bringing back year-on-year inflation towards our 6-percent target by end-2011, while fostering investors' confidence through increases in gross and net international reserves. More specifically, we consider that credit growth of 15 to 20 percent is consistent with noninflationary growth. To meet these objectives, the NBG has already raised the policy rates and considers increasing reserve requirements on foreign exchange deposits and external borrowing. The latter should also contribute to strengthening the ongoing dedollarization process. The need for additional tightening will be assessed based on inflation, credit, and foreign exchange market developments.

21. The exchange rate policy will remain flexible. Within the aforementioned limit, the NBG will intervene only to smooth extreme volatility, to counter speculative pressures and if too fast and too large depreciation threatens financial stability. Intervention will also be constrained by our objective to increase net international reserves in 2011 to around \$885 million by end-2011. Should persistent appreciation pressures materialize, we will address them through a tightening of the fiscal stance. Should external developments prove more favorable than currently projected, we stand ready to raise the NIR targets for future reviews, so as to strengthen our exit strategy from official balance of payments support.

22. To further strengthen regulatory disincentive for lending in foreign currency and taking into account recent rapid recovery, the NBG is considering increasing the weight for loans denominated in foreign currency in risk-weighted assets from 1.5 to 1.75. In line with changes in legislation, which enable the supervisor to conduct risk-based supervision, a reorganization process is under way to enable the NBG to use more effectively its resources for risk based supervision. The move toward a risk based framework is done gradually, to minimize regulatory risk for the industry and enable smooth transition towards the new regulatory framework.

23. To facilitate reduction of information costs and promote the cross product and cross bank comparability of the financial products NBG plans to implement consumer financial protection framework in 2011. In line with short term objectives, Georgian banks will be obliged to standardize retail contracts in more understandable way, disclosing all necessary information with new features like effective annual percentage rate and other vital information for informed decision making. A special unit is planned to be created inside NBG that will be in charge of monitoring and strengthening consumer protection.

### **Structural reforms**

24. In order to enhance the safety and efficiency of the international reserves management process, the NBG is implementing a new portfolio management system. The system will cover front-middle-back office and accounting functionality based on Straight Through Processing (STP) principles. The system will be IFRS compliant and will allow NBG to introduce new, more sophisticated financial instruments and investment techniques in its reserves management process. The new system will help NBG bring its reserves management procedures in line with international best practices. NBG has signed the contract on system supply and implementation with WallstreetSystems, leading portfolio management system supplier who has over 30 central banks clients around the world. The system is expected to become fully operational by end of April 2011.

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

26. Based on the higher than projected budget support disbursements from IFIs in 2010, we reduced the Government's use of IMF financing for the budget. Accordingly, the purchase that was made upon completion of the sixth review was the last purchase for budget support in 2010.

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

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

- The Internal Audit Service reviewed operations of the newly implemented core banking system.

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

### **Program Monitoring**

28. We expect all end-December performance criteria under the Stand-By Arrangement to be met, with the exception of the general government deficit and total expenditure targets, owing to the delayed disbursement of budget grants in the amount of GEL 56 million, which we expect to receive in 2011, and the early disbursement by KfW-EBRD-EIB (and on-lending by the government) of a GEL 100-million amount under the high voltage power transmission project loan. These will cause deficit and spending overruns of about GEL 156 million (or 0.75 percent of GDP) and GEL 100 million (or 0.5 percent of GDP), respectively, relative to the program targets. Even though the delay in the disbursement of budget grants does not affect the underlying fiscal adjustment commitment, we expect that other revenues will compensate in large part for this shortfall in 2010. Similarly, we do not consider that the overruns related to the early disbursement of KfW-EBRD-EIB's project loan, and related on-lending by the government, affect the underlying fiscal adjustment. Moreover this operation has a zero net expected impact on public finances, since it is equivalent to guaranteeing a loan to a commercially viable public enterprise. As such we do not consider it necessary or appropriate to adjust the government's fiscal position in response to changes in the disbursement schedule of this loan. To avoid such problems going forward, we request that the fiscal deficit and general government expenditure targets be adjusted for any changes in the timing of disbursements under this loan relative to our expectations as reflected in the program deficit and expenditure ceilings.

29. Therefore, based on our performance under the program, we request waivers of nonobservance of the end-December 2010 PCs on the cash deficit of the general government and on the general government expenditures, a rephrasing of purchases, the establishment of end-March 2011 PCs, and the completion of the seventh and eighth Reviews. We will maintain our usual close policy dialogue with the Fund and are ready to take additional measures as appropriate to ensure that we meet program objectives.

