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GEORGIA

June 2019

FOURTH REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATIONS OF QUANTITATIVE PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; AND A STATEMENT BY THE EXECUTIVE DIRECTOR FOR GEORGIA

In the context of the Fourth Review Under the Extended Fund Facility Arrangement and Request for Modifications of Quantitative Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 19, 2019, following discussions that ended on May 13, 2019 with the officials of Georgia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on June 6, 2019.
- A **Statement by the Executive Director** for Georgia.

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

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

*Also included in the abovementioned Staff Report

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

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Press Release No. 19/227
FOR IMMEDIATE RELEASE
June 19, 2019

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

- Georgia's economic performance remains robust with resilient growth, inflation under control, and reduced external vulnerabilities.
- Continued implementation of the authorities' reform agenda remains vital to ensure that growth is sustainable and inclusive.
- A comprehensive education reform needs to boost education quality and reduce skills mismatches in the labor force.

On June 19, the Executive Board of the International Monetary Fund (IMF) completed the Fourth Review of Georgia's economic reform program supported by a three-year extended arrangement under the Extended Fund Facility (EFF). The completion of the review will release SDR 30 million (about $41.4 million), bringing total disbursements under the arrangement to SDR 150 million (about $207.2 million).The extended arrangement for SDR 210.4 million (100 percent of quota) was approved by the Executive Board on April 12, 2017 (see Press Release No. 17/130).

Following the Executive Board discussion, Mr. David Lipton, First Deputy Managing Director and Acting Chair, said:

"Georgia's economic performance remains robust with resilient growth, inflation under control, and reduced external vulnerabilities. Although the outlook is favorable, the authorities need to be prepared to address any negative spillovers from external developments and persevere with structural reforms to promote higher and more inclusive growth.

"The fiscal deficit is projected to remain relatively stable in 2019 and over the medium term reflecting the authorities' commitment to fiscal sustainability. Higher spending on public education will be offset with slower growth in infrastructure investment. Regarding education spending, salary increases can only be effective if accompanied by other steps to boost education quality, which requires further work on a comprehensive education reform.

“Monetary policy is rightly focused on price stability. As recent increases in inflation are driven by temporary factors, a neutral monetary policy stance remains appropriate. Tighter lending standards have slowed credit growth as expected, making credit growth more sustainable. The inflation-targeting framework, combined with exchange rate flexibility, and interventions that help build reserves continue to serve Georgia well.

“Continued implementation of the authorities’ reform agenda remains vital to ensure that growth is sustainable and inclusive. The authorities are advancing education reform to reduce skills mismatches in the labor force. A new insolvency law, together with making the pension agency fully operational and reforms to promote a transparent and independent judiciary, would help mobilize investment. The authorities’ energy market reforms could improve market competition and energy efficiency.

“Sound policies and further reforms under the IMF program will help preserve the gains made, strengthen economic resilience, and foster stronger and more inclusive growth.”

Georgia: Selected Economic and Financial Indicators, 2016-2020

	2016	2017	2018	2019	2019	2020
		Actual		CR 18/373 1/	Projections	
National accounts and prices	(annual percentage change; unless otherwise indicated)					
Real GDP	2.8	4.8	4.7	4.6	4.6	4.8
Nominal GDP (in billion of laris)	34.0	37.8	41.1	45.0	44.5	48.1
Nominal GDP (in billion of U.S. dollars)	14.4	15.1	16.2	17.2	16.6	18.1
GDP per capita (in thousand of U.S. dollars)	3.9	4.0	4.3	4.6	4.5	4.9
GDP deflator, period average	4.2	6.1	3.7	3.4	3.5	3.3
CPI, Period average	2.1	6.0	2.6	3.1	3.8	3.2
CPI, End-of-period	1.8	6.7	1.5	3.0	4.5	3.0
Investment and saving	(in percent of GDP)					
Gross national saving	19.6	23.6	25.7	25.4	25.6	26.4
Investment	32.7	32.4	33.4	34.9	33.1	33.8
Public	5.0	6.1	7.0	7.1	7.2	6.9
Private	27.7	26.3	26.4	27.9	25.9	26.8
Consolidated government operations	(in percent of GDP)					
Revenue and grants	28.3	29.2	28.6	28.0	28.4	28.1
o.w. Tax revenue	25.7	26.2	25.4	25.1	25.4	25.2
Expenditures	32.5	32.8	31.7	30.9	31.4	31.1
Current expenditures	26.0	24.3	23.1	23.1	23.4	23.5
Capital spending and budget lending	6.5	8.5	8.6	7.8	8.0	7.6
Net Lending/Borrowing (GFSM 2001)	-1.5	-0.5	-0.9	-1.9	-1.9	-2.0
Augmented Net lending / borrowing (Program definition) 2/	-2.9	-2.9	-2.5	-2.6	-2.6	-2.7
Public debt	44.4	45.1	44.9	43.5	46.7	48.3
o.w. NBG debt to the IMF	...	0.6	0.5	1.0	1.0	1.1
o.w. Foreign-currency denominated	35.1	35.7	35.3	33.8	35.6	35.0
Money and credit	(in percent; unless otherwise indicated)					
Credit to the private sector (annual percentage change)	19.6	17.6	19.3	12.6	12.3	10.8
In constant exchange rate	11.8	19.1	17.1	13.1	11.9	11.5
Broad money (annual percentage change)	20.4	14.8	14.0	12.2	12.8	12.9
Broad money (incl. fx deposits, annual percentage change)	19.1	13.7	13.3	10.8	11.8	10.8
In constant exchange rate	13.4	16.3	12.1	12.8	12.4	13.6
Deposit dollarization (in percent of total)	69.9	63.7	62.1	59.6	60.6	59.6
Credit dollarization (in percent of total)	64.6	56.1	55.8	51.3	53.7	51.3
Credit to GDP	54.9	58.1	63.8	64.6	66.2	67.8
External sector	(in percent of GDP; unless otherwise indicated)					
Current account balance	-13.1	-8.8	-7.7	-9.5	-7.5	-7.3
Trade balance	-26.9	-25.2	-25.3	-27.4	-25.2	-24.9
Terms of trade (percent change)	-1.4	-2.6	-4.9	-0.9	1.2	-1.3
Gross international reserves (in billions of US$)	2.8	3.0	3.3	3.5	3.7	4.1
In percent of IMF Composite measure (floating)	0.0	88.9	90.8	95.6	100.1	105.2
Gross external debt	109.9	113.7	112.9	113.3	117.0	116.4
Gross external debt, excl. intercompany loans	92.0	96.3	94.6	95.0	97.8	97.4
Laris per U.S. dollar (period average)	2.37	2.51	...	...	...	...
Laris per euro (period average)	2.62	2.83	...	...	...	...
REER (period average; CPI based, 2010=100)	100.5	100.6	...	...	...	...

Sources: Georgian authorities; and Fund staff estimates.

1/ Please refer to this link for details https://www.imf.org/en/Publications/CR/Issues/2018/12/19/Georgia-Third-Review-Under-the-Extended-Fund-Facility-Arrangement-Press-Release-Staff-Report-46484

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

INTERNATIONAL MONETARY FUND

GEORGIA

June 6, 2019

FOURTH REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATIONS OF QUANTITATIVE PERFORMANCE CRITERIA

KEY ISSUES

Recent economic developments. Economic performance remained robust in 2018: growth reached 4.7 percent, supported by external demand; inflation stayed below the three percent target, the fiscal deficit remained in line with program commitments, and the current account improved. Tighter lending standards helped decelerate credit growth towards more sustainable levels. The banking sector remains well capitalized, liquid, and profitable. Dollarization remains elevated. In early 2019, growth conditions were favorable, with average inflation slightly above the target reflecting increased excises.

Program status. The 36-month EFF arrangement with access of SDR 210.4 million (100 percent of quota) is broadly on track. All end-December 2018 quantitative performance criteria were met. Four out of seven structural benchmarks (SBs) for this review were observed; one SB was completed with a one-month delay and the others were reset to year-end. Completion of the review will make available SDR30 million.

Program policies. The 2019 fiscal deficit target implies a slightly expansionary fiscal stance; current primary spending, other than social and education spending, will remain contained. Medium-term fiscal plans, including spending on the public education reform, are consistent with program objectives. Strengthening revenue administration, containing fiscal risks, and reforming SOEs will further support fiscal sustainability. The monetary policy stance is appropriately neutral. The central bank remains committed to reserve accumulation while maintaining the floating exchange rate regime. Decisive implementation of structural reforms is critical to support higher and more inclusive growth. The planned emergency liquidity assistance and bank resolution framework will strengthen financial stability. The new insolvency law and the development of the local capital markets, together with the judiciary reform, will improve further the business environment and support private investment.

Approved By
Juha Kähkönen (MCD) and Rupa Duttagupta (SPR)

Discussions were held in Tbilisi during April 30-May 13, 2019 with Prime Minister Bakhtadze, NBG Governor Gvenetadze, Minister of Finance Matchavariani, Minister of Economy and Sustainable Development Turnava, other senior officials, and representatives of the private sector, the civil society, and the diplomatic community. The team comprised Ms. Vera-Martin (head), Messrs. Painchaud (resident representative), Rodriguez and Saksonovs, and Ms. Sharashidze (local economist) (all MCD), Messrs. Hellwig (FAD), Noumon (SPR), and Rawat (MCM). Mr. Cakir (resident representative effective end-June 2019) joined the mission May 6-13). Ms. Stetsenko (LEG) joined the mission May 6-8 to discuss progress toward the new insolvency framework. Mr. Hanson (OED) joined the discussions. Ms. Al Farah provided research assistance. Ms. Gedrimaite and Mr. Laumann helped with document preparation.

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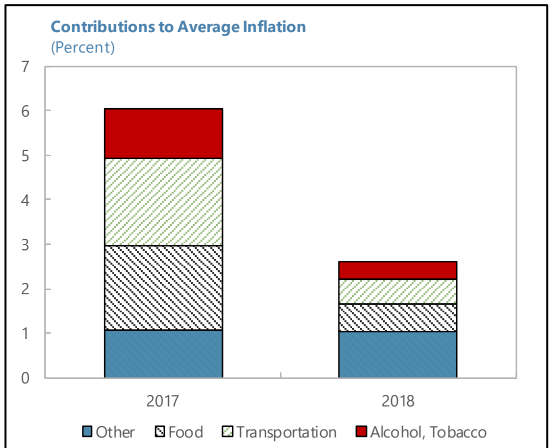
CONTEXT

1. Economic performance remained robust in 2018, supported by external demand (Figures 1-6, Tables 1-5).

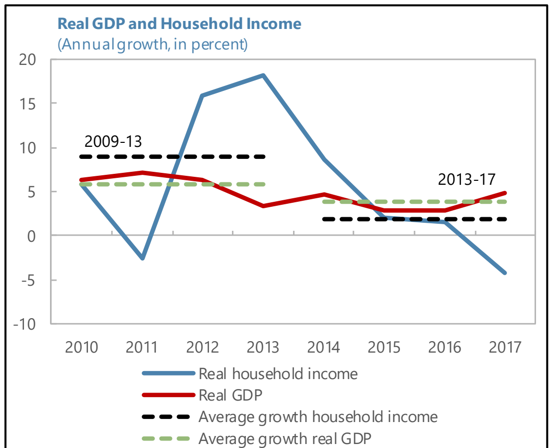
- Growth, at 4.7 percent, was driven by net exports. Growth was lower than projected at the Third Review[1] (by 0.3 percentage points), reflecting weaker construction activity and delays in public investment. The unemployment rate, at 12.7 percent, reached a 15-year low.

- Headline inflation averaged 2.6 percent (y/y), down from 6 percent in 2017, largely reflecting base effects from excise tax increases in 2017 and lower imported inflation. Average core inflation, at 1.2 percent, remained subdued.



Source: GeoStat and IMF staff calculations.

- Continued strong growth in exports and tourism receipts, subdued import growth, and lower profit repatriation narrowed the current account deficit to 7.7 percent of GDP. The deficit remained mostly financed by FDI. The net international investment position improved by 7 percent of GDP from end-2017 to -143 percent of GDP at end-2018, while external debt (excluding intercompany loans) declined by 2 percent of GDP to 95 percent of GDP (Table 10).



Source: Georgia Household Surveys 2009-17, and IMF staff calculations.

- Gross international reserves (GIR) rose to $3.3 billion by end-2018 (91 percent of the ARA metric), driven by higher FX reserve requirements ($275 million) and net FX purchases ($198 million).

- Growth in average household income has remained below GDP growth since 2015. Wages, pensions/transfers, and remittances—accounting for 70 percent of income—have driven this development. Income inequality (as measured by the Gini coefficient) has increased slightly in recent years and is still above inequality in peer countries (Southeastern Europe and oil importers in the Caucasus and Central Asia).

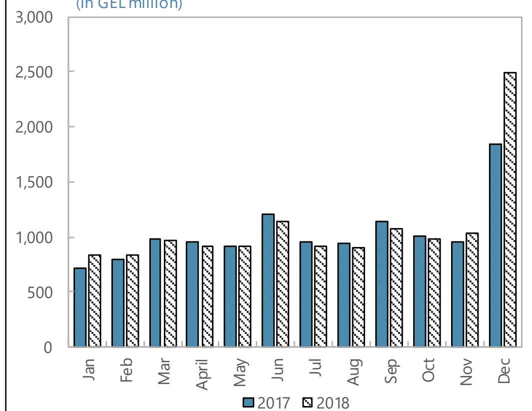
2. The favorable performance continued in early 2019. Based on preliminary data, growth in 2019Q1 was 4.7 percent y/y. Average inflation in January-April 2019 was 3.1 percent y/y, reflecting increased excises on unfiltered cigarettes and higher food prices. In February, Fitch upgraded Georgia

[1] The Staff Report for the Third Review can be found at https://www.imf.org/~/media/Files/Publications/CR/2018/cr18373.ashx

to BB (two notches below investment grade) highlighting economic resilience to Turkey's stress and reduced external imbalances. In April, S&P revised Georgia's outlook to positive.

3. **Fiscal performance in 2018 was in line with program commitments.** Following slow budget execution and a surplus through November, higher-than-expected external disbursements in December brought the 2018 augmented fiscal deficit to 2.5 percent of GDP, in line with the adjusted program target. With current spending consistent with program commitments, higher-than-anticipated revenues (due to lower losses from the SME tax reform and higher non-tax revenues) offset higher-than-programmed capital spending and budget lending. VAT credit refunds more than doubled, reducing the stock of VAT credits by 0.9 percent of GDP, to 3.8 percent of GDP.[2] Gross public debt fell to 44.9 percent of GDP, and general government deposits increased to 2.7 percent of GDP. The structural primary deficit fell by 0.5 percent of potential GDP, exerting a negative fiscal impulse on the economy. The impulse may have been more contractionary than suggested by the cash-based figures as the impact of project-related advance payments in late December will only be felt in 2019.

Monthly Budget Execution
(In GEL million)



Source: National authorities, and IMF staff calculations.

4. **The National Bank of Georgia (NBG) reduced the policy rate and accumulated reserves.** With subdued inflation expectations, the NBG reduced the policy rate by 50 basis points, to 6.50 percent, between July 2018 and March 2019. In January-May 2019, the NBG purchased $186 million in the foreign exchange market, of which $51 million was via put options.[3]

5. **Credit growth has slowed, as expected.** Household credit growth declined after the NBG introduced in May 2018 limits on lending to households without verifiable income (25 percent of bank's regulatory capital). Household credit growth decelerated to 19 percent in 2018 from 27 percent in 2017 (y/y).[4] Credit to corporations has grown steadily, at around 17 percent (y/y), while mortgage credit accelerated in anticipation of tighter lending standards. Effective January 1, 2019 loans to households are subject to payment-to-income (PTI) and loan-to-value (LTV) ratios, and banks need to verify borrowers' income. On January 23, the authorities doubled the floor (to GEL 200,000) under

Payment to Income (PTI) and Loan to Value (LTV) Lending Limits

Monthly income in GEL	**PTI Limit** (In percent)	
	Hedged borrower	Non-hedged borrower
	Maximum maturity (15 years) / Contractual maturity	
< 1000	20 / 25	25 / 35
1000 - 2000		35 / 45
2000 - 4000	25 / 30	45 / 55
> 4,000	30 / 35	50 / 60
	LTV limit (In percent)	
	GEL loans	FX loans
Maximum LTV	85	70

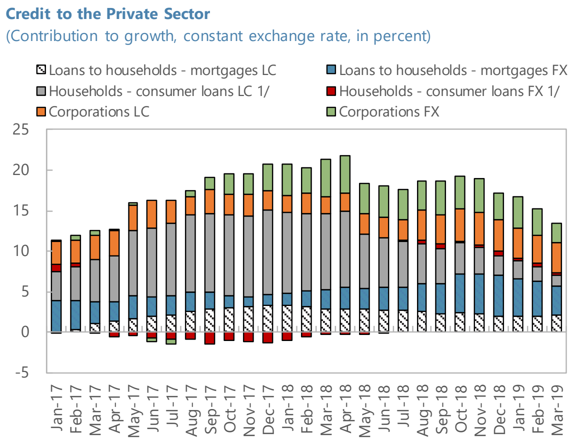
Source: National Bank of Georgia, NBG.

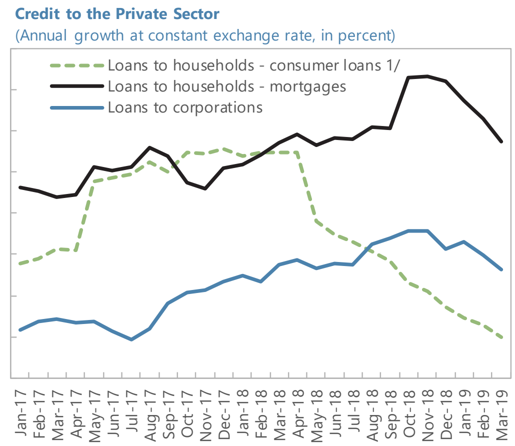
[2] Around 0.3 percent of GDP in stock reduction was due to adjustments resulting from increased audit activity.

[3] In January 2019, the NBG started selling one-month put options that give banks the right to purchase GEL in exchange for dollars or euros. Banks exercise the option when the GEL rate is above its average during the previous 20 working days. As of end-April 2019, the NBG has sold options worth GEL 650 million.

[4] Household credit includes consumer loans, loans to individual entrepreneurs and mortgages. Figures on credit growth are at constant exchange rates.

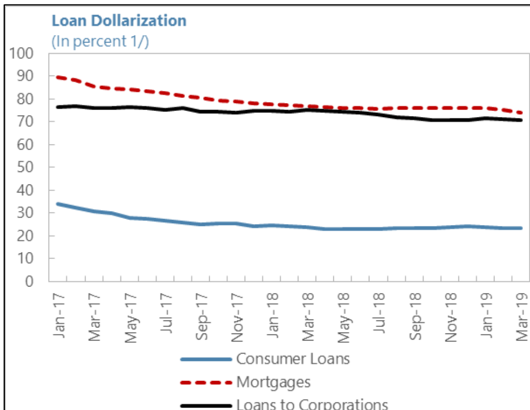
which new FX loans are prohibited. Credit growth has continued to slow in 2019, mainly driven by reduced consumer loans, FX mortgages, and FX corporate loans.





Source: NBG, and IMF staff calculations.
1/ Includes consumer and individual business loans.

6. The banking sector remains well capitalized, liquid, and profitable (Table 5). Capital and liquidity buffers are well above minimum requirements. Nonperforming loans (NPLs), at 3 percent in March 2019, remained subdued. Watch loans continued to decline, reaching 4 percent in March 2019. Dollarization remains elevated. Progress in de-dollarizing consumer loans and credit to corporations was mostly offset by an increase in FX mortgages in 2018. Regulation and supervision of non-bank lenders has led to consolidation, with non-solvent entities opting for liquidation.



Source: NBG, and IMF staff calculations.
1/ FX loans in percent of total loans to households and corporations. Consumer loans include loans to individual entrepreneurs.

PROGRAM PERFORMANCE

7. Quantitative program targets and four out of the seven structural benchmarks (SBs) for this review were met (MEFP, Tables 1-3). All QPCs were met. One of the actions was implemented with a one-month delay as the fiscal risk statement (FRS, end-December 2018 SB) was revised to include detailed PPA analysis in January 2019. More time is needed to complete the remaining two benchmarks: (i) evaluate the indexation formula for the basic public pension (end-February 2019 SB)[5], and (ii) develop safeguards for sharing information between the Financial Monitoring Services (FMS) and Georgia Revenue Services (GRS) (end-May 2019 SB). Accordingly, it is proposed to reset these missed SBs to year-end. The authorities reiterated their commitment to program objectives and targets.

[5] The authorities are still discussing options for the indexation of the basic public pension, to come into effect in 2021.

OUTLOOK AND RISKS

8. Growth is expected to remain robust over the medium term. Carryover from late-2018 budget execution and measures to improve execution of capital spending would support growth in 2019, in a less favorable external environment. Growth in 2020-21 has been revised down, by 0.2 percentage points, due to a slower-than-envisaged pace of capital spending compared to the Third Review. A small negative output gap is projected to close in 2021. With output still below potential, the strong tax revenue performance in 2018 is unlikely to be merely cyclical. Structural reforms and infrastructure investment are expected to gradually increase growth to 5¼ percent, notwithstanding a slight reduction in capital spending to finance education reform. In 2019, inflation is expected to remain above the NBG target due to increases in excises. As these one-off effects dissipate, inflation is expected to reach the three-percent target in 2020. The current account deficit, mostly financed by FDI, will gradually narrow to 7 percent of GDP over the medium term. External debt is expected to decline gradually, reducing external financing requirements.

9. Downside risks dominate (Annex I). Georgia remains vulnerable to spillovers from external developments, including escalating trade tensions and financial market volatility. With high dollarization, external shocks could lead to a large lari depreciation, and undermine growth and financial stability. Domestically, a sharper-than-expected slowdown in credit could limit economic activity in the short term. Increased political uncertainty ahead of the 2020 parliamentary elections could dampen the reform momentum and thereby weaken medium-term growth prospects.

10. The authorities shared staff's views on the outlook and risks. They noted that, despite improving fiscal and external buffers, Georgia remains vulnerable to external shocks. They also shared concerns about negative spillovers from weaker growth in major trading partners.

POLICY DISCUSSIONS

The authorities agreed on the need to maintain prudent policies and maintain reform efforts given Georgia's vulnerability to external shocks. They are committed to implement the education reform consistent with the program's medium-term objectives, and plan to advance reforms to develop the local capital markets, strengthen revenue administration, contain fiscal risks, improve public investment management (PIM), and upgrade fiscal reporting. The NBG plans to keep the policy rate on hold, and to continue building up reserves while preserving exchange rate flexibility. Structural reforms remain key to promote higher and more inclusive growth.

A. Creating Fiscal Space for Education while Advancing Structural Fiscal Reforms

11. Staff and the authorities agreed to an end-2019 augmented deficit target—consistent with the budget approved by parliament—of GEL 1,170 million (2.6 percent of GDP) (MEFP, ¶7). Although cash-based figures indicate a broadly neutral fiscal stance, the large advance payments recorded in late 2018 are expected to support domestic demand during 2019. This makes the underlying fiscal stance slightly expansionary. In 2019Q1, revenues remained strong, although customs receipts slowed in line with lower import growth. The yield of the cigarette excise increase in 2019Q1 has been below expectations due to smuggling and a shift in consumption towards untaxed rolling tobacco; in response, the authorities plan to introduce an excise tax on rolling tobacco by mid-2019. Current primary spending—other than social and education spending—will remain contained in real terms. Additional revenues relative to projected amounts are to be used for VAT refunds and capital spending.

12. The reform of public education—the government's key priority—will be consistent with the program's fiscal framework (MEFP ¶7-8, 28). In May 2019, the authorities announced measures that included severance payments to less qualified teachers, training for others, and higher salaries (by GEL115) for certified teachers. They have also begun to increase investment in education infrastructure. These measures, costing up to 0.2 percent of GDP in one-off payments and permanently 0.1 percent of GDP, will be accommodated within the current spending envelope, as agreed at the time of the Third Review.[6] Over the medium term, the authorities envisage further salary increases while scaling up education infrastructure spending. Staff agreed on the need for a comprehensive and well-costed education reform; that current salaries are low relative to private sector alternatives; and that salary increases can only be effective if combined with measures to boost education quality. The additional investment in human capital will be accommodated within the fiscal deficit targets by slowing growth in infrastructure investment correspondingly.[7] In staff's view, the slowdown in capital spending over the medium term could be moderated through revenue measures such as pro-environment taxes and a more modern property tax system.

13. The authorities submitted legislation to introduce a floor on education spending at 6 percent of GDP from 2022. Staff agreed that an increase in education spending (from the current 3.8 percent of GDP) would be needed to raise the quality of education but advocated a needs-based approach rather than a fixed floor. Such a floor would reduce budget flexibility and may weaken incentives for efficient spending and undermine accounting practices. Instead, staff recommended reforms to make the existing medium-term budget framework (MTBF) more binding, thereby giving the authorities a more appropriate tool to formulate medium-term spending priorities. The authorities indicated they intend to proceed with setting the spending floor, stressing that it would help to persevere with the education reform over the medium term.

14. The authorities intend to facilitate budget financing through development of the local capital markets (Box 1). Increasing issuance of longer-maturity bonds will enhance liquidity, which should make treasury securities more attractive for foreign investors. The funds raised through additional domestic issuance will be invested in long-term deposits at commercial banks through auctions, with public debt—net of government deposits—below 45 percent of GDP. To promote private participation, the authorities are drafting legislation on establishing investment funds (to be submitted to Parliament by September 2019); on securities holding, derivatives and financial collateral;

[6] The authorities expect a budget amendment to this effect to be passed by mid-2019.

[7] While education reform measures for the post-program period have yet to be specified, the medium-term current spending projections (Tables 3a, 3b) incorporate education spending needs as assessed by the authorities (increasing from 3.8 percent of GDP in 2019 to 6.2 percent of GDP by 2022).

and on taxation of collective investments. To enhance trading, the authorities plan to transition to a primary dealer system.

15. The authorities continue to strengthen revenue administration (MEFP ¶11). All new VAT declarations are being risk-assessed since January 2019. Staff welcomed progress to make the new GRS structure operational and commended the authorities for the new automatic risk assessment system for VAT declarations.

16. The authorities remain committed to contain fiscal risks, improve public investment management, and upgrade fiscal reporting (MEFP ¶12). The 2020 FRS will include estimates on the return of equity and loans held by the government (**new SB, end-December 2019**). Any new government guarantees should be transparently disclosed and assessed in the FRS. The authorities are also advancing in (i) upgrading and enforcing the PIM methodology (**SB, end-December 2019**); (ii) qualifying SOEs as public corporations according to Government Finance Statistics Manual 2014 (GFSM2014) (**SB, end-September 2019**); and (iii) strengthening SOEs governance and reporting (**SB, end-November 2019**). In this context, the authorities should clarify the mandate of SOEs and improve their corporate governance and reporting requirements, including through corporatization if needed. The authorities are also committed to shifting the public finance presentation from GSFM2001 to GFSM2014 in the 2020 budget.