30. The attached Table 1 establishes end-March 2011 PCs on the fiscal deficit, NIR, NDA, and total government expenditures, as well as an end-March 2011 indicative target on external public debt. We request that the ninth review be based on end-March 2011 performance criteria and be scheduled for completion by June 14, 2011.

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

Sincerely yours,

*/s/*  
Nika Gilauri  
Prime Minister of Georgia

*/s/*  
Kakha Baidurashvili  
Minister of Finance

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

Table 1. Georgia: Quantitative Performance Criteria (PC) and Indicative Targets, 2010-11

Performance Criteria	Sep-10			Dec-10	Mar-11
	PC	Adjusted PC	Actual	PC	Proposed PC
	(Cumulative change since the beginning of the year, in millions of lari)				
Ceiling on cash deficit of the general government	867		773	1,241	170
Ceiling on the general government expenditures	5,023		5,009	7,106	1,553
	(End-period stock, in millions of lari)				
Ceiling on net domestic assets (NDA) of the NBG 1/	506	564	513	714	516
	(End-period stock, in millions of U.S. dollars)				
Floor on net international reserves (NIR) of the NBG 1/	740	705	708	721	757
	(Cumulative change since the beginning of the year, in millions of U.S. dollars)				
Ceiling on accumulation of external arrears 2/	0		0	0	0
<b>Indicative target</b>	<b>Ind. Target</b>		<b>Actual</b>	<b>Ind. Target</b>	<b>Prop. Ind. Target</b>
	(Cumulative change since the beginning of the year, in millions of U.S. dollars)				
Ceiling on contracting or guaranteeing of new total external debt by the public sector	1,000		646	1,000	500

Sources: Georgian authorities; and Fund staff estimates.

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

2/ The continuous performance criterion for external arrears is defined in paragraph 21 of the TMU.

Table 2. Georgia: Structural Benchmarks

Action	Proposed Time Frame	Type of Conditionality	Status
FSA and NBG to sign and implement a memorandum of understanding to strengthen cooperation.	End-Oct-08	Structural Benchmark	Observed
NBG to introduce revised LOLR facility.	End-Dec-08	Structural Performance Criterion	Observed
Submission to parliament of a state budget for 2009 with an overall fiscal deficit of no more than 3¼ percent of projected GDP (subject to an adjustor of at most 3 percent of GDP as set out in the TMU).	End-Dec-08	Structural Benchmark	Observed
NBG to develop and publish a liquidity management framework, including the introduction of a refinancing mechanism as the main instrument to provide liquidity.	End-Mar-09	Structural Benchmark	Not observed. Implemented with delay
The NBG, the FSA, and the government to develop a financial stability plan that will contain policy actions to respond to potential situations of stress by defining the roles and responsibilities of the different players—the NBG, the FSA and the government—under each circumstance.	End-Jun-09	Structural Performance Criterion	Observed
Appointment of the remaining members to the FSA board.	End-Jun-09	Structural Benchmark	Not observed, became redundant with elimination of FSA board
Submission of a new budget code to the cabinet to make the budget preparation process more inclusive, enhance the budget execution monitoring process, and move to performance driven policy by improving strategic planning.	End-Jul-09	Structural Benchmark	Observed
Status report on the implementation of the action plan described in the Financial Stability Plan, including bank-by-bank contingency measures based on stress test results and assurances of support from foreign shareholders.	End-Sep-09	Structural Benchmark	Observed

Submission to parliament of the Law on Internal Audit.	End-Sep-09	Structural Benchmark	Observed
Submission to parliament of a state budget for 2010 that: (i) is consistent with the program targets and assumptions, and an overall deficit of no more than 7.3 percent of GDP (program definition); (ii) contains a medium-term fiscal framework consistent with the program's medium-term deficit reduction targets; and (iii) describes the medium-term policies underlying the fiscal deficit objectives through 2013.	October 1, 2009	Structural Benchmark	Observed
Cabinet approval of a new medium-term expenditure framework (Basic Data and Directions) that includes expenditure ceilings applicable to the 2011 budget.	July 31, 2010	Structural Benchmark	Observed
Cabinet approval of guidelines for pilot ministries to introduce a programmatic approach to budgeting, in line with the recommendations of the IMF technical assistance report "Georgia—Advancing Program Budgeting," by D. Radev, S. Flynn, L. Eyraud, and S. Gurr, May 2010.	September 30, 2010	Structural Benchmark	Implemented with delay on October 13.

**ATTACHMENT II. GEORGIA: REVISED TECHNICAL MEMORANDUM OF UNDERSTANDING**  
December 22, 2010

1. This memorandum sets out the understandings between the Georgian authorities and the IMF staff regarding the definitions of quantitative performance criteria and indicative targets, as well as respective reporting requirements for the Stand-By Arrangement (SBA). It replaces the technical memorandum of understanding dated June 24, 2010.