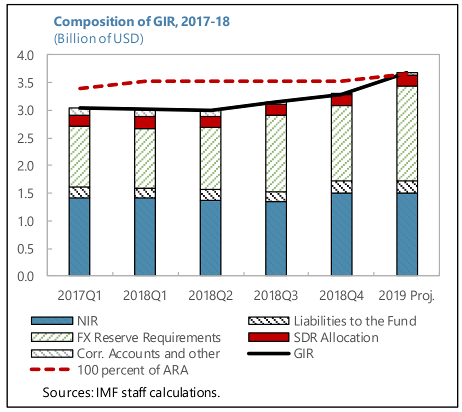
17. The authorities need to reassess the role of and rationale for the Partnership Fund (PF). With limited dividends from SOEs (the source of PF's funding), the PF is financially constrained. The PF is no longer operating consistent with the terms agreed under the program, as some of its investments do not follow commercial objectives and are not limited to minority shares. This could result in contingent liabilities. Staff called for the PF to operate within the terms agreed under the program and for the authorities to reconsider the need for a PF, given other support programs, including the newly created credit guarantee scheme for SMEs.

B. Supporting Price Stability and Reserve Accumulation with Continued Exchange Rate Flexibility

18. The NBG plans to keep monetary policy on hold (MEFP ¶12). The monetary policy stance is appropriately neutral. With subdued inflation and well-anchored inflation expectations, the NBG has been gradually lowering the policy rate. With the inflation target expected to be reached in 2020, the NBG plans to keep the policy rate on hold, provided that inflationary pressures remain subdued. The authorities and staff agreed that domestic liquidity conditions remain broadly appropriate.[8]

[8] The NBG continues to provide short-term liquidity via refinancing loans and open market operations, and long-term liquidity via outright purchases of treasury securities.

19. Efforts to accumulate international reserves need to be sustained (MEFP ¶15). The exchange rate is broadly in line with fundamentals and desirable policy settings (Annex II). Staff commended the NBG for increasing reserves while maintaining exchange rate flexibility, which continues to serve Georgia well. Staff also noted that the buildup in GIR has been mostly driven by higher FX reserve requirements.[9] The NIR target was set at $1,520 million for end-December 2019, in line with reserve accumulation efforts envisaged during the Third Review. Staff agreed with the NBG's policy of primarily relying mostly on put options for intervention, while resorting to discretionary purchases if the amounts purchased via FX put options, which will depend on exchange rate dynamics[10], prove insufficient. The NIR target and higher FX reserve requirements ($300 million, effective May 2019) will help reach 100 percent of the ARA metric by end-2019. The authorities agreed that any liability management operation to improve the structure of public debt should not undermine reserve targets.



Composition of GIR, 2017-18
(Billion of USD)
Sources: IMF staff calculations.

C. Strengthening Financial Resilience

20. The authorities continue to advance financial sector reforms (MEFP ¶20-21). They are working on legislation to make emergency liquidity assistance and the banking resolution framework consistent with best international practice (MEFP ¶22). The authorities submitted relevant legal amendments to Parliament (**SB, end-May 2019**) and enact the legislation (**new SB, end-December 2019**). The NBG is also assessing the impact of using consolidated IFRS data for prudential requirements and finalizing regulation on consolidated supervision. The authorities plan to submit an enhanced supervisory framework for financial conglomerates to Parliament soon. New regulation requires banks to maintain 100 percent coverage for the net stable funding ratio starting September 2019, consistent with Basel III.[11]

21. The impact of tighter credit standards should be closely monitored (MEFP ¶19). Staff agreed with the authorities that the tighter lending standards instituted over the past year will make credit growth more sustainable in the long term. While banks are still adjusting to the new standards, preliminary evidence suggests that they have slowed credit growth in line with expectations. The authorities are considering simplifying the regulations without affecting its fundamental objectives. Staff cautioned against making changes until sufficient data are available to fully assess the impact on credit growth. It was agreed to continue assessing credit developments ahead of any regulatory changes.

[9] FX reserve requirements represented 41 percent of GIR at end-2018 and are expected to become 47 percent of GIR in 2019.

[10] Banks will only have an incentive to utilize FX put options if the lari is appreciating.

[11] As a result, the liquid asset requirements, including for non-resident deposits (a residency-based capital flow management measure), will be abolished effective January 2020.

22. The authorities are preparing a forward-looking financial stability report (**SB, end-November 2019**). This report will assess risks and vulnerabilities in the financial system and private non-financial sector balance sheets and discuss priority financial policy actions.

D. Harnessing Structural Reforms to Promote More Inclusive Growth

23. The authorities underscored the need to continue advancing structural reforms to increase potential growth and make it more inclusive (MEFP ¶27-35). Specifically,

- Besides the initial measures already taken (see ¶12), the authorities are working on other education reform measures. In cooperation with the World Bank, they are developing a new policy for choosing school locations and a qualification system for pre-school education professionals. A new teacher policy aims to align teacher standards to the OECD benchmarks. A new funding model for universities aims to establish performance indicators, rather than focusing on the number of students. Vocational education will focus on short-term programs to provide specific skills based on labor market needs, which could facilitate female labor participation (Box 2).
- The authorities are finalizing a new draft insolvency law (SB, end-July 2019) consistent with best international practices. A robust regulatory framework for independent insolvency professionals, who will manage the insolvency process under the new regime (as opposed to a government agency now), will help maximize the benefits of the reform. This, together with reforms to promote a transparent and independent judiciary, should help mobilize investment.
- The authorities continue to promote trade integration. The feasibility study for the Georgia-India Free Trade Agreement (FTA) was finalized, while the one for the Georgia-Israel FTA is expected by June 2019. Discussions continue on FTAs with the UK, US, and the GCC.
- Reforms in the energy market would increase market competition, promote renewable energy, and enhance energy efficiency. As of May 2019, some large electricity consumers can access directly the wholesale market. The goal is to move towards a third-party access model, separating transmission and distribution from suppliers, traders, and generators starting in 2019.

24. The pension agency is expected to be fully operational by end-2019. Contributions are already being collected, and the investment board will be formed in early June. The investment strategy is expected to be approved in September, creating an institutional investor for long-term lari assets.

25. The authorities created a credit guarantee scheme to ease access to finance for small and medium enterprises (SMEs, MEFP ¶9). The scheme will receive an annual budget allocation (GEL 20 million each in the next 5 years) to cover for up to 15 percent of the loan portfolio of each participating bank. Banks will select the loans. Staff and the authorities agreed that limiting the size of the credit guarantee scheme was critical to contain contingent liabilities. To enhance governance, the scheme will be subject to external and internal audits and reporting requirements.

PROGRAM ISSUES AND FINANCING

26. The authorities and staff agreed to propose an update of program conditionality as follows (MEFP, Tables 1-4):

- **Performance criteria** are proposed for end-December 2019, consistent with program projections. New targets for inflation were proposed for December 2019. A new quantitative performance criterion (QPC) is proposed on net budget lending operations to support the implementation of new guidelines on these operations, and a new indicative target (IT) on the stock of VAT credits (mid-December 2019) to support a further reduction on VAT credits.[12]

- **Adjustors.** The following new adjustors and modifications to adjustors will be applied starting from end-June 2019.

  - An annual cap of GEL450 million is proposed on the adjustor of VAT refunds. Under the new automated mechanism, the flow of gross VAT refunds could become less predictable.[13]

  - The symmetric NIR adjustor on disbursements of project loans and grants to the treasury single account at the NBG is proposed to be raised from 75 percent to 100 percent. The NBG has no control over such disbursements. Raising the adjustor will obviate the need for last-minute FX intervention. Reserve accumulation will be safeguarded by the NIR target and the NBG's commitment to raise reserves.

  - To safeguard reserves, the adjustors on budget support loans and net Eurobond issuances are proposed to be modified. If program disbursements exceed net Eurobond outflows, the NIR target will be adjusted upward by the difference (**TMU, ¶31**).

- **New SBs** are proposed by end-December 2019: (i) adopt a 2020 budget in line with policies agreed at the time of the Fifth Review; (ii) expand the FRS to cover general government financial asset operations; (iii) enact legislation on the banking resolution framework; (iv) submit to Parliament legislation proposing a rules-based mechanism to index basic pension that preserves medium-term fiscal sustainability; and (v) grant GRS access to information on suspicious transactions from the FMS.

27. Financing assurances are in place for the Fourth Review. The program is fully financed for the next twelve months, with good prospects for adequate financing for the remainder of the program (Table 7).

28. Capacity to repay the Fund remains adequate. Georgia's debt remains sustainable, warranting low scrutiny under the Emerging Market Debt Sustainability Analysis. Debt service to the IMF will remain manageable, even if more adverse circumstances materialize. The full drawing under

[12] The stock of VAT credits is reported mid-month, at the time of the tax declarations (see TMU).

[13] Staff expects a substantial increase in gross tax refunds and a weakening relationship between gross refunds and net changes in the stock of tax credits. This is because (i) taxes paid in excess of amounts due are immediately refunded; and (ii) tax payments in cash are set to increase as taxpayers no longer have a stock of credits to offset against new liabilities.

the EFF would correspond to maximum repayments at 0.2 percent of GDP or 1.0 percent of gross reserves in 2024 (Tables 8 and 9).

29. Risks to the program are manageable. Political backlash and/or reform fatigue could undermine reform implementation. The authorities stand ready to adopt measures to fulfill their commitments. The continued program ownership provides safeguards and mitigates these risks.

30. The authorities are putting best efforts in negotiating arrears to Turkmenistan. They predate the program and were covered under the representative Paris Club Agreement.

STAFF APPRAISAL

31. Georgia's economic performance remains robust, but downside risks dominate the outlook. Growth has proven resilient, inflation remains under control, and external vulnerabilities have been reduced. Despite the positive trajectory, the authorities need to be prepared to address any negative spillovers from external developments and persevere with structural reform efforts to promote higher and more inclusive growth.

32. The 2019 budget appropriately targets a slightly expansionary stance. The budget allows for higher capital and social spending, including on education. Enhanced public investment management would support smoother execution. Amendments to the budget code to introduce a floor on spending education would reduce budget flexibility and may undermine transparent accounting and reduce incentives for spending efficiency.

33. Fiscal institutional reforms need to continue. Strengthening revenue administration would support medium-term revenue collection. In this regard, access to information from the FMS is critical. Building on progress in addressing fiscal risks, new government guarantees should be transparently disclosed and assessed as part of the fiscal risks statement. As part of this, the authorities should clarify the mandate of SOEs and strengthen their governance and reporting requirements, including through corporatization if needed.

34. Monetary policy remains rightly focused on price stability, supported by exchange rate flexibility. The inflation-targeting framework, combined with the floating exchange rate regime, continues to serve Georgia well. The monetary policy stance is appropriately neutral, provided that inflationary pressures remain subdued. Foreign exchange intervention should support the buildup in external buffers. Liability management operations should not undermine efforts to accumulate reserves.

35. Persevering with structural reforms is critical for achieving higher and more inclusive growth. The authorities are taking steps by preparing a new insolvency law and strengthening the bank resolution framework. To maximize the benefits of the new insolvency reform, it needs to be supported with a robust framework for regulating insolvency professionals. The funded pension pillar will help mobilize domestic savings for investment, complementing the development of local capital markets and gradually reducing dependency on external financing. The energy market reform will further improve economic efficiency and enhance potential growth.

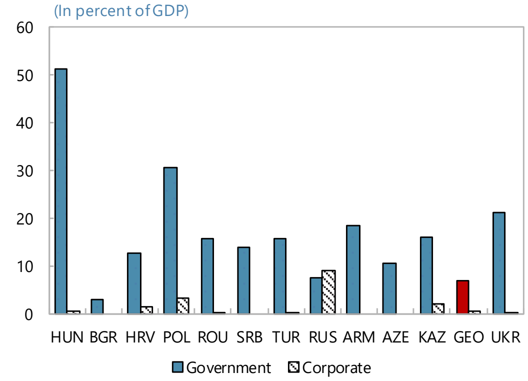
36. Staff supports the authorities' request for completing the Fourth Review under the Extended Fund Facility, modifying two quantitative performance criteria, and setting a new QPC, targets for inflation, and a new IT. Strong implementation of macroeconomic policies and advancing structural reforms provide confidence that the home-grown program will meet its objectives. Staff supports the proposed changes to conditionality.

Box 1. Developing Local Capital Markets in Georgia

The Georgia authorities are embarking on a multi-pronged reform strategy to develop the local capital markets. The debt securities market (both government and corporate) is relatively small compared to its peers.

Increasing domestic bond issuance will enhance bond market liquidity and help build a benchmark yield curve. In 2018, the Ministry of Finance announced its first one-year issuance calendar for all tenors (6-month, 12-month, 2-year, 5-year, and 10-year) providing auction and re-opening auction dates and issuance sizes. The primary auctions were met with a bid-to-cover ratio averaging around two. However, domestic banks remain the main buyer of government debt and secondary market activity remains thin. The lack of liquidity in the secondary market and the relatively small size of the issues remain constraints for foreign investors.

Local Currency Debt Security Outstanding, 2018
(In percent of GDP)



Source: Dealogic, NBG, MoF Serbia, MoF Armenia, National Bank of Kazakhstan, Sovereign investor base estimates by Arslanalp & Tsuda (2014), and IMF staff calculations.

The authorities have agreed on a roadmap for implementing a Primary Dealers (PD) system that will help deepen the market and diversify the investor base. A pilot PD system, expected to start in 2020Q2, will potentially transition to a full-fledged PD system by end-2021. The authorities are developing a strategy to engage with foreign investors through an investor relation office and roadshows.

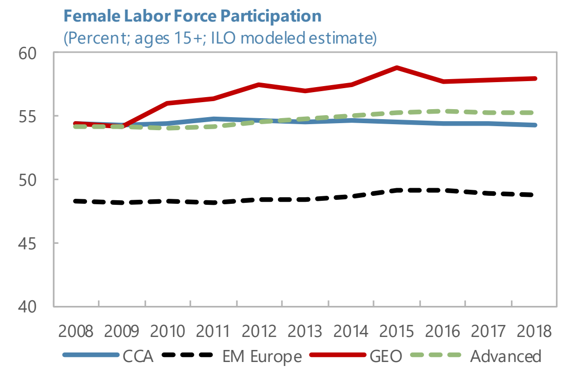
Corporate debt market is still nascent. It has been supported by the NBG policy to allow the use of corporate bonds as collateral in the repo market. However, the inability to price corporate credit risk due to the absence of a benchmark yield curve and rating agency to rate corporate debt remains a key hurdle.

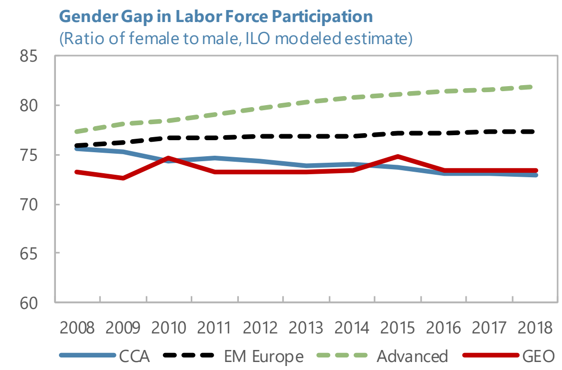
Market infrastructure is in place. Trading, custody, and settlement processes are secure and fast as most of the activity is transacted via Bloomberg's trading systems. Government bonds are euro-clearable via Clear-stream in Luxembourg, which should be attractive for foreign investor participation. Moreover, the authorities are advancing a comprehensive legal framework for securities holding.

Several regulatory reforms are underway to promote development of financial entities/products. These include: (i) a law establishing investment funds that transposes the European directive on collective investment in transferable securities (2009/65/EC) and important pillars from the directive on alternative investment fund managers (2011/61/EU) (expected submission to Parliament by September 2019); (ii) initiating preparation of the legal and regulatory framework for covered bonds by end-2019; (iii) finalizing the law on derivatives and financial collateral by end-2019; (iv) clarifying the taxation of publicly-issued securities and secondary market transactions involving those securities (with various core tax measures to facilitate foreign investor participation in the primary market having already been enacted); and (v) reforming capital market supervision, to ensure the transparent and efficient functioning of capital market and to support a smooth approximation with the EU legislation. Additionally, the NBG is finalizing development of an advanced and comprehensive framework for the securities holding legislation (Securities Market Law).

Box 2. Female Labor Force Participation in Georgia

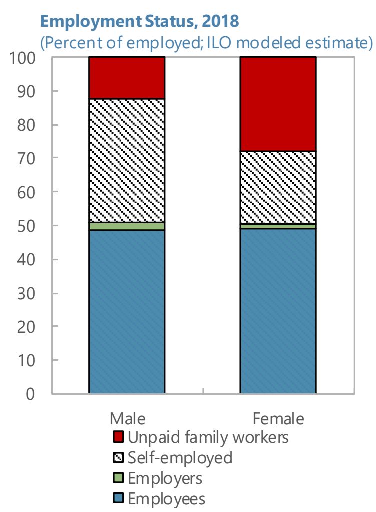
Female labor force participation in Georgia is high, well above its peers. For the past decade, female labor force participation in Georgia has been increasing (by 4 percentage points since 2008). In 2018, 58 percent of women, aged 15+, participated in the labor market in Georgia, compared to 54 percent in the CCA, 48 percent in emerging Europe, and 55 percent in advanced economies. However, the gender gap is not negligible as female participation is around 20 percentage points lower than for males, and has been persistent across time.

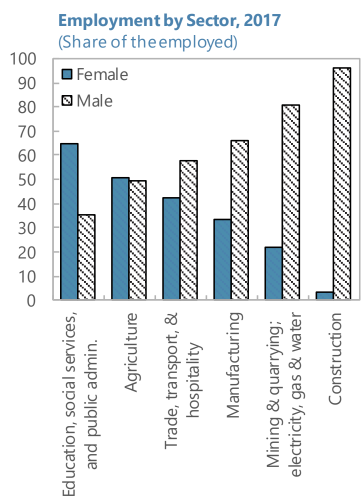


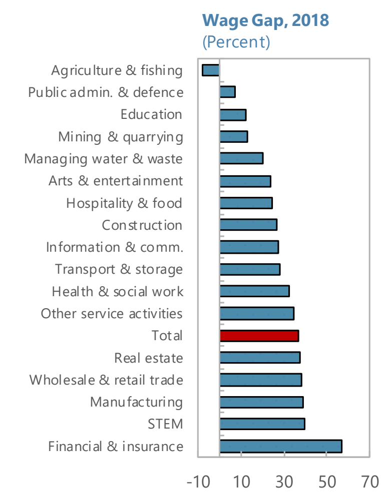


Source: World Bank, International Labor Organization, and IMF staff calculations.

Women are more likely to face a lower pay and seek more flexible jobs. Women are less likely than men to be employers (1.2 percent of the employed compared to 3 percent), and more likely to perform unpaid work (28 percent as opposed to 21 percent). As employees, women are concentrated in education, social and personal services, and public administration, whereas manufacturing, mining, and construction are highly dominated by men. The wage gap in Georgia reached 38 percent in 2018, but is only partially explained by more flexible jobs, as women's salaries appear to be lower than men across almost all sectors of employment.







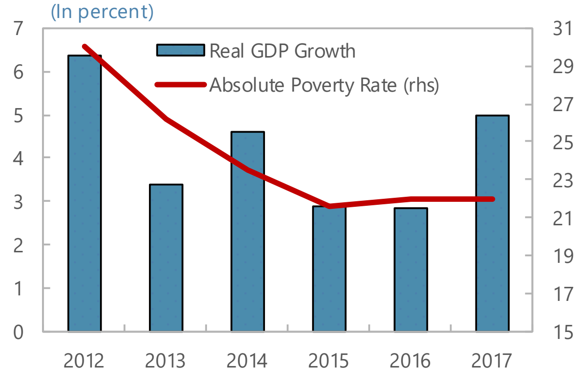
Source: GeoStat, International Labor Organization, and IMF staff calculations.

Gender gaps in the labor market contribute to a loss of 11 percent of per capita GDP, with two thirds of the loss explained by occupational choices. Based on estimates presented in Cuberes and Teignier (2016), greater gender equality in entrepreneurship and labor force participation would raise Georgia's GDP by 11.3 percent.

Figure 1. Georgia: Real Sector and Inflation Developments

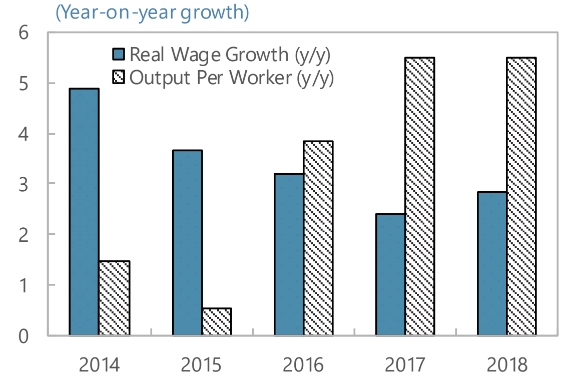
Poverty reduction stalled in spite of higher growth…

Real GDP Growth and Absolute Poverty Rate
(In percent)



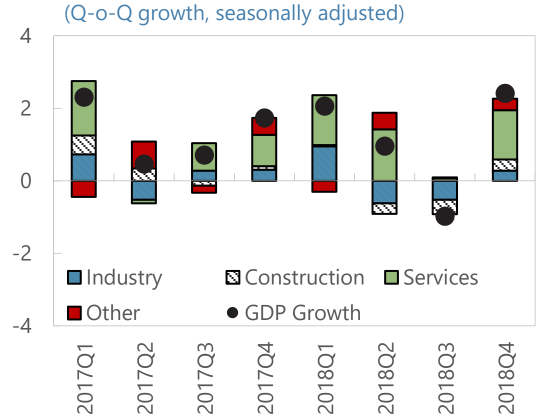
… as real wage growth fell below labor productivity growth.

Real Wage Growth and Labor Productivity
(Year-on-year growth)



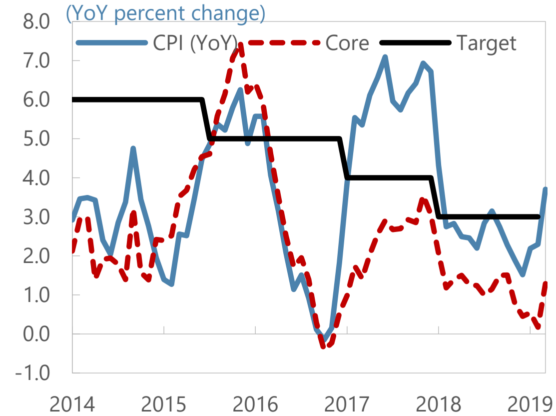
Growth slowed in the middle of 2018 due to lower construction and industry activity.

Real GDP Growth Decomposition
(Q-o-Q growth, seasonally adjusted)



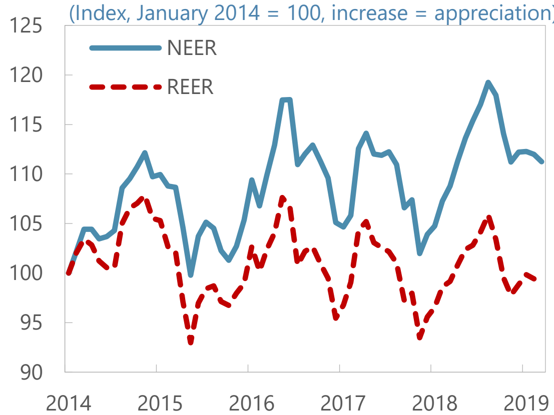
Inflation generally remained below target with core inflation subdued.

Inflation: Headline and Core Inflation
(YoY percent change)



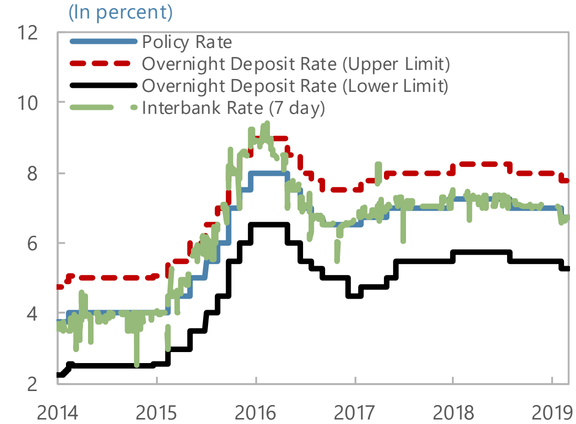
Nominal and real effective exchange rates appreciated marginally in 2018.

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



NBG has eased the policy rates by 50 bps by end-March.

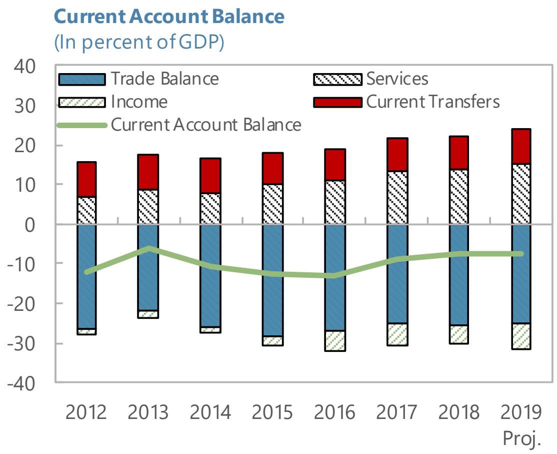
Interest Rates
(In percent)



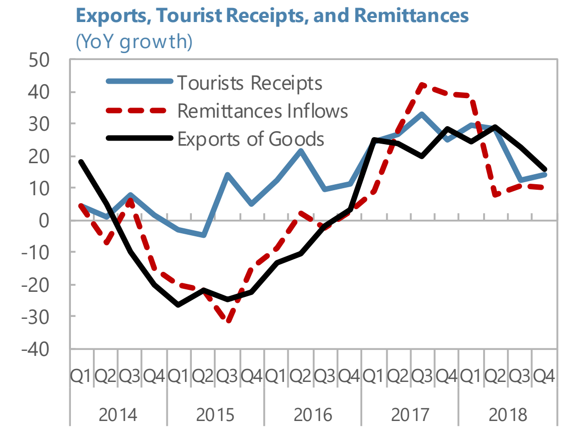
Source: National authorities, and IMF staff calculations.