2. These performance criteria and indicative targets are reported in Tables 1 attached to the Letter of Intent dated December 22, 2010. The exchange rate for the purposes of the program of the Georgian lari to the U.S. dollar is set at GEL 1.67 = \$1. The corresponding cross exchange rates are provided in Table 1.

**I. GENERAL GOVERNMENT AND THE PUBLIC SECTOR**

3. **Definition:** The general government is defined as the central government, local governments, and extra-budgetary funds. The public sector consists of the general government and the National Bank of Georgia (NBG).

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

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

**A. Quantitative Performance Criteria and Indicative Targets**

5. The quantitative performance criteria and indicative targets specified in Table 1 attached to the Letter of Intent are:

- a performance criterion (ceiling) on the cash deficit of the general government;
- a performance criterion (ceiling) on the general government expenditures;
- a performance criterion (floor) on net international reserves (NIR) of the NBG;
- a performance criterion (ceiling) on net domestic assets (NDA) of the NBG;

- a continuous performance criterion (zero ceiling) on the accumulation of external arrears; and
- an indicative target (ceiling) on the contracting and guaranteeing of new total external debt by the public sector.

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

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

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

- Net domestic financing consists of bank and nonbank net financing to the general government which will be defined as follows:
  - (i) Net lending (borrowing net of repayments) provided by commercial banks to the general government plus the use of deposits held by the general government at commercial banks. Monitoring of net lending and government accounts will be based on the NBG's monetary survey and Treasury data. The change in cash balances of the local government at commercial banks for budget financing purposes will be monitored based on the "budget of territorial unit" account data provided by the Treasury Department. Any securities issued by the general government and purchased by commercial banks (for example, T-Bills) are also included in domestic financing.
  - (ii) Net lending (borrowing net of repayments) provided by the NBG to the general government plus the use of deposits of the general government held at the NBG. Monitoring of net lending and government accounts will be based on the Central Bank survey and Treasury data. The change in cash balances of the central government at the NBG for budget financing purposes will be monitored based on the "GEL TSA state budget" account data provided by the Treasury Department. Any securities issued by the general government and purchased by the NBG (for example, T-Bills) are also included in domestic financing.
  - (iii) Any securities issued by the general government and purchased by the nonbanks (for example, T-Bills or securitized claims on the government sold by the NBG) are also included in domestic financing.

- Net external financing is defined as the total of loans disbursed to the general government for budget support (including from the IMF), and project financing (capital expenditure and net lending), net change in external arrears, change in the accounts of the general government abroad, minus amortization. Amortization includes all external debt-related payments of principal by the general government.
- Privatization receipts consist of all transfers of monies received by the central and local governments in connection with the sale of central or local government assets. This includes receipts from the sale of shares, the sale of non-financial assets as well as leases and the sale of licenses with duration of 10 years and longer.

7. **Adjustor:**

- The end-March 2011 ceiling on the cash deficit of the general government will be adjusted upward/downward by 100 percent for any excess/shortfall in on-lending by the government of the disbursements of the Black Sea Transmission Network project loans relative to the projected GEL 40 million.

8. **Supporting material:**

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

### C. Ceiling on the General Government Expenditures

9. **Definition:** General government expenditures comprise all current and capital expenditures as well as net lending: (i) current expenditures comprise compensation of employees, use of goods and services, subsidies, grants, social expenses, other expenses, other account payables and domestic and external interest payments; (ii) capital

expenditures include projects financed by foreign loans and grants; (iii) net lending is defined as lending by, minus repayments to, the general government.

10. **Adjustor:**

- The end-March 2011 ceiling on the general government expenditures will be adjusted upward/downward by 100 percent for any excess/shortfall in on-lending by the government of the disbursements of the Black Sea Transmission Network project loans relative to the projected GEL 40 million.

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

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

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

13. **Adjustors:**

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

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

- (c) upward by 100 percent for any shortfall in the amount of conversion for government imports relative to the projected amounts presented in Table 2.
- (d) upward by 100 percent for the amount of any Eurobond issuance, net of cost of redemption of previously issued Eurobonds.

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

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

15. **Definition:** Net domestic assets of the NBG are defined as the difference between reserve money and NIR as defined above in paragraph 10. Therefore, the ceiling on NDA is defined as projected reserve money (as defined in Table 3) minus the target NIR.

#### 16. **Adjustors:**

The ceiling on the NDA of the NBG will be adjusted:

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

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

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

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

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

19. **Adjustor:**

- The end-March 2011 ceiling on contracting or guaranteeing of new external debt by the public sector will be adjusted upward by 100 percent for the amount of any Eurobond issuance.