Figure 2. Georgia: External Sector Developments

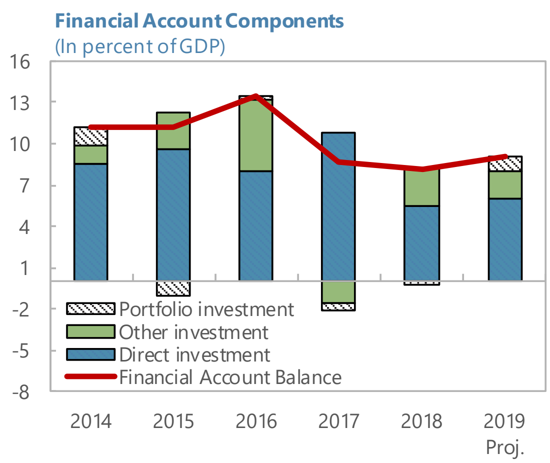
The current account deficit narrowed…



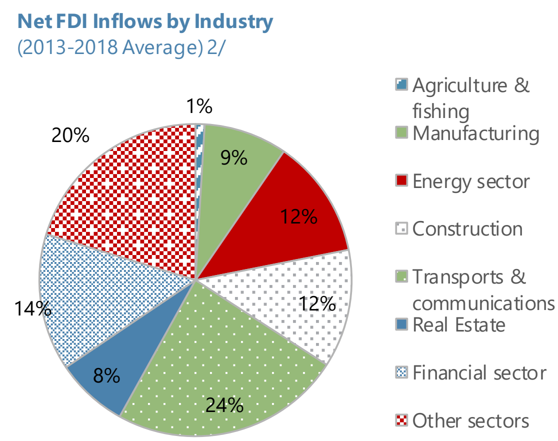
… supported by strong growth in exports, tourism, and remittances.



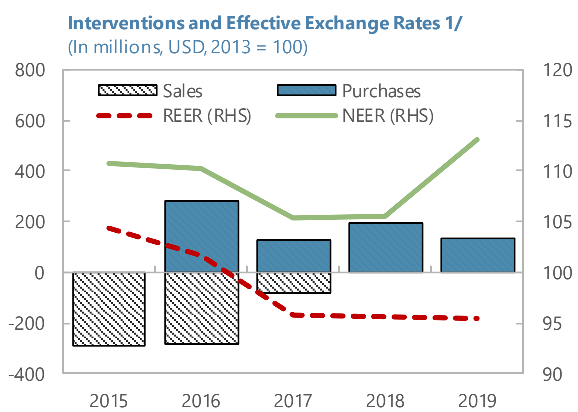
Direct investment dropped by 35 percent in 2017…



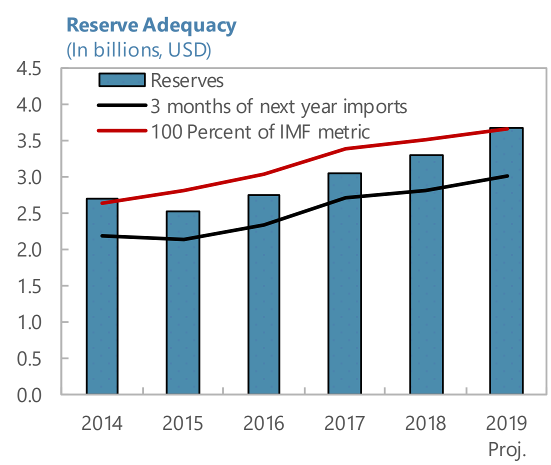
… but remains concentrated in transport and energy sectors.



NBG's FX intervention shifted to only purchases….



… helping set up reserve accumulation.



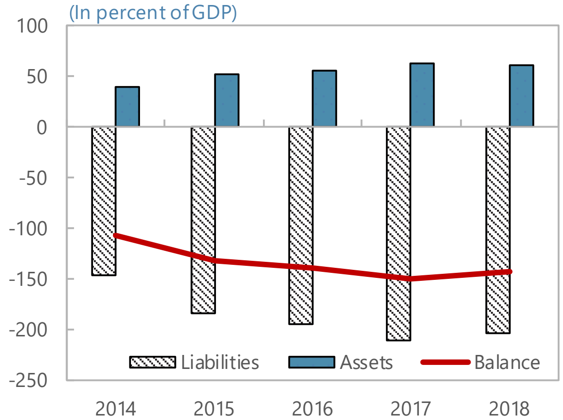
1/ Interventions for 2019 as of February.

Source: National authorities, GEOStat, and IMF staff calculations.

Figure 3. Georgia: International Investment Position (IIP)

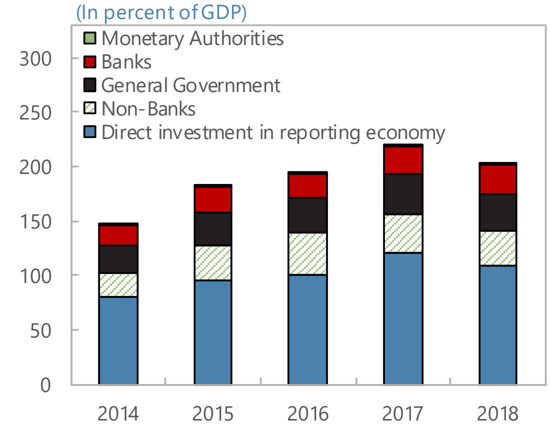
The net IIP improved up to 2018, …

International Investment Position, Overall
(In percent of GDP)



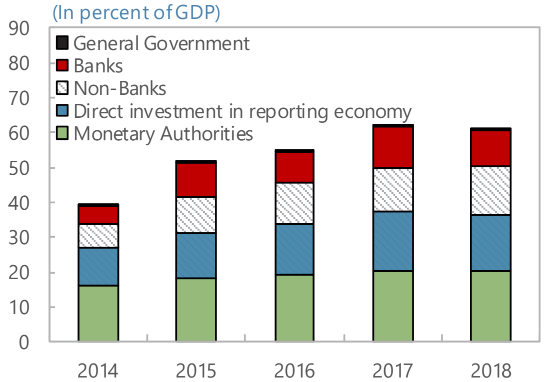
… due to declining FDI liabilities, …

Gross Liabilities by Borrower
(In percent of GDP)



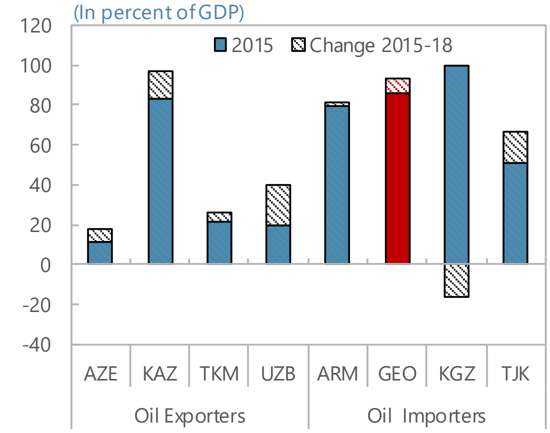
… and banks' foreign asset repatriation.

Gross Assets by Borrower
(In percent of GDP)



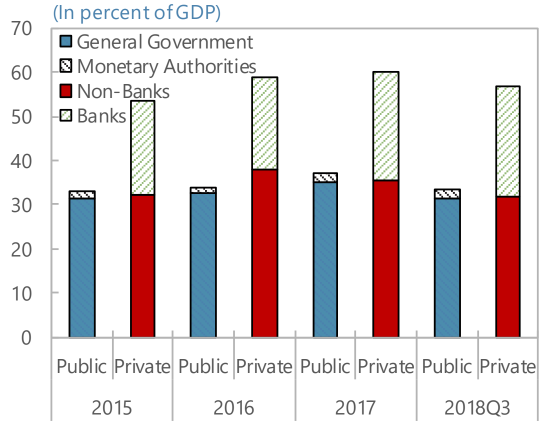
Georgia's external debt has slightly increased, in line with other oil importers in the Caucasus.

External Debt
(In percent of GDP)



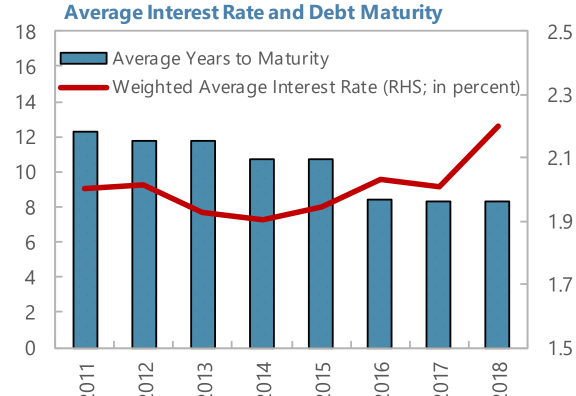
External debt declined in 2018.

Total External Debt 1/
(In percent of GDP)



External public debt continues to exhibit long maturity and low interest rates.

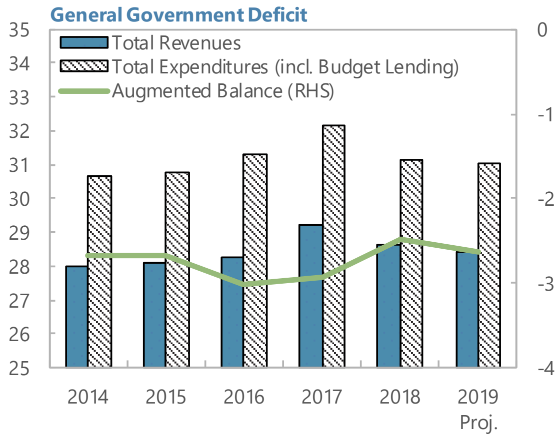
Average Interest Rate and Debt Maturity



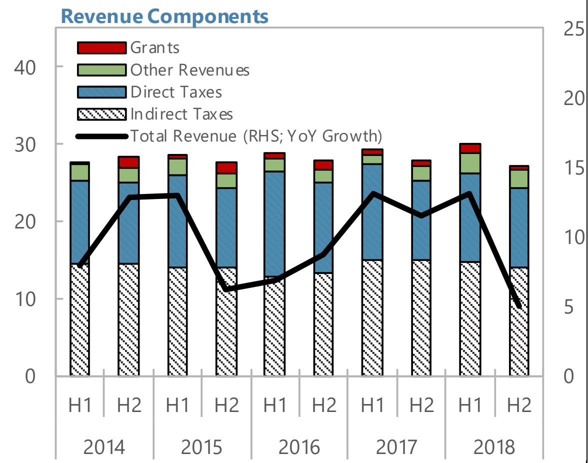
1/ Excludes intercompany lending. Private includes financial institutions and corporations.
Sources: National authorities; World Economic Outlook; and IMF staff estimates.

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

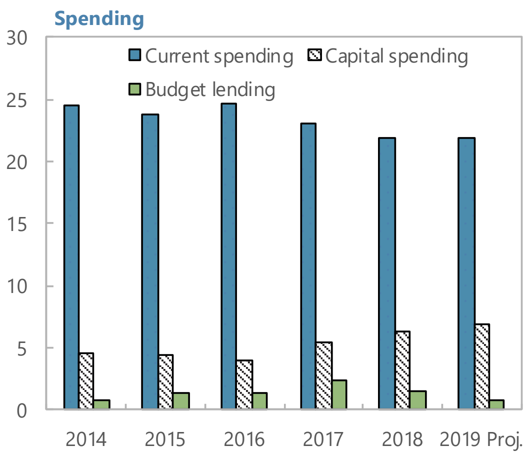
The augmented fiscal balance has improved since 2016 …



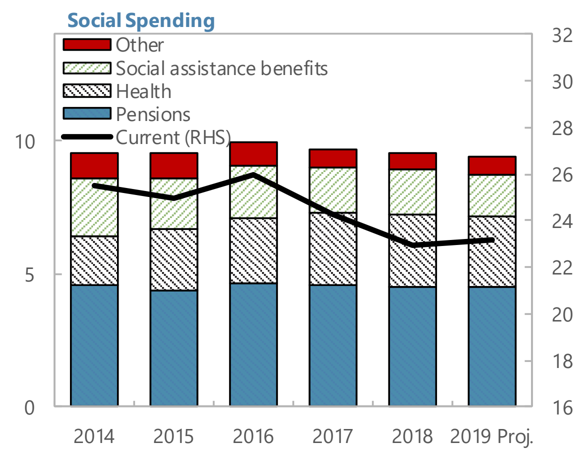
… driven by strong revenue performance …



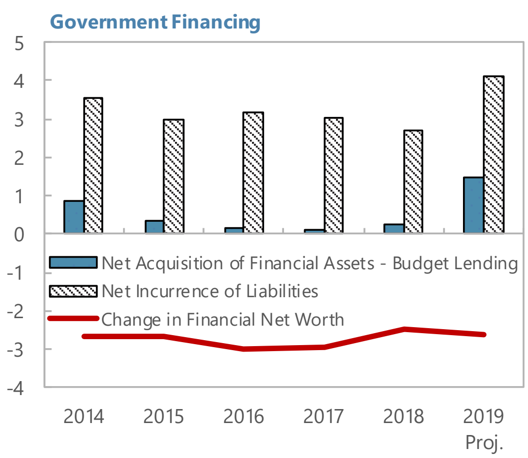
… and contained current spending, creating space to expand public investment.



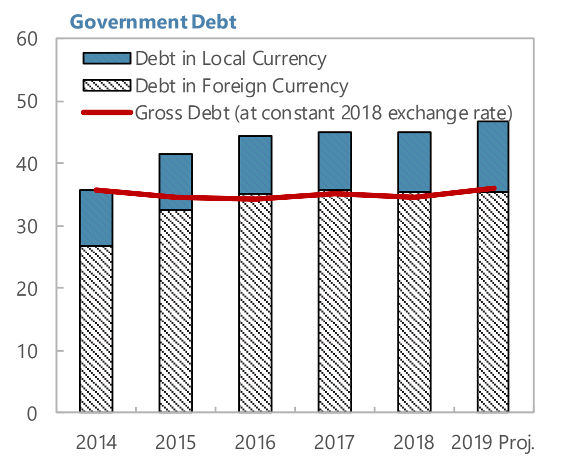
Social spending remains a key component of current spending.



Financing needs remain relatively stable.



Public debt is highly exposed to FX risks.

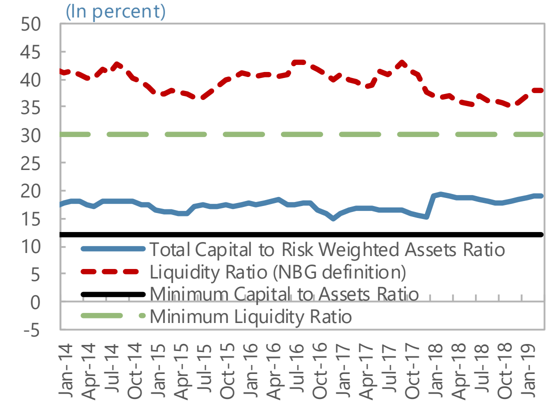


Source: National authorities, and IMF staff estimates.

Figure 5. Georgia: Financial Sector Developments

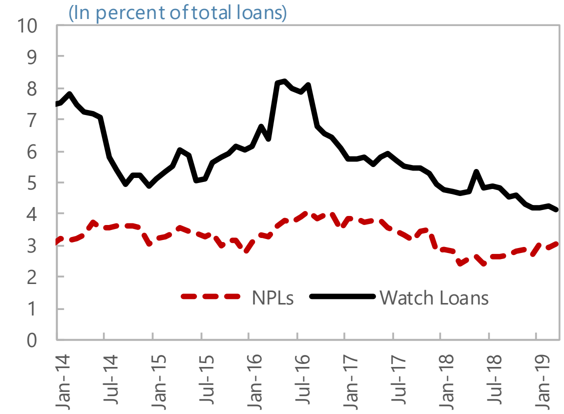
Banks are liquid and well capitalized.

Capital and Liquidity Ratios
(In percent)



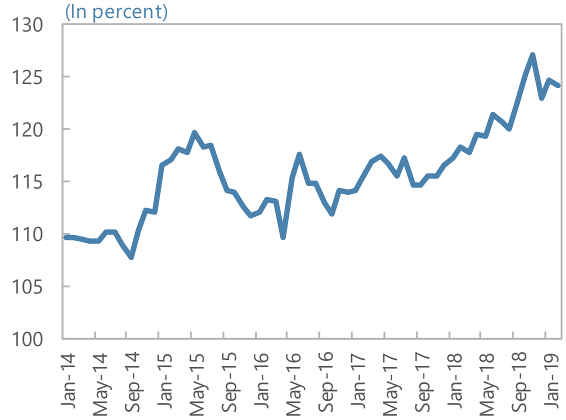
NPLs have stabilized and watch loans have maintained a downward trend.

Non-Performing and Watch Loans
(In percent of total loans)



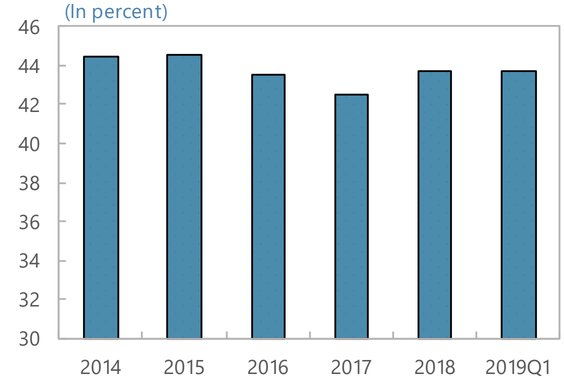
The loan-to-deposit ratio (at constant exchange rates) have increased in the last year, lately in anticipation of lending standards,

Loan-To-Deposit Ratio
(In percent)



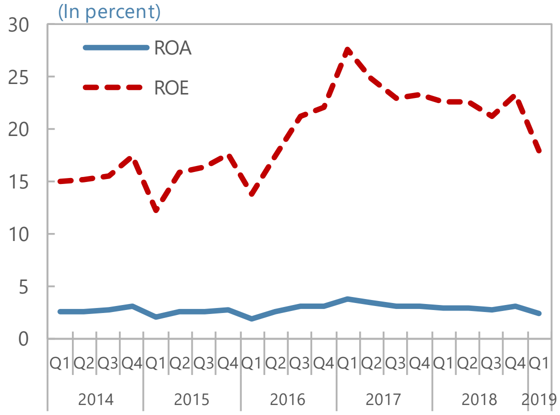
Financial performance continues to be strong, …

Net Interest Income-To-Gross Income Ratio
(In percent)



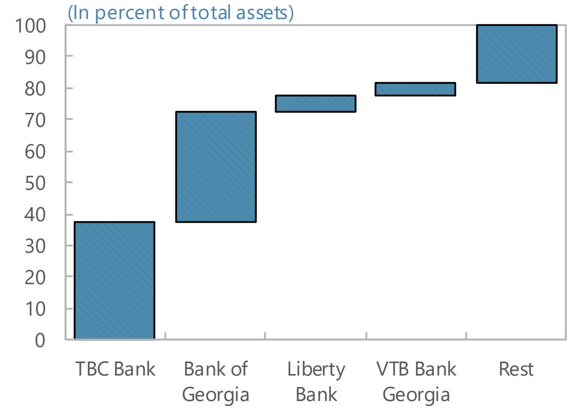
… supporting high banks' profitability, …

Return on Assets and Equity Ratios
(In percent)



… in the context of a highly concentrated market.

Market Concentration of Assets, March 2019
(In percent of total assets)

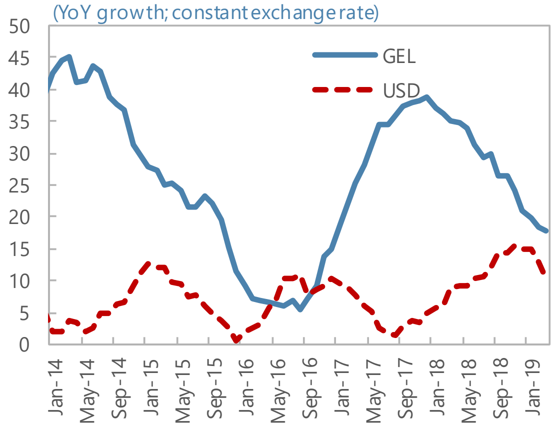


Source: National Bank of Georgia, and IMF staff calculations.

Figure 5. Georgia: Financial Sector Developments (concluded)

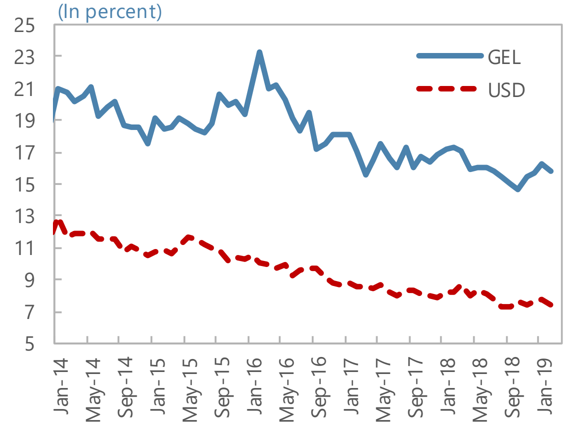
Lari-dominated credit to the private sector has slowed since early 2018...

Private Sector Credit
(YoY growth; constant exchange rate)



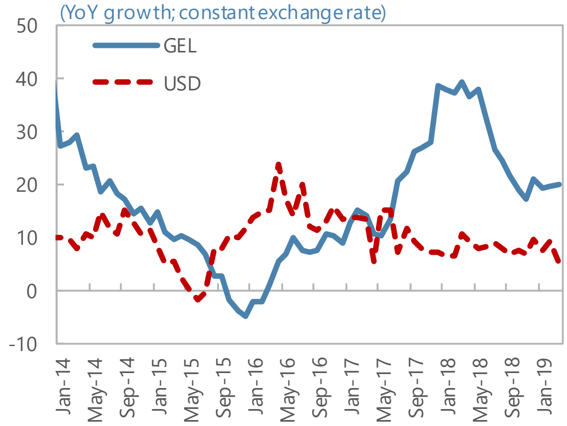
... and lending rates have been declining.

Interest Rates For Loans
(In percent)



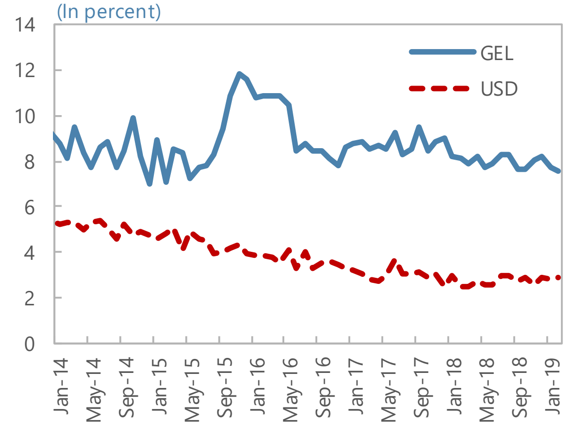
Deposit growth has fallen recently, ...

Resident Deposits
(YoY growth; constant exchange rate)



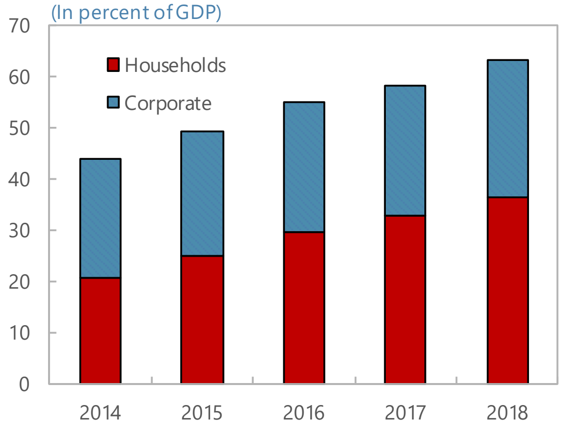
... while interest rates on deposits have remained stable.

Interest Rates For Deposits
(In percent)



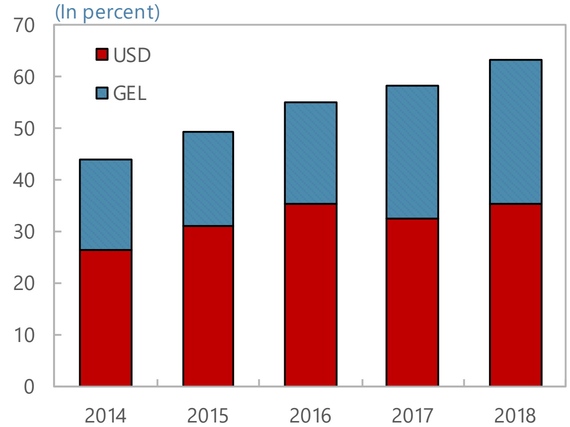
Credit developments are driven by credit to households, ...

Credit to the Private Sector
(In percent of GDP)



with an increasing share of loans in local currency.

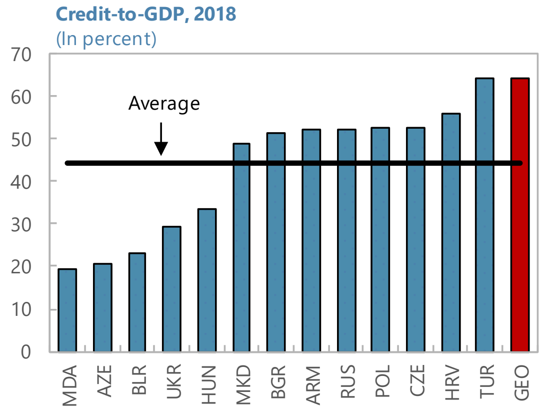
Private Sector Credit-To-GDP Ratio
(In percent)



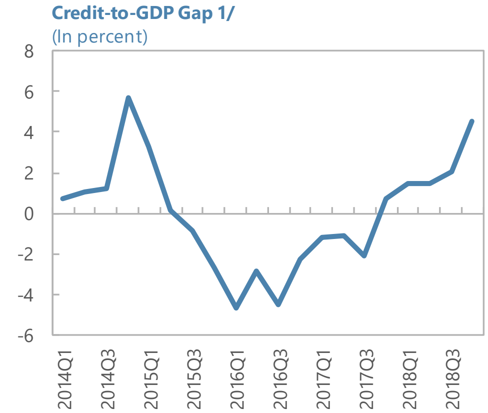
Source: National Bank of Georgia, and IMF staff calculations.

Figure 6. Georgia: Macro-Financial Developments

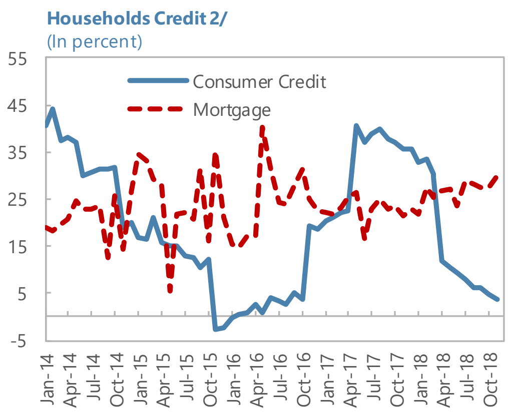
Georgia's credit-to-GDP ratio is higher than peers...