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

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

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

21. **Definition:** External arrears are defined as unpaid debt service by the public sector to official creditors beyond 30 days after the due date.
22. **Supporting material:** Details of official arrears accumulated on interest and principal payments to creditors will be reported to the IMF within one week from the date of the missed payment. Data will be provided using actual exchange rates.

Table 1. Program Exchange Rates

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

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

	Balance-of-payments support loans and balance-of- payments support grants	Project loans and project grants	Conversion for government imports
December 31, 2010	219.6	238.8	243.4
March 31, 2011	37.7	34.7	31.0

1/ Cumulative from the beginning of the calendar year.

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

December 31, 2010	1,918.3
March 31, 2011	1,781.4

INTERNATIONAL MONETARY FUND

GEORGIA

**Seventh and Eighth Reviews Under the Stand-By Arrangement, and Requests for  
Waivers of Nonobservance of Performance Criteria and Rephasing of Purchases**

**Informational Annex**

Prepared by the Middle East and Central Asia Department

December 23, 2010

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**ANNEX I. GEORGIA: RELATIONS WITH THE FUND**

(As of November 30, 2010)

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

II.	<b>General Resources Account:</b>	<b>SDR Million</b>	<b>Percent of Quota</b>
	Quota	150.30	100.00
	Fund holdings of currency	727.40	483.97
	Reserve position in Fund	0.01	0.01
III.	<b>SDR Department:</b>	<b>SDR Million</b>	<b>Percent of Allocation</b>
	Holdings	145.82	101.29
IV.	<b>Outstanding Purchases and Loans:</b>	<b>SDR Million</b>	<b>Percent of Quota</b>
	Stand-by Arrangements	577.10	383.97
	ECF <sup>1</sup>	106.40	70.79

V. **Latest Financial Arrangements:**

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR million)</u>	<u>Amount Drawn SDR Million)</u>
Stand-By	9/15/08	6/14/11	747.10	577.10
ECF <sup>1</sup>	6/4/04	9/30/07	98.00	98.00
ECF <sup>1</sup>	1/12/01	1/11/04	108.00	49.50

VI. **Projected Payments to Fund (Expectation Basis):**

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

	Forthcoming				
	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>Principal</b>	1.40	38.11	159.90	251.11	166.75
<b>Charges/interest</b>		10.50	9.17	5.20	1.98
<b>Total</b>	1.40	48.61	169.07	256.32	168.73

VII. **Safeguard Assessments:**

An update of the December 2008 safeguards assessment of the National Bank of Georgia (NBG) was completed on January 21, 2010 in conjunction with an augmentation of access

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<sup>1</sup> Following the Low Income Countries (LIC) reforms, effective January 7, 2010, the PRGF arrangements were renamed the Extended Credit Facility (ECF) Arrangements.

under the SBA approved on August 6, 2009. The NBG continues to publish financial statements that comply with International Financial Reporting Standards, and are externally audited by an international firm in accordance with International Standards on Auditing. In response to the safeguards assessment, the authorities have agreed to a multi-year appointment of an external audit firm, beginning with financial year 2010.

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

Not Applicable.

**IX. Implementation of HIPC Initiative:**

Not Applicable.

**X. Exchange Arrangements:**

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

(b) The government uses the official exchange rate for budget and tax accounting purposes as well as for all payments between the government and enterprises and other legal entities. The official rate may differ by more than two percent from freely determined market rates, which gives rise to a multiple currency practice. In practice, the official and market rates have never differed by more than 2 percent since the introduction of foreign exchange auctions in March 2009.

**XI. Article IV Consultation:**

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

**XII. FSAP Participation:**

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

**XIII. Technical Assistance:**

See Table 1 of this Annex.