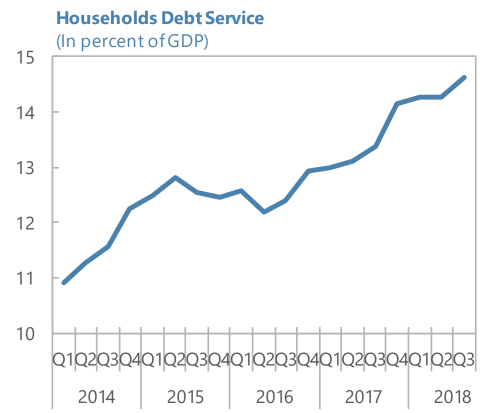
... and above its long-term trend.



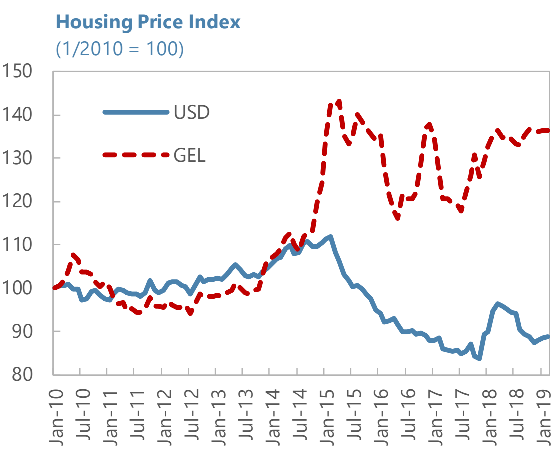
Household debt has been driven by consumer and mortgage loans...



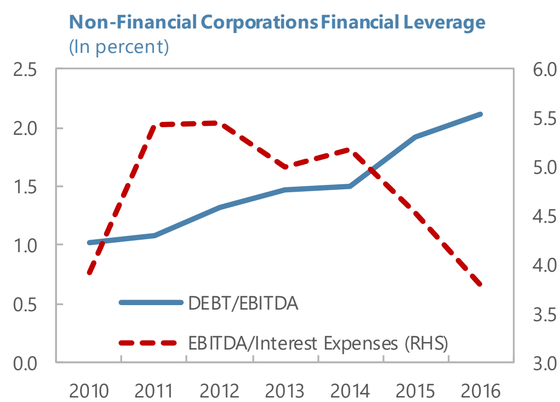
... increasing debt service.



There are no evident signs of pressures in the real estate market, ...

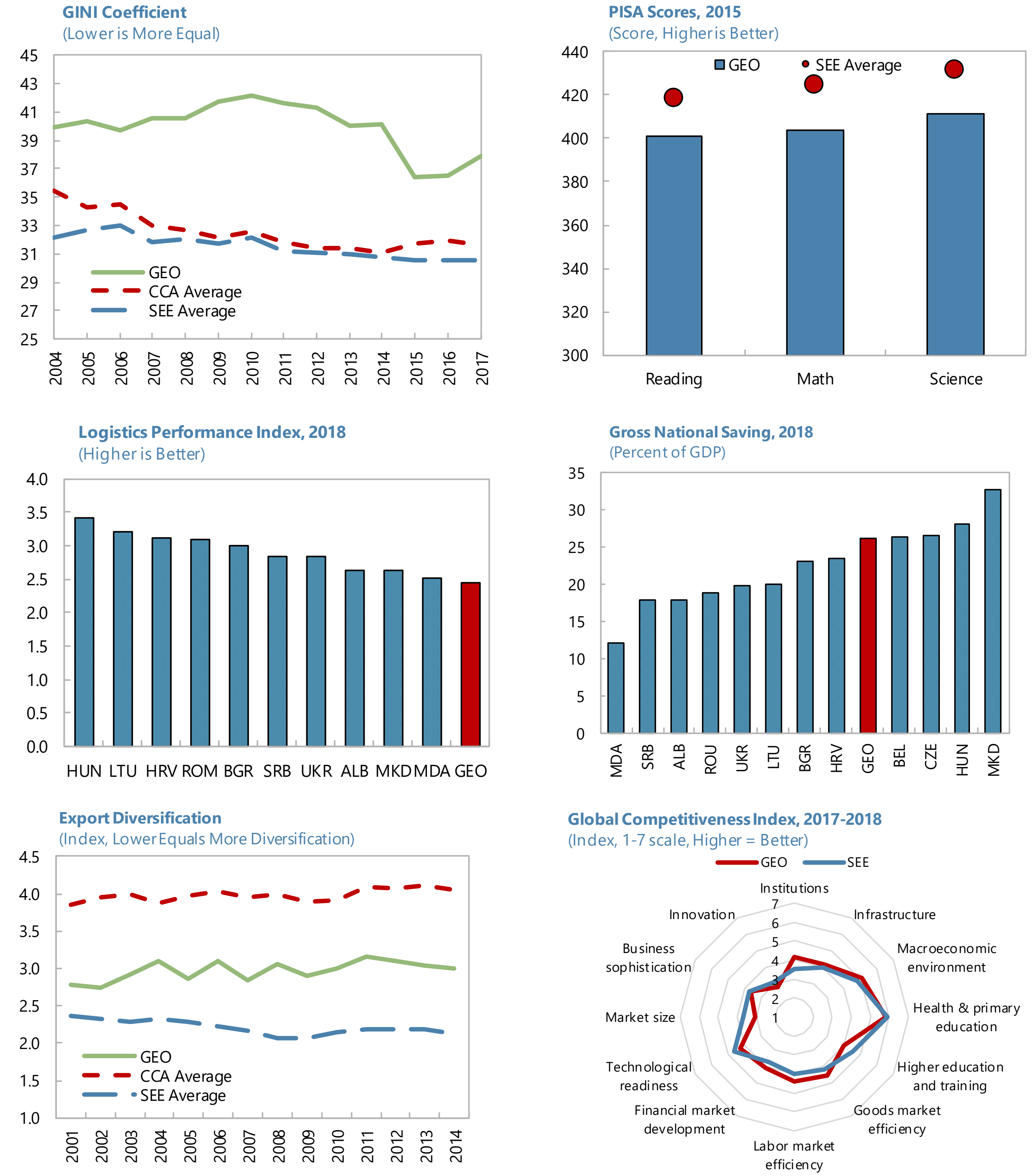


... neither of debt service pressures in the non-financial corporate sector.



1/ The Hodric-Prescott Filter was used to remove the cyclical components of credit-to-GDP time-series. 2/ In the fourth quarter of 2015, the NBG reclassified consumer loans from 'by product' to 'by aim.'
Sources: National Bank of Georgia; and IMF staff calculations.

Figure 7. Georgia: Macro-Structural Challenges



Sources: National authorities; World Bank; Eurostat; OECD; EBRD; World Economic Forum; and IMF staff estimates.
Note: SEE indicates Southeastern Europe and is a simple average of available data for: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Kosovo, Lithuania, Macedonia, Romania, Moldova, Serbia, Ukraine. CCA indicated Caucasus and Central Asia and is a simple average of the available data for: Armenia, Azerbaijan, Kyrgyz Republic, Kazakhstan, Tajikistan, Turkmenistan, and Uzbekistan.

Figure 8. Georgia Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

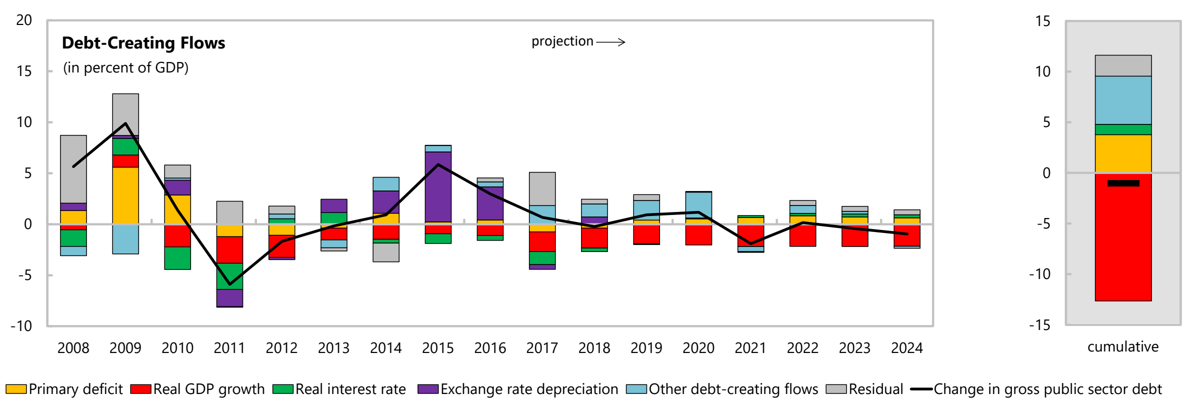
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of November 06, 2018		
	2008-2016 [2]	2017	2018	2019	2020	2021	2022	2023	2024	Sovereign Spreads		
Nominal gross public debt	38.0	45.1	44.9	45.8	46.9	45.0	45.2	44.8	43.8	EMBIG (bp) 3/		227
Public gross financing needs	4.5	4.6	5.7	7.4	6.9	8.3	6.2	6.3	6.4	5Y CDS (bp)		384
Real GDP growth (in percent)	3.6	4.8	4.7	4.6	4.8	5.0	5.2	5.2	5.2	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	4.4	6.1	3.7	3.5	3.3	3.0	3.0	3.0	3.0	Moody's	Ba2	Ba2
Nominal GDP growth (in percent)	8.2	11.2	8.5	8.4	8.0	8.3	8.3	8.4	8.4	S&Ps	BB-	BB-
Effective interest rate (in percent) [4]	2.9	3.2	3.0	3.4	3.6	3.6	3.7	3.8	3.9	Fitch	BB-	BB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [10]
Change in gross public sector debt	2.1	0.7	-0.2	0.9	1.2	-1.9	0.2	-0.4	-1.0	-1.0	
Identified debt-creating flows	0.6	-2.6	-0.7	0.3	1.1	-1.8	-0.3	-0.9	-1.4	-3.1	
Primary deficit	1.0	-0.8	-0.4	0.4	0.5	0.7	0.8	0.7	0.6	3.8	-2.1
Primary (noninterest) revenue and grants	29.0	29.2	28.6	28.4	28.1	28.0	28.0	28.0	28.0	168.4	
Primary (noninterest) expenditure	30.0	28.4	28.3	28.8	28.6	28.6	28.8	28.7	28.6	172.2	
Automatic debt dynamics [5]	-0.2	-3.7	-1.6	-2.0	-1.9	-2.0	-1.9	-1.9	-1.9	-11.6	
Interest rate/growth differential [6]	-1.8	-3.2	-2.3	-2.0	-1.9	-2.0	-1.9	-1.9	-1.9	-11.6	
Of which: real interest rate	-0.5	-1.3	-0.3	-0.1	0.1	0.2	0.2	0.3	0.3	1.0	
Of which: real GDP growth	-1.2	-1.9	-2.0	-1.9	-2.0	-2.2	-2.2	-2.2	-2.2	-12.6	
Exchange rate depreciation [7]	1.6	-0.5	0.7	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.2	1.8	1.3	1.9	2.5	-0.5	0.8	0.3	-0.2	4.8	
GG: Privatization and Drawdown of deposits (negative)	-1.1	-0.6	-0.3	1.2	1.9	-1.1	0.2	-0.3	-0.7	1.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
GG: Net acquisition of financial assets: Budget lending [8]	0.9	2.4	1.6	0.8	0.7	0.6	0.6	0.5	0.5	3.6	
Residual, including asset changes [9]	1.5	3.3	0.5	0.6	0.1	-0.1	0.5	0.5	0.5	2.1	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

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

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

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

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

8/ Includes net budget lending.

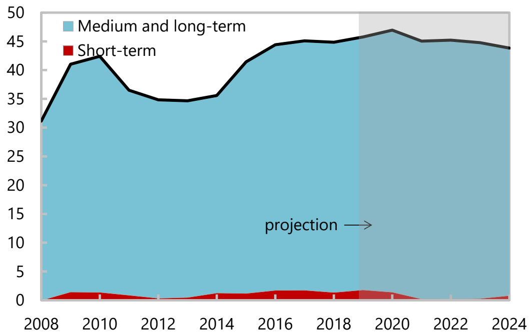
9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

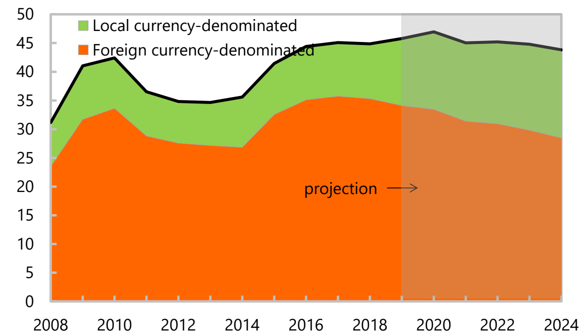
Figure 9. Georgia Public Sector Debt Sustainability Analysis - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



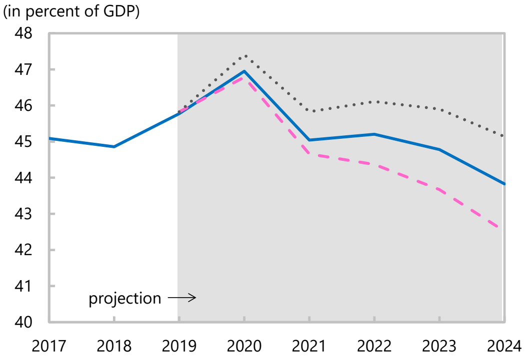
By Currency
(in percent of GDP)



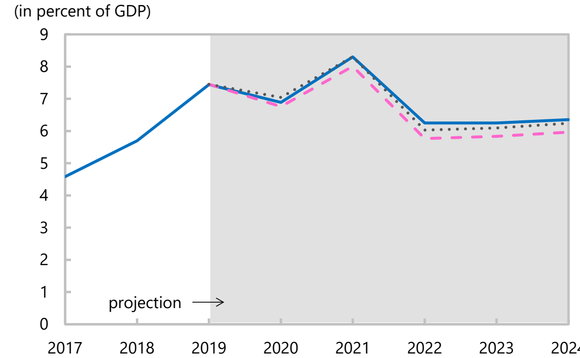
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



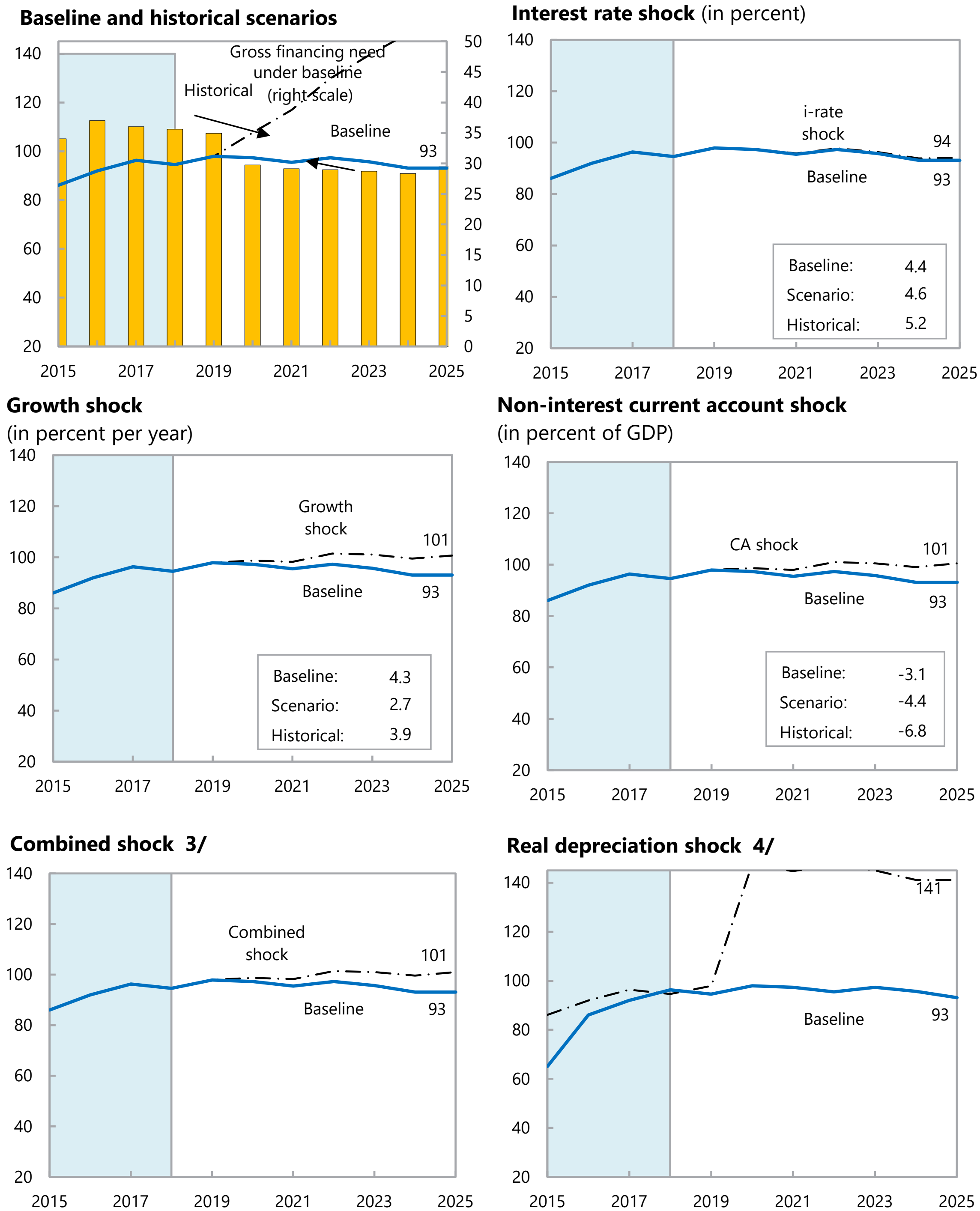
Underlying Assumptions
(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	4.6	4.8	5.0	5.2	5.2	5.2
Inflation	3.5	3.3	3.0	3.0	3.0	3.0
Primary Balance	-0.4	-0.5	-0.7	-0.8	-0.7	-0.6
Effective interest rate	3.4	3.6	3.6	3.7	3.8	3.9
Constant Primary Balance Scenario						
Real GDP growth	4.6	4.8	5.0	5.2	5.2	5.2
Inflation	3.5	3.3	3.0	3.0	3.0	3.0
Primary Balance	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Effective interest rate	3.4	3.6	3.6	3.7	3.8	3.9

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	4.6	3.9	3.9	3.9	3.9	3.9
Inflation	3.5	3.3	3.0	3.0	3.0	3.0
Primary Balance	-0.4	-0.6	-0.6	-0.6	-0.6	-0.6
Effective interest rate	3.4	3.6	3.3	3.2	3.2	3.1

Source: IMF staff.

Figure 10. Georgia: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2019.

Table 1. Georgia: Selected Economic and Financial Indicators, 2017–24

	2017	2018	2018	2019	2019	2020	2021	2022	2023	2024
	Actual	EFF 3rd Review	Prel.	EFF 3rd Review	Projections					
National accounts and prices	(annual percentage change; unless otherwise indicated)									
Real GDP	4.8	5.0	4.7	4.6	4.6	4.8	5.0	5.2	5.2	5.2
Output Gap	-1.9	-1.5	-1.5	-1.0	-1.0	-0.5	0.0	0.0	0.0	0.0
Nominal GDP (in billion of laris)	37.8	41.6	41.1	45.0	44.5	48.1	52.1	56.4	61.1	66.2
Nominal GDP (in billion of U.S. dollars)	15.1	16.5	16.2	17.2	16.6	18.1	19.9	21.5	23.2	25.1
GDP per capita (in thousand of U.S. dollars)	4.0	4.4	4.3	4.6	4.5	4.9	5.4	5.8	6.2	6.6
GDP deflator, period average	6.1	4.2	3.7	3.4	3.5	3.3	3.0	3.0	3.0	3.0
CPI, Period average	6.0	2.8	2.6	3.1	3.8	3.2	3.0	3.0	3.0	3.0
CPI, End-of-period	6.7	2.3	1.5	3.0	4.5	3.0	3.0	3.0	3.0	3.0
Investment and saving	(in percent of GDP)									
Gross national saving	23.6	25.5	25.7	25.4	25.6	26.4	27.2	27.8	28.5	29.2
Investment	32.4	34.5	33.4	34.9	33.1	33.8	34.4	34.9	35.5	36.1
Public	6.1	6.6	7.0	7.1	7.2	6.9	7.1	7.0	6.9	6.8
Private	26.3	27.9	26.4	27.9	25.9	26.8	27.3	27.9	28.6	29.3
Consolidated government operations	(in percent of GDP)									
Revenue and grants	29.2	27.9	28.6	28.0	28.4	28.1	28.0	28.0	28.0	28.0
o.w. Tax revenue	26.2	25.0	25.4	25.1	25.4	25.2	25.2	25.2	25.3	25.3
Expenditures	32.8	30.8	31.7	30.9	31.4	31.1	31.1	31.3	31.1	31.0
Current expenditures	24.3	23.0	23.1	23.1	23.4	23.5	23.4	23.6	23.7	23.7
Capital spending and budget lending	8.5	7.8	8.6	7.8	8.0	7.6	7.7	7.6	7.4	7.3
Net Lending/Borrowing (GFSM 2001)	-0.5	-1.2	-0.9	-1.9	-1.9	-2.0	-2.2	-2.3	-2.3	-2.2
Augmented Net lending / borrowing (Program definition) 1/	-2.9	-2.3	-2.5	-2.6	-2.6	-2.7	-2.8	-2.9	-2.8	-2.7
Public debt 2/	45.1	43.4	44.9	43.5	46.7	48.3	46.4	46.7	46.3	45.4
o.w. Foreign-currency denominated	35.7	34.1	35.3	33.8	35.6	35.0	32.0	31.7	30.7	29.4
Public debt net of government deposits 2/	42.4	41.3	42.2	40.8	42.7	42.4	41.7	41.7	41.6	41.4
Money and credit	(in percent; unless otherwise indicated)									
Credit to the private sector (annual percentage change)	17.6	17.6	19.3	12.6	12.3	10.8	9.4	8.9	8.6	8.4
In constant exchange rate	19.1	16.3	17.1	13.1	11.9	11.5	10.1	8.9	8.4	8.1
Broad money (annual percentage change)	14.8	13.6	14.0	12.2	12.8	12.9	10.8	10.4	10.2	9.6
Broad money (incl. fx deposits, annual percentage change)	13.7	12.6	13.3	10.8	11.8	10.8	10.3	10.1	9.9	9.3
In constant exchange rate	16.3	12.5	12.1	12.8	12.4	13.6	11.5	10.2	9.9	9.4
Deposit dollarization (in percent of total)	63.7	62.2	62.1	59.6	60.6	59.6	58.6	57.6	56.8	56.3
Credit dollarization (in percent of total)	56.1	53.7	55.8	51.3	53.7	51.3	50.4	49.5	48.6	47.7
Credit to GDP	58.1	62.1	63.8	64.6	66.2	67.8	68.5	68.9	69.0	69.0
External sector	(in percent of GDP; unless otherwise indicated)									
Current account balance (in billions of US$)	-1.3	-1.5	-1.2	-1.6	-1.2	-1.3	-1.4	-1.5	-1.6	-1.7
Current account balance	-8.8	-9.0	-7.7	-9.5	-7.5	-7.3	-7.2	-7.1	-7.0	-6.9
Trade balance	-25.2	-26.2	-25.3	-27.4	-25.2	-24.9	-24.8	-24.5	-24.3	-24.0
Terms of trade (percent change)	-2.6	-4.9	-4.9	-0.9	1.2	-1.3	1.3	1.0	1.2	2.0
Gross international reserves (in billions of US$)	3.0	3.2	3.3	3.5	3.7	4.1	4.1	4.5	4.9	5.3
In percent of IMF Composite measure (floating)	88.9	92.3	90.8	95.6	100.1	105.2	103.6	108.3	112.8	118.0
Gross external debt	113.7	108.9	112.9	113.3	117.0	116.4	114.1	116.1	115.6	113.0
Gross external debt, excl. intercompany loans	96.3	91.5	94.6	95.0	97.8	97.4	95.5	97.4	95.7	93.1
Laris per U.S. dollar (period average)	2.51	…	2.53	…	…	…	…	…	…	…
Laris per euro (period average)	2.83	…	2.99	…	…	…	…	…	…	…
REER (period average; CPI based, 2010=100)	100.6	…	104.1	…	…	…	…	…	…	…

Sources: Georgian authorities; and Fund staff estimates.
1/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.
2/ Public debt includes central government and NBG.