**XIV. Resident Representative:**

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

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

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

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

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

Table 1. Georgia: Fund Technical Assistance Missions, 2007–10

Subject	Type of Mission	Timing	Counterpart
<b>Fiscal Affairs Department (FAD)</b>			
Tax Administration	Follow-up mission	Jan. 17–30, 2007	Ministry of Finance
Tax Administration	Expert assistance (Woodley)	Jan/Feb and Apr/May 2008	Ministry of Finance
Budget Classification and Accounting Reforms	Expert assistance (Swarap)	Jun. 11-22, 2007	Ministry of Finance
Budget Classification and Accounting Reforms	Expert assistance (Swarap)	Jun. 11-22, 2007	Ministry of Finance
Public Financial Management	Expert assistance	Apr. 6-19, 2010	Ministry of Finance
<b>Monetary and Capital Markets Department (MCM)</b>			
Monetary Operations/Monetary Policy/Foreign Exchange	Advisory	Feb. 16–Mar. 2, 2007	National Bank of Georgia
Consolidated Supervision	Advisory	Dec. 4–14, 2007	National Bank of Georgia
Lender of Last Resort Framework	Advisory	Dec. 11-17, 2008	National Bank of Georgia
Stress Testing and Foreign Exchange Market	Advisory	Apr. 21-30, 2009	Financial Supervisory Agency; National Bank of Georgia
Macroeconomic Modeling for Monetary Policy Formulation	Advisory	June 2-10, 2010	National Bank of Georgia
Macroeconomic Modeling for Monetary Policy Formulation	Advisory	October 4-13, 2010	National Bank of Georgia
<b>Statistics Department (STA)</b>			
Balance of Payments	Follow-up assistance	Jul. 9-20, 2007	National Bank of Georgia
Monetary and Financial Statistics	Advisory	Mar. 18-31, 2009	National Bank of Georgia
Evaluation of Technical Assistance	Follow-up assistance	Jul. 14–16, 2010	National Statistics Office, National Bank of Georgia, Ministry of Finance
External Sector Statistics	Follow-up assistance	Oct. 4–15, 2010	National Bank of Georgia

Table 1. Georgia: Fund Technical Assistance Missions, 2007–10

Subject	Type of Mission	Timing	Counterpart
<b>Legal Department (LEG)</b>			
Payment Systems	Advisory	May 25–Jun. 5, 2010	National Bank of Georgia
Payment Systems	Follow-up assistance	Nov. 8–14, 2010	National Bank of Georgia

**ANNEX II. GEORGIA: RELATIONS WITH THE WORLD BANK**

(As of September 1, 2010)

<b>Title</b>	<b>Product</b>	<b>Tentative Timing of Mission</b>	<b>Expected Delivery of Report</b>
<b>Bank</b>	<i>Operations</i>		
	DPO program, including ongoing policy dialogue on:  public investment management program budgeting social safety nets tax and customs reforms trade-related reforms	Quarterly	July 2011
	Public Sector Financial Management Project	Ongoing	Ongoing
	<i>Analytical Work</i>		
	Programmatic PER Trade Dialogue / Technical Assistance Programmatic Poverty Assessment	Quarterly Ongoing Periodic	End-2010/Mid-2011 Ongoing Periodic
<b>Fund</b>	<i>Missions and Technical Assistance:</i>		
	Staff visit on 2011 budget and macroeconomic framework update	Sept.8-16, 2010	Sept 20, 2010
	SBA 7 <sup>th</sup> and 8 <sup>th</sup> Reviews	Oct.26-Nov.5, 2010	Nov.10 (draft)
	SBA 9 <sup>th</sup> Review and Art.IV Consultation	Feb 1-11, 2011	Feb 16 (draft)
	SBA 10 <sup>th</sup> Review	Mar.30-Apr.8, 2010	Apr.12 (draft)
	TA: payments system legal framework, follow up	January, 2011	February 2011
	TA: Payments system oversight	undecided	...
	TA: macroeconomic model for monetary policy analysis	Oct.4-14, 2010	November 2010
	<i>Analytical work</i>		
	DSGE model for monetary policy analysis Inflation process and forecast Potential output estimation Equilibrium exchange rate assessment International reserve adequacy assessment		
<b>Joint Bank-Fund</b>	Joint Debt Sustainability Analysis		February 2011

### **ANNEX III. GEORGIA: RELATIONS WITH THE EBRD**

(As of December 15, 2010)

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

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

As of end-November 2010, the Bank had signed 131 investments in Georgia with the cumulative commitment totaling € 1 billion. Its outstanding portfolio stands at around € 700 million. The majority of the portfolio is in the financial sector (around 2/5<sup>th</sup>), energy sector and infrastructure (1/5<sup>th</sup> each). The ratio of private sector projects in the portfolio currently stands at 80 percent. The Bank will give preference to non-sovereign operations. Where sovereign guarantees are required, donor co-funding on a grant basis will be sought.

In 2008-9, the Bank played an important role in stabilizing Georgia's financial system that had suffered from the August 2008 conflict and the global financial crisis. Along with the IFC, the EBRD provided Bank of Georgia and TBC Bank, the two largest systemic banks, with equity, quasi equity and loan facilities aggregating \$170 million.

In 2010, the EBRD's operations focused on the infrastructure sector. The Bank signed several large projects, including Tbilisi Railway By-Pass (€112 million), a sovereign guaranteed loan to finance the Black Sea Transmission Line (€80 million), the second stage of the rehabilitation of the Enghuri hydro power plant (€20 million) as well as a berth rehabilitation project at the Poti port (€8 million) and Adjara solid waste landfill project (€3million).

The Bank also signed a number of smaller projects in the financial and industrial sectors. The Bank increased its equity participation in Bank Republic and provided SME credit lines to TBC Bank and Bank of Georgia (€ 5.6 million and € 15 million, respectively). It enhanced its Medium size Co-Financing Facility (MCFE) and signed four sub-projects in the manufacturing, agriculture and health sectors (totaling € 16 million). MCFE has been working successfully for several years. The Bank also expanded the efforts in promoting its

Energy Efficiency Initiative by providing € 3.7 million facility for residential and industrial on-lending to Bank of Georgia.

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

Going forward, the EBRD is actively engaged in promoting local currency lending and de-dollarisation of the Georgian banking system. Georgia is one of the first countries to undergo a joint EBRD-IMF-World Bank assessment of the economic policy, regulatory and legal frameworks for development of the local currency capital markets. Next steps are expected to include a framework agreement with the authorities on policy reforms required to support de-dollarisation, expansion of EBRD lending in lari and technical assistance activities.

**Statement by the Staff Representative on Georgia  
Executive Board Meeting  
January 12, 2011**

1. The following information has become available since the issuance of the staff report (EBS/10/244). These developments do not change the thrust of the staff appraisal.

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

Performance Criteria	Sep-10			Dec-10		
	PC	Adjusted PC	Actual	PC	Adjusted PC	Actual/Proj. 3/
	(Cumulative change since the beginning of 2010, in millions of lari)					
Ceiling on cash deficit of the general government	867		773	1,241		1,397
Ceiling on the general government expenditures	5,023		5,009	7,106		7,256
	(End-period stock, in millions of lari)					
Ceiling on net domestic assets (NDA) of the NBG 1/	506	564	513	714	689	344
	(End-period stock, in millions of U.S. dollars)					
Floor on net international reserves (NIR) of the NBG 1/	740	705	708	721	736	885
	(Cumulative change since the beginning of 2010, in millions of U.S. dollars)					
Ceiling on accumulation of external arrears 2/	0		0	0		0
Indicative target	Ind. Target		Actual	Ind. Target		Proj.
	(Cumulative change since the beginning of 2010, in millions of U.S. dollars)					
Ceiling on contracting or guaranteeing of new total external debt by the public sector	1,000		646	1,000		692

Sources: Georgian authorities; and Fund staff estimates.

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

2/ The continuous performance criterion for external arrears is defined in paragraph 21 of the TMU.

3/ Actual figures for the NIR and NDA, and projections for all other indicators.

2. The end-December NDA and NIR PCs were met by even larger margins than anticipated reflecting the absence of seasonal intervention in December, which the central bank had anticipated. The level of new external debt contracted or guaranteed by the public sector is expected to be within the ceiling set as an indicative target.

3. The authorities expect government expenditure at end-December 2010 to be slightly higher, by GEL 24 million (0.1 percent of GDP), than projected in the staff report owing to a faster pace of capital project implementation by local governments. Since this revision reflects changes in the implementation schedule of projects that have been budgeted, it should in principle be offset by lower capital spending in 2011, and therefore not affect the underlying fiscal stance. At the same time, the authorities noted that this is still a projection and therefore subject to possible deviations. In order to cover such uncertainty and minimize the risk of misreporting, staff and the authorities agreed to adjust upward the projected level of spending by a total of GEL 50 million (0.2 percent of GDP) relative to the staff report, as reflected in the above table. Because of better-than-anticipated performance on the revenue side, a similar adjustment is not being sought for the deficit projection. The budget deficit PC is still expected to be missed as set out in the staff report.

4. Real GDP growth was 6.5 percent year-on-year in the first three quarters of 2010, in line with the annual projection of 6.3 percent. CPI inflation reached 11.2 percent at end-2010, fueled by rising food prices.

5. The authorities have indicated that they do not intend to draw under the arrangement at this time, reflecting improved balance of payments conditions, and the fact that gross international reserves are expected to be further boosted by a return to the market in the near future.



Press Release No. 11/7  
FOR IMMEDIATE RELEASE  
January 12, 2011

International Monetary Fund  
Washington, D.C. 20431 USA

**IMF Executive Board Completes Seventh and Eighth Reviews Under the Stand-By Arrangement for Georgia, Approves US\$153 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) today completed the seventh and eighth reviews of Georgia's economic performance under a Stand-By Arrangement (SBA) for an amount equivalent to SDR 477.1 million (about US\$728 million<sup>1</sup>) approved on September 15, 2008 (see Press Release No. 08/208). On August 6, 2009, the Executive Board approved an augmentation of access under the SBA to an amount equivalent to SDR 747.1 million (about US\$1 billion) and an extension of the SBA until June 14, 2011 (see Press Release No. 09/277).