Table 2. Georgia: Balance of Payments, 2017-24

	2017	2018	2018	2019	2019	2020	2021	2022	2023	2024
		EFF 3rd		EFF 3rd						
	Actual	Review	Prel.	Review			Projections			
				(in millions of U.S. dollars)						
Current account balance	-1,332	-1,488	-1,248	-1,636	-1,243	-1,329	-1,438	-1,525	-1,632	-1,728
Trade balance	-3,796	-4,314	-4,107	-4,703	-4,170	-4,516	-4,925	-5,255	-5,641	-6,009
Exports	3,634	4,416	4,448	4,709	4,807	5,159	5,501	5,844	6,189	6,524
Imports	-7,430	-8,731	-8,556	-9,412	-8,976	-9,674	-10,426	-11,099	-11,830	-12,533
Services	2,014	2,350	2,242	2,626	2,492	2,754	3,048	3,211	3,385	3,569
Services: credit	3,976	4,544	4,482	4,973	4,730	5,084	5,536	5,869	6,223	6,680
Services: debit	-1,962	-2,194	-2,241	-2,347	-2,238	-2,330	-2,488	-2,658	-2,838	-3,111
Income	-825	-942	-744	-1,073	-1,048	-1,152	-1,251	-1,284	-1,262	-1,317
Of which : interest payments	-520	-553	-589	-591	-633	-663	-694	-724	-585	-645
Transfers	1,274	1,418	1,361	1,515	1,482	1,585	1,690	1,803	1,886	2,029
Of which : remittances credit	750	903	865	966	926	991	1,060	1,139	1,200	1,266
Capital account	109	82	77	80	94	93	91	89	87	85
General government	83	82	72	80	94	93	91	89	87	85
Financial account	1,194	1,393	1,145	1,627	1,363	1,512	1,431	1,795	1,910	2,056
Direct investment (net)	1,625	1,222	892	1,359	988	1,178	1,335	1,495	1,614	1,744
Portfolio investment (net)	-77	106	-28	0	192	50	-250	75	100	100
Equity	-53	-24	-43	0	0	0	0	0	0	0
Debt securities	-25	130	15	0	192	50	-250	75	100	100
Loans (net)	251	334	212	501	288	731	837	742	641	555
Short-term loans (net)	31	-60	-56	15	78	21	20	21	21	23
Public	3	3	4	3	4	4	4	4	4	4
Private	29	-63	-60	13	73	16	15	17	17	18
Medium and long-term loans (net)	220	394	268	486	210	711	817	721	619	533
Public 1/	238	96	148	309	198	309	463	383	271	193
Private	-18	298	120	177	13	402	354	338	348	339
Bank	194	307	339	138	106	341	303	283	298	290
Non-bank	-212	-9	-219	40	-93	61	51	56	50	49
Others (net) 2/	-605	-269	69	-233	-104	-447	-491	-518	-445	-343
Errors and omissions	-65	0	-49	0	0	0	0	0	0	0
Overall balance	-95	-13	-75	72	214	276	84	359	365	414
Financing	-90	-161	-120	-249	-395	-367	-84	-359	-377	-427
Gross International Reserves (-increase)	-242	-199	-279	-249	-395	-367	-84	-359	-377	-427
Rescheduled debts and arrears clearance	152	38	160	0	0	0	0	0	0	0
Financing gap	192	174	201	177	181	91	0	0	0	0
Proposed use of Fund Resources	71	28	27	35	35	43	0	0	0	0
Proposed IMF EFF	84	85	84	84	84	43	0	0	0	0
Repayment 3/	-13	-57	-57	-49	-49	0	0	0	0	0
Official creditors	121	146	174	142	145	48	0	0	0	0
World Bank	106	0	0	0	0	0	0	0	0	0
EU	15	17	17	23	23	0	0	0	0	0
AFD	0	129	157	119	123	48	0	0	0	0
Memorandum items:					(In percent of GDP)					
Current account balance	-8.8	-9.0	-7.7	-9.5	-7.5	-7.3	-7.2	-7.1	-7.0	-6.9
Trade balance	-25.2	-26.2	-25.3	-27.4	-25.2	-24.9	-24.8	-24.5	-24.3	-24.0
Financial account	7.9	8.5	7.1	9.5	8.2	8.3	7.2	8.4	8.2	8.2
Foreign direct investment (net)	10.8	7.4	5.5	7.9	6.0	6.5	6.7	7.0	7.0	7.0
External financing requirement	37.5	34.1	37.0	34.2	32.5	31.0	30.4	30.1	29.8	29.4
Gross international reserves (in million of USD)	3,039	3,238	3,289	3,487	3,684	4,051	4,134	4,493	4,871	5,298
in months of next year GNFS imports	3.4	3.3	3.5	3.3	3.7	3.8	3.6	3.7	3.7	3.8
in percent of short-term debt at remaining maturity	68	79	74	83	92	94	89	91	92	94
in percent of broad money and non-resident deposits	36	34	35	33	35	35	32	31	31	31
in percent of IMF Composite measure (floating)	89	92	91	96	100	105	104	108	113	118
Reserve cover (percent) 4/	42.4	43.3	43.2	45.6	48.8	53.9	51.0	51.7	52.5	53.6

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

1/ Including general government and monetary authorities

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

3/ Repayment for exisitng Fund resources over 2017-20 will be recorded as a part of financing gap.

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

Table 3a. Georgia: General Government Operations, GFSM2001 2017–24
(In millions of GEL)

	2017	2018	2019	2019	2020	2021	2022	2023	2024
			EFF 3rd						
	Actual	Prel.	Review			Projections			
Revenue	11,051	11,761	12,607	12,660	13,490	14,561	15,780	17,102	18,524
Taxes	9,909	10,445	11,304	11,285	12,105	13,112	14,230	15,447	16,756
Taxes on income, profits, and capital gains	3,675	3,984	4,196	4,200	4,554	4,937	5,374	5,841	6,333
Payable by individuals	2,919	3,247	3,396	3,392	3,696	4,026	4,403	4,803	5,209
Payable by corporations	757	737	801	808	859	911	972	1,038	1,125
Taxes on property	394	441	468	458	494	535	580	628	681
Taxes on goods and services	5,573	5,893	6,560	6,356	6,860	7,429	8,045	8,720	9,449
General taxes on goods and services (VAT)	4,123	4,427	5,014	4,858	5,182	5,612	6,078	6,587	7,138
Excises	1,451	1,466	1,545	1,498	1,678	1,817	1,968	2,132	2,311
Taxes on international trade	72	73	84	75	80	85	90	97	105
Other taxes 1/	195	54	-4	197	117	126	141	161	187
Grants	304	341	393	395	326	303	308	309	310
Other revenue	838	975	910	980	1,059	1,146	1,241	1,346	1,458
Total Expenditure	11,248	12,125	13,441	13,493	14,464	15,690	17,090	18,482	19,972
Expense	9,194	9,496	10,392	10,428	11,314	12,210	13,337	14,497	15,726
Compensation of employees	1,649	1,685	1,765	1,785	1,842	1,943	2,050	2,221	2,407
Use of goods and services	1,536	1,584	1,548	1,600	1,651	1,700	1,793	1,944	2,106
Interest	482	520	620	655	720	779	840	944	1,032
External	238	269	321	347	321	292	273	301	324
Domestic	244	252	299	309	399	487	567	643	708
Subsidies	871	849	936	935	965	993	1,048	1,136	1,231
Grants	64	66	128	128	132	136	143	155	168
Social benefits	3,544	3,732	4,186	4,120	4,620	5,006	5,431	5,895	6,395
Other expense	1,050	1,060	1,210	1,205	1,384	1,653	2,032	2,202	2,386
Net acquisition of nonfinancial assets	2,054	2,629	3,049	3,065	3,150	3,480	3,753	3,985	4,246
Increase (capital spending)	2,314	2,860	3,189	3,205	3,330	3,680	3,970	4,220	4,500
Decrease (privatization proceeds)	-260	-231	-140	-140	-180	-200	-217	-235	-254
Net lending / borrowing before adjustment	-197	-364	-834	-833	-974	-1,129	-1,310	-1,381	-1,448
Unidentified measures	0	0	0	0	0	0	0	0	0
Net lending / borrowing	-198	-364	-834	-833	-974	-1,129	-1,310	-1,381	-1,448
Change in net financial worth, transactions	-198	-364	-834	-833	-974	-1,129	-1,310	-1,381	-1,448
Net acquisition of financial assets ("+": increase in assets)	954	753	685	998	1,391	-65	655	391	118
Domestic	954	753	685	998	1,391	-65	655	391	118
Budget lending	915	657	335	335	320	320	320	320	320
Deposits (NBG and commercial banks)	39	96	350	663	1,071	-385	335	71	-202
Financial privatization	0	0	0	0	0	0	0	0	0
Net incurrence of liabilities ("+": increase in liabilities)	1,152	1,117	1,520	1,831	2,365	1,064	1,965	1,772	1,566
Domestic	354	377	467	1,023	1,419	1,160	960	1,060	1,060
Securities other than shares	354	377	467	1,023	1,419	1,160	960	1,060	1,060
Loans	0	0	0	0	0	0	0	0	0
Foreign	798	740	1,053	808	947	-96	1,005	712	506
Loans	798	740	1,053	808	947	-96	1,005	712	506
Memorandum items:									
Nominal GDP	37,847	41,077	45,032	44,516	48,087	52,073	56,395	61,121	66,235
Public debt	17,064	18,426	19,572	20,777	23,214	24,180	26,335	28,307	30,072
End-year government deposits	1,012	1,108	1,216	1,771	2,843	2,458	2,793	2,864	2,661
Operating balance	1,857	2,265	2,215	2,232	2,176	2,351	2,443	2,604	2,798
Net lending / borrowing (excluding privatization)	-457	-595	-974	-973	-1,154	-1,329	-1,527	-1,616	-1,702
Augmented Net lending / borrowing (Program definition) 2/	-1,113	-1,021	-1,169	-1,168	-1,294	-1,449	-1,630	-1,701	-1,768
Cyclically-adjusted primary balance (Program definition)	-416	-299	-424	-369	-459	-629	-737	-705	-677

Sources: Ministry of Finance; and Fund staff estimates.
1/ Includes cash outflows due to tax credit refunds.
2/ Augmented Net lending / borrowing (Program definition) = Net lending / borrowing - Budget lending.

Table 3b. Georgia: General Government Operations, GFSM2001 2017–24

(In percent of GDP)

	2017	2018	2018	2019	2019	2020	2021	2022	2023	2024
		EFF 3rd		EFF 3rd						
	Actual	Review	Prel.	Review			Projections			
Revenue	29.2	27.9	28.6	28.0	28.4	28.1	28.0	28.0	28.0	28.0
Taxes	26.2	25.0	25.4	25.1	25.4	25.2	25.2	25.2	25.3	25.3
Taxes on income, profits, and capital gains	9.7	9.5	9.7	9.3	9.4	9.5	9.5	9.5	9.6	9.6
Payable by individuals	7.7	7.7	7.9	7.5	7.6	7.7	7.7	7.8	7.9	7.9
Payable by corporations	2.0	1.8	1.8	1.8	1.8	1.8	1.7	1.7	1.7	1.7
Taxes on property	1.0	1.0	1.1	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Taxes on goods and services	14.7	14.4	14.3	14.6	14.3	14.3	14.3	14.3	14.3	14.3
General taxes on goods and services (VAT)	10.9	10.9	10.8	11.1	10.9	10.8	10.8	10.8	10.8	10.8
Excises	3.8	3.5	3.6	3.4	3.4	3.5	3.5	3.5	3.5	3.5
Taxes on international trade	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other taxes 1/	0.5	-0.1	0.1	0.0	0.4	0.2	0.2	0.2	0.3	0.3
Grants	0.8	0.7	0.8	0.9	0.9	0.7	0.6	0.5	0.5	0.5
Other revenue	2.2	2.1	2.4	2.0	2.2	2.2	2.2	2.2	2.2	2.2
Total Expenditure	29.7	29.1	29.5	29.8	30.3	30.1	30.1	30.3	30.2	30.2
Expense	24.3	23.0	23.1	23.1	23.4	23.5	23.4	23.6	23.7	23.7
Compensation of employees	4.4	4.1	4.1	3.9	4.0	3.8	3.7	3.6	3.6	3.6
Use of goods and services	4.1	3.7	3.9	3.4	3.6	3.4	3.3	3.2	3.2	3.2
Interest	1.3	1.3	1.3	1.4	1.5	1.5	1.5	1.5	1.5	1.6
External	0.6	0.7	0.7	0.7	0.8	0.7	0.6	0.5	0.5	0.5
Domestic	0.6	0.6	0.6	0.7	0.7	0.8	0.9	1.0	1.1	1.1
Subsidies	2.3	2.1	2.1	2.1	2.1	2.0	1.9	1.9	1.9	1.9
Grants	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social benefits	9.4	8.9	9.1	9.3	9.3	9.6	9.6	9.6	9.6	9.7
Other expense	2.8	2.7	2.6	2.7	2.7	2.9	3.2	3.6	3.6	3.6
Net acquisition of nonfinancial assets	5.4	6.1	6.4	6.8	6.9	6.6	6.7	6.7	6.5	6.4
Increase (capital spending)	6.1	6.6	7.0	7.1	7.2	6.9	7.1	7.0	6.9	6.8
Decrease (privatization proceeds)	-0.7	-0.5	-0.6	-0.3	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4
Net lending / borrowing before adjustment	-0.5	-1.2	-0.9	-1.9	-1.9	-2.0	-2.2	-2.3	-2.3	-2.2
Unidentified measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending / borrowing	-0.5	-1.2	-0.9	-1.9	-1.9	-2.0	-2.2	-2.3	-2.3	-2.2
Change in net financial worth, transactions	-0.5	-1.2	-0.9	-1.9	-1.9	-2.0	-2.2	-2.3	-2.3	-2.2
Net acquisition of financial assets ("+": increase in assets)	2.5	0.8	1.8	1.5	2.2	2.9	-0.1	1.2	0.6	0.2
Domestic	2.5	0.8	1.8	1.5	2.2	2.9	-0.1	1.2	0.6	0.2
Budget lending	2.4	1.2	1.6	0.7	0.8	0.7	0.6	0.6	0.5	0.5
Deposits (NBG and commercial banks)	0.1	-0.3	0.2	0.8	1.5	2.2	-0.7	0.6	0.1	-0.3
Financial privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities ("+": increase in liabilities)	3.0	2.0	2.7	3.4	4.1	4.9	2.0	3.5	2.9	2.4
Domestic	0.9	0.9	0.9	1.0	2.3	3.0	2.2	1.7	1.7	1.6
Securities other than shares	0.9	0.9	0.9	1.0	2.3	3.0	2.2	1.7	1.7	1.6
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	2.1	1.1	1.8	2.3	1.8	2.0	-0.2	1.8	1.2	0.8
Loans	2.1	1.1	1.8	2.3	1.8	2.0	-0.2	1.8	1.2	0.8
Memorandum items:										
Nominal GDP (in millions of GEL)	37,847	41,629	41,077	45,032	44,516	48,087	52,073	56,395	61,121	66,235
Public debt	45.1	43.4	44.9	43.5	46.7	48.3	46.4	46.7	46.3	45.4
End-year government deposits	2.7	2.1	2.7	2.7	4.0	5.9	4.7	5.0	4.7	4.0
Operating balance (before adjustment)	4.9	4.9	5.5	4.9	5.0	4.5	4.5	4.3	4.3	4.2
Net lending / borrowing (excluding privatization)	-1.2	-1.7	-1.4	-2.2	-2.2	-2.4	-2.6	-2.7	-2.6	-2.6
Augmented Net lending / borrowing (Program definition) 2/	-2.9	-2.3	-2.5	-2.6	-2.6	-2.7	-2.8	-2.9	-2.8	-2.7
Cyclically-adjusted primary balance (Program definition)	-1.1	-0.8	-0.7	-0.9	-0.8	-1.0	-1.2	-1.3	-1.2	-1.0

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes cash outflows due to tax credit refunds.

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

Table 4. Georgia: Monetary Survey, 2017-20

	2017	2018		2019		2020	
				Projections			
		June	Dec	June	Dec	June	Dec
Central Bank			(In billions of lari)				
Net foreign assets	4.0	3.6	4.2	4.5	3.6	4.5	3.9
Gross international reserves	7.9	7.4	8.8	10.7	9.9	11.6	10.8
Other foreign assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign currency liabilities	-3.9	-3.8	-4.6	-6.2	-6.4	-7.0	-6.9
Of which : use of Fund resources	-0.2	-0.3	-0.4	-0.6	-0.7	-0.7	-0.7
Of which : compulsory reserves in USD	-2.8	-2.7	-3.6	-4.8	-5.1	-5.5	-5.7
Net domestic assets	-0.3	0.1	0.0	-0.6	0.8	-0.3	0.9
Net claims on general government	-0.5	0.0	-0.1	0.2	0.4	0.0	0.1
Claims on general government (incl. T-bills)	0.5	0.5	0.6	0.8	0.9	0.9	1.0
Nontradable govt. debt	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Securitized debt (marketable)	0.2	0.2	0.4	0.6	0.7	0.7	0.8
Deposits	-1.0	-0.5	-0.8	-0.6	-0.5	-0.9	-0.9
Claims on rest of economy	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on banks	1.7	1.4	1.9	1.0	2.3	1.6	2.6
Bank refinancing	1.8	1.5	1.9	1.1	2.3	1.7	2.7
Certificates of deposits and bonds	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other items, net	-1.5	-1.3	-1.7	-1.8	-1.8	-1.8	-1.8
Banking System			(In billions of lari)				
Net foreign assets	1.0	-1.3	-1.0	-0.5	-1.4	-0.5	-1.3
NBG	6.8	6.3	7.8	9.3	8.7	10.1	9.5
Commercial banks	-5.8	-7.6	-8.8	-9.8	-10.0	-10.5	-10.8
Net domestic assets	17.4	19.4	22.0	22.0	25.1	25.8	28.0
Domestic credit	22.9	23.8	27.6	27.7	31.6	32.6	35.8
Net claims on general government	0.9	0.9	1.4	1.8	2.1	2.7	3.2
Of which : government deposits at NBG	-1.0	-0.5	-0.8	-0.6	-0.5	-0.9	-0.9
Of which : T-bills at commercial banks	2.4	2.5	2.8	3.6	3.9	4.9	5.4
Private credit	22.0	22.9	26.2	25.9	29.4	29.9	32.6
Other items, net	-5.5	-4.4	-5.6	-5.7	-6.5	-6.9	-7.8
Broad money (M3)	18.4	18.1	21.0	21.5	23.7	25.3	26.8
(Broad money, percent change year on year)	14.8	16.4	14.0	18.9	12.8	17.4	12.9
Lari Broad money (M2)	8.4	8.6	9.7	10.2	11.4	11.9	13.0
Currency held by the public	2.7	2.5	2.7	2.9	3.4	3.3	3.7
Lari resident deposits	5.7	6.1	6.9	7.2	8.0	8.7	9.3
Resident foreign exchange deposits	10.0	9.5	11.3	11.4	12.3	13.4	13.7
Sources of funds of commercial banks	25.9	27.3	31.1	32.3	34.3	36.4	37.7
Resident deposits	15.7	15.6	18.3	18.6	20.3	22.0	23.0
Non-resident deposits	3.8	3.8	4.2	4.3	4.5	4.4	4.5
Other foreign liabilities	6.3	8.0	8.6	9.4	9.5	10.0	10.2
Uses of funds of commercial banks	25.9	27.3	31.1	32.3	34.3	38.4	38.0
Reserves	6.9	6.6	7.2	7.7	8.1	6.8	7.7
Domestic credit	23.4	23.9	27.8	27.5	31.2	32.7	35.7
Lari domestic credit	11.0	11.5	13.1	13.2	15.4	17.0	19.0
Fx domestic credit	12.3	12.3	14.6	14.2	15.8	15.7	16.7
Other foreign assets	0.5	0.5	0.7	0.7	0.7	0.7	0.7
Other items, net	-4.4	-3.1	-3.9	-2.9	-5.0	-1.1	-5.5
Broad money (M3)	48.7	45.9	51.2	50.3	53.2	54.6	55.6
Lari Broad money (M2)	22.2	21.8	23.5	23.7	25.5	25.7	27.1
Currency held by the public	7.1	6.4	6.7	6.9	7.5	7.0	7.7
Non-resident deposits (percent of total deposits)	16.6	16.5	16.5	16.4	15.7	15.0	14.1
Private credit (Percent change, year on year)	17.6	19.8	19.3	13.0	12.3	15.6	10.8
Private credit	58.1	58.1	63.8	60.6	66.2	64.7	67.8
Nominal GDP (billions of lari)	37.8	39.5	41.1	42.8	44.5	46.3	48.1

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

Table 5. Selected Monetary and Financial Soundness Indicators, 2016 – Mar 2019

	2016	2017	Sept 2018	Dec 2018	Jan 2019	Mar 2019
Deposit dollarization (residents, in percent)	69.9	63.7	63.2	62.1	62.1	61.7
Loan-to-deposit ratio (in percent) 1/	103.6	107.0	108.6	111.4	112.1	112.2
Credit-to-GDP ratio (in percent)	54.9	58.1	60.9	63.8	63.0	63.1
Capital adequacy ratio (in percent) 2/	15.1	19.1	17.6	18.4	18.8	19.1
Capital adequacy ratio (in percent) 3/	23.2	22.5	…	…	…	…
Liquidity ratio (in percent) 4/	39.7	37.8	35.9	35.7	37.0	38.0
Nonperforming loans (in percent of total loans) 5/	7.3	6.0	5.6	5.6	5.8	5.9
Nonperforming loans (in percent of total loans) 6/	3.5	2.8	2.7	2.7	3.0	3.0
Loans collateralized by real estate (in percent of total loans)	59.2	59.0	60.8	62.0	62.5	63.2
Loans in foreign exchange (in percent of total loans)	65.4	57.1	55.7	57.1	57.2	56.5
Specific provisions (in percent of total loans)	3.6	2.8	2.7	2.5	2.6	2.7
Net foreign assets (in percent of total assets)	-15.0	-14.9	-18.3	-18.3	-20.2	-19.5
Net open foreign exchange position (in percent of regulatory capital)	4.4	4.2	4.8	5.2	3.4	0.1
Return on equity (cumulative through the year, annualized) 7/	19.2	20.7	19.4	19.5	15.8	15.2
Borrowed funds from abroad-to-GDP ratio 8/	15.3	16.5	16.6	16.2	14.0	14.4

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

1/ Loans and deposits from the banking sector.

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

3/ Basel I definition. This ratio was discontinued as of end-2017.

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

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

6/ IMF definition.

7/ Pre tax.

8/ Borrowed funds include Subordinated Debt.

Table 6. Georgia: External Vulnerability Indicators, 2017–24

	2017	2018	2019	2020	2021	2022	2023	2024
	Actual	Prel.	Projections					
Value of exports of goods and services, percent change	22.2	17.4	6.8	7.4	7.7	6.1	6.0	6.4
Value of imports of goods and services, percent change	10.1	15.0	3.9	7.0	7.6	6.5	6.6	6.7
Terms of trade (deterioration -)	-2.6	-4.9	1.2	-1.3	1.3	1.0	1.2	2.0
Current account balance (percent of GDP)	-8.8	-7.7	-7.5	-7.3	-7.2	-7.1	-7.0	-6.9
Capital and financial account (percent of GDP)	9.4	8.6	9.7	9.1	7.7	8.8	8.7	8.6
External public debt (percent of GDP)	36.2	35.2	37.1	36.5	33.3	32.9	31.8	30.4
(in percent of exports of goods and services)	71.8	63.9	64.5	64.5	60.0	60.3	59.4	57.7
Debt service on external public debt								
(in percent of exports of goods and services)	3.7	4.5	4.9	4.3	4.1	4.0	4.0	4.1
External debt (percent of GDP)[1]	96.3	94.6	97.8	97.4	95.5	97.4	95.7	93.1
(in percent of exports of goods and services)	190.9	171.6	169.9	172.3	172.1	178.6	178.8	176.7
Debt service on MLT external debt								
(in percent of exports of goods and services)	21.9	21.6	17.8	15.7	15.4	15.6	14.2	14.6
Gross international reserves								
in millions of USD	3,039	3,289	3,684	4,051	4,134	4,493	4,871	5,298
in months of next year's imports of goods and services	3.4	3.5	3.7	3.8	3.6	3.7	3.7	3.8
in percent of external debt	20.9	21.5	22.7	22.9	21.8	21.5	21.9	22.7
in percent of short-term external debt (remaining maturity)	68	74	92	94	89	91	92	94

Source: Fund staff estimates and projections.

[1] Excluding intercompany loans.

Table 7. Georgia: Gross External Requirements, 2017-24

(In millions of U.S. Dollars)

	2017	2018	2019	2020	2021	2022	2023	2024
	Actual				Projections			
Total financing requirement	3,260	2,606	2,251	2,751	3,286	3,169	3,244	3,347
Current account deficit	1,332	1,248	1,243	1,329	1,438	1,525	1,632	1,728
Medium and long-term debt	1,245	1,399	1,096	1,026	1,107	1,202	1,266	1,377
Private	1,079	1,172	804	712	766	844	890	964
Banks	341	596	283	163	200	260	288	343
Corporates	738	576	522	549	566	584	602	621
Public	165	227	292	314	341	358	377	413
Others (net)	683	-41	-88	397	741	443	345	243
Total financing sources	3,230	2,580	2,466	3,027	3,370	3,529	3,608	3,759
Capital transfers	109	77	94	93	91	89	87	85
Direct investment, net	1,625	892	988	1,178	1,335	1,495	1,614	1,744
Medium and long-term debt	1,465	1,667	1,306	1,736	1,924	1,923	1,885	1,907
Private	1,061	1,292	817	1,113	1,119	1,182	1,238	1,303
Banks	536	935	389	503	503	543	586	633
Corporates	525	357	428	610	617	639	652	670
Public (only project loans)	404	375	489	623	804	741	647	604
Short-term debt (net)	31	-56	78	21	20	21	21	23
Increase in gross reserves	242	279	395	367	84	359	377	427
Rescheduled debt and arrears clearance	-152	-160	0	0	0	0	1	2
Errors and omissions	-65	-49	0	0	0	0	0	0
Total financing needs	186	195	181	91	0	0	14	15
Official financing	192	201	181	91	0	0	0	0
IMF	71	27	35	43	0	0	0	0
Prospective purchases	84	84	84	43	0	0	0	0
Repurchases	-13	-57	-49	0	0	0	0	0
Official creditors	121	174	145	48	0	0	0	0
World Bank	106	0	0	0	0	0	0	0
EU	15	17	23	0	0	0	0	0
Others	0	157	123	48	0	0	0	0
Memorandum items:								
Gross international reserves	3,039	3,289	3,684	4,051	4,134	4,493	4,871	5,298
in months of next year GNFS imports	3	4	4	4	4	4	4	4
in percent of short-term debt at remaining maturity	68	74	92	94	89	91	92	94
in percent of IMF Composite measure (floating)	89	91	100	105	104	108	113	118
EFF in percent of total official financing	37	14	19	47	…	…	…	…

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

Table 8. Georgia: Indicators of Fund Credit, 2018-24
(In millions of SDR)

	2018	2019	2020	2021	2022	2023	2024
	Actual	Projections					
Existing Fund credit							
Disbursements (EFF)	60.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock 1/	155.0	120.0	120.0	117.5	105.0	85.0	65.0
SBA and EFF	155.0	120.0	120.0	117.5	105.0	85.0	65.0
Obligations	42.5	37.3	2.6	5.1	15.0	22.2	21.8
SBA and EFF	42.5	37.3	2.6	5.1	15.0	22.2	21.8
Principal (repurchases)	40.0	35.0	0.0	2.5	12.5	20.0	20.0
Interest charges	2.5	2.3	2.6	2.6	2.5	2.2	1.8
Prospective purchases							
Disbursements	0.0	60.0	30.4	0.0	0.0	0.0	0.0
Stock 1/	0.0	60.0	90.4	90.4	90.4	87.9	75.4
Obligations 2/	0.0	0.5	1.8	1.9	1.9	4.4	14.4
Principal (repurchases)	0.0	0.0	0.0	0.0	0.0	2.5	12.5
Interest charges	0.0	0.5	1.8	1.9	1.9	1.9	1.8
Stock of existing and prospective Fund credit 1/	155.0	180.0	210.4	207.9	195.4	172.9	140.4
In percent of quota 3/	73.7	85.6	100.0	98.8	92.9	82.2	66.7
In percent of GDP	1.4	1.5	1.6	1.5	1.3	1.1	0.8
In percent of exports of goods and nonfactor services	2.5	2.6	2.9	2.7	2.4	2.0	1.5
In percent of gross reserves	6.7	6.8	7.3	7.1	6.2	5.1	3.8
In percent of public external debt	3.8	4.1	4.5	4.4	3.9	3.4	2.7
Obligations to the Fund from existing and prospective Fund credit	42.5	37.8	4.4	7.0	16.9	26.6	36.1
In percent of quota	20.2	18.0	2.1	3.3	8.0	12.6	17.2
In percent of GDP	0.4	0.3	0.0	0.0	0.1	0.2	0.2
In percent of exports of goods and nonfactor services	0.7	0.6	0.1	0.1	0.2	0.3	0.4
In percent of gross reserves	1.8	1.4	0.2	0.2	0.5	0.8	1.0
In percent of public external debt service	14.9	11.3	1.4	2.2	5.2	7.7	9.7

Source: Fund staff estimates and projections.