The completion of the seventh and eighth reviews allows for the immediate disbursement of an amount equivalent to SDR 100 million (about US\$153 million). In completing the review the Executive Board granted waivers for the nonobservance of the end-December 2010 performance criteria on the cash deficit of the consolidated government and total expenditures of the general government. The Executive Board also approved the rephrasing of the remaining disbursements under the SBA.

The authorities indicated that they do not intend to draw the amounts (SDR 100 million) that became available to Georgia after the completion of the seventh and eight reviews.

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

“Backed by the steady implementation of the program’s economic policies, Georgia’s economic recovery has strengthened, as evidenced by better-than-expected growth and the stabilization of the exchange rate. The authorities’ economic policies, focused on tighter monetary and fiscal policies and exchange rate flexibility, will lay the groundwork for achieving macroeconomic stability and growth based on private sector financing and investment. While short-term risks to growth appear balanced, significant downside medium-term external risks remain, related in particular to the uncertainty surrounding the recovery in private capital inflows, including FDI.

“The budget for 2011, which provides for a further reduction of the deficit of about 2½ percent of GDP, is consistent with the authorities’ objective of reestablishing fiscal sustainability. The authorities’ commitment to cap expenditure in 2011 is commendable, as is their decision to introduce an escape clause in the constitutional amendment subjecting tax increases to a referendum. This clause will provide the authorities with more flexibility in implementing the consolidation efforts necessary over the medium term.

“While the recent increase in the policy rate and the decision to tighten reserve requirements will help to bring down inflation in 2011, the authorities should stand ready to tighten monetary policy further should inflationary pressures persist. Consistent with the need to rebuild net international reserves, exchange rate flexibility should remain an anchor of the authorities’ economic strategy.

“The banking sector’s high levels of capital and provisioning continue to provide adequate buffers against adverse shocks, but continued close supervision of banks remains critical. In this regard, capacity building toward risk-based supervision is welcome. As announced by the authorities, it is also important to continue tightening the regulatory framework as financial sector stability solidifies.”

**Statement by Age Bakker, Executive Director for Georgia  
And David Lezhava, Assistant to Executive Director  
January 12, 2011**

**Economic performance**

2010 can be considered as the recovery year for Georgia. In the first quarter of 2010 estimates for growth were around 2.0 percent. In the course of the year, GDP growth has accelerated substantially, narrowing the negative output gap. The growth rate in the third quarter reached 6.7 percent with 6.5 percent year-on-year for the first three quarters. Several sectors showed double digit growth: manufacturing, trade, transport, and finance.

Since the sixth review, both the authorities and staff have raised their estimates for growth for 2010. The authorities' projections remain more conservative compared to staff, largely reflecting the preference for upside risks. According to the authorities' latest estimates, the GDP growth rate in 2010 will be close to 6.0 percent.

Increased external demand for goods and services made a significant positive contribution to growth. Export and import of goods and services in the first three quarters grew at 22.8 and 13.7 percent respectively. Distinct annual growth by 1.6 times was observed in tourism services in the third quarter, as a result of infrastructure development. Overall, the current account deficit for the first 9 months of 2010 was 15.6% less, compared to the same period of 2009.

In the third quarter of 2010 prices started accelerating and inflation now stands at 11.2 percent. Food prices largely contributed to this increase, reflecting low agricultural yields as well as an increase in international food prices. Monetary policy was tightened several times in the second half of the year, but its effect on prices has not materialized yet. However, core annual inflation during the last month fell from 9.7 to 7.6 percent.

Nominal and real exchange rates have appreciated by 2.4 and 0.4 percent during the year. The exchange rate against the dollar depreciated by 4.7 percent during the year. The trend was uneven during the year, with clearly defined depreciation pressures in the first half and appreciation pressures in the period September-November. The appreciation was due to a mix of factors, including an increase in non-resident FX deposits and market expectations.

The authorities used the opportunity to accumulate reserves. As a result, both end-September and end-December NIR targets were met with significant margins. The authorities stand ready to allow exchange rate depreciation, unless extreme volatility or speculative pressures are observed or if too fast and/or too large depreciation threatens financial stability.

Fiscal performance in the first three quarters of 2010 has been stronger than anticipated. There are no final figures yet for Q4, but probably the budget deficit and expenditure ceiling PCs will be missed. Such an outcome is highly probable largely due to unrealized budget grants on the one hand and disbursement for a high voltage power transmission project loan on the other hand, which the authorities had anticipated would be disbursed in 2011, due to

the conditions they needed to fulfill. Therefore the authorities estimate the amount of general government expenditure to be below 7256 million GEL and the deficit of the general government to be 1397 million GEL. However, the deficit will decline significantly in 2010, to 6.8 percent of GDP from 9.2 percent of GDP in 2009. The fiscal deficit will be reduced further to 4.3 percent of GDP in 2011.