1/ End of period.

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

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

Table 9. Georgia: Schedule of Reviews and Available Purchases

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

Source: Fund staff estimates and projections.

Table 10. Georgia: External Debt Sustainability Framework, 2015-2024

(In percent of GDP, unless otherwise indicated)

	Actual						Projections						
	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
Baseline: External debt	86.1	92.0	96.3	94.6			**97.9**	**97.3**	**95.5**	**97.3**	**95.7**	**93.1**	**-3.4**
Change in external debt	21.0	5.9	4.3	-1.7			3.4	-0.6	-1.8	1.8	-1.6	-2.6	
Identified external debt-creating flows (4+8+9)	14.7	2.9	-5.9	-4.3			-2.7	-3.5	-3.9	-4.5	-4.6	-4.7	
Current account deficit, excluding interest payments	8.1	8.5	4.3	3.0			2.5	2.7	2.8	2.8	3.6	3.4	
Deficit in balance of goods and services	18.2	16.0	11.8	11.5			10.1	9.7	9.4	9.5	9.7	9.7	
Exports	44.1	43.3	50.5	55.1			57.6	56.5	55.5	54.5	53.5	52.7	
Imports	62.2	59.3	62.3	66.6			67.8	66.2	64.9	64.0	63.3	62.4	
Net non-debt creating capital inflows (negative)	-9.6	-8.0	-10.4	-5.2			-6.0	-6.5	-6.7	-7.0	-7.0	-7.0	
Automatic debt dynamics 1/	16.2	2.4	0.2	-2.1			0.7	0.3	-0.1	-0.3	-1.3	-1.1	
Contribution from nominal interest rate	4.5	4.7	4.5	4.7			5.0	4.6	4.4	4.3	3.5	3.5	
Contribution from real GDP growth	-2.2	-2.4	-4.2	-4.2			-4.3	-4.3	-4.5	-4.6	-4.7	-4.6	
Contribution from price and exchange rate changes 2/	13.9	0.1	-0.1	-2.5			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	6.3	3.0	10.2	2.5			6.1	2.9	2.1	6.3	3.0	2.1	
External debt-to-exports ratio (in percent)	195.4	212.4	190.9	171.6			169.9	172.3	172.1	178.6	178.8	176.7	
Gross external financing need (in billions of US dollars) 4/	4.8	5.3	5.4	5.8			5.8	5.4	5.8	6.2	6.7	7.1	
in percent of GDP	34.1	37.0	36.0	35.6	10-Year	10-Year	34.9	29.8	29.2	29.0	28.7	28.4	
Scenario with key variables at their historical averages 5/							**97.9**	**107.6**	**116.8**	**129.8**	**139.4**	**148.4**	**-3.6**
Key Macroeconomic Assumptions Underlying Baseline					Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.9	2.8	4.8	4.7	3.9	3.1	4.6	4.8	5.0	5.2	5.2	5.2	
GDP deflator in US dollars (change in percent)	-17.6	-0.1	0.1	2.7	-1.0	9.1	-2.4	4.6	4.4	2.7	2.5	2.7	
Nominal external interest rate (in percent)	5.9	5.6	5.1	5.2	5.2	0.4	5.4	5.1	5.0	4.9	3.8	4.0	
Growth of exports (US dollar terms, in percent)	-13.1	1.0	22.2	17.4	10.3	15.8	6.8	7.4	7.7	6.1	6.0	6.4	
Growth of imports (US dollar terms, in percent)	-13.6	-2.0	10.1	15.0	5.1	17.1	3.9	7.0	7.6	6.5	6.6	6.7	
Current account balance, excluding interest payments	-8.1	-8.5	-4.3	-3.0	-6.8	2.5	-2.5	-2.7	-2.8	-2.8	-3.6	-3.4	
Net non-debt creating capital inflows	9.6	8.0	10.4	5.2	7.1	2.0	6.0	6.5	6.7	7.0	7.0	7.0	

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

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

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

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

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

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

Annex I. Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood/Time Horizon	Expected Impact on the Economy if Risks Materialize	Policy Response
Global Shocks			
Rising protectionism and retreat from multilateralism In the near term, escalating and sustained trade actions threaten the global trade system, regional integration, and global and regional collaboration. Additional barriers and the threat of new actions reduce growth both directly and through adverse confidence effects (increasing financial market volatility). In the medium term, geopolitical competition and fraying consensus about the benefits of globalization lead to economic fragmentation and undermine the global rules-based order, with adverse effects on growth and stability.	**High** **Short to Medium Term**	**Medium** Protectionism could jeopardize Georgia's plans for economic diversification and to become a regional transit hub. The prospective reduction in exports and FDI will reduce growth. An increase in external imbalances would put pressure on the lari.	Flexible exchange rate should serve as a first line of defense. Accelerate implementation of structural reforms to enhance confidence and improve competitiveness. Strengthen reserve accumulation, fiscal sustainability to weather external shocks from a stronger position.
Sharp tightening of global financial conditions. This causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; capital account pressures; and a broad-based downturn. The tightening could be a result of: • Market expectation of tighter U.S. monetary policy triggered by strong wage growth and higher than-expected inflation. • Sustained rise in risk premium in reaction to concerns about debt levels in some euro area countries; a disorderly Brexit; or idiosyncratic policy missteps in large emerging markets.	**Low** **Short Term** **Medium** **Short Term**	**Medium** Higher lari volatility and depreciating pressures could generate negative balance-sheet effects and threaten financial stability. Georgia has relied mostly on bilateral and multilateral external financing at long-term maturities. However, tighter global financial conditions could increase financing costs and external financing requirements remain large.	Flexible exchange rate should serve as a first line of defense. Continue de-dollarization efforts, supported by market-based policies. Strengthen financial stability, including by bolstering inflation targeting and bank resolution frameworks, to weather external shocks from a stronger position. Continue building up foreign reserves. Closely monitor potential FX mismatches and enhance transparency about financial stability.

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

Source of Risks	Relative Likelihood/Time Horizon	Expected Impact on the Economy if Risks Materialize	Policy Response
Cyber-attacks on critical global financial, transport or communication infrastructure and broader private and public institutions trigger systemic financial instability or widespread disruptions in socio-economic activities.	Medium **Short to Medium Term**	Medium Georgia has adopted cybersecurity legislation, but its effectiveness could be challenged by the nature of the attack.	Strengthen banking regulation and supervision to ensure that the system is prepared to address relevant risks, including from cyber-attacks.
Weaker-than-expected global growth • **U.S.:** Confidence wanes against a backdrop of a long expansion with stretched asset valuations, rising leverage, and unwinding of the fiscal stimulus, leading to abrupt closure of the output gap rather than a smooth landing. • **Europe:** In the near term, weak foreign demand makes euro area businesses delay investment, while faltering confidence reduces private consumption. Adverse financial market reaction to debt sustainability concerns further dampens growth. A disorderly Brexit could cause market disruption with negative spillovers. In the medium term, disregard for the common fiscal rules and rising sovereign yields for high-debt countries test the euro area policy framework, with adverse impact on confidence and growth. • **China:** In the short term, intensification of trade tensions and/or a housing market downturn prompt a slowdown, which is not fully offset by policy easing. Deleveraging is delayed and financial stresses, including capital outflow and exchange rate pressures, emerge. In the medium term, insufficient progress in deleveraging and rebalancing reduces growth and raises the probability of a larger disruptive adjustment. There would be negative spillovers on the global economy through trade volumes, commodity prices, and financial markets.	Medium **Short to Medium Term** High **Short to Medium Term** Medium **Short to Medium Term**	Medium Weaker global demand, and a potential slowdown to Georgia's main trading partners' growth, alongside with weakness in domestic demand could reduce growth. This would reduce the appetite for much-needed structural reforms to achieve economic diversification and more inclusive growth.	A flexible exchange rate should serve as a first line of defense. Accelerate structural reforms to enhance confidence and improve competitiveness. Strengthen fiscal sustainability, reserve accumulation, and be ready to adjust macroprudential measures to avoid an undue tightening in financial conditions. Strengthen social safety nets to protect the most vulnerable segments of the population. Continue to expand trade integration to build a more diversified export base and economic resilience.

Source of Risks	Relative Likelihood/Time Horizon	Expected Impact on the Economy if Risks Materialize	Policy Response
Georgia-Specific Risks			
Financial risks. New lending regulations could risk a sharper-than-expected tightening of lending standards, and, accordingly, stronger negative effects on growth. Risks could also stem from the non-banking sector.	Medium	Medium	Use the flexible exchange rate as a first line of defense. Accelerate implementation of structural reforms to improve confidence and competitiveness. Monitor the impact of the new lending regulations and stand ready to adjust them to avoid an undue tightening in financial conditions. Strengthen fiscal sustainability and institutions and enhance financial stability to weather external shocks from a stronger position.
Fiscal risks. Materialization of contingent liabilities/fiscal risks could deteriorate public debt dynamics.	Medium	High	
Political risks. Political backlash or/and reform fatigue could undermine efforts to undertake structural reforms.	Low	Medium	

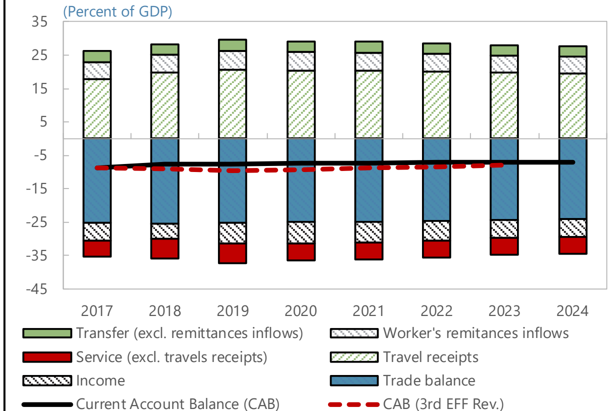
Annex II. External Sector Assessment

Georgia's external position in 2018 was consistent with fundamentals and desired policies. A narrowing of the current account deficit (to 7.7 percent of GDP) was primarily driven by an improved trade balance. The completion of major FDI-related projects in 2018 helped contain imports growth and improve the Net International Investment Position (NIIP) by 7 percent of GDP in 2018. Reserve accumulation in 2018 was higher than expected, boosted by the NBG FX intervention, including by the new FX put options. Over the medium-term, the current account deficit is projected to narrow to 7 percent of GDP, helped by continued prudent fiscal policy, exchange rate flexibility and the timely implementation of structural reforms, which remain essential to safeguard external sustainability.

Current Account and Real Exchange Rate Developments

1. The 2018 current account (CA) deficit improved to 7.7 percent of GDP. Compared to the Third Review projections, the narrowing of the 2018 CA deficit (by 1.3 percentage of GDP) was driven by lower-than-expected imports (by 1.1 percent of GDP) and higher-than-expected income account balance (by 1.2 percent of GDP due to declining FDI profit repatriation). Continued strong growth in merchandise exports (22 percent), travel receipts (19 percent), and robust remittances' growth (15 percent) also supported the current account. Imports in 2018 were lower-than-expected owing to lower imports prices and declining imports related to FDI and government projects. In 2019, the current account is expected to slightly fall to (7.5 percent of GDP), as the fiscal impulse from end-2018 spending is partially offset by lower import prices and receding off-imports. In the medium term, the current account is expected to decline to below 7 percent of GDP, owing to contained domestic spending and strong exports, provided that structural reforms to diversify the economy are implemented.

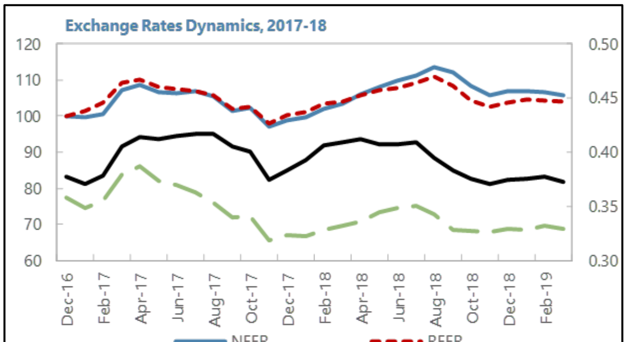
Current Account, 2017-24
(Percent of GDP)



Source: IMF Staff Calculations, NBG, GeoStat.

2. Georgia exchange rate fluctuated in 2018, driven by market forces, seasonal factors and regional spillover. The lari depreciated against the dollar, from its peak (2.4 GEL/USD) in April 2018, reaching its lower level in November 2018 (2.7 GEL/USD). Against the euro, the lari depreciated started in august 2018. As in 2017, and reflecting seasonal factors, the lari appreciated to 2.67 GEL/USD in December 2018. The lari exchange rate depreciated in real effective terms from August to December 2018 (by

Exchange Rates Dynamics, 2017-18



Source: National Bank of Georgia
1/ Effective exchange rates are as of (December 2016 = 100)
2/An increase in the REER or the NEER means an appreciation of the currency.

7 percent), reflecting regional spillovers and seasonal factors. The REER grew by less than the NEER, starting from the 2nd part of 2018, in line with the relatively lower inflation in Georgia compared with trading partners' countries.

3. **Georgia's external position in 2018 was consistent with fundamentals and desired policies.** The CA approach of the IMF's External Balance Assessment (EBA-lite) Methodology suggests an there is no current account gap of in 2018 as opposed to a gap of -0.3 percent of GDP during the Third Review.[1] The CA gap corresponds a further narrowing compared with the 2017 REER overvaluation (0.6 percent), with a higher contribution coming from macro policies as measured by the policy gap. The fit of the CA approach's regression has improved with a substantial narrowing of the residuals (by 4 percent of GDP), reflecting structural bottlenecks not captured in the model, such as underdeveloped financial system and a weak education system.[2] This may suggest initial outcomes of the authorities' reforms agenda, which should be sustained to enhance external competitiveness and raise net private savings.[3] Similarly, Georgia's policies and reforms will continue to help narrowing the CA gap if sustained over the medium term, in line with the planned fiscal consolidation and adequate reserve accumulation.

Georgia: External Balance Assessment, CA approach
(In percent)

	Fourth Review (2018)	Second Review (2017)	First Review (2016)
CA-Projected	-7.7	-8.7	-10.4
Cyclical Contributions (from model)	0.2	0.2	0.1
Additional temporary/statistical factors	0.0	0.0	0.0
Cyclically adjusted CA	-7.9	-8.9	-10.5
CA-Norm	-7.7	-8.4	-8.4
Additional adjustments to the norm	0.0	0.0	0.0
Cyclically adjusted CA Norm	-7.9	-8.7	-8.5
CA-Gap	0.0	-0.3	-2.0
o/w Policy gap	0.2	1.5	1.5
Elasticity	-0.4	-0.4	-0.4
REER Gap	0.0	0.6	5.1

Source: IMF staff calculations.

External Balance Sheets

4. **The large negative net IIP (as a percentage of GDP) has declined in 2018, in line with decelerating FDI and improved CA deficit.** In end-2017, Georgia's gross liabilities to non-residents exceeded gross foreign assets by 150 percent of GDP, with FDI and loans accounting respectively for about 54 percent and 31 percent of total liabilities. The rapid accumulation of gross external liabilities over 2014–17 (by 71 percent of GDP), peaked at 218 percent of GDP in September 2017, mostly attributable FDI that increased by almost 40 percent of GDP (to 115 percent of GDP) over the same

[1] https://www.imf.org/external/np/pp/eng/2016/020516.pdf

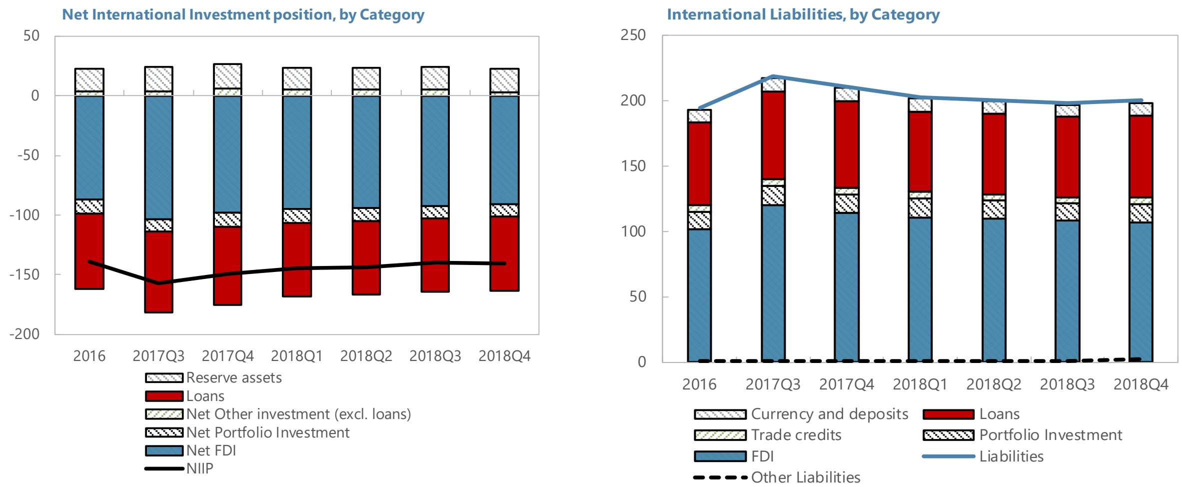
[2] The REER index approach, typically less accurate, led to a residual of 17 percent.

[3] The external sustainability approach (highly sensitive to the choice of the anchor) suggests an REER undervaluation of 3.9 percent and a CA gap of 1.6 percent of GDP, assuming a net foreign asset (NFA) anchor of -138 percent of GDP, in line with most recent observations.

period. From 2017Q3, the stock of FDI liabilities fell by 12 percent of GDP, contributing to a decline of the total external liabilities to 204 percent of GDP in 2018Q4. In 2018Q4, Georgia NIIP stood at 143 percent of GDP, 7 percent of GDP lower than in December 2017 and is expected to further decline in the medium term, driven by the expected improvement in the current account and decline in FDI inflows.

Georgia: International Investment Position

(In percent of GDP)



Source: National authorities, and IMF staff calculations.

Capital and Financial Flows

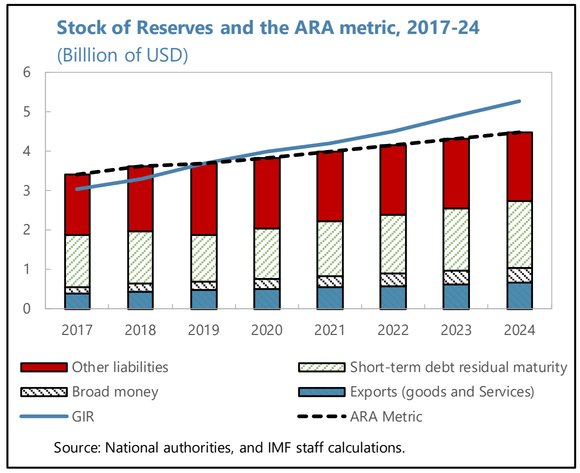
5. **Net FDI inflows are the main source of financing of the current account deficit, representing 75 percent of the financial account balance.** FDI net inflows is estimated to have declined by 45 percent y-o-y to 5.5 percent of GDP in 2018, following the completion of a large energy-related projects.[4] In the medium term, FDI inflows are projected to increase at a slower pace than expected, stabilizing around 9 percent of GDP, as successful structural reforms increase competitiveness. In 2018, portfolio inflows contribution to the financial account was small, as the retrenchment in institutional investors in government and bank debt securities ($253 million outflow) was more than compensated by the first international issuance corporate bond in Georgia ($270 million).[5] Similarly, the increase (by about 2 percent of GDP) in cross-border bank borrowing ahead of the tightening of the regulation limiting domestic FX lending helped compensate for the declining FDI financing. In 2019 Q1, the $200 international corporate issuance (by Silknet) will also help support net portfolio inflows. Generally, external loans are mostly medium and long term, with concessional/favorable interest rates and grace periods.

[4] FDI inflows have been concentrated in transports and communication, construction, and the real estate and energy sectors

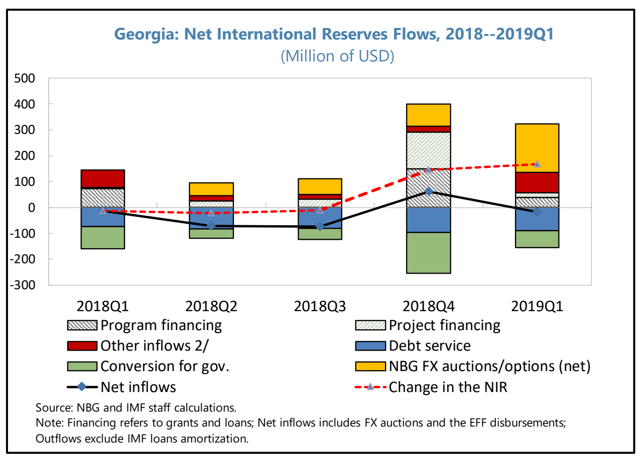
[5] Georgia Capital portfolio issuance in March 2018.

Reserves

6. Gross international reserves accumulation improved in 2018 and is expected to reach 100 percent of the ARA metric by end-2019. Gross international reserves stood at $3.3 billion (20 percent of GDP) at end-2018, $250 million higher than in end-2017, owing to FX interventions ($197.5 million) and increased FX reserve requirements (by $274 million) that partially offset the declining correspondent bank accounts balances (by $126 million). The stock of GIR is projected to reach $3.7 billion in 2019 (100 percent of the ARA metric) driven by the increase of FX reserve requirements introduced in March and effective in May (expected to yield $300 million) and FX interventions. Compared with the Third EFF review, end-2019 reserves were revised upward from 93 to 100 percent of the ARA. The refinancing of the $500 million Eurobond in 2021, with an expected $200 million foreign participation, is expected to slow down reserve accumulation (by 3 percent of the ARA metric). Over the medium term, the stock of GIR is projected to reach 118 percent of the ARA metric, also supported by increasing foreign participation in the domestic bond market as it develops.



7. The end-December 2018 NIR target was met with a comfortable margin. The end-2018 NIR at program rates reached $1.5 billion, $36 million above the adjusted NIR target ($1.48 billion) as the NBG FX intervention and higher-than-expected program and project financing in Q4 (by total of $95 million compared with the Third review) more than offset higher-than-expected outflows. The spike in outflows was mostly driven by conversions for government, which grew by 39 percent y/y, likely in relation to end-2018 project-related spending. In 2019 Q1, BP pipeline transit fees and large FXI interventions ($186 million) supported the accumulation of NIR.



Appendix I. Letter of Intent

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

Tbilisi, June 3, 2019

Dear Ms. Lagarde:

1. **We remain committed to the policies detailed in our Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) of March 27, 2017, updated most recently on December 4, 2018.** Our vision for Georgia's economic development, detailed in our government program (Freedom, Rapid Development and Welfare), is based on free market principles. Our policies aim at alleviating Georgia's structural challenges by introducing education reform, scaling-up core infrastructure, strengthening governance, supporting SMEs and entrepreneurship, and further integrating Georgia into the global economy. The central bank will continue strengthening the monetary policy framework and enhancing financial supervision, regulation and safety nets. Together with this ambitious reform package, we are committed to preserve macroeconomic and financial stability, as pre-requisites for sustainable and more inclusive economic growth.

2. **Resilient economic growth provides an opportunity for steadfast implementation of our reform program**. Growth in 2018 stood at 4.7 percent (y/y) supported by strong external demand and prudent policies. Inflation has remained close to our 3-percent inflation target. Growth in exports and tourism, and subdued imports, narrowed the current account deficit to 7.7 percent of GDP, which remains mostly financed by FDI. Our gross foreign exchange (FX) reserves reached $3.3 billion by end-2018. Higher-than-expected revenues and contained current spending led to an augmented deficit of 2.5 percent of GDP for 2018.

3. **We have met most of the conditionality under our IMF-supported program.** We have met all end-December quantitative performance criteria (QPCs), and inflation has remained within the inflation consultation clause (ICC). Four out of seven structural benchmarks (SBs) for the fourth review were met. Although our initial fiscal risks statement was submitted to Parliament in December 2018, it had to be revised one month later to be consistent with our commitment under the EFF. More time was needed to design the basic pension indexation in consultation with the World Bank and the IMF, and we will submit our proposal to Parliament by December 2019. In addition, we now expect to be able to provide the Georgia Revenue Service with access to the information on suspicious transactions received by the Financial Monitoring Service from monitoring entities by end-2019, after developing appropriate safeguards to ensure adequate use of the information.

4. We request the completion of the Fourth Review under the Extended Fund Facility and the release of the related purchase. Given the performance under the program so far, and the policies described in the enclosed MEFP, we intend to purchase SDR 30 million, bringing our drawings under this program to SDR 150 million. Our program will continue to be monitored through an Inflation Consultation Clause (ICC), Quantitative Performance Criteria (QPCs), and indicative targets with end-June and end-December test dates, and continuous performance criteria. Consistent with our reform agenda, our program also envisages Structural Benchmarks (SBs). These are set out in Tables 1–3 of the MEFP (Attachment I) and defined in the attached Technical Memorandum of Understanding (TMU, Attachment II). Reviews will be conducted semi-annually. The Fifth Review will be based on end-June 2019 performance criteria and is expected to be completed on or after October 25, 2019. The Sixth Review will be based on end-December 2019 performance criteria and is expected to take place on or after March 20, 2020.

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

Very truly yours,

/s/
Ivane Matchavariani
Minister of Finance

/s/
Natia Turnava
Minister of Economy and Sustainable Development

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

Attachments:

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

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

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

MACROECONOMIC FRAMEWORK

2. Resilient economic growth in 2018 was supported by our prudent policies and external demand. Despite turbulence in Turkey, growth in Georgia reached 4.7 percent, slightly higher than considered in the 2018 Budget. Robust growth in exports and tourism receipts narrowed the current account deficit to 7.7 percent of GDP and supported economic activity. Inflation remained close to the central bank's target in 2018. We surpassed the end-December program target on net international reserves (NIR) with some margin. De-dollarization has continued, albeit at a slower pace than before. Continued reform implementation also resulted in favorable upgrades from credit rating agencies. Fitch upgraded our credit rating to BB in February, and S&P revised its outlook to positive in April. We will continue to implement prudent macroeconomic policies, bolster economic resilience and promote higher and more inclusive growth.

3. Georgia's economic outlook is positive due to prudent policies and our commitment to continued reforms.

a) We expect growth at 4.6 percent in 2019, with a stronger contribution of domestic demand compared to 2018. The downward impact on growth from a worsening external environment and softening credit growth is expected to be partly offset by a slightly positive fiscal stance. Over the medium term, growth is expected to gradually increase due to the steadfast implementation of our structural reforms and investment in infrastructure.

b) Continued expenditure restraint and robust growth will generate additional fiscal space. This will allow us to undertake education reform (see below), continue investing in core infrastructure, and address pressing social needs while maintaining medium-term fiscal sustainability.

c) The current account deficit is expected to gradually decline to 7 percent of GDP over the medium term. While external financing will continue to rely mostly on FDI, its share is expected to decline slightly over time. A stronger external position and FX purchases will help us reach 100 percent of the ARA metric by end-2019.

4. While we expect continued robust economic growth, downside risks to the outlook have increased. Although economic resilience has improved, Georgia remains vulnerable to external developments, including escalating global trade tensions and financial market volatility. Our structural reform agenda aims to mitigate medium-term risks associated with Georgia's relatively high but still sustainable external debt, improving current account deficit and falling dollarization. In the meantime, our first line of defense against external risks is our commitment to exchange rate flexibility, and sound macroeconomic and financial policies. Georgia's IMF-supported program provides an additional anchor to help us cope with negative shocks.

ECONOMIC POLICIES

A. Fiscal Policy

5. **The 2018 augmented fiscal deficit was marginally lower than programmed.** The 2018 augmented deficit (TMU definition) was GEL 1,021 million, 2.5 percent of GDP, compared to an adjusted program ceiling of GEL1,032 million. We met our indicative target on primary current spending, which reached GEL8,976 million. As programmed, contained current spending and robust revenues allowed for higher infrastructure spending. Through November, the budget was in surplus, partly reflecting delays in infrastructure spending. External disbursements and advance payments led to a significant acceleration in spending in December 2018, which is expected to support economic activity in 2019. We have taken measures to reduce the risks of further project delays and to smooth out the intra-year path of capital spending. Our efforts to strengthen the VAT system, with the help of IMF TA, are bearing fruit. Gross VAT credit refunds have more than doubled in 2018, compared to 2017, reducing the stock of VAT credits by 0.9 percent of GDP, to 3.8 percent of GDP.

6. **We will maintain fiscal prudence.**

a) For 2019, we remain committed to keep the end-June augmented deficit below the program ceiling of GEL250 million and aim for an augmented deficit below GEL1,170 by end-year (performance criterion). We are committed to limit budget lending operations in net terms to GEL335 million (new performance criterion) to support compliance with new guidelines (new adjustor in TMU). We will continue containing current primary spending (indicative target). As part of the comprehensive education reform, we are providing in 2019 financial incentives to pension-age teachers for their retirement and increasing wages for qualified teachers. We increased our targeted social assistance to address child poverty and provided for its more gradual withdrawal to encourage beneficiaries to participate in the labor market. To create fiscal space for these reforms, we have increased excise rates on cigarettes and will further adjust rates on other tobacco products to avoid losses from shifting consumption patterns. We will also eliminate the so-called golden list of taxpayers who are currently eligible for delayed VAT payments, yielding GEL 100 million.

b) Our basic public pension was increased to GEL 200 per month, which is marginally higher than the subsistence minimum. We will increase the basic pension to GEL 220 per month in 2020. In line with our commitment to the IMF, we had planned to submit to Parliament legislation proposing a rule-based mechanism to index basic pensions by end-February 2019 (structural benchmark). As we need more time to assess the fiscal implications of different proposals in consultation with the World Bank and the IMF, we now plan to submit the rule-based mechanism by December 2019 (new structural benchmark, end-December 2019).

c) We will continue our efforts to reduce our stock of VAT credits. For mid-December 2019, we aim to reduce the stock below GEL 1,570 million (new indicative target). We expect to refund GEL250 million in VAT credits through June 2019, and GEL550 million for 2019. We will put additional efforts to increase VAT refunds above these levels; additional refunds (up to GEL450 million) will be accommodated under the program through an adjustor (see Technical Memorandum of Understanding (TMU, ¶14).

d) We stand ready to adopt additional measures, if needed, to keep the augmented deficit in line with the program. In consultation with the IMF, we are committed to use revenue over-performance or additional savings in current spending toward high priority, growth-enhancing net acquisition of non-financial assets, and any under-execution in investment towards a lower deficit.

7. We will appropriately account for emerging fiscal pressures in the budget, so that debt remains anchored at safe levels over the medium term. We are committed to limit our fiscal deficits and remain proactive in addressing fiscal pressures that could emerge. To this end, we revised the fiscal rule consistent with IMF recommendations[1], and submitted it to parliament in end-2018 (structural benchmark). We have finalized and costed our comprehensive education reform (see ¶29), to be included in the 2020 medium-term budget framework. The budgetary effect of Public-Private Partnerships (PPPs) and Purchasing Power Agreements (PPAs) are inherently uncertain, generating contingent liabilities. With the assistance of IMF TA, we are strengthening our scenario analysis to estimate plausible fiscal costs associated with these activities and, in anticipation of risks that could materialize, will prudently consider the need for additional fiscal measures to build precautionary buffers.

8. We remain committed to medium-term fiscal sustainability. We will submit to Parliament the 2020 budget consistent with the IMF program (new structural benchmark, December 2019). We will create fiscal room for our education reform by shifting spending from physical to human capital, while protecting infrastructure spending on key items. We will also improve public administration efficiency by (i) containing the wage bill and administrative expenses; (ii) improving the targeting of subsidies and of social assistance programs; (iii) reducing transfers and privatizing loss-making state-owned enterprises (SOEs); and (iv) improving performance-based budgeting. We do not plan to extend the dividend distribution model of corporate income taxation to financial institutions until 2025, to avoid the resulting revenue loss (up to 0.5 percent of GDP) in the near term. However, in consultation with the IMF, we may consider moving the insurance sector to the dividend distribution model sooner. We stand ready to identify additional measures in coordination with the IMF, if needed, within the scope of our fiscal framework to achieve our deficit target.

9. Our financing strategy aims to support domestic market development and to reduce external vulnerabilities. We are publishing our multi-year plan of government bond issuance to develop benchmarks along the yield curve to facilitate price discovery for private-sector bonds. The

[1] The revised fiscal rule no longer includes an expenditure ceiling, which was procyclical and interfered with proper accounting practices. It applies to fiscal outturns, provides more clarity on definitions of aggregates and escape clauses, communication, transparency, and oversight. The revised fiscal framework will also help contain fiscal risks by including PPP liabilities under the debt ceiling.

plan envisages an increase in the issuance size of domestic benchmark bonds, to encourage foreign investors participation into the domestic market.[2]

10. We aim to contain fiscal risks and remain committed to avoid domestic/external debt payment arrears.

a) We will not (i) accumulate any general government's external debt payment arrears outside those under negotiation (performance criterion); (ii) accumulate net domestic expenditure arrears of the general government (indicative target); or (iii) issue new public guarantees (performance criterion), or comfort letters.

b) The Partnership Fund (PF) will not run a cash deficit (performance criterion), or issue any new guarantees. New net borrowing of the Partnership Fund will be limited to $20 million at end-June 2019 and end-December 2019 (cumulative from the beginning of the EFF program, performance criterion). We remain committed to maintain a non-negative cash position at the Partnership Fund by end-June and end-December 2019 (performance criteria). As the PF no longer pursues only commercial objectives, we commit to revisit the status and role of the PF in the coming months, in consultation with the IMF.

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

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

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

ii. The guaranteed purchase tariff shall not be more than US 6c per kWh; and

iii. The cumulative installed capacity of these projects under negotiations will not exceed MW650.

e) We signed a memorandum of understanding (MoU) associated with the Namakhvani HPP Cascade Project (planned capacity of MW433). Because this PPA is outside the terms mentioned above, we conducted a detailed fiscal risks analysis to be consistent with our program commitments (see previous MEFP).

f) We created a credit guarantee scheme (CGS) to support SMEs' access to finance. The CGS will receive budget allocations of GEL 20 million per year over the next 5 years. It will guarantee 70 percent of individual loans, subject to losses not exceeding 15 percent of participating banks' portfolio, and no more than the budgeted amount. It is set up as a program within Enterprise Georgia. It will use market-based principles for its operations, be subject to internal and external audits, and issue regular reports on its activities and financial outcomes. Plans for establishing an

[2] Since domestic issuance exceeds the government's financing needs, we hold any excess funds in long-term deposits, allocated transparently to commercial banks through auctions.

export credit agency (ECA) have been abandoned, but if they are retaken, we will consult with the IMF on its characteristics before establishing it (see previous MEFP).

B. Structural Fiscal Policies

11. We are strengthening our revenue administration to secure full compliance by all taxpayers and improve taxpayer services. Following the 2016 Tax Administration Diagnostic Assessment and follow-up IMF TA, we are implementing a 3-year plan, supported by the Revenue Mobilization Trust Fund, that focuses on improving:

a) **Organizational structure.** Georgia's Revenue Service's (GRS) headquarters were restructured into a function-based organization to modernize tax administration. We have created a special unit within the Audit Department to deal with large tax payers. We will continue building capacity of the GRS by adequately staffing the new HQ departments and by empowering HQ to direct field operations. We hired two new deputy directors general and allocated responsibilities.

b) **VAT tax administration.**

i. Stock of unrefunded VAT credits. We are committed to eliminate unrefunded VAT credits and, by end-2021, aim to reduce by at least 50 percent the outstanding stock (at end-2017) of those VAT credits that are within the limitation period for audit (from GEL 1.4 billion at end-2017 to GEL 700 million by end-2021). For the stock of existing credits, we are committed to risk-assess 100 percent of declarations (within the statute of limitations for audit) by mid-2020. We submitted changes to the tax code granting the GRS powers to pay out refunds without the need for a refund request (structural benchmark, end-December 2018).

ii. Automatic risk assessment and risk-based auditing. All new VAT declarations are being risk-assessed under the automated system since January 2019. Under this system, 90 percent of new declarations with the lowest risk score will not be subject to further manual review and be immediately eligible for a refund, if requested by taxpayers and if there are no outstanding tax liabilities (structural benchmark, end-June 2019). The 10 percent of declarations with the highest risk score will be reviewed by the specialized VAT unit in the Audit Department to determine compliance actions.

iii. Automatic refunding of new VAT credits. From January 2020, all risk-assessed new credits approved by the system will be either offset against existing liabilities or refunded to the taxpayer without the need for an explicit request for refund. The VAT declaration form will be changed accordingly. The option to offset the stock of existing credits against new liabilities will remain unchanged, and taxpayers will retain the option to request a cash refund of those stocks that are within the three-year statute of limitations through a separate form.

c) **Compliance and audit yields.** With IMF TA, we plan to use risk-based audits to identify non-compliant cases that are likely to produce higher yields. We will better manage the audit scope and develop audit plans to give a balanced coverage of tax categories. We will have a pilot audit management system by December 2019. Once implemented, this will enhance audit timeliness and productivity, and enable us to take a systematic approach to terminating non-productive audits. We will ensure that an IT strategy and resources at the MoF are adequate for achieving these objectives.

d) **Filing compliance.** We established key performance indicators to help improve filing compliance. Initially developed for VAT, the program will be expanded to all tax categories. We submitted to Parliament legal amendments so that an unfiled declaration is no longer deemed to be a nil declaration., where the MoF requires a declaration. The MoF will issue an order defining cases needing a declaration.

e) **Taxpayer register.** By end-October 2019, we will clarify tax registration requirements and give the GRS the mandate to enforce compliance and control of the registration process for all tax types, including the issuance and allocation of tax identification numbers. The proposed changes would not impact a physical "one-stop" window for a business registration process, managed by the NAPR. In addition, the GRS will create and maintain a register of employees for tax administration purposes.

f) **Penalty regime**. Taxpayers' reluctance to request a refund has been a constraint to reducing tax credits. To create a more effective system, we submitted to Parliament a penalty regime based on materiality (structural benchmark, end-December 2018). We will continue working towards a penalty regime that reflects the degree of culpability and develop guidelines for assessing culpability.

g) **Automatic access to third-party information**. Risk analysis relies on data to make tax administration more effective. GRS has no direct access to risk-relevant databases held in other government agencies despite no legal impediment to gaining access. MoF agreed with other ministries and agencies on access to their databases for tax administration purposes. However, due to technical requirements, the GRS will gain automatic access to third-party information from appropriate government agencies, including information from: (i) the National Agency of Public Registry on real estate, rentals and leases by December 2019; and (ii) municipalities, information on construction permits. We will also provide GRS access to data from the Financial Monitoring Service (FMS) on suspicious transactions as defined in the law on facilitating the prevention of illicit income. To this end, we are requesting more time to submit to Parliament changes in the legislation allowing the GRS access to the information received by the FMS from monitoring entities and implemented safeguards to ensure adequate use of the information (structural benchmark, end-May 2019). We remain committed to submit to Parliament changes in the legislation allowing the GRS access to the information received by the FMS on suspicious transactions from monitoring entities and implemented safeguards to ensure adequate use of the information (new end-December 2019 structural benchmark). We are committed to provide GRS access to information on Joint Stock Companies (JSC) partners and changes in company equity by December 2019.

12. We are committed to contain fiscal risks to safeguard fiscal sustainability. We are carefully studying risks that could arise from state-owned enterprises (SOEs) and PPPs, including PPAs in the energy sector. At the same time, we recognize that PPPs can play a pivotal role in Georgia's development by attracting investment, including FDI. In this vein, improvements in the relevant legislation are required to reap the benefits of further PPPs. Hence, we are committed to:

a) Adopt a new PPP law and associated regulations. Parliament approved a PPP law in May 2018 that includes sound elements following best international practices, prepared with assistance from the World Bank (WB), the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), and the IMF. A government decree implementing the PPP law was adopted in August 2018 (structural benchmark, end-December 2018) and incorporated recommendations from the IMF (see previous MEFP for details). We are committed to issuing guidelines establishing the evaluation methodology for PPPs by end-September 2019.

b) Continue strengthening the Fiscal Risk Statement (FRS) accompanying the budget.

i. Our latest FRS expanded the analysis of fiscal risks stemming from PPPs, PPAs and SOEs (SB, end-December 2018). Building on this progress, the FRS in the 2020 budget law will include a more comprehensive coverage of general government financial asset operations and provide information on the rates of return on general government equity holdings and loans (new structural benchmark, end-December 2019).

ii. For the MoF fiscal risk management unit, recruitment process has been delayed but is ongoing. It is expected to be finalized by September-2019.

c) Strengthen the monitoring of SOEs. To effectively supervise SOEs, we will ensure that the MoF and the Ministry of Economy and Sustainable Development (MOESD) collect data on SOEs, including performance information, transfers between the state and SOEs and among SOEs, borrowing, guarantees and any litigation, at least, on an annual basis. In consultation with the IMF, we will (i) establish a complete inventory of SOEs with a clear determination of SOEs qualifying as public corporations and SOEs qualifying as general government entities under GFSM2014 (structural benchmark, end-September 2019); and (ii) adopt a government decree clarifying the mandate of SOEs that are public interest entities, governance and reporting requirements (structural benchmark, end-November 2019). In assessing the financial situation of the SOEs, we will refrain from taking over any SOE debt or providing equity injections to SOEs without a comprehensive strategy that, among other things, fully supports commercial viability with no further financial support in the future and improves corporate governance; we will consult with the IMF on the strategy and on specific measures.

d) Improve the Public Investment Management Framework (PIMF). A Public Investment Management Assessment (PIMA), conducted by the IMF in May 2018, identified weaknesses, particularly in project appraisal, selection, and management. We have strengthened MoF's role in public investment management. To this end, we created a dedicated public investment council at the MoF, where information on public investment projects will be centralized. This council will evaluate investment projects based on cost/benefit analysis and other relevant analyses. This will help establish a single project pipeline, support adequate project evaluations, help prioritize investment projects and identify their financing, and integrate them within our Medium-Term Budget Framework (MTBF). The PIMF will cover PPP-type projects to ensure they are prioritized and assessed alongside traditionally procured projects. In coordination with the IMF, we are committed (structural benchmark, end-December 2019) to (i) strengthen further our PIMF by strengthening the public investment management methodology that guides project appraisal, selection and management; and (ii) adopt a government decree implementing reporting and oversight requirements for public investment projects at the MoF. By enhancing monitoring over the project cycle, these measures would also help identify project implementation delays early in the process. In line with PIMA recommendations, these measures will include enforcing existing regulations, notably the gatekeeper role of the Ministry of Finance, updating the PIM methodology, and designing a system for regular intra-year reporting of project implementation progress.

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

a) **Strengthen the Medium-Term Budget Framework (MTBF).** The documentation accompanying the 2019 budget includes an analysis of revisions to the medium-term macroeconomic outlook and revenue projections. The 2020 budget will expand the discussion to compliance with respect to the fiscal rule and revised expenditure plans, and any projected deviation of expenditure from the 2018 MTBF.

b) **Follow new guidelines for budget lending operations.** We prepared the 2019 State Budget applying the Government Finance Statistics (GFS) classification of equity injections and on-lending following the "reasonable commercial return test". Only on-lending operations will now be reported as budget lending operations.

c) **Improve the quality of fiscal reports.** We included Legal Entities of Public Law's (LEPLs) revenues and expenditures in the budget documentation starting in the 2018 State Budget. We have determined that all LEPLs should be classified as general government units, based on the GFSM2014 principles.

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

C. Monetary Policy

14. We are committed to our inflation targeting (IT) framework to maintain price stability. Inflation has remained close to the NBG's target of 3 percent since early 2018. We will continue to abide by the Inflation Consultation Clause (ICC) under the program. As such, inflation developments will be monitored via dual consultation bands set symmetrically around the forecast for headline CPI (Table 1). Should actual inflation be higher or lower than the inner consultation band of ± 2 percent, the NBG will consult with IMF staff on the reasons for the deviation and the policies to return to target. Should actual inflation be higher or lower than the outer consultation band of ± 3 percent, a consultation with the IMF Board will be triggered.

15. We will maintain a flexible exchange rate regime to protect the economy against external shocks. The floating exchange rate regime continues to work well as a shock absorber. Hence, FX interventions are limited to smoothing excessive exchange rate volatility and to build up international reserves. We will continue accumulating gross international reserves (GIR) throughout the program, which will be monitored by a floor on net international reserves (NIR, performance criterion). FX purchases enabled us to accumulate more reserves (by $36 million) than initially envisaged under the 2018 end-December program floor.

16. In light of the deteriorated global and regional outlook, we will maintain efforts to accumulate net international reserves. We are committed to reach 100 percent coverage of the ARA metric by end-2019, helped by the increased reserve requirements on FX deposits and FX interventions. To support further reserve accumulation, we introduced preannounced and transparent auctions for FX put options to facilitate FX purchases. Through end-April, we purchased $186 million on FX markets, of which $51 million was via FX options. We intend to primarily accumulate reserves through FX put options, and resort to discretionary purchases only if this proves insufficient to meet our commitments. We are committed to reach an NIR floor of $1,520 million by end-December 2019, which reflects our commitment to sustain NIR levels. Given the inherent uncertainty associated with project disbursements, we request an increase in the NIR adjustor from 75 percent to 100 percent on disbursements of the project loans and grants to the treasury single account at the NBG.

17. We will continue strengthening the monetary policy transmission mechanism. We strengthened lari liquidity management and extended open market operations to outright purchases of treasury securities. Strengthened NBG's liquidity management helps promote maturity transformation in the banking sector. The interbank interest rates remain close to the policy rate. We have reformed our interbank money market index TIBR, which is now based on actual market transactions, in line with international reforms underway with major global indices. The new methodology better reflects underlying market conditions, has transparent rules for excluding outliers, and includes fallback scenarios in the absence of sufficient market activity. We have published overnight and term indices to support pricing of swaps and floating rate securities. By June 2019, we will submit legal amendments to Parliament to support derivatives and repo transactions in line with best international practices.

18. Monetary policy was enhanced by improving our communication toolkit. In March 2019, we published a manual on monetary policy operations in line with the IMF TA recommendations.

D. Financial Sector Policy

19. Our policies will continue to strengthen financial sector stability. As noted in previous MEFPs, we took significant steps to enhance our financial stability policy framework, regulation and supervision. This will support the banking sector's ability to cope with shocks and improve financial intermediation. We are working on further strengthening: (i) the supervisory and regulatory framework for consolidated banking supervision and non-bank supervision; (ii) the financial stability policy framework including by publishing the macroprudential strategy document; and (iii) the emergency liquidity assistance facility and the banking resolution framework. We will also step up efforts to incentivize the use of the domestic currency and support the development of the domestic capital market.

20. We made progress on strengthening the financial stability policy framework, regulation and supervision.

a) NBG aims to fully transfer banks' regulatory reporting, while maintaining some supervisory filters, to IFRS framework through EU standards (FINREP/COREP forms) by 2022. Relatedly, we will request capital adequacy information both on a stand-alone and a consolidated basis under IFRS accounting framework.

b) To support a more sustainable credit growth, we introduced limits on loan-to-value ratios (LTVs) and debt service payments-to-income (PTIs) by income group for retail loans, with more binding constraints for FX loans for unhedged FX exposures as they encompass higher risks. These limits became binding in January 2019 and have been effective in curbing growth in consumer loans and moderating growth in FX mortgages, contributing to a credit growth of 13 percent in March 2019 compared to 17 percent in December 2018. We will continue to monitor credit dynamics and assess the impact of regulations; as data becomes available and in consultation with the IMF, we will take actions if needed.

c) The NBG and the State Insurance Supervision Agency developed a law on supplementary supervision framework for financial conglomerates, which was shared with Parliament in March 2019.

d) We introduced regulations on net stable funding ratio in line with Basel III principles. Banks should maintain 100 percent NSFR starting September 2019.

e) We plan to issue regulation on large exposures in line with Basel principles and relevant EU regulations, and update limits on related-party transactions accordingly by September 2019.

f) We will introduce standards for interest rate risk in the banking book in line with Basel and EBA guidelines by end-2019.

g) With IMF TA, we initiated regulation, supervision and oversight of non-bank financial institutions. The prudential regulatory framework for MFI's became operational in September 2018, while the non-prudential oversight of other lenders became operational in January 2019. We are planning to further strengthen supervision of non-bank financial institutions with the help of IMF TA.

21. We will resume our Financial Stability Report (FSR) as a stand-alone publication. With IMF TA, we have already started working on the FSR. The publication of the new FSR (structural benchmark, end-November 2019) will provide a forward-looking assessment of risks and vulnerabilities in the financial system, detailed analysis of private non-financial sector balance sheet and the macro-prudential policy actions taken to mitigate risks.

22. We will enhance our financial policies by publishing a macroprudential policy strategy. We are committed to outline our general framework for macroprudential regulation by end-September 2019, consistent with the recommendations of the European Systemic Risk Board and best international practices. The strategy, to be published by September 2019, will improve transparency, and predictability of macroprudential policy for financial market participants.

23. We are developing a sustainable finance framework to integrate environmental, social and governance criteria into business or investment decisions. In April 2019, we published the roadmap for sustainable finance aiming at establishing a credible, predictable and stable regulatory framework for sustainable finance. As part of this framework, we are currently working with the OECD on Environmental, Social and Governance Reporting and Disclosure Principles for financial institutions.

24. We are strengthening financial safety nets. We continue to cooperate with banks to strengthen their recovery plans. Following international best practices, we will strengthen our capacity to act as lender of last resort by submitting legal amendments to prohibit unsecured lending by the NBG, to mandate a penalty rate for emergency liquidity assistance (ELA), and to clarify the role of the

MoF to ensure an effective ELA framework. With IMF TA support, we plan to revamp the banking resolution framework and enhance crisis management, including clarifying the authorities' role and the decision-making process, and granting the NBG resolution authority. We will submit to Parliament legislative changes to implement effective ELA and resolution frameworks in line with international best practices (structural benchmark, end-May 2019) and enact this legislation (new structural benchmark, end-December 2019).

25. We have taken steps to further enhance larization to reduce FX risks and improve monetary policy transmission mechanisms. We recently increased further FX reserve requirements on FX deposits from 25 to 30 percent while keeping the reserve requirements on local currency deposits unchanged at 5 percent. We also increased from GEL100,000 to GEL200,000 the threshold under which loans can be issued only in local currency. Revised threshold covers loans issued to legal entities as well. Lending rules, which impose stricter payment-to-income and loan-to-value limits on FX retail loans, will further help internalize higher risks associated with FX borrowing and protect consumers.

26. We are committed to strengthening consumer protection, financial inclusion and literacy. Expanding financial education will help households have a better understanding of their responsibilities and risks associated with FX borrowing. With the help of our partners, we developed and implemented a financial education program for micro and small enterprises. Following the integration of financial literacy in the education curriculum, in cooperation with the Ministry of Education, Science, Culture and Sports, we are working to develop educational materials and strengthen teachers' capacity. Furthermore, we are working to scale up our SchoolBank project to more public and private schools.

27. Capital market development will support larization while reducing external vulnerabilities. The non-bank financial system is shallow in Georgia, limiting competition for savings and their efficient use within the economy. We developed a strategy for capital market development, which is one of the key priorities of Georgia. Reforms have already been implemented or are ongoing to promote a sound legal and regulatory environment and infrastructure.

a) Investment fund vehicles and structured products (securitization, covered bonds) play an important role in financial markets. The existing legal framework does not provide an adequate basis for developing these financial products. These legal gaps will be addressed as follows:

- A law establishing investment funds is expected to be submitted to Parliament by September 2019. The draft law transposes the UCITS Directive (2009/65/EC) and important pillars from the AIFM Directive (2011/61/EU).
- The legislation for covered bonds will be initiated by end-2019. The covered bond market will improve access to long-term GEL funding for commercial banks, and develop the fixed-income market.
- The law on derivatives and financial collateral will be finalized by end-2019, creating the environment for money markets' development.

b) We have clarified the taxation of publicly-issued securities. We are committed to further improve our laws on taxation of financial instruments, specifically derivatives and investment funds, in cooperation with the IMF.

c) We have initiated reforms concerning capital market supervision, to support transparent and efficient capital markets and smooth convergence with the EU legislation.

d) We upgraded our infrastructure by having a single security settlement system for all Georgian securities with two participating central security depositories (CSDs), one for commercial bonds and shares, and another for government bonds. The new system allows for delivery-versus-payments settlements in central bank money for all securities and full integration with the Georgian Stock Exchange and OTC trading platforms.

e) We are finalizing a legislative framework for securities holding. The objective of the securities holding law is to create sound legal basis for dematerialized securities, aligned with the international best practices (The Hague Convention, UNIDROIT Geneva Convention, Belgian (Euroclear)/Frankfurt (Clearstream)/US Law). The framework will incorporate indirect holding regime as well, where only banks and brokers ("Account Keepers") will be eligible members of CSD and authorized to hold securities on behalf of their clients.

f) We will further improve the legal framework for government securities by making it more robust and flexible, to support greater reliance on domestic market borrowing. We aim to transition gradually to a primary-dealer system, in consultation with the IMF.

g) We will take steps to further improve transparency in local FX market, by adhering to the FX Global Code. We have created the Georgian Financial Markets Treasury Association (GFMTA) to support adoption of the Code locally. NBG plans to announce its full compliance with principles of the Code by June 2019 and other market participants are expected to follow gradually.