The banking sector indicators continue to show steadily improved performance. ROE and ROA for the entire banking sector for the end of November was 10.7 and 1.9 percent respectively. The banking sector remains highly capitalized, with an average capital adequacy ratio of 18.2 at end-November 2010. Since May non-performing loans have decreased in nominal terms by 13.2 percent. The volume of deposits and bank lending are growing steadily.

### **Policy response to economic developments**

In response to inflationary pressures the monetary authorities have taken several tightening measures. The monetary policy rate was gradually increased from 5.0 to 7.5 percent, although in a dollarized economy increases in local currency interest rates have become less effective. Therefore, the National Bank extended the coverage of reserve requirements to external borrowing of commercial banks. In addition, as of January 20, 2011 reserve requirements on foreign currency will be increased from 5 to 10 percent as a first step to a planned increase of up to 15 percent.

In order to further strengthen regulatory disincentives for lending in foreign currency and taking into account the recent rapid recovery, the NBG has increased the weight for loans denominated in foreign currency in risk-weighted assets from 1.5 to 1.75 starting from January 1, 2011. Since October the NBG increased the minimum liquidity ratio from 20 to 30 percent, restoring pre-crisis requirements.

The Ministry of Finance is broadly on track in implementing the Public Finance Management Reform Policy Vision 2009–2013. The Reform Action Plan for 2010 is successfully being implemented. Consistent with the new budget code, by end-July 2010 the cabinet endorsed the medium-term expenditure framework that included expenditure ceilings applicable to the 2011 budget (structural benchmark under the program). Also, in October 2010 the cabinet endorsed guidelines for pilot ministries to introduce a programmatic approach to budgeting, in line with the recommendations from the Fiscal Affairs Department's technical assistance (structural benchmark).

A New Tax Code and its regulations are in force from January 1, 2011. An important change in the tax code is simpler taxes for small taxpayers. A number of structural reforms has been implemented by the Revenue Service of the Ministry of Finance. To create a convenient tax payment process the authorities put relevant infrastructure in place and e-services are being implemented. These and many other changes in the system are aimed at the formation of a fair, simple and reliable tax system.

The NBG is implementing a new portfolio management system. The system will be IFRS compliant and will allow the NBG to introduce new, more sophisticated financial instruments

and investment techniques in its reserves management process. The new system will help the NBG bring its reserves management procedures in line with international best practices. The recently implemented new Real Time Gross Settlement (RTGS) increases both speed and capacity of the transaction system, making it more reliable and allowing for new functions, such as intraday lending. The government has introduced an electronic treasury system. The established direct electronic link has significantly increased the efficiency of interaction between the treasury and all government institutions.

### **Policies Going Forward**

The authorities consider a sound fiscal position critical for the sustainability of the recovery and also to preserve the stability of Georgia's external accounts. Therefore they are committed to deficit reduction. Based on further expenditure containment, an expected recovery of tax revenues owing to sustained GDP growth as well as the revenue measures taken in 2010 and 2011, the authorities are committed to steady reductions in the deficit to 2–3 percent of GDP by 2013.

The authorities are not satisfied with the current FDI levels. An increase is needed in order to foster high sustainable growth. The authorities are implementing reforms to eliminate structural constraints. Thanks to the reforms conducted in the last few years, Georgia is ranked number 12 in the ease of doing business. A recent unilateral initiative to declare that Georgia will never use force for the country's reunification should facilitate normalization of the political climate. During the year rating agencies have upgraded Georgia's rating. All this together with global recovery prospects strengthens confidence that FDI can be increased.

One of the most actively discussed issues in the Executive Board during the preceding reviews was the authorities' decision to make tax increases subject to referendums. This constitutional amendment now has been adopted, but with the introduction of an escape clause. The conditions under which the referendum requirement would be suspended will be defined by the Economic Freedom Act, which will be resubmitted to parliament in 2011.

Monetary policy will aim at bringing year-on-year inflation back towards the 6-percent target by end-2011, while fostering investor confidence through increases in gross and net international reserves. Due to the cooperation between the monetary and fiscal authorities containing inflation within sustainable limits is guaranteed. Dedollarization remains one of the main objectives of the monetary authorities. They realize that a successful dedollarisation process is a precondition for the efficiency of monetary policy in the future.

As was mentioned above, economic developments allowed the National Bank to build up some international reserves. According to the BOP forecasts the National Bank will be able to further add to reserves. The authorities do not see an urgent need to draw from the Fund at the moment. Therefore, the authorities will maintain a close policy dialogue with the Fund and stand ready to take additional measures as appropriate to ensure that we meet the program objectives.