E. Structural Reforms

28. Achieving more robust and inclusive growth will require steadfast implementation of our comprehensive structural reform agenda. We are counting on our partners to support our reform program, including the IMF, the WB, the ADB, the EBRD, the European Investment Bank (EIB), KfW Development Bank, Agence Française de Développement (AFD), and the European Commission. Our reforms aim at strengthening Georgia's connectivity, including through infrastructure spending and trade initiatives, improving education and vocational training, the business environment, and land and energy reforms. We firmly believe that our reform program will boost long-term growth, diversify the economy, strengthen our external position, create jobs and reduce poverty. At the same time, targeted social assistance and health care will continue to protect the most vulnerable.

29. Enhancing infrastructure and spatial planning is key to Georgia's development. Despite some delays, we will finish our investment in core infrastructure, which will transform Georgia into a transport and logistics hub connecting Europe with Asia and support development in the regions. Combined with the government's support for tourism development (including water and electricity infrastructure), Georgia will turn into a four-season tourist destination.

30. We will start implementing our comprehensive education reform to improve job creation, productivity and wages. Unqualified labor force is reported as one of the most problematic factors for doing business in Georgia. At the same time, unemployment and underemployment remain high, suggesting skill mismatches in our labor force. With the help of our partners, we will implement our comprehensive education reform that covers the following areas: (i) early childhood education; (ii) secondary education; (iii) vocational education and training; (iv) higher education; and (v) science and research. This reform entails, among other things, setting curriculum standards, a new teacher policy framework, and more effective vocational training and adult learning. We are encouraging the participation of employers in the design of curriculum to better prepare the young for labor market demands. Finally, we will support job seekers with guidance on job selection, preparation and retraining.

31. Our funded pension pillar will become fully operational by end 2019. The pension agency has been created and contributions are collected, and the investment board will soon be formed. The investment strategy is expected to be approved by December 2019. It is expected that the agency would become fully operational by end-2019. This will improve the standards of living of our future retirees, promote savings and create an institutional investor for long-term lari assets. In parallel, we are committed to formulate a private pension savings system (Pillar 3) in 2019.

32. We will continue to improve the business environment. To improve corporate governance, corporations will gradually be required to publish audited financial statements based on IFRS standards. We also plan to submit to Parliament a new insolvency law ensuring adequate protection of creditor rights, timely and efficient insolvency processes and effective rehabilitation framework in line with best international practices (structural benchmark, end-July 2019). An efficient VAT tax system will also improve the business environment. In addition, we will apply regulatory impact assessments to analyze the possible impact of major policy decisions and protect the economy from undue costs. We signed a MoU with the International Court of Arbitration of the International Chamber of Commerce in December 2018 to enhance dispute resolution mechanisms. We will establish a Business House by 2020 to provide public services to enterprises under a one-stop shop.

33. Land registration will be pivotal for rural and agricultural development. Land cadasters are important for protecting property rights, simplifying land transactions and providing collateral for borrowing. We have simplified land registration, especially for agricultural land plots, through a fee waiver program. We will assist citizens in searching for property ownership documents and facilitate dispute resolution through mediation. Currently, registered land plots amount to 1.9 million, where 33 percent (0.62 million) of those were registered within the land reform launched on August 1, 2016. We have also recently undertaken the creation of a farmer's registry and a geo-information land use system to ensure the rational use of agricultural land.

34. Deepening trade relations with the rest of the world is one of Georgia's key priority. As a small open economy, free trade agreements (FTAs) will help Georgia mobilize FDI in tradable sectors to improve competitiveness, reduce external vulnerabilities, and generate balanced growth. Georgia has FTAs with the EU (Deep and Comprehensive Free Trade Area), the European Free Trade Association (EFTA), the People's Republic of China, Turkey, Hong Kong Special Administrative Region and CIS countries. We are negotiating with Turkey an expansion of the current FTA. We remain committed to pursue other FTAs with priority countries, including the United States, Israel, India, the Gulf Cooperation Council countries, and others.

35. Our energy reform strategy will increase market competition, promote renewable energy, and enhance energy efficiency.

a) As Georgia becomes a member of the Energy Community, we will develop competitive electricity and gas markets based on the EU energy market principles. Our goal is to move towards a third-party access model, separating transmission and distribution from suppliers, traders and generators starting in 2019. This would foster wholesale competition (which would cascade into the retail market), promote an efficient cross-border trading capacity, and open the sector to private investment in renewable energy. In parallel, we will gradually deregulate the natural gas sector.

b) Legislation on promoting the production and use of renewable energy will be submitted to Parliament in 2019. The law will: (i) set mandatory national targets for the share of energy from renewable sources in gross final consumption and energy transportation; and (ii) set sustainability parameters for biofuels and bioliquids.

c) We will continue to promote energy savings and independence, security in energy supply, and energy efficiency in the energy market. We will submit to Parliament a new Primary Law on Energy Efficiency, intended to accelerate energy efficiency across the full energy supply in all end-use sectors. We also plan to develop a national energy efficiency target and set up an energy efficiency obligation scheme and/or alternative policy measures for energy savings.

36. We are strengthening our statistics to support strong economic policy-making. We will start publishing national accounts based on NACE 2 sectoral classification by November 2019. Along with the migration to NACE 2 classification, we will compute GDP based on supply and use tables and quarterly GDP by expenditure in constant prices in 2020. This will provide a more detailed picture of the structural transformations in our economy. With help from IMF TA, we are expanding the coverage of the monthly producer price index (PPI) and developing a quarterly residential property price index (RPPI), both expected to be released in 2020.

F. Program Monitoring and Safeguards

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

38. The NBG continues to maintain a strong safeguards framework and internal controls environment. As required by the safeguards policy, we will continue to engage independent external audit firms to conduct the audit of the NBG in accordance with international standards.

Table 1. Georgia: Inflation Consultation Targets and Bands for 2018–19

	2018				2019	
	End June	Outturn	End Dec.	Outturn	End June	End Dec.
Inflation Consultation Bands for CPI (in percent)						
Central point	3	2.2	3	1.5	3	4.5
Inner band, upper limit/lower limit	5/1	…	5/1		5/1	6.5 / 2.5
Outer band, upper limit/lower limit	6/0	…	6/0		6/0	7.5 / 1.5

Source: Geostat, IMF staff estimates

Table 2. Georgia: Quantitative Performance Criteria and Indicative Targets for 2018, end-June 2019, and end-December 2019

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

	2018					2019			
	End-December					End-June			Proposed End-December
	Target	Revised Target	Adjusted Target[1]	Outturn	Status	Target	Projected Adjusted Target	Projected outturn	Target
Performance Criteria									
Ceiling on augmented general government deficit (program definition)	1,150		1,032	1,021	Met	250		158	1170
Ceiling on general government net budget lending									335
Floor on NIR of NBG[1] (end-period stock, million of U.S. dollars)	1,550	1,550	1,483	1,519	Met	1,456	1,453	1,573	1,520
Ceiling on the accumulation of external debt arrears of the Public Sector (continuous criterion) (million of U.S. dollars)	0			0	Met	0			0
Ceiling on new public guarantees (continuous criterion)	0			0	Met	0			0
Ceiling on the cash deficit of the Partnership Fund	0			0	Met	0			0
Ceiling on the new net borrowing of the Partnership Fund (million of U.S. dollars, cumulative from the beginning of the EFF program)	20					20			20
Indicative Targets									
Ceiling on the accumulation of net domestic expenditure arrears of the general government	0			0	Met	0		0	0
Ceiling on Primary Current Expenditures of the General Government (in mn lari)	9,035			8,976	Met	4,600		4587	9,790
Stock of VAT credits									1,570

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

Table 3a. Georgia: Completed Structural Benchmarks

Measure	Date	Status
Financial Sector		
Financial Stability		
Introduction of LCR for commercial banks, with preferential treatment of GEL-deposits	End-September 2017	Met
Adoption of regulation on capital add-ons in CAR for systemically important banks	End-December 2017	Met
Submit to Parliament legislation giving NBG oversight power over credit information bureaus	End-December 2017	Met
Increase in minimum regulatory capital for commercial banks to GEL50 million, phased in by 2019	End-June 2017	Met
Introduce regulation on bank's real estate appraisal in line with International Valuation Standards	End-June 2018	Met
Introduce regulation on leverage ratio based on Basel Principles and relevant EU regulation	End-September 2018	Met
Introduce regulation on banks corporate governance in line with Basel Principles	End-September 2018	Met
Capital Markets Development		
Publication of a multi-year calendar for government benchmark bonds	End-December 2017	Met
Monetary policy operations and communication		
Signing of a Memorandum of Understanding between the Ministry of Finance and the NBG on information sharing for liquidity forecasting purposes	End-June 2017	Met
Deposit insurance		
Submission to Parliament legislation establishing deposit insurance as of January 1, 2018	End-June 2017	Met
Bank Resolution Framework		
Submit to Parliament amendments to NBG Law that will give it the authority to resolve a bank through a temporary administration at an early stage of a bank's financial difficulty, in line with good international practices as identified in the 2014 FSAP recommendations	End-September 2017	Met
Fiscal		
Submission to Parliament of a 2018 budget consistent with the fiscal deficit in the Fund-supported program	End-December 2017	Met
Adopt a remuneration law for public civil service	End-December 2017	Met
Tax Administration		
Action plan to address accumulated outstanding VAT refunds in an orderly manner over time (including analysis, refund, set-offs, and write-offs)	End-September 2017	Met
Restructure the GRS headquarters into a function-based organization	End-February 2018	Met
The steering committee will propose any necessary legal amendments or ministerial decrees to facilitate the implementation of the action plan to address outstanding VAT claims	End-March 2018	Not Met 1/
Create a new specialized VAT unit focusing on validating VAT claims	End-June 2018	Met
Public-Private Partnership and Fiscal Risks		
Submission of a public-private partnership law to Parliament, establishing reporting and monitoring as well as requiring a ceiling on government exposure from such partnerships	End-December 2017	Met
Include all PPP and PPA liabilities, and expand the analysis of contingent liabilities from state-owned enterprises, reporting quasi-fiscal activity in the 2018 Annual Fiscal Risk Statement	End-December 2017	Met
Public Financial Management		
Issue guidelines for new budget lending operations requiring reasonable expectation of commercial returns	End-December 2017	Met
Pension Reform		
Submission of a pension law establishing a 2nd pillar pension system	End-December 2017	Met
Establishing an independent pension agency.	End-July 2018	Met 2/

1/ Amendments and decrees were proposed in May 2018.
2/ Implemented with a two week delay.

Table 3b. Georgia: Structural Benchmarks by Completion Date

Fourth Review	Date	Status
The 2019 FRS will expand the analysis of fiscal risks stemming from PPPs and PPAs, and SOEs as described in the MEFP (MEFP ¶12)	End-December 2018	No met, implemented with a one-month delay
Adopt the government decree implementing the PPP law following the recommendations of the FAD TA report (MEFP ¶12)	End-December 2018	Met
Submit to Parliament a revised penalty regime with gradual tax-geared penalties based on materiality and approve changes to the tax code granting the GRS powers to pay out refunds without the need for a refund	End-December 2018	Met
Submit to Parliament a new fiscal rule framework consistent with IMF TA recommendations (MEFP ¶7)	End-December 2018	Met
Submit to Parliament legislation proposing a rule-based mechanism to index basic pensions (MEFP ¶6)	End-February 2019	Not met, reset for end-December 2019
Submit to Parliament changes in the legislation allowing the GRS access to the information received by the FMS from the monitoring entities, and put in place safeguards that protect the information from improper use (MEFP ¶11)	End-May 2019	Not met, reset for end-December 2019
Submit to Parliament legal amendments bringing the banking resolution framework, the role of the central bank as the lender of last resort, and crisis management in line with best international practice (MEFP ¶25)	End-May 2019	Met
Upcoming		
90 percent of the VAT refund requests approved by the system will be automatically refunded, upon request, after offsetting against existing tax liabilities (MEFP ¶11)	End-June 2019	
Submit to parliament the new insolvency law ensuring adequate protection of creditors rights, timely insolvency processes and effective rehabilitation framework (in line with best international practice) (MEFP ¶33)	End-July 2019	
Provide a complete list of the SOEs qualifying as public corporation and SOEs qualifying as general government under the GFSM2014. The assessment should be done in consultation with FAD's regional resident advisor (MEFP ¶12)	End-September 2019	
Adopt a government decree clarifying the mandate of SOEs that are public interest entities, their governmenance and reporting requirements, in line with recent FAD recommendations (MEFP ¶12)	End-November 2019	
NBG to publish a renewed financial stability report (MEFP ¶21)	End-November 2019	
Strengthen the public investment management methodology that guides project appraisal, selection and management; and adopt a government decree implementing reporting and oversight requirements for public investment projects at the MoF (MEFP ¶12)	End-December 2019	
Proposed Reset Structural Benchmarks		
Submit to Parliament legislation proposing a rule-based mechanism to index basic pensions (MEFP ¶6)	End-December 2019	
Submit to Parliament changes in the legislation allowing the GRS access to the information received by the FMS from the monitoring entities on suspicious transactions, and put in place safeguards that protect the information from improper use (MEFP ¶11)	End-December 2019	
Proposed New Structural Benchmarks		
Adopting a 2020 Budget in line with policies agreed at the Fifth Review (MEFP ¶8)	End-December 2019	
Publishing a Fiscal Risk Statement with more comprehensive coverage of general government financial assets (MEFP ¶12)	End-December 2019	
Enact the legal amendments bringing the banking resolution framework, the role of the central bank as the lender of last resort, and crisis management in line with best international practice (MEFP ¶25)	End-December 2019	

Attachment II. Technical Memorandum of Understanding (TMU)

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

A. Program Assumptions

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

Table 1. Georgia: Program Exchange Rates

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

B. Institutional Definition

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

4. **Supporting material:** The Treasury Department of the Ministry of Finance will provide to the IMF detailed information on monthly revenues of the general government within two weeks of the end of each month and monthly expenditures and arrears of the central government within four weeks of the end of each month. The Ministry of Finance will provide the stock of general government debt, broken down by currency and original maturity within one month from the end of each quarter. The

Treasury will provide, on a daily basis, the cash balances in all the accounts of the general government as of the end of the previous business day.

C. Quantitative Program Targets

5. The program will be assessed through performance criteria and indicative targets. Performance criteria are set with respect to:

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

In addition, the program will include a consultation clause on the 12-month rate of inflation (Tables 1, 2 attached to the Letter of Intent).

6. Performance criteria and indicative targets have been set for end-June 2019 and end-December 2019 (the next two test dates). They are monitored on a cumulative basis from the beginning of the calendar year (except for (i) the NIR target, which is monitored in terms of stock levels and (ii) the new net borrowing by the Partnership Fund, which is monitored since program approval), while continuous performance criteria are monitored on a continuous basis.

D. Inflation Consultation Mechanism

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

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

E. Program Definitions, Adjustors, and Reporting Requirements

General Government

Ceilings on (i) the augmented cash deficit of the general government and (ii) net budget lending

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

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

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

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

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

14. Adjustor: The ceiling on the augmented cash deficit of the general government will be adjusted upward (higher deficit)/downward (lower deficit) by the cumulative amount of VAT credits refunded in cash above/below the program amounts (Table 2). The adjustment will not exceed GEL 450 million per year, in absolute terms.

15. Adjustor: The ceiling on net budget lending will be adjusted upward (higher deficit)/downward (lower deficit) by the cumulative total amount of on-lent amounts from foreign-financed project loan disbursements above/below the program amounts (Table 2).

Table 2. Georgia: Projected Financing for Cash Deficit of the General Government (in millions of GEL, cumulative from the beginning of the calendar year)		
	June 30, 2019	**December 31, 2019**
Disbursements of foreign-financed project loans	760	1,314
Receipts from sale of non-financial assets	70	140
VAT refunds	250	550
On-lent amounts from project loan disbursements	200	400

Supporting Material:

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

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

c. Data will be provided at actual exchange rates.

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

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

f. Data for the previous month will be provided by the Georgia Revenue Service by the end of each month on:

- Number and GEL value of claims for cash refunds submitted by taxpayers, separately for VAT and other taxes,
- Number and GEL value of cash refunds paid, separately for VAT and other taxes,
- Number and GEL value of cash refunds paid automatically (i.e., without manual check or audit), separately for VAT and other taxes.

Ceiling on the Current Primary Expenditures of the General Government

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

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

Ceiling on the Outstanding stock of VAT credit refunds

18. Supporting material: Data for the period from the 16th day of the previous month to the 15th day of the current month will be provided by the Georgia Revenue Service by the end of each month on:

- Opening balance in taxpayer accounts (stock)
- New tax credits declared by taxpayers,
- Tax credit balance adjustments made by GRS after desk check / audit and by taxpayers,
- Tax payments to the budget
- Tax credits offset against tax liabilities,
- Tax credit refunds paid in cash,
- Other flows (residual),
- Closing balance in taxpayer accounts (stock),
- Closing balance amounts not eligible for a cash refund (stock).

Continuous Performance Criterion on Accumulation of General Government External Debt Arrears

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

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

[1] Arrears to Turkmenistan.

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

Continuous Indicative Target on Accumulation of General Government Domestic Expenditure Arrears

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

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

Guarantees

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

Partnership Fund

Ceiling on the Cash Deficit of the Partnership Fund

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

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

26. The Partnership Fund's expenditures comprise all current and capital expenditures. Current expenditures comprise compensation of employees, the purchase of goods and services, transfers to other entities, other account payables and domestic and external interest payments. Capital expenditures comprises the net acquisition of nonfinancial assets as defined under GFSM 2001. The Partnership Fund's purchase of financial assets (e.g. lending and equity participation) will not be considered part of its expenditures.

Ceiling on New Net Borrowing by the Partnership Fund

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

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

Net International Reserves

Floor on the Net International Reserves of the NBG

29. Definition: Net international reserves (NIR) of the NBG in U.S. dollars are defined as foreign assets of the NBG minus the sum of foreign liabilities of the NBG, including all of Georgia's liabilities to the IMF. **Foreign assets of the NBG** include gold, gross foreign exchange reserves, Georgia's SDR holdings, and the reserve position in the IMF. Gross foreign exchange reserves of the NBG are defined as liquid, convertible currency claims of the NBG on nonresidents, including cash holdings of foreign exchange that are readily available. Pledged or otherwise encumbered assets, including (but not limited to) assets used as collateral (or guarantee for third party external liabilities) are excluded from foreign assets. **Foreign liabilities of the NBG** shall be defined as the sum of Georgia's outstanding liabilities to the IMF (at face value), Georgia's SDR allocation, and any other liabilities of the NBG (including foreign currency deposits of financial institutions at the NBG and currency swaps and foreign exchange forward contracts with financial institutions), excluding the foreign exchange balances in the government's account with the NBG. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the NBG shall be valued at program exchange rates as described in paragraph 2 above. The stock of NIR amounted to $1,387 million as of June 30, 2018 (at program exchange rates).

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

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

- Upward (downward) by any excess (shortfall) by any FX privatization revenue in foreign exchange above (below) the programmed amounts. Privatization receipts are defined in this context as the proceeds from sale, lease, or concessions of all or portions of entities and properties held by the public.
- Upward (downward) by any excess (shortfall) of budget support grants compared to program amounts (Table 3).
- Downward by any shortfall of budget support loans compared to program amounts (Table 3).
- Upward by the sum of the total excess of budget support loans compared to program amounts (Table 3) and any negative net Eurobond issuance by the government, if this sum is positive.
- Upward by any positive net Eurobond issuance by the government.

- Upward/downward by 100 percent for any excess/shortfall related to disbursements of the project loans and grants to the treasury single account at the NBG relative to the projected amounts (Table 3).

Table 3. Georgia: Projected Balance of Payment Support Financing
(in millions of U.S. dollars)

	June 30, 2019 [1]	December 31, 2019 [2]
Projected privatization revenue	0	0
Budget support grants from external donors and not related to project financing	40.6	87.5
Budget support loans, including bilateral and multilateral donors for budget support	165.6	145.4
Disbursements of project loans and grants	179.4	182.9

[1] Cumulative from end-September 2018 to end-June 2019.
[2] Cumulative for 2019.

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

Appendix to the TMU: The Partnership Fund

A. Organization and Operational Structure

Legal Structure and Corporate Governance

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

The PF is organized as a commercial financial institution. However, the PF no longer pursues only commercial objectives and in its governance structure, the risk management committee is no longer in place; and equity injections are undertaken without government's approval. In addition, the corporate structure incorporates:

- An investment board, including CEO, CIO, and portfolio officers, which approves business cases and initiates projects;
- A supervisory board (i.e. board of directors), which approves projects (based on the feasibility studies, risk assessments, and business cases presented by the investment board and risk committee) and approves budget for project development needs. The supervisory board includes four ministers and is chaired by the Prime Minister.

B. Corporate Mandate and Portfolio Management

Corporate Mandate

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

Portfolio Management Strategy

The PF's portfolio management strategy has been developed. It sets portfolio limits, performance management objectives, and project evaluation guidelines, which focus on evaluating PF's performance based on an internal rate of return. The PF does not longer participate only in commercially viable projects, taking into considerations non-commercial objectives in its portfolio strategy.

Project Development Methodology

The PF will mostly participate in projects in which a corporate investor, with sufficient experience in industry, expresses its willingness to take an equity participation that represents at least 51 percent of the project's total equity. The PF no longer pursue only commercial objectives and there are projects in which the financing of the PF (debt plus equity guarantees) exceeds 100 percent of the equity contribution of the private partner in the project.

Reporting and Auditing

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

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

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

Fiscal risks associated with the PF will be limited since:

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

Statement by Mr. Doornbosch, Alternate Executive Director and Mr. Hanson, Advisor on Georgia June 19, 2019

The Georgian authorities would like to thank staff for their constructive engagement during the mission and their insightful report. They would also like to thank the Managing Director for her personal interest in the program during her visit to the country from May 19-21, 2019.

The authorities agree with staff that growth has proven resilient, inflation remains under control and external vulnerabilities have been reduced. At the same time, they acknowledge that continued efforts are needed to achieve high and inclusive growth against a background of external risks. They reiterate their strong commitment to the reforms under the Extended Fund Facility (EFF).

Two years underway, the EFF has served the Georgian economy well. Growth remained robust at 4.7% in 2018. Fiscal outturns and medium-term fiscal plans are in line with program objectives. Fitch recently upgraded Georgia's sovereign rating to BB, while S&P revised its outlook to positive, up from BB- with a stable outlook. Inflation is close to the 3% target and expectations are well-anchored. International reserves increased from 88% of the ARA metric in 2016 to 91% in 2018 and are expected to reach 100% by end-2019. The current account deficit improved from 13% in 2016 to 7.7% in 2018 and will gradually narrow to below 7% in the medium term. The current account is mostly financed by FDI, which concentrates in the transport and energy sectors.

The authorities met all end-December quantitative performance criteria. Five out of seven structural benchmarks were implemented (one with a 1-month delay) and the remaining two will be implemented by end-December:

- In consultation with staff, the authorities have not yet submitted legislation for a **rule-based pension indexation mechanism** to parliament by end-February. Pension levels are currently marginally higher than the subsistence minimum and a rules-based indexation would support inclusive growth and help reduce inequality. At the same time, the authorities agree that the fiscal implications of different alternatives need to be further assessed and are looking forward to continuing discussions with staff before submitting a proposal by end-December 2019.
- The authorities will provide the Georgia Revenue Service (GRS) with access to third-party information to make tax administration more effective. This includes data from different sources on real estate, construction permits, suspicious transactions and changes in company equity. **Access to data on suspicious transactions** received by

the Financial Monitoring Service from monitoring entities will help fight tax evasion and improve compliance but concerns about privacy and abuse warrant that appropriate safeguards are in place. The authorities are currently working on such safeguards and will submit legislative changes to parliament by end-December 2019.

Policy Priorities

The EFF is aimed at strengthening macroeconomic stability and financial resilience and supporting the government reform agenda focused on four pillars:

(1) **education reform** to promote skill development, productivity growth and job creation;
(2) investing in road infrastructure to transform Georgia into a **transport and logistics hub** connecting Europe and Asia;
(3) making the **public administration** more efficient; and
(4) improving the **business environment** to boost the private sector as a growth engine.

Progress has been achieved and is ongoing in pillars (2), (3) and (4): investments in core infrastructure are on track; a large number of fiscal reforms to strengthen public administration was implemented as part of previous reviews (Table 3a of the MEFP), including a remuneration law for public civil service, while the authorities will continue their efforts to strengthen SOE governance, to automatically refund new VAT credits, and to strengthen public investment management; the business environment will be improved by the measures to support local capital market development discussed in Box 1 and the new insolvency law which will ensure adequate protection of creditor rights, timely insolvency processes and an effective rehabilitation framework.

Education reform is the remaining pillar of the reform program. A comprehensive education reform and ongoing efforts to strengthen macroeconomic stability are the key priorities of the authorities.

A comprehensive reform of the education system will bolster inclusive growth. Although at its lowest level in 15 years, unemployment remains high at 12.7 percent as skill mismatches and underqualification persist. The authorities are working on a multi-year education reform to foster employment, productivity and inclusion. This comprehensive reform includes training and certification of teachers, severance of less qualified teachers, investment in school infrastructure and improvement of the curriculum. The reform is based on OECD benchmarks and designed in cooperation with the World Bank.

The authorities are committed to finance the education reform under the 3% deficit ceiling of the new fiscal rule. They will continue infrastructure investments, but as core infrastructure projects are finalized in the upcoming years, they will redirect spending towards education. Education spending will increase from 3.8% of GDP today to 6% of GDP in 2022. To safeguard their lasting commitment to the reform, they intend to introduce a floor on education spending. They understand staff's concern about the rigidity of such a floor, and they would welcome engagement with staff about ways to strengthen the medium-term budget framework, but they see a strong multi-annual spending commitment under the deficit ceiling as an important safeguard for the success of this key policy priority.

Prudent monetary policy and reserve accumulation will strengthen macroeconomic stability. Monetary policy remains focused on the 3% inflation target. The National Bank of Georgia (NBG) stepped up its efforts to accumulate international reserves with the introduction of a regular auction for FX put options in January. These put options allow banks to purchase lari in exchange for dollars or euros when the lari exchange rate is above its average during the previous 20 working days. Banks will have an incentive to exercise these options when the lari appreciates, allowing the NBG to accumulate reserves without disrupting the exchange rate. In result, the net international reserve criterion was met with a comfortable margin and the authorities are committed to sustain reserve accumulation efforts.

The authorities are confident that they can meet the three new end-December structural benchmarks.

- They will submit to Parliament a **2020 budget** consistent with the program.
- They will include a more comprehensive coverage of general government financial asset operations and information on the rates of return on general government equity holdings and loans in the **fiscal risk statement** in the 2020 budget.
- In May, they submitted legal amendments to parliament to make **emergency liquidity assistance and the banking resolution framework** consistent with international best practice. They are committed to enactment of this legislation